

CHAPTER 13

METHODS OF APPLYING THE LAND TAX

Technical ways of applying the land tax are little discussed in the classrooms. George did not prescribe any details in *Progress and Poverty*, the basic course deals with his theory, and there are no advanced courses that cover the practicalities. Nevertheless, there is a good deal of literature on the subject with which Georgists bent on legislative efforts are in varying degrees familiar. To follow are the chief methods by which the land tax has been, or could be applied.

The first step is *the separate assessment of land and improvements*. Formerly it was customary to assess a house and the plot on which it stood as if they formed a joined unit, like a statue fixed to its pedestal. Now it is often recognized that it is more logical to assess land and buildings separately. Since 1911 this has been increasingly done in the United States, and many local governments in foreign countries do likewise.

Although the term "improvements" usually refers to buildings, it can include many other things too. As defined in a constitutional amendment once proposed by California Georgists:

" 'Improvements' includes structures of any character in or upon land, and pipes, ditches, wells, tunnels, roads (private), clearing and leveling; also vineyards, orchards, alfalfa, growing crops, planted timber, and applied fertility or other alterations or additions to nature made by man."¹

While some of these items are just as separable from intrinsic

land values as are buildings, others present a problem as far as the justice of taxing them is concerned. Clearing, drainage and fertilization, for instance, may have been accomplished last month by the owner, or they may be the result of work centuries ago. According to Georgist practice, where such achievements are traceable to the owner or require continued maintenance on his part, they should be tax-exempt to the extent necessary to insure him a due return on his investment and labor; but after a lapse of time they are held to be part of the intrinsic land value. Obviously such a general principle is subject to conflicting interpretations. Nevertheless, the differential assessment of even non-urban land has proved feasible.²

Once the intrinsic land value has been fixed, the crucial problem is *how the tax rate should be determined*. To answer this, one must distinguish sharply between the full land tax as advocated in *Progress and Poverty*, and the partial applications of it, usually known as land value taxation, which have actually taken place.

The Full Land Tax

Application of the full tax would mean that virtually *all* of the rental value of the land would go into the public treasury. This proposal is in the direction of, but not synonymous with the "single tax," for governments might collect all land value and yet impose other taxes.

How does one calculate the tax rate necessary to collect the "full economic rent" of land?

Suppose a man living in a place where the real estate tax is 6% and the general rate of interest is 8%, buys a plot of land for \$1,000. He will have to pay \$60 a year in taxes, and if instead of buying the land he had invested the money, he would be reaping \$80 a year in interest. Consequently the land must be worth \$140 a year to him. This is the full rental value, and to collect it requires a tax—in this particular time and place—of 14%.

Embodying this in a formula, one can say that the rate needed to collect the total rental value of land is the prevailing rate of interest plus the current real estate tax.

So far, so good. But now a technical dilemma arises. For as the tax increases, the capital or market price falls. Naturally a buyer is going to offer less for a piece of land, the greater the tax is going to be, for he will capitalize the expected tax-burden in his mind and deduct that from what he is willing to pay. At the full rate which absorbs the land's entire annual rental value, the buying-and-selling price would fall to zero, and there would be no base left on which to compute the tax.

The best way of coping with the mathematical difficulty would be to lay the tax not on the capital but on the rental value, that is, on the annual amount which the tenant could be expected to pay for the use of the land. The capital or market price could still be used as a point of departure, but once the system was in operation, a shift could be made to assessing the "economic rent" and capturing almost all of it. In the example given, this would mean shifting from close to 8% of the buying price to close to 100% of the rental value.³

To be quite accurate, the appropriation here discussed should be entitled "*almost* the full value of land". For George suggested that five or ten percent of the land value be left untaxed to the owner as a fee for his trouble in buying and selling, and collecting the rent; and this is still advocated.

All the above, however, is just for the record. For in actual practise probably no government has ever taxed land to its full value; and in any case, to apply the rate as calculated above is not legislatively proposed. But there have been many *partial* applications of the land tax, some of which theoretically could be extended to absorb total land value. They all presuppose accurate, hence usually higher, assessment of land to begin with.

So many methods and variants thereof have been either proposed or applied that it would be unrewarding to study them all, but four suggested by Georgists are outstanding. They are the *unearned-increment method*, the *inheritance-tax method*, the *limited-duration monopoly* of natural resources, and—by far the most important in the history of the movement—*differential taxation of land and buildings* (known as "land value taxation" or "site value taxation"). In addition there are three other methods suggested by non-Georgists.

1) The *unearned-increment method*, derived from a suggestion of John Stuart Mill, lays the increased tax rate only on such value as has accrued to the owner since his purchase of the land. The charge may absorb the entire accrual, or merely some fraction thereof. The advantage is that no actual injustice is visited upon landholders, but at worst some disappointment. The drawback is that all the land value prior to the dates of acquisition remains inadequately captured by the state.⁴

This plan has been temporarily adopted from time to time, notably in some German cities, in Denmark, and in some localities in England just prior to World War II. The method has not been much used in the United States. Although it was the chief concession to George's theory recommended by the American textbook economists of his day and a little later, they never urged it enthusiastically; and Georgists look upon it as too neglectful of all the value accumulated *before* the date of application.

2) The *inheritance-tax method* suggests—among other variants of the plan—that all lands transferred at death be henceforth subject to a tax sufficient to absorb the rental value or a great part thereof. This method is not as promising now as it was long ago, since so much land is presently owned by corporations, which don't die.⁵

3) The *limited-duration monopoly* would apply to natural resources where some incentive is considered desirable to induce men to undertake prospecting or other uncertain initiatives. The developer would receive full, untaxed profits for a certain period. After that, all of the profit over and above that appropriate to rewarding the owner for his labor and investment in extracting the raw material would go to the state.⁶

A method somewhat equivalent to this but simpler has been successfully adopted in the Canadian province of Alberta where the state, in leasing subsoil wealth to developers, has increased not only the purchase price of the leases but also the rents and royalties collected on the oil that is surfaced.⁷ In Australia too, a more substantial amount of rental value from natural resources now goes directly to the government.

4) The most usual way of applying the land tax—and the

only one which many Georgists look upon as true "land value taxation"—is *the differential taxation of land and improvements*. This means not only that buildings, etc. are partly or wholly tax-exempt—for this might be done in addition, no matter how the increased land charge was applied—but that a reduction of taxes on improvements automatically accompanies the increased rate on land.

One way of applying the differential method is illustrated by the gradual process, known as the Graded Tax Plan, which took place in Pittsburgh and Scranton, two Pennsylvania cities, from 1914 to 1925. Before the reform was instituted, land and buildings were taxed, as is usual, at the same rate. Put another way, the building tax was 100% of the land tax. The new law required that after three years the building tax should be 90% of the land tax, with the rates so adjusted that the total tax-yield from both types of real estate would remain the same as it would have been regardless of the reform. After three years more the building tax was to be 80% of the land tax, then 70% and so on, until by 1925 it fell to 50% of the land tax—where it remained (until further dropped many years later). The actual rates are fixed annually by the City Council at such figures as they think necessary to meet the budget. This procedure *could* be extended to putting the whole real estate tax on land.⁸

Another way of shifting from building-tax yield to land-tax yield is to keep the rate on both kinds of real estate uniform but to exempt part or all of the building value from taxation. This method has been used in municipalities of Australia, New Zealand, Denmark and Canada.

To effect such shifts, a city-wide ratio of building value to land value is calculated, and an owner would automatically benefit or lose under the change according to whether his individual ratio exceeded or fell short of this average ratio. Suppose a city in which the buildings amount to 60% and the land 40% of the combined real estate assessment. Mr. Green who has a house in a residential district (house worth 82%, land 18% of his combined property value); the Jones corporation owning a well-built office or apartment building (building 75%, land 25%); or the Brickson manufacturing plant on outlying

land (plant 90%, land 10%), would all undergo net tax relief. But higher payments would result for Mr. Fine who owns a slum building (12%) on a good site (88%); for Olson's dilapidated store (30%) in a central location (70%), and for Mr. Skinner who holds vacant lots (land 100%).

Much statistical work has been done by Georgists showing how householders, owners of industrial buildings and even some farmers would, on the whole, undergo net tax relief by having their taxes shifted away from improvements. But ignorance of such data, an emotional feeling that their land should remain financially as inviolate as possible, or fear of an unjust differential impact upon different landholders at the time of transition, have kept people in most countries from any widespread consideration of the plan. Two exceptions to this are Australia and New Zealand where in many localities the landowners themselves have voted the plan into existence, with a perceptible increase in crops and new dwellings as a result, and in some cases a beneficial effect upon slum clearance.

So much for methods to be found in Georgist writings and practices. But in 1968 a non-Georgist *Report*, that of the *National Commission on Urban Problems* headed by former Senator Paul Douglas, came out with suggestions for capturing more of the value of land for the government. Four specific methods were outlined, the first being the differential method just described. The others are:

2) *A separate recurrent tax upon land values.* This would be a surtax on land only, most likely state-administered, and could cover not only realty subject to the general property tax, but also public and semi-public land.

3) *Special income-tax treatment of land value gains.* This would tax at a higher rate than at present the profits from the sale of land—which now are subject only to the lower capital-gains rate.

4) *A transaction tax on land value increments.* This differs from (3) in that the tax would be based on sale-realized gains in value arising after enactment of the law, and not on the

owner's income bracket. It could have progressive rates that would capture a great deal of high-rate increases in land value, and could be expected to bring in more revenue than (3). (Both (3) and (4), like John Stuart Mill's "unearned increment" would tap "emergent" values only, not the whole past value of the land.)

A further recommendation of the "Douglas Report," not precisely aimed at land taxation but related to it, suggests that renovations to old buildings be tax-exempt; and that there might be tax relief for owner-occupied residential property below a certain income level.

Finally, it should be noted that *realistic assessment of land values*—strictly speaking, a prerequisite to rather than a form of the land tax—would go far in the same direction, since the national average of land assessment is far below its actual market value.

If one believes in the general theory of land value taxation, what are seen as the chief stumbling-blocks to its actual application, and how well do these methods respectively deal with these difficulties?

Historically, the chief objection on the part of those who otherwise see some merit in the proposal has been that the transition to the new system would be unfair to current landholders. Before amplifying this, it will be well to review George's approach to the subject of compensation:

His attitude while not self-contradictory was rather ambivalent. On the one hand, he held that landowners were morally no more entitled to compensation than were slaveholders, and he was flatly against any specific indemnification to individuals. On the other hand, he believed that the relief from general taxes that would accompany the increased land tax would be so great and widely extended as to reimburse almost everyone except the very rich and speculators.

Neither of these reasonings convinced the public. People thought landowners *were* morally entitled to compensation. As for general tax relief, they felt that—in addition to the legis-

lative difficulty of changing existent tax laws so drastically —there was no guarantee that individual justice would be adequately served thereby.

It will be recalled that the economists and civic leaders of George's day made these points with striking frequency. The argument, intensified by the involvement of land with insurance assets, is just as prevalent in modern times. Sometimes it is advanced along with other objections, but surprisingly often it appears alone. That is, the critic thinks the land proposal a good idea in itself, but impossible of attainment now, due to its unfairness.

The historian Gerald Johnson wrote in reply to a question: "I have never seen a successful refutation of Henry George's reasoning, but he came too late. To blast out the errors in our economic system would wreck the whole system and more than offset the good accomplished by adoption of George's principle of taxation."

The writings of many other well-informed people disclose a similar belief, and while the compensatory aspect is not the only feature which they think presents an obstacle, it usually looms large. Are these objectors right or wrong? Is it possible to give a satisfactory answer to this problem of "confiscation?"

The answer would appear to fall into three parts: (1) consideration of the method most extensively tried—namely, differential taxation of land and buildings; (2) consideration of all the other methods; (3) analysis of a frequent misunderstanding about the whole problem of the land tax's "injustice."

1) The differential method has not proved onerous where it has been tried, especially when applied gradually with the real estate tax shifting little by little from buildings to land. In Australia and New Zealand, the landowners themselves have petitioned for it.¹² In Pittsburgh and Scranton it has been satisfactory; in several small American cities, homeowners are working for it. That the method has not been more widely adopted is not due to its being considered unjust. Even owners of vacant land have had an opportunity to sell out at a good price or build upon their land before having the tax go up.

2) All the other methods outlined, with one exception, make

compensation, at least from a certain point of view, unnecessary. With the limited-monopoly method (or some variant thereof) for natural resources, the developer is rewarded up to a point suitable for his pains. The inheritance-tax method would disadvantage only the heirs, and it can be argued that the heirs should not expect a windfall. This same logic—that much of an unearned gain need not be compensated—also applies to John Stuart Mill's "future increment" method, and to the recent suggestions for specially high income-tax treatment of, or else a transaction tax upon landed sales.

The exceptional method that denies even to-be-expected compensation is the "separate recurrent tax upon land values," the most "unfair" of the proposed procedures, since it would tax past land values as well as immediate gains, without offering building-tax relief.

There is not much actual data on most of these methods, since they have been used either not at all or very little. The collection of extra profits from natural resources has apparently proved the most feasible.

3) Apart from the merits or demerits as regards compensation of the various possible techniques of application, the whole problem of making the shift is complicated by a frequent vague but powerful misunderstanding. This is that the land tax is viewed as something *permanently* unjust. For in all the talk about the unfairness of depriving landholders without compensation for the value of their investment, the distinction between the temporary and the permanent situation has often not been adequately drawn. Critics both within and outside economic textbooks often lump temporary dislocations more or less to be expected, along with objections to the plan itself, in such a way that the inexperienced reader or listener gets the impression that the system in itself is discriminatory. Yet this is not the case at all.

For once the men who were landowners at the time the law was passed had taken such losses as might befall some of them, these losses would rarely recur. Thereafter everyone would know that land was no longer to be prized as a source of possible fiscal advantage, but was rather to serve as a basis for residence

or profitable production. People would be no more chagrined at not being able to profit from the land itself than they now are at not being allowed to sublet their apartments or business offices at an increase. Yet to many the whole proposition has mistakenly appeared to be intrinsically—not just transitionally, perhaps—confiscatory. This blurring of the distinction between transitional difficulties and the permanent aspect of the reform itself is one of the most insidious causes of popular misunderstanding of the land tax.

If the question of injustice to current landowners has been one of the chief objections in the past to the consideration of George's theory, there is now one of probably equal importance: the problem of land usage.

If taxes are to be increased on land—so runs the argument—would this not incite owners to recoup the increased land charge by covering every foot of space in the cities, by building up their plots with skyscrapers whose occupants further congest traffic, by spreading factories or vacation bungalows or spacious office buildings in precious open space that had best be left agricultural or rural? Would it not mean despoiling forests and mineral deposits in order to obtain a quick return on the more highly taxed land?

There are several Georgist answers to this.

First, it is thought that eventually the adoption of the land tax would actually help to solve rather than complicate conservation problems. Here again, as in the question of "confiscation," people have not made a clear enough distinction between the transitional and the ultimate situations. For while it is true that at the *beginning* of the shift to a high land tax owners might feel impelled to utilize with intensified building the land *they had already paid for*, as time went on the tendency wastefully to preempt *new* land would be lessened. With all the profit taken out of land speculation, speculators would no longer buy up new land for holding purposes, nor for promoting comparatively non-essential uses for which there was no intrinsic demand.

Moreover, there is nothing in the land-tax system to prevent governments from exercising as much control as ever over the use of land, nor from applying whatever safeguards are currently offered to curb the destruction of open space. And higher taxation of vacant city land, forcing it into use, would tend to decrease the demand for land at the outskirts.

It is really the building-tax-relief component of the differential method which poses the chief, or at any rate a further problem in the question of suitable land usage. For though lessened taxes on buildings would *enable* developers to put up needed construction which otherwise they might not be able to afford to build, does that mean that they would necessarily do so? The same building-tax relief that would permit them to build needed housing at a reasonable profit would also allow them to erect high-rent apartments, luxurious office parks, etc. at a still greater profit. Whether the increased construction undoubtedly engendered by this method is to be a blessing would seem to depend on the choice of the builders.

Moreover, this favored method has limitations as to coverage. It could apply only to areas where buildings and other improvements existed whose tax reduction could be expected to offset the increased land charge. It is inapplicable to all the immensely valuable natural resources: mines, timber, water-power, oil, airwaves, which constitute such a large part of land.

Although the legislative drive of the movement has gone so predominantly in the direction of this differential "land value taxation" (at times also called "site value taxation"), Georgists sometimes have advocated at least three other procedures. Especially in the British Commonwealth, Denmark and Holland, there are many who feel that communally held land-trusts should be established; several have already been created in the United States and Canada. There is also considerable pressure, some of it successful, for raising assessments to their market value—which is not precisely a tax on land, but has the same effect of getting more revenue from it. Another method occasionally adopted by Georgists, as in the water districts of California, is to levy special assessments on land benefited by public improvements.