

## In Defense of the Property Tax

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Abstract. The real property tax as a source of financing for government services is much maligned because it is not generally realized that it is a two-pronged tax. The part that falls on land values has a favorable effect on the economy and is the more just tax; that falling on improvements is the bane of the economy and should be abolished. The property tax should not be summarily abandoned, but should be a tax on land values only. The efficacy of this reform has been demonstrated in communities as nearby as Pennsylvania and as distant as Australia.

Introduction. The property tax as a source of public revenue has come to be scorned almost to the point of hysteria. For example, in the summer of 1993, the Michigan legislature passed a bill to eliminate local property taxes as a source of funding for public schools with no plan for replacement revenue. This problem was resolved, however, in March, 1995, when voters passed a referendum to raise the state sales tax from 4% to 6%. Wisconsin followed suit by rejecting property tax revenue for education and even proposed that a tax give-back be phased in. A commission was to report in September, 1995 on the revenue source question.

On the assumption that the property tax should be axed, officials are groping wildly for a replacement which they can only hope will prove to be more acceptable, whether or not it will be a more easily administered or more equitable tax. It might be wiser to dissect the present property tax system to discern why it is not working. A careful look at a single tax on land values is advocated.

Economic Effects of the Real Property Tax. Real property is "land, including buildings or improvements on it and natural assets such as minerals, water, etc." The simpler definition, "land and the structures that are permanently attached to it", will be used here, although the importance of natural assets cannot be ignored in establishing the value of land. The word "tax" may mean the rate of taxation on or the revenue resulting from the taxation of an assessed valuation.

A crucial feature of the property tax as it is administered in New York State and many other parts of the world is its heavy

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incidence on the value of improvements which is the component of the property that represents the owners' contribution to its value. Thus, of two homeowners living on comparable lots, the one who has invested more income and industry in his or her home pays the higher tax, which is probably not commensurate with the difference in governmental and educational costs associated with the sites. This situation inhibits the improvement and maintenance of properties.

At the same time, the relatively light tax on vacant and under-used land encourages the holding of land off the market which leads to increased land prices, a stagnant tax base and attendant economic problems, and an unearned reward for the owner when the land is sold. In urban areas, deterioration of properties and inefficiencies in the use of government services ensue. Development takes place horizontally instead of vertically and surrounding farmlands and natural areas are invaded.

Reason tells us that the deleterious effects of the present system will be largely eliminated by moving the tax burden off improvement values and onto land. The increased tax on vacant and under-used land will drastically reduce the profit in land speculation. Interest in this pursuit will decline, land prices will fall, and the tax on a property will become of more concern to the buyer than its price.

Reforming the Property Tax. Although many localities in Australia have converted in one step to a tax on land value only (LVT) without repercussion, most advocates propose a gradual reform. The approach taken may be influenced by particulars of the taxing jurisdiction and will depend upon existing laws. Several methods have been described by Steven Cord.

One of these is the selection of a lower assessment ratio for improvements than for land. At the same time, the tax burden will be shifted toward land. Recently, Peoria, Illinois considered adopting a ratio of 62.5% for land and 25% for buildings. Of course, a split tax rate applied to assessments at the same percentage of value would accomplish the same thing and would probably be more understandable to the public than an assessment roll using two different assessment levels. Assessment practices are not disturbed, but tax rates are gradually lowered on improvements and increased on land.

Attractive to some jurisdictions may be the use of exemptions on the assessments of improvements. This could be a percentage or a dollar amount which is increased each year. With the former, all properties would attain complete relief from the tax on improvements at the same time. The dollar amount exemption might appeal to less affluent property owners because they

would be the first to be freed of the tax. The use of tax abatements on new construction (at the expense of established properties) to lure new enterprises is an admission that municipal officials recognize the adverse effects of the tax. Still, they continue to shun the reform that would preclude the use of abatements of this type.

There is no lack of experience with either the two-rate tax or LVT. Some of the results in only two countries should be considered. In the State of Victoria, Australia, outside of the City of Melbourne, 7% of the municipalities taxed only land during the period 1921 to 1923, but they accounted for 46% of the newly constructed homes. From 1954 to 1958, the 19% which used LVT accounted for 62% of new home construction. For five areas that adopted LVT for the period 1958 to 1962, there was an increase in construction activity 34% greater than for neighboring areas that also taxed improvements. Especially significant is the fact that the LVT was not phased in but always adopted by one plebiscite of the property owners. Also of note is the fact that there is a large farming population in those communities. By 1979, two-thirds of Australian jurisdictions taxed only land as their sole source of revenue.

Although some cities in Pennsylvania have had permission to use a two-rate tax since 1913 and other classes have been added to the list since then, the conversion to LVT has been less dramatic than in Australia and in no case has it been complete. Fifteen cities now have a two-rate system. In 1993, third-class school districts coterminous with third-class cities were given two-rate home rule, and Aliquippa School District immediately prepared to introduce a 16.3% tax on land assessments and 1.1% on buildings to replace the single rate of 5.3%.

These Pennsylvania cities consistently experienced increases in construction activity upon lowering the tax on improvements. For example, gauging from the value in permits issued in the first three years after Oil City adopted a two-rate tax in 1989, new construction was 58% greater than in the prior three-year period, whereas for nearby Franklin, which held to a one-rate tax during this period, there was a 12% decrease in construction.

New York State and the Two-Rate Tax. In states whose constitutions and laws permit little home rule with respect to administration of the local property tax, a formidable barrier is presented to tax reformers. The Constitution of New York State, although it does not dictate the tax rate, requires that the same rate be applied against land and improvements and limits the amount of revenue that can be raised.

Only recently has any locality been given permission to test the two-rate tax. After a long struggle by proponents and their allies in the legislature, the City of Amsterdam, reeling with

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financial problems, was persuaded to petition for home rule with respect to the two-rate tax. In August, 1993 enabling legislation was passed. The city then prepared to convert to a mill rate of 130 on land and 61 on buildings. A study had shown that if the land tax were doubled to yield 25% of the total revenue and the tax on improvements lowered accordingly, 80% of homeowners would enjoy a lower total tax and owners of vacant land would experience a tax increase.

**Fairness and the Land Tax.** There is no lack of written material for and against land-value taxation. In the foregoing, I have indicated economic and social effects which might be considered support for its adoption. I have touched on the subject of fairness with respect to the larger tax that the more affluent landowner pays, which is not based on a greater use of government services, but on the greater private investment put into the property. Thus, for developed property, most of the tax can be considered to be in accord with the principle of ability-to-pay which seems to receive much approval. That this principle also applies to the land-value tax is attributable to the likelihood that wealthy people tend to own large amounts of land and land of high value. In Vancouver, British Columbia in 1975, the richest 1% of landowners held 62% of the total land value and the richest 10% owned 73%. In the United States, 5% of the landowners own 75% of the privately held land. Based on data like these compared with the distribution of income, Cord argues that the land tax is more progressive than the income tax. In any case, it is not so blatantly a tax on productivity as are sales and income taxes, and therefore should not be replaced by either of these.

A tax on improvements is a tax on personal property in which the owner

has invested income that has survived sales and income and perhaps other taxes, and the property is no less "personal" because it is attached to the land. The tax, because it is an annual levy on a one-time investment, is tantamount to a rent. The tax on land can also be construed as a rent. The concept of rent is charged with the sense of non-possession, but in urban areas in particular, the value of a site is rooted in intangibles rather than in anything intrinsic to the land. Thus, thinking of the land tax as payment for continuing services takes the bite out of the word "rent". Even in rural areas as witnessed by the Australian experience, there can be strong support for LVT.

The land tax is therefore fairer than a tax on both land and improvements. However, if one invokes the free-market principle, payment-for-value-received, as a measure of fairness, the land tax is wanting. It does not take into account, for example, the number of persons, school children and automobiles resident at a site. These data could be taken into consideration when levying taxes, but such a modification would also raise the issue of the social philosophy of public education. For the present, let us say that the first step in replacing the conventional property tax as a source of local public revenue should not be to jump into the untested waters of income or sales taxes which are both taxes on productivity, but to take the gentler, tested path of the land-value tax which is a fee for local services.

In an area where roads and other government services are to be introduced and development is anticipated, land speculation waits in the wings and the low tax on land encourages it. Under LVT, the municipality would assess land according to a potential market value instead of waiting for development to be completed so that a tax on improvements

could be applied. Undeveloped land could not then be kept off the market for long and still reward the owner with a profit. The unrealized profit would be retained by the community and would help to defray the cost of governmental investment. Land prices would be lower, real property sold more readily, and the community rather than the speculator would be the beneficiary.

The argument that LVT is a more desirable tax can be extended to the problem of the encroachment of development on the natural environment such as farm land that is not being farmed but held off the market as a speculation. A higher land tax would promote compact development close to urban areas. At the same time, one must realize that changing life styles and population growth seem bound to contribute to the shrinking of the natural environment.

Another advantage of LVT is that it would diminish the workload of assessors. Neither assessors nor property owners like revaluations, and it is not surprising that some assessments are not in line or up-to-date and that grievances are all too common. With the taxing of land values only, assessments would be fairer and less open to challenge. Because much less inventory data would need to be collected and recorded, they could be administered with less effort and expense. Once land-value profiles are established for a locality, assessments can be kept current and taxes easily adjusted for changes in assessed value and to meet budgetary requirements.

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