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FORTUNE REBUTS CRITICS OF PROPERTY TAX

One more prestigious publication has added its voice to the growing public debate over the property tax. *Fortune* (May 1972), the big business magazine, devoted its "Viewpoint" column to "A Word for the Property Tax."

In essence, author Dan Cordtz says the property tax is just too much a part of the American fiscal fabric, is too fruitful a source of revenue, too economical to be abolished. Along, the way, he pays considerable attention to the advisability of shifting the incidence of the tax from improvements to the site.

Citing the recent court decisions that would bar use of the property tax for local school support and President Nixon's criticism of this levy, the article calls "the idea of shifting an important share of the property tax burden to other revenue sources. . .unrealistic, misleading, and potentially dangerous."

Mason Gaffney's argument is repeated – the concentration of property ownership is even greater than that of income in this country and, therefore, the property tax is not regressive, "If property were assessed correctly and taxed equitably, the burden would fall heavily on those with wealth."

"Viewpoint" also makes reference to Prof. Dick Netzer's work and sums up: "Not only are the property tax's purported flaws exaggerated, but its virtues are too often slighted. Properly applied, it can help a free real-estate market function in a way that maximizes the benefits to society."

Commenting on Allen Manvel's study for the National Commission on Urban

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"Tax Law Favors Homeowner"

By LESTER O. BUMAS
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Once upon a time there lived in the Land of Politics twin brothers. Each had one wife and two children, and had jobs that paid them $25,000 a year.

They lived in new identical $40,000 homes, and were equally generous (or at least claimed to be) with respect to contributions to tax deductible charities and the medical profession. To the myopic observer they were virtually one and the same person—but not so to the sharp-eyed Internal Revenue Service.

The service saw them as two fundamentally different people. It knew that one rented his $40,000 home, which was owned by a bank. The other was a "homeowner"—that is, he was starting the 30-year process of buying a palace. Actually, the same bank that owned Brother Tenant's home also owned that of Brother "Homeowner."

Real estate taxes were high on the block where the brothers lived, being $2,000 a year on homes valued at $40,000. Moreover, the bank felt that it should make 8 per cent on its invest-

(continued on next page)

City Ignores Housing Agency Scandal

Beleaguered by mismanagement and corruption, New York City's Housing and Development Administration was up for dismantling after a thorough going over by a special committee of the City Council.

That was early in the year. Now the City Fathers are going to rehabilitate the agency by adding another department to the already existing multitude. A Housing and Development Corporation, previously authorized by the state legislature to administer public aid to private housing, was voted into existence with pocket money of $700 million in bonds.

The chairman of the same committee which denounced HDA urged passage of the bond issue because "the well has run dry – there will be no more subsidized middle-income housing built in this city unless this passes. We cannot let housing construction come to a dead halt." He explained that the Council would create a new HDA structure, and that the corporation would be the first step in a "thorough house-cleaning" by the Council.

Other councilmen were not so sanguine about house-cleaning by first tacking on a new room. One declared the housing program a "blueprint for disaster," to be administered by "the same incompetent officials" who "mismanaged HDA." Another called it a "wolf in sheep's clothing." Two councilmen voted against the bond issue on the grounds that it would not benefit middle-income families, but rather called for tearing down low and middle-income housing and replacing it with upper-income housing.

Nevertheless, the City Council debate on the issue lasted only an hour and a half, with the final vote 26-6.

The board of the new Housing and Development Corporation consists of the senior vice-president of an investment bank, the assistant vice-president of a savings bank, the Director of HDA, and the Finance and Budget Directors of the City.

Public programs never die, public wells never run dry.

"Tax Law Favors Homeowner"

ments. Thus, Brother Tenant paid $5,200 in rent, $2,000 of which was to cover real estate taxes the bank had to pay and $3,200 of which was to give the bank an 8 per cent return on its $40,000 investment. Brother "Homeowner" had precisely the same relevant costs, $2,000 in real estate taxes and $3,200 in interest payments to the bank.

But in what way did the Internal Revenue Service see these seemingly identical twins as different? The difference was that Brother "Homeowner," who paid his interest and real estate taxes directly rather than indirectly as did Brother Tenant, was allowed to deduct these payments of $5,200 from the amount on which he had to pay taxes.

Assuming that such income would have been taxed at a 25 per cent rate, Brother "Homeowner," identical in all income and expense considerations, pays $1,300 a year less in taxes than does Brother Tenant. In effect then, Brother Tenant can be considered as paying $2,000 in real estate taxes while Brother "Homeowner" only pays $700.

Let us quickly move the calendar ahead 30 years. Brother "Homeowner" —in quotes—has now become Brother Homeowner. The quotation marks are off because now he really owns his $40,000 palace, whereas Brother Tenant, who had to be more parsimonious, owns $40,000 in 8 per cent blue chip corporate bonds. In other words each had investments valued at $40,000.

Looking at the tax side of things Brother Tenant still pays the $2,000 in real estate taxes, albeit indirectly, as well as, at a 25 per cent rate, $800 on the $3,200 he earned from his bond. These taxes total $2,800.

Brother Homeowner still pays $2,000 in real estate taxes but by deducting this at the 25 per cent rate, he saves $500 on his Federal income tax. Thus the taxes for our almost identical twins are now $2,800 and $1,500, again a tax advantage of $1,300 for Brother Homeowner, two-thirds of the amount of the real estate tax.

Do these hypothetical figures exaggerate the tax advantage given to homeowners? Not at all. For 1966, the last year for which comprehensive analyses have been made, Henry Aaron of the Bookings Institution estimates the tax savings advantage granted to homeowners to be in the range of $7-billion to $9-billion. Dick Netzer, dean of the Graduate School of Public Administration at New York University, estimates that the total tax on owner-occupied housing was then $8.8-billion. Thus, tax gimmickery in effect reduced the real estate tax burden on homeowners to very close to zero.

This is not to say that discriminatory income tax deductions and omissions wiped out the burden of the tax in the case of each individual homeowner. Things are in fact far less fair even than that. Poor homeowners benefit little from the tax favoritism. The rich benefit handsomely and even by amounts substantially in excess of their real estate taxes.

That this is so can be seen by considering Brother "Homeowner" to have an income of sufficient size to put him in the 70 per cent tax bracket. Since he can deduct in effect $5,200 from taxable earnings, which Brother Tenant cannot, he pays $3,640 less in taxes. And his real estate tax was only $2,000.

Why is it that in this important area our tax system so strongly favors the rich over the poor? The answer is implied in the opening line of our parable. Recall that it takes place in the Land of Politics. The name of the game is political clout. The rich have it; the poor do not.

One final note. The tax relief given homeowners is almost identical in magnitude to the total expenditure for all Federal, state and local welfare programs. But how little handwringing accompanies relief to our fortunate; how much accompanies relief to those whose needs are many time greater. What a disgrace.

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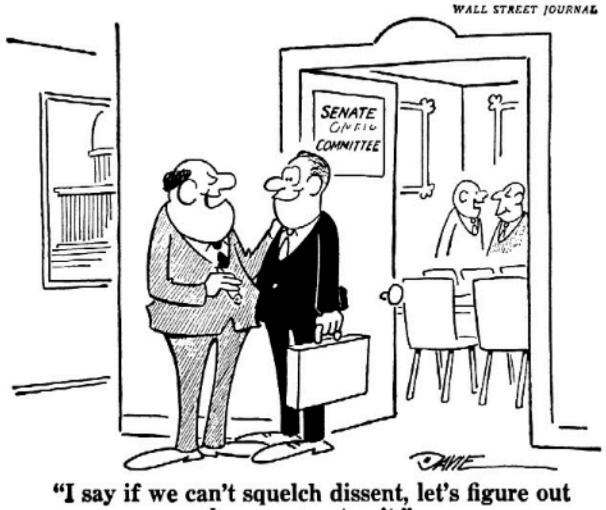

"I say if we can't squelch dissent, let's figure out how we can tax it."

news briefs

Secretary of the Treasury John Connally is against heavier capital gains taxation — "I don't want to destroy the real estate industry and the securities industry — I don't want to see the Dow Jones average hit 500." Mr. Connally denounced Democratic presidential aspirants who seek tax reform as having a combined 100 years of service without ever producing a tax bill. The candidates attack provisions Mr. Connally does not regard as "loopholes." He is of the opinion that criticism of national institutions has gone "too far."

* * *

The eyes of Texas are on the Supreme Court, which will rule this month on whether local property taxation is a constitutional means of financing public education. The attorneys general of 30 states filed a friend-of-the-court brief stating that an estimated $8 billion increase would be required to raise educational spending to the level in the wealthiest districts. Counties in Indiana, Maryland, and Michigan also signed the brief. A separate appeal was submitted by 4 Texas banks and the Securities Industry Association, who want the court to ensure payment on school bonds, whatever the financing decision.