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surprisingly good job, under all the circumstances; and that while it is very easy to abolish the excess profits tax, it is exceedingly hard to find a substitute that is not worse.

I offer the following suggestions:

1. *Reduce the higher surtax brackets on individuals so that the maximum tax does not exceed fifty per cent.*

2. *Revise the administrative features of the excess profits tax and establish local board in each district where at least 90 per cent of all the returns can be checked and passed upon, and only the most complicated sent to Washington. This will be in line with the English method, which works very well.*

3. *Establish a Board of Adjustment*

to which cases can be referred for final settlement.

4. *That the Constitution be amended so that there will be no tax-free securities and all income will be taxed.*

5. *That 75 per cent of the taxes be raised from income taxes and 25 per cent from consumption and other taxes.*

That the present income tax and excess profits tax do not produce sufficient revenue; that the rates be raised sufficiently on individual incomes between \$10,000 and \$50,000 to make up the difference.

6. *The enactment of H. R. 14198.*

7. *That net loss for any year may be deducted from the succeeding year or years.*

The Ralston-Nolan Bill

A Proposed Tax on Unimproved Land Values

By S. H. PATTERSON

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“THE tariff a local issue” was made the presidential campaign slogan of a generation ago. The same might be said of taxation. Various individuals are vigorously agitating for the repeal of certain taxes which they find repressive—that is, which hit *them*. They feel that the industrial prosperity of the country will be furthered by other kinds of taxes, the final burden of which seems to lie in another direction. The political atmosphere is full of taxes and rumors of taxes.

On February 7, 1920, Mr. Nolan introduced into the House of Representatives a bill taxing large land values, which was subsequently referred to the Ways and Means Committee. The measure is technically known as House of Representatives Bill No. 12397 or more popularly as the Ralston-Nolan Bill. It proposes to “provide for the raising of public revenues by a

tax upon the privileges of the use and enjoyment of lands of large value.” The bill defines land in its true economic sense, that is, including all natural resources and excluding all improvements which represent labor and capital.

That for the purposes of this Act, land is defined to be the surface of the ground, with all easements in, on, and over the same whether covered by water or not, and including water powers and rights, natural growths, if any, of land and including wild forests, natural deposits of coal, minerals of all kinds, oils, gases, peats, waters and all other substances and not including the improvements the result in whole or in part of the application of labor to land.

The rate of taxation is one per cent upon all land values in excess of ten thousand dollars.

That all persons, firms, associations and corporations owning land in excess of ten thousand dollars whether in possession or leased to others shall be subject to an excise tax upon the privilege of the use and enjoyment of such excess at the rate of one per centum. It shall be the duty of every owner where the value of the land itself excluding improvements exceeds ten thousand dollars to report his interests before March the first of each year to the Commissioner of Internal Revenue.

The bill concludes with sections covering the administration and the enforcement of the act.

Let us see what this proposed law would mean. Suppose Mr. Brown owns a farm worth \$35,000. Let us assume his house, barn, shed, fences and other improvements or capital to be worth \$10,000. This would make the value of the land itself \$25,000. As there is an exemption feature of \$10,000 Mr. Brown would have to pay a tax upon \$15,000 worth of unimproved land value. At one per cent his yearly tax bill under this law would be \$150. It must be remembered, however, that this tax is a new federal tax independent of and in addition to the existing local or general property tax, which covers buildings as well as land value.

It is estimated that the Ralston-Nolan Bill will yield an annual revenue of one billion dollars or one-fourth of the total needs.

Mr. W. I. King, in his study of "The Wealth and Income of the People of the United States," attempts an analysis of the distribution of the national income among the factors of production. Because of the anticipated gains from a rise in land value he capitalizes rent at the rather low rate of four per cent. On the basis of figures for 1910 he estimates rent at \$2,673,900,000. Capitalized at his rate, the value of our natural resources for 1910 was \$66,847,500,000. The

Ralston-Nolan Bill proposes a tax of one per cent on land values. This would yield annually in the above figures a little over half a billion dollars. Land values have increased since 1910 but the estimated yield of one billion dollars on the part of the advocates of this bill seems excessive. It represents, moreover, the invasion of a new field by federal taxation. The general property tax in this country is usually regarded as within the sphere of the local governments of the individual states. It required a special amendment to our federal constitution to give Congress the power "to lay and collect taxes on incomes from whatever source derived without apportionment among the several states and without regard to any census or enumeration."

Disregarding the constitutionality of the law, from an economic point of view the differentiation between land itself and the improvements upon it is very important. Unimproved land including all natural resources is a distinct element in production from the improvements upon land which are the result of labor and represent a third element, namely, capital.

This theoretical distinction is beset with certain practical difficulties. Improvements upon land are of such a permanent nature that they tend to become part of the land. Witness the labor expended in clearing or draining a piece of land for farming. Shall we say that a stream is a natural resource but that an irrigation ditch of the same size is capital? How can fertilizer be classified? The practical difficulties of differentiating between land itself and the improvements upon it are very great. City real estate assessors find it difficult to apportion the value of a building between the value of the building itself and the site or land value.

It would seem that the small farmer

would have little to fear. The advocates of the Ralston-Nolan Bill estimate that ninety per cent of the farmers of the country would be untouched. The measure is designed to hit at large holdings of our natural resources which are frequently alleged to be under monopolistic control. It seeks to prevent speculation in land values. The bill makes no distinction between idle land and that in use. Indeed, one of its avowed objects is to tax idle natural resources and productive land held out of cultivation and thus to force it into use. Such a tax would also discourage large holdings in favor of the smaller. Such forms of taxation are not new to the American farmer, nor, as is frequently alleged, is he as hostile to such proposals. The Farmers' National Congress at its annual convention in Indianapolis in October of 1916 adopted the following:

Resolved that this Congress view with alarm the increase in farm tenancy, recommends that the several states adopt a gradual land tax adapted to their peculiar conditions in order to promote more and better farm homes, farm citizenship and country life in general.

The National Grange at its annual convention in Washington endorsed the so-called Crosser Bill, introduced before a former session of Congress with somewhat similar aims. The Farmers' Non-Partisan League of North Dakota, which elected a single-tax governor, had a land value tax in its platform.

There are certain elementary economic principles contained in the Ralston-Nolan Bill which require examination. In the first place a tax on land values is a direct tax. A tax upon economic rent can not be shifted. It is the opinion of most economists that such a tax can not be passed on to the tenant, nor can its final burden rest

upon the consumer in the form of higher food prices. Rent in its economic sense is due to the superior productivity or location of various pieces of land. If one acre of ground equally accessible to markets will produce with the same amount of labor and capital an average yield of ten dollars' worth more of potatoes than another acre of land, it will yield ten dollars more in rent to its owner. If the rents paid for different pieces of land afford an accurate measure of their varying degrees of productivity, the tenant is already paying what the land is worth. He can not and will not pay more rent because of the new tax, provided there is no change in the value of his land due to other economic conditions. A general attempt to shift the tax in the form of higher rents will bring poorer sites and uncultivated land into operation. They tend to fix prices of commodities, for rent due to superior qualities of certain pieces of land is in the nature of a surplus going to the fortunate owners. Unless there is some other economic cause a tax upon land values can not be shifted by the owner to the renter or to the consumer in the form of higher food prices.

If a tax upon land values is permanent it can not be shifted to the next purchaser, because he will discount the value of the property by the value of the tax. Suppose a piece of farm land to be yielding a rent of \$6,000. Capitalized at six per cent, its value would be \$100,000. If a one per cent tax is placed upon it, this would amount to \$1,000 a year. The rent must remain \$6,000, for we have attempted to show that a tax on land value can not raise rent. The yearly income from this piece of land is now only \$5,000 (\$6,000 rent minus \$1,000 tax). Capitalizing his now diminished income of \$5,000 at the same rate of six per cent, the investment value of the same farm

is but \$8,333.33. No future buyer will pay more than that sum because of the new tax. By becoming a silent partner to the extent of one per cent in all the future earnings of the given piece of land, the government at one stroke has taken \$16,666.66 from its investment value.

It may be asked if this does not amount to something like confiscation. The answer depends upon one's theory of taxation. Of these theories there are many, as for example the ability to pay theory, of which the income tax is supposed to be an illustration. Another is the benefit theory by which an individual should contribute in proportion to the benefits he receives. Again, the taxes might be based upon special privileges. Is the ownership of land and other natural resources a special privilege? Single-taxers reaffirm that "the earth is the Lord's and the fulness thereof." They lament the appropriation of large tracts of land and the seizure of especially valuable natural resource by private individuals. The owners should at least contribute in taxes in proportion to their ownership of natural resources, such as land, which rightfully belong to society in general. Thus a tax upon land values is defended by the so-called special privilege theory of taxation. Whether just or unjust, however, society has given its assent for centuries to the private ownership of land. An individual with \$100,000 invested in a piece of unimproved land would find \$16,666.66 sliced off the value of his investment by such a tax on land values as the proposed Ralston-Nolan Bill. A similar sum invested in buildings would not be so much affected by that law.

It must be remembered, however, that there are other laws which have precisely the same effect upon the value of securities. The income tax has sliced similarly the investment

values of stocks and bonds to many individuals. To some owners the surtaxes, by taking a greater proportion of their income, have reduced the investment value of their securities to a far greater extent. Professor Seligman in his "Essays upon Taxation," written some years ago, was inclined to agree to the oft-quoted statement that the farmer was taxed more heavily in proportion to his ability to pay than most other classes. It is doubtful whether this is still true. The war has brought a flood of new taxes, resting more heavily upon other factors in production than upon land. Thus, the excess profits tax, if it is to be permanent and not merely for the period of war-inflated prices and profits, will represent a new burden, just or unjust, upon business enterprise. To prove quantitatively that the owners of natural resources are now less heavily taxed than formerly in comparison with owners of other forms of wealth would reopen the whole problem of the incidence of taxation.

The proof is made more difficult by the overlapping of taxes as in the case of the income and the excess profits tax. Theoretically, the base of the income tax is income and the base of the general property tax is wealth, but naturally income arises from wealth. The problem is still further complicated by the fact that current taxes are based upon not only economic wealth, but upon certificates of ownership or property rights, *e. g.*, bonds, mortgages, etc. Such a solution is made more difficult by the overlapping of federal and state taxation. Many individual states have income taxes. The general property taxes differ in the forty-eight states. The base is both real and personal property, but the frequent evasion of the tax upon personal property represents another difficulty.

The *Statistics of Income* compiled

from the returns for 1918 under the direction of the Commissioner of Internal Revenue show the following sources of income from personal returns. They may be divided into two groups—personal service and property, roughly representing the distinction between service and funded incomes. The amount of income taxable in the first group was \$12,897,846,872 or 73 per cent of the total and that in the second was only \$4,847,914,601 or 27 per cent. The conclusion that funded income is paying but a small share must not be arrived at too hastily, for there are many things to be considered as, for illustration, the element of progression. The surtaxes rest especially upon those receiving property incomes. The taxable property income is divided into three divisions as follows: Rents and royalties \$975,679,666 or 5 per cent of the total, interest on bonds and notes \$1,403,485,691 or eight per cent and dividends \$2,468,749,244 or fourteen per cent of the total. As indicated in the last paragraph there are many facts which make us hesitate at the tempting generalization that the owners of natural resources are no longer taxed as heavily in proportion as the owners of other forms of economic wealth and paper certificates of wealth.

The Ralston-Nolan Bill proposes to tax all unimproved land values whether agricultural or not. Our same line of economic reasoning applies to coal and mineral land as well as to farm land. It is the same principle of economic rent—the superior values of different pieces of land whether useful in producing potatoes or coal.

In general, such a tax can not be shifted. Suppose, however, a monopoly exists. Can not the consumer be made to pay a higher price for the product? A monopoly presumes such a control over supply as to permit

price-fixing. A monopoly fixes its price at that point where the profit is greatest. This is frequently but not necessarily a high price. Experience may have shown that a higher price means fewer sales and that higher profits may come with more sales at lower prices. If monopoly exists, a monopoly price should be already fixed at that point at which the profit is the greatest. If such is the case it will be a loss to the monopoly to try to raise the price, for the sales will be decreased and profits will fall off.

Hence, such a tax upon monopoly profits can not be shifted. Moreover a tax upon land values would tend to make it unprofitable to keep productive land idle. By bringing it into use monopoly control might even be broken. An increased supply of products resulting from the use of hitherto uncultivated land would tend to bring down the prices of the products.

The English economist, Mr. J. A. Hobson, in his recent book, *Taxation in the New State*, has recast the whole philosophy of taxation. He tries to analyze more closely the so-called ability to pay. Mr. Hobson would draw a line between costs of production, which are incapable of bearing taxation and surplus wealth, out of which all taxes must eventually come. Under "surplus" wealth he would include among other things excessive or monopoly profits, inherited wealth and economic rent, which we have seen is based upon unimproved land values. A tax which bears upon cost of production is either immediately shifted or else curtails production, raises prices and is finally shifted. Many of our war taxes which bore upon industry hit the cost of production and hence were shifted. The final burden was frequently hard to trace in its devious course, but it sometimes gathered in size like the proverbial snowball. A

tax upon commodities is the classic illustration of an indirect tax shifted to consumers. During the war everything in sight was taxed from silk shirts to spectacles.

Part of agitation today over revision of taxes is due to the failure to study the location of the final burden of the various taxes imposed. The principle of taxation during the war was that of the drunken Irishman at the country fair—"Every time you see a head, hit it." The only defense of such a system is that money was raised in a quick way to help win the war. Now that the conflict is over it is surely time, to paraphrase the words of the walrus, to stop talking in incoherent terms of "ships and shoes and sealing wax, of cabbages and kings." The

entire theory of taxation must be reviewed and some guiding principles adopted. Thus a tax must be proportionate to one's ability to pay and we must know where the final burden rests if we expect to escape the pernicious shifting of taxes.

The Ralston-Nolan Bill will place its burden upon the large holders of land and natural resources. It will be unfair if it taxes one form of wealth, namely land values, out of proportion to other forms of wealth equally capable of bearing taxation. The social effects will be beneficial in so far as speculation in land is discouraged and idle land is brought under cultivation. It may tap monopoly profits, but it is sure in any case to raise an enormous revenue to help defray our war debts.

The Sales Tax

By JOHN S. HORD

Washington, D. C. Formerly Collector of Internal Revenue in the Philippine Islands. President of the Bank of the Philippine Islands. Sometime President of the Manila Merchants Association

THE Secretary of the Treasury has informed Congress that this country's revenue needs are now about four times as great as they were in pre-war times. Four billion dollars will be needed each year for several years to come. Probably less than twenty per cent of this amount can be economically collected as customs duties, and internal taxation must be relied on to produce the remainder.

But, unfortunately, the two main sources, during war times, of internal revenues, excess profits and income taxes, are declining in importance. It is this awkward situation which has brought a discussion of the sales-tax principle to the forefront in this country during the last six months. Some productive, untapped reservoir of reve-

nue must be discovered without delay.

This monograph is being written on the eve of the change in the national administration. For a proper appreciation of the trend of events in the immediate past, affecting the subject matter of this discussion, a review thereof is made as follows:

TAX REVISION PROGRAM OF THE SECRETARY OF THE TREASURY

In his last annual report and in statements made to the Ways and Means Committee and in articles published in leading magazines and newspapers, Secretary Houston and his official spokesmen and tax advisers have made recommendations to the following effect:

(a) That the rates of the surtaxes on