POLICY ISSUES ON THE INTRODUCTION OF LAND/SITE VALUE TAXATION

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OUTLINE OF PRESENTATION

- Economics principles for designing a good tax
- What are site/land value taxes?
- Why tax only site/land value?
- Where is site/land value taxation used?
- What is the impact of site/land value taxes?
- What are the challenges with implementation?

Economic Principles for Designing a Good Local Tax

ECONOMIC PRINCIPLES FOR DESIGNING A GOOD TAX

- Equity based on benefits received
- Equity based on ability to pay
- Efficiency
- Accountability
- Stability and predictability
- Ease of administration

ECONOMICS PRINCIPLES VERSUS POLITICAL REALITIES

- "Tax policy is the product of political decision making, with economic analysis playing only a minor supporting role" (Randall Holcombe 1998).

- Political pressure to maintain the tax burden at or near its current level (e.g. capping increases) or to favour one group of taxpayers over another (e.g. over-taxation of business) often overrides economics principles.

What is a land/site value tax?

TYPES OF SITE/LAND VALUE TAXES

- **Site value:** land alone without consideration of privately financed improvements (e.g. excludes grading, drainage, etc.)
- **Land value:** limited to land value (including grading, drainage, etc.) rather than land and buildings
- **Graded property tax (two-rate; split-rate):** higher rates on land than on buildings
- **Single tax**: site value tax (at a confiscatory rate) serving as sole source of government tax revenue (Henry George, 1879)

Why tax only land/site value?

"The property tax is, economically speaking, a combination of one of the worst taxes – the part that is assessed on real estate improvements… and one of the best taxes – the tax on land or site value."

William Vickrey 1999
1996 Nobel Prize laureate in economics

EFFICIENCY

- Neutral tax: collects revenue without discouraging investment in new buildings
  - Fixed supply of land means land owner cannot reduce the supply of land even if price changes
  - Is supply of land fixed?
- Neutral tax: with respect to timing, location, and density of development (assuming base reflects highest and best use)

EFFICIENCY

- Neutral tax BUT a switch from a property tax to a land value tax would likely increase density and restrain urban sprawl
- Lowering tax on structures will encourage more structures on a given land area – greater density
- Potential problem: greater density would necessitate more infrastructure (e.g. transportation, schools)

EQUITY

- Because the quantity of land is fixed, the burden falls on the landowner with no opportunity to shift it others (can’t avoid tax by reducing the supply of land or using it less productively)
- Tax falls on landowner – progressive burden

- Taxes the “unearned increment,” the value resulting from community development; tax revenues go back to the community

Where is site/land value taxation used?

AUSTRALIA

- State tax on site value in all states (excl. Northern Territory)
- Local taxes on land value, rental value, total value
- New South Wales:
  - land tax under pressure because of rapid increases in values and high tax rates for land only tax
  - dearth of undeveloped sites makes values high for remaining sites
  - exclusion of primary residences lessens resistance

NEW ZEALAND

- Local choice over tax base:
  - Capital improved value
  - Land value only
  - Annual rental value

- Land value more prominent in rural areas; capital improved value increasingly more common in urban areas

SOUTH AFRICA

- Site value taxation no longer used

- Three possible reasons:
  - Major portion of wealth is excluded if improvements not included
  - Single uniform system replace three locally determined options
  - Difficult to find credible sales data in highly urbanized areas

Franzsen and McCluskey, 2008

UNITED STATES: GRADED PROPERTY TAX

- Pennsylvania, US: tax on land values ranges from 1.66:1 to 30:1 among the 16 communities that levy split rates
- Hawaii: graded property tax from 1963 to 1977
- Virginia: Fairfax and Roanoke permitted to use graded property tax but haven’t implemented it

What is the impact of site/land value taxation?

IMPACT OF SITE VALUE TAXATION: REGRESSION STUDIES

- **Mathis and Zech (1983)** found no relationship between land value tax and level of building activity across Pennsylvania municipalities
- **Bourassa (1990)** found land value tax had significant impact on residential building activity in Pittsburgh but not other two cities
- **Oates and Schwab (1997)** found impact of tax on building permit activity in Pittsburgh (but city launched economic development campaign at the same time)

IMPACT OF SITE VALUE TAXATION: REGRESSION STUDIES

- **Plassmann and Tideman (2000)** found that a split-rate tax in Pennsylvania results in a 3% to 4% increase in residential construction

- **Lusht (1992)** found higher levels of development in communities around Melbourne with land value taxation (choice of communities may be a problem)

IMPACT OF SITE VALUE TAXATION

- Studies of impact on development are inconclusive
- Studies do not control sufficiently for nontax influences on building activity e.g. economic development initiatives; planning and zoning regulations, etc.
- Should taxes be used to encourage development?

"Rural land reform, the control of urban land speculation reaping land value increments for public purposes – all of these are worthy objectives. But attempts to achieve them indirectly through clever design of fiscal instruments may at times be counterproductive and have almost always proved not to be worth the effort."

Bird and Slack, 2006

What are the implementation challenges?

REVENUE ADEQUACY

- Is the tax base too small to generate sufficient revenue?

- Revenue adequacy depends on:
  - Revenue needs
  - Ratio of land value to total property value
  - How high tax rate can go without confiscating all of the annual land rents

HIGH RATE OF TAX

	Tax on land value (land valued at €60,000)	Tax on Improvements (valued at €180,000)	Total tax
Property tax @1%	600	1,800	2,400
Split tax rate (2.5% on land; 0.5% on improvements	1,500	900	2,400
Land value tax @4%	2,400	0	2,400

ASSESSMENT CHALLENGES

- Many jurisdictions require assessment of land and improvements separately
- With similar tax rates, need for accuracy in components less pressing; only total value matters
- With two-rate system, both components need to be assessed accurately
- Sales of unimproved land are rare, especially in highly developed urban areas

ASSESSMENT METHODS

- Residual method: assess market value of property and subtract cost of replacing building and improvements
- Allocation method: assumes land values are same % of total value for every property
- Contribution method: CAMA can break down sales prices into values contributed by location, lot size, age, etc.; use GIS to define neighbourhoods with roughly the same land values per acre

ASSESSMENT REQUIREMENTS

- Uniform assessments with respect to market value of land
- Frequent reassessments
- Public understanding of assessment methodology

IMPLEMENTATION CHALLENGES

- Less easily understood by taxpayers – they know the value of their property but do they know the value of their land?

- Transition from property tax to land value tax: existing taxes are built into expectations and decisions – where to live, how much to spend on a house, etc.

IMPLEMENTATION CHALLENGES

- Winners and losers – those whose ratio of land to total property value equal to the average of the jurisdiction will face no change; parcels with above average land % will face increases
  - Car dealerships and parking lots will pay higher taxes; owners of high-rise office buildings will pay lower taxes
- Land values more volatile than improvement values

IMPLEMENTATION CHALLENGES

- May need enabling legislation
- Shifts within and between property classes
- Need broad coalition of support
- May need to phase in land value taxation
- May need to offer tax credits to protect owners of modest properties with high land intensity

FINAL COMMENTS ON SITE/LAND VALUE TAXES

- Popular tax with economists on efficiency grounds: tax on land is less distortionary than tax on improvements
- Problems with moving from tax on land and improvements to tax on land only
  - Assessment problems
  - Revenue adequacy
  - Winners and losers
- Declining use around the world as more and more countries move to capital value taxation