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**PROPERTY TAX REFORM: FOREIGN AND UNITED STATES**

**EXPERIENCE WITH SITE VALUE TAXATION**

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LEGAL AND PUBLIC POLICY ASPECTS OF IMPLEMENTING  
SITE VALUE TAXATION

by

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"The law like the traveller must be ready for the morrow." Benjamin  
M. Cardozo, The Growth of the Law.

This paper is intended to provide some of the legal and policy aspects of the site value tax as opening background for the economic and administrative presentations which follow. My survey considers some of the legal and policy problems of complete or partial site value tax (SVT) implementation that would arise if the tax were to be given ardent consideration or were to be adopted in taxing jurisdictions in the United States. I will do this by examining briefly the nature and possible merits of; the alleged negative results flowing from; the presumed positive benefits of; and the legal, policy, and institutional barriers to possible SVT utilization here. This not altogether inconsiderable assignment, hopefully, will provide one partial basis for evaluating SVT potentials and related implementation problems in American state and local fiscal systems.

Basic Characteristics of Site Value Taxation

Tax conferences provide one of the many opportunities for semantic confusion presented by our complex society and, as Justice Holmes so well said, "A word is not a crystal, transparent and unchanging, it is the skin of a living thought and may vary greatly in color and content according to the circumstances and time in which it is used." <sup>4</sup> So a brief review of the relevant conceptual troops, as they appear to a temporarily one-eyed academic this particular morning, may be, if not refreshing, not altogether irrelevant despite a certain Cyclopean architectural quality.

Most alternatives to existing ad valorem real property taxation, as Netzer points out, fall into four categories:

1. Taxation of property on an annual rather than on a capital basis;
2. Site value taxation, or differential taxation of land and improvements;
3. Taxation of land value increments;
4. Expanded use of special charges for public programs of fairly direct benefit to property.<sup>5</sup>

For present purposes the second of these categories, site value taxation is of primary concern. Taxing land value without including the value of improvements is an idea that occurred in the last century to the British economists David Ricardo and John Stuart Mill and to the American reformer Henry George although some would also include both Adam Smith, the French Physiocrats and Sir William Petty, in the family geneology of this tax idea. The argument for SVT is simply that economic land rent is a factor payment derived from productivity and location which does not depend upon human effort or the nature of improvements. Hence taxation of this surplus will presumably be neutral in economic effect and be an equitable ingredient of tax policy. SVT was oversold as a universal panacea for the socioeconomic ills of humankind prior to World War I and not surprisingly developed a sustained bad press for a time. Then, Woodruff puts it, "After World War II, the erstwhile single-tax movement mellowed into a modulated advocacy of site value taxation."<sup>6</sup>

Recent interest in SVT in the United States stems in part from notions of distributional equity as well as from an interest in moderating the disincentive effects of current full ad valorem property taxation upon improvements and urban renewal. In the 1960's SVT gained support as one possibly useful tax device for stimulating both improved land use and urban development.<sup>7</sup>

Discounting for past exaggeration, the case for SVT based upon two elements, (1) equity and (2) neutrality, appears to be a good one. The argument is that much of land value derives from either natural endowment or community action or population growth and economic development. Owners can realize so-called "unearned increments" (location rents) which may be recaptured for public purposes. This argument is often countered by noting that the "tax does not distinguish between values purchased with earned income and those that accrued without the owner's exertion, skill, or abstinence"<sup>8</sup> and may discriminate against those who have invested in land rather than other asset categories. While gains and losses, windfalls and wipeouts to use Professor Hagman's colorful phrase,<sup>9</sup> could no doubt be minimized by a policy of gradual implementation, this discrimination remains one very real drawback to complete site value taxation since present owners may have unearned increments ranging from zero to full value and the tax would presumably have a uniform impact. While this does not constitute an insurmountable problem, it does, I suspect, represent an intriguing challenge to legislative ingenuity.

The economic or development argument for SVT is quite compelling. The present property tax applied to both land and buildings is not neutral but is a disincentive to investment in buildings. SVT, independent of improvements, is neutral with respect to land use decisions. As Dan Holland has succinctly stated,

"Unlike a tax on improvements, a tax on site value would be invariant with the development decision. What was the optimal development in the absence of the tax will remain optimal in its presence. Construction--new or remodeling--would not be penalized. This might be called the pragmatic case for site value taxation."<sup>10</sup>

As a result, SVT does not restrict production or impede effective land use. It may stimulate increased investment in structures, lessen speculative deferment of development and facilitate urban redevelopment. While miracles are hardly to be expected, the effects of this tax device do seem to point in a desirable direction. Even relatively recent media-type conventional wisdom suggests the merit of SVT adoption<sup>11</sup> as well as much scholarly advice. What of policy reality?

### Scholarly Advice and Policy Reality

The property tax in the American states has been roundly criticized time out of mind.<sup>12</sup> While many suggestions for improvement have not resulted in policy action, property tax modification has to at least some extent been a policy reality. Ronald Welch, now the Dean Emeritus of American Property Tax Administrators, has suggested five significant changes in the property tax during the last half-century more or less. These include its virtual elimination as a source of state revenue, a relative decline as a source of local government revenue, a substantial increase in total revenue dollars produced, a tendency to become less general in coverage due to the development of both increased exemptions and additional classification of property categories for ad valorem tax purposes, and, finally, distinct improvements in property tax administration.<sup>13</sup> The absence of SVT from this list suggests the presence of significant implementation barriers and/or policy uncertainty despite the fact that "most economists, however agree that the site value tax should have better resource allocation effects than the prevalent property tax institution."<sup>14</sup>

Two items of advice bear repeating here.

Dean Netzer gives his opinion on property tax reform as follows:

"My own agenda for property tax reform--is to reduce reliance on the conventional tax, in favor of the two local finance alternatives that seem distinctly superior on efficiency and equity grounds. The first is heavier reliance on properly designed user charges, particularly congestion and pollution charges. The second is reliance on land value taxation.

Since my bent is for incremental reform, I would accomplish the latter in stages, starting with elimination of the existing drastic under-taxation of land relative to improvements. Twenty years hence, my ideal system of local finance would comprise user charges and land value taxation, period."<sup>15</sup>

Ron Welch puts the message somewhat differently:

"Such local governments could do much worse, however, than to seek authority, and if successful use it, to tax land more heavily than improvements, to tax capital gains on land at moderate rates or revert to special assessments to recapture windfalls to landowners, and to impose user charges to finance some of the government services commonly financed out of general funds but to rely mainly on improvements in assessment administration of a conventional property tax to restore their financial health."<sup>16</sup>

While the tone differs, the content is remarkably similar in the advice of these two property tax sages. Why then continued inaction? To that question, we next turn our attention and consider domestic SVT implementation barriers.

#### American Legal Barriers to SVT

One can readily visualize a number of barriers to SVT adoption which would be a major institutional change. There are, as always, factors like inertia, gaps in the data, and questions about the distribution of gains and losses, administrative difficulties, questions of revenue adequacy, and so forth which may, at least in considerable part, explain deferred SVT implementation. However, my assigned topic puts legal barriers first on the agenda, so on to that aspect of the matter.

Although the law must be ready to evolve as circumstances require, the rule and content of law need also to provide at least some social stability. Given the inevitable tension between these conflicting goals of stability and change, it is appropriate to consider legal and related administrative barriers to SVT implementation. Such blocks result from both past history and current attitudes. As Oliver Wendell Holmes, Jr. said long ago not far from here:

"The substance of the law at any given time pretty nearly corresponds, so far as it goes, with what is then understood to be convenient; but its form and machinery, and the degree to which it is able to work out desired results, depend very much upon its past."<sup>18</sup>

Now the nineteenth century general property tax is the fiscal institution that generated the legal norms whose modification or erosion is our present subject. The property tax was an ad valorem tax on

all property, regardless of its nature, at a uniform rate throughout the tax levying jurisdiction. This pattern of taxation by uniform rule according to value became a fiscal norm and was embedded in many state constitutions partly as a result of popular appeal and also partly as a result of popular distrust of legislative judgment concerning both exemptions and preferential treatment of particular forms of property. This institution, which is really a collection of taxes rather than a single one, characterized by the notions of uniformity and universality, generated many of the legal norms that conflict with SVT adoption and implementation. While property tax change is often at a glacial rate, it does occur and on occasion accelerates. While bold bounds appear unlikely, development comes; nevertheless, examination of these derived variable legal barriers suggests some SVT implementation problems.

### Definition of Land

Actual and potential legal barriers to SVT adoption or implementation that could be trouble spots in particular jurisdictions include the following areas: (1) legal definition of land; (2) uniformity and equality bars to SVT, differential real property taxation, and related tax exemption policy; (3) legal constraints upon assessment methods; (4) tax rate and levy limitations; and (5) debt limitation laws.

If one assumes that, since it permits tax exemption and reasonable classification of property for ad valorem tax purposes, the equal protection clause of the United States Constitution does not prevent SVT; that neither the due process nor the privileges and immunities provision of the fourteenth amendment are bars; and that the possible problem of taxing unrealized capital gains is not involved, the five problem areas listed above appear to be those that would provide legal problems for and obstacles to a SVT system cast in the form of an annual levy.

As is the case with any tax-classification arrangement, SVT would require effective definition of the tax base. This would place greater importance than now exists upon the respective definitions of land, real estate, and tangible personal property. Definitional variation would be a determinant of tax liability and could impede realization of LVT policy objectives by complicating the assessment process. Under most existing ad valorem tax systems in the United States, all real property is taxable. Consequently, the necessity for drawing a legal tax distinction between "land" and "improvements" has seldom been of consequence except where certain improvements could be considered not attached to the land and, hence, taxable, if at all, as tangible personalty rather than real property. Our nice distinctions do not quite draw an interpretative line between land as such and improvements but only between items attached to and a part of realty and those not so attached. 19

The boundaries of site value taxability must be precisely defined. This is no inconsiderable legal task as the Australian experience suggests.<sup>20</sup> Moreover, this definitional process presumably would build upon some reasonably precise conceptual base defining the concept of land for SVT purposes. While it is good manners to leave Pandora's box alone, conceptual ambiguity about SVT base definition seems very likely to create legal problems abundantly. Moreover, this situation may leave the assessor with an unclear mandate with the usual problems that result.<sup>21</sup> The country reports, hopefully, may suggest effective solutions to this particular difficulty as may also in due course the Minnesota experience.

### Problems of Uniformity

Numerous state constitutions in the United States contain a provision requiring uniformity in some--typically property--taxes. For example, article XII, section 2 of the Ohio constitution provides in relevant part: "Land and the improvements thereon shall be taxed by uniform rule according to value...". Originally, such constitutional uniformity provisions sought to embed nineteenth century general property tax concepts of universality and uniformity in state organic law. Such aims were often achieved in the period 1818-1896 which was essentially a restrictive one. Later relaxation and liberalization of such provisions occurred, in part, incident to the classification movement.<sup>22</sup> In 1959, Wade Newhouse in an exhaustive study found that 43 of the then 48 states had constitutional uniformity provisions of which 23 were relatively strict.<sup>23</sup> In 1965, Professor Hagman concluded that such provisions in 16 states would bar SVT adoption by means of exempting buildings.<sup>24</sup> In 1973, the Advisory Commission of Intergovernmental Relations on the basis of an analysis by Professor Oldman and others, reported that 16 states would need to amend their constitution to adopt SVT or, equivalently, to exempt improvements completely or, indeed, to adopt differential taxation of land and improvements with positive tax rates on each category.<sup>25</sup> The present legality of SVT appeared at least doubtful in 13 additional states although some 8 may permit differential taxation of land and improvements. It was suggested that Minnesota law might permit classification and taxation at a zero rate. This appears not unlikely.<sup>25a</sup>

So while state uniformity requirements are not the barrier to SVT at present that they were in the past, they exist and are an obstacle in at least some 29 of the American states.<sup>26</sup> Also constitutional provisions limiting exemption policy may restrict the availability of SVT in particular jurisdictions. However, the old universality and uniformity doctrines are increasingly breached by laws providing for agricultural use-value assessment (20 states)<sup>27</sup>, open space and green acres preferment as well as by comprehensive property classification<sup>28</sup> all of which developments tend either to relax or to encourage a more liberal interpretation of legal constraints upon differential property taxation. To the extent this trend continues, the uniformity barrier to SVT utilization will be reduced. It is not insurmountable.

### Constraints Upon Assessment

Property tax history includes numerous examples of administrative variance from legal assessment standards. Some may represent different approaches to the determination of value; others may represent extra-legal determination of liability differentials. At any rate, legal assessment standards in particular jurisdictions may at times conflict with value-determination methods for SVT; such conflicts may impede SVT use.

A related question involves not only the legal expression of the valuation standard but also agreement upon the standard itself. For example, Kenneth Back, an experienced assessor, has noted:

"If it can be assumed that what is sought in site value taxation is current market value of land in its present state, then I see no insurmountable valuation problem."<sup>29</sup>

Is this the appropriate SVT assessment standard? If not, what modification is acceptable and what room is to be allowed for the variable discretionary judgmental artistry of the assessor?<sup>30</sup> Another matter, when the highest and best use is not the zoned use which prevails? The degree to which answers to such question are legally specified or left to administrative discretion will, of course, affect the yield and impact of SVT. Accordingly, resolution of this mixed congeries of technical and policy questions is one more necessary step along the potential SVT implementation path.

### Maximum Tax Rates Laws

Many states limit the authority of their constituent local governments to levy property taxes by either constitutional or statutory prescription. Limits were initiated by Rhode Island in 1870 presumably at least in part as a result of the notable Panic of that year. In 1962, ACIR reported 43 states with a property tax rate limit; 21 of these by means of a constitutional provision.<sup>31</sup> A second generation study of this topic in 1977 indicates that as of 1974 26 states had a rate limit, 12 states a tax levy limit, and 12 states retain a laissez-faire no limit policy.<sup>32</sup> Moreover, since 1970, 14 states and the District of Columbia have enacted some new control on local fiscal powers.

Accordingly, if SVT limited to land were substituted for present real property taxation and the land value tax base were smaller than its predecessor--a likely although not uncontroversial probability--existing tax-rate and/or levy limitation ceilings would have relevance and might even limit! Despite the proliferation of limit--avoidance mechanisms, SVT or differential land taxation by means of complete or partial untaxing of improvements will find in at least some instances a collateral obstacle in such property-tax-rate limits.<sup>33</sup>

## Base Reduction and Debt Limitation

After the 19th century panics of 1837 and 1870, many of the American states adopted constitutional restrictions against state borrowing. While such limits have in some instances been relaxed, only a minority of state governments have not limited their own borrowing power.<sup>34</sup> Similarly, the states have often restricted the debt creation powers of their subordinate local governments. In a 1961 report, the Advisory Commission on Intergovernmental Relations noted that 34 state constitutions included some local-government debt-limitation provision although in six cases the restriction applied only to a specified category of local government.<sup>35</sup> Such limits fall into three categories: (1) a limit on debt expressed as a percentage of the property tax base; (2) a limit on tax rates for all or some particular debt service category; (3) a requirement for passage of a local referendum as a condition precedent to authorize bond issuance. Current reviews of this slowly bubbling technical quagmire suggest that this limitation category has not dissipated and remains one element of rigidity in the present property tax system.<sup>36</sup>

Reducing the total assessed value of the property base or the resultant revenue yield by either exemption or differential taxation of improvements would in some instances reduce local government borrowing power and in others possibly be prevented by existing debt-service requirements or, for that matter, by bond indenture provisions especially since the U.S. Supreme Court appears to have given the contract clause of the Constitution new vitality.

While commentators have long suggested elimination or relaxation of this limitation category, movement in this direction is extremely slow.

### Summary

The legal barriers here reviewed, at least in their present form, often would constitute significant obstacles in some jurisdictions to adoption and implementation of SVT or of differential ad valorem property taxation.

Rereading a summing up made several years ago, I find it continues to be not inappropriate:

"Nevertheless, the law does tend to evolve toward those rules which a majority consider just and convenient. If and as the emergent problems of an urban society produce a consensus in support of property tax modernization along site value tax lines, existing legal barriers appear by no means insurmountable. Under

such circumstances, this area of the law, like Cardozo's traveller, can indeed become ready for the morrow."<sup>37</sup>

As one considers the drift of institutional change, one notes that the property tax is a non-uniform group of partial taxes. Non-uniformity has been reinforced by the usual practice, legal or extralegal, of systematic assessment differentials. Recently, such differentials have been increasingly legalized although techniques vary considerably. Such developments suggest that non-uniformities are acceptable to legislators and taxpayers alike. I suspect that this long slow roll of fiscal development will continue and a pattern of gradual incrementalism will occur.

FOOTNOTES

1. See 31 Journal of Policy Relevant Tax Analysis 3 (August 1, 1977).
2. Economics and the Art of Controversy (New York: Vintage, 1959) p. ix.
3. Hereafter herein often SVT and/or LVT.
4. Towne v. Eisner, 245 U.S. 418, 425 (1918).
5. See Netzer, Economics of the Property Tax, pp. 191-220.
6. A.M. Woodruff, "Land Value Taxation: A 1966 Evaluation" in The Property Tax: Problems and Potentials (Princeton: Tax Institute of America, 1967) p. 427 at 433.
7. U.S., President's Commission on Urban Housing, REPORT OF THE PRESIDENT'S COMMISSION ON URBAN HOUSING: A DECENT HOME (Washington, D.C.: Government Printing Office, 1968), pp. 99-100, 103-4; U.S., National Commission on Urban Problems, REPORT OF THE NATIONAL COMMISSION ON URBAN PROBLEMS: BUILDING THE AMERICAN CITY (Washington, D.C.: Government Printing Office, 1968), p. 384.
8. Ronald B. Welch, "Property Tax Developments: Modernization, Classification, Site Value Taxation," National Tax Journal, 29:322, 325 (September, 1976).
9. Donald Hagman, National Tax Journal, 28 (December, 1975) 437.
10. Daniel M. Holland, "Introduction" in Daniel M. Holland, ed., The Assessment of Land Value, (University of Wisconsin Press, 1970) p. 6.
11. See eg. Gurney Breckenfeld, "It's Up to the Cities to Save Themselves," Fortune, March, 1977, p. 194 at 204-5.
12. See eg. my. "Property Tax Development: Selected Historical Perspectives" in Property Taxation USA, ed. Richard W. Lindholm (Madison: University of Wisconsin Press, 1967) pp. 7-19; "The Institutional Context of Property Tax Administration" in Lynn, ed., The Property Tax and Its Administration, (University of Wisconsin Press, 1969) p. 3ff.
13. "The Way We Were: Four Decades of Change in the Property Tax," The Property Tax in a Changing Environment, Advisory Commission on Intergovernmental Relations, Washington, D.C., 1974, M83, p. 29.
14. Dick Netzer, "Property Taxes, Taxation," 15 Int'l. Ency. Soc. Sc. 545 at 549.
15. Dick Netzer, "Is There Too Much Reliance on the Local Property Tax," in Property Tax Reform, George E. Peterson, ed. (Washington, D.C.: John C. Lincoln Institute and Urban Institute, 1973) p. 13 at 23.
16. Welch, op. cit., n. 8, p. 326.

17. Not surprisingly this section will draw upon my "Legal Problems and Obstacles in Assessing Land for Site Value Taxation" in D. Holland, ed., The Assessment of Land Value, (1970), p. 143-155, and "Note: Site Value Taxation: Economic Incentives and Land Use Planning," Harvard Journal on Legislation, 9 (1971) 115-155.
18. Oliver Wendell Holmes, Jr., The Common Law (Boston: Little Brown, 1881) pp. 1-2.
19. See eg. the Ohio Story in Teaff v. Hewitt, 1 Ohio St. 511 (1853); Zangerle v. Republic Steel Corporation, 144 Ohio St. 529, 60 N.E. 2d 170 (1945); Roseville Pottery, Inc. v. County Bd. of Revision, 149 Ohio St. 89, 77 N.E. 20608 (1948); Reed v. County Bd. of Revision, 152 Ohio St. 207, 88 N.E. 2d 701 (1949); Holden, "Classification of Property as Real or Personal for Ohio Property Taxes: An Appraisal," 11 Ohio St. L. J. 153 (1950); Lynn and Oster, "Real Property Taxation of Farm Lands and Structures," 17 Ohio St. L. J. 75 (1956); Wheeling-Pittsburgh Steel Corp. v. Board of Revision, 27 Ohio St. 2d 45, 271 N.E. 2d 861 (1971) and Shutter Bug v. Kosydar, 40 Ohio St. 2d 99, 321 N.E. 2d 239 (1974).
20. See eg. McGeoch v. Federal Commissioner of Land Tax, 43 Commw. L. R. 277 (H.C. 1929).
21. See Hicks, "Can Land be Assessed for Purposes of Site Value Taxation" p. 9; Vickrey, "Defining Land Value for Tax Purposes," p. 25; and Back, "Land Value Taxation in Light of Current Assessment Theory and Practice" p. 37, all in D. Holland, ed. The Assessment of Land Value (1970).
22. See generally Simeon E. Leland, The Classified Property Tax in the United States (Boston: Houghton Mifflin, 1928) and Jerome R. Hellerstein, State and Local Taxation, 3d ed. 1969, pp. 36-39.
23. See Wade J. Newhouse, Jr., Constitutional Uniformity and Equality in State Taxation (Ann Arbor: University of Michigan Law School, 1959); also see Glenn Morrow, "State Constitutional Limitations on Taxing Authority of State Legislatures," National Tax Journal 9 (1956) 126.
24. Donald M. Hagman, "The Single Tax and Land Use Planning: Henry George Updated," 12 U.C.L.A. L. Rev. 762, 771 (1965).
25. Advisory Commission on Intergovernmental Relations: Financing Schools and Property Tax Relief--A State Responsibility (Washington, D.C., 1973) pp. 86-90 and see therein Appendix G., Oliver Oldman, Charles Cobb, and Paul Oosterbuis, "Problems Under State Law of Federal Residential Property Tax Relief Proposals" p. 203 ff.
- 25a. Minn. Const. art X, sec. 1 (1857 amended 1974); see Johnson v. Donovan, 290 Minn. 421, 188 N.W. 2d 864, 866 (1971). Elwell v. County of Hennepin, 301 Minn. 63, 221 N.W. 2d 538 (1974).
26. As of 1973: Arkansas, California, Colorado, Florida, Georgia, Illinois, Indiana, Missouri, Nebraska, Nevada, West Virginia, Ohio, South Carolina, Tennessee, Texas, Utah are the 16; the 13 "doubtful jurisdictions" include

Idaho, Kansas, Massachusetts, Minnesota and New Hampshire along with Arizona, Kentucky, Louisiana, Montana, New Mexico, North Carolina, Oklahoma, and Virginia.

27. Advisory Commission on Intergovernmental Relations; Significant Features of Fiscal Federalism, 1976-77 Edition, Vol II, Table 80, "States With Differential Farmland Assessment Provisions" p. 126 (Washington, D.C. M-110, March, 1977).
28. Ibid., Table 81, p. 127.
29. "Land Value Taxation in Light of Current Assessment Theory and Practice," op. cit. p. 37,41.
30. On methodology see International Association of Assessing Officers: Assessing and the Appraisal Process, 2nd ed. (Chicago: The Association, 1968) especially Chapter 4.
31. Advisory Commission on Intergovernmental Relations, State Constitutional and Statutory Restrictions on Local Taxing Powers, A-14 (Washington, D.C.: U.S. Government Printing Office), October, 1962, p. 28.
32. Advisory Commission on Intergovernmental Relations, State Limitations on Local Taxes and Expenditures, A-64 (Washington, D.C.: U.S. Government Printing Office), February, 1977, p. 20.
33. See generally Irving Howards, "Property Tax-Rate Limits: A View of Local Government," in Property Taxation--USA, ed., Richard W. Lindholm (Madison: University of Wisconsin Press, 1967) p. 169.
34. See A. James Heins, Constitutional Restrictions Against State Debt (Madison: University of Wisconsin Press, 1963) esp. p. 82.
35. Advisory Commission on Intergovernmental Relations, State Constitutional and Statutory Restrictions on Local Government Debt (Washington, D.C.: U.S. Government Printing Office, 1961), p. 1.
36. For a suggestive general view of this technical quagmire see Table 61-- State Constitutional and Statutory Limitations On Local Government Power to Issue General Obligation Long-Term Debt, 1976 and Table 62--State Constitutional and Statutory Referendum Requirements for Local Government Issuance of General Obligation Long-Term Debt, 1976, in Advisory Commission on Intergovernmental Relations, Significant Features of Fiscal Federalism, 1976-77 Edition (Washington, D.C.: U.S. Government Printing Office, March, 1977) p. 83-91; p. 92-96.
37. Lynn, op. cit. n. 17 at p. 155.