
Response to the West Virginia Report on Fair Taxation

by William Batt, Albany, NY

1. The first point to recognize in this report is that there is recognition of the principles that should guide the design and evaluation of sound tax practice. Increasingly there is awareness that there are "better" taxes and "worse" taxes; i.e. that all taxes are not equal. As corroboration of this, one should look at the reports of other Tax Study Commissions, two others of which can be accessible right from the

Internet. Those others are Hawaii (http://www.hawaii.gov/tax/trc_rpt.pdf), and Washington, DC (<http://www.dctrc.org/>). The former, for reasons of limited resources, has chosen not to address the local tax on real property at this time, but it may do so later as it is authorized as a continuing commission. Over the past two decades, there have been several other states that have constituted similar commissions to evaluate their tax struc-

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tures. Among them are Arizona, Connecticut, Indiana, Louisiana, Maryland, Massachusetts, Michigan, Minnesota, Nebraska, Nevada, New Hampshire, New Jersey, New York, Ohio, and Texas. Indeed, there may be others. Most of these begin by enumerating the principles of sound tax theory, which typically can be found also in textbooks on public finance.

2. The West Virginia Report on Fair Taxation recognizes the principle of equity as a criteria of evaluating the soundness of a tax structure. But it sometimes fails to clearly distinguish between the two aspects of equity: the ability-to-pay principle and the benefits-received principle. These sometimes lead to different designs. The former typically is employed to accomplish what Richard Musgrave calls the distributive function of tax policy. It is applied to what are usually identified as public goods. The benefits received principle is the framework employed for charges intended to recover costs or for benefits from services provided by governments that have the character of private goods. It does conclude that the property tax is a good "measure of the benefits received from government."

3. This response to the Report will attempt to address only those aspects concerning its reference to the property tax. West Virginia classifies property into four types: Class I includes intangible personal property. Class II includes owner-occupied residential property. Class III includes all property located outside of a municipality that is not classified as Class I or II property. Class IV includes all property located within the corporate boundaries of a municipality that is not classified as Class I or II property. There is a good deal to be said for this division, although the details of Class IV are not amplified. Presumably Class III is unplatted real property for which it is difficult to make assessments. This practice is followed in several other states, such as Maine, Minnesota, and

South Dakota. There is no indication of how real property used for commercial or industrial purposes is classified. Class I, intangible personal property, is often difficult to assess or collect on, and most states have abolished taxes on personal property for reasons that it is administratively unfeasible (except sometimes for motor vehicles). The main concern of this response is Class II (residential) and whatever other real property parcels are conventionally classified as commercial and industrial.

4. It should also be noted that "all property is to be appraised at 100 percent of its market value," although it then goes on to say that it is then assessed at

60 percent of this. This is needless confusion, and it contravenes the principle that tax design should be simple so as to be easily comprehensible and not subject to qualification and exception. It further compromises this principle by its allowance of several additional exemptions, a matter that will be addressed further below.

5. Although the report recognizes that the property tax satisfies to a considerable extent the benefits received criteria of tax theory, it then proceeds to argue that:

Property taxes on residences do not conform to the ability to pay principal and are considered to be regressive to income. This is because housing represents a smaller percentage of total income for higher income individuals than it does for those with lower incomes. While the wealthy may live in more expensive houses, they do not spend as great a percentage of their income on housing as do those with lower incomes.

This has now been contradicted in a number of studies. One most often referred to is that of Henry Aaron at the Brookings Institute, but there have been others. Moreover, one could argue that many households of greater means settle in more expensive housing districts, mitigating whatever regressivity might be at first apparent in this form of taxation. In better understanding

the incidence of the property tax, however, it is best to refer to a contemporary textbook explanation.

6. The leading graduate text in Public Finance course in the country, used in over 200 schools, is that of Princeton University Economics Professor Harvey Rosen. He spends several pages explicating the tax on real property, refuting the notion that a tax on real property is necessarily regressive. He points out that it is really two separate taxes that work in very different ways and with very different dynamic effects. It constitutes a tax on the value of the land and a separate tax on any improvements. Increasingly, some of the more thorough literature on the property tax shows an awareness of this, although not universally. One recent summary of the research literature shows that a tax on the land component is progressive. In fact, were the tax on improvements eliminated, the property tax, reconstituted as a land-value tax, would be highly progressive.

7. A point is often made concerning retired people who, although once in higher income brackets, are now living on pensions and social security payments and can ill afford to stay in their homes. This is presented as an argument about the regressivity of the tax on real property. There are several points to be made in response.

A. Residential property typically constitutes only a fraction of the property tax base on which localities rely for their revenues. In most cases it is about 50 percent of the tax base, even before several exemptions, deductions and credits are applied. As a group, therefore, residential parcels pay only a portion, sometimes a small portion when such provisions as the Homestead clause are applied.

B. Retirees living in their own homes typically are capital rich even if they are income poor. Over the course of decades of home ownership they have typically been able to capitalize the value of their residential property

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through generous provisions of tax shelters. Logic and equity would call for them to return that equity in times of their changed circumstances. An analogy might be with a worker's pension: stored up during one's working years to be then drawn upon during one's retirement years. Another analogy is with what have come to be called "reverse mortgages" where the equity that has accrued in a home over the course of years is gradually returned to the lender in reverse payments.

C. Several states have established provisions whereby there are deferrals of property taxes for primary residences of retirees until such time as they "cash out." This means either selling to move into a nursing or retirement home or die. A total of 21 states have established deferral programs, and they would appear to be a far more equitable means by which to address the temporal inequities of the property tax system than other designs.

8. The Report makes a point of saying that:

It is much more difficult to determine the burden of the property tax on commercial property. Is it passed on to consumers in the form of higher prices, or is it absorbed by the company in lower profits? It is possible that some of the tax may be passed on to employees in the form of lower benefits or wages. It depends on the competitive conditions in the market. If there is strong competition for the products or services of the business, then the tax is likely to be absorbed. If the labor market is tight, the tax will not rest on workers.

This is patent nonsense. While it may be true that the improvements proportion of the real property tax will be shifted, either backwards onto stockholders or onto workers, or forward to consumers of the products or services rendered, the land component must necessarily be capitalized in the value of the property itself. The reasons for this are explained in Rosen's text and

in most other books dealing with real property taxation. Even where the non-land component may constitute a burden of sorts, several studies show that taxation is seldom a factor in business locational decisions, and should not be used as a whipping boy or plausible reason for the economic activity of an area or lack of it.

9. Although the Report enumerates the principles that should guide sound tax design, there is little further discussion about issues of stability, efficiency or neutrality. It should be pointed out that a tax on real property, reliant largely if not entirely upon the land component, would go far toward stabilizing the cycles in the economy. Students, especially of the Georgist persuasion, have argued that it is the speculation in land that provokes the booms and busts in various national economies, and that capturing the surplus rent that is capitalized in land for the purposes of financing government services would go far toward stabilizing not just revenue streams but economies generally. There is ample evidence, particularly with reference to the economies of Japan and Southeast Asia in the 1990s, that the collapse of their economies was precipitated by a crash in the speculative bubble of land values.

10. With respect to efficiency and neutrality, the best short statement of the merit of land value taxation compared with alternative approaches can be found in a volume of papers done in connection with a report made to the State of Arizona in connection with its Tax Study Commission. Work in progress will soon be able to demonstrate how much cost there is to our economic productivity by our reliance upon the current tax structure.

11. It is important, particularly now with concern about global warming and reliance upon fossil fuels looming, that attention be given to the problem of urban sprawl. Among other problems, sprawl makes people automobile dependent, a considerable problem for the one third of the population

that are increasingly disenfranchised from community and society by virtue of not being drivers or car-owners. As a rule of thumb, experts argue that a household density of about 10 per acre is minimally necessary to make public transit service economically viable. Beyond the transit problem itself is the destruction wrought by sprawl on the viability of community itself. This is increasingly evident in the documentation of the decline in civic participation, in many cases due to the limitations imposed by motor vehicle transportation.

12. Criticism is often raised about the problems and challenges of assuring fair, accurate and reliable assessment of real property, since it must serve as the tax base for local tax revenues. To be sure, there has been a problem in assuring such accuracy in past years. Statistical analyses at the present time are capable of overcoming most such problems, and there is high reason to believe that it will improve rapidly in the near future with further application of computer programs. Moreover, were land alone made the basis of taxation, computer applications could be brought to bear that would be far better than anything now done by current practices. Using Geographic Information Systems technology, profiles of land values can be made that measure parcels against one another and against sales data. At the present time, any assessments with a performance accuracy of under 15 percent variance are considered not just satisfactory but commendable. Even at the present time, GIS approaches using triangulation algorithms can easily exceed such standards, making assessment both more accurate and reliable, easier and cheaper than reliance upon assessors are possible. West Virginia would be wise to invest in GIS technology and data collection as a means by which to improve its tax on landed property, not continue in the direction of seeing it as suspect.

13. Comparative data analysis is

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quickly becoming available, particularly by the work of this writer, that will be able to demonstrate the value of land value taxation in real-world applications, not just for the theoretical juxtaposition vis-a-vis other taxes. The

fortuitous development of both computer programs powerful enough to handle cadastres of thousands and tens of thousands of parcels, coupled with the increasing availability of data compilations from governments, makes land value taxation a real possibility. A century ago, journalists and economists put forth compelling arguments for land value taxation; today it is possible to actually test those ideas in actual instances to show what will happen. The wisdom of a century can be applied to show now that what had

been a visionary idea is easily implemented.

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