Two Property Tax Relief Measures: Land Value Taxation to Stabilize and Deferral as Provisional Tax Relief

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The property tax structure in New York, as in most other places, has many problems, but with a bit of attention and tweaking it could be the perfect tax. I've written extensively on this, about a hundred articles,[1] but I will deal with only two matters here. I want to address what has often been called the "poor widow" problem,[2] the person who fears being expelled from her home by lack of ability to afford her property taxes.

First one must understand that the property tax is really two taxes to an economist, a tax on land values and a tax on improvement values, each with its own dynamic. We should just get rid of the tax on improvements, now something easy to do in light of new computer assessment technology and what we know about the destructive impact of taxing them.[3] Experience shows that doing so is the most effective tool available to revitalize economies. But, along with many others, I have dealt with that elsewhere.

The tax on land value can be corrected with better assessments,[4] shifting the rates, and allowing for payment at a time when it is not burdensome. But one has to understand what land value is first of all. Then one can understand a land value tax and its virtues.

The value of any parcel site is a function of the flow of what classical economists know as ground rent.[5] Ground rent, or economic rent, is different than rent for payment for using a house or car. More importantly, it reflects the economic vitality of a neighborhood or a region and has nothing to do with what any one titleholder does or doesn't do on his property. If all the market transactions and productivity were to leave a place, there would be no rent to flow and the land values would fall to zero. One can no more alter or eliminate the flow of rent in any area than one can stop the force of gravity. The more productive enterprise a region has, the higher the flow of rent.

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1 Most of them can be found on www.urbantools.org, www.schalkenbach.org, www.cooperativeindividualism.org, www.wealthandwant.com, www.progress.org, or by searching my name at www.askhenry.com.

2 "Property Tax Relief Measures: Answers to the 'Poor Widow' Argument," Prepared for the Center for the Study of Economics, Philadelphia, at www.wealthandwant.com/docs/unindexed/Batt_poor_widow_solution.htm

3 What is commonly known as Land Value Taxation, or the "Two-Rate" tax, is described extensively at www.urbantools.org. Several of my articles on the sites above discuss this approach at length.

4 "Equity in Assessment Practices," Testimony prepared for the New York State Assembly Property Tax Committee, 6, February, 2007 at www.cooperativeindividualism.org/batt-h-william_on-equity-in-assessment-practices.html

5 Many of the concepts discussed in this presentation are rooted in the framework of classical (as opposed to neoclassical) economics and may not be familiar to the reader. There is an extensive list of such concepts and terms, linked to articles discussing them, at the Wealth and Want website: See http://www.wealthandwant.com/themes/aa_all_themes.htm

People in this country, even many economists, don't understanding that rent is a flow; they often think of land value as a stock, like a house, or a car, or an industrial plant. It is actually more like a river, or an emission from a radioactive mineral. Viewed in this way, land sites, just like other natural resources like water, air, the spectrum, and even occasionally time; all have a yield value, even when they are not used. That's because the value is reflective of the broader community's activity.

The total value of rent flow through a location is a constant. It can be broken up into pieces, however, and this offers us a solution: whatever is not paid in a land tax, which is really an expression of rent recapture by the community, is then capitalized in market price. The volume of rent can be captured all at once or over a period of time. The assessment of land is its capitalized rent flow, and this is clearly manifest when a parcel is bought and sold. It is also reflective of capitalized transportation costs.[6]

Because the flow of rent is constant and continuous, the more that is captured in taxes, the less remains to be capitalized in a site's market price. If the tax on land value were totally abolished, all the rent would accrue to parcel sites and escalate their market price accordingly. Relieving households of the burden of their property taxes through caps, circuit-breakers, homestead options, or any other exemption simply results in the increased flow of rent to, and ultimately the market price of property. But the higher the cost of real estate, the less attractive a location becomes to outsiders: areas of California, to take one example, have become prohibitively expensive. When property prices escalate beyond what the flow of rent dictates, speculators move in to generate bubbles of expectancy, resulting in even higher prices than what the community's productive enterprise is able to generate. Ultimately there comes a corrective, even a crash – witness what Japan experienced and what we may be going through now, and that downward slide can be as economically painful as the initial euphoric rise in parcel prices earlier.

So, one way to maintain a viable and stable economy is to tax land according to its market value and even out site values. The higher the payment in taxes, the lower the market prices for land sites. From a strictly economic viewpoint, taxing all the economic rent would lead to a sale price of zero and a rental value commensurate with its continuing flow, and this creation of a perfect market for locations would foster very healthy economies. It could totally supplant taxes on wages and capital that result in so much lost productivity and economic drag (Economists call this deadweight loss.) The reality is that rent, left to stick in parcel sites, often "gums up the works" in a way that

6 See my article "Stemming Sprawl: The Fiscal Approach," Chapter 10 from the book, Suburban Sprawl: Culture, Theory, and Politics, edited by Matthew J. Lindstrom and Hugh Bartling; Rowman & Littlefield Publishers, Inc., 2003. Reprinted with permission from the publisher. All rights reserved. Online at www.cooperativeindividualism.org/batt-h-william_stemming_sprawl.html

slows down markets and makes economies less efficient. Better to remove it, and taxing it away is the best way to do so. Significantly, one might note, those governments that employ land value taxation have weathered economic cycles most easily of all places.

Ultimately, all tax burdens are shifted to land in any case, as Professor Mason Gaffney so clearly explains: “After-tax interest rates are determined in world markets and the local supply of capital funds is highly elastic. So, local taxes on capital do not stick to capital. Even national taxes on capital typically fail to stick, because capital is a citizen of the world. Local labor supplies are also pretty elastic, although not so totally. Local taxes on labor, therefore, do not stick to labor, either. Payroll taxes drive people out of localities that impose them, for example. Ditto for sales taxes. Customers move, or shift their purchases, to where taxes are lower, or zero. Sellers shift, too, to the extent they bear the tax. What else is left? Just land, and land cannot emigrate or immigrate from the local jurisdiction.”[7] Professor Fred Foldvary follows up by asking why not just put the tax on land from the start and improve economic efficiency.[8] Finally, because a tax based solely on rent would supplant taxes on wage labor, and on products of people's hands and minds, it would be on windfall gains only, and be essentially painless.[9]

But that's not likely to happen, at least soon. What we can do, however, is 1) foster economic vitality by phasing out taxes on improvements, 2) shift the burden to land values in a revenue neutral manner, and 3) allow households to pay their property taxes when they have the means to do so -- when they cash out. They would do this when they sell their property, paying a portion of the gain to the community along with any interest due. Some 24 states and the District of Columbia do this, and it is the fairest solution of all. How can this all be implemented?[10]

By state law, assessors must separate out the land value of each parcel from its total value. This is standard assessment practice. Economists have known since the time of Adam Smith that taxing just the land value is the ideal way to raise revenue. “Ground-rents,” he avowed, “and the ordinary rent of land are . . . the species of revenue which can best bear to have a peculiar tax imposed on them."[11] Some 700 places worldwide do this, with remarkable results.[12] In Johannesburg, there is no tax on buildings at all. So,

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7 This author's personal (email) communication with Professor Gaffney in December, 2001, quoted in “The Nexus of Transportation, Economic Rent, and Land Use,” at www.wealthandwant.com/docs/Batt_Nexus_TERLU.html

8 Fred E. Foldvary, “The Ultimate Tax Reform: Public Revenue from Land Rent,” CSI Policy Study, Civil Societey Institute, Santa Clara University, January, 2006. Downloadable at cse@sci.edu and the SSRN document website.

9 H. William Batt, “Painless Taxation,” my submission to the President's Advisory Panel on Federal Tax Reform, April 24, 2005, www.wealthandwant.com/docs/Batt_Painless.htm

10 Several studies of various state policies have been completed. Among them are those by AARP, NCSL, and, most recently by the staff of the Property Reappraisal Committee of the State of Montana, 2004. See http://mt.gov/revenue/legislativeinformation/propertyreappraisal/finalreport/Addendum%20J.doc

11 Adam Smith, *The Wealth of Nations*, (1776) Bk.5, Ch.2, Pt.2, Art.1.

12 Robert V. Andelson, *Land-Value Taxation Around the World. American Journal of Economics and Sociology*, Vol 59. No. 5

effectively, does Hong Kong. Twenty cities in Pennsylvania do it,[13] and the power of computers and available data now allow simulation of results so it's no longer a matter of just appreciating the economic theory. It's not my place to reveal anything, but I'm now working with two cities in New York State exploring this option. Gradually phasing out of the building tax rate and raising the land tax rate in a revenue neutral manner could be done in a decade. If the assessments are good, about 2/3 of homeowners pay less. Parcels underused relative to their assessed land value pay more. This gives them an incentive to improve their parcels or sell to someone who will.

The deferral option is fair to both the homeowner and the community. Relieved of any fear that the tax collector will evict a household, it can live assured it can reside in place so long as it wishes. This addresses the concern that many households may be very equity rich, even if they are income poor. It also assures that the locality will ultimately, even if not immediately, receive its fair share of property taxes due; no special favoritism is involved. The capital gain when a parcel is ultimately sold provides the income necessary to pay the tax office with appropriate interest.

One should appreciate that the deferral provision is not only fair and accommodating, it also comports with all the textbook principles of sound tax theory. As I've explained often elsewhere, deferral of payment is neutral, efficient, equitable, administrable, stable, simple, and certain.[14] This is important at a time when we have come to realize how much the property tax fosters sprawl development,[15] leads to under use of strategically valuable site parcels urban cores, how much it fosters real estate speculation, and how much it dis-equilibrates the whole market in housing.

I won't go into detail on the various formulas and permutations of the deferral option that states employ; I have sent the staff some material on that. Sometimes only homeowners beyond a certain age can defer their property taxes. Sometimes there are income caps and thresholds for eligibility, sometimes it is restricted to homes below a certain assessed value, sometimes only a portion of the tax can be deferred or only a certain component-- school and not municipal, special assessments and not utilities. Sometimes the provision is statewide, sometimes it is a local option. It is interesting to see that some states impose an interest rate on deferred obligations so high that it prohibits its extensive use -- 10% in Tennessee, 8% in Texas. I think the option should be broadly available, and interest rates reasonable.

(Supplement, 2000), and Blackwell Publishers, 2000.

13 See the work of the Center for the Study of Economics, Philadelphia, at www.urbantools.org.

14 See my articles, "The Merits of Site Value Taxation," originally presented at St. John's University, Proceedings, Conference: Taxation Alternatives for the 21st Century, New York, NY, September 30, 1999 – October 2, 1999, on line at www.wealthandwant.com/docs/Batt_Merits_SVT.html and "Principles of Sound Tax Theory," www.progress.org/cg/battprincip02.htm

15 See "Stemming Sprawl," cited earlier, at www.cooperativeindividualism.org/batt-h-william_stemming_sprawl.html

Some observers compare it to a reverse mortgage, but experience shows that there are many more abuses involved there, and it is frequently far more burdensome financially.[16] There may also be concern that municipalities might incur a transitory deficit when many households first avail themselves of the option. Some states have allowed a bridge loan from state sources until revenue streams have once again stabilized. A bond backed by the same necessary liens against properties are another answer.

Yet the deferral option, where legal, is not extensively employed. This is because homeowners often don't want to forfeit any of the equity they might have built up in the course of many years of ownership. People often see any home appreciation as their rightful gain. The availability of the deferral option, however, exposes those who are shedding crocodile tears about their property tax burden while salivating over future windfall gains, as opposed to those who may have a genuine hardship. Here is why:

Houses, a Federal Reserve study[17] shows, depreciate at about 1 percent annually, so that net appreciation a home typically has is due to the appreciation of the land value and any inflation. Again, buildings depreciate; only land appreciates. I have already explained that the land value is a function of the flow of economic rent, and has nothing to do with what the titleholder has done; rather it is due to the social enterprise of the community. The community's recapture of land rent in the form of taxes is, morally speaking, a claim of what it, the public, is properly due. Even if the real estate industry and banks argue that homeownership is an assured way to "build equity," the parcel title provides a passive that gain is morally problematic. "Landlords," John Stuart Mill observed, "grow richer in their sleep without working, risking or economizing. The increase in the value of land, arising as it does from the efforts of an entire community, should belong to the community and not to the individual who might hold title."[18]

Offering homeowners the opportunity to pay taxes on their property with appropriate

16 See Residential Reverse Mortgage, a commercial agency, at www.reverseny.com . See also the National Reverse Mortgage Lenders Association, at www.reversemortgage.org , and the website for the US Department of Housing and Urban Development, at http://www.hud.gov/buying/rvrsmort.cfm . "More San Diego seniors jumping on reverse mortgage train," Mon Jul 28, 2003, San Diego Daily Transcript, "Reverse-mortgage market zooms forward: Plenty of new products are emerging, but consumers still need to be wary," *Marketwatch*, June 21, 2007; "Owning a home: from money faucet to drain," by Froma Harrop, *Creators Syndicate*, July 06, 2006; "Cash poor and house rich: Reverse mortgages can unlock money for those in a pinch," by Bruce Mohl, *Boston Globe* March 21, 2004; "A mortgage tailor-made for seniors," Robert Bruss, *Tribune Media Services*, November 1, 2002; "Living Large On a Mortgage Of Last Resort: Tool Designed to Cover Basic Needs Of Retirees Is Used Increasingly For Second Homes, Luxury Items," by Kelly Greene, Staff Reporter of *The Wall Street Journal*, April 26, 2005; Page D1.

17 Morris A. Davis and Michael G. Palumbo, "The Price of Residential Land in Large U.S. Cities," Finance and Economics Discussion Series, Washington: DC: Federal Reserve Board, 2006. Also, John P. Harding, et al., "Depreciation of Housing Capital, Maintenance, and House Price Inflation: Estimates from a Repeat Sales Model," *Journal of Urban Economics,* Vol. 61, No. 2 (March, 2007);

18 *Principles of Political Economy,* bk.5, ch.2, sec.5.

interest and at a convenient time in their lives is a fair and equitable solution to both the community and to all households at risk. Taxing away the surplus economic rent that runs up the parcel values to prohibitively expensive and speculative levels assures that real estate markets are more stable, more competitive and attractive on a wider scale.

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