Land Speculation and the Taxing Power

By J. RUPERT MASON

IN THE DRAFTING of our Federal Constitution, perhaps the most difficult single question was whether the sovereign states should delegate any power to the national government to tax land. In the debates, especially the *Federalist Essays,* this question caused more discussion than any other: Which government would retain the sovereign power to tax land, after the adoption of the Federal Constitution? But, even the leading "federalist" finally conceded that the sovereign power of the states would remain "independent and uncontrollable" in the "most absolute and unqualified sense."[1]

The United States Supreme Court affirmed, time and again, beginning with McCulloch v. Maryland Bank (4 Wheat. 316), that this power of the states was not abridged by anything in the Federal Constitution. The framers of the U. S. Constitution very carefully restricted the authority delegated to Congress to lay direct taxes on land, by the so-called "regulation of apportionment," as interpreted and applied by the Supreme Court in the famous Pollock cases.[2]

Thus, the dual sovereignty principle, insisted upon by Thomas Jefferson as a protection against centralization of power, which he knew had made Caesars and Bonapartes possible in other lands, was safeguarded and each state retained its sovereign and inexhaustive power to tax and control the private tenure of all land within its domain after the adoption of the national Constitution, except as the Constitution of that state might limit or restrict the execution of that power by the legislature of the state.

This principle was steadfastly respected by Congress until the federal income tax law was proposed in 1909. The first

[1] *The Federalist,* Essays Nos. 12, 30–6, 80–1.
[2] *Pollock opinions,* 157 US 429, 158 US 601 (U. S. Supreme Court).

income tax law was ruled unconstitutional. This court ruling was made because of the source of some of the income which was to be taxed. For 118 years the federal government had abided by the judgment of the constitutional fathers that, except by the rule of apportionment, Congress could not levy a tax upon land directly; hence, any federal tax imposed on income derived from the land, as ground rent, was construed as repugnant to the Constitution. But soon after this ruling the proponents of the income tax made a plea for and got an amendment to the national Constitution. This was the Sixteenth Amendment. It provides that "Congress shall have power to lay and collect taxes on income, from whatsoever sources derived. . . ."

Although the Sixteenth Amendment validated the taxation of rent under the income tax, a landholder, corporate or individual, can still withhold from use potentially valuable land in any amount and of any description—urban, agricultural, mineral or timber land—and so escape the payment of any federal tax. Not until land is used by the title owner, or by others, to yield an income is the landholder now required to pay a federal tax on the land holding. The individual or corporation wishing merely to hold land for speculative purposes, awaiting the time when it may be rented, leased or sold at higher levels of return to those who would use if for productive purposes, is completely exempt from the burden of any federal tax. And such speculators in lands are at liberty to demand as high ground rents[3] as any user of the land can be made to pay. In a period such as the present, when the demand is far greater than the supply at prices that will yield a return to labor and capital, the landholder exercises supreme control over every productive enterprise, including housing for veterans and industrial expansion of all kinds.

[3] Rent and selling price of land titles are used here as but two aspects of the same thing; selling price is the capitalization of rent.

Moreover, under the federal income tax law, these land title owners are permitted to deduct from the top bracket of their income tax returns any and all taxes levied on the land by state, county or other local governments. Because of this privilege, large landholders and corporations are able to get as much as 90 per cent of their state and local direct taxes on land paid by the federal treasury. As a result of this windfall provision, large holders of land are not under pressure to develop, improve or use in any way the land they control. Unused land is now taxed only the minimum by the states while its speculative value increases. If used, it would be more heavily taxed by the states and any income that was produced would be fully taxable under the federal laws.

However, favorable as are the federal regulations regarding the exemption of land from taxation, the speculators had their difficulties with state and local taxation during the Thirties. With soaring land values in both farm and urban areas after World War I, new subdivisions sprang up all over the country, and particularly in California and Florida, the nurseries of such schemes. With the influx of new population, cities floated bond issues rather than levy the taxes in a single year to finance the cost of water supply, roads, sewers and schools, which added to the municipal debt structure. Meanwhile, prices being paid for land titles all over the country were far in excess of true value, and banks were holding heavy mortgages. Likewise, the cities and counties held first liens against vast amounts of land for delinquent real estate taxes. When the mortgage situation became critical, a campaign was started to have Congress enact laws to free the holders of mortgages from having to pay the delinquent taxes due the states. This federal legislation was urged chiefly to prevent the state or local government from recovering the tax-defaulted land or other property free and clear of mort-

gages or other private liens or claims. Under applicable laws the states could have become the beneficent holder of millions of acres of land, which could then have been sold, leased, or otherwise administered by it. This public recovery is actually what did happen after 1929 in many states when land speculators defaulted on their tax payments.

In most of the forty-eight states, the legislatures after 1930 allowed more time for the payment of defaulted real estate taxes. This, of course, increased the local property tax rate and thereby the burden of those taxpayers who were able to pay their local property taxes when due.

These facts were brought to light with the passage by Congress of the Municipal Bankruptcy Act in 1934.[4] In the Ashton case[5] the United States Supreme Court ruled that the bankruptcy power of Congress does not extend to the fiscal affairs of a state or its political subdivisions, and further, that state consent or submission could not serve to enlarge the powers belonging to the Congress. Powerful pressure groups soon determined to have some new judges appointed to the Supreme Court. At the same time, these lobbyists and interested parties exerted every effort to have another municipal bankruptcy law enacted, replacing the one that had been declared unconstitutional. In both endeavors they were successful. Not only were several new judges appointed to the high court bench but another Municipal Bankruptcy Act was passed.[6] When the federal district court ruled that the amended act was unconstitutional because it sought to accomplish the same thing that the original Chapter IX had attempted, an appeal was taken to the Supreme Court. Here the judgment of the lower court was reversed and the amended act was held "not unconstitutional."[7]

[4] 11 USCA 301–4, or Chapter IX.
[5] 298 US 513.
[6] 11 USCA 401–3, or the amended Chapter IX.
[7] *U. S. v. Bekins*, 304 US 27.

Thus, the present status of the constitutional power to tax privately-held land seems to be that although Congress cannot *tax* such land except under restrictions, it does have the power to *untax* it. Moreover, according to the most recent ruling of the Supreme Court, Congress may validly authorize the courts to interfere with the exercise by the states of their power to tax land. This practice is clearly in opposition to the best opinion held by our constitutional fathers, who strongly urged that the taxing power of the states remain "independent and uncontrollable."

It was well recognized by Thomas Jefferson and the others who assisted in founding this republic that every government can derive its necessary revenue from two sources only: (1) from those who hold land; or (2) from those who produce wealth and increase the amount of products all of us desire and need. This fundamental of taxation was well understood in England and in France, also, at the end of the eighteenth century. The principle we long applied in this country was to levy direct taxes on those who held the land, in proportion to benefits received. But latterly a basically different canon of taxation has taken its place: ability to pay. And so we find that those who produce wealth are not permitted to enjoy the full fruits of their efforts, but are penalized by taxation of earned incomes for supplying the things needed by all.

The attitude of Jefferson toward the land question is summed up in the following:

> The Earth is given a common stock for men to labor and live on. If, for the encouragement of industry we allow it to be appropriated, we must take care that other employment be provided for those excluded from the appropriation. If we do not, the fundamental right to the earth which is denied, returns to the unemployed.

Jefferson was clear in his mind about the equal right of every individual to use the earth "to labor and live on," and it is

this philosophy that is so clearly expressed in the Declaration of Independence. The greatest thinkers of all ages and countries have warned of the importance of recognizing man's equal right to the use of land and the dangers resulting from monopolization of the original source of all wealth. In this country Thomas Paine, Jefferson's contemporary, and several others have penned very strong words on this subject. Paine's position, set out in his "Agrarian Justice," is worth rereading in its entirety today. Lincoln's statement of the issue is not so well known:

> The land, the Earth that God gave to man for his home, sustenance and support, should never be the possession of any man, corporation, society, or unfriendly government, any more than air or water, if as much. An individual or company, or enterprise requiring land should hold no more than is required for their home and sustenance, and never more than they have in actual use in the prudent management of their legitimate business, and this much should not be permitted when it creates an exclusive monopoly. All that is not so used should be held for the free use of every family to make homesteads, and to hold them as long as they are so occupied.[8]

Those who are landless and whose industry produces wealth are bearing more and more of the total costs of federal, state and local government because those who speculatively hold land out of use are exempt from federal taxes and because tax-evading land holders are also able to escape state tax liens under laws recently enacted by Congress. The federal revenue is derived today mainly from taxes on all wealth produced, and from the innumerable other hidden and indirect taxes levied against consumers. Here is the leech that is enabling special privilege to thrive, but is sapping the vitality of labor and management, decreasing consumer purchasing power and increasing the cost of living.

[8] Quoted from R. H. Browne, "Abraham Lincoln, the Man of His Time," Chicago, Blakely Oswald Publishing Co., Vol. II, p. 89.

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