

VII: OPTIMUM LAND TAXES

A State Land Tax assessed at 3 percent of the current real market value of all freehold sites, coupled with municipal rates based on site values, would increase the supply of sites and bring down the price of land. That would stimulate employment and boost the economy - but land taxes need not stop there.

Land taxes and rates can be increased progressively - as the price of land comes down - until the annual total (land taxes plus rates) becomes equal to the market price of land.

In other words, land taxes and rates can be increased until a combined level of 100 cents in the dollar is reached.

The mechanics of this proposal should become clear if we consider:

- (a) the nature of land price, and:
- (b) the relationship between land prices and taxes on land.

The Nature of Land Price

In Western society, land usually has a capital price - and we should ask ourselves why this is so.

Land is not produced or moved about like goods and services. Therefore, while the price of goods and services depends, at least in part, on production and transport costs, the price of land must arise in some other way.

In actual fact, the price of land is set by site rentals, because most of us buy land in preference to renting it.

We do this to provide a sense of permanence and to secure ourselves against the twin dangers of eviction or an arbitrary rent increase.

Hence, when buying a site we judge its price in relation to the rent payable for any similar or alternative site. If the purchase price were well above the likely rental, we would probably settle for tenancy, but if the purchase price and rent were much the same, then most of us would opt for ownership.

About Twenty Years Rent?

A certain amount of guesswork or entrepreneurial judgement is involved in these decisions. In addition, the amount we pay depends on the supply of sites, the number of vendors seeking purchasers, and the number of persons competing for sites. It is also affected by interest rates.

However, to illustrate the point, we may assume a purchaser who pays twenty years rent in exchange for his site.

We do this for two reasons. Firstly, it is more or less a standard commercial procedure to regard the price of land as being equivalent to about twenty years' rent. Secondly, the Net Annual Value of property is often assessed at five percent of its improved capital or market value. Net Annual Value is the estimated rental value of each property. If this is five percent of the market value, then the market value is twenty times the annual rent.

Gross Rent and Net Rent

In Australia there are two components to the rental value of sites. These are:

1: Site rent collected by the community as land

taxes or rates, and:

2: Site rent remaining in the landowner's hands.

Because of this, we may speak of:

(a) Gross Rent - i.e., the full rental value of any site, and:

(b) Net Rent - the amount the owner retains after payment of land taxes and rates.

Net Rent Determines the Purchase Price

The purchase price of sites depends upon their Net Rent, and the reason for this is fairly obvious.

All who use land pay land taxes and rates, whether they own a site themselves or rent one from somebody else.

Landowners obviously pay their own land taxes and rates, but tenants are no different in this regard. A tenant may pay land taxes and rates directly, to the relevant State government or Municipality. Or he may pay them indirectly, as part of his rent. (In which case the landlord passes them on to the appropriate government.)

Therefore, land taxes and rates do not enter into our calculations when we are choosing between rental and purchase. Rates and land taxes must be paid in either case. Hence, they neither influence the choice between buying or tenancy, nor enter into the purchase price of sites.

Because of this, if a purchaser paid twenty years' rent in exchange for a site, he would pay twenty years' Net Rent, where: Net Rent = Gross Rent minus Taxes and Rates.

Gross Rent is Not Affected by Taxes and Rates

We must note, also, that land taxes and rates have no direct effect on the Gross Rental Value of individual sites.

Gross rents depend on several factors, which are discussed in Chapter VIII. Each factor exerts its own effect on rents and land prices, but none of them has any direct connection with taxes or rates. Consequently, land taxes and rates draw site rent into the Treasury, without affecting the Gross Rental Value of individual sites.

Market Price = 20 x Net Rent

Having covered the groundwork, we may now show the relationship between land taxes and the market price of sites. To do this we use the following formula:

Market Price = 20 (years) x (Gross Rent minus Taxes and Rates).

Gross Rent \$1,000 per annum, Market Price = ?

For the calculation, we may assume a site with a gross rent of \$1,000 per annum. The market price of such a site - for different levels of land tax or rates - would be as follows:

- 1: If no rates or taxes were payable on the site, its market price would be $20 \times \text{Gross Rent} = 20 \times \$1,000 = \$20,000$.
- 2: With rates and taxes totalling \$100 per annum, the market price of the site would be $20 \times (\$1,000 - \$100) = \$18,000$.
- 3: Rates and taxes at \$500 per annum would bring the price of the site down to: $20 \times (\$1,000 -$

\$500) or \$10,000; and with rates and taxes at \$900 per annum, it would cost $20 \times (\$1,000 - \$900) = \$2,000$.

4: Finally, if rates and taxes reached \$1,000 per annum, the market price of the site should be zero. (As $20 \times (\$1,000 - \$1,000) = \text{zero}$.)

A Zero Price for Sites?

In practice, a zero price for sites is probably undesirable. Land taxes and rates are usually calculated as a percentage of site value. On this basis, a zero price means zero tax. Therefore, we would have to change the terminology of our rating system if rates and taxes absorbed the entire Gross Rent of sites.

Such changes are probably undesirable. In any case they are hardly necessary. Satisfactory results can be achieved under the established system, so why change it needlessly?

Taxes as a Percentage of Site Value

It is not quite so easy to calculate the market value of sites for any given rate of tax. Each increase in the tax rate reduces the market price of sites, so any calculation would be somewhat complicated.

Potential changes in either the tax rate or the rate of inflation add further complications. However, if the currency were stable and changes in the tax rate occurred at ten to twenty year intervals, then the figures given in Table 4 would apply.

Trial and Error Calculations

Table 4 has been calculated by trial and error from the formula: $\text{Market Price} = 20 \times (\text{Gross}$

TABLE 4: APPROXIMATE MARKET PRICE AND ANNUAL TAX
FOR DIFFERENT LEVELS OF LAND TAX - FOR A SITE
WITH A GROSS RENT OF \$1,000 P.A.

Tax Rate Cents/\$1	Approximate Market Value of Site (\$)	Annual Tax Payable (\$)
0.0	20,000	0.00
0.1	19,608	19.60
0.25	19,048	47.60
0.5	18,182	90.90
1.0	16,666	166.70
2.0	14,286	285.70
3.0	12,500	375.00
4.0	11,112	444.40
5.0	10,000	500.00
7.0	8,344	583.30
10.0	6,666	666.70
15.0	5,000	750.00
20.0	4,000	800.00
30.0	2,858	857.10
40.0	2,222	888.90
50.0	1,818	909.10
60.0	1,538	923.10
70.0	1,334	933.30
80.0	1,176	941.20
90.0	1,052	947.40
100.0	952	952.40
120.0	800	960.00
150.0	646	967.70
200.0	488	975.60
300.0	328	983.60
500.0	198	990.10

Rent minus Taxes and Rates).

For instance, with a tax of \$19.60 per annum,
the market price of the site would be:

$$20 \times (\$1,000 - \$19.60) = 20 \times \$980.40 = \$19,608.$$

$\$19.60/\$19,608 = 0.1\%$, so if the tax rate were

set at 0.1% or 0.1 cents in the dollar, then the annual tax payable on this site would be \$19.60, and its market price would be \$19,608.

Similarly, if the annual tax payable were \$444.40, then the market price of the site would be:

$$20 \times (\$1,000 - \$444.40) = 20 \times \$555.60 = \$11,112.$$

$\$444.40/\$11,112 = 4\%$. Therefore, with land tax at 4 cents in the dollar, the owner of this site would contribute \$444.40 to the Treasury each year, while the site would cost \$11,112.

Similar calculations can be made for various other levels of land tax. Table 4 is the result - with the tax calculated to the nearest ten cents for any given level of land tax.

Table 4 shows that low rates of land tax produce a proportionately greater effect than much higher ones.

Thus, if the tax rate were increased tenfold from 0.1 cents to one cent in \$1, the price of some sites could fall by \$3,000, as the tax payable on them increased eightfold. By contrast, if the tax rate on the same site jumped from 50 to 500 cents in \$1, only \$1,600 would come off its price and the tax payable would increase by less than ten percent.

Gradual at First, Then More Steeply

Because of this, land taxes should be introduced gradually - at least in established economies. However, the rate can be increased rapidly once a level of five cents in the dollar is reached. Increases above that level have only a mild effect. We could, therefore, increase the rate from five to one hundred cents in the dollar in

four or five steps (e.g., from five cents in the dollar to ten, twenty, fifty and one hundred cents) - if reasonable time were left between each step:

- (a) to allow the market to adjust to the changed conditions, and:
- (b) to allow valuers to revalue all sites - to keep the tax base and valuations up to date.

A Combination of Rates and Land Tax

The final level of land tax would be a combination of land tax plus municipal rates. Some of it would pass to local government, while the remainder passed to State governments.

Land Tax Collections

The tax could be collected partly by the State and partly by local government. Alternatively, it could all be collected by local governments, who would then forward an appropriate proportion to the State treasury.

These practical details could be settled by negotiation as time went on. At present, increases in land tax are an urgent necessity. They should not be delayed while finer points are being sorted out.

Other Taxes

Another matter to sort out is the question of other taxes. These would be reduced as land taxes increased.

Indeed, some other taxes could vanish completely as land taxes increased towards the definitive level of 100 cents in \$1.

We should try to reduce or eliminate taxes that spread widely throughout the community and affect people in the lowest income brackets. Sales tax, motor vehicle taxes, company tax, excise taxes and other indirect taxes all add to prices. Therefore, these taxes should probably be reduced or eliminated first. Income tax may also add to prices, so a lowering of income tax rates would benefit most people in the community. Alternatively, the level at which income tax first becomes payable could be doubled for married couples with a single income between them. This would bring these married folk into line with those who have separate incomes - as the latter couples now have twice the tax-free income of the former ones.

Taxation per Head

As noted on page 17, an average single worker paid over \$3,000 in income tax in 1980 (\$64 per week), while his home site cost \$15,625. In addition, Australia's 14,500,000 citizens paid \$29,468 million in taxes in 1978-79 - over \$2,000 per head¹⁵.

I don't know what the eventual tax on a \$15,625 home site would be. However, it would certainly be less than \$3,000, and far below the amount an average Australian family now contributes to the various Treasuries. Consequently, there are plenty of other taxes to reduce as the level of land tax is steadily increased.

ACHIEVING THE OPTIMUM

Over the next four or five years, but beginning as soon as possible:

- 1: Land tax should be levied on all privately-owned sites,

- 2: Low levels of land tax should be increased until a uniform land tax - at about 3 cents in the dollar - applies throughout each State,
- 3: Rates now assessed against N.A.V. should be transferred to site value, and:
- 4: Rates should be increased to finance more of the activities of local government, and to reduce the municipalities' dependence on central government.

Then, over the succeeding four or five years, land tax and/or rates should be progressively increased until their combined total reaches 100 cents in the dollar for all privately owned land.

An End To Sub-Optimal Land Use

Land tax at that level would ensure that only people who wished to use land immediately would bid for it - provided sites were revalued annually, to keep the taxes in line with changing market values.

Therefore, a tax at 100 cents in \$1 would eliminate all speculation and investment in idle land. It would also increase the utilization of under-used land and thereby decrease the total area of land in use. In this way it would make a great deal of land available for conservation, for re-forestation or timber production, for recreational pursuits, for use by aborigines, or for the hygienic and aesthetic disposal of sewage effluents and other wastes.

Taxation in this form would alter the balance of land costs - in a beneficial direction. Purchasers would no longer outlay huge capital amounts, or borrow money and pay interest in order to buy land. Instead, they would outlay a small sum in exchange for a title, and pay the bulk of their

land costs annually, as taxes and/or rates.

The same measure would maximize the supply of sites and minimize demand for them - thereby bringing land costs down to the lowest possible level and placing ownership or tenancy within easy reach of everyone.

We can therefore recommend this proposal with confidence - to every nation in the world.

Very Low Taxes on Some Land

Under the above-mentioned arrangements, very little tax could be payable on quite a lot of sites.

This is so because the proposed steep increases in land tax would bring hundreds of unused or under-used sites onto the market. Many of these, might remain unsold or unoccupied for extended periods.

If a site could not be sold, that would prove that no one needed it. Its market price would then be zero, and no tax would be payable on it.

However, in practice only land at really outlying locations and utterly uneconomical sites would have a zero price. Other sites - both in the country and in the suburbs - would be bought or sold for a few dollars - with the purchaser then paying the same few dollars annually as taxes or rates.

Nevertheless, this would not happen if the price of marginal land rose unduly. So some sites (particularly those in isolated areas) could be almost exempt from land tax for many years.

Owners of such sites could retain the title if they wished, or pass it to their descendants. Alternatively, if they had no further use for

the land and no one to give or sell it to, they could allow the title to revert to the Crown. However, there need be no compulsion in this matter - except upon the Crown to accept any titles offered to it in this way. These landowners - in common with all others - would be free to retain the land for their own use, to sell it to the highest bidder, or to give it to the Crown if no buyer could be found.