TAXATION OF LAND VALUE INCREMENTS

The equity argument for taxation of *increases* in land values is at least as strong as that for annual taxes on total land values. This kind of tax is aimed at recapturing for the government a higher proportion of what economists call the unearned increment—the rise of land value that occurs, not through efforts of an owner but through governmental action (new highways, subway lines, zoning changes, etc.) and through growth of the population and industry of the community.

Land value increment taxes strike directly at the unearned increments realized by specific individual owners, and do not penalize present owners who have *not* realized substantial land value increments. The claim in this case is not that community improvements *tend* to enrich landowners in general; tax liability occurs only when enrichment is demonstrated by the realization of capital gains on land.

Variants of this approach to taxation are used in a number of countries. In some Hispanic countries, specific public improvements are financed from taxes on the estimated (although not necessarily realized by sale) increase in the value of adjacent properties; this is done on a very large scale in some of the major cities in Colombia. In our own country, special assessments to finance street and sewer projects have a similar rationale. In a number of European countries, this approach shows up in the income tax treatment of capital gains on land, which is much less favorable than that of other types of capital gains.

Thus, land value increments could be taxes in a number of ways and at different levels of government. Perhaps the easiest method might be through State income taxation, by a special supplemental rate on capital gains on land or by including a larger portion of the gain as ordinary income (rather than the 50 percent now included in most States, following the Federal practice). This seems easiest, because the gains are already reported and legal definitions do exist and are applied.

Like annual land value taxation, this form of taxation would be largely neutral with respect to the use of land and would not discourage new construction. However, its economic impact and revenue potential would be somewhat less. Presumably, the land value increment tax would apply only to gains actually realized (including constructive realization at the death of the owner). Very high tax rates would tend to postpone realization of gains, although closing the transfer-by-death loophole would reduce this. Nevertheless, the economic impact would be in the right direction and the equity effects appropriate. Therefore, this seems good policy, especially if straightforward annual land value taxation does not prove acceptable.

IMPROVEMENT OF THE EXISTING INSTITUTION

Since some of the major defects in the existing institution relate to the fragmented structure of local government in urban areas, an obvious direction for reform is application of the property tax over wider geographic areas, thereby reducing tax rate disparities by evening out the differences in tax base per capita or per pupil. There are two approaches to this.