

This paper, which we shall publish in two parts, examines various essential elements, in both the practical and philosophical spheres, of site- or land-value taxation.

This first part outlines differing individual views of the tax, considers the shift in burden that it implies and defines the basis of its assessment.

In our next issue, the author examines in further detail the practical consequences of site-value taxation and the way in which it measures up to criteria of sound taxation.

THERE is a great interest stirring currently in Canada and elsewhere in tapping for the public revenues more of the economic rent of natural resources and/or the unearned increment of land values. "Economic rent", not long ago a strange alien wording, has become common currency in Canadian discussion.

Individuals react to these proposals in a variety of ways, depending in part on their individuality; but also, it seems, depending on what they take the proposal to be. My purpose in this paper, therefore, is not to defend or attack site-value taxation but rather to define it. The spirited debates of the past on this topic rather resembled those among the four legendary blind men who examined different parts of the elephant.

I will take a position on two introductory points in order to dispense with them. First, is it administrable? The answer here is clearly "Yes." It entails the use of the same property tax assessment and collection machinery that already exists. Techniques for assessing land have been extensively applied and discussed in works of which I will cite those below.\* This is not to say we should adopt the policy but merely that we need to decide on some basis other than workability.

\**The Assessment of Land Value*, edited by Daniel Holland, (Madison: University of Wisconsin Press, 1970.) and J. F. N. Murray, *Principles and Practice of Valuation*, (Sidney Commonwealth Institute of Valuers, Fourth Edition, 1969.)

# What is Site-value Taxation? (Part I)

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From a paper *The Many Faces of Site-value Taxation* delivered at the Canadian Tax Foundation, Quebec

Second, the question is often raised, "Would it have any effects anyway?" Here again the answer is clearly "Yes." It would have substantial effects on the incentives to develop and improve land, the time of decisions and so on. There are a few studies suggesting the policy has little effect but these were studies of cases where there was actually little or no policy to cause any effect.

## What is site-value taxation?

There is no one simple "thing" called site-value taxation. It is a bundle including several elements, and each element is variable along a spectrum of degrees. The possible combinations of elements and degrees is unlimited. No wonder the blind men got into disputes about the structure and dimensions of the elephant. One person takes it to be a radical revolutionary proposal to destroy private property. The next one takes it as a minor modification in a tax system we always had. A third takes it as a tool of city planning. A fourth sees it as the only way to make free enterprise work. Let's hold off any such sweeping characterizations and look at the elements, piece by piece.

Element No. 1: A higher share of the total tax burden would come from property, mainly through "the property tax." Site-value taxation is not just the absence of taxes on buildings; it is the presence of taxes on land.

Element 1 clearly is not present in the case of Hawaii, for instance, where the property tax was recently modified to exempt part of building value. Over the last fifteen years a substantial respectable body of economic literature has appeared which emphasizes the social advantages of exempting buildings from the property tax without necessarily taxing land to compensate. More recently the trend has been to emphasize instead the advantages of imposing

heavier taxes on site value, and reducing income and payroll taxes on wages and salaries.

Element No. 2: A higher share of property tax revenues should come from "land"—broadly construed—and a lesser share from buildings, improvements and capital generally.

Capital should be exempt from the property tax, in whole or in part. Capital means buildings, but capital also includes roads and street improvements, intangibles like knowledge, machinery, personal property, and so on.

Element 3: The assessed value of land for tax purposes would be based more on its capacity to serve, as opposed to actual current use. This is related to, but different from, the question of using market value as opposed to use value, because market value also includes the speculative premium.

The use of capacity-to-serve, as opposed to actual-use, in assessing land values may be carried to various degrees, and is, in different assessment jurisdictions. A great deal depends on assessment practices determined by law, the disposition of courts, local political pressures and professional standards.

Capacity to serve means to serve in the highest currently economical use. That doesn't mean the highest use that may become economical in the future, but today. Neither does it mean the use yielding the highest gross return, but the highest net return.



Subject to those two constraints, it still often is higher than the existing use. The idea of site-

value taxation is to base tax liability on that capacity to serve.

Another constraint on the assessment is zoning. The highest



capacity of land to serve may be forbidden by zoning. This poses no serious assessment problem provided the zoning is credible. The assessor simply rules out what would be the highest use in the absence of zoning.

Site-value taxation makes this whole question more critical inasmuch as zoning becomes a more important limitation on assessments. This might be interpreted as a strike against site-value taxation because of the problems it creates. On the other hand it might be construed as a point in its favour since it would force a correction of the zoning practices which create the problem, along with many others. Partisans of site taxes have claimed that site taxes can make zoning work better by goading the holders of land with high zoning to satisfy the demand for which they are zoned, thus removing pressure toward excessive and premature zoning elsewhere.

To identify the capacity to serve carries us frequently into aspects of the land market which most people rarely think about. One of these is "plottage" which is the increment of unit land value achieved by assembling small parcels into a larger one where the larger one is the optimal size and shape. It is often very difficult to assess unrealized plottage and it is often considered unfair that it should be assessed. Yet the assessment of unrealized plottage could be a tool to help lubricate the land market, which sorely needs lubricating. When we do assess unrealized plottage we make it that much easier to realize it, since the assessment brings uniform pressure to bear on all owners to come to terms with each other, and it is very much to their mutual advantage to do so. Thus, there is in the situation

an element of feedback: doing something that seems unfair when it is not done, by virtue of being done, becomes more fair. It is not hard to imagine the different emotional and philosophical buttons which this set of issues pushes in different individuals, and it has, raising questions which we will not try to resolve here.

The question is presented in clearer form when the plottage increment is negative, which is when the land needs to be subdivided, rather than assembled, in order to maximize the unit value. Here one individual landowner is in control and cannot blame his failure to maximize unit values on the refusal of his neighbours to cooperate.

Capacity to serve might be expressed as an annual figure and occasionally is, or it might be expressed as a capitalized value, as it normally is. In either case the essential point is that the tax should be *independent of what the owner does*. Most taxes are activity based and require a taxable event. Property taxes fall due with only the passage of time. Property taxes on buildings, of course require that the building be constructed and that is a sort of taxable event. Taxes on site value require no taxable activity whatever.

The difference in incentives to the taxpayer is sharp. The site-value tax adds nothing to the variable costs of developing or using land. The result is that the landowner will develop the "intensive margin" of his land more fully. In respect to mineral deposits, for example, we often hear that the imposition of a royalty, based on gross production, causes "high grading". The royalty adds to the marginal cost of extracting low quality ore and so raises the cut-off grade. A site-value tax applied to mines, on the other hand, would be based on the value of reserves in place, levied at a constant amount regardless of the amount of ore extracted in a given year. It would not raise the cut-off grade.

In respect to urban buildings likewise, the exemption of buildings from the property tax lowers the cut-off grade. It results in owners' adding marginal increments of size and quality which

would have been submarginal if taxed.

Most taxes other than the site-value tax are synchronized with the taxpayer's liquidity. The site-value tax is not so designed, either in philosophy or application. It is in vain to criticize it because it is inconvenient for some landowners to raise the cash to pay it. It is not supposed to convenience such landowners. On the contrary, its philosophy is that the landowner owes society something for the privilege of holding a piece of the limited surface of this small planet, and an annual required cash payment is calculated to inconvenience him into using his land so as to render service to others and offer employment to others, many of whom may not own land. One may subscribe to that philosophy or not, but that is the issue rather than the issue of convenience to the taxpayer.

Untaxing improvements and untaxing activity on land is permissive of higher uses; taxing land as a positive step adds pressure to utilize land. The combination undoubtedly pushes or pulls land into higher uses. That may or may not be universally desirable—it all may boil down to an issue of when and where. In any case site-value taxation is oriented towards encouraging and goading landowners to use land more intensively.

*To be continued*

#### LANDED GENTRY

**T**WO and a half million pounds, a castle and 60,000 acres of Scottish land was the inheritance of twenty-two year old Duke of Roxburghe. He is to marry Lady Jane Grosvenor, daughter of the Duke of Westminster whose fortune, estimated at £300 million, includes 300 acres of Mayfair and Belgravia and 136,000 acres in England and Ireland.

The Duke hopes to take a course in economics at Cambridge next Autumn where he should have the opportunity of contrasting Marx and Keynes with Ricardo and George.