CHAPTER XIV

TAXES ON THE PUBLIC VALUE OF LAND

§ 1. It has become apparent in the course of our study that, when a tax is assessed on anybody by reference to the value of some object in his possession of such a sort that that value cannot be altered by any action on his part, the tax, in its announcement aspect, works like a poll-tax and is, in that aspect, an ideal tax from the standpoint of least aggregate sacrifice. In order that it may possess this quality it is not necessary that the object of assessment should be inalienable by the present owner. He may be free to sell it — of course at a price diminished by the discounted value of the tax — and the tax will remain, in its announcement aspect, wholly innocuous. The essential point is that the object of assessment is such that its value, and, therefore, the amount of the impost to be collected, cannot be altered by anything that the owner, whoever he may be, decides to do.

§ 2. Now, if we select any piece of durable property, determine its value in 1936, and decree that henceforward its owner shall pay a tax based on that value, we have an object of assessment of the type contemplated above. There is, however, a certain appearance of absurdity in basing taxes on historical values of this kind. It is easy to imagine how anomalous taxes so based would seem when they had continued for 100 years. In practice, if any value is to be taken as an object of assessment for taxation, it must be current, or, at all events, very recent value. The values of all ordinary sorts of property are, however, liable to be altered by work or investment on the part of the owners or occupiers. Taxes assessed upon them will, therefore, vary in amount according to what these persons do, and, therefore, will react upon their conduct. Thus these taxes do not conform to the poll-tax type. There is, however, one current value, taxes upon which do so conform. This is what is called in Australia the "unimproved value" of land.

§ 3. In Great Britain up to the present time, apart from the small "undeveloped land" duty of the 1909 Budget, no

resort has been had to this taxable object. In New Zealand and the Australian colonies, however, it has for many years played an important part both in local and in national finance. In South Australia a special national tax on unimproved land values was first imposed in 1884. One halfpenny in the £ was levied on all unimproved (capital) values; an extra halfpenny on unimproved values exceeding £5000; and an absentee tax, amounting to 20 per cent, on absentee owners.[1] In New South Wales: "The land tax of the State is levied on unimproved value at the rate of 1d. in the £. A sum of £240 is allowed by way of exemption, and, when the unimproved value is in excess of that sum, a reduction equal to the exemption is made; but, when several blocks of land within the State are held by a person or company, only one amount of £240 may be deducted from the aggregate unimproved value. In cases where land is mortgaged the mortgagor is permitted to deduct from the tax payable a sum equal to the income tax paid by the mortgagee on the interest derived from the mortgage on the whole property including improvements."[2] In 1910 the Commonwealth of Australia introduced a central tax on unimproved land of the same general character as the State taxes, with a graduated scale rising from $\frac{1}{300\frac{1}{0}0}$ of a penny on the first £ of taxable balance to 6d. on each £ in excess of £75,000. The rates were raised substantially during the first world war, subsequently reduced, and in 1940–41 raised again to approximately the 1914–17 level.[3] In New Zealand: "In 1891 the Property Tax Act then in force was repealed and replaced by the Land and Income Assessment Act, under which a land tax was imposed on land and mortgages of land, and an income tax on all income other than income derived from land and mortgages of land. Improvements on land were exempted up to £3000. In 1893 an amending Act was passed by which all improvements on land were entirely exempted, and in 1896 an Act was passed by which the principle of taxation on the 'unimproved value' was extended to local rating, by enabling local authorities to adopt the system on a poll of the ratepayers being taken and a majority voting in favour of its adoption."[4] The amount of

[1] [Cd. 3191], p. 20.
[2] [Cd. 3191], p. 21.
[3] *22nd Report of the Commissioner of Taxation Commonwealth of Australia*, 1940, p. 7.
[4] [Cd. 3191], p. 24.

the national tax in this colony was ordinarily one penny in the £ on unimproved (capital) value. "Land in possession of natives is treated specially, and, out of consideration for small peasant farmers, plots worth less than £500 are exempted and plots worth less than £1500 are allowed an abatement. In addition to the ordinary land tax, the same Act imposed a graduated State tax on large estates, commencing at one-sixteenth of a penny in the £ on land of an unimproved value of £5000, and rising to threepence in the £ on land of an unimproved value of £210,000 or more." [1] The arrangements existing in 1940 are summarised in the New Zealand official Year Book for that year as follows. "Land tax is assessed on the unimproved value of land after deductions provided for by Statute have been made by way of special exemptions. An owner of land the unimproved value of which does not exceed £1500 is allowed an exemption of £500; . . . [and with larger values an exemption gradually diminishing, so that no exemption is allowed when £2500 is reached. . . .] When the unimproved value, on which land tax is payable, does not exceed £500, the present rate of land tax is 1d. in the £. The rate is increased by $\frac{1}{8000}$ of a penny for every £ in excess of £5000, with, however, a maximum of 6d. in the £." [2]

§ 4. In all these arrangements the essential matter is the distinction between improved and unimproved value. Some light on the precise way in which this distinction is drawn may be gathered from a very interesting explanatory memorandum furnished by the Valuer-General of New Zealand, Mr. G. F. C. Campbell, in the Report [Cd. 3191], from which extracts have been quoted above. Mr. Campbell cites the definition clauses of the Government Valuation of Land Act, 1896, and adds certain comments of his own. The principal points to be noted are the following:

First: "The increased value attaching to any piece of land due to the successful working of other lands in the district or to progressive works effected by the State, the general prosperity of the country, high markets for produce, etc., form a portion of the unimproved value under the New Zealand law. Any increased value, however, which is represented by the improvements effected by the individual pos-

[1] Chorlton, *The Rating of Land Values*, p. 160.
[2] *Loc. cit.* p. 587.

sessor, either past or present, does not form part of the unimproved value." [1]

Secondly: "Improvements can only be valued *to the extent to which they increase the selling value of the land.* This fact should not be forgotten; the valuer must, therefore, value an improvement at the proportionate sum which it represents in the selling value of the whole property. We sometimes find a large house built on a small area of farming land. The ordinary farmer who would purchase such a property would not be likely to pay for the house anything approaching its cost — he would only pay the price of a house which suits the requirements of the farm. The selling value of the house must, therefore, be put at what the ordinary purchaser would be likely to give for it, or, in other words, at the sum by which it increases the selling value of the property. Sometimes an owner will expend his capital and labour injudiciously, and the result will prove detrimental to the land instead of being an improvement. Some lands hold grass better without first being ploughed than they do after the plough. The effect of ploughing in such cases would not be to improve the selling value. Some improvements, such as ornamental shrubbery, orchards, lawns, vineries, etc., rarely increase the selling value to the full extent of their cost, and should, therefore, be valued accordingly. . . . No work can be considered an improvement if the benefit is exhausted at the time of valuation. . . . The amount at which improvements are to be valued is defined by the Act as the sum by which they increase the selling value of the land, *provided that the value must not exceed the cost*, although it may be below the cost if their condition warrants it. The cost of an improvement is not necessarily its selling value, as its suitability and condition must be taken into consideration." [2]

Thirdly: "It is the actual improvement which is valued, not the effect of that improvement. For instance, suppose that the expenditure of a small sum in cutting an outlet for water has converted a swamp into first-class agricultural land. The fact that the swamp was capable of easy drainage would enhance its unimproved value, and the cost only of cutting the drain would be valued as the improvement." [3]

[1] [Cd. 3191], p. 37. [2] *Ibid.* pp. 39-40.
[3] *Ibid.* pp. 40-41.

Lastly: An improvement, to be classed as such, must be made by the owner. Suppose that there are two pieces of land adjacent to one another, and that the cutting of a drain or the erection of a fence upon one of them would enhance the total value of both. If the two pieces are owned by the same person, their unimproved value, both before and after the drain is cut, would appear to be equal to their total value *minus* the cost of cutting the drain. If, however, they are in different hands, the unimproved value of the piece on which the improvement is not required is enhanced so soon as the improvement on the other piece is carried out. The same point arises in connection with collective improvements. Thus Mr. Campbell observes: "It has been argued that public works done by small communities, and for which those communities agree to rate themselves, shall be valued as an improvement" for the purpose of the national land tax.[1] The New Zealand Act, however, does not accept the view.[2]

§ 5. The general nature of the distinction between improved and unimproved value has long been familiar to economists. It corresponds to the Ricardian distinction between true economic rent and profits from capital invested in land. Unimproved value is the capitalised value of the true rent, and improvement value that of profits. A terminology for some purposes more convenient was suggested many years ago by Marshall. True rent is that part of the annual value of land which arises from its position, its extension, its yearly income of sunlight and heat and rain and air. "The (annual) value of the land", he wrote, "is sometimes called its 'inherent value'; but much of that value is the result of the action of men, though not of its individual holders; and, therefore, it is perhaps more correct to call this part of the annual value of land its 'public value', while that part of its value which can be traced to work and outlay by its individual holder may be called its 'private value'."[3] Public value capitalised corresponds to the unimproved (capital) value, and private value capitalised to the improvement (capital) value of the Australasian laws.

[1] [Cd. 3191], p. 40.

[2] For an account of some of the difficulties of valuation, cf. Scheftel, *The Taxation of Land Value*, pp. 69 *et sqq.*

[3] *Memorandum on Imperial and Local Taxes* [Cd. 9528], p. 115.

§ 6. Having thus found in the unimproved or public value of land a taxable object, which, from the standpoint of "announcement", conforms perfectly to the principle of least aggregate sacrifice, we have now to inquire how far it conforms to that principle in its distributional aspects. In attacking this problem, we have to apply the general method of Chapter IX, §§ 19-22, to the facts of this particular case. In this country, among people at any given income level, the proportions in which their incomes are drawn from the public value of land vary enormously. One rich man's income is made up almost entirely of rents, another's contains scarcely any rents. Hence, as between persons of equal incomes, this type of tax will act very unequally, and, so far, will be distributionally bad. On the other hand, the ownership of rents is in this country concentrated in a high degree upon rich people. Hence, as between people of different incomes, this type of tax is distributionally good.

§ 7. There is, however, a *special* consideration which commends this type of tax up to a point from the distributional angle. It is, in a measure, preventive of distributional evils, which government expenditure of taxation otherwise tends to bring about. Thus Marshall wrote: "There may be great difficulty in allocating the betterment due to any particular improvement. But, as it is, the expenditure of such private societies as the Metropolitan Public Gardens Association, and much of the rates raised on building values for public improvements, is really a free gift of wealth to owners who are already fortunate." [1] It is true, no doubt, that those who have purchased urban land recently may have partially discounted this betterment in their purchase price; but they are not likely to have discounted it entirely; while those owners who are not recent purchasers will not have discounted it at all. Consequently, it is to be expected that the special burden which new taxes upon site-values would impose upon site-owners — at all events in urban districts — would be partially offset by a special increment in no way due to their own effort and expenditure.

§ 8. In view of the excellence of a tax on the public value of land from the standpoint of announcement we should plainly need proof that, taken all in all, it was abnormally

[1] *Memorandum on Imperial and Local Taxes* [Cd. 9528], p. 125.

bad distributionally before being justified in rejecting its claims to a place in the tax system. If it were proposed to put a very high rate of duty upon the annual — still more upon the capitalised — public value of land, owners of valuable sites would, indeed, have ground for complaint that *gross* discrimination was being practised as between them and other equally wealthy persons. Even with a fairly low rate of tax the discrimination may be considerably more important than it is at all likely to be in the case of, say, a tea tax ; because some persons draw a proportion of their income from true rents larger than the proportion of their income that any persons spend on tea. Moreover, taxes on true rents, if imposed with an expectation of continuance, are apt to become amortised : that is to say, the present owners of land, should they wish to sell their property, are forced to accept a purchase price reduced by the discounted value of the future annual imposts. When this happens they are hit, *pro tanto*, with greater severity. This is a sound reason against imposing very high rates of tax on true rents.[1] It is of little weight, however, against low or moderate rates ; for, after all, *every* single tax taken by itself is bound to be in *some* degree unfair between individuals. On the whole, therefore, I conclude that, in any tax system which relies on a number of different imposts, there is a strong case for including among the rest a moderate tax assessed at a moderate percentage upon the (annual) public value of land.

[1] If a tax of this sort is in existence and has been in existence long enough for a large proportion of the affected property to have changed hands by sale or inheritance, these same considerations constitute a strong argument against remitting it ; for, just as the imposition of the tax mulcted one arbitrarily selected set of men who are to receive no compensation, so the removal of it gives a present to another arbitrarily selected set who have suffered no previous hurt. It is with this consideration in mind that Marshall writes : " Any relief as regards old rates should, therefore, apply only to new buildings and other fresh investments of capital " (Marshall, *Memorandum on Imperial and Local Taxes* [Cd. 9528], p. 121).