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## **Land Value Taxation: Persuasive Theory but Practically Difficult**

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In the last edition of the Property Valuer Tom Power used the principles of theoretical economics to discuss Land Value Taxation. He demonstrated how economic theory indicates that taxes levied on the value of what could be called raw undeveloped land will fall wholly on the landowner and that the imposing such a tax will not result in a welfare loss to the community. This is a significant feature of land value taxes compared to other taxes. As Tom puts it, the loss to the landowner is equal to the gain to the government and there is no deadweight loss; i.e. there is no welfare loss to the community resulting from Land Value Taxation.

Tom also pointed out that this lay behind the “single tax” argument of Henry George whose book *Progress and Poverty* became hugely popular following its publication in 1879. George’s idea was that all taxes could be replaced by a single tax on land values. By the end of the 19<sup>th</sup> century George’s ideas were being widely debated in Europe and the United States and were highly influential. Inevitably they swayed political thinking and in the UK, for example, Liberal governments in the early part of the 20<sup>th</sup> century introduced radical measures concerning the tax treatment of land and property. It is, however, important to note that for the most part the prominent economists of the day argued against the idea. Certainly it was doubted that in relatively rich countries the “single tax” could generate sufficient revenue to fund the state.

While the theoretical case for Land Value Taxation is regarded as being very persuasive, most people looking closely at the idea form the view that the practical difficulties of introducing it into an established modern economy are compelling. Nevertheless, in Europe and America the ideas put forward by George continue to influence many people discussing issues around land use planning, urban development and methods of funding infrastructure and local government.<sup>1</sup>

The concept of a land value tax is very simple but often there is confusion surrounding what is meant by the term due to the association with other forms of property taxes. Also other terms are used to convey the same basic idea. Certainly land value taxes are property taxes but the arguments put forward by George and economists supporting the introduction of such taxes do not necessarily apply to other property taxes. Care is needed, therefore, to understand the particular nature of what is being advocated when Land Value Tax is put forward.

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<sup>1</sup> To research contributions to debates about LVT in the US see [www.lincolninst.edu](http://www.lincolninst.edu) and in the UK see [www.landvaluetax.org.uk](http://www.landvaluetax.org.uk).

Land Value Taxation is a tax on the value of land excluding improvements. If applied solely to urban areas it is often referred to as a Site Value Taxation and when suggested as a method of funding local authorities can be called Site Value Rating. The notion behind Site Value Rating is that every property occupier would be liable to contribute to funding their local authority in proportion to the site value of the property they occupy.

With Land Value Taxation the idea is that the tax only falls on the value of the land element of the property; i.e. the real estate. This would be the open market value of the land or site on which the buildings sit on the assumption that it is available for development at what planners call its highest and best use. This may be thought of as the use that will throw up the highest site value assuming development can be carried out immediately at locally prevailing densities. In most instances this would be the open market value less the cost of development. To get a feel for what the site value might be in the case of a suburban house simply deduct the reinstatement cost, or what is known as the insurance value, from the market value and the balance would approximate to the value of the site to which the Land Value Tax would be applied.

It is important to distinguish Land Value Taxation from the rating system operating here in Ireland (which used to apply to residential property). Under the Rates system the amount paid to the local authority is based on the annual letting value of the entire property including buildings and improvements taken as a whole. In some countries the distinction between land and improvements in the form of buildings etc. is recognised and a “split rate” tax is applied where the site attracts one rate of tax and the buildings a different rate. Under a Land Value Tax system only the value of the land element would be taken into account.

The rating system taxes not only the land but also the capital added in the form of buildings and improvements. Under this arrangement if the property was further improved the occupier's rates bill goes up. Hence rates are partly a tax on improvements to property and act as a disincentive to investment in real estate. This aspect of the rating system is particularly unappealing and was one of the reasons why rates were unpopular when they were charged on domestic property. A family putting their resources into improving their living accommodation were taxed for doing so, hardly a popular policy in an age of mass home ownership or where there is considerable emphasis on urban regeneration. Ireland is not unique in having a Rates system although it is almost alone in the industrialised world in not applying it to domestic property.

Property taxes are very common and are among the oldest form of taxation. They exist all over the world mostly as a means of funding local government. Being old they are often encrusted with historical features that make them obscure as is the case with the Rates system here. Popular understanding of them is often not helped by the use of archaic language which may have been current at the time of the tax being introduced but is now somewhat unintelligible. As a result they are poorly understood by those levying and paying such taxes. All taxes are unpopular but often property taxes are particularly unpopular for these and other reasons and appear to be completely off the agenda politically.

Despite this, numerous economists continue to find the theoretical case for property taxes very persuasive. In particular many of them find the case for land value taxation compelling and have put forward strong arguments supporting it. Tom Power quoted Milton Friedman who is not known as an advocate of taxation. There are many others that could be cited. Here is one from Robert Solow<sup>2</sup>. “Users of land should not be allowed to acquire rights of indefinite duration for single payments. For efficiency, for adequate revenue and for justice, every user of land should be required to make an annual payment to the local government equal to the current rental value of the land that he or she prevents others from using”. Here is another from Franco Modigliani<sup>3</sup>; “It is important that the rent of land be retained as a source of government revenue”

These quotes indicate support for the theoretical case for the introduction of land taxes. They are taken from a letter to Mikhail Gorbachev arguing the case for particular approaches to the Russian economy following the fall of the Soviet system which was seen as a particular opportunity to introduce land taxes<sup>4</sup>. Solow certainly had reservations about the appropriateness of applying such a tax in a rich capitalist developed economy.

It should not be surprising, therefore, that using property taxes as a means of funding local government consistently appears as a recommendation in reports to government on the issue. When the Irish tax system was examined by the Commission on Taxation in the mid 1980s it concluded that property taxation was the only practicable method of raising significant sums in local taxation. In their report they recommended a local property tax be introduced on self assessed open market capital values of residences assuming the property is occupied on a fee simple basis<sup>5</sup>. Like the Commission on Taxation most of these refer to property taxes and not specifically to Land Value Taxation but more recently bodies as diverse as the Chambers of Commerce of Ireland and CORI have advocated site or land value taxation in budget submissions to government. Perhaps this marks a renewed interest in the concept here in the light of the need to find a more appropriate means of funding local government than now exists and continuing interest in issues around funding infrastructure, capturing betterment and reforming the tax system.

Advocates of Land Value Taxation put forward a long list of advantages which include the notion that there can be no avoidance or evasion because land cannot be removed or hidden. This is one of the chief attractions of the tax as a means of

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<sup>2</sup> Solow was one of the major figures of the Neo-Keynesian [Synthesis](#) macroeconomics. Together with Paul [Samuelson](#), he formed the core of the M.I.T. economics department which has been widely viewed as *the* "mainstream" of the post-war period.

<sup>3</sup> In 1985 Modigliani won a Nobel prize for two major contributions - his life-cycle savings hypothesis and his work on corporate finance. He had been a leading voice in the controversy that has dominated technical economics for much of the late 20<sup>th</sup> century, the clash between the Keynesians, who emphasize failures of markets, and the New Classicals, who tend to see only their successes.

<sup>4</sup> The letter to Gorbachev was dated November 7<sup>th</sup> and is reprinted in Richard Noyes (ed.) [Now the Synthesis: Capitalism, Socialism & the New Social Contract](#). London Shepard-Walwyn, 1991, pp225-230

<sup>5</sup> Final Report Commission on Taxation 1985 Government Publications

funding local government. They also suggest that the tax cannot be passed on to consumers and producers. Moreover, it is suggested that such a tax would mitigate against property speculation and moderate the boom and bust cycles that historically are a familiar feature of urban real estate markets both here and abroad.

From the point of view of the economics of urban areas, advantages mainly centre around betterment, the more efficient uses of the stock of available buildings and increased incentives for higher density development. Let us briefly consider these in more detail.

Firstly, the increase in the value of individual properties due to infrastructure and local service improvements would be captured in part at least by the state if there was a system of Land Value Taxation in place. For example, recently there were reports that property values along the Luas lines went up more rapidly than other property in Dublin. With a system of Land Value Taxation those benefiting from this would find their taxes increased while those not benefiting would find their taxes reduced. From this it should be clear that there is a strong moral argument in favour of Land Value Taxation in that it is closely associated with taxing what is known as betterment; i.e. the increase in site/land values due to decisions made by the community.

Secondly, land use efficiency would be improved as a disincentive to holding on to land surplus to immediate requirements would exist. Sites would be brought to the market more quickly as the costs of leaving them undeveloped would mount. This would make more efficient use of a scarce resource, serviced urban land.

Thirdly, in the long run Land Value Taxation would provide an incentive to developing urban land at a realistic density as the land value tax is spread among a greater number of property owners per unit area of land. The tax to be paid on a hectare of urban development land available for development would be the same whether it was developed at 20 houses to the hectare or at a permitted higher density. This factor is seen by advocates of Land Value Taxation as acting in a way that discourages the urban sprawl which is an unwelcome feature of many developing urban areas.

The difficulties associated with Land Value Taxation are mostly practical in nature although it should be said also that the introduction of any form of property tax would be politically unpopular if not impossible in Ireland at present.

In the first place there would be a need to create and maintain a land value registry and this could be a costly exercise. Also this would need to be updated consistently for the system to work and information on property transactions would need to be gathered. This would, however, not be without benefits related to ease of conveyancing and providing reliable information about property markets. Furthermore the development of information technology linked to geographic information systems is reducing the magnitude of the problems involved with this.

Furthermore, there would be difficulties around identifying the value of the land element, a valuation exercise not without difficulty. This would require professional judgments by valuers and disputes would certainly arise. There would have to be a trade-off between accuracy in any given case and maintaining the viability of the

entire system. There would have to be, therefore, an acceptance of a degree of arbitrariness with assessments.

Moreover, restrictions on the use of land and buildings would have to be taken into account in particular cases. For example, would it be fair to tax a building owner on the value of the site on which a listed period house stands? Redevelopment is not an option in cases such as this. Also a Land Value Tax system would work best where property markets are as free as possible from prescriptive forms of land use planning and other legislation. Laws giving tenure rights to tenants under landlord and tenant legislation would be an example of this. For Land Value Taxation to work there would probably be a need for significant changes to the institutional arrangements now made for property/real estate in our society.

Finally and of crucial importance after a long boom in property values, the introduction of a Land Value Tax would change fundamentally the economics of property ownership. Without doubt high rates of taxes on land values would mean departing significantly from existing tax structures and liabilities. It would mean a shift from taxes on labour and goods and on to property. While this might be seen as desirable it would have consequent negative effects on the capital values of real estate assets particularly urban development land. Certainly there would be transitional difficulties if there was an attempt to introduce such a tax in a period when property values, and therefore site values, are high. This can be clearly seen if one considers the position of someone who paid a high price for a site before the introduction of Land Value Taxation out of their savings. The subsequent reduction in the value of the site could be seen as taxing away their savings that enabled them to buy it in the first place<sup>6</sup>.

In conclusion it must be said there is considerable theoretical merit in Land Value Taxation. There is also a weighty moral argument in favour of its introduction. Moreover, if introduced there is little doubt that in the longer run there would be many beneficial effects on urban form and shape and many of these would be in sympathy with the principles of sustainable development. On a wider level there is considerable weight to the argument that we should reduce the taxes on income and goods and increase taxes on property. For these and other reasons the case for Land Value Taxation will continue to be made and the successors of Henry George will endure. In particular, many economists and others, searching for equitable means of funding local government and providing infrastructure will continue to find the arguments for Land Value Taxation enthralling and become advocates for the case.

On the other hand when the difficulties of implementing such a tax are examined the theoretical and moral imperatives will pale against the practical obstacles that will certainly emerge. The real world and political realities would seem against Land Value Taxation at the moment.

*Doc,f Articles byTt. Dunne Land Value Taxation for Property Valuer Feb 05 final*

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<sup>6</sup>Solow was particularly concerned about this