

Real Estate Taxes

The real estate tax combines two inherently different kinds of assets: land, which is the gift of nature, and buildings, which are the product of labor.

Land is worth the most that anyone is willing to pay for it. More land cannot be produced, so a tax on the value of land cannot diminish the supply of land. It is the best of all taxes because it is a charge for the value of the benefits received by the taxpayer.

By contrast, an annual tax on the value of buildings is confiscatory and makes them more expensive to own. Therefore, it might seem like the higher cost of owning a house contributes to a decrease in the supply of housing. And it would if we were living in America when free land Homesteads were available. Where there's free land the cost of housing is equal to the cost of building it. So, when there's a free land alternative, an annual tax on the value of buildings adds to the cost of owning them. It makes houses more expensive to own and diminishes their supply. However, the free land that offered an independent living is gone.

Suppose you have a quarter acre parcel of residential land in one of the very best suburbs. There is no house or other improvements on it, but you want to lease it to someone else and collect the annual rents. You might be willing to fix the rent for several years, but not so long that you can't raise it when and if the land increases in value. How much could you charge for this ideal parcel of residential land without a house on it? Of course you will charge the most that anyone is willing to pay, but few

people want to rent a lot without a house except for a vegetable garden. The lessee could put his own house on the lot, but he couldn't easily move it if you raise the rent too much when the lease is up.

Without a house you would only be able to charge a small amount, because of the very limited potential. With a house on the land, people will pay far more than it would cost to provide the house. Add the current rate of interest times the value of the building, plus maintenance, management, and depreciation, and the difference is land rent. The rental value (Potential Rent) of residential land is the result of building whatever house will yield the largest difference between the cost of providing the building and what people are willing to pay for it on that particular parcel of land. The tax on buildings adds to the cost of providing the building, but the building is necessary to get the maximum land-rent. Therefore, the tax on buildings reduces the land-rent by the same amount.

Taxes on the value of buildings are paid out of what would otherwise add to the rental value of land, which is an unearned income and a legitimate source of revenue.

However, if the land is under used, the tax and the incentive to use the land are diminished. If there are no buildings or other improvements, there is no tax.

Therefore, there is no penalty for land speculators who leave their land under used or idle causing a shortage of housing or unemployment while the selling value of the land appreciates. Under used and idle land increases the cost of the infrastructure and public services. The roads, pipes, and wires have to be much longer; all people and goods must travel past under used and unused land.

By contrast, taxes on the value of land must be paid even if the land is vacant and its owner gets no income.

Therefore, the higher the tax on the rental value of land, up to its full value, the greater the incentive to put the land to its full economic use — providing housing or jobs. For that reason all taxes should be shifted to the rental value of land.

There are exceptions where taxes on buildings do discourage construction and diminish the supply. Taxes on buildings that cost more per square foot to build as they get higher do grossly diminish their height and add to the shortage of housing and jobs. Second: In the most distressed areas of many old industrial cities there are parcels of land where their rental value is so low that if the buildings were rehabilitated or replaced by new construction, the taxes on those buildings would exceed the rental value of the land. In those cases or anywhere the building tax exceeds the rental value of the land, they do make the buildings more expensive to own and therefore, diminish their supply. Taxing the value of land is far better than taxing the value of buildings, not only because under used and idle land pays its fair share, but it enables the full use of the most valuable city sites, and it removes the penalty for the rehabilitation of city slums. []