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Source: *The American Journal of Economics and Sociology*, Vol. 35, No. 1 (Jan., 1976), pp. 71-75

Published by: Wiley

Stable URL: <https://www.jstor.org/stable/3485140>

Accessed: 21-09-2024 23:14 UTC

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The Impact of a Graded Tax on a Rural Area:

A Case Study in Indiana County, Pa.

By STEVEN CORD

ABSTRACT. The graded tax is a reform of the property tax which would tax land values at a higher rate than improvements in or on the land. What would be its impact on different types of rural owners of real property? A study of rural Indiana County, Pennsylvania, by William Ritter shows that the impact would vary according to the level of development the individual tract or parcel has undergone.

TAX EXPERTS have long advocated a reform of the real property tax whereby the tax rate on land would be gradually increased while simultaneously the tax rate on buildings would be gradually decreased. Such a reform has been called land value taxation, or more specifically the Graded Tax (because done in graded annual steps). Briefly, the advantages claimed for this reform are that if land is more heavily taxed, it must be used more efficiently, and if buildings are un-taxed, they will be cheaper to operate and construct. A tax on land is thus an incentive tax because it encourages private initiative. It cannot burden production; in fact, it can only help it by making more land available for production.

In recent years, there have been many studies of the impact of the Graded Tax on different types of urban owners of real property and there has been general agreement as to which of them would pay more taxes and which less. But there have been few or no studies of the impact of the Graded Tax on different types of *rural* owners of real property. Would farmers as a group pay more taxes under the Graded Tax than under the current real property tax, or would they pay less? Which type of farmers would pay more, which less? Farmers have been a prime force behind the spread of the Graded Tax in Australia, New Zealand and Denmark, indicating that they benefit from it financially, but precise studies of its rural impact are nevertheless needed.

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SUCH A STUDY has recently been completed by a graduate student, William Ritter, at Indiana University of Pennsylvania, Indiana, Pa. (1) Ritter studied the impact of a Graded Tax on the rural areas in Indiana County, which has a total population of 75,000 and is located about 55

miles northeast of Pittsburgh in the foothills of the Alleghenies. The county contains only one sizable city, Indiana (pop. 13,000), along with a number of other smaller towns. There is considerable coal mining carried on in the county and not a little manufacturing. Approximately 55 per cent of its area is in woodland and 33 per cent is in crop and pasture (2). Dairying is the chief farm activity; others are the raising of sheep, poultry, hogs and beef cattle. Another quite important farm activity is Christmas-tree growing.

Ritter found that the average school district in the county imposed a tax of 42.6 mills on real property officially assessed at about 35 per cent of true market value. He then took a representative sample of 60 farms out of the approximately 1200 on the tax books and determined how each of them would be affected by a 25 per cent reduction in the building tax rate (from 42.6 to 32 mills) and a corresponding increase in the land tax rate (from 42.6 to 70.3 mills) which would be necessary to yield the same revenue to the county's school districts as under the present uniform rate system. From this survey, he was able to draw these conclusions:

- 1) If a rural township adopted the Graded Tax, those farmers who have developed their properties more than the average would get tax reductions, and the opposite-type farmers would get tax increases, but naturally the township's farmers as a group would be unaffected. There is every reason to expect, though, that in the future the un-taxing of buildings would be an incentive to the more rapid improvement at no tax penalty of the township's farms.

- 2) If the whole county adopted the Graded Tax, either for school purposes or otherwise, more farm properties would get tax increases than decreases. Of the 60 farm properties studied, 10 would receive tax reductions under the Graded Tax, 7 would be practically unaffected, and 43 would receive tax increases. Reason: since the urban areas are more developed than rural areas, the un-taxing of improvements would tend, on the average, to benefit them at the expense of the less developed rural areas; remember that the Graded Tax favors development.

The disparity in land development is indicated by these statistics: Indiana County has a 2.6:1 building-to-land assessment ratio; the ratio for Indiana Borough, the biggest town, is 4.4:1, although somewhat surprisingly the ratio for all the smaller towns in the county was even higher (one can wonder how accurately the assessments reflect market value); the average ratio for all towns in the county was 5.6:1, while the ratio for purely rural townships averaged 1.8:1.

Exactly how large would be the tax increases and decreases for various types of rural property? For half the sample, the tax changes would amount to less than \$50 at the end of the first year, when buildings would receive a 25 per cent tax exemption; or this amount would be \$200 if improvements were exempted altogether. We could assume that these changes would be considered rather negligible.

Another quarter of the sample would receive tax increases or decreases within the \$50–\$100 range when improvements would receive a first-year 25 per cent tax reduction, and tax increases or decreases within the \$200–\$400 range if improvements were to be exempted altogether. Tax changes of this magnitude would generally be considered quite moderate.

In fact, only two properties would receive considerable tax changes. One farmer, quite near to town and fronting on a main highway, would receive a tax reduction of \$681.90 if building were 25 per cent tax exempt, or \$2727.60 if buildings were totally tax-exempt. But his farm is highly developed and efficient, and the part of his property fronting on the highway is developed with a motel, rest home, apartments and dairy store. He is indeed more than just a farmer.

The other property would receive a tax increase—\$2,988.40 if buildings are 25 per cent tax-exempt, and \$11,953.60 if buildings are totally tax-exempt. But these figures are quite overshadowed by the property under consideration—we are dealing here with a multi-million dollar corporation growing Christmas trees and landscaping shrubbery. The true value of its holdings in Indiana County alone amount to \$7 million, and the company estimates its total number of trees in the county at 35 million. But since most of its land is waste, woodland or brush, the company's tax burden would increase under the Graded Tax.

Farmers who might find themselves paying more under the Graded Tax could at least protect themselves against such an eventuality by divesting themselves of the marginal land they don't really need and by developing more intensively (at no tax penalty) the land they wish to keep.

3) Generally speaking, the following types of properties would experience tax increases under the Graded Tax: those having a significant amount of wasteland, brush and non-productive woodland, those near Indiana borough, those having substantial coal reserves, and those fronting on highways.

4) Properties which would experience tax decreases under the Graded Tax would be the more highly developed ones. Dairy farms tended to be in this group while Christmas tree farms tended not to be.

5) The effects of the Graded Tax on future land use can only be conjectured, but it would seem likely that in addition to the encouragement of development and modernization because of favorable tax treatment of these activities, the price of waste, wooded and brush land would fall noticeably because they would be taxed at a higher rate. This in itself might encourage the quicker development of such marginal land.

II

TO SUM UP: while most farmers in Indiana County—and similar counties—could expect to pay more taxes under the Graded Tax, their tax increases would generally not be very substantial. They could protect themselves against even this eventuality by adjusting their land usage. And in any case, perhaps they would be wise to look beyond the immediate impact upon their pocketbook and ask whether such a tax shift would benefit the county's total economy, as the tax experts generally think it would. After all, a tax on land is an incentive tax which encourages private initiative, not burdening production as all other taxes do, and especially as the current type of property tax does; in fact, the graded tax can only help production by making more land available for use, and at a lower cost. The economic growth thus encouraged could create opportunities not only for the farmer himself, but could create jobs for his children who might otherwise have to migrate to distant cities in search for them, as an increasing number of farmers' children are forced to do these days. This might be of far greater importance to the farmer than small changes in his property tax.

And if farmland were more accurately assessed than it is now, it is conceivable that the Graded Tax would actually reduce the farmers' tax payments. Government assessors should exempt not only the farmers' improvements *on* the land (buildings, fences, etc.), but they should also exempt those important improvements farmers make *in* the land, such as clearing, grading, draining, irrigation and fertilizing. The best way to do this is for the assessor to determine in each case how much such improvements increase the selling price of the land, and then, say, for ten years, deduct from the farmer's land tax bill one-tenth of the increase (plus interest on the unpaid balance). By thus recompensing him for his improvements which have become part of the taxable land value, the farmer would receive a legitimate reduction in his land tax bill. With this improvement in assessment procedures, many farmers would be paying less taxes as the result of a shift to the Graded Tax.

One last consideration: the farmer could legitimately ask aid from

the government to cushion the changes envisaged by a shift to the Graded Tax. If the rules of the game are changed, those who are disadvantaged through no fault of their own have a claim to our consideration, no matter how slight or temporary their disadvantage might be.

In this regard, there are two things the government might do. First, low-cost loans could be made available to farmers by the state or federal governments to provide them with the necessary capital to develop their farms properly. Secondly, tax abatements could be offered them, so that any tax increases resulting from the shift to the Graded Tax could be left unpaid, to accrue against the eventual transfer of the farm by either sale or death; when the transfer is made, then the government can collect its back taxes from the new owner. If the government made these concessions to the farmer, any inconvenience some of them might be caused by what the experts consider to be a more effective property tax system would seem to be very minor indeed.

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1. William Ritter, "Expected Effects of the Graded Tax Upon Rural Development in Indiana County," January 1973, unpublished manuscript, 9 pp. and xiv.
2. Pennsylvania Dept. of Commerce, *Industrial Census Series: Indiana County Profile* (Harrisburg, Pa.: Commonwealth Printing Office, 1972), p. 5.

On the Death of Paul E. Alyea

THE PASSING of Paul E. Alyea (September 8, 1899—January 8, 1975), noted fiscal economist and humanist, has cost the Committee on Taxation, Resources and Economic Development—the inspiration and wise counsel of one of its most prized members.

Dr. Alyea took his bachelor's, master's and doctorate degrees at the University of Illinois. His teaching apprenticeship was served at the University of Pittsburgh, Butler University and the University of Illinois. The year following he obtained his Ph.D. and moved to the University of Alabama where—except for service as Senior Economist with the U.S. Office of Price Administration and as director of a division of the Smaller War Plants Corporation from 1942 to 1945—he remained until his retirement in 1965. On his return to Tuscaloosa in 1945 he was appointed Professor of Finance.

His *Alabama's Balancing Budget* was published in 1941, followed by *Alabama Revenue System* in 1947, when he was also serving as Director of Research for the Alabama Legislative Revenue Survey Commission.