
PROPERTY TAX REFORM: FOREIGN AND UNITED STATES

EXPERIENCE WITH SITE VALUE TAXATION

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LAND TAXATION IN TAIWAN: SELECTED ASPECTS

by

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Dr. Sun Yat-sen emphasized the taxation of land. Taiwan taxes it -- and also buildings. But they are taxed quite separately. Valuation of buildings is made by a special staff. They utilize processes which are distinctly different from those used in valuing land. The tax rates are not the same. The tax rates where they apply are not subject to local control but are governed by principles which apply to the whole country. The actual burdens on land (tax rates related to value) differ according to rules which are unusual. The revenues are divided among levels of government somewhat differently. The separation of the taxes on land from that on improvements appears to operate successfully.

Urban Land Taxation

In Taiwan, the urban land is subject to two taxes. Though related, they have widely different features. (1) An annual tax applies to the capital value. (2) Land which is sold may be subject to a land increment tax. Moreover, the 1977 revisions of the land law apply the increment tax to rural land but subject to various exceptions.

Dr. Sun Yat-sen, founder of the Republic, considered land problems to be of crucial importance. Landlord-tenant relations in agriculture were of special concern to him. His writings before the Revolution of 1911, and thoughts as he developed them later, seem to have followed lines which resemble those we associate with Henry George. Some of the present system grows more less directly out of the principles he expounded.

Coverage

The Land Value Tax (LVT) applies only in a "city planning area that has been designated according to law." Until the changes in the law made in 1977 the Land Value Increment Tax (LVIT) was also exclusively an urban tax. The Rural Land Tax (RLT) applies in areas which are not subject to the LVT. In both areas, in addition, a "house tax" is assessed on the value of improvements. Furthermore, a deed tax applies on sales and other transfers of real property and also on leases; rates differ as among sales and gifts ($7\frac{1}{2}\%$), divisions ($2\frac{1}{2}\%$), and others. The revenue importance of the four major real estate taxes in fiscal 1975 was as follows:

TABLE I
LAND TAXES AS PERCENT OF TOTAL REVENUES, 1975

	<u>Percentage of Total Tax Revenue¹</u>
Rural land tax	2.2
Land value tax	1.5
Land value increment tax	<u>2.7</u>
Land taxes, total	6.4
House tax	3.0

Base and Rates

The land value tax is imposed -- at progressive rates -- on the value of all land that is held by a landowner (individual or corporate) within the same taxing jurisdiction -- the city planning area of a prefect (hsien) or special municipality. Suffice it here to say that each landowner must "declare" the value of all his (or its) taxable land within the jurisdiction; that is, the worth of all separate parcels must be aggregated. Tax is due according to the total.

The tax rates are fixed and uniform wherever the tax applies throughout the whole country. Local governments receive most of the revenue, but they have no control over the yield by either (1) influencing assessments or (2) adjusting tax rates. However, localities do have some power

¹Including yields of fiscal monopolies.

to alter the timing by which land on the outskirts is brought into the urban planning area; use of this power seems to present many problems. Apparently, the process of bringing land from rural to urban taxation lags behind what might be justified by the actual spread of areas having urban characteristics.

The basis of graduation is the value in each of the 31 jurisdictions imposing the tax of 7 ares of land. One "are" equals 100 square meters; 7 "are" equal somewhat less than one-sixth of an acre. A standard unit, the money value of 7 ares in a central (typical) location is computed for each locality. This Progressive Starting Value (PSV) differs from one city to another.

The following bracket rates apply, subject to exceptions as noted later:

Aggregate land values in the jurisdiction*

Not in excess of PSV	1.5
100-500 percent of PSV	2.0
500-1,000 percent of PSV	3.0
1,000-1,500 percent of PSV	4.0
1,500-2,000 percent of PSV	5.0
2,000-2,500 percent of PSV	6.0
Over 2,500 percent of PSV	7.0

Preferential Rates

Preferential rates are offered to implement land policy objectives. A large fraction of potential taxpayers receive a reduced rate of tax. A practice somewhat like the homestead exemption in parts of the U.S. provides a favorable low rate. Until 1977 it was 0.7% -- slightly less than half of the normal starting rate -- then it became 0.5% -- on land used for owner-occupied houses having not over 3 ares for urban housing and 7 ares if nonurban. The land may not be used for rent or business. Moreover, industry, greenbelt areas, and agricultural land located within urban planning areas are accorded favorable treatment.

Land used as building sites in areas reserved for public facilities may be taxed at 1% (unless qualifying for the reduced tax for small residential use). Unused governmentally owned lands may be exempted from tax. Publicly owned lands used for public purposes are exempt; other public lands are to be taxed at the basic rate (1.5%).** The administration

*The designation NT\$ applies to Chinese dollars. There are approximately 38 to the U.S. dollar.

**This practice relative to public ports, timber, grazing and mineral lands in the U.S. has been advocated from time to time but action in this direction has been limited.

is to make special provisions for lands used as public sidewalks and corridors with recognition for any "constructional improvements."

The tax rates are shown below, along with other relevant figures, for 1974:

	<u>Number of Taxpayers</u>	<u>Area (Hectares)</u>	<u>Assessed Value (Millions of NT\$)</u>	<u>Tax Rate</u>
Agricultural and greenbelt	13,010	531	753.4	1.0
Urban agricultural land	30,903	1,400	6,093.0	1.5
Factory sites	2,560	2,654	5,556.4	1.5
Industrial estates	468	517	441.6	1.5
Residential land	<u>169,534</u>	<u>2,121</u>	<u>9,285.5</u>	0.7
TOTAL	216,475	7,223	22,129.9	
Total of all urban jurisdictions	868,151	22,089	83,000.0	

SOURCE: Ministry of Finance

This privately owned land makes up around one third of the total urban land subject to tax. The assessed value comes to about one fourth of the entire amount as assessed.

The articulated rationale for preferential treatment for homeowners would probably be the encouragement of homeownership. One may also expect desire to please voters. The worth of the lower rate to the typical homeowner, however, is not large. The influence on the decision to own a home will rarely be more than marginal. In 1974 the average LVT paid per occupier of residential land was NT\$383 (equivalent to US\$10). If the standard 1.5% rate had applied, the average tax would have been increased to only NT\$820. Because of the large number of homeowners, however, revenue in 1974 would have been NT\$88.4 million greater, an increase of 6.3% in total LVT revenue. The 1975 revenue would have been 6.3% greater.

In 1974 there were 2,560 separate factory sites not subject to graduated rates. The total value was 7.7% of all LVT assessed value; 468 sites in industrial estates accounted for an additional 0.5%. It is not possible to determine the amount of taxes saved because we do not have data on the bracket rates which would have applied. But much of the land would undoubtedly have been subject to rates of up to 6% and 7%. Assuming an average rate of 3.0%, the tax effect in 1974 was around 3% of the total. This preferential treatment forms part of Taiwan's many-sided program for industrialization. Property tax concessions are consistent with the total of governmental efforts but cannot be large enough to have more than a marginal influence on investment, prices, or output. Factories may have been enabled to acquire and hold more land than otherwise.

The Use of Progressive Rates: A Type of Land Reform

With tax valuations generally around, perhaps, two-thirds of market prices but at times higher, rates as high as 5%, 6%, and 7% of capital value each year will certainly affect incentives. And so will differences of nearly one to five in rates.

Rationale for the particular type of tax progression of LVT was not found in any written documents I saw, or in any oral discussions. (Opposition to land speculation is one exception.) Dr. Sun Yat-sen did not specify such rate differentiation. His own illustrations of the tax use a flat rate of 1%; if he attached more (or any) potential significance to graduation, one would expect his writings to make some reference to it. True, some "extra" revenue is obtained, but not a great deal as compared with an average that could be applied.

The chief reason, I expect, is not one of revenue so much as forcing the break up of "large" holdings. An analogy from rural land reform may have been carried over to urban areas. The long history of rural land reform has played a large part in reform goals. Small holdings in agriculture (farmed by the owner) may have, or have been conceived as having, social, political, and economic advantages as compared with large estates. Whatever the facts for agriculture, in cities the most attractive and productive use of land often requires "considerable" area. Obviously, conditions differ tremendously. But in Taiwan the persons familiar with urban planning and development with whom I spoke -- a knowledgeable but by no means large group -- were unanimous in agreeing that fragmentation of land holdings was undesirable. Often, consolidation is clearly needed; and in fact, governmental policies have been devoted to urban land consolidation. Tax inducements to the extent that any are to be provided one way or another would probably be better directed toward encouraging rather than discouraging consolidation. Changes made in the law in 1977 seem to be designed to assist in consolidating land into larger holdings.

The effectiveness of wide graduation in preventing (undesirable) speculative holdings will not be clear, especially as compared with, say, an average rate that would produce the same revenue. Does the value of landholdings reflect ability to pay taxes in a generally supportable sense? It may be noted that the incidence of land taxes is on the landowner. Therefore, cannot graduation be justified on somewhat the same grounds as income taxes? Scarcely so. Only one type of asset is involved. And even for that land, amounts in various localities are not aggregated. Moreover, there is no adjustment for borrowings made to purchase land.

The application of graduated rates to corporate and other group ownership deserves special attention. Commercial properties, hotels, office buildings, and apartments are owned and used by several or many persons. Graduation of tax rates can hardly be justified on ability-to-pay grounds.

Special information on holdings in Taipei reveals that most of the tax paid at the higher graduated rates comes from what we would call publicly held (as distinguished from private) companies. In 1975 they accounted for 82% of the land value tax from corporations subject to the top rate.

Much of the land taxed at the top rates, in fact, is owned by businesses and quasi-government businesses, including those owned by the Nationalist Party. In principle, if progression is to be applied to land (even though not to all assets), rate graduation should be based on the total value of land holdings of each person in Taiwan. Doing so would require a standard progressive starting value (PSV) for the entire country. The change, however, would result in revenue losses for all localities whose present PSV's are less than the average and would increase revenues for municipalities such as Taipei, Kaohsiung, and Keelung that have high PSV's. No easy solution is possible. Some centralization and perhaps redistribution of revenues to local governments might be attempted. Yet among taxpayers and governments inequality of results of any change would be inescapable.

The present system leads to large differences in LVT on holdings of the same value but in different communities. This inequality results from the use of multiples of PSV's which vary from one locality to another. (The variations in tax burden do not relate to differences in services provided by local governments.) For example, because the 1975 PSV in Taipei was five times that in Taichung, land in Taipei valued at NT\$10 million was taxed at less than half the rate on the equivalent value in Taichung (2.0% vs. 4.2%). Illogical, yes. But revising the system would disadvantage some and favor others. The 1977 legislation did not change the longstanding arrangements.

Speculation and Underused Land

A second special feature seeks to improve the use of land. The speculative underuse of land is a matter of concern. Holding plots of urban land essentially idle or nearly so (in a use of only nominal value) has been evident in cities of Taiwan. Where land prices have risen rapidly, and such has been the case in Taiwan, mere waiting for price increase has often paid off well. Speculative underuse is one reason often given for high land prices; if more parcels were offered for sale, land prices would be lower. Less than the wisest use of land is associated with speculation. The "speculator" may not be defined clearly, but he is the object of criticism. A surtax exists to exert pressure for better use.

The surtax is not less than 200 nor more than 500 percent on any private land that has been designated as a site for building but has not been so used. The objective is to alter urban land use. Revenue yield is not, apparently, a key consideration. Speculative underutilization of land is the target.

The tax was enacted in 1968, but implementation was delayed. Plots on which the building and other improvements are not worth more than 10% of the declared value of land are subject to the higher tax.

Problems will arise in the application of this provision. For one thing, where land prices are subject to much change, the tax may have erratic effects. For example, a sharp rise in land value will make this provision apply where it had not done so a relatively short time before. The law was to be made effective in two stages. Vacant land was to be put to higher use in three years (two years in Taipei). One year later, underimproved land was to be subject to the tax pressure. Five years were to be allowed (but only one in Taipei) for building, altering, or reconstructing in some qualifying way.

The tax can, of course, put new pressure on owners, pressure which at the margin may be significant -- a tax payable in cash and conceivably very large relative to the income from the property. The revenues collected reached a peak of NT\$22 million in 1973. This was also the year the tax was suspended because of a shortage of construction materials.

Observers on the spot are reported to believe that a significant fraction of landowners to whom the tax applied in fact responded. There is no assurance that the location of the new construction will always be the best. Moreover, as a permanent feature of the system one wonders about the true effectiveness. The force of general land price increases can overpower the surtax if rates of increase approximate those of recent years.

The surtax in fact applies to a relatively small area -- only 103 hectares by the beginning of 1974, less than 1% of the land area covered by the land value tax.

The tax can be defended, in principle, as an instrument to stimulate better use of land and to discourage underutilization and sheer speculation. Whether or not enforcement has in practice been as effective as reasonably to be expected may be debated. An outsider has difficulty making anything like a competent judgment. The tax has been imposed at the lower end of the scale -- but above the minimum 200% (of LVT). The average rate in 1973 was 3.3%. In view of the apparent underassessment of land values and the rate of price increase, the tax could well have been swamped by other forces in final decisions about new construction. The three-year waiting period, one should note, provided a considerable time for purely speculative retention as vacant or greatly underutilized area.

The economy as a whole may not have any significant amount of unutilized building capacity. Owners of land may not have capital funds, or ready access to them, to proceed with development.

Pressure to get land into "higher and better" use, in both the older and the newer sections of an urban area, can lead to a different, and a better, allocation of resources than otherwise. Underutilization imposes costs on the community, disadvantages not always recognized. Building more in areas of high land prices, including rebuilding in older sections of cities, can be beneficial to the community as contrasted with extension into the outlying areas. But the tax instrument when applied as under this tax can be a crude device.

Defining "vacant" and "underutilized" to serve "operationally" cannot rest on tested experience. How many cases will there be? Will they be close to each other or dispersed? Border line situations and arbitrary distinctions are inevitable. Some will lead to unwelcome and inequitable results. The degree of accuracy of valuations can be especially significant. Only time and experience can indicate the actual effects. An annual tax rate applying generally at a level somewhat higher than is now the case for most properties would produce more uniform results, exerting pressure broadly.

Tax on Structures

Improvements on land, other than agricultural improvements, are subject to a separate tax. The revenue goes to local governments.

Land Value Increment Tax (LVIT)

A separate and quite unique tax applies to certain increments of land value. One can say that here is a land increment tax with its own identity that "works" - not a part of an income tax falling on capital gains. Dr. Sun believed that the public as a whole (government), rather than particular landowners, should get the benefits that result from the forces which make for rising land prices. Extensive governmental ownership of land would provide a means of doing so. But on Taiwan such broad ownership has not been attempted. In lieu, in a sense, is a tax on the increments which non-governmental owners realize in urban areas (and beginning in 1977 over the entire country expect for many special provisions).

Graduation of Rates*

Tax rates are graduated and in a rather unusual way. They do not differ according to either the absolute size of the increment or the income or wealth of the seller. Instead, the rate applicable varies with the percentage increase in the increment above adjusted (indexed) 1964 values (or a previous selling price after 1964). At first, the rates started at 30% on increments of less than 100% and rose by 20 percentage points for each 100% increment until they reached 100% on all increments exceeding 400% of the original value. Later revisions cut the first rate to 20% and lowered the top marginal rate to 80%. The 1976 schedule, one which had been in effect for several years, was as follows:

<u>Percentage of Increment Increases</u>	<u>Rate (%-1977)</u>
Less than 100	40
100-200	50
Over 200	60

A rate as high as 60% or 80% must influence behavior. One would expect actions to escape tax, legally and illegally. Revenue yield has risen sharply, in spite of the indexation of the basis. Urban land prices have risen more than prices generally, and there has been an

*Up to 5% of the increment tax may in some cases be offset by certain increases in land tax which the owner has paid.

active market. Recently revenue has exceeded the yield of the annual tax on land value. Increment tax has averaged around 38% of the increment in value on taxable sales of privately owned land from around 36% to over 38% from 1969 to 1975 (except 1972 with 28%)-- an effective rate which exceeds that on realized (long-term) capital gains in the United States. In 1975, about 55% of the revenue came from transactions which were subject to the top rate of 80%; the average tax rate on these transactions was 57.9% of the increment. Land price increases have obviously been very large, at least in some cases, leading to the recording of "over 300%" increments. The transfers in this rate category made up only around one-third of the total increase in values reported and 22% of the number of cases. Nontaxable transactions reported accounted for more than one-fourth of the cases and one-sixth of the value of increments.

The rationale for the form of rate graduation must differ from that generally used in the United States. The increase in the rate of tax depends upon the rate of increase in value of land, without regard for the length of time held or the dollar amount of the gain itself or for the economic circumstances of the owner. The percentage increase in the particular base is determining. Perhaps one concept of equity and ability to pay does fit into graduation according to percentage of increment. The absolute amount might seem more suitable. And the length of time held may be relevant.

Sharp increases in urban land values within a short period have not been uncommon in Taiwan. Nevertheless, even in Taipei, the most rapidly developing area, the average annual increase in land prices (adjusting, as does the increment tax, for changes in the general price level) between 1964 and 1974 was estimated at 20.8%. About 4 years, on the average, would be required for the gain to rise by more than 100%.

The prospects of very high tax may well deter sale. Is a useful purpose served by this tax inducement to modify behavior for holding land? A good market in land is important for economic progress. Re-allocation of the use of land will be necessary as opportunities change. A very heavy tax on sale cannot help mobility of use.

Certain Additional Provisions of 1977 Legislation

The 1977 law includes more provisions for special cases than can be noted here. Some would seem to apply to rare cases only. If land is compulsorily purchased (for governmental use) the LVIT is reduced by 40% (more in certain cases if designated for such purchase before Sept. 6, 1973). The tax is increased by 10% when uncultivated land has not been improved for

use or when vacant land has not been used for construction since purchase by the landowner. But in the opposite cases -- if the owner has improved uncultivated land or built on vacant land -- tax is reduced by 20%.

Landowners selling residential, industrial, or farm land used by themselves and purchasing other land for similar use -- or if the land is taken by compulsory purchase -- may claim refund of LVIT. Moreover, anyone buying up to 3 hectares (about 7 acres) of farm land to cultivate himself can receive from the government a subsidy equal to 20% of the LVIT that has been imposed.

A substantially lower rate -- 10% without any graduation -- applies to gains from the sale of owner-occupied residential land. The tax paid is relatively small -- NT\$18 million in 1975 on only 3,535 transactions. The tax may be refunded, however, if the home is replaced. Claims for refund are reported to be infrequent. The 1975 yield was only 0.68% of the total increment tax.

Justification for this preferential treatment is said to be a desire to encourage home ownership. The preference also fits into the philosophy of a tax aimed at significantly large speculative gains. It does not, of course, fit into the "normal" principle of ability-to-pay as the basis for taxation. In view of the provision for indexing gains accruing over a period of years -- and the fact that the area of a typical home will be small (1.25 are) the increment realized will ordinarily be small. In 1975 it was around NT\$50,000, approximately US \$1,325. Assuming the new (1977) rate of 40%, the full LVIT on final sale would be about NT\$20,000 (US \$530).

Factory lands with increments are taxed at only half of the standard rate, and the tax is refunded if the factory is relocated. We do not have data on the extent to which factory owners take advantage of the opportunity for refunds. The provision, one would assume, eliminates a possible reason for delaying or refraining from relocation that would be attractive.

Bequests and Gifts

The original law called for taxing increments on land transferred by gift or inheritance. In practice, however, only gifts were subjected to the increment tax. Proposals to apply the tax to inheritances encounter the objection that the estate tax is already imposed on such transfers.

Gift and estate tax rates now reach 50% (on the value, net, over NT\$20 million). This maximum falls considerably below the former 80% and the present 60% maximum of the LVIT. We can only speculate on the relative burdens that might result. The goals of the increment tax would seem to call for applying it to increments passed at death as well as those on property transferred by gift. Application of the tax to gifts but not inheritances creates an incentive to hold land that might be sold for higher and better use. The original 1964 value (as adjusted for inflation) could carry over to inherited property if the increment is not taxed at death; the value would eventually be taxed when the heirs sell the land.

Summary

Land taxation in Taiwan is used extensively to move the utilization of land in directions considered desirable. The land tax and related revenue producing legislation have also proven to be the source of substantial and increasing revenues.