Is It Time to Reform the Property Tax?

"A weird combination of overtaxation and undertaxation," a conference of experts called it—one that provides an incentive "for what we don't want and a disincentive . . . for what we do want"

Much too much nonsense is being spoken and written and believed about the property tax.

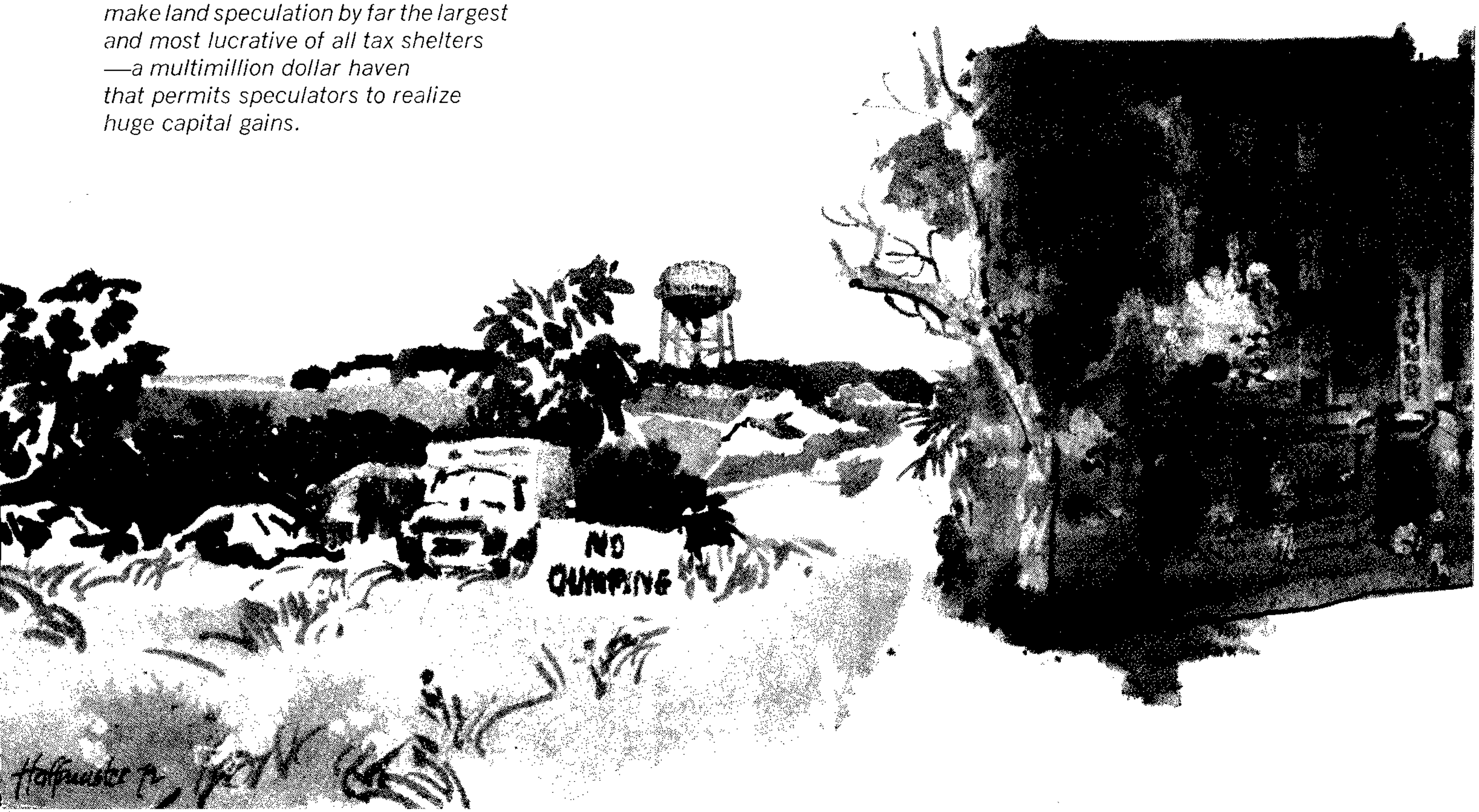
Not one taxpayer in a thousand, and not one businessman in a hundred, understands what is wrong with it. Even assessors charged with its administration are too apt to confuse it with an income tax—they grossly underassess land that is kept so underused or misused that it is earning too little income, and then grossly overassess land whose owners have put it to good use to earn a good income.

The one and only thing most taxpayers seem to know about property levies is that their bills keep getting bigger and bigger and bigger.

And indeed, property tax collections have multiplied by eight since 1939. But nobody seems to realize the reason: Over these same years local government costs have multiplied by more than 13.

ILLUSTRATION: PAUL HOFFMASTER

In most tax districts, says the author, underassessment and undertaxation make land speculation by far the largest and most lucrative of all tax shelters —a multimillion dollar haven that permits speculators to realize huge capital gains.



Local government has become America's biggest growth industry, and somebody has to pay its costs.

There is another aspect of property taxation that few taxpayers realize—or seem to care about. Its misapplication is the biggest single cause of blight in our cities, and of the sprawl in the suburbs that prematurely urbanizes millions of acres which should be left open country for years to come.

In too many tax districts, improvements are taxed so heavily that there is little if any profit in them unless they are given some kind of open or hidden subsidy (and often as many as four different kinds of subsidy).

Conversely, land is taxed so lightly that in-city landowners are under too little tax pressure to put it to good use and suburban landowners can afford to hold millions of acres, needed now for orderly growth, off the market until they can get tomorrow's prices today—thereby forcing developers to leapfrog far into the boondocks to get land they can afford to buy.

Sadly unwise

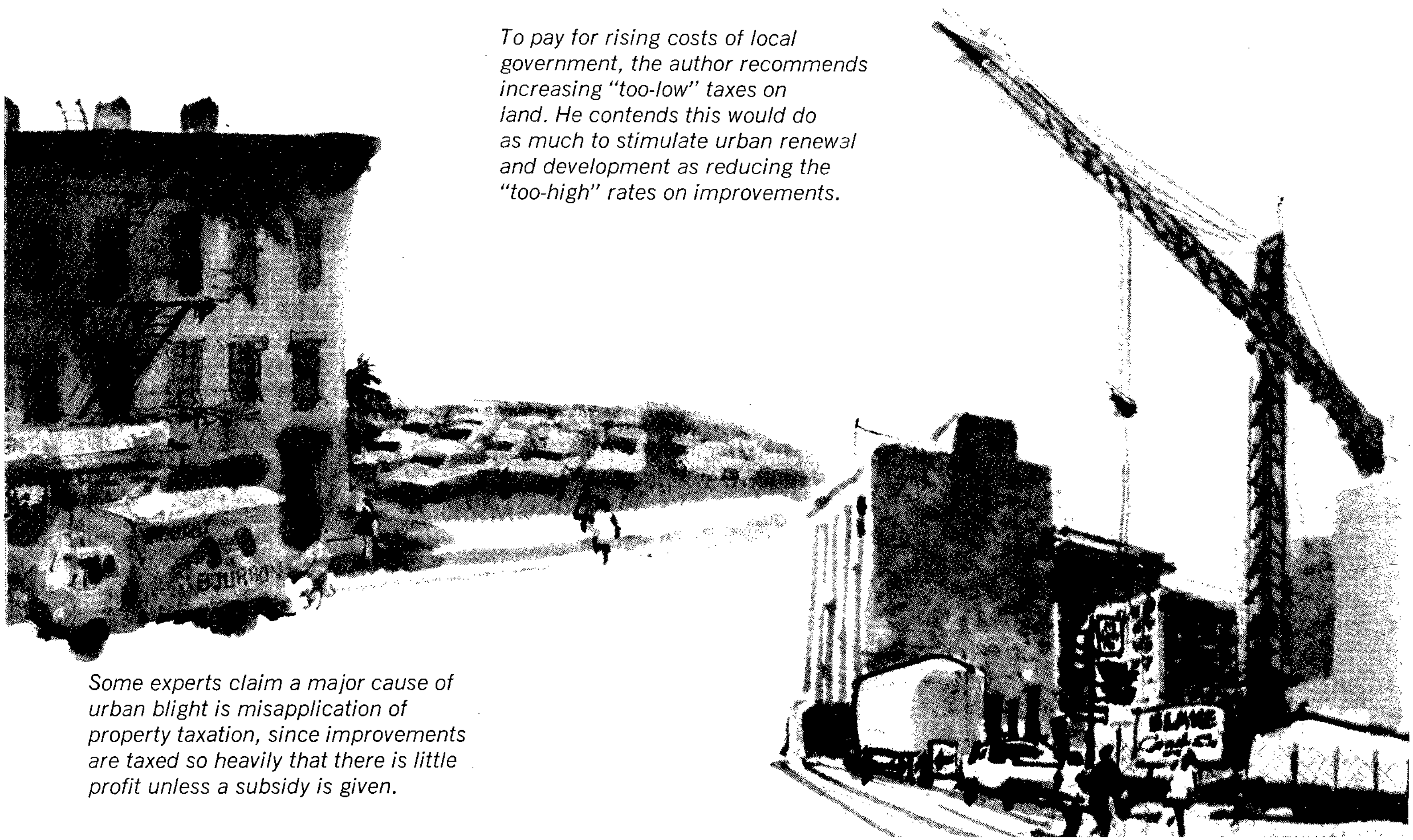
Said the consensus of a round table conference of urban experts cosponsored by the Conference of Mayors, the Council of State Governments, the National League of Cities, the National Governors Conference, the International City Management Association and the National Association of Counties:

"Wisely applied, the property tax on which local governments depend for 87 per cent of their tax revenue could be one of the . . . fairest of all taxes; but as most cities apply it today it may well be the very worst—a weird combination of overtaxation and undertaxation, an incentive tax for what we don't want and a disincentive tax for what we do want.

"It harnesses the profit motive backward instead of forward to both urban renewal and urban development. Too often it makes it more profitable to misuse and underuse land than to use it wisely and fully, more profitable to let buildings decay than to improve them or replace them.

"Too few tax levyers seem to understand that the property tax is not just one tax; on the contrary, it combines and confuses two completely opposite and conflicting taxes, and it would be hard to imagine two taxes whose consequences for urban renewal and urban development would be more different.

"One of the conflicting taxes . . . is the tax on the improvement—on what past, present and future owners of the property have spent or will spend to improve it. And it must be obvious to anyone that heavy taxes on improvements are bound to dis-



To pay for rising costs of local government, the author recommends increasing "too-low" taxes on land. He contends this would do as much to stimulate urban renewal and development as reducing the "too-high" rates on improvements.

Some experts claim a major cause of urban blight is misapplication of property taxation, since improvements are taxed so heavily that there is little profit unless a subsidy is given.

courage, inhibit and often prevent improvements.

"The other levy . . . is the land tax—the tax on the unimproved location value of the site, on what the property would be worth if the owners had never done anything or spent anything to improve it. . . . And it must be obvious to anyone that heavy taxes on the location cannot discourage or inhibit improvements; on the contrary . . . [they] could put effective pressure on owners to put sites to better use so as to bring in enough income to earn a good profit after paying the heavier taxes. . . .

"You would think every city would try to tax land heavily and tax improvements lightly if at all; but just the opposite is the case. Almost every city collects two or three times as much money from taxes on improvements as from taxes on lands. In fact, many cities tax improvements more heavily than the combined local, state and federal taxes on any other product of American industry except hard liquor, cigarets and, perhaps, gasoline."

How big is 3 per cent?

A 3 per-cent-a-year tax on improvements—a rate exceeded in many hard-pressed cities—may not sound big compared with the federal income tax that scales up to 70 per cent and actually takes away almost 11¼ per cent of consumer income. But it sounds small only because it is expressed as a percentage of capital, whereas the income tax—as its name makes clear—is expressed as a percentage of income.

The enormity of the improvement tax becomes self-evident when we restate it in income tax, sales tax and consumer tax terms.

- First, in income tax terms:

A 3-per-cent-of-true-value levy on improvements is apt to tax away 75 per cent of the net income a new building could otherwise earn.

- And now, in sales tax terms:

A 3-per-cent-of-true-value levy on improvements is the instalment plan equivalent of a 52 per cent sales tax; i.e., it will cost the improver as much as a 52 per cent lump sum sales tax would cost him if he could finance it at 5 per cent interest over the 60-year life of the improvement.

- And finally, in consumer tax terms:

A 3-per-cent-of-true-value tax on improvements will cost the consumer more than a 25 per cent consumption tax; i.e., it will add more than 25 per cent to the rent a tenant must pay, or more than 25 per cent to the carrying costs an owner must meet.

Other people's money

Conversely, most tax districts assess and tax underused land so lightly that its owners can hold $1 million worth of land off the market at a net yearly tax cost seldom if ever exceeding $10,000 while its price climbs an average of $60,000! Such undertaxation has made land speculation by far the biggest and most lucrative of all tax shelters—a multibillion-dollar one that allows speculators capital gains treatment not only on their own investment but on the many-times-bigger unearned increment their "ripening" land derives from the investment of other people's money that is needed to make the land reachable, livable and richly salable.

(Around New York, investment by other taxpayers to pay the proportionate capital cost of added police and fire protection, and new schools, streets, water supplies, sewage systems, hospitals, etc., is itemized by the Regional Plan Association at $20,000 per residence—or, say, roughly $80,000 per acre. And that's a juicy subsidy, enabling a speculator to sell land for, perhaps, 20 times what he paid for it.)

Taxpayers may find it easy to understand that heavy taxes on improvements are bad not only for themselves but for everybody. But they also must understand that increasing the tax on land is just as important, for at least three big reasons.

1. There is no other tax by which local governments could recover the revenue they would lose by reducing the tax on improvements.

2. Increasing the too-low tax on land would do as much to stimulate urban development and urban renewal as reducing the too-high tax on improvements, for it would combine the carrot of tax reduction on improvements with the stick of heavy taxation on land.

An eight-year study covering land sales in Milwaukee indicated a startling result if improvements were untaxed and the whole weight of the city's 4-per-cent-of-true-value property tax were shifted to land: The arithmetic of property ownership would so change that, with no urban renewal subsidies whatever, it would be profitable for owners of all the vacant lots and obsolete buildings now preempting so much valuable Milwaukee land to erect buildings that make better use of the sites.

3. Unless land is taxed quite heavily—and this means much more heavily than it is now taxed—any reduction in the levy on improvements would be capitalized overnight into higher land prices.

Why? Because land on which you can erect a lightly taxed improvement is worth a lot more than land on which any improvement will be heavily taxed.

Today's almost universal underassessment and undertaxation of land is the No. 1 reason why the Douglas Commission found land prices in this country soaring 6.19 times as fast as the rest of the price level. It is the No. 1 reason why St. Louis, where the property tax is too low, is in even more trouble than Buffalo, where the property tax is so high.

It is the No. 1 reason why in Europe, where the property tax is close to zero, land prices are so crazily high that a 50-by-100-foot lot in a quite ordinary suburb 15 miles from the capital of Switzerland costs more than $60,000; the No. 1 reason why, on the fringe of London, land zoned residential sells for $120,000 an acre in Hendon, $168,000 in Hampstead, $183,000 in Ealing and $192,000 in Wimbledon.

It's also the No. 1 reason why more than 80 per cent of new homes being built in Europe today have to be land-thrifty high-rise apartments, and why private enterprise has been priced out of 45 per cent to 80 per cent of the housing market there. END

PERRY PRENTICE, *author of this article, was vice president of Time, Inc., from 1939 to 1965 and is still active with the company in the construction and realty fields. He has been publisher of* Time *magazine, editor and publisher of* House & Home, *and editor and publisher of* Architectural Forum.