

The Ultimate Tax Reform

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What is the optimal tax reform? The best is a tax on land values because that is the only way to effectively promote growth, reduce poverty, increase equality, prevent the boom-bust cycle, prevent rent-seeking subsidies, and raise wages.

Other taxes impose costs which stifle entrepreneurs and investment while increasing the cost of living. The bad effects of taxes come from the “marginal tax rate,” the tax on extra output, extra trade, and extra consumption. Tax reformers agree we should reduce marginal tax rates. Why do it half-way? A tax on land value has a zero marginal tax rate.

The public goods provided by government make locations more attractive and productive, increasing the demand to be there, and so increasing the land rent and land value. Therefore, public goods are a subsidy unless the land owner pays back the generated rent. Also, much of the gains from economic progress are captured by higher land rent. Land speculators, watching real estate prices rise, add to the demand. That creates an unsustainable boom, followed by a crash as in 2008. The real estate crash brings down the financial system. The effective way to prevent the boom and bust is to tax land value.

If we tax labor, we get less labor. If we tax capital, we get less capital. But if we tax land, we don't get less land. Land does not flee, shrink, or hide when taxed. There is no tax evasion, and, unlike with income taxes, there are no tax audits.

Much of the excessive inequality of our economy comes from the land-value subsidy. By taxing land value, we equalize income without sacrificing growth and productivity. Indeed, land-value taxation (LVT) promotes efficient land use and growth by pushing idle land and under-used land to productive use. LVT assesses land value in its highest and best use.

LVT is based on the market value of land, not including buildings and other improvements. LVT does not increase the land rent, since if landlords raise the rent, they get fewer tenants. LVT does reduce the purchase price of land, but that makes it more affordable. After the transition, LVT does not burden even the landowner, because the tax replaces mortgage interest.

See the other side for how LVT can be implemented and contact details.

How to Implement Land-Value Taxation

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Locally, we can use the existing property tax system, reducing the tax rate on buildings while increasing the tax rate on land value, until all improvements are tax exempt. The land value would be assessed at least annually. Pennsylvania and some other states enable local governments to have a split-rate tax on real estate.

For a gradual implementation by the US states, sales and income tax rates get reduced, along with the property tax rate on buildings, while the tax rate on land value is increased. Pollution levies and congestion fees can supplement LVT.

A federal implementation of LVT can be implemented within the current Constitution in two ways. One way is as a direct tax on land value. The US Constitution authorizes a direct tax if the revenues are proportional to state population. Indeed, the federal government levied direct taxes to help pay for the War of 1812, with a discount if the state collected the tax and passed it on.

The other method would be to use the income tax to tax the rental income from land, which would apply also to the imputed rent of owner-occupied land. At least a third of national income is land rent, providing ample revenue.

Compensation for higher tax rates is not advocated for increases in income or sales taxes, but the issue arises with LVT because asset values are affected and are important. A shift to land value taxation can be made politically more feasible by compensating those with net losses. The few with net losses would be compensated with bonds.

Even if not fully implemented, LVT provides the best direction for tax reform. Lower marginal tax rates can be accompanied by the *elimination* of: 1) deductions for mortgage interest and depreciation, 2) tax-free property exchange, and 3) the tax exemption for gains in land value. There can be higher tax rates for land gains than from gains in the value of financial assets. The deduction for property taxes should be kept as an incentive for local government to levy LVT.

A 36-page version is at <http://www.foldvary.net/works/policystudy.pdf>

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