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## THE NEW UNEARNED INCREMENT TAXES IN GERMANY.

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UNEARNED increment and means of reaching it by taxation have long been favorite subjects for discussion among economists and students of public finance. Frequently the justice of such schemes is sharply attacked, and many practical objections are urged against them, as, for instance, the extreme vagueness of the concept of unearned increment, the great variety of forms in which it appears, the consequent difficulty of proper assessment, the absence of popular demand for fiscal measures of this sort, and so on. With regard to certain kinds of unearned increment doubtless these difficulties will prove insurmountable for a considerable time at least, but, on the other hand, the recent rapid development in Germany of the so-called *Wertzuwachssteuer*<sup>1</sup> proves pretty conclusively the practicability of tapping the unearned increment on land. The novelty of the principle involved, the extended literature that has already sprung from its discussion,<sup>2</sup> the variety and comparative value of the forms it has assumed, and, finally, the possibility of adapting it to American conditions should justify a brief discussion of the subject.

1 Literally, "increase of value tax." Unearned increment tax, however, seems closer to the English idiom.

2 Two excellent systematic treatises have appeared: Robert Brunhuber's *Die Wertzuwachssteuer, Zur Praxis und Theorie*, (Jena, G. Fischer, 1906, 118 pp.); and Karl Kumpmann's *Die Wertzuwachssteuer* (Tubingen, H. Laupp, 1907, 124 pp., *Erganzungsheft XXIV, Ztschr. f. d. ges. Staatswissenschaft*). The two volumes of the *Jahrbuch der Bodenreform* issued by A. Damaschke (Jena, Gustav Fischer, 1905, 1906. 320 pp. each) contain several valuable essays and many reprints of original documents. To the above mentioned works the writer is indebted for a large part of the materials presented. An extremely abundant pamphlet and periodical literature has also been drawn upon and referred to in footnotes. For a bibliography see *Mitteilungen d. Zentralstelle d. deutschen Stddtetags* (Berlin), No. 1, 1907, pp. 10 and 11.

Curiously enough the first practical application of the new principle to land taxation was made by the Navy Department of the German Imperial Government. Shortly after the seizure of Kiao Chau in 1897, the admiral in charge caused a careful investigation to be made of land rentals, prices, and tenures in the territory under his control. By the payment to native holders of twice the amount of their annual land tax the government secured an exclusive option to purchase later, at prices prevailing at the time of seizure, any land it might desire within the limits of the colony. Extensive tracts suitable for city and harbor building were then bought in, and on September 2, 1898, a thorough-going land and tax ordinance was promulgated, with regard to which all that need be said here is that it provided for a tax of 33.3%, on the increase of value, apart from improvements, of land sold by the government to private parties.<sup>3</sup> The purpose behind all this procedure was to prevent speculators from snapping up desirable tracts and realizing large profits from an increase in their value, created largely, as it would be, by government expenditures for harbor and defence works, etc., and by privileges granted by the Empire to the new colony. Instead of this the land was to be held open at low prices that would attract bona fide settlers, the latter were to be assured the larger part of any future increase of values, while at the same time the government was to share to the extent of one-third in this increase. On Jan. 1, 1899, the budget of Kiao Chau came up for discussion in the Imperial Diet at Berlin and the policy of the new *Wertzuwachssteuer* included in it met with the warm approval of all the parties represented in that body except the Social-democrats.

3 For further details see Admiralitätsrat Dr. Schrameier's *Wie die Landordnung von Kiautschou entstand*. (Berlin, J. Harrwitz, 1902, Heft XIV, *Soziale Streitfragen*, 24 pp.) The original ordinance is reprinted in full in the *Jahrbuch der Bodenrefo*

Although not next in order historically, it will be well to consider at this point the action of the Diets of the various states of the German Empire that have taken up the

unearned increment tax.<sup>4</sup> Early in 1906, Prussia enacted a new County and Provincial Tax Act permitting the legislative bodies of the counties (Kreistage) to introduce the Wertzuwachssteuer. It was felt that a tax of this sort might prove exceedingly successful in counties where extensive railroad and canal building was going on, and particularly so in counties near large cities within which suburban settlements were growing up. One such county, Teltow, near Berlin, now has such a tax officially in preparation. In Bavaria a resolution was offered in the parliament of 1902 asking the government to introduce a bill applying an unearned increment tax of 20%, to all communes which showed a more than average rapidity of growth during the last census period, the sums yielded by the tax to be divided equally between commune and state. This resolution, and a somewhat altered form of it prepared a year later, failed of adoption, more on account of partisan politics and differences regarding details than because of the principle involved. In Baden the second chamber of the Diet unanimously asked the government on June 30, 1904, to submit at its next session a tax reform bill including an unearned increment tax. During the same year the government of Hesse introduced a bill permitting municipalities to establish the Wertzuwachssteuer, which passed the second house almost unanimously. The first house objected to certain matters of detail but did not vote the bill down, and it was returned to the government with a request that it be amended and resubmitted. A very sweeping bill was introduced by the Saxon government on Jan. 26, 1904. It made mandatory upon communes of more than 10,000 inhabitants the establishment of an unearned increment tax on land which was not built upon, and fixed in detail the rates of such taxation, rising to 25%, in case of an increase of value in excess of 50%. Under special local conditions smaller Saxon communes were also empowered to establish the tax with the consent of the proper supervisory administrative authority (Aufsichtsbehörde), and it was expressly provided that this consent must not be refused in case the petitioning commune could show itself to be suburban in character or to be increasing extraordinarily in population. With certain unimportant limitations communes were further empowered to employ the Wertzuwachssteuer on land that had been built upon. Although accepted in principal by the second chamber, certain criticisms were made which led the Saxon government to withdraw the bill, but in revised form it will be presented again at the next meeting of the Diet. To sum up the action hitherto taken by the legislatures of the German states on the new tax it may be said that five of them have considered its introduction in one form or another; one (Prussia) has approved it in facultative form for counties, in three the government is preparing new or amended bills for consideration, and in none has the new tax been beaten squarely on its merits.

<sup>4</sup> Except Bremen, which, although an imperial free city, may for our present purpose be considered simply as a city.

It is in the municipalities of Germany, however, that the unearned increment tax has

made the greatest progress. Under existing laws in some of the States, cities already possess the implied, if not the express, right, with the consent of the supervisory administrative authority, to introduce the Wertzuwachssteuer in indirect form<sup>5</sup>. Of this right extensive use has been made within the last few years. Beginning in 1905 with Cologne,<sup>6</sup> which enjoys an enviable reputation among German cities for its contributions to municipal advance along many lines, the Wertzuwachssteuer is now in effect in Dortmund, Essen, Frankfort a. M., Gelsenkirchen, Hanau, Liegnitz, Markranstadt near Leipsic, Zabrze O.—S., and in Gr. Lichterfelde, Weissensee and Zehlendorf, the last three being suburbs of Berlin.<sup>7</sup> The following cities have passed tax ordinances and are now waiting the action of the supervisory administrative authorities: Breslau, Emden, Jena, Kreuznach, Marburg a. d. Lahn, Naumburg a. S., Paderborn, Wetzlar, and the two Berlin suburbs, Reinickendorf and Tegel. In Berlin the council has voted in favor of the principle of the new tax and an appropriate ordinance is now in the final stages of preparation for submission to that body. The following city governments have the Wertzuwachssteuer officially under consideration at one stage or another: Barmen, Bochum, Erfurt, Frankfort a. O., Gottingen, Halle a. S., Linden vor Hannover, Liinen in Westf., Posen and Rixdorf near Berlin. Unofficially agitation in favor of the new tax has been begun in a very large number of cities. Adolf Damaschke, the tireless leader of the German Land Reformers' Association, whose work has contributed largely to the popularization of the idea, stated on the 20th of October last that in no fewer than fifty cities organized sentiment was being created in favor of the Wertzuwachssteuer.<sup>8</sup> Newspaper announcements since that date indicate a large increase in this number. In only three cities, namely Bremen, Wiesbaden, and Schoneberg near Berlin, has the tax been defeated, but even in these places the agitation has by no means been given up. 5As e. g. in Prussia under §§ 13, 18, and 82 of the Municipal Tax Act of July 14, 1893. Cf. Brunhuber, p. 33; Kumpmann, p. 99.

<sup>6</sup>Kumpmann, p. 105, notes earlier instances in a few small rural communes in Saxony, — Oetzsch and Leutzsch near Leipsic, Hilbersdorf near Chemnitz, etc.

<sup>7</sup>Data regarding cities which have introduced or are considering the introduction of the tax from the Mitteilungen d. Zentralstelle (Berlin) d. deutschen Stadtetags, No. 1, cols. 9, 10. (Apr. 18, 1907.)

<sup>8</sup>The unearned increment tax is already receiving serious attention outside of Germany. In May, 1905, the Austrian Stadtetag, which includes in its membership the principal cities of the country, recommended its adoption, and Vienna and Brunn have considered it officially. Bern in Switzerland has also taken up the subject.

The foregoing facts have not been cited merely to show the extent of territory within which the unearned increment tax has gained some sort of standing. So rapid a movement within so short a time also indicates pretty clearly that the new principle has met with wide approval both as regards expediency and justice. Naturally there

has been vigorous opposition, particularly on the part of associations of land owners. On the other hand, economists and students of public finance generally have entered the lists in favor of the new tax. Prof. Adolph Wagner, who as far back as 1872 took up the advocacy of a sweeping application of the principle of taxing unearned increment in a variety of forms, has particularly distinguished himself by a vigorous, almost passionate, championship of the Wertsuwachssteuer. The press is overwhelmed with communications on the subject, and in several instances municipal elections have been fought out largely on this issue. Particularly worthy of note in the development of the tax up to the present time is the fact that legislative bodies of all three grades, — imperial, state, and municipal, — have passed upon it favorably. In numerous instances definite tax ordinances have received the approval, sometimes of course conditionally, of supervisory administrative authorities. Finally the Prussian Superior Administrative Court, by a decision of Nov. 7, 1905, unqualifiedly recognized the legality of the new tax according to the fundamental provisions of the Municipal Tax Act of 1893.

Rapid as has been the development of the unearned increment tax after a beginning was once made, it is nevertheless true that the cities came to it under the spur of extreme necessity. Germany is quite as familiar as the United States with the spectacle of enormously increasing municipal expenditures. The causes are fundamentally the same in the two countries, although possibly there is a more frank recognition in the former of the necessity of a broad policy of social reform, particularly along the lines of education, sanitation, charity, public amusements, and the elevation of the laboring classes. To meet these rapidly growing needs the cities first developed to an extreme degree the principal existing taxes, i. e., the so-called real taxes on land, buildings, and business, and the local additions permitted to the state income tax. The peculiar cul de sac in which, under the Municipal Tax Act of 1893, they found themselves involved as a result of this policy has been described in another place;<sup>9</sup> suffice it to say here that sources apart from the real and income taxes are now absolutely necessary. In this extremity various expedients have been resorted to as follows:—<sup>10</sup>

9 Berlin's Tax Problem, *Political Science Quarterly*, Vol. XX, p. 666, Dec., 1905.

10 Bremen's early experiment along this line and the Bauplatssteuer, both of which were failures, are of interest in this connection. See Kumpmann, PP- 32. 34; also p. 3 of A. Wagner's *Zur Rechtfertigung der Zuwachssteuer* (Jena, G. Fischer, 1906).

1. The strengthening of old or the creation of new indirect taxes within the narrow limits allowed by the Municipal Tax Act of 1893, chiefly on liquor dealers, dogs, theatre tickets, etc. These need not concern us further here beyond noting that the yield from such sources cannot be large.

2. A change in the manner of assessing the land tax from rental to selling value as a

basis. Within the last six or seven years 102 cities and 129 rural communes in Prussia have adopted this plan.<sup>11</sup> The chief significance of this reform from the point of view of the present article is that it was designed to lay heavier burdens upon land not yet, or only partially, built upon, and consequently yielding no or very low rentals, the tax on which represented only a microscopic fraction of the selling value of the land as a site for future building. In other words the new method of assessment was designed to discourage land speculation, — a purpose which it has in common with the unearned increment tax. From the financial point of view, however, it offered little advantage.

3. An increase of the real estate transfer tax (Umsatzsteuer). This tax is levied upon the price paid for real estate at the time of sale. In Berlin, for example, the municipal rates of 0.5% and 1.5% of the selling value of built upon and unbuilt upon properties respectively were doubled in 1904.<sup>12</sup> The chief virtues of the real estate transfer tax are that it is easily administered and enormously productive. On the other hand, it is extremely harsh in that it falls with the same weight upon every sale of real estate regardless of whether the price paid represents a gain or a loss to the seller. This defect becomes increasingly apparent with every increase of the tax and at times of depressed prices might very seriously cripple the real estate market.

<sup>12</sup>Among them Aix, Barmen, Berlin, Breslau, Danzig, Dortmund, DQsseldorf, Elberfeld, Erfurt, Essen, Gorkitz, Hanau, Kiel, Coblenz, Cologne, Konigsberg, Magdeburg, Spandau, Stettin, Stralsund, Wiesbaden, etc. For complete lists see *Jahrbuch der Bodenreform*, 1905, pp. 80, 320; and 1906, p. 78.

<sup>13</sup>The result was an increase in the net yield of the tax from 2,831,783 marks in 1903-04 to 5,570,521 marks in 1904-05, and 6,385,571 marks in 1905-06. The latter figure was 8 per cent, of the total net yield of Berlin's municipal taxes for the year. *Stat. Jahrb. d. Stadt Berlin*, 30. Jahrg., p. 405.

Summing up the three financial expedients noted above, the first two, it will be seen, promise little from the point of view of productivity, while the third is defective from the point of view of justice. The unearned increment tax, which really forms a fourth term of the series, doubtless owes no small part of its popularity to the fact that it reconciles these difficulties by apparently combining the social purpose of the new method of assessing the land tax and the productivity of the real estate transfer tax. Its close connection with the latter may best be brought out by a brief presentation of the situation in Cologne, the unearned increment tax of which is typical in many particulars.

The ordinance of the Rhine city by which the new tax was introduced first raises the real estate transfer tax from 1 to 2%, regardless of whether the land sold is built or not built upon. This is to be paid by the purchaser.<sup>13</sup> Section 3 provides that in addition to

the preceding an unearned increment tax shall be laid upon the seller. Following is a translation and condensation of the more important succeeding sections of the ordinance.<sup>14</sup>

13The taking of property by right of eminent domain is regarded as a sale under the ordinance, also auction sales ordinarily, but transfers resting directly upon inheritance are excluded. § I, but see also § 7 below.

14The original is given in full in the Jahrbuch der Bodenreform, 1905, pp. 47 and 287.

§ 4. The increase of value shown by the transaction [i. e., sale of a piece of real estate] serves as the basis for the reckoning of the tax provided for in § 3. As increase of value is to be understood the difference between the last price paid for the property plus the additions thereto permitted by § 5, and the present price minus the deductions permitted by § 5.'

§ 5. To the last price paid are to be added:

(a) In the case of land not built upon, interest at the rate of 4%, not compounded, on the last price from the time of its payment, or of interest payments upon it to the time fixed for the conclusion of the present contract of sale.

(b) All expenditures that can be shown to have been made for the improvement of the land, including costs of street building; also costs of new buildings or rebuilding including interest on building costs during time of building and architects' fees, except in so far as these costs have been met out of insurance indemnities. To sums paid for street building 4% interest from the date of payment, not compounded, is to be added.

(c) 5% of the last price paid as compensation for the costs of purchase. (Stamp tax, real estate transfer tax, court costs, recording deed, clerical costs, etc.)

In case parcels of a landed property forming an economic and local whole are sold at various times by the same owner or his heirs in such a way that losses occur on certain sales, these losses are to be deducted from the increase of value obtained from other sales, provided that the losing sales occur at the same time as the profitable sales or within a period of three years previous.

§ 6. An increase of value of 10% or less is in all cases exempt from the tax. If the increase of value exceeds this percentage the whole percentage of increase is to be counted in determining the rate of taxation. The increase of value in excess of 10% is taxed as follows: — 10% in case of an increase of value of more than 10% up to and including 20%; 11% in case of an increase of value of more than 20%, up to and including 30%; 12% in case of an increase of value of more than 30%, up to and

including 40%; and so on, the rate of tax increasing 1% for each 10% of increase of value up to a rate of 25% on an increase of value in excess of 160%.

These rates, however, are only applied in case less than five years have elapsed since the last sale. If more than five and less than ten years have elapsed only two-thirds of the above rates will be applied; if more than ten years, only one-third.

§ 7. The tax will not be collected (1) in case of sale at auction by court order when the bidder is able to show that as owner, mortgagee, creditor, responsible former owner, or surety he is able to avoid loss only by making the purchase; (2) in case of enclosures (Zusammenlegungen); (3) in case of the laying out of new sections of the city where the separate properties of unlike sizes and shapes are temporarily pooled in order that street lines may be run and other improvements provided for, after which lots are apportioned out among the owners on the basis of the value of their former holdings (Untiegungen); (4) in case of acquisitions by the fiscus of the German Empire or the Prussian state, in so far as these purchases are free from the stamp tax under § 4 of the Prussian Stamp Act of July 31, 1895; (5) in case of gifts between relatives in the ascending or descending line, or between husband and wife; (6) in case of the division of property among co-heirs or of the common property of husband and wife, or the legal successors of these; (7) in case of the division of a former common property between co-owners so far as the latter do not receive more than the value of their former share of the property so divided; (8) in the case of the transfer from the heirs to the legatee of a piece of real estate left as a legacy.

§ 14. The following provisions regulate the unearned increment tax for the first transfer of property occurring after this tax ordinance takes effect. Instead of the earlier selling price together with additions mentioned under § 5 a-c, the estimated selling price of the real estate (gemeiner Wert) on April 1, 1905, shall be used. The estimated selling price on this date shall be computed separately for each piece of real estate in the city.

§ 15 In case the yield of the unearned increment tax at the close of a fiscal year exceeds 400,000 marks the rate of the real estate transfer tax will be reduced  $\frac{1}{2}$  per cent, for the following year; if the yield of the former exceeds 800,000 marks the rate of the latter will be reduced 1%.

Taking up the various elements of the Cologne ordinance as they are presented above, it will be observed that the method of computing the unearned increment is first dealt with in some detail. The best brief expression of the principle underlying this procedure in all the plans for unearned increment taxes must be credited to Prof. Adolph Wagner. According to him the following three elements are to be

distinguished in the value of each piece of real estate: (1) "the value expressed by the original purchase price, or [as in the case of Cologne,—§ 14] ascertained by appraisement at the time the tax goes into effect; (2) next, the increase of value through the application of new capital for building, improvements, etc., (not taking into account expenditures for repairs, etc., to keep the property in condition); (3) and, finally, the increase of value brought about by general conditions." The first and third of these elements will be considered later. With regard to the second it may be said that all the new tax plans aim to pursue a generous policy. The Cologne ordinance (§5) particularly distinguishes itself in this way. It differs from others chiefly in the fact that it allows interest to be counted on land not yet built upon. The idea behind this is that the owner of such land does not receive an adequate current return in rent, while the man with a house and lot derives income from it during the time of possession. Critics of the Cologne ordinance urge, on the other hand, that it is chiefly land not yet built upon which real estate speculators deal in, and that for this reason no interest allowance should be made in favor of land of this character. Nearly all the other cities take this point of view and seek to burden land not built upon more heavily than land already built upon. Usually this is accomplished not by interest allowance, but by a manipulation of the provisions reducing the rate of taxation contingent upon the number of years the property has been held by its former owner. Thus Berlin proposes to reduce the tax rate one-third on built-up land that has been in the possession of the seller between 5 and 10 years, and two-thirds when the ownership has lasted over 10 years. If the land is not built upon, however, these reductions are made only after 10 and 20 years' possession respectively. Cologne, it will be seen, makes no difference of this sort (§6).

Apart from definition, the chief difficulty confronting that portion of the unearned increment tax which deals with improvements is administrative in character. All sorts of claims will be made regarding the extent and character of capital investments, some of them probably fraudulent. The longer the time elapsing between sales, — and in some cases this may mean several decades, — the greater the difficulty of properly estimating the value of improvements made in the intervening time. Tax officials thoroughly familiar with values, the records of the building police, and, if necessary, a few penal sentences for perjury are relied upon to solve the problem. The same means will be effective also, it is thought, as against fictitious sales at prices less than the real value of the property. For the latter case Damaschke and others suggest that the city be given a permanent right to buy at the price announced any real estate offered for sale. This rule exists as yet only under the Kiao Chau land ordinance, and with wide-awake officials would doubtless prove entirely effective. Curiously enough, no provision regarding depreciation of improvements is made in any existing legislation, and some opportunity for evasion along this line would seem to be present.

With regard to the scale of tax rates the Cologne ordinance is thoroughly typical. In every instance, except Kiao Chau, some form of progression is employed, and also, with the same exception, some minimum percentage of unearned increment is left free from taxation. Essen and Gelsenkirchen leave 20% free; Liegnitz goes to the other extreme, exempting only 5% increase on built-up land after 5 years' possession, and nothing on other land. In these exemptions, as in the allowances for improvements, the purpose of the new taxes not to burden thrift or enterprise is clearly expressed. Turning now to the scale of rates, Cologne is also seen to occupy middle ground here. The lowest rates yet proposed in any of the plans range from 3% (in three cases), and 5% (in three cases), to 10%. The rate of progression varies considerably, as for instance, 1% tax to each 10% increase of value in Cologne, to 10% of tax for each 5% increase of value in the Saxon bill. At the upper limit of the tax scale very great differences exist; thus Liegnitz, 10% tax on increase of value over 100%; Paderborn, 15%, over 75%; Dortmund, 15%, over 80%; Essen, 15%, over 140%; Hanau, 15%, over 200%; Frankfort a. M., 25%, over 130%; Cologne, 25%, over 160%; Gelsenkirchen, 30%, over 155%. An extremely wide diversity of opinion prevails regarding these various scales. Prof. Wagner's radical position is well known: in taxing unearned increment, he said, one "can hardly go high enough. Even here, however, I would leave something to the winner, — let us say 10%. But the city should get 90%. As, however, such a proposition is not yet practically possible, let us say 50%, or even, so far as I am concerned, only 30%."<sup>15</sup> Probably the highest rate was mentioned by Prof. Wagner largely in jest; the lowest, it will be observed, has already been approximated in practice on very large increases of value. There is no doubt, moreover, that most of the supporters of the tax expect the rates to be raised in the future, particularly in the case of very large gains where the element of unearned increment is supposed to be especially prominent. For the present the existing scales are recognized as sufficient. The difficulty of the question is enhanced by the recognized impossibility of fixing exactly the unearned increment in any given case. Subtracting the former price plus improvements from the selling price may show an increase of value to be sure, but it does not answer the question as to what this increase is due. It is frankly recognized that part of it may be due to the efforts of the landowner, as, for instance, in developing a profitable business on a given site, by making the property more attractive, by voluntary contributions to various communal purposes, etc. To this extent the increment is obviously earned by him. Imperial and state governments also contribute to the increase of land values, — a point to which we will have to return later. On grounds of justice, therefore, the municipal government is not entitled to all the unearned increment (i. e., unearned by the landlord), but only to such portion of it as the municipality itself has earned by providing good local government. So far, however, as fixed scales can take account of the great variety of circumstances affecting individual cases, it must be conceded that

existing ordinances remain well within the limits determined by the above considerations.

15 P. 30, Vortrag erstattet der Ortsgruppe Berlin der Gesellschaft für Sociale Reform. (Jena, G. Fischer, 1904.)

Two time elements are of fundamental importance in connection with the unearned increment tax, — first, the question of a modification of the normal rates based on length of possession (which has already been discussed), and, second, the question as to whether or not the tax shall be retroactive in effect. The latter question has been answered variously in practice. Some cities propose to tax the increase of value since the last sale, no matter if it did occur prior to the enactment of the tax.<sup>16</sup> In other cases attempts are made to fix a certain date, say twenty or thirty years prior to the enactment of the tax, and to compute the increase of value only from this date to the time of sale.<sup>17</sup> Cologne alone among the cities provides that for the first sale after the introduction of the new tax the increase of value shall be computed only from April 1, 1905 (§ 14), practically the date when the ordinance took effect. After the first sale, of course, the increase will be reckoned simply from sale to sale. (§ 4.) The question fundamentally involved in all the foregoing modes of procedure, namely, the justice of taxing unearned increment that has accrued in the past, is far too thorny a one for detailed discussion here. That society has hitherto tacitly guaranteed the security of unearned increment by both passively and actively aiding or allowing private parties to appropriate it is unquestionable. Nevertheless, so far as German law is concerned, the retroactive features of the new ordinances seem to be quite permissible. Here if anywhere the cry of the landlords that the tax amounted to confiscation of private property was justified. On the other hand, of course, all taxation is confiscation to some degree. Moreover the hardship, so far as any occurred, was considerably softened by the provisions reducing the normal rates of taxation in case possession had extended over five or ten years. Besides objections on the ground of justice, however, various administrative difficulties threaten to embarrass the application of the retroactive feature of the unearned increment tax. Improvements made a long time ago can not be assessed so accurately as those of more recent date. Owners' records may prove faulty, or be missing entirely. Still more dangerous is the possibility of evasion by fictitious sales, perhaps coupled with the right of repurchase, made immediately before the tax goes into effect. If this were to occur on a large scale, as is said to have been the case in at least one instance,<sup>18</sup> the retroactive feature of the tax would "simply prove a snare for small landowners unfamiliar with the intricacies of business."<sup>19</sup> Conscious of these objections, the more moderate advocates of the Wertzuwachssteuer are inclined to approve Cologne's position in the matter. Even in that city, however, the first draft of the new tax ordinance provided for a retroactive effect, and this feature was only removed after a strenuous fight against it. Largely because of this amendment Mayor Becker found himself forced to admit sorrowfully

that what he had succeeded in obtaining from the city council was "more a theoretical concept than a real tax." This statement goes directly to the root of the matter, and brings out clearly the Scylla and Charybdis between which the new tax must trim its course. If it is made retroactive, considerable income will be derived at once; if it is not made retroactive, it will yield no income until the future growth of the unearned increment produces one. Those who favor the former course point out the enormous advance in the value of real estate in Germany since the seventies and eighties, although this, of course, is merely an argument ad hominem. "Shall we throw away the meat, keep the bones, and put off our hunger by pointing consolingly to what the future may bring forth?" pathetically asks one such advocate.<sup>20</sup>

16Thus Dortmund, built up property; Essen, property not built upon.

17Thus Dortmund, property not built upon since Jan. I, 1860; Essen, property built upon to last sale if it occurred within twenty years, otherwise only back to selling value twenty years before enactment of tax.

18 Kumpmann, p. 92, quoting Bredt's *Der Wertzuwachs an Grundstücken und seine Besteuerung in Preussen*, says this was the case in Cologne before the retroactive feature was removed from the proposed ordinance by amendment.

19Kumpmann *ibid*, quoting from *Wirkl. Geh. Rat Hamm's article, Kann eine indirekte Wertzuwachssteuer den Wertzuivachs vor Einföhrung der Steuer trefjcn?* in No. 14 of the *Deutschen Juristenzeitung*, 1906.

20Koppe, *Die seitliche Begrenzung des steuerpflichtigen Wertzuwachses in Jahrbuch der Bodenreform*, 1906, p. 226.

A minor advantage of the Cologne plan of disregarding old unearned increment consists in the fuller assessment of real estate which it has brought about. In many German cities the assessed value of property under the regular Land and Building Tax notoriously falls considerably under the real selling value. Confronted by the necessity under the unearned increment tax of fixing the value of their holdings on April 1, 1905 (§ 14), the landlords found themselves between two fires. Too low a figure for that date meant higher unearned increment tax in the future; too high a figure meant heavier land and building taxes annually. The result was a much higher assessment in the case of a considerable number of pieces of real estate.<sup>21</sup>

21Wie vfir in Koln zur Zuzvachssteuer kamen, by Carl Trimbom in the *Deutsche Volksstimme*, 17 Jahrg., No. 8, p. 233. (Apr. 20, 1906.)

Reference has already been made to the relationship between the real estate transfer tax and the unearned increment tax. This appears in two places in the Cologne ordinance,—§ 1, par. 2, and § 15. Little can be said in favor of the first of these, which provides that "if the seller of a piece of real estate pays an unearned increment tax, the buyer will be entitled to count the amount so paid toward the real estate transfer tax which he [the buyer] has to pay, not, however, to exceed 50% of the amount of the

real estate transfer tax." The second, which provides for a reduction in the rate of the real estate transfer tax in case the yield of the unearned increment tax reaches a certain figure (see p. 246), has met with much approval, although for a considerable time in the future it deprives the tax of its significance as a new source for the city's budget. Practically what it will accomplish, and what it is hoped will be accomplished elsewhere, is the substitution of the unearned increment tax for the real estate transfer tax. At least it may make unnecessary in Germany an increase of the rate of the latter tax to the high figures prevailing in France, where it has almost reached 6%.<sup>22</sup> As this means the substitution of a more just and less burdensome tax for one notoriously crude and harsh, it must be counted a distinct argument in favor of the unearned increment tax.

22Wagner, *Zur Rechtfertigung*, etc., p. 19.

The foregoing discussion of the principal features of the ordinances of Cologne and other cities plainly reveals the social, as distinguished from the purely fiscal purpose of the new tax. Its burdens will fall primarily on landholders, a very small class compared with the total population of most of the larger German cities at the present time.<sup>23</sup> And even among this small class the heavier tax rates will strike only those making extraordinarily large gains, that is, mainly speculators in city real estate, with whose operations German cities are fully as familiar as American cities. The participation of many banks of deposit in this business, depriving merchants of loanable capital and increasing their rents, has unquestionably intensified the feeling in favor of the new tax. On the other hand, there seems to be a cordial disposition to recognize the services frequently performed by real estate companies in opening up to settlement desirable tracts, building roads, sewers, etc., and otherwise improving them. Not all the large gains sometimes made by such companies are regarded as unearned, and to this consideration the new tax seeks to do justice by the exemption of small increases of value, low rates of taxation, ample allowance for capital invested in improvements, etc. Brunhuber further distinguishes between two kinds of real estate speculation; — first, that in which operations are carried on largely on the basis of borrowed capital and with the intention of making sales and pocketing profits as soon as possible; second, the withholding from improvement for considerable periods of time of tracts of land, fully paid for, in the immediate neighborhood of the already built up portions of cities. Obviously the taxes already in force with their reductions from normal rates based on long tenure will be much more favorable to the latter kind of speculation. Of the two, however, the former is much the more common. Both are regarded as having a tendency to increase rents and to affect housing conditions unfavorably. It would, of course, be possible to adapt the unearned increment tax to long term speculation by providing for an increase (instead of a decrease as at present) in the rate of taxation based on the length of tenure. In the *Zuschl'dge* to its real estate transfer tax Frankfort a. M. already employs this principle, — a fact all the more

significant because that city is reputed to be pretty well girdled by large holdings of real estate which have already been held for considerable periods of time by the Rothschilds, Bethmann-Hollwegs, Mumms, and other enormously wealthy families. While landholders and particularly land speculators will first pay the unearned increment tax, the question as to its final incidence is far more important. Practical experience on this point is as yet too limited to be of much value, and in its absence the most divergent theories are proposed. From the side of the real estate owners associations the view is frequently expressed that the tax will be shifted from the seller to the buyer and will simply be added by the latter to capitalization and rents. In support of this contention the fact is often cited that at present many side contracts are being executed obligating purchasers to assume the tax in case it is imposed. These contracts are admittedly legal, but they hardly suffice to establish the contention of the real estate owners associations, for the question still remains as to how far the threat of the new tax may have operated to depress the value of the land expressed in the primary contract of sale. Moreover the strenuous opposition of landowners to the new tax argues considerable fear that they will bear it, in part at least.

23In Berlin only 1% of the population lives in houses it owns. The percentage is doubtless considerably larger in smaller cities. Cf. Brunhuber, p. 69.

Directly opposed to the preceding is the view, based on the Ricardian law of rent, that the tax cannot be shifted in any degree.<sup>24</sup> If free competition prevailed in city real estate markets and if the number of possible building sites were practically unlimited, no doubt this would be true. But notoriously this is not the case; indeed one of the strongest arguments favoring the introduction of the new tax is the existence of more or less complete monopolies in the hands of real estate companies. Under such conditions the incidence of the tax is greatly complicated. Kumpmann expresses the opinion<sup>25</sup> that it will resolve itself into a question of might. The land companies are fewer in number and backed by larger capital than those who purchase from them, and conditions in a rapidly growing city will be in their favor. They will possess greater advantages in the center of the city than on its periphery. On the other hand, he calls attention to the fact that the new tax is only one of many factors affecting the price of land, that in most cases the owner will be unable to tell either when it must be paid or how high it will be, and finally that it will fall only on a comparatively small number of landowners. On the whole, therefore, he concludes that the tax will not regularly be shifted.

24Cf. Wagner, *Die Finansielle Mitbeteiligung der Gemeinden*, etc., p. 52.

25Ibid., p. 56.

One possibility with regard to the incidence of the tax about which there is pretty general agreement is that with too high rates owners will simply retain possession of their property and enjoy the unearned increment, untouched by the tax, in the form of

higher rents. As a means of meeting such a condition it is proposed that the tax be collected periodically, say every ten or twenty years, in the case of property which remains for so long a time in the same hands. This would convert the tax from an indirect to a direct form. Under existing law Prussian cities have no right to make the change, and an amendment to the Municipal Tax Act of 1893 would be necessary to empower them to do so. Kiao Chau affords the only example at present of a direct periodic unearned increment tax, collectible at twenty-five year intervals in the case of property which has not been sold during this time. One objection to the direct form of the tax is that it will be felt more severely than the indirect, inasmuch as it will not be collected at the time of a sale when the value of the property is temporarily available in the form of current funds. With short periods of time, however, this burden would be reduced to a minimum. Besides it could be estimated more or less roughly and provided for in advance.

Apart from the stock arguments of landowners and objections based on local conditions, two or three general criticisms of the unearned increment tax deserve notice here. The first of these is that it is unjust to single out unearned increment on land for taxation and allow all other forms of unearned increment to go free. Many advocates of the new principle answer this in a way which may best be reproduced in our slang phrase: "Not yet, but soon." Unearned increment on land is the easiest to reach, they say, hence we have attacked it first, and regret only that economic and administrative difficulties force us to leave more sweeping applications of a just principle to the future. Wagner instances the Bourse Tax, the Inheritance Tax, and the Tax on Gifts (Schenkungssteuer) as involving the general principle of laying higher burdens on unearned increment. Other writers draw a sharp distinction on economic grounds between speculation in land and speculation in movable goods, and contend that the greater harmfulness, as well as the greater ease of reaching the former, justifies a distinction in taxation between the two.

A second general objection to the unearned increment tax is that if private profits on land investments are to be taken, private losses should also be assumed by the city. It is easy to reply to this that taxation usually concerns itself with "him that hath," and even to point out instances in the assessment of the German income and other taxes where losses are disregarded. The peculiar character of the unearned increment tax, however, is that it attempts to reach gains alone, not property or income as such, and hence the question regarding losses cannot so easily be evaded. Damaschke and some of the other leaders of the land reformers recognize the fundamental justice of the claims made on this basis. Jaeger rather too optimistically says that "among nations with a progressive civilization unearned increment will always prove the rule, and innocent loss the exception,"<sup>26</sup> and concludes that the recognition of the principle of reimbursing losses is therefore not dangerous. Obviously, however, its administration

would be extremely difficult and would lead to all sorts of fraudulent claims. Brunhuber admits the principle<sup>27</sup> but points out that it could be applied only to the same degree as the tax itself. As the latter exempts small gains from taxation, conversely small losses could not be considered. The city endeavors to take only that part of the unearned increment which it has itself earned; in justice, therefore, the landowner could claim reimbursement only for depreciation of his property caused by some action for which the city government was responsible. Clear cases of this sort occur, as, for instance, in the erection by a city of an elevated railway, and for such damages the courts already provide remedies. Changes in the location of public markets, theaters, bridges, etc., are not in the same category, Brunhuber holds, as no property owner has a legal claim to have institutions of this sort placed or retained in his immediate neighborhood. Cologne attempts in § 4c of its ordinance to make allowances for losses where a number of transactions connected with the same tract of land have occurred, but the effect of this provision will obviously be favorable to speculators and leave untouched the loss incurred by the owner of a single house. With this exception the point has been passed over in silence in existing legislation, and, in spite of the question of justice involved, probably will continue to be ignored in the future.

26 P. 18, *Die Zuwachssteuer, Versuche it. Erwagungen*, by Prof. Baumeister and E. Jaeger. (Berlin, Verlag Bodenreform, No. XVIII of *Sociale Zeitfragen*.)

27Op. cit., p. 58.

A third criticism of the unearned increment tax is that although imperial and state governments contribute to the growth of land values no provision has yet been made whereby they are to participate in the returns from the new tax. The Bavarian resolution, as we have seen, contemplated a division; half to go to the city, half to the state. A motion to investigate the new tax and take steps to secure the interests of the Empire in connection with it was made in the Reichstag, Dec. 17, 1905, but it met with little support.<sup>28</sup> In opposition to this criticism it is urged that both the Empire and the separate states have reserved certain fields of taxation for themselves, and that they should not poach on the communal preserve of land taxation. Doubtless the activities of both the federal and the state governments contribute largely to the growth of land values in special cases. Thus Berlin and Kiel owe relatively much to the Empire; Koblenz and Bonn to the state. But ordinarily the chief governmental activity affecting city land values is that of the municipal government. A still further view of this question is that the new tax, once it is fully developed, will prove such an Aladdin's lamp that all three governments can share abundantly and without jealousy in its golden proceeds.

28Kumpmann, p. 17.

On the latter point, namely the financial productivity of the unearned increment tax,

the future alone can speak with decision. It is a matter of common knowledge that enormous increases in land values have occurred in Germany during the last three decades. Thus Muller<sup>29</sup> estimates that the land values of Berlin increased 3,500,000,000 marks (\$833,000,000) between 1870 and 1890. Increase in rentals on which the land tax was then based indicate a capital increase of \$63,500,000 in the value of the real estate of the city during the year 1902-03. Of course, Berlin furnishes the most brilliant example of this development, but in smaller cities the same process is going on more slowly. One of the great services of the new tax which should be appreciated both by scientific investigators and public officials is that it will provide a mass of accurate statistical material to take the place of the crude estimates of unearned increment hitherto employed. As for the actual income yielded by the new tax, materials are as yet exceedingly scanty. Kiao Chau alone has had any considerable experience, and here the returns were, by years, as follows: — 1899-1900, no report; 1900-01, \$613; 1901-02, \$2,054; 1902-03, \$1,128; 1903-04, \$1,474; 1904-05, \$417.30 The conditions of a new colony are but ill-adapted, however, for comparison with those of a populous city in a highly developed country. In discussing the Cologne ordinance reference was made to the amendments which deprived it of the hope of large returns in the immediate future. So keenly was this felt that the new tax was put down in the budget for 1905 at the nominal figure of 20,000 marks (\$4,760.00). According to newspaper reports<sup>31</sup> published at the end of March, 1907, the tax had, contrary to all expectations, yielded nearly 200,000 marks (\$47,600.00) up to that time. As Cologne assesses only the increase in value since April 1, 1905, this sum, small as it is, in comparison with the whole budget, nevertheless indicates a rapid and enormous increase in the value of the city's real estate during the period covered. It is not to be inferred, however, that the returns from the new tax will prove constant in growth. All investigations of land value indicate the existence of rhythmic movements both locally and generally over long periods of time. During prolonged periods of depression the unearned increment tax may produce little or nothing financially. For this reason commentators usually suggest that its proceeds should not be applied either to special purposes of a social reform character as is sometimes done, nor to current expenses, but should be turned into reserve funds collected for important projects, as, for example, the carrying out of a large policy of new street construction, the building of new schools, hospitals, etc. Kumpmann philosophically remarks, with regard to the fluctuating character of the new tax, that its results should be satisfactory either way; if they are large, it means that the city is participating largely in landowner's profits; if they are small, it means that land values and rents are not increasing, which from the social point of view is extremely satisfactory.

29Wohnungsnot u. Grundrent, Conrad's Jahrbücher für Nat. Oek. u. Stat., 1902, p. 43.

30 Brunhuber, p. 102. The average exchange value of the dollar is stated as 2.12 marks, equal to \$.505 American.

31Quoted by Kumpmann, p. 113.

With regard to the administration of the new tax and its more general results the following statement by Mayor Adickes of Frankfort a. M. is of interest :<sup>32</sup>  
32Besitzwechselabgabe mid Wertzuwachssteuer in Deutsche Juristenseitung, No. S, March 1, 1906, quoted by Kumpmann, p. 109.

"Hardly any newly introduced tax has been so easily borne as this one. . . . As to its practical administration no considerable difficulties have been encountered so far. The information necessary to ascertain the increase in value, so far as it was not given in documents already at hand, has for the most part been easily secured by sending out a formal schedule of questions. Above all it is particularly noteworthy that all prophecies regarding the destructive effect of the new tax on the sale of real estate have turned out as false. ... In reality the real estate market has not been demonstrably affected in any way by the tax, indeed it has hardly ever shown greater strength. On the other hand, to be sure, the hope that the new tax would exert a restraining influence upon the increase of land values has, up to the present time, not been realized to any perceptible degree."

The experience of other cities from which reports are obtainable is also favorable in the main. Of course, many diverse opinions prevail regarding the possible development of the unearned increment tax. Brunhuber enthusiastically says it is "the land tax of the future, its principle of taxing profits (Gezinnbesteuerung) will be the general tax principle of the future."<sup>33</sup> Kumpmann is more conservative; the new tax, he thinks, will not supplant the continuous direct taxation of land, but it will form an important part of the general financial and housing policy which cities must pursue.<sup>34</sup> Nearly all writers agree that the solution of the housing question in cities must be sought by the variety of means besides taxation, as, for instance, by improvements in transportation, reform of building regulations, attempts to cheapen cost of construction, the opening up of credit on easy terms to prospective builders, increase of wages, etc. Pohlmann<sup>35</sup> boldly suggests that if all other means should fail to break up land monopoly the cities themselves should undertake the business of opening new tracts of land in their environs for building purposes. By controlling local transportation facilities and the supply of municipal services generally (gas, water, sewers, etc.), the success of such enterprises, he thinks, would be beyond question. His argument, of course, rests upon the assumption of a technical efficiency and incorruptibility hardly to be expected in American cities.

33Op. cit., p. 113.

34Op. cit., p. 123.

35 Unsere Stellung zu den Terraingesellscliaflen in Deutsche Volksstimme, p. 470, No. 16, Aug. 20, 1906.

Up to the present time, of course, German experience is scarcely extensive enough to justify a positive answer to the question as to how far the new tax is applicable to our own conditions. Moreover, certain broad differences of practice enter to complicate the question. Thus our large employment of special assessments is to a considerable extent an anticipation of the unearned increment tax. Apparently there was no legal barrier to the development of the principle of special assessments in Germany and occasional instances of its use occur.<sup>36</sup> One wonders that they are not more frequent, for in addition to the usual circumstances which lead to its use in the United States two forms of public improvements common abroad would seem to suggest it very strongly. These are (1) the large projects frequently undertaken for the construction of new streets and avenues in the tortuous central sections of old cities, and (2) the removal of walls and fortifications to a greater distance from the center of growing garrison cities whose expansion they had been retarding. Most of the German authorities agree, however, that the unearned increment tax is vastly superior to the betterment plan, first, because it takes hold of the whole increase of land value due to general circumstances rather than the increase due to a special improvement alone, and, second, because it is more easily administered and at least in the indirect form more easily borne. A comparison of the unearned increment tax with the single tax proposed by Henry George would be of considerable interest in this place, but limitations of space preclude anything more than the mention of one or two points. First, the unearned increment tax does not attempt to take the whole value of the economic rent of land; what it does take is the capitalized value of a part of the economic rent. Second, unearned increment is a much more readily comprehensible concept than pure land rent; it is, indeed, a matter of everyday notice, and its nature as essentially unearned gain is very readily demonstrable. It would seem, therefore, much more easy to make propaganda for the unearned increment tax than for the single tax.

<sup>36</sup>Kumpmann, p. 38; Jahrbuch der Bodenreform, 1905, p. 209; 1906, pp. 44, 131, and 201.

In all the discussions of the new tax by German writers their thought regarding unearned increment on land is evidently very closely, if not exclusively, connected with the increase of value that emerges during the transition period from agricultural to building uses. The reason, of course, is that German building regulations which forbid the erection of skyscrapers also prevent the increase of the value of centrally-located realty to the enormous figures with which we are familiar. Unearned increment taxes in our cities would probably strike two main areas, the periphery and the business section. Thus we would have the advantage of two main sources as against one in German cities.

The most striking single difference between German and American municipal finance, however, is the relative unimportance of the regular land tax there, and its overwhelming importance here. At present the income tax is the backbone of the finances of German cities. In the larger Prussian cities the land and building tax contributes only about one-fourth of the total municipal income from taxation.<sup>37</sup> Under these circumstances it is not strange that the agitation in favor of laying heavier burdens on city real estate should be sweeping over Germany like a tidal wave. A similar movement would have far less justification in America. Nevertheless there would seem to be great possibilities for the development of the unearned increment tax within our system in two directions. First, it might be used as a substitute for and an improvement upon special assessments. Second, it could be employed as a means of readjusting the burdens of our land tax, laying them more heavily upon property of rapidly increasing value and diminishing them on other property.

<sup>37</sup>Stotistisches Jahrbuch deutscher Stadte, 1906, p. 376.