

Can Property Tax Reform Help The Low-Income Tenant?

I. INTRODUCTION

In order to fill our minimum housing needs by 1980, it is estimated that 2 to 2.25 million new housing units must be built each year.¹ Over the six years from 1962 to 1968 an average of only 1.45 million units have been built.² The resulting shortage in adequate housing primarily affects the low-income renter. Private enterprise alone cannot provide the poor's housing needs. Rents that cover the costs of land, building, maintenance, interest, property taxes, and reasonable profits are often beyond the means of the poor. Even worse, the federal government's public housing projects have not been able to fill the low-rent housing need. As a result, approximately 7.8 million households cannot afford decent housing.³

Thirty years of public housing programs have produced only 800,000 units, one-tenth of the need for this type of housing.⁴ More significantly, federal programs do not provide enough new housing for the low-income family in the urban ghetto: half of the new units constructed annually are exclusively for the elderly, who are

¹NATIONAL COMM. ON URBAN PROBLEMS, BUILDING THE AMERICAN CITY, H. R. DOC. NO. 91-34, 91st Cong., 1st Sess. 11 (1969) [hereinafter cited as NATIONAL COMM. ON URBAN PROBLEMS].

²*Id.*

³PRESIDENT'S COMM. ON URBAN HOUSING, A DECENT HOME 53 (1969) [hereinafter cited as PRESIDENT'S COMM. ON URBAN HOUSING].

⁴*Id.*

not all low-income renters, and many are located in small towns, where ghettos rarely exist.⁵ Future low-rent housing programs, involving the sale of privately constructed low-rent housing to public housing authorities, will not correct this serious housing deficit.

This paper considers one factor contributing to the lack of adequate rental housing for the poor, the property tax. The tax on housing, viewed as an excise tax, is higher in rate than any other American consumption tax, except the taxes on liquor, tobacco, and gasoline.⁶ According to Richard Netzer, an authority on the property tax and its effect on housing:

It is simply inconceivable that, if we were starting to develop a tax system from scratch, we would single out housing for extraordinarily high levels of consumption taxation. More likely, we would exempt housing entirely from taxation, just as many states exempt food from the sales tax.⁷

Netzer calculated that in 1965 the property tax on non-farm housing in the United States averaged 19 percent of rental value or 24 percent excise tax on the consumption of housing.⁸ James Heilbrun, another property tax and housing expert, estimates that real estate taxes take between 16 and 20 percent of the gross receipts of all rental housing.⁹

A. TYPICAL PROPERTY TAX STRUCTURE

Less is known about the property tax and its economic and social effects than any other tax because of its local nature. There is not a *single* property tax in the United States, comparable to the federal income tax, but a tax in each of thousands of local governmental districts. Although the tax is administered locally there are standards imposed by state constitutions and statutes.

For example, the CALIFORNIA REVENUE AND TAXATION CODE provides that all property in the state, not exempt under the laws of the United States or California, is subject to taxation.¹⁰ The real estate tax includes land, improvements, mines, minerals and quarries in the land, and standing timber.¹¹ The California Constitution

⁵Ellickson, *Government Housing Assistance to the Poor*, 76 YALE L. J. 511 (1967).

⁶R. NETZER, *ECONOMICS OF THE PROPERTY TAX* 30 (1966) [hereinafter cited as NETZER].

⁷PRESIDENT'S COMM. ON URBAN HOUSING, *supra* note 3, at 145.

⁸*Id.*

⁹J. HEILBRUN, *REAL ESTATE TAXES AND URBAN HOUSING* 1 (1966).

¹⁰CAL. REV. & TAX. CODE §201 (West 1970).

¹¹CAL. REV. & TAX CODE §104 (West 1970).

requires that land and the improvements thereon shall be separately assessed¹² and that all property is to be assessed at full cash value.¹³ According to statute, "full cash value" means the amount at which property would be taken in payment of a just debt from a solvent debtor.¹⁴ Other states have imposed variations of this concept either in their constitutions or by statute, e.g., "fair market value," "true value in money," or "true and full cash value."¹⁵ In California, the assessor may consider uses or purposes for which land is adapted, even though it is not presently used for such purposes.¹⁶ This interpretation by the courts allows a higher tax on land which has a high potential value but is not being used efficiently.

A number of states, including California, have recently set up statutory standards for assessment at less than full value since in practice assessors did not follow the full value standard and inequities resulted.¹⁷ In Louisiana, which requires full value assessment, a study in 1965 found that New Orleans tax assessments varied from 5 to 95 percent of actual value.¹⁸ A recent study group characterized the whole property tax structure as having an "air of informality, personal inequity and 'folkishness' ".¹⁹ To achieve more uniformity in assessment and leave less to the discretion of the assessor about half of the states have set more realistic standards varying from 20 to 70 percent of actual value.²⁰ Since 1966 the local assessor in California must disclose to the taxpayer, along with the notice of an assessment increase, the assessment ratio and an estimate of the full cash value of the property.²¹

Although theoretically most states are striving for uniformity in

¹²CAL. CONST. art. 13, § 2.

¹³CAL. CONST. art. 11, § 12.

¹⁴CAL. REV. & TAX CODE § 110 (West 1970).

¹⁵J. JENSEN, PROPERTY TAXATION IN THE UNITED STATES 165 (1931).

¹⁶A. F. Gilmore Co. v. Los Angeles County, 186 Cal. App.2d 471, 9 Cal. Rptr. 67 (1961).

¹⁷For a table showing the conflict between assessment law and practice in the states in 1961, see Shannon, *Conflict Between Assessment Law and Local Assessment Practice* in PROPERTY TAXATION U.S.A. 40-41 (R. Lindholm ed. 1967). For example, in 1961 California had an assessment standard of 100%, but the actual average ratio used was 17.5%.

¹⁸*Fun Cities: New Orleans Is Out-of-Date*, 69 ESQUIRE 72 (June 1968), in G. LEFCOE, LAND FINANCE LAW, MATERIALS AND CASES 23 (1969).

¹⁹*Id.*

²⁰California now requires assessors to assess all property subject to general property taxation at between 20 and 25 percent. After 1971 all such property will be assessed at 25% of its full cash value. Shannon, *Full Disclosure Policy—The State's Role in the Assessment Process*, in THE PROPERTY TAX: PROBLEMS AND POTENTIALS 108-110 (1967).

²¹*Id.* at 105.

assessment ratios and rates, the tax policy of favoring unimproved land with lower taxes is still followed. According to recent statistics, nationally, raw land is assessed at less than 20 percent of its actual market value while single-family homes are assessed at 32 percent.²² Though the land speculator has the advantage tax-wise over the homeowner, the homeowner is still better off than the owner of apartment houses or commercial buildings.²³

B. PROPERTY TAX AND LOCAL REVENUE

Although the property tax has been widely criticized over the years, it is still the primary source of local revenue in the United States and is important in all English-speaking countries. Municipal and county governments are limited as to tax sources, and the property tax has been the major resource of local governments in this country since seventeenth-century colonial days.²⁴ It now accounts for almost nine-tenths of local government tax revenue.²⁵ In 1962 state and local property tax revenues totaled \$19.1 billion; in 1967 the total was \$27.7 billion, with metropolitan areas supplying about three-fourths of the revenue.²⁶ The property tax annual growth rate from 1948 to 1964 was 8.1 percent during a period when the gross national product grew at a rate of 5.7 percent.²⁷ The President's National Commission on Urban Problems noted the rise in property taxation and commented:

While a shift of more Federal funding would be worthwhile, local taxation most likely will have to continue to rise, even if at a relatively slower pace. So it becomes increasingly important to perfect the property tax which remains the fiscal bulwark of local government.²⁸

A few large cities have successfully diversified their revenue sources, so that the property tax is no longer so important in their economy. The sales tax has been the most productive nonproperty tax used by local government, with income tax next. Sales taxes are used in 13 states by over 2,000 local governments, and local income

²²Friedenberg, *America's Land Boom*, 236 HARPER'S 30 (May 1968), in G. LEFCOE, *supra* note 18, at 20.

²³*Id.* at 21.

²⁴NETZER, *supra* note 6, at 3.

²⁵*Id.* at vii.

²⁶NATIONAL COMM. ON URBAN PROBLEMS, *supra* note 1, at 6.

²⁷J. PECHMAN, *FEDERAL TAX POLICY* 207 (1966).

²⁸NATIONAL COMM. ON URBAN PROBLEMS, *supra* note 1, at 28.

taxes are used in 8 states.²⁹ Almost all large cities use either sales or income taxes and New York City uses both. Local nonproperty taxes provide nearly 40 percent of the tax revenues in the 43 largest cities in the United States.³⁰ Dr. Netzer suggests that local nonproperty taxes are a second-best solution to the property tax problem but are superior to further increases in the conventional property tax.³¹

C. PROPERTY TAX, HIGH RENTS, AND INSUFFICIENT HOUSING

Although the property tax is nearly universal in the United States and is the chief source of local revenue, it results in a number of problems. First, there seems to be agreement among those concerned with urban problems and the housing situation in particular that the property tax is a deterrent to private investment in rental housing, particularly for low-income families. It not only discourages new building but encourages blight by imposing high taxes on improved buildings. Landlords are hesitant to invest in rehabilitation of substandard buildings and thus greatly increase their taxes when the tenants cannot afford to pay higher rents. In Chicago, it is estimated that replacing four old single-family houses which were purchased for \$50,000 with an apartment house costing \$250,000 would involve a tenfold increase in property taxes. The owner's best choice under the present tax system would be to remodel the old houses rather than to rebuild.³² When tax rates are low in nearby suburban communities, the high tax rates on urban improvements deter investment in the city to an even greater extent.

The question arises how does the property tax harm the tenant, particularly the low-income tenant, when property owners rather than tenants pay the taxes. The tenant is harmed if investment in housing is discouraged, thereby causing a lack of adequate housing and higher rents for existing substandard housing. Second, the tenant is harmed if, though theoretically the tax is imposed on the owner, the incidence of the tax really falls on the tenant.

It is generally held that the incidence of the property tax on housing falls on the occupant, and in the case of rental housing on the tenant. Occupants who are owners will suffer a capital loss, which will be realized when they sell the property. Owners of rental property, if

²⁹J. PECHMAN, *supra* note 27.

³⁰R. NETZER, *ECONOMICS AND URBAN PROBLEMS* 200 (1970).

³¹*Id.* at 201-202.

³²NETZER, *supra* note 6, at 83-85.

there is an elastic demand, will raise the rents and pass on the tax to the tenants. If there is not an elastic demand for rental housing and rents cannot be raised, the landlords will earn less on their investment, and over time, the deterrent to investment will reduce the supply of available housing, thus raising rental prices.³³

Third, the low-income tenant is harmed by the property tax because of its regressivity, or because it does not increase progressively as income rises. If it is assumed that the effect of the property tax really falls on the renter because it is passed on to him in higher rents, the low-income renter pays a much higher proportion of his income in real estate tax than the renter or owner with a higher income. According to a study based on the 1960 Census of Housing, persons in the income class of less than \$2000 are paying an estimated effective rate of real estate tax of 8.49 percent while those with an income of over \$15,000 pay only 1.35 percent of their income in real estate taxes.³⁴

Since at the present time there is so much hypothesis and so little empirical data on how the property tax contributes to urban blight and how restructuring of the tax can promote rehabilitation and investment, the Department of Housing and Urban Development (HUD) is planning to arrange for contracted research in this area.³⁵ One projected study, "Property Taxes and Urban Blight," would provide data on the extent of penalties imposed by the tax in its present form on property owners who improve their properties. This study would explore possible changes in the structure of the tax to remove these penalty aspects. Assessments based on land according to "highest and best use" without regard to current use and assessments based on present use without regard to actual physical condition of the property would also be explored.

A second study, "The Use of Property Taxes to Promote Rehabilitation and New Construction," would provide data on whether tax abatement now practiced in some jurisdictions really encourages more property rehabilitation than is obtainable through other means. This study would also weigh advantages and disadvantages of various alternative tax incentive techniques which have been proposed by government officials, economists, and tax specialists, and which will be discussed in the remainder of this paper.

³³*Id.* at 45.

³⁴*Id.* at 52.

³⁵Letter from Arnold Diamond, Office of Economic and Market Analysis, U. S. Dept. of Housing and Urban Development, to Betty Wolfe, March 6, 1970.

II. GOVERNMENT SUBSIDIZATION

Subsidization or outright abatement of property taxes by federal or local government is a widely suggested and frequently implemented proposal for reform. Government subsidization of the property tax can involve subsidies by the federal or state government either to the local governments to recover revenue which they lose by reducing, deferring, or exempting taxes on low-income rental housing, to the owners of a low-income housing to encourage investment and rehabilitation, or to the tenants themselves in the form of rent subsidies.

A. TAX EXPENDITURES

Tax exemptions, tax deferrals plus exemptions, and tax credits are frequently used to encourage investment in housing and urban renewal. Although varying somewhat in particulars, these methods all involve a common element: tax expenditures, revenue "spent" through the tax structure rather than through the budget.

The term "tax expenditure" has been used mostly to describe income tax provisions which have social or economic objectives rather than ordinary tax objectives. The provision in the 1969 Tax Reform Act allowing five-year amortization of capital expenditures which would normally be depreciated over a longer period is an income tax incentive designed to encourage rehabilitation of low-income housing.³⁶ Although most tax expenditures which are also tax incentives³⁷ are part of the federal income tax, they are also woven into other forms of taxation, including the local property tax. Tax exemptions or credits which are granted to encourage investment in low-income rental housing fall into this category.

Tax expenditures have been criticized as an inferior method to the direct subsidy as a method of achieving social or economic goals. The government spends as much money, and sometimes more, than it would by granting a direct subsidy. Tax incentives are often inequitable because they are worth more to the high-income taxpayer than to the low-income taxpayer, especially when incorporated into the income tax.³⁸ The five-year amortization of rehabilitation ex-

³⁶Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 721 (1970).

³⁷*Id.* at 712. Some tax expenditures are not tax incentives. These include extra exemptions for the blind or aged, which do not encourage any particular kind of activity but are designed merely to relieve hardship.

³⁸*Id.* at 720-725.

penditure in the 1969 Tax Reform Act in effect allows a wealthy person to borrow funds at 3 percent interest while a poor person pays 7 or 8 percent.³⁹

Tax expenditures also may outlive the purpose for which they were created, while direct subsidies can be made on an annual basis. New tax incentive programs should, when adopted, have a time limit set on their operation so that they will at least be evaluated at a later time.⁴⁰

Tax exemption or abatement for particular projects has been used by many states and cities to overcome the tax obstacle to private building and rebuilding. New York has been the primary user, with over \$750 million in assessed values of multi-family housing—5.5 percent of the total—exempt from taxation in 1961. Most of the exemptions granted were in New York City.⁴¹

Wisconsin has a program designed to relieve the property tax burden of homeowners and renters who are over 65 years of age and have less than \$3500 in annual income. This law is at present unusual because it applies directly to the renter as well as to the homeowner; the renter receives a tax credit of 25 percent of his rental payments.⁴²

However, tax exemptions subsidize some groups at the expense of other groups who may also not be able to afford higher taxes. Exemptions erode the property tax base and force higher rates on those who are not favored by an exemption. In California 50 percent of the land area is owned by the federal government or the state, and it is estimated that the assessed value of this property is between 15 and 30 percent of the assessed value of taxable real property.⁴³ In 1964 it was estimated that government and other nonprofit organizations held more than 22 percent of the nation's real estate, with practically all of it exempt from property taxation.⁴⁴

Church tax exemptions were recently questioned by a New York property owner who claimed that exemption granted to churches by New York State forced him, as a property taxpayer, indirectly to contribute to religious organizations, thereby violating the "estab-

³⁹*Id.* at 722.

⁴⁰*Id.* at 738. The 1969 Tax Reform Act puts a five-year termination date on the new five-year amortization incentive for rehabilitation of low-income housing.

⁴¹NETZER, *supra* note 6, at 85.

⁴²Quindry and Cook, *Humanization of the Property Tax for Low Income Households*, 22 NAT'L TAX J. 357 (1969).

⁴³Myers, *General Appraisal of the Effect of Exemption on Tax Base*, in THE PROPERTY TAX: PROBLEMS AND POTENTIALS 268 (1967).

⁴⁴*Id.* at 269.

lishment clause” of the U. S. Constitution.⁴⁵ The U. S. Supreme Court upheld the constitutionality of property tax exemptions to churches, whose assets today total more than \$141 billion.⁴⁶

B. PROPERTY TAX ABATEMENT: THE ROLE OF THE FEDERAL GOVERNMENT

By providing limited amounts of tax abatement grants, the federal government has attempted to accommodate the dependency of local government on the property tax and still avoid the pitfalls of a tax expenditures program. The federal government’s public housing projects do not pay local real estate taxes, but smaller amounts are paid to the local governments out of rent payments. These payments in-lieu-of-taxes (PILOT) may not exceed 10 percent of the shelter rent (i.e., rent paid minus utility charges).⁴⁷

Another form of property tax abatement was included in now-dead Senate Bill 2100, “a bill to encourage and assist private enterprise to provide adequate housing in urban poverty areas for low income and lower middle income persons.”⁴⁸ In addition to other tax incentives to encourage private development of housing, the bill contained a provision for property tax abatement designed to lower tenant rentals in projects built under the program. The bill authorized grants to cities participating in the program of:

- (1) 50 percentum of the amount by which the tax revenues received or receivable by such city during any year were reduced by reason of any tax benefits granted by such city, pursuant to Section 101 (a)(1), to one or more certified projects, and
- (2) an amount equal to any contribution paid or payable to such city by a state to defray any part of the loss of tax revenues incurred or incurable by such city during such year as the result of such benefit: Provided that in no case shall the amount of any such grant exceed 75 percentum of the amount by which the tax revenues received or receivable by any such city during any year were reduced by reason of such tax benefit.⁴⁹

To qualify for this relief, the cities had to agree that local real estate taxes on these housing projects would not be more than 5 percent of the rental charges. To finance the program, the bill provided for an initial fund of \$30 million subject to later Congressional appropria-

⁴⁵The First Amendment to the Constitution specifies that “Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof.”

⁴⁶Walz v. Tax Commission of the City of New York, 397 U.S. 664 (1970).

⁴⁷NATIONAL COMM. ON URBAN PROBLEMS, *supra* note 1, at 116.

⁴⁸S. 2100, 90th Cong., 1st Sess. (1967).

⁴⁹*Id.* at 17-18.

tions to maintain that balance. In order to meet arguments that most states would not be able to take advantage of S. 2100 because of uniformity clauses in their constitutions prohibiting the establishment of differential tax rates, Senator Robert Kennedy proposed a remedial amendment to the bill allowing direct subsidies to project owners.⁵⁰

Although this proposal did not become law, the idea of property tax abatement to relieve critical housing shortages has not been discarded. The President's Committee on Urban Housing recommends direct federal acquisition of land to be leased for the development of subsidized housing. Moreover, this recommendation would provide assistance to local governments:

To assure local communities that the federal acquisition of land within their boundaries will not reduce their tax base, the legislation governing the program should require the payment of local real estate taxes. If the statute provided for federal payment of these taxes, this would further reduce rents in the subsidized projects by as much as 15 or 20 percent in some cases.⁵¹

The National Commission on Urban Problems has also advocated federal government subsidization for low-income housing:

For the localities themselves to underwrite the cost of land assembly, removal of buildings, and loss of property tax payments would bankrupt almost any city. Only a massive addition of public funds can meet the situation

Why should we subsidize on such a massive scale? The question is largely based on an uninformed notion of how our economy grew. American enterprise has been fueled again and again with subsidies, starting with land grants from the 17th to the 19th century. We often subsidize the richest people in the country: There are more than 30 families in the United States who have annual incomes over \$500,000 but who pay no taxes. Perhaps more relevant to the housing problem, about 3½ times as much in housing subsidies goes to those with middle or higher incomes through income tax deductions than the amount of the subsidies which go to the poor for housing.

In a recent year, the upper 20 percent of income groups got twice as much in housing subsidies as did the lower 20 percent.⁵²

These reports appear to favor federal payment of the property tax as a more direct and efficient incentive for investment in rental hous-

⁵⁰*Hearings on S. 2100 Before the Senate Comm. on Finance*, 90th Cong., 1st Sess. 67 (1967). These subsidies would be either from both Federal and State governments, or from the Federal government alone in states where an outright abatement is constitutionally impossible.

⁵¹PRESIDENT'S COMM. ON URBAN HOUSING, *supra* note 3, at 147.

⁵²NATIONAL COMM. ON URBAN PROBLEMS, *supra* note 1, at 27.

ing than incentives based on the income tax which often benefit only the richest investor. Since the incidence of the property tax in rental housing usually falls on the tenant perhaps this is one tax incentive which does benefit the low-income group.

The only government subsidy program which would seem to benefit the tenant more directly than federal payment of property taxes either directly to the local governments or to the private developer is the rent supplement program. This program, begun in 1965, was intended to help tenants directly by paying the difference between the market rent and 25 percent of the family income.⁵³ Rent supplements have the advantage of flexibility because the supplements can be varied from person to person according to income.⁵⁴

The rent supplement program, however, never had a substantial impact on the slums because of Congressional opposition and inadequate appropriations.⁵⁵ Investment in rent-supplemented buildings was also made unprofitable by rising costs of construction and loans.⁵⁶ Although it is still possible that this program will be more successful, its effect on low-income rental housing is at present uncertain.

III. REFORM OF THE TAX

Although government subsidization can mitigate the effects of the property tax on rental housing, it is only a substitute for the real remedy: reform of the tax system itself, both as it is administered and structured. Unfair or incompetent administration is one of the major criticisms of the property tax, but poor administration probably does not harm the low-income renter more than any other group. Accordingly, this paper will be limited to substantive, or structural, reform of the tax rather than to procedural reform.

A. SITE-VALUE TAXATION

A substantive tax reform widely discussed and favored is site-value or land-value taxation. Under the land-value system, buildings are either entirely exempt from property taxation, or land and build-

⁵³*Id.* at 149.

⁵⁴*Id.*

⁵⁵Note, *Government Programs to Encourage Private Investment in Low-Income Housing*, 81 HARV. L. REV. 1299 (1968).

⁵⁶*Id.*

ings are classified separately for tax purposes so that the heavier burden of the tax falls on the land. This form of taxation is based on the single tax theory of Henry George, who advocated complete reliance on land-value taxation as a source of all government revenues, leaving all improvements untaxed. George's single tax theory, propounded in 1879, has had many zealous advocates and equally zealous critics, partially because it was hailed as a cure for all social ills. "Site value taxation has been presented not only as a panacea for urban land use but also as a cure for unemployment, a preventative for inflation, and guarantor of perpetual industrial and international peace."⁵⁷

Today, tax specialists still consider the George theory, but in attenuated form, as a means of alleviating the rental housing shortage. It is widely believed that a high tax on land and a low tax on improvements will discourage land speculation, will encourage investment in new rental housing, and will encourage the rehabilitation of slums; all of which should provide more adequate housing for the tenant at a price he can afford.

Taxing land more heavily would increase the cost of holding land for speculation and encourage more intensive utilization of the land. Critics of the present property tax argue that "our tax system - local, state, and national - gives land speculation so many special breaks that land speculation has been by far the easiest way to get rich."⁵⁸

Underlying the land-value tax is the assumption that all land speculation is evil.⁵⁹ This assumption is questionable since investment in land is recognized as a valuable means of hedging "real dollar loss" through inflation against the expected rise in value of the property. Speculation may also be contributing to conservation by reserving land for better use at a later time. Critics of the land-value tax claim that its tendency to encourage intensive development of land would deplete necessary open spaces. Dr. Netzer, however, refutes this argument.⁶⁰ He believes that the site-value tax is neutral with respect to land use decisions, that it would not result in over-intensive use of land with inadequate open spaces. On the other hand, he thinks that the present property tax is unneutral in favoring low return uses of land. The present tax is thus a factor contributing to the urban sprawl which results when large portions of land on the fringe of a city are held by speculators and cannot be used. The city grows in a disorgan-

⁵⁷NETZER, *supra* note 6, at 197-198.

⁵⁸18 HOUSE AND HOME 136 (Aug. 1960).

⁵⁹Hansen, *Henry George: Economics or Theology?* in PROPERTY TAXATION U.S.A. 73 (R. Lindholm ed. 1967).

⁶⁰NETZER, *supra* note 6, at 206-207.

ized pattern and residents are forced to commute long distances to the central city.

The land-value tax should, by lowering taxes on buildings, encourage the building of rental housing on vacant land since the income from the site will be much higher when developed while the property tax will rise only slightly. Also, a low tax on improvements can be a factor in encouraging the rehabilitation of slums. The present property tax offers no incentive to tear down old apartments and build better ones in their places. A new building is at a tax disadvantage as compared to an old one. Proponents of the reform claim that the site-value tax would be a boon to urban renewal.

To exempt improvements and at the same time to tax land more heavily would provide a double incentive to the owners of derelict buildings to demolish them and to use the land more intensively. Here surely is a golden key to urban renewal, to the automatic regeneration of the city—and not at the public expense.⁶¹

Another argument in favor of site-value taxation is that land should be taxed more heavily than improvements because the value of land results not from individual action but from population growth and general community development. Because the community is responsible for the rapid increase in value of the land, proponents argue, the community should benefit rather than the individual landowner.

Probably the major criticism of a land-value tax is that it is administratively infeasible, primarily because there is no way of separating the value of land from the value of improvements if the land is already improved. Anti-Georgists contend that the demand for urban land depends on the intensity and character of the demand for structures in general and that the nature of improvements on particular land shapes the demand for the land itself. However, this conclusion may rest on the failure to distinguish between the value of land in general and the value of one specific site. "The valuation process does not ask what properties could be sold for if *all* were offered simultaneously, but what each would bring in a bona fide sale when added to whatever properties are being transferred as of the date on which the appraisal is being made."⁶²

If there is no conceptual problem in valuing sites for taxation, there is still a practical problem. Assessing land at market value in highly developed areas, where the only comparable sales are of developed sites, is difficult. In this case, neither the sales price nor the

⁶¹M. RAWSON, PROPERTY TAXATION AND URBAN DEVELOPMENT 28 (1961).

⁶²NETZER, *supra* note 6, at 199.

original purchase price is reliable evidence of actual value. Separate valuation problems are not insurmountable, however, since they are regularly solved in computing depreciation allowances for improvements on real property,⁶³ and in California the assessor is already required to assess land and improvements separately.⁶⁴

The process of shifting from the present system to site-value taxation raises some of the most serious problems. In some cases the land is not in the hands of those who received the "unearned" increase in value; the present owners may have paid full value for the land. Then a heavy taxation of land, which decreases its value, penalizes the owners who have put their capital into land rather than other investments. This difficulty could be minimized by a change-over in tax systems over a period of time; Pittsburgh allowed twelve years for its shift to the graded tax or site-value tax system. Also if the shift involved a partial rather than a complete untaxing of improvements the hardship on any particular landowner would be much less.⁶⁵

Exemption of buildings and the use of separate classifications for land and improvements have been barred in many states by constitutional provisions requiring uniformity in taxation.

As of 1959, forty-three (possibly forty-five) of the forty-eight states had provisions which could be described as uniformity clauses in their constitutions. Of these states it was probable that the constitutions of sixteen would prevent the accomplishment of land-value taxation by exemption of buildings. Classification would not be permitted in twenty-three states. In thirteen states neither exemption nor classification would be constitutional. The equal protection clause of the United States Constitution, however, would have presented no barrier to land-value taxes as it had been interpreted to permit exemption for reasonable classification.⁶⁶

Although the theory has had some practical application, its use in the United States has been so limited that the results are inconclusive. The most important land-value tax experiment in the United States occurred in Pennsylvania, where the state constitutional uniformity provision allowed enough leeway to the legislature to grant the city of Pittsburgh authority to reduce taxes on improvements by 50 percent from the years 1913 to 1925 and to increase taxes on land to twice the rate on improvements. The theory behind the change

⁶³*Id.* at 202.

⁶⁴CAL. CONST. art. 13, § 2.

⁶⁵NETZER, *supra* note 6, at 209-210.

⁶⁶Hagman, *The Single Tax and Land-Use Planning: Henry George Updated*, 12 U.C.L.A. L. REV. 771 (1965).

was that it would stimulate improvements and depress land values. The assessed valuation of land in Pittsburgh has decreased from \$481 million in 1914 to \$424 million in 1960 and the total of assessed building valuation has greatly increased.⁶⁷ The tremendous building activity in the city seems to indicate that the tax change does encourage growth, but before any firm conclusions could be reached as to the effect of the land-value tax, it would be necessary to consider other facts and to compare statistical data with other cities.⁶⁸

The experiment's effect was lessened by the fact that Pittsburgh has instead of a unified city government three overlapping local units: city, county, and school district. Since only the city government applied the land-value tax system and this was only a fraction of the local revenue, the Pittsburgh experience is not a good example of the effects of land-value taxation. In reality it is estimated that in Pittsburgh in 1960 the "total property tax on improvements was, in fact at 71 percent of the rate on land, not at 50 percent."⁶⁹ Although the Pennsylvania legislature in 1951 and 1959 authorized differential taxation in 48 other cities in Pennsylvania, few cities have taken advantage of the authorization.⁷⁰

Site-value taxation is common in other countries, particularly in Australia, New Zealand, Canada, South Africa, and Denmark. Australia has gone furthest with the theory. A national tax on the unimproved value of land was adopted in 1910 and abolished in 1952; however local governments are making increasing use of the tax.⁷¹ In Sydney land is taxed as though fully improved in accordance with zoning, and Brisbane forbids taxes on improvements, with a uniform 9 percent tax on all land.⁷² The form of the tax used in Denmark, similar to that used in Pittsburgh, is less radical, taxing both land and improvements, but land at a steeper rate.⁷³

Hawaii has adopted a modified land valuation tax system under which the land may eventually be valued at a ratio of 2.5:1 as com-

⁶⁷Walker, *Land Use and Local Finance*, 29 TAX POLICY 19 (1962) [hereinafter cited as Walker].

⁶⁸Jerome Pickard, who recently studied land value effect of the graded tax in Pittsburgh, recommended that further study of the Pittsburgh situation be made to determine the desirability of a graded tax in relation to "the prevention or amelioration of blight and slums and the encouragement of privately financed urban renewal and rehabilitation." Harrison, *Housing Rehabilitation and the Pittsburgh Property Tax*, 2 DUQUESNE L. REV. 218 (1964).

⁶⁹Walker, *supra* note 67, at 18.

⁷⁰NETZER, *supra* note 6, at 203.

⁷¹Walker, *supra* note 67, at 21.

⁷²Friedenberg, *supra* note 22, at 21.

⁷³*Id.* at 22.

pared to buildings.⁷⁴ Here the theory has been coordinated with land-use planning, and the higher tax on land than on buildings, designed to force development, does not apply in agricultural and conservation districts.⁷⁵ Perhaps results in Hawaii will prove to be more conclusive than those of the older Pennsylvania experience.

The site-value tax is a possible source of aid to the low-income renter. Taxing land more heavily than improvements does appear to stimulate investment in housing, thereby creating better housing. And since taxes on buildings are passed on to tenants, lower taxes on buildings should result in lower rents for the tenant. Land-value taxation is no longer considered as "a grand scheme" but as a tool to be used by land-use planners and those concerned with the lack of adequate rental housing.⁷⁶

B. LAND VALUE INCREMENT TAXATION

A tax on increments in land value, or on appreciation of land, has been used in a number of countries and viewed favorably in this country. The National Commission on Urban Problems suggests its use:

Another approach that has most appeal and which we favor is to recognize existing land values as private property which is not to be substantially impaired, but to take for society a large share of the future increase in these values.⁷⁷

This proposal has been generally considered as a supplement to other real estate taxes rather than as an alternative, since it could not produce a sufficient yield to replace all other property taxes.

There is controversy over whether the tax should be levied only at the time of transfer of land or whether it should be assessed at fixed intervals. Most authorities would levy the tax every time the property is transferred, whether by sale, gift, or bequest. Although this method may produce less revenue because owners would tend to retain appreciated property, the tax could be avoided only during the owner's lifetime if the increment were always taxable at the owner's death. A periodic tax would fall when there is no realization of profit and would be harsh on the owner. Assessment would be easier, also, when there is a transfer, since in most transfers sales figures are available to aid in computing the increase in value. In the case of ownership

⁷⁴Hagman, *supra* note 66, at 788.

⁷⁵*Id.*

⁷⁶*Id.*

⁷⁷NATIONAL COMM. ON URBAN PROBLEMS, *supra* note 1, at 397.

by corporations, partnerships, or family trusts, the tax would have to be assessed every 10 or 20 years.⁷⁸

A tax on increases in land values appears equitable since the rise in value is usually a result of population and community growth rather than of individual effort. The tax would fall lightly on a homeowner who sold his home for a little more than he paid for it but would hit speculators harder. Taxing capital gains on land more heavily than gains on other investments should marginally depress land prices, which has positive effects on development.⁷⁹ Assuming that a relatively high tax on land encourages intensive use of land and discourages holding land for speculative profits, the tax should have a beneficial effect on the rental housing shortage and the plight of the low-income tenant.

The effectiveness of the tax in curbing land speculation and recovering land profits for the community would, of course, depend on the rate. It has been estimated that the public would not accept an increment tax on land values that together with the existing 25 percent capital gains tax would take more than half of the gain from speculation.⁸⁰

C. PROPERTY INCOME TAXATION

Another proposal for substantive property tax reform is that of basing the assessment on income value rather than capital value. This method of appraisal would utilize gross rents, net rents, or some variation. The British real estate tax, for example, is based on income ("net annual value") determined by subtracting certain standard deductions for maintenance and insurance costs from gross rents. Instead of a deduction for actual costs, however, there is a statutory formula under which the deductions decline as the gross rents rise, creating a graduated tax on gross rents rather than a net rents tax.⁸¹

In the 1930's when the Depression caused high vacancy rates in rental housing, there was considerable advocacy for this form of taxation, since it does not tax vacancies. More recently, it has been suggested as a means of taxing the profits out of slums. Whether basing the assessment on rents rather than on capital value will encourage the rehabilitation of slums is speculative. Nevertheless, it is

⁷⁸*Id.*

⁷⁹NETZER, *supra* note 6, at 213.

⁸⁰Walker, *supra* note 67, at 29.

⁸¹NETZER, *supra* note 6, at 193.

true that under our present system dilapidated slum buildings with high gross rent receipts and low capital value often pay low property taxes, although modern assessors do consider income of rental properties in computing capital value.⁸² The reason for high rents and low property taxes in slums is probably that the market value of slum buildings is low in relation to their earnings. This is because the market price reflects the higher risk in investment in slums than in other rental properties. Assessors in the United States rely more and more on income as a basis for capital value, and in Great Britain assessors, although using income as their basis, consider the market price.⁸³ So in practice perhaps the two systems are not too dissimilar.

The President's Committee on Urban Housing suggests:

If condition has little relationship to market value, any increase in assessment related to the physical improvement of the property will result in an over-evaluation of the rehabilitated structure inconsistent with the legal requirement of a uniform tax policy.

To remove this disincentive to good maintenance, tax assessors should look to the earning ability of the property as reflected by annual gross rents in determining the value of the property for tax purposes. (In some states this change could be made rather simply through administrative action.) The level of rents which can be charged for a unit often depend more on neighborhood characteristics than on the condition of the property. Consequently, rehabilitation does not automatically increase annual gross rents, and if it does not, it should not result in increased tax assessments.⁸⁴

On the other hand, in weighing a tax based on income against the present American property tax, Heilbrun finds that a tax on gross rent has negative effects on quality of operation and condition of structures and is a deterrent to remodeling and new construction. The tax yield would be adequate, except perhaps in a period of severe depression, and its administrative feasibility is probably about the same as that of the tax based on capital value. Heilbrun does not consider either gross rents, net rents, or the British "rates" an improvement over the American system.⁸⁵

Proponents of the reform argue that a property tax based on rents is less difficult to administer because there is objective evidence of rents. This is usually true for multi-family dwellings, but in some

⁸²Holmes, *Other Comments*, in *SHOULD THE UNITED STATES ADOPT THE BRITISH SYSTEM OF ASSESSING REALTY?* 25-26 (1944); Walker, *supra* note 67, at 30.

⁸³Walker, *supra* note 67, at 30.

⁸⁴PRESIDENT'S COMM. ON URBAN HOUSING, *supra* note 3, at 104.

⁸⁵J. HEILBRUN, *supra* note 9, at 169-170.

areas rented single-family houses are rare and finding sales evidence is much less difficult. Also, in the United States sales prices are easily obtained while assessors do not have access to information on rents.

D. INCREASING THE PROPERTY TAX BASE

Historically the property tax was instituted as a tax on land. However, property or wealth falls into four primary types—land, improvements, tangible personal property, and intangible personal property. Intangible personal property, which includes corporate stock, securities, etc., has been generally excluded from the property tax but represents a large portion of the nation's wealth. This form of property in 1962 constituted more than half of the individually held property in the United States.⁸⁶ The aggregate value of stocks alone (excluding bonds, life insurance, and bank deposits) on the New York Stock Exchange and other national markets was approximately \$450 billion, while the total individual wealth in the United States was about a trillion dollars.⁸⁷ By taxing real property and excluding most personal property, particularly intangibles, the tax system may be in error. If the property tax on real property is a significant deterrent to investment in housing, perhaps these other sources of potential revenue need to be considered.

During the nineteenth century, the property tax in the United States became a general property tax, that is, a tax on *all* kinds of property at the same rate. However, this inclusion of all property has been gradually eroded in most states. Certain categories of personal property have been exempted in a majority of states, and in New York and Delaware personal property has been completely eliminated from the tax rolls. Some categories of tangible personalty are still widely taxed, e.g., household furniture, but intangibles are generally no longer taxed. Intangible property is now part of the legal tax base in only 15 states, and is a significant element only in West Virginia.⁸⁸

The best argument for ignoring this vast source of revenue is that intangibles do not lend themselves to an *ad valorem* tax. Compiling a reasonably complete tax roll of intangibles is excessively difficult⁸⁹ since they are easily concealed and transferred. According to a recent

⁸⁶A. BERLE, *THE AMERICAN ECONOMIC REPUBLIC* 27 (1963).

⁸⁷*Id.* at 29.

⁸⁸NETZER, *supra* note 6, at 141.

⁸⁹Becker, *Principles of Taxing Land and Buildings for Economic Development*, in *LAND AND BUILDING TAXES* 15 (A. Becker ed. 1969).

report in Illinois, which still retains the old general property tax, intangibles contribute only .5 percent to the Illinois tax base although they constitute more than half of the wealth in that state.⁹⁰

Another problem in taxing the national wealth is double counting. One person's intangible property may be an interest in another's tangible property, e.g., stock in a corporation may be invested in land, buildings, or machinery. By taxing both the stock and the tangible property there is double taxation. Professor John R. Commons cites a Supreme Court decision in which the Court recognized that a company's tangible property is only a small fraction of the whole property, that whenever separate tangible properties are joined together in use there develops an intangible property which exceeds in value the aggregate value of the separate pieces of property.⁹¹ He concluded that "there are, in fact, not two kinds of value, tangible and intangible; there is but one value and it is intangible."⁹²

Although the idea of taxing all property is difficult to administer, it should not be discarded. When the states modified their tax systems to exempt intangible property, intangibles represented a smaller proportion of our national wealth than they do today. If it is impracticable to increase the property tax base, at least further erosion of the base should be prevented.

IV. CONCLUSION

The present property tax has been widely criticized as an obstacle to private investment in low-rent housing and urban rehabilitation. Radical changes in its form have not been attempted because of inadequate knowledge of their effects when in actual use. Even when there is more data assembled on the effects of the reform proposals, change will be difficult because of the local nature of the tax; there are presently more than 87,000 local governmental units in the United States.⁹³

All of the most popular ways of overcoming the property tax hurdle discussed in this paper have advantages and disadvantages. Possi-

⁹⁰Groves, *Property Taxation of Intangibles*, in PROPERTY TAXATION U.S.A. 122 (R. Lindholm ed. 1967); ILL. COMM. ON PERSONAL PROPERTY TAXES, REPORT 7 (1959).

⁹¹Adams Express Co. v. Ohio, 166 U.S. 185 (1897).

⁹²Groves, *supra* note 90, at 121.

⁹³Walker, *supra* note 67, at 7.

bly the best solution would be a combination of the best features of each, proposed by both Mabel Walker and Richard Netzer. In 1961 Dr. Netzer suggested in an address before the Regional Science Association:

I suspect that urban development would be well served by replacement of the traditional property tax with a three-tiered device which taxes improvements on earnings, land stiffly on a capital value basis, and land value increments on a capital gains basis.⁹⁴

James Heilbrun recommended adopting one of the following three reforms:

1. Using the Pittsburgh plan of moving gradually toward a building tax rate set at only half the land rate. . . .
2. Retaining the present tax on assessed value of land and improvements but continuing it with a tax abatement to encourage housing rehabilitation and perhaps new construction.
3. A combination of the first two reforms, involving the following elements: (a) setting a ceiling on building tax rates at their present level; (b) leaving the rate of tax on land value free to rise as necessary in the future; and (c) using tax abatement to encourage rehabilitation and perhaps new construction.⁹⁵

Until more empirical data is collected and analyzed, probably the best solution to the problem is the expedient one of subsidization by the federal, state and local governments. Hopefully, the previously outlined studies planned by the Department of Housing and Urban Development will provide the data necessary for improving the unpopular but necessary tax. Only then can effective action be taken.

Betty Wolfe

⁹⁴*Id.* at 31.

⁹⁵Heilbrun, *Reforming the Real Estate Tax to Encourage Housing Maintenance and Rehabilitation*, in *LAND AND BUILDING TAXES* 79 (A. Becker ed. 1969).

