CHAPTER II

REAL PROPERTY

SECTION I — *Classification.* SECTION II — *Capital Value of Improvements.* SECTION III — *Capital Value of Land.* SECTION IV — *Rent of Improvements.* SECTION V — *Ground-rent.*

SECTION I—CLASSIFICATION

THE second of the classes into which general property is divisible is real, or immovable, property. Property of this kind is again divisible into two classes: land and improvements. These classes, however, physically inseparable, are usually considered together under the term real estate. That land and improvements constitute, however, two distinct forms of value is evident upon a moment's thought. Land is created by cosmic processes over which the human being has no control; improvements are created, immediately, at least, by man. The distinction between the two is important in any examination of real property as a source of national revenue.

Property of this kind may again be estimated in two ways: either at total capitalization or at its annual rental value. Real property, therefore, may be considered under four heads: 1, Capital value of improvements; 2, Capital value of land; 3, Rental value of improvements; 4, Rental value of land.

SECTION II—CAPITAL VALUE OF IMPROVEMENTS

Among the most obvious forms of taxable property is that of improvements and buildings. Where such property is taxed, the value of the improvement is estimated and a percentage of the total assessed.

This tax is practically a tax on the improvement of land, and to be evenly distributed it is essential that all improvements should be capable of exact valuation in relation to each other. Attempts at such relative valuation gave rise to the old English custom of counting the number of hearths in a house, later superseded by the more convenient method of counting the windows, number of stories, or other means of approximating its value in relation to other buildings. In the taxation of improvements, the ever-present difficulty of exact valuation is met, and as accurate relative estimates must form the basis of any just system, this difficulty is a serious one. Other difficulties may be mentioned.

Taxes on improvements may fall largely or entirely, not upon the owner of the improvement, for whom they are intended, but upon the tenant. This seems to apply in particular where improvements are represented by larger investments in buildings, houses, warehouses, factories and so forth. If capital employed in these investments could be taxed, so that its returns were less than the possibilities offered by other forms of employment, no more capital would seek such channels. The fact, however, that capital flows in these directions suggests that such capital is no more effectively reached in the majority of cases, than the average of capital employed in other fields.

If, however, a tax of this kind could be made effective, that is, if capital employed in the improvement of land could be taxed in proportion to the value of improvements, such a tax would be of disadvantage to the community; for it would restrict and destroy the most productive of all activities: the improvements of land.

Improvements of this kind are but chattels attached to the soil, and many considerations suggested in the study of chattels in general apply to the improvements of land. Buildings, houses, and improvements cannot be hidden or moved from place to place; but their number and quality may be adversely affected by taxation, while the great difficulty of exact relative valuation is always present.

If such methods really place the intended burden upon the owners of improvements, the result will be to restrict the productive powers of the society; if the burden is shifted to others, the property assessed contributes nothing, and the tax may act in many cases as an indirect tax on consumption or living expenses, instead of a direct contribution from real property. On the other hand, improvements present great advantages over ordinary movable chattels, as a source of revenue, the chief of which are their relative availability and the slight expense involved.

Section III — Capital Value of Land

The capital value of land presents another obvious source of social revenue, and has formed one of the oldest objects of taxation. Land, as a basis for social contribution, possesses peculiar advantages presented by no other form of property. Land cannot be hidden, as can valuable chattels; it cannot be moved, transferred or held in different neighbourhoods, as can securities; its quantity cannot be restricted or diminished, as in the case of houses and improvements; its amount may be estimated with almost ideal precision, and the relative value of different holdings thus much more closely approximated than in any other form of property. Again, the value of the situation of land cannot be deteriorated to any extent by the owner, as is possible in the case of improvements; for to do so would, in the majority of cases, decrease rather than increase his revenue. The extent of land areas may be accurately calculated and their value approximated independently of interested testimony, thus doing away with the otherwise inevitable premium upon fraud. These qualifications are possessed in the same degree by no other element of wealth.

In order to assess the total, or capitalized, value of land, surveys must be made with estimates of the relative value of its component parts. A tax of this nature, upon the total value of land, falls upon rent to a certain extent, but only to a certain extent; for, unless the land is revalued every time the tax is imposed, the contribution will not vary in proportion to the rental value, the tax remaining a fixed quantity as established in relation to the value of the land at a definite time. The value of the land will, of course, vary with changing conditions. the value of the different portions will vary actually and in relation to each other. A fixed contribution, based upon the capitalized value of land, therefore, however just at the time of assessment, becomes less so with every alteration in value within the area considered. A tax of this kind is called an invariable land-tax and has played an important part in fiscal history.

Taxes may be payable in different forms of wealth: the produce of land, military service, in various forms of obligations, and in coin of the realm. For modern administrative purposes, contributions to the public treasury are nearly always estimated in money, and this money has a certain relation to the value of gold. A fixed land-tax, therefore, is open to two objections: it will vary with the value of the different portions of the land, both actually and relatively; and again, with the variations of the gold, money, or wealth in which it is payable. A tax of this nature must, therefore, be relatively variable, subject, as it is, to changing influences.

A contribution of £10 annually from a certain property may become a lighter or heavier burden as the value of the property rises or falls, and with changes in the value of money. The rental value of the property might increase or decrease indefinitely; the value of gold might change in its relation to consumable wealth; all of these variations would have a marked effect, both upon the burden borne by the property, and the revenue obtained by the State. This variable nature of the fixed land-tax is a serious objection; although such a tax as applied to the land possesses marked advantages.

"A land-tax," says Adam Smith,[1] "which, like that of Great Britain, is assessed upon each district according to a certain invariable canon, though it should be equal at the time of the first establishment, necessarily becomes unequal in the process of time, according to the unequal degrees of improvement or neglect in the cultivation of the different parts of the country. . . . This tax, therefore, so far offends against the first of the four maxims above mentioned. It is perfectly agreeable to the other three."

These considerations apply to contributions assessed upon land and improvements combined. In so far as such a tax falls upon improvements it is open to the objections mentioned. In so far as it falls upon the value of the land, it possesses the advantages with the disadvantages pointed out.

In connexion with a land-tax, however, a new form of property appears an element of wealth presenting important distinctions separating it from other forms considered. This element of wealth is the value attaching to land irrespective of improvements; that is, the value inherent in land considered apart from the value of labour applied to it. This new element may be examined, therefore, in reference to its qualifications as a source of revenue.

Taxes, if paid, must fall somewhere; are borne by some form of property, sooner or later. Taxes on commodities nearly always fall upon consumers. Taxes falling entirely on trade are paid out of the profits of the traders. Taxes assessed upon the owners of houses fall upon tenants in the majority of cases, and taxes on credits usually fall upon debtors when collected. It may be asked, upon what form of wealth does a tax fall, assessed upon the value of unimproved land? Such a tax, properly assessed, should not affect human industry in connexion with improvements, for no value represented by them is laid

[1] *The Wealth of Nations.* Book V., ch. ii., Part II, Art. 1, p. 417.

under contribution. Contribution from unimproved land regards the land as freed from the results of human effort; it considers the land in its natural condition, and estimates value as affected by social, not individual, causes.

The land, in its unimproved state, is untouched by the hand of man; that is, free from the results of labour. The unimproved value of those portions of the surface of the earth, upon which great populations exist, is caused by the existence of those populations. It represents neither labour, capital, skill, credit nor industry, in any individual or corporate form. It does represent, however, the combined number, wealth, industrial powers, and productive energies of a population existing upon a given portion of the earth at a given time; and to these in their collective sense is due the value possessed by unimproved land. This value, moreover, created by a society, as a society, is a form of wealth belonging peculiarly to the social organization. Revenue, therefore, derived from the unimproved value of land is derived from wealth created by society and belonging to it in its collective sense; and not from wealth created by individuals or belonging to them. Fiscal contributions, properly levied through the medium of unimproved land fall, apparently, upon socially created wealth without infringing upon individual or corporate wealth. Regarded, therefore, in relation to other forms of property, as a source of social revenue, the value of unimproved land presents exceptional advantages. It presents, at the same time, however, an important difficulty: variability, for relative and actual variations create important inequalities in incidence.

The variability in the values of real property suggests another method of estimation and assessment. Rentals, it may be said, form an exact, self-regulating register of values, and, therefore, contributions levied upon rentals are not open to objections met in a fixed house or land-tax. Rentals represent the annual value of the capital invested, and a contribution assessed upon rent not only estimates the property at its actual value, but varies with this value and establishes it in relation to other values at the same time: rent serving to measure and register automatically these important factors in fiscal requirements.

Another fiscal resource is thus reached: one assessed upon rental, or annual value, rather than upon total, or capital, value. The rental value of real property may be assessed in two ways; the rent of improvements and the rent of land presenting two distinct values which may be assessed separately or in combination. The rent of real estate is thus divisible into improvement rent and ground-rent; the incidence of a tax upon rent in general, therefore, is twofold and these two sources must be considered separately.

Section IV—Rent of Improvements

If profits of buildings and improvements, as expressed in rent, were lowered by fiscal pressure, capital would flow into other channels and only the most profitable improvements would be developed. It seems, therefore, that the portion of a tax assessed upon building or improvement rent falls eventually upon the tenant, or consumer of the improvement.

A large portion of social revenue, assessed upon the rent of improvements, is derived from the rent of houses, and contributions raised from this source present advantages over other forms of revenue. The impossibility of hiding houses, or holding them outside the taxing area, combined with the estimates, actual and relative, rendered by rental values, are important in this connexion. The fact that rent, in its action, eliminates difficulty with regard to actual and relative estimates, renders this source the most equal yet discussed. Mill and Adam Smith unite in their approval of a tax on the rent of houses. Says the latter:[1] "In general, there is not perhaps any one article of expense or consumption by which the liberality or narrowness of a man's whole expense can be better judged of than by his house rent. A proportional tax upon this particular article of expense might, perhaps, produce a more considerable revenue than any which has hitherto been drawn from it in any part of Europe."

Mill[2] says speaking of this tax: "In so far as it falls on the occupier, if justly proportioned to the value of the house, it is one of the fairest and most unobjectionable of all taxes. . . . A house-tax is a nearer approach to a fair income-tax, than a direct assessment on income can easily be."

The advantage of a tax of this nature is the accuracy with which rent serves as a basis of proportionate estimates; registering values, as it does, actually and in relation to each other at the same time. The chief disadvantage of such a tax is the inequality with

[1] *The Wealth of Nations.* Bk. V., ch. ii., p. 435.
[2] *Principles of Political Economy.* Bk. V., ch. iii., § 6, p. 502.

which it falls upon owner and occupier, for the owner is not proportionately reached.

Section V — Ground-rent

The remaining form of rent is the annual value of land independent of improvements. The study of this form of property, in the light of earlier considerations, and in relation to other forms of taxable wealth, brings a combination of these into view. In an examination of assessments upon real property, land offered the greater number of advantages; when the land was regarded as separate from improvements, the resulting value presented a form of wealth not traceable to individual endeavour, but to the society as a whole, as the source of its existence. This value, therefore, seemed a peculiarly suitable source from which social needs might be supplied. A difficulty appeared: the variable nature of the values considered. This difficulty disappears, however, if, instead of capital values, annual values derived from these are considered. The advantages of land, as a source of revenue, with the advantages offered by rent, as a means of registering values, are combined in this way. It seems, in fact, that in the combination of unimproved land and rent, a form of property is met, presenting exceptional conditions as a subject for fiscal attention.

A method of supplying social needs, which only touches socially created wealth, cannot have escaped the attention of the abler economists. "Ground rents," says Smith,[1] "are a still more proper subject of taxation than the rent of houses. A tax upon ground rents would not raise the rent of houses. It would fall altogether upon the owner of the ground rent, who acts always as a monopolist, and exacts the greatest rent which can be got for it. . . . Ground rents seem, in this repect, a more proper subject of peculiar taxation than even the ordinary rent of land. The ordinary rent of land is, in many cases, owing partly at least to the attention and good management of the landlord. A very heavy tax might discourage too much this attention and good management. Ground rents, so far as they exceed the ordinary rent of land, are altogether owing to the good government of the sovereign, which, by protecting either the industry of the whole people, or of the inhabitants of some particular place, enables them to pay so much more than the real value of the ground which they build

[1] *The Wealth of Nations.* Bk. V., ch. ii., pp. 436-437.

their houses upon; or to make to its owner so much more than compensation for the loss which he might sustain by this use of it. Nothing can be more reasonable than that a fund which owes its existence to the good government of the State should be taxed peculiarly, or should contribute something more than the greater part of other funds, toward the support of that government."

After pointing out that the predominant element of rent in large cities is usually that paid for the use of land, Mill[1] says: "Among the very few kinds of income which are fit subject for peculiar taxation, these ground-rents hold the principal place, being the most gigantic example extant of enormous accessions of riches acquired rapidly, and in many cases unexpectedly, by a few families from the mere accident of their possessing certain tracts of land, without their having themselves aided in the acquisition by the smallest exertion, outlay, or risk. So far, therefore, as the house-tax falls on the ground-landlord, it is liable to no valid objection."

These two economists unite in regarding a tax on the rent of unimproved land as the best of all sources of social revenue: "Among the very few kinds of revenue which are fit subject for peculiar taxation," says one. "Ground-rents seem, in this respect, a more proper subject of peculiar taxation than even the ordinary rent of land," says the other.

The three productive sources of private revenue are rent, profits, and wages. Rent is of two kinds: improvement rent and ground-rent. The distinction between tax upon ground-rent and a tax upon the rent of improvements is important.

The annual value of a portion of land, independent of improvements, is due to the profit to be derived from its use; through its proximity to harbour, markets, railway, or mineral wealth, in relation to centres of population. These profits determine the rental value of the land, or the price the tenant is willing to pay for its use. Ground-rent, therefore, is directly dependent upon profits. Profits, however, will be dependent upon something else — the consuming power of the people at large, or upon the return to productive occupation, or wages, in the broadest sense of the term. Thus rent, derived from the ownership of unimproved land, takes its rise from improvement rent, profits, and wages combined; or from the productive energies of the society as a whole, and represents, not rent alone, but a value combining all three sources of revenue. A tax, therefore, upon ground-rent seems to reach all three sources of

[1] *Principles of Political Economy.* Bk. V., ch. iii, § 6, p. 502.

revenue in proportion to their amount. An analogous train of reasoning does not seem available with reference to improvement rent; for the reason that improvement rent is due to individual initiative; if, therefore, this rent is reached by a tax, a disproportionate burden is placed upon it; if the tax is shifted to tenant, a disproportionate burden is placed upon profit and wages.

These considerations suggest that a tax on ground-rent conforms to the first principle laid down by Adam Smith, stating that individuals should contribute "in proportion to their respective abilities." As their abilities are measured by their revenues, in the form of improvement rent, profit, and wages, and, as ground-rents are proportionate to these, a tax proportionate to ground-rents seems "proportionate to their abilities."

The second principle states that a tax should be "certain and not arbitrary." Ground-rents seem to meet this condition automatically.

The third principle states that a tax should be payable at the time most convenient for the contributor. A tax upon ground-rents may easily be regulated to suit this maxim.

The fourth principle shows that a tax should "take and keep out of the pockets of the people as little as possible over and above what it brings into the treasury of the State." A tax levied upon ground-rent offers exceptionally inexpensive methods of assessments and collection.

"Both ground rents and the ordinary rent of land," says Smith,[1] "are a species of revenue which the owner, in many cases, enjoys without any care or attention of his own. Though a part of this revenue should be taken from him in order to defray the expenses of the State, no discouragement will thereby be given to any sort of industry. The annual produce of the land and labour of the society, the real wealth and revenue of the great body of the people, might be the same after such a tax as before. Ground rents, and the ordinary rent of land, are therefore, perhaps, the species of revenue which can best bear to have a peculiar tax imposed upon them."

[1] *The Wealth of Nations.* Bk. V., ch. ii., p. 437.