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By Dr. Mason Gaffney

This article was first published in GroundSwell, a publication from Common Ground, USA. The Robert Schalkenbach Foundation has received approval from Common Ground, USA to republish this article at no cost for educational purposes.

Article citation:
Gaffney, Mason. “Balkanization and Specious Regressivity of the Property Tax.” *GroundSwell*, Jan. 2014, pp. 7–9.

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BALKANIZATION AND SPECIOUS REGRESSIVITY OF THE PROPERTY TAX

By Dr. Mason Gaffney, Riverside, CA

My inlaws retired 5 years ago and sold their home in San Jose. It was shipshape, but they spent thousands spiffing it up more. They cleaned and scrubbed and patched and painted and rewired and replumbed and glazed and waxed. They removed shoes before entering to keep everything "nasty neat" for the fussy, and ready-Freddy for the urgent. They got about a million for it.

A reward of virtue? Not entirely: the buyers never moved in, but 'dozed the house and built a new one to their liking. A San Jose shopping mall may still be named "The Pruneyard", honoring a great history, but the fruit that moves you has moved itself, releasing space for higher uses. The Bay Area's back yard has become Silicon Valley. In numbers of people, San Jose now ranks above San Francisco, #3 in California and #10 in the U.S.A. Land prices have soared.

Meantime my wife and I are marketing our empty nest down south. We consult with a broker on what we should fix up, and the answer keeps echoing back, "not much". New granite countertops? No, the buyers might prefer another material. New heat, new air, new windows ... no, no, no, they'll cost you more than they add to the price. What are the selling points? "Location, location, and location", and "access, access, access". Oh, yes, our senior water right in the Santa Ana River is worth something, too – but water is a natural resource, a form of economic "land", growing ever scarcer and worth hogging in this time of drought-panic.

Metrolink station nearby with service to Orange County and L.A.: yes! Major shopping center close by, with Nordstrom, Macy, and Penney anchors : yes! Huge new Kaiser Hospital; Freeway Interchange; hundreds of small retailers and eateries; good schools with active PTAs; neighborhood with attractive reputation; churches of all brands; major but uncrowded airport nearby: yes, yes, yes, yes, and yes! College campuses, public and private, in abundance and variety. (We are blessedly free of the usurious diploma-mills springing up around the airport.) Public warm-water beaches half an hour away to the southwest; mountains and desert resorts ditto in to the east. They are selling points too, but nothing we can create or destroy.

Jobs? We could use more, who couldn't? But workers in Orange County commute there from here for the "cheap dirt" we boast, relative to theirs, thanks to which it's not so "affordable" any more, and never was if you looked in from the "flyover" states.

Personal property? Treasured heirlooms? We thought we'd cash out from downsizing, but have you ever sat around waiting for customers in an antique shop, while rent and interest and your time mount up? A couple of dealers sniffed around and shook their heads and offered us $500 for the few pieces they thought they could move. "Obsolescence" is the word. Remember when "The Methodist ladies sewing circle will meet Wednesday: Mrs. Smythe will pour."? Well, Aunt Julia's mahogany tea cozy isn't the treasure of yore: that bubble has popped. It's land, land, land: most else is fuel for a bonfire of the vanities. It's owning it that counts, not just living on it: tenants pay rent, which is not deductible from taxable income, the way mortgage interest and property taxes are.

I spoke of residential land. As Georgists know, or think they do, commercial and industrial lands are where the big values are. Their premia are enhanced now, since Prop 13 passed in 1978, by their increasingly blatant underassessment relative to owner-occupied homes. On the other hand, the latter get the best income-tax breaks, while labor and growing families, creating the future labor supply, pay most of the income and consumer taxes, offsetting the famous break for "imputed interest" on the value of a big house. "Cannery Row" has given way to yacht harbors, coast to coast and on inland beach fronts, too. Toting up the pluses and minuses, the bottom line is that residential and amenity demands and the dacha economy drive land pricing in vast areas of the more scenic states.

Real estate interests spin the myth that owner-occupied homes are the poor man's and his widow's savings accounts; taxing them would be regressive. Émile de Laveleye, Belgian economist of the 1880s, observed how the very rich, and politicians drawn from their ranks or fronting for them, made a point of building up la petite propriété as a bulwark to protect la grande propriété from egalitarian voters. George quotes Laveleye that small holdings form "a kind of rampart and safeguard for the holders of large estates... a lightning conductor that averts from society dangers that might otherwise lead to violent catastrophes" (P&P p.327). Les Grandes have been doing it ever since, with growing success, until today the dominant theme dumped on readers is that only personal income taxes are truly progressive. Property taxes are regressive, because "the poor people own all the land". Those exact words would be too transparent, but they keep minting and circulating the idea in different guises until it is common coin. It has subverted even labor union intellectuals, long led by adamantine Robert McIntyre of Citizens for Tax Justice, the major union lobby on K Street.

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Rebels against Prop. 13 in California, led by union thinker Lenny Goldberg of Sacramento, see through the fallacy, and have compiled and analyzed many data on the shocking underassessment of Commercial and Industrial (C&I) land. But even Goldberg, who sees the cat clear enough with the inner eye, does not think it politic now, if ever, to take on Laveleye's "small holders", manipulated by *les grandes* who are ever glad to tell *les petites* what to think.

The documented fact is that residential land ownership is much more concentrated than personal income. To begin with the most obvious, the bottom 1/3 or so of income-receivers are tenants who own no homes at at all. It is just a matter of organizing and analyzing available data to test the hypothesis fairly, evading statistical fallacies and fabricated data. Adam Smith got the point with his sharp eyes and common sense way, back in 1776: "The necessaries of life occasion the great expence of the poor. They find it difficult to get food, and the greater part of their little revenue is spent in getting it. The luxuries and vanities of life occasion the principal expence of the rich, and a magnificent house embellishes and sets off to the best advantage all the other luxuries and vanities which they possess. A tax upon house-rents, therefore, would in general fall heaviest upon the rich; and in this sort of inequality there would not, perhaps, be anything very unreasonable. ... the rich should contribute to the public expence, not only in proportion to their revenue, but ... more than in that proportion." (WN V. 2. 71.)

This writer has published several pieces on the subject. No need to repeat them here. They are available on line in www.masongaffney.org. Try "Housing, Income, and the Progressivity of Taxing Property" (*Groundswell*, May-June 2008); "The Taxable Capacity of Land"; "The Hidden Taxable Capacity of Land (IJSE 2009;) "Rent, Taxation, Dissipation and Federalism" (W.E.A. July 1990); "The Property Tax is a Progressive Tax", 1972 Prcdgs of The NTA; and others. Here you will find that rich residential enclaves like Rancho Santa Fe near San Diego, or The University Endowment Lands in Vancouver, B.C., have high ratios of owners' home values to their incomes, while the "Poverty Flats" and "Podunks" and "Pouce Coupes" of this world have low ones, often approaching zero. Rented slums, of course, have ratios of zero, since the renters do not own the homes in question – a fact so obvious that a common ruse is to leave them quietly out of the data, refuting the point by ignoring it.

Putting aside statistical tricks and blunders and false data and maladministration, the substantive case for regressivity of the property tax is BALKANIZATION of the base. People with expensive homes and sweeping lawns and grounds tend to cluster in sheltered enclaves, where like attracts like. If that weren't enough, rich enclaves are increasingly gated, and/or insulated from the riff-raff by snob zoning. Their ratio of land value to income is high, so they can provide local services with a low property tax rate. People with cheap homes require a higher tax rate for the same local services, so the property tax rates are high relative to their incomes. As our spotlight moves from cities of low income to high, say from Santa Ana west through Costa Mesa to Newport Beach, property tax RATES may fall relative to incomes because the property tax BASE is rising relative to incomes. Thus the data show enclaves with higher incomes enjoying better schools with lower property tax rates than their opposite numbers, and behold: the property tax is regressive.

Critics of property taxation, and *a fortiori* of land value taxation, seize on this to damn LVT as regressive relative to income. It is, however, an artifact of Balkanization, not of the mode of taxation. The obvious solution is to raise the property tax from the local to the state level, so property in the rich enclaves helps pay for schools in the poor ones. Many state courts have found this is not only permissible under state constitutions, but mandatory. Leading cases were *Rodriguez v. San Antonio I.S.D.* (1971) in Texas, and *Serrano v. Priest* (1971-77) in California.

Les Grandes have marshaled their forces to submarine such actions, and generally prevailed by subterfuge and distractions, but the idea still has legs. In Vermont enclaves with high property values per school child are classed as "Donors" and contribute to a State fund to help poor districts. The monies involved are trivial today, but donor enclaves see the thin end of a wedge and take extreme measures to evade their "donations". The rich ski resort of Killington actually sought to secede from Vermont and join New Hampshire, which it does not even border. The evasive maneuvers of rich Manchester would do credit to a destroyer dodging U-Boats. Georgists, it seems to me, need to add their legs to the strong and constitutional forces already seeking to equalize revenues per school child. This was never a question for Henry George: when he wrote most state-level revenues were from property.

Here we are focusing just on residential real estate. That is less than half the story. The most blatant tax enclaves are of other kinds:

industrial, like Emeryville in the Bay Area , the Cities of Industry and Commerce in greater L.A.

agricultural, like millions of acres of farmland underassessed by virtue of basing taxable values on capitalizing just current crop or cow income, disregarding all values derived from prospective future incomes and (continued on page 9)

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resale values and other uses.

timber, sheltered from ad valorem assessments in almost every state using assessment formulae written by and for big landowners or their puppets in State Forestry Schools

minerals and hydrocarbons and discovery prospects. Lands with such prospects are called "prone" to them, and sell for speculative premia over some 15% or more of America's "farm" land.

utility rights of way

water licenses, including power drops (licenses are not real property, hence not part of the tax base)

pollution licenses over airs and waters

leaseholds on Federal offshore lands, outside jurisdictions of any state

licenses to radio spectrum

take-off and landing rights, with access to airport gates in peak time-slots

individual fishing quotas

lands used or reserved for recreation, including riding, shooting, fishing, docking, beaching,

One could go on and on, but notice how mere land surface, even including central urban sites, barely scratches the surface of what is valuable, and what is outside the tax reach of jurisdictions where most people live.

Some activists, moved by good intentions, take what I consider the wrong fork in the road on this issue. They idealize local governments and fault others of wider scope. There is plenty of fault to go around at all levels, but under cover of these distractions states have been shifting the weight of school finance to the state level by using sales and payroll taxes rather than statewide property taxes. Thus the shift from local to state finance, which is sorely needed, has shifted the tax base from property to sales and payrolls, with all their regressivity and excess burdens. That is using a good reason to support a bad change, weakening each state and the whole nation.

Some apologists explain the shift by saying it is too great a change from custom and tradition to tax property at the state or provincial level. That is backwards history, butt before belly. Before about 1931 there were no state sales taxes, none at all, and few state income taxes. There was no wage-withholding, so few income taxes, state or federal, fell on wages or salaries. From 1789 and even before, most state or colonial taxes were property-based. States set up Boards of Equalization to keep local assessors from cheating on other localities by underassessing property. Georgist lawyer Stanley Sapiro (R.I.P.) left me a deeply scholarly brief on the history and purpose of the California State Board of Equalization (*Groundswell, April 2012)*. The Board still exists, but its original function has been forgotten and pushed down the memory tubes. How quickly we forget , when strong vested powers want us to. Don't blame careless youth: most of what they know about history is what schools and colleges have taught them. Let us use this present venue to help all of us remember, and revive state property taxes and use them to de-Balkanize the property tax and make it support schools and other human services as of yore.

What about Federal taxes? Several statesmen who once plumped for Georgist property-tax reform at home have dropped it when arriving in the Nation's Capitol, saying it is not relevant there where there is no national property tax. That, too, Is bad history. We had a corporate income tax before we had a personal one, and corporate taxable income is mostly from corporate property – wages and salaries are deductible. The reason we have a 16th Amendment was precisely to let the I.R.S. include property income in the base of the personal income tax. For years after 1913 most reachable personal income was property income, because there was no wage withholding until 1942. That was when Beardsley Ruml and Milton Friedman - yes, himself, the supposed enemy of income taxes - sold it in Washington and worked out the details, apparently in league with devils who lurk there.

Income taxes (corporate and personal, Federal and state) on the cash flow of fixed capital were tempered by depreciation allowances. Sometimes these were so fast as to zero out the taxable income from the capital totally. Land was not depreciable, and should not be, and still is not, *de jure*. Gradually over time, however, owners of fixed capital have contrived to stew their books so as to stir land in with fixed capital, and depreciate some of their land along with the capital on it. Their local tax assessors have abetted this ploy by underassessing land relative to old buildings, and the I.R.S. has empowered the local assessors, who don't even report to it, by accepting their allocation of value between depreciable buildings and non-depreciable land. Michael Hudson and Kris Feder have exposed and documented this ongoing outrage in a monograph they published with The Levy Economics Institute of Bard College, 1997, "What's missing from the capital gains tax debate". It is the worse because owners in sequence do it again and again, each time the old buildings change owners. It is of huge fiscal weight, as Hudson/Feder show, but hard enough to understand so that most people don't get it - unless they are accountants, and they aren't telling. It deserves an encyclopedia of exposés , but there's no more space here and now. I will devote my next op-ed to it.

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