



Book Review: Who Pays the Property Tax: A New View

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Who pays the property tax: A new view. By HENRY J. AARON. Studies of Government Finance. Washington, D.C.: Brookings Institution, 1975. Pp. xii, 110. \$5.95, cloth; \$2.50, paper. JEL 76-0133

This monograph surveys some of the literature on property taxation. The strong thesis is that a general tax on all property in all jurisdictions is not shifted, but lodges on the owners of property. A corollary is that the property tax is not regressive because property is more concentrated than income. Dr. Aaron favors keeping the tax largely as is (with exceptions noted below).

The style purports to be semi-popular. "The primary purpose . . . is to shorten the lag between advances in economic analysis and their entry into popular debate" (pp. 2–3). It is difficult to pull this off without condescension. Some of the argumentation becomes heavy and involuted. It should be possible for the intelligent layman to grasp the difference between partial and general taxation and between global and local analysis without extended be-

laboring. The overall effect is a change of pace between brisk prose and circumlocutious overkill. Too many *obiter dicta* distract from the main theme and leave loose threads around. The space might have been devoted to providing more data in support of the basic thesis: for example, the breakdown of property value between land and buildings, which are treated separately; and data on the concentration of property ownership which is postulated but not documented.

Style apart, this book is a milestone in the rehabilitation of the property tax. The "old view" applied partial-equilibrium assumptions and concluded the tax was shifted forward, making it a regressive tax on consumption. The "new view" asks rather what is the effect of taxing capital in all jurisdictions and in all forms. Such a tax is unlikely to be shifted, at least not in any such simple way.

The "new view" also changes the answer to the question, what happens when we tax capital in one locality only? The new answer is that the tax on capital is shifted into lower land rents and values, land being the only input strictly fixed in local supply. Aaron draws back, however, from full commitment to this finding. That is a pity because the next creative step would be to analyze the substitution of land for capital that logically follows—and the attendant diversion of capital into longer extensions of roads and utilities. To the extent that he touches on such effects, he assumes strong complementary relations between capital and land and fails to contemplate substitution. He also assumes strict complementarity between capital and labor, an assumption increasingly under challenge.

The "new view" of shifting leads to new conclusions about progressivity. The "new view" makes the property tax more progressive. Aaron contrasts old-view and new-view data, showing the change. The "new view" involves more than abandoning forward shifting. One also changes toward a longer accounting period for defining income. One also recognizes that value/rent ratios rise with rent.

In chapter 4, "Tax Capitalization and Administrative Reform," Aaron enters the thicket as to whether an old bias to underassess some properties is legitimized by time and custom. He emerges weakly with the advice that assess-

ment reform "could be made more palatable if introduced gradually."

In chapter 5, "Reforming the Property Tax," Aaron reviews reform proposals. The circuit breaker he rejects as "an income maintenance system whose benefits are related to income and property-tax payments." He proposes "grants to households related negatively to income and net worth; and provision for tax deferral."

Second, he disfavors using property-tax exemptions in lieu of cash grants, citing the usual reasons with some extra emphasis on how this form of subsidy biases exempt owners to substitute land and capital for labor. Would that he had treated substitution effects elsewhere, too.

Third, he opposes preferential assessment of farm land on urban fringes, resting his case on the market mechanism.

Fourth, he favors exempting business "personal" property (inventories, machinery, equipment) on grounds of administrative convenience.

Fifth, he opposes general exemption of buildings and higher rates on land value, largely on the grounds that an old tax is a good tax and any change of policy disturbs existing values. He favors instead "reduced tax rates to investors contemplating sites within the jurisdiction," by "special arrangement."

Sixth, he rejects a net-worth tax on legal grounds.

The net thrust of those proposals is a major shift away from business machinery, equipment, and inventories, and by special negotiation certain new buildings; and on to institutional exempt property and ripening land, with minor shifts (to which he devotes major attention) among hardship cases. These proposals are evidently for immediate adoption (a "drastic overhaul" of exemptions), while true assessments are to be phased in gradually if at all.

This is a useful summary of recent ferment, but too hasty. Many back doors are left open.

The "new view" owes much to old views long espoused by Jacob Stockfish and Earl Rolph who drew on Ragnar Frisch, T. S. Adams, E. R. A. Seligman, H. G. Brown, and others, none of whom is credited. "The New View" smacks of fads and fashions. There is nothing new about distinguishing open and closed economies; partial and general equilib-

rium; and uniform from differential taxes. Aaron uses "excise tax effects" to mean the effects of differential taxes, when in fact a general sales tax or value-added tax has fewer such effects than a differential tax on property (or any other base). The usage could lead to missing the essence of a major link in the argument.

Nowhere does he treat the point that differential tax rates among jurisdictions may be offset by differential service levels, except at one point cursorily to dismiss it. It would have been useful for him to adopt Marshall's distinction of onerous and beneficial local taxation.

What is newer about the "new view" is to note that a nonshiftable property tax is progressive. In making this case, Aaron understates two of his supporting points. First, he defines income over a long accounting period, but says nothing about adding imputed and unrealized property income to measured income, nor the effect of loopholes on income reporting. Neither does he look at other aspects of regression fallacy. Second, in dealing with the point that value/rent ratios rise with rent, he deals with the property tax on residential property in a vacuum, as though there were such a thing as "the housing property tax," omitting the fact that higher rent-paying people are more likely to own nonresidential property, thus introducing a large bias.

The chapters on reform editorialize. This leads to a number of contradictions. The "old tax is a good tax" judgment is selectively applied to block some reforms, like land value taxation and true assessment, but to let pass others like repealing farm preferences and tax exemptions. The proposal to exempt industrial machinery and equipment is at odds with the presumption for greater progressivity emphasized elsewhere.

The treatment of land taxation is unresponsive to most points made by advocates; his analysis of effects seems contrived and indefensible; and it all leads to a Mayor Daley-like proposal for cities to negotiate individual tax rates with outside investors—a proposal he excoriates on pages 61–62. Having rehabilitated the property tax in theory as uniform and progressive, he here seems bent on making it partial, discriminatory and regressive in fact.

There is an appalling misinterpretation of data on page 53 where Aaron identifies the

industry group labeled "real estate" with real estate as a tax base and writes as though capital used in "any other industry" were not real estate. This leads him to infer that the corporate income tax fails to tap real estate income.

Regardless, this is an important book which consolidates recent gains in better understanding of the property tax. It will continue to make progress towards the author's goal of enlightening the public and the profession. May it serve as a springboard for future work.

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Proposals for the reform of direct taxes: Report of the Commission on Tax Reform. By HAIM BEN-SHAHAR *et al.* Jerusalem: Ministry of Finance, State Revenue Administration, 1976. Pp. irregular. Paper. JEL 77-0719

By the end of 1974 the Israeli individual income tax had become so distorted by inflation and by structural deficiencies that the Minister of Finance appointed a Public Committee of three professors, one auditor, and one lawyer, chaired by Professor Haim Ben-Shahar of Tel Aviv University, to recommend structural and administrative reforms. The Committee had only ten weeks for the job [1, Ben-Porath and Bruno, 1977, p. 287], which explains why the *Report* does not live up to its title. It is essentially an analysis of the Israeli individual income tax; the corporation income tax is treated only briefly, and other direct taxes are not covered.

Some dozens of specific recommendations were made, and the net result was to maintain or slightly decrease total income tax revenue, through expanding the tax base, lowering the rates, and improving administration.

Vertical distortions had resulted from an accelerating inflation unaccompanied by adequate changes in the progressive rate scale and in the personal exemptions [1, 1977, pp. 296-97]. Horizontal distortions, some of them introduced to soften the impact of the vertical distortions on this or that group of taxpayers, took the form of nontaxable fringe benefits, inappropriate deductions, and a serious lag in collection from some taxpayers, chiefly the self-employed. In addition, outright evasion was high within certain groups. The Committee

concluded that "[t]he tax rates specified by the law are frequently a dead letter and bear no resemblance to the effective rates" (p. 2-1). In a recent article, two members of the Committee, Professors Yoram Ben-Porath and Michael Bruno, say that "[t]he allocative inefficiencies arising from differential opportunities to avoid or evade were probably more important than the distortion in the leisure-effort margin" [1, 1977, p. 289].

A few examples from the list of gaps in the law and administrative concessions are the following: reduced tax rates on overtime earnings, "measured output" premiums, and shift premiums; five sets of exemptions for five types of development areas; exemption of the cost of living allowances, specified in labor contracts, up to a certain maximum, and a corresponding exemption for the self-employed; a number of fringe benefits, including even the employee's total home telephone bill, a customary perquisite; extension of the concept of "work garments" to those worn by persons "in contact with the public" (including civil servants); and, above all, the "car allowances." Dr. Amnon Rafael [2, 1976, p. 506] says that "only a small fraction of these so-called expenses were sanctioned by law, e.g., professional literature; . . . a greater part, were merely extra-legal concessions."

The car allowances were "a major device for eroding the tax base," according to the Committee (pp. 2-12, 13) and sometimes took the form of outright evasion: "firms acquire cars for employees even when their work does not require it (p. 2-13). Six pages of the *Report* are devoted to car allowances alone, and Rafael goes so far as to say that "[t]he general collapse of the Israeli tax base can, in the main, be attributed to 'car expenses.' . . . The game was played . . . by the filing of fictitious meticulous reports, detailing long untravelled journeys" [1, 1976, p. 506].

The Ben-Shahar Committee recommended elimination of virtually all of these "erosion" techniques, along with adoption of a simplified rate schedule, higher personal exemptions (transformed into credits) and repeal of the compulsory loan. The credits and the brackets were to be linked to a price index (for further discussion of this point, see Ben-Porath and Bruno [1, 1977, pp. 298-301]).