



The Property Tax

By Dr. Mason Gaffney

Article citation:

Gaffney, Mason. "The Property Tax." Econ 132, 1999. Study guide.

Fair Use Disclaimer

The Robert Schalkenbach Foundation, a non profit private foundation, is publishing this article, at no cost, pursuant to the Fair Use provisions of Section 107 of the Copyright Act which states that under certain circumstances, the fair use of a copyrighted material for purposes of criticism, comment, teaching, scholarship and research is not an infringement of copyright. If you have any concerns about the publication of this article, please contact us at info@schalkenbach.org.

The Robert Schalkenbach Foundation's Digital Collections and Archives is an extension of the Robert Schalkenbach Foundation's Engel Georgist Library. It collects, organizes, preserves, and provides free online access to researchers and the general public of Georgist literature including books, newspapers, pamphlets, scholarly articles and archival materials.

RSF is particularly proud to offer free online access to the works of the late Georgist scholar Mason Gaffney, made possible through the generosity of the Danica Foundation and with the consent of the Mason and Letitia Gaffney Trust.

Robert Schalkenbach Foundation: <https://schalkenbach.org/>

Engel Georgist Library: <https://www.librarycat.org/lib/EngelGeorgistLibrary>

RSF Digital Collections and Archives: <https://schalkenbach.starter1ua.preservica.com/>

THE PROPERTY TAX

Econ. 132, (orig. '99, version 3), Prof. Gaffney

Outline of major points, for class discussion

The property tax is probably the simplest of taxes, and the oldest, so it is a good place to begin our study. Still, nothing is as simple as it at first appears, and mankind has managed to make it a good deal less simple than it might be.

A. All taxes consist of at least six elements: base, rate, rate structure, taxable event, responsible taxpaying unit (whom do you collect from), and scope of sovereignty (how far can the government reach).

Base

1. Lawyers recognize 2 kinds of property: real estate (land, improvements) and "personal" (tangible and intangible). "Personal" is a misnomer: it really means movable, and its major components are not personal at all, but business inventories, equipment and furnishings. What we think of as truly "personal" is exempt, de facto if not de jure: no assessor would dare go through your closet and drawers.

Real property means land, and improvements affixed to it. Why "real"? It's not that other property is imaginary. "Real" probably derives from "regal," reminding us that all land titles hark back to some sovereign (regal or otherwise) who or which granted them. In the law, land transactions are treated quite differently from other contracts, a tradition going back centuries.

Economists break things down differently: improvements and tangible personal property (movables) alike are man-made capital; land is still land. The schema below shows the difference between economists' lingo and lawyers' lingo. To the lawyer, buildings are part of "real estate"; to the economist, buildings are part of "capital."

<u>Economesse</u>		<u>Legalese</u>
Land	Land	} <---- "Real Estate"
	{ Buildings }	
Capital <----> {	{ Movables }	

In economics, "land" includes all natural resources, including some that the law, which lags behind technology, does not subject to the property tax (radio spectrum, water licenses,

commercial fishing permits, etc.). What poets call "the land" - farmland - is a minor component in terms of value: city land is the gold mine. Many economists, including myself, also include in "land" many exclusive and limited privileges associated with territories, like taxi permits, liquor licenses, banking charters, country club memberships, etc.

To the lawyer, capital affixed to a building is a "fixture," hence part of the building, hence part of "real estate." To the economist it is capital, whether affixed or not. It's often just a matter of loosening some bolts. *Canals + castles.*

"Intangible" personal property consists largely of layered paper claims without intrinsic value, and is mostly excluded from the property tax base. This is on the theory that the true value of layered claims is only "extrinsic" (derived from other sources), so their value derives mainly from the backing of material assets of intrinsic value, as the lands and plants and equipment and inventories of corporations back the value of their shares; and the material assets are already subject to the property tax (in many blue-collar towns, industries pay most of the property tax). *Mortgage-backed Securities*

There is also the practical administrative problem that paper assets are easy to conceal and remove.

California proptax rolls are divided into "secured" (immovable) and "unsecured" (movable) rolls. The secured roll is aka a "cadaster," esp. in Europe, and esp. when displayed on a map. A famous old cadaster is that established in England by William the Conqueror, in 1086 AD, called "The Domesday Book." It was the basis of English public finance for centuries; the English duly celebrated its 900th anniversary in 1986. May your children be around to celebrate its millennium, 80 years ahead!

Johannesburg
Another famous cadaster was that of Joseph II of Austria, ca. 1775-80 - see notes on the Physiocrats. Charlemagne had one in 800 AD; Egyptian Pharaohs used them; they have been around a long, long time. Copenhagen's cadastral map has been in use for scores of years, and is of such exemplary quality that it has been published in many journals. Some American cities have published their cadastral maps and posted them so every taxpayer may compare his valuation with his neighbors'.

"Furnishings" go on the unsecured roll; "fixtures," bolted to the floor, on the secured roll. See if you can explain why.

There is a growing trend in America to exempt all personal property from the proptax. The results are probably quite inequitable - to exempt the rich man's cattle, machinery, horses, and rolling stock while continuing to tax the poor man's hearth and home - but the movement rolls quietly ahead. California has

compromised, exempting inventories (to keep them from warehouses in Nevada and Arizona) but not furnishings. In Canada, whose provinces all exempt personal property, you can turn taxable fixtures into exempt furnishings by unbolting them and putting them on heavy casters (thus demonstrating the realism of the economists' classing them all as "capital," as opposed to the lawyers' calling one "real" and the other "personal").

Registered licensed vehicles, although movable, are hard to conceal, so the State continues to tax them annually. Most of you pay this tax, although you may not be aware of it.

Some miscellaneous forms of taxable property are possessory interests on public land; and state-assessed property (rails, utilities, vehicles). Rails and utilities are state-assessed to protect them from overassessment by locally-elected assessors, who see the rails and utilities as vulnerable because they cross county lines, and cannot withdraw service. This thread is resumed below, under "fractional assessment."

✓ Housing comprises a large share of the base, but by no means all, and often less than half. Foes of the property tax often label it "the housing tax," but there is no special tax on housing. The property tax falls on all land and the capital affixed to it. Industrial and commercial and mineral-bearing land comprise a large share of the base. It is true, though, that the property tax is our ONLY tax that taps the imputed income of owner-occupied housing, along with "sporting estates," horse farms, country seats, manors, lakesides, ski chalets, and the like, which now occupy astonishingly vast and valuable areas of the nation. ~~£~~ C+I

Some jurisdictions, like New York City, classify land uses informally (illegally), and appear to underassess owner-occupied housing relative to commerce, industry, and rental housing. On the other hand, California in the early 1970s seems to have overassessed housing relative to commerce and industry. This was done by assessing housing on the basis of current sales values, while assessing commercial/industrial land on the basis of capitalized current rents, and omitting the growth factor, "g", from the cap rate. Many believe it was this policy that led to Prop. 13 in 1978.

→ 15% of U.S. taxes are prop. taxes, vs. 1% in Europe
2. Equity or total value? The base is total value, regardless of the use of real estate as security for private debts.

At one time, 1879, the then-new California Constitution provided for a property tax on equity alone, coupled with another one on the value of recorded liens. Thus, if you owned 10% of your home, and the bank "owned" 90% (as the saying goes), the bank would pay 90% of the taxes. This experiment did not last; I

2012
- 1918
34

4

am searching for information on how it worked, and why California abandoned it. You can imagine that the banks threw their political influence against it.

3. Assessment of the Base. A public official, the "Assessor," puts a taxable valuation on each parcel, every year. (Valuing real property, for public or private purposes, is a profession, with its own vast literature, professional associations, and journals. Generically, it is called "appraisal.") Most state Constitutions stipulate that this tax valuation should be the market value, as determined by observing sales of "comparable" property.

Sapir; Gwarkney

A frequent synonym for the property tax is "the ad valorem tax." This is to signalize that it is not a tax on the area of land, but the value. A square foot at 5th and Market in San Francisco may be worth more than 10,000 acres in the desert. In the peculiar lingo of public finance, taxes on bases other than value (e.g. gallons of gas) are called "specific" taxes.

4. Assessment discrimination. Assessments should be current and uniform, but in practice often lag behind changing market values. This results in discrimination, since some values rise faster than others, and some even fall. It also results in "regressive" assessment, because appreciating real estate gravitates into the "strong hands" of the wealthy, while declining neighborhoods go to the poor. This is illegal, but the pain of the poor has less effective legal, political, and p.r. representation than the pain of the rich, in the absence of conscious, ongoing public actions to prevent such bias. Such public actions depend on the existence of a militant, insistent, combative democratic spirit in the populace, a spirit notably absent in recent years.

There is a tendency by some assessors to revalue properties only when they are newly bought and sold. This results in regressive assessments (lower on the richer) because higher-valued properties turn over slower than cheaper ones. Some "dynastic" landholdings go back 200 years or more in the same ownership.

California institutionalized this lag with Prop. 13, 1978. The result after ~~21~~ ³⁴ years is extreme discrimination. Newcomers and the young are the major victims, so this is sarcastically called the "welcome, stranger" law. Immigrants and young parents are less well organized than the "old settlers."

Unsubdivided acreage is highly underassessed relative to subdivided lots. Much land used or owned by industries is unsubdivided, even when heavily improved, resulting in a bias against residential land uses. Land is generally underassessed relative to buildings, in recent years. (Before about 1940 that was less true, and in some places reversed.)

Assessors in practice also supplement the use of market observation by using the "capitalized income" method of

Rising rents,
p. 5

$$\frac{a}{i} \ll \frac{a}{i-g}$$

valuation, as well as historical cost, replacement cost, and some other methods. The result is a good deal of latitude within the assessment process, which may be used for good or ill. Much depends on the public consciousness of the process, and the philosophies guiding it.

Systematic discrimination can result when assessors use the capitalized income method for one class of property, and market valuations for another class. This occurred in California during a sharply rising market, 1975-78, when most assessors were valuing owner-occupied residences by looking at the current market, but valuing "income property" (commercial, industrial) based on capitalizing current income (and failing to capitalize growth expectations). In result, taxes on housing rose much faster than taxes on business properties, leading to discontents that would have forced taxes back onto business properties. A lobbyist for owners of rental properties, Howard Jarvis, cleverly turned aside this reaction when he orchestrated Prop. 13, 1978.

5. Fractional assessment. In some jurisdictions it has become customary to assess all property at some fixed fraction of its appraised market value (and then raise the tax rate to compensate). This is a sloppy practice, and entirely "extralegal," which is a complaisant euphemism for illegal and unconstitutional. Every tax assessor takes an oath to uphold the Constitution, and then is told he or she must go along with this charade because it is "customary," and agreeable to powerful interests.

In 1975 or so the Assessor of Sacramento County, Irene Hickman, raised all assessments to 100% of market, from the previous level of about 22%. She was challenged, and the California Supreme Court ruled against her in an amazing decision. They patted her on the head for being right, and obeying the constitution, but said they would not overturn a long-standing custom. It's enough to make one cynical. When the power elite want things done a certain way, they don't punish you for violating the constitution, but for upholding it. If they let her do it, all other counties would have had to follow suit, for reasons explained next.

The State "Board of Equalization" -- what does it "equalize"? Rails and utilities are state-assessed, but the tax payments go to localities where the property is sited. Locally-elected assessors are tempted to underassess all locally assessed property while the State is assessing rails and utilities at correct (or at least, higher) values. This is known as "competitive underassessment." If unrestrained, it would dump all taxes onto rails and utilities. These, being politically powerful, took steps from an early date to prevent it by setting up the Board of Equalization with the power to second-guess all local assessments and bring them all up to market.

As a sop to local interests, they let them assess fractionally, at about 22%, creating the illusion they were overtaxing the rails and utilities.

Nothing prevents the state from underassessing rails and utilities to compensate for what the locals do, but rails and utilities have incentives to pay taxes: first, to discourage local movements for public power; and second because they can pass their taxes to ratepayers, using their monopoly power and the rules of rate-regulation. Thus, an uneasy compromise had been reached, a sort of "equilibrium." Such are the messy ways of political compromise.

Irene Hickman threatened to unbalance the equilibrium with her 100% assessment, and force a whole new round of negotiations to rebalance things. At the end of the process, utility taxes would have dropped, utility rates would have dropped an equal amount, and other property would have paid more. The hidden mechanism behind all the protest was that utility rates had been inflated to shift the tax burden from property owners to ratepayers; and the power elite wanted to keep it that way.

Complicated? Not really, once you get the picture. It's a picture worth your getting. The richest economists are those who work in this field, either for the taxed or the taxers and rate-regulators.

Fractional assessment has another seductive charm for lazy assessors. It makes it easier for the assessor to defend assessments when challenged. He asks the protester if the latter would sell his parcel for the assessed value, and, if not, how can he object to it?

6. "Preferential assessment" is legalized assessment discrimination. This was quite rare until the idea caught on in the 1950s, and has now swept the country. The technique is to mandate that land in certain preferred uses shall be valued by its capitalized net revenue from the current use, regardless of alternative higher uses. In most states, the major preferred land uses are farming and timber. The Chino dairy district, straddling I-15 between Norco and the Pomona Freeway, is an example you can smell from time to time. It is protected by our version of preferential assessment, called the "Williamson Act."

Up north, hundreds of square miles of timberland get the same preference, discussed in more detail in other papers (#2,a&b) for this course.

In California, golf courses get the same privileges. A result of that is the rapid proliferation of golf courses, each one taking about 200 acres of land, and about 1200 acre-feet of water per year. (That's enough water for the domestic and lawn-watering needs of 2400 households, containing 7200 or more persons. There are 120 or so golf courses now in Riverside County, and more every year. Go figure: $120 \times 7200 = 864,000$ persons.)

7. Exemptions. Some users are completely exempt. These are mainly governments, and so-called "eleemosynary" institutions (churches [unless they rent], hospitals, colleges [but not primary or secondary private schools], cemeteries, foundations,

museums, charities, orphanages, etc.). Most economists believe this is an exceedingly clumsy, inefficient way to subsidize these institutions, if they should be subsidized at all, resulting in what is often called a "bricks and mortar bias," and should be called a parking-lot bias. That is, a clergyman living on peanuts, and fully taxed on his salary, will often be preaching from an expensive monumental structure, surrounded by acres of parking space that is used for just one hour a week, if that.

Standing timber is exempt. Many farm crops, new groves, and other improvements are exempt. Much personal property is exempt - a growing trend is to exempt it all, but in California we exempt inventories and tax furnishings.

No one knows for sure the aggregate value of the property tax base in the U.S. because records are poor, doctored, local and scattered, and Washington resists documenting or publicizing the total. As a lowball guess, though, try \$100,000 per capita, for a total of \$25 trillions. A tax of 2% on that would yield annual revenues of \$500 billions.

In 1920, well over half of all taxes in the U.S.A. (Federal, State, and Local) came from the property tax, in spite of World War I and its aftermath. Now the fraction is a good deal lower, but what happened back then gives an idea of the high revenues this tax can raise when the public so desires.

Rate

1. There is a wide range of nominal rates in the U.S. The mean is around 1%. The real rates are lower, because of underassessment. The effect of Prop. 13 in California has been to lower nominal rates to 1%, and real rates far below that. New buyers pay the 1% rate, because sales trigger off a reassessment, but then, over the period of ownership, the real rate falls as market values soar while assessed values hardly change. The fall of tax revenues has been made up by raising sales taxes, income taxes, business taxes, and misc. other charges.

Real rates are above the national average in New England and the upper midwest. They approach zero in Alabama and New Mexico.

2. Nominal vs. real rates. People play childish games with fractional assessment, to baffle the unwary and untutored. Some states still express rates in "mills," making nominal rates look 10 times the nominal rate, which in turn far exceeds the real rate. Transparency and clarity are not the idea.

3. What is the effect of high rates on incentives to improve land? Less than you might assume. Arbitrage and "tax capitalization" lower land values, so some improvement remains

profitable at the lower level of land values, while the lower taxation of sales and income permits more intensive use of those parcels that are improved. New Hampshire relies heavily on the property tax, and has no taxes on sales or income: it is one of our fastest-growing states, both in population and income per capita. Only marginal investments are aborted. Thus, economic life goes on in high-tax states, with a few adjustments.

4. Tax shifting and tax capitalization. The Physiocratic theory, or "ATCOR," works in all cities and states because each is an "open economy," as the Physiocrats postulated.

"Tax capitalization" partly offsets the effect of higher tax rates on tax payments, but only partly, never wholly. There is never a "Laffer-Curve Effect." $\text{Tax} = tV = at/(i+t)$ (see "Rising Rents," Eqn. (5), p.7).

5. One set of factors makes rates higher than they appear; another set makes them lower than they appear.

Higher than they look because:

a. Tax is based on lump value, not current flow. A tax rate of 1% on lump value might take 20% of the annual taxable surplus from a parcel, especially one that is highly improved.

b. The rate is undiluted by inflation (unlike an interest rate).

Lower than they look because:

a. Fractional assessment

b. Lagging reassessment in rising markets, leads to conventional underassessment of rising values. Example: part of the Domenigoni Ranch near Hemet was condemned for a new MWD water reservoir, and MWD had to pay about \$2 psf. The assessed value was 7¢ psf. 2nd example: the corner of Lamart and El Cerrito in Riverside was sold in 1978 for \$240,000, but assessed at about \$8,000.

c. "Capitalization" means taxing only the after-tax value, so raising the rate results in less than proportionate rises in the tax levy (see #4, above).

d. Proptax payments are deductible from Federal inctax, even when much of the corresponding income is not taxed currently, or ever (imputed income and unrealized gains are never taxed).

6. Why the effective rate depends on the interest rate:
 $\text{Tax} = tV = at/(i+t)$ (see "Rising Rents," Eqn. (5), p.7).

8. How to find the real interest rate, using the property

tax rate as a tool. Step one is to solve for (i-g).

Rate Structure

1. Graduated rates are often proposed, but are rare, and hard to apply in practice. They are found in Taiwan, Australia, and elsewhere. Some are graduated by the owner's total wealth; others by the value of land per acre.

Owing to the high concentration of ownership, a simple flat rate has a progressive effect, relative to most other taxes, so a progressive rate structure is redundant.

2. "Homestead exemption," practiced in some southeastern states, has a roughly progressive effect among homeowners, since there is a cap on the exempt value. However, it does nothing for renters, and is widely regarded as a device for discriminating against renters, most of whom are poor.

3. "Circuit-breaker" systems in some states abate the tax for those who own property, but report low incomes. They do nothing for renters, and waste a lot of relief on those with high real incomes coupled with low reported incomes - i.e., those with good shelters against the income tax.

4. Some states "classify" lands by use, and apply different rates to different uses. Minnesota has carried this farthest, partly as a means of raising taxes on iron ore in the Mesabi, owned by out-of-state corporations. The economic effects are similar to preferential assessment, but the legal basis makes some states choose one method over another.

5. Most states classify forest uses separately, and apply special lower rates to the land, and substitute a yield tax for the property tax on the timber. Yield tax rates are everywhere much too low to be "revenue-neutral," so this is mainly a tax dodge masquerading as a conservation measure.

6. Pennsylvania grants cities a "local option" for exempting buildings wholly or partly, raising the rate on land to compensate. This is a move towards a "Physiocratic" system. Pittsburgh does it; Philadelphia does not.

This system is also found in the turf of the old "Non-Partisan League," mainly consisting of N.D. in the U.S., and the four western provinces of Canada: Manitoba, Saskatchewan, Alberta, and British Columbia. It also prevails, with local variations, in various cities around the world: Australia, New Zealand, Taiwan, Hong Kong, Singapore, Denmark, South Africa, parts of eastern Africa, and elsewhere.

7. IDs, SIDs, BIDs, and TIF.

These are Irrigation Districts, Special Improvement

Districts, Business Improvement Districts, and Tax Increment Financing. Each has a variant way of taxing property; IDs and SIDs tax land alone, exempting improvements.

Some 20% of all land-related revenues in California are raised by IDs and SIDs, so they are important. They are even more important than that, because they are exempt from the tax limitations of Prop. 13, and carry the constitutional potential of restoring the property tax reliance that Prop. 13 destroyed.

8. Deferral for hardship

There are various provisions whereby retired people with valuable property, but low cash flow, can defer taxes by giving the county a lien on their homes. The debt grows at compound interest, but the lien is not exercised until the owner dies. Few people actually elect this option, but its existence is a comfort to tax men who do not like being accused of "driving the widow from her home," etc.

9. Balkanization

In most states, local rates vary from place to place, because jurisdictions rich in property per capita can raise a given amount per capita with lower rates. (A "jurisdiction" is a taxing unit, such as a county, municipality, school district, or special district.) A "tax enclave" is a jurisdiction with valuable taxable property and few people, like Emeryville, Irwindale, Avalon, Vernon, City of Industry, et al. The result is not so much a "structure" of rates as a patchwork. Many children are crowded into "loser" districts, separated from the tax bases that might support their schools.

Taxable Event

There is no taxable event with the part of the proptax that falls on land: it is based on owning land, not doing something with it. This is the only tax of which this is true, which adds force to the Physiocrats' reasons for focusing taxes on land per se. Death duties come close, but even they depend on one's dying.

Because of the lack of taxable event, some economists refer to the proptax on land as a "lump-sum" tax, meaning it does not vary with the use of the property. This is a confusing usage, because "lump-sum" has several overlapping meanings, and carries a lot of baggage, so I avoid the term.

If one does not buy land in the first place, one pays no proptax, but someone else does. The liability goes with the land, not the particular owner. The purchase itself is not a

taxable event, nor does it affect the tax liability. California has made itself an exception, by its Prop. 13, where a new purchase triggers off a reassessment. The Prop. 13 system fundamentally changes the character of the tax, into a tax on land transfers, and probably should be called that instead of a proptax.

To own an existing building involves no taxable event, but the proptax on buildings goes up when one builds, or remodels, or even just maintains a building. So the proptax on buildings requires no taxable event in the short run, one year at a time; it does not tax you for using buildings. It does, though, tax you for erecting them in the first place.

Taxable unit

The taxable unit is the land parcel as such. The tax is not an obligation of the owner as a person; rather, it is a lien on the land. Lawyers call such a tax in rem, levied on a thing, as opposed to the other kind, in personam.

The penalty for non-payment is forfeiture of the land, not any action against the owner as a person; no jailing, for example, as with the income tax; no penalties for non-filing, or concealment. Filing is not needed, and concealment is impossible: all owners are listed, with great formality, in the office of the County Recorder, in records open to public inspection; all parcels with their boundaries are likewise of public record.

One party, the title-holder, is unambiguously responsible for taxes, which are levied on the total value of the assets, regardless of any mortgage or other debts recorded as liens on the land. Tax claims are always first liens, "senior" to any private claims. The entire asset, land and improvements, is the bond or forfeit in case taxes are unpaid. Back taxes with interest must be fully satisfied before any other creditor gets anything. Lenders make loans on real estate in full knowledge of the law on this matter.

Likewise, the entire value is taxable regardless of the owners' sales of partial interests like easements, or covenants, or granting of long-term leases - these are private arrangements, of no concern to the taxing authority.

Some landlords offer leases in which the lessee agrees to pay the property taxes; and some lessees sign them. This is strictly a private contract: the tax collector's relationship is always with the owner of record, or title-holder, who is responsible to the collector for paying taxes. Such private contracts have been outlawed in some state constitutions, but whether legal or not, they do not stand between the tax collector

and the owner of record.

The owner of record may be some fictitious entity fronting for who-knows-what or whom, but this owner, fictitious or not, must pay up or lose the land. An American may flee overseas, and some do, to avoid income tax liens, but one must pay the property tax or lose the land, for land is not removable. Alien owners must pay, too. There's no need to track them down, the land is the permanent hostage. Offshore tax havens let people avoid income taxes, but not property taxes.

Collection enforcement is simple and straightforward: real estate is always hostage to the taxing jurisdiction of situs. Identify yourself, pay up, or the sheriff sells it. In the Great Depression, some states allowed long delinquencies, which were abused, and have now been tightened up.

Sovereignty

Probable etymology of "real estate" as the Regal Estate, or King's land. Regardless of etymology, that is the basis of feudal law, of common law, and of U.S. law, which derives from them. We displaced the monarchy, but not the concept of sovereignty. In Canada, the government is still "The Crown."

In our federal system, sovereignty is shared between the State and Federal governments. Land titles originate with the national authority, but the power to tax real estate is a state power, which states then "delegate" to local units.

A government can only tax real estate inside its boundaries. Thus, no state can tax offshore oil leaseholds, in spite of their great value, because they are outside all states. Leaseholds on Federal lands inside the states may be taxed as "possessory interests."

Counties containing lots of Federal land are often compensated by receiving payments "in lieu" of taxes. Most of these in lieu payments go to the timber counties, and are based on a fraction of the gross stumpage (value of the cut). This causes great political pressure to overcut the National Forests, and is a source of great friction nowadays.

D. Allocational Effects

Define "effects" of increasing the property tax. Always ask, "compared to what?"

1. Hold public spending constant and reduce other taxes.
Land tax is stimulating and developmental. An unusual

"incentive tax" that motivates rather than drags.

- a) Fixed base
- b) No taxable event

Building tax:

a. In open economy is shifted to land (the Physiocratic model of Quesnay et al.), reducing in the process the capital-intensity of use. Sometimes reduces, sometimes increases labor-intensity of land use, as labor is substituted for capital.

b. In closed economy, reduces the RRAT but in a manner nearly neutral. The "Harberger" model, (although many others preceded him). This is currently often called "the new view" of property tax incidence, although "revived" or "exhumed" would be more accurate. It puts the supposedly conservative Chicago School (which Harberger represents) in the position of justifying heavy taxes on capital. This is not just an accidental deviation from the conservative stereotype, but is more consistent with Chicago's traditional effort to identify capital and land. Harberger in effect is treating the capital supply as fixed, just like land.

c. In partial equilibrium analysis, one form of capital is taxed while others are not. This reduces supply and tax is shifted forward, like an excise tax. These are called "excise tax effects." Models like this come from Musgrave and Netzer.

Tax on personal (movable) property

Much movable property escapes assessment. Uniformity is impossible; bias results.

2. Hold other taxes constant; increase spending.

Results depend on circumstances: how productive and useful is public spending? Are we short-changing schools and other people-services and falling behind other nations?

James Buchanan's view: all public spending is wasteful, so the best tax is the most destructive tax because it will raise the least revenue. (Curiously, Buchanan has spent his entire career teaching at tax-supported schools.)

Marshall's "onerous" vs. "beneficial" taxation, and its modern implications: tax property only for services to property, not to people.

Social dividend view: assert the public equity in property through taxation and spread the benefits around.

Feudal view: military spending is a service to property and property should support it. "Custer died for your sins," so don't just ask "what have you done for me lately?"

E. Distributional Effects

1. Allegations of regressivity
2. History of being regarded as progressive and "levelling." Bradford; Madison; Paine; Hamilton; Livingston; Quesnay; Du Pont; Franklin vs. the heirs of Wm. Penn; Patroons in New York, Patronos in California; resistance to organizing counties, incorporated municipalities, and taxing districts with universal suffrage; voter exclusion; Adam Smith, J.S. Mill, Henry George; Tom Johnson, Brand Whitlock, Newton Baker, cheap transit and civic revival, 1900-20; exporting tax ideas to LDCs after WWII; applications in Japan, Taiwan, Korea, Singapore, Hong Kong.
3. Contract vs. organic theory of government. "Benefits received" construed narrowly and broadly.
4. Maladministration: regressive assessment (e.g., timber in Oregon).
5. Balkanization. Low-tax enclaves in California. Fallacy of identification: enclaves of low income taxation in Wisconsin.
6. Concentration of property holdings. Dependence of high incomes on property sources. Especial concentration of unrealized "capital gains" which escape income tax but not property tax.
7. Regressive use of property. Slow sales by large holders. (Land/labor ratios rise with size of firms.)
8. Bias in partial inventories of wealth. Diversified large holders. Multi-national holders escape much income tax, but not property tax.
9. Allegations of forward shifting: Musgrave, Netzer.
10. High share of real estate is land: 45% of assessed value, probably 65% of true value (using building-residual method of separating).
11. Tax on capital not generally shifted forward, but downward. Still a tax on property.
12. Regression Fallacy. The Procrustean Bed of "income", a

catchword that has obscured analysis for 50 years. The use of AGI as the criterion of "like circumstances", horizontal equity and vertical equity.

13. Defining income properly. AGI is after loopholes, and no index to real income. Property income in various forms largely escapes AGI, and property provides loopholes to shelter other income.

14. Property taxes are not proportional to rents but to capital values, which are progressive w.r.t. rents.

15. Appreciating land is most closely held of all assets, and free of all but property taxes.

F. Central Government and Local Incentives

1. Social dividends issued nationally or statewide tend to make local governments compete to attract people.

2. Kinds of partial social dividends: G.I. Bill; loans with per person limits; school aids based on ADA; HEW payments; social security payments (not taxes); cash payments (e.g. Alaska); reapportionment according to population.

3. Competing for a fixed population is zero-sum, population-wise; but increases bargaining power of the movable population vis-a-vis holders of immovable property.

4. New move in Congress to assume more people-aids; shift more property aids to locals.

5. Negative social dividends: payroll tax; most of personal income tax; conscription; sales tax (except the portion shared locally); etc. Any exported tax based on population and/or activity acts as a negative social dividend. Marshall's "onerous" tax concept again.

6. Mandated county welfare spending, maximizes fear of "swamping the lifeboat." Turns local property tax into a "tragedy of the commons", one step removed. Kicking MediCal around.

7. The current imbalance: Feds subsidize land development while extracting negative social dividends. Result: exclusionary local zoning.

8. People-based revenue sharing formulae in other Federal states: Canada; West Germany.

G. Summary of rationale for property tax

1. Simultaneously progressive and incenting, resolving greatest trade-off in tax policy
2. Strikes surgically at non-functional source of economic power, exempts functional income. Implements the productivity theory of distribution and the Puritan ethic, at least w.r.t. labor. Exempt capital and it also implements the ethic w.r.t. saving.
3. Promotes intergenerational equity. Other taxes strike upward mobility.
4. If "Custer died for your sins" this tax makes us pay for our sins. (Alternatively, give it all back to the Indians and then tax it heavily.)
5. Is part of implied social compact -- or the actual Mayflower compact, as implemented by Bradford.
6. Promotes all three kinds of equity: functional; egalitarian; and market. And a fourth kind, too: interregional equity.
7. Penalizes cartels for holding excess capacity.
8. Is the effective seller motivation that keeps land markets from turning to glue. Moving the market reduces need for people to hold advance reserves.
9. Recoups for public the benefits of public works.
10. Moves landholders to respond quickly to new opportunities, e.g. from new extension of public works.
11. Offsets boom and bust in land markets (if assessors move quickly with the market).
12. Offsets major loopholes in the income tax.
13. Compensates those who missed out (or whose ancestors missed out) on the original political distribution of land by moving landholders to use land to: a, pay taxes; b, employ workers; c, produce goods.
14. An effective and indispensable part of "supply-side" macro-economics. Fights unemployment by promoting land use and investment.
15. Base is non-erosive, non-migratory.

16. Implements Haig-Simons by taxing unrealized capital gains, inherently and automatically.

17. Imposes a Performance Standard on landholders: "What have you done with the Golden Talents" which society has placed in your stewardship?

18. Does not discourage new investment (especially if capital is exempted).

19. Focuses on unearned income, which places one on a higher plane of well-being than the equivalent earned income since one has the leisure to enjoy it.

(More on this in "The Economics of Abundance," on reserve)

Sharpen up; distrib. to class

1

THE PROPERTY TAX

Major points, Ec 132, orig. F86, minor changes W92

A. Base, rate, and taxable event

Base

1. 4 kinds of property: land, improvements, personal (tangible and intangible). Meaning of real estate; secured and unsecured rolls; furnishings and fixtures; possessory interests; state-assessed property; Board of Equalization.

2. Assessment of the Base. Constitution stipulates market value. Assessors also use capitalized income method, and historical cost, resulting in discrimination. Slow assessment cycles and lags behind market value. Institutionalized lag: Calif. after Prop 13. (See appendix on self-assessment.)

3. Assessment discrimination

4. Preferential assessment

5. Exemptions

6. Aggregate values: a \$7 trillion base

7. Fractional assessment, the assessors' defense mechanism. Smoke and mirrors. Irene Hickman and the California Constitution.

Rate

1. Wide range of rates in U.S.; mean around 1.4%; effect of Prop. 13.

2. Nominal vs. real rates: games people play

3. Effects of high rates: how values adjust, investment remains profitable at lower level of land values

4. Tax shifting and tax capitalization

5. Why rates are higher and lower than they look

Higher than they look because:

a. Tax based on lump value, not current flow

b. Undiluted by inflation, (unlike i.r.).

Lower than they look because:

- a. Fractional assessment
- b. Conventional underassessment of rising values
- c. "Capitalization" means taxing only the after-tax value
- d. Assessment lag
- e. Deductible from income tax, even though much of the corresponding income not taxed currently, or ever

7. Why effective rate depends on interest rate

8. How to find the real interest rate, using the property tax rate as a tool

9. Graduated rates are uncommon

10. Classification and differential rates

- a. Minnesota system: several classes of real estate
- b. Southeastern system: homestead exemptions
- c. Pennsylvania system: local option for exempting buildings wholly or partly, raising rate on land.

Taxable Event

1. Based on holding, not doing. Reversing the love song theme, this tax is "not caring what you are, but just what you own"; (and thank you, Tommy Dorsey, for "There are Such Things")

2. Largely unavoidable because in rem, not in personam, and the land portion of the "rem" is not removable. Aliens pay, too; and offshore shelters don't cut any ice. Even Jimmy Goldsmith pays his share.

3. Simple collection enforcement: real estate is always hostage to the taxing jurisdiction of situs. Identify yourself, pay up, or the sheriff sells it.

4. Redemption rights and delinquency: more games people play

5. Automatic pass-through of rail and utility property

taxes in higher rates: turning property tax into a user tax.
 Effect on incentives of utility managers: removal of penalty on
 capital-intensiveness. Effect on rails: history of land-hogging.

B. Short History

1. Ancient

The oldest tax. Originally less a "tax" than a royal
 rent from the royal estate (hence "real estate").

Rome took tax in form of military service. This is
 inherently regressive -- smallholders gave us much as large
 holders. This wiped out smallholders and next the Roman Republic
 itself.

2. Feudal

Nearly universal in Europe and Asia. Land held subject
 to royal dues, often military service. William the Conqueror
 based dues on assessed values (The Domesday Book). Feudal basis
 of modern property law, land held from sovereign, subject to
 "servitudes", including taxation. Slow erosion of feudal
 principle in England over 9 centuries; new life in former English
 colonies.

3. American

a. Colonial Period

The main tax, especially in New England. William Bradford,
 Plymouth Plantation, land distribution and taxation. Contrast of
 English colonies with Spanish and Russian.

b. 19th Century

"The tax that won the west." Characteristically American and
 Western: an element of native radicalism as per Jefferson,
 Jackson and Lincoln, but at the local level mainly. Resident
 settlers vs. absentee speculators. The opposition exemplified
 by Livingston and Hamilton in New York. Franklin's attack on the
 Penn heirs in Pennsylvania. Developmental tendency: used to
 finance infrastructure.

Parallel usage in other Anglo colonies: Canada, Australia,
 New Zealand, E. Africa, Singapore, Hong Kong.

c. 20th Century

Gradually overborne by income, excise and payroll taxes.
 State subventions and Federal Revenue-sharing replace it at local

Page 4 missing from
Archive.

D. Allocational Effects

Define "effects" of increasing the property tax.

1. Hold public spending constant and reduce other taxes.

Land tax is stimulating and developmental. An unusual "incentive tax" that motivates rather than drags.

Building tax:

a. In open economy is shifted to land (the Physiocratic model of Quesnay et al.), reducing in the process the capital-intensity of use. Sometimes reduces, sometimes increases labor-intensity of land use, as labor is substituted for capital.

b. In closed economy, reduces the RRAT but in a manner nearly neutral. The "Harberger" model, (although many others preceded him). This is currently often called "the new view" of property tax incidence, although "revived" or "exhumed" would be more accurate. It puts the supposedly conservative Chicago School (which Harberger represents) in the position of justifying heavy taxes on capital. This is not just an accidental deviation from the conservative stereotype, but is more consistent with Chicago's traditional effort to identify capital and land. Harberger in effect is treating the capital supply as fixed, just like land.

c. In partial equilibrium analysis, one form of capital is taxed while others are not. This reduces supply and tax is shifted forward, like an excise tax. These are called "excise tax effects." Models like this come from Musgrave and Netzer.

Tax on personal (movable) property

Much movable property escapes assessment. Uniformity is impossible; bias results.

2. Hold other taxes constant; increase spending.

Results depend on circumstances: how productive and useful is public spending? Are we short-changing schools and other people-services and falling behind other nations?

James Buchanan's view: all public spending is wasteful, so the best tax is the most destructive tax because it will raise the least revenue. (Curiously, Buchanan has spent his entire career teaching at tax-supported schools.)

Marshall's "onerous" vs. "beneficial" taxation, and its

modern implications: tax property only for services to property, not to people.

Social dividend view: assert the public equity in property through taxation and spread the benefits around.

Feudal view: military spending is a service to property and property should support it. "Custer died for your sins," so don't just ask "what have you done for me lately?"

E. Distributional Effects

1. Allegations of regressivity
2. History of being regarded as progressive and "levelling." Bradford; Madison; Paine; Hamilton; Livingston; Quesnay; Du Pont; Franklin vs. the heirs of Wm. Penn; Patroons in New York, Patronos in California; resistance to organizing counties, incorporated municipalities, and taxing districts with universal suffrage; voter exclusion; Adam Smith, J.S. Mill, Henry George; Tom Johnson, Brand Whitlock, Newton Baker, cheap transit and civic revival, 1900-20; exporting tax ideas to LDCs after WWII; applications in Japan, Taiwan, Korea, Singapore, Hong Kong.
3. Contract vs. organic theory of government. "Benefits received" construed narrowly and broadly.
4. Maladministration: regressive assessment.
5. Balkanization. Low-tax enclaves in California. Fallacy of identification: enclaves of low income taxation in Wisconsin.
6. Concentration of property holdings. Dependence of high incomes on property sources. Especial concentration of unrealized "capital gains" which escape income tax but not property tax.
7. Regressive use of property. Slow sales by large holders.
8. Bias in partial inventories of wealth. Diversified large holders. Multi-national holders escape much income tax, but not property tax.
9. Allegations of forward shifting: Musgrave, Netzer.
10. High share of real estate is land: 45% of assessed value, probably 65% of true value (using building-residual method of separating).
11. Tax on capital not generally shifted forward, but downward. Still a tax on property.

12. Regression Fallacy. The Procrustean Bed of "income", a catchword that has obscured analysis for 50 years. The use of AGI as the criterion of "like circumstances", horizontal equity and vertical equity.

13. Defining income properly. AGI is after loopholes, and no index to real income. Property income in various forms largely escapes AGI, and property provides loopholes to shelter other income.

14. Property taxes are not proportional to rents but to capital values, which are progressive w.r.t. rents.

15. Appreciating land is most closely held of all assets, and free of all but property taxes.

F. Central Government and Local Incentives

1. Social dividends issued nationally or statewide tend to make local governments compete to attract people.

2. Kinds of partial social dividends: G.I. Bill; loans with per person limits; school aids based on ADA; HEW payments; social security payments (not taxes); cash payments (e.g. Alaska); reapportionment according to population.

3. Competing for a fixed population is zero-sum, population-wise; but increases bargaining power of the movable population vis-a-vis holders of immovable property.

4. New move in Congress to assume more people-aids; shift more property aids to locals.

5. Negative social dividends: payroll tax; most of personal income tax; conscription; sales tax (except the portion shared locally); etc. Any exported tax based on population and/or activity acts as a negative social dividend. Marshall's "onerous" tax concept again.

6. Mandated county welfare spending, maximizes fear of "swamping the lifeboat." Turns local property tax into a "tragedy of the commons", one step removed. Kicking MediCal around.

7. The current imbalance: Feds subsidize land development while extracting negative social dividends. Result: exclusionary local zoning.

8. People-based revenue sharing formulae in other Federal states: Canada; West Germany.

G. Summary of rationale for property tax

1. Simultaneously progressive and incenting, resolving greatest trade-off in tax policy
2. Strikes surgically at non-functional source of economic power, exempts functional income. Implements the productivity theory of distribution and the Puritan ethic, at least w.r.t. labor. Exempt capital and it also implements the ethic w.r.t. saving.
3. Promotes intergenerational equity. Other taxes strike upward mobility.
4. If "Custer died for your sins" this tax makes us pay for our sins. (Alternatively, give it all back to the Indians and then tax it heavily.)
5. Is part of implied social compact -- or the actual Mayflower compact, as implemented by Bradford.
6. Promotes all three kinds of equity: functional; egalitarian; and market. And a fourth kind, too: interregional equity.
7. Penalizes cartels for holding excess capacity.
8. Is the effective seller motivation that keeps land markets from turning to glue. Moving the market reduces need for people to hold advance reserves.
9. Recoups for public the benefits of public works.
10. Moves landholders to respond quickly to new opportunities, e.g. from new extension of public works.
11. Offsets boom and bust in land markets (if assessors move quickly with the market).
12. Offsets major loopholes in the income tax.
13. Compensates those who missed out (or whose ancestors missed out) on the original political distribution of land by moving landholders to use land to: a, pay taxes; b, employ workers; c, produce goods.
14. An effective and indispensable part of "supply-side" macro-economics. Fights unemployment by promoting land use and investment.
15. Base is non-erosive, non-migratory.

16. Implements Haig-Simons by taxing unrealized capital gains, inherently and automatically.

17. Imposes a Performance Standard on landholders: "What have you done with the Golden Talents" which society has placed in your stewardship?

18. Does not discourage new investment (especially if capital is exempted).

19. Focuses on unearned income, which places one on a higher plane of well-being than the equivalent earned income since one has the leisure to enjoy it.