FACULTY STUDIES IN BUSINESS ADMINISTRATION

Reprint Series

The Property Tax in the Fiscal System

by

C. Ward Macy

SCHOOL OF BUSINESS ADMINISTRATION

Eugene, Oregon

[Reprinted from the Proceedings of the Fifty-First Annual Conference on Taxation sponsored by the National Tax Association, 1958.]

THE PROPERTY TAX IN THE FISCAL SYSTEM

C. WARD MACY
Professor of Economics, University of Oregon

The property tax, prominent as a source of revenue in America over a period of two centuries, continues to be a large producer of funds for the support of government. Local jurisdictions in the United States obtain approximately 87 percent of their current tax revenues from this source; the states about 3.5 percent. This fiscal measure accounts for slightly less than 13 percent of total tax receipts to all governmental units, exclusive of payroll taxes,[1] being surpassed in productivity only by the income tax. Annual property tax collections have been greater in recent years than at any time in the past.[2]

It is evident from current data on public revenues that the role of the property tax in contemporary government finance is highly significant. Nonetheless, the position of the property tax among all taxes has declined in relative importance in the last few decades, with the major part of the decline having occurred during a fifteen year period that ended with the conclusion of World War II. Little change in the relationship between revenue from the property tax and total receipts from other taxes has taken place since the war.

Less than thirty years ago, more revenue was obtained from the property tax than from any other tax in use.[3] Today the income tax is the leading producer with the property tax running far behind in second place.[4] Several developments have been responsible for the change in the position of the property tax in the total scene. Most influential among these has been the extensive utilization of personal and corporate income taxes by the federal government. This has caused income tax collections to increase much more rapidly than property tax

[1] These data are for 1956. See Table 1 below. Only state and local governmental units tax property. The Federal Constitution provides that "direct Taxes shall be apportioned among the several States which may be included in this union, according to their respective members, . . ." (Art. I, sec. 2). This constitutional provision prohibits the use of the property tax by the federal government. See also Art. I, sec. 9.

[2] Revenue from property taxes was $11.7 billion in 1956, approximately $1 billion in excess of the 1955 total. In 1932, the total was $4.5 billion; in 1944, $4.6 billion. See Table 2 below for property tax collections in most years between 1932 and 1956.

[3] In 1932, property tax revenue was 55.5 percent of total tax revenue; 18.1 percent of state tax revenue; 92.5 percent of local tax revenue. See Table 1 below.

[4] The income tax accounted for 60.6 percent of all tax revenue in 1956, exclusive of payroll taxes. For the federal government, it produced 81.4 percent of the total; for the states, 16.9 percent; for local units, 1.3 percent. See the Tax Institute's study, "Total Tax Collections in 1956," *Tax Policy*, Vol. XXIV, Nov., 1957, p. 3.

receipts. Also many states have been employing income taxes, thus adding to total revenues derived from non-property tax sources. General retail sales taxes, introduced on a broad scale by states during the depression decade before the war, have been continued in use with favorable results from the standpoint of productivity. In addition, certain excises have become producers of substantial amounts of revenue and are being levied now by taxing units at all levels of government. These major developments within the last quarter-century have caused the relative importance of the property tax to decrease, particularly between the years 1932 and 1946.

The property tax, although widely used and quite generally accepted in the past, has been subjected to severe criticisms over a long period. It has been maligned on both theoretical and pragmatic grounds.[5] In the face of the abuse which this tax has taken, why has it continued to be employed on a broad scale? One very practical reason is found in its well-demonstrated capacity to produce large sums of revenue for governments, especially local units. Another is the failure to discover substitutes for the property tax which would justify the abandonment of this means of acquiring funds for public use. Opposition to the taxation of property is strong and demands for property tax relief are increasing. There is little reason to believe, however, that the demise of the property tax is imminent. Even though both intergovernmental revenues in the form of receipts to local governments from states and local non-property tax revenues are becoming increasingly prominent each year as supplements to collections from the property tax, they do not serve as full replacements except in rare cases. During the next few years, the property tax will probably become relatively less important than it is today in the revenue structure of the country but it will not be unimportant in the foreseeable future. Pending a much more pronounced shift away from the property tax than is now in the offing,

[5] Most writers on taxation, including authors of public finance text books, refer to certain recognized weaknesses of the property tax. An unrelenting critic of property taxation was the late E. R. A. Seligman whose works are often cited by others. He contended that "the property tax is as destitute of theoretical justification as it is defective in its practical application." According to Seligman, "The general property tax in the United States is a dismal failure." See his *Essays in Taxation*, 9th ed. New York: The Macmillan Co., 1921, pp. 19, 31, for the above statements. Chapter II of this book is devoted entirely to the general property tax, and includes a discussion of the practical and theoretical defects of this tax.

Another critic of the property tax, writing approximately a half-century ago, pointed out the importance of its role at that time, especially in financing local governments, and concluded that "the United States has the most crude, inequitable and unsatisfactory system of local taxation . . . that can be found in any important country in the civilized world." C. J. Bullock, *The General Property Tax in the United States*. Columbus: The International Tax Association, 1909, p. 7. The property tax is now somewhat less significant as a producer of revenue for the support of local government than it was in 1909, but its present position is sufficiently prominent to suggest that criticisms of this tax have not had the effect of driving it into obscurity.

this revenue measure is entitled to careful attention on the part of tax economists and practitioners.

In this paper the history of the property tax and its role in the fiscal scene of recent years are treated briefly. Consideration is then given to major property tax supplements and replacements now in use, followed by an examination of some theoretical and administrative issues concerning the property tax as a source of revenue in mid-twentieth-century America.

Historical Aspects of Property Taxation

The taxation of property dates back to antiquity.[6] During the sixth century B.C., a tax on land was levied in Athens. Through the centuries that followed, the property tax in some form was prominent in the fiscal programs of many governments. Early Rome imposed taxes on land, the base later being extended to include other types of property. At the start of the Mediaeval period, land was the main form of wealth and bore the major part of the burden of taxation until trade created large quantities of movable goods which were made subject to taxation.[7] Gradually over a span of years, items of property other than land became parts of the tax base.

Throughout Europe in the late Middle Ages and prior to the establishment of the America colonies, the pattern of levying taxes initially on land and later on other kinds of property was followed.[8] Before the commercial and industrial revolutions, land was the principal form of property that could be taxed. Consequently, land taxes were predominant in the early stages of the development of direct taxation in Europe. As additional types of wealth appeared, the property tax base was expanded to include them. Since property taxes were quite well-suited to the economies of the pre-industrial period, they tended then to be fairly successful in operation. Ownership of land and other property was a reasonably satisfactory measure of ability to pay at that time.

In the American colonial era, land in New England was usually held under the Crown with payments for its use taking the form of quasi-feudal quitrents.[9] These were, in effect, appropriations of a portion of

[6] See Seligman, *op. cit.*, pp. 32-37, for a good statement on the general property tax in the Greek and Roman eras. Seligman has been recognized over a period of many decades as a thorough student of taxation history.

[7] *Ibid.*, pp. 38-45.

[8] *Ibid.*, pp. 45-56, for a discussion of the property tax in the late Mediaeval period.

[9] The quitrent as a fiscal device is discussed in J. P. Jensen, *Property Taxation in the United States*. Chicago: University of Chicago Press, 1931, pp. 19 ff. Jensen writes: "It was implicit in all land grants, to proprietary lords as well as to quasi-public corporations, that the annual sum, usually ranging from one shilling per hundred acres to one penny per acre, was payable to the Crown or the vassal of the Crown, as revenue or at least as token of inferior tenure of the land." p. 20.

land values to meet public expenditures. Evasion of quitrents was common, however, because of opposition to them on the part of colonists. Property taxes were introduced into New England when quitrents ceased to serve adequately as producers of public revenue. They began as levies on real property but were soon extended in coverage to include other properties. In the middle and southern colonies, property taxation developed more slowly than in New England because of the prevalence of export and import duties, excises, and other indirect taxes in these sections.[10] Nevertheless, the general property tax was used widely in most parts of colonial America by the middle of the eighteenth century.

The notion that taxes should be levied on the basis of income-earning capacity, or faculty, had an appeal to colonists.[11] Property in the form of visible wealth was regarded as one measure of faculty. The general acceptance of this view gave impetus to the real estate taxation movement. As in other parts of the world, the tax base was soon extended to include property other than realty. The experiences with property taxation in colonial days set the stage for the future employment of this means of raising revenue on the part of the American states and their subdivisions. Throughout the nineteenth century, the property tax was a very important source of public revenue with provisions governing its use being embedded firmly in the constitutions of most states.

Only minor difficulties were encountered in the taxation of property in the United States during the early part of the nineteenth century. At that time wealth was mainly tangible and visible. The problem of attaining a high degree of uniformity in valuation was not serious. Tax rates were low; burdens of taxation were not heavy. These conditions were drastically altered, however, in the second half of the century. Property tax rates increased; the organization of corporations introduced moneyed capital and intangibles into the picture as additional types of property; appraisal of property for taxation purposes was done in a manner that resulted in undervaluations. Complaints against the general property tax grew as inequities developed. Tax commissions were established in an attempt to cope with the issues. General property taxation gave way gradually to a classified property tax system. At the present time, some properties are entirely exempt from taxation while special rates apply to others.

In reviewing the history of the general property tax, one writer has contended that it is "largely indigenous in the United States"[12]; another that it is "peculiarly an American development."[13] In contrast to these opinions, a prominent scholar has insisted that this tax is a relic of mediaevalism,[14] while another has branded it as a device imported from Europe, devoid of specific American and democratic qualities.[15] The property tax as Americans have come to know it did not exist in Europe or elsewhere, of course, at the time the colonies were established, but the idea that property can serve in some manner as a base for taxation is ancient in origin. The very rapid growth of the property tax in the United States over the past century and the broad expansion of its base to include newly developed forms of wealth as they have been created have given a strong American flavor to this revenue measure. These factors have prompted many students to regard this tax as basically an American institution. History reveals clearly, however, that the taxation of property did not have its beginning in this country.

The Property Tax in Recent Years

In the last few years, the property tax has been important as a source of revenue in the United States only at the local level of government. With few exceptions, it is insignificant today in the fiscal operations of states.[16] Recent data pertaining to revenue for the support of counties, cities, school districts, and other local taxing jurisdictions reveal the current role of the property tax at this level. In 1956, local revenues totaled $26.3 billion. Of this amount, $19.4 billion came from local sources; $6.9 billion from other governments, mainly from states. Utility, liquor store, and insurance trust revenues were responsible for $3.2 billion. The remaining portion of the sum obtained from local sources ($16.2 billion) was general revenue resulting from taxes and from miscellaneous producers of funds such as fees, licenses, and parking charges. Taxes accounted for $13 billion, or approximately 80 percent of the general revenue. Property tax receipts were $11.3 billion. This total was 87 percent of local tax revenue and 70 percent of

10 Seligman, *op. cit.*, pp. 16-18.

11 Jensen, *op. cit.*, pp. 26 ff.

12 *Ibid.*, p. vii. Jensen develops this point more fully in a later section, pp. 19 ff.

13 W. H. Anderson, *Taxation and the American Economy*. New York: Prentice-Hall, Inc., 1951, p. 113.

14 Seligman, *op. cit.*, p. 56. This writer suggests that history everywhere teaches the same lesson concerning property taxes. He states that direct taxation takes the form of a land tax at the outset with other items of property being included later in the tax base. Various kinds of personal property tend then to escape taxation. This leads to exemptions and modifications and brings the property tax back toward a levy principally on real property. According to Seligman, "The property tax in the United States is simply one instance of this universal tendency; it is not an American institution. . . ."

15 Bullock, *op. cit.*, p. 6.

16 Nebraska is the most notable exception. In 1956, this state obtained in excess of 30 percent of its total revenue from the property tax. See Tax Institute, *op. cit.*, pp. 6-7, for data on state tax collections by sources in 1956.

local general revenue.[17] It is apparent from these data that the property tax continues to be the hub of the wheel of local finance. As previously noted, however, the relative importance of this tax among the many revenue measures used by all governments has declined over the past three decades, especially between 1932 and the end of the war.

A picture of property tax revenue as a percent of total tax revenue, state tax revenue, and local tax revenue in selected years since 1932 is presented in Table 1. Revenue from payroll taxes is not included in the data. The statistics show that the most pronounced shift in the relative position of the property tax in the last three decades occurred between 1932 and the end of World War II. During those years, the very rapid increase in federal and state non-property tax revenues exceeded greatly the modest growth in property tax receipts. Since the war, the marked rise in property tax collections has caused property tax revenue as a percent of total tax revenues to remain fairly constant. Over the same period, property tax revenue as a percent of state and local tax revenues respectively has continued to decline, but only in a moderate manner.

TABLE 1.—*Property tax revenue as a percent of total tax revenue, state tax revenue, and local tax revenue in selected years* [18]

(Exclusive of payroll taxes)

(1) Year	(2) Total tax revenue	(3) State tax revenue	(4) Local tax revenue
1932	55.5	18.1	92.5
1942	27.0	5.4	92.8
1945	8.8	5.4	92.0
1946	9.3	4.6	92.1
1947	11.2	4.5	90.6
1948	11.5	4.1	88.5
1949	12.9	3.8	88.4
1950	13.9	3.9	88.2
1951	12.1	3.9	87.9
1952	10.7	3.8	87.5
1953	11.2	3.5	87.0
1954	11.8	3.5	87.2
1955	13.2	3.6	86.9
1956	12.8	3.5	86.8

17 These data were selected for this presentation from the Bureau of Census, *Summary of Governmental Finances in 1956,* United States Department of Commerce, August 23, 1957, pp. 20-23.

18 Some of these percentages were computed by the writer from data on tax collections obtained from many issues of *Tax Policy* and from the Bureau of Census, *Historical Review of State and Local Government Finances,* Special Studies in State and Local Finance: No. 25, United States Department of Commerce, June, 1948, p. 13. For the years 1952 through 1956, the percentage computations were obtained from the following issues of *Tax Policy:* Vol. XX, Sept., 1953; Vol. XXI, Sept., 1954; Vol. XXII, Oct., 1955; Vol. XXIII, July, 1956; and Vol. XXIV, Nov., 1957.

Data on total property tax revenues and per capita property taxes for most of the years since 1932 are presented in Table 2. They reveal that annual receipts increased more than 160 percent and the per capita tax approximately 100 percent within the last quarter-century.[19] The changes that occurred in the ten-year period after the war were particularly important because of the large absolute amounts involved. They explain why a growing interest has been shown recently in the taxation of property.

TABLE 2 [20]

(1) Year	(2) State and local property tax revenue (In millions)	(3) Per capita property tax	(4) Per capita personal income	(5) Per capita property tax as a percent of per capita personal income
1932	$ 4,487	$35.89	$ 401	8.9
1934	4,076	32.35	423	7.6
1936	4,093	32.00	534	6.0
1938	4,440	34.15	527	6.5
1940	4,430	33.56	595	5.6
1942	4,537	33.86	909	3.7
1944	4,608	34.38	1,194	2.9
1945	4,551	34.22	1,234	2.8
1946	4,540	32.20	1,249	2.6
1947	5,512	38.27	1,316	2.9
1948	6,135	42.02	1,420	3.0
1949	6,843	45.93	1,382	3.3
1950	7,367	48.79	1,491	3.3
1951	7,926	51.80	1,649	3.1
1952	8,652	55.46	1,727	3.2
1953	9,375	59.30	1,788	3.3
1954	9,967	61.91	1,767	3.5
1955	10,735	65.46	1,847	3.5
1956	11,749	69.94	1,950	3.6

19 The increases in total property tax revenue and in the per capita property tax since 1932 are less striking on a percentage basis than those in the first quarter of the present century. In 1902, total state and local property tax revenue was $707 million and the per capita tax was $8.35. By 1912, property tax revenue was $1183; the per capita tax was $11.20. Within the following ten years, both total property tax revenue and the per capita property tax rose almost 200 percent, the amounts in 1922 being $3321 million and $30.55 respectively. Further increases in total revenue to $4531 million and in the per capita tax to $38.50 had occurred by 1927. See Jensen, *op. cit.,* p. 2.

20 State and local property tax data for the years 1932 through 1944 were obtained from the Bureau of Census, *Historical Statistics on State and Local Government Finances, 1902-1953,* Special Studies in State and Local Finance: No. 38, United States Department of Commerce, 1955, p. 17; for the years 1945 through 1956, from various issues of *Tax Policy.* Population statistics used in computing per capita property taxes were taken from the Office of Business Economics, *Personal Income by States, Since 1929,* United States Department of Commerce, 1956, pp. 144-145. Per capita personal income data were also obtained from this publication.

The data on total revenue from the property tax and on the per capita property tax since 1932 have added significance when viewed alongside per capita personal income figures for the same years. The latter are included as a part of Table 2, together with the computation of the per capita property tax as a percent of per capita personal income for each year under review. The statistics in the table show that per capita personal income has risen almost 400 percent since 1932, with the percentage increase being more marked before 1946 than after that date; that per capita personal income rose about 60 percent from 1946 to 1956, whereas the per capita property tax more than doubled in those years; and that the per capita property tax as a percent of per capita personal income decreased sharply from 1932 to 1946 but rose slightly during the ten-year period after 1946. If the incomes of those who paid the property taxes between 1932 and 1946 were typical of over-all personal incomes of those years, the position of property taxpayers was favorable at that time. Since 1946, however, the increase in the per capita property tax in relation to the growth in per capita personal income has reversed the earlier favorable trend. This shift in relationship serves as a plausible explanation of the current agitation for property tax relief and accounts for the concerted efforts to find substitutes or partial replacements for property taxes. The pre-eminent place which the property tax held in the total fiscal picture a few decades ago has been lost, but its present role in financing government, particularly at the local level, continues to be important enough to command much attention.

Property Tax Supplements and Substitutes

It is noted above that the property tax has been generally abandoned as a major source of financial support for state governments. General and selective sales taxes and income taxes have tended to replace property taxes as leading sources of revenue at the state level. A movement toward the use of similar measures by cities and counties has been underway in recent years, but it has not developed to the point that local property taxpayers, with the exception of those in a limited number of jurisdictions, have gained much relief. Intergovernmental revenues in the form of receipts to local governments from states, on the other hand, have become very important as elements in local finance. They serve today as substantial additions to revenue from local property taxes.

In giving consideration here to property tax supplements and substitutes, attention is directed only to those which operate at the local level since the property tax is now a significant source of revenue mainly to local units. In 1956, local taxes other than levies on property produced $1.7 billion, with general and selective sales taxes and gross receipts taxes accounting for 52 percent and individual income

taxes 10 percent of this amount.[21] The total from non-property taxes was 13 percent of all local tax revenue and slightly less than 10 percent of local general revenue for that year. The major portion of "other" tax revenue was raised by cities through the use of sales taxes, both general and selective, and individual income taxes. The introduction of these taxes has had little effect, however, upon the relative position of the property tax in the over-all structure of local finance. A larger sum, $3.2 billion or roughly 20 percent of local general revenue, was acquired by local governments in 1956 from fees, charges, special assessments, and the like. Cities received about one-half of this. But the total revenue produced by all of the above-mentioned property tax supplements was no more than 30 percent of local general revenue in that year. The remaining 70 percent came from the property tax.[22]

In contrast to the moderate amount of revenue produced by local fiscal measures other than the property tax, the sums obtained annually by local units from states have been large over the past few years. In 1956, local governments received $6.6 billion from states to assist in meeting their expenditures. This was approximately 30 percent of total local receipts from all sources, exclusive of utility, liquor store, and insurance trust revenues. School districts were the recipients of almost one-half of the funds distributed to local jurisdictions by the states. Cities and towns obtained a smaller part of the total, with their receipts resulting mainly from the functioning of various types of revenue-sharing plans of states. It is clear from the data pertaining to intergovernmental revenues to local governments that these supplements to locally produced revenues have become vital factors in local government finance.[23]

Within the past quarter-century, local property tax revenue as a percent of total local expenditures has changed in a marked manner. Some of the more recent changes illustrate the increasing dependence of local governments on revenue from sources other than the property tax. In 1932, revenue from the local property tax was 65 percent of total local expenditures; in 1950, 79.1 percent; in 1956, 45.1 percent.[24]

[21] *Summary of Governmental Finances in 1956* (see footnote 17), pp. 20, 21. About 38 percent of the total non-property tax receipts came from miscellaneous sources, including certain licenses and permits.

[22] *Ibid.* Percentage calculations were made by using appropriate absolute amounts included in the data.

[23] *Ibid.*

[24] Data on local expenditures for 1932 and 1950 were obtained from *Tax Policy*, Vols. XVIII, Nov., 1951, p. 3 and XIX, Oct., 1952, p. 2; for 1956, they were computed from data in *Summary of Governmental Finances in 1956* (see footnote 17), p. 24. Local property tax revenues for 1932 and 1950 were secured from *Historical Statistics on State and Local Government Finances, 1902-1953* (see footnote 20), p. 21; for 1956, from *Tax Policy*, Vol. XXIV, p. 3. With these data available, percentages were determined.

In spite of the rapid increase in property tax revenue since 1950, it has failed to match the greater growth in local expenditures. Local governments have been moving, therefore, in the direction of heavier reliance on revenue sources other than the property tax to meet the costs of their expanding services. While the property tax continues to be the most prominent revenue producer among the many in use for the support of local government and thus continues to warrant special attention in studies of local finance, other sources of revenue have developed to the point that they must be recognized as significant factors in the total picture.

Theoretical and Administrative Issues in Property Taxation

It is shown in preceding sections of this study that the property tax has retained a commanding position within the domain of government finance, particularly at the local level, despite efforts to find other sources of revenue to replace or supplement it. While it is highly unlikely that the states will resort again to the taxation of property on a large scale, local governments will probably be compelled to rely heavily on revenue from this source in the foreseeable future. Therefore, consideration of certain theoretical and administrative issues involved in the taxation of property is in order.

The Property Tax and the Principles of Ability-to-Pay and Benefits-Received. As indicated above, the property tax has long been subjected to criticism on grounds of principles of taxation. Students of government finance are in general agreement that its burdens are not distributed on the basis of ability to pay. Also, they find fault with this tax when it is examined in the light of the benefits-received principle. Although the evidence in support of the latter objection to the property tax is not wholly convincing, it is nonetheless impossible to find strong arguments in terms of benefits to taxpayers which justify the use of this revenue measure. In an explanation of the prominent place of property taxation in modern fiscal operations, more weight must be given to expediency than to basic principles.

Ownership of property does not necessarily signify an ability to pay taxes. Levies imposed on durable consumer goods, *e.g.*, homes and personalty, bear no dependable relationship to the tax-paying capacity of those who make the payments. Taxes on income-producing properties are levied at proportional, not progressive, rates on assessed values which are seldom determined by capitalizing property income. These taxes may be shifted to consumers, in whole or in part. It is evident that they are not related to income, whether paid finally by property owners or consumers. Under certain conditions, owners of property may have a degree of ability to pay taxes not possessed by non-property holders, but there is little that can be presented in defense of the property tax on the ability principle. This fiscal device is regressive to income, as shown later, and thus violates the principle of ability-to-pay to the extent that income measures ability.

On the side of benefits received, it is acknowledged that property owners are beneficiaries of many direct public services financed by levies on property, such as police and fire protection, street maintenance, and the like. In addition, owners of property benefit from the increase in values of their land and buildings which results from expenditures of property tax revenues for schools, libraries, and recreational facilities. Therefore, benefits accruing to property owners should not be ignored completely in an analysis of property taxes. At the same time, limitations on the use of the benefit principle to justify the taxation of property must be recognized. In the first place, benefits to property owners are largely subjective and difficult to measure accurately; secondly, benefits which arise from public spending of property tax receipts are not restricted to owners of property, but tend to be widely diffused; and finally, some property taxes are likely to be shifted, which may cause the direct monetary burdens of their payment to fall on non-property owners. In the face of these limitations, the case for the taxation of property on grounds of benefits to taxpayers is weakened. At best, the benefits-received principle can be employed to provide no more than a partial justification of taxes on property.

Shifting, Incidence, and Capitalization of Property Taxes. Final appraisal of a tax should be based on its over-all and long-run consequences. Fiscal theorists agree that a tax for revenue purposes should not only be productive and fair, but also that it should have minimum repressive effects on the total economy. In order, however, to determine long-run effects of a tax, the incidence of the levy must be known. Incidence is interpreted here to mean the "coming to rest" of the direct monetary burden involved in the payment of the tax.[25] It does not refer, in addition, to the indirect burdens which a tax may impose on many segments of the economy.[26] These are effects.

[25] According to Hugh Dalton, "The total money burden imposed by any tax is equal to the total yield of the tax to the public treasury." See his *Public Finance,* 6th ed. London: George Routledge and Sons, 1930, p. 51.

[26] Many fiscal theorists do not attempt to separate incidence and effects of taxes, preferring to regard effects as a part of a broad concept of incidence. It is frequently contended that incidence means the over-all and long-run burdens occasioned by taxes, including those which bear on income, employment, saving, investment, and other aspects of the total economy. While there is no denying the influence of taxes on different phases of the economic order, there is, nevertheless, an advantage in attaching to incidence a less sweeping interpretation. A point of departure in tracing the effects of any tax is provided by knowledge concerning the "coming to rest" of its monetary burden. This view, expressed by Seligman, holds that "it is only when we have ascertained the incidence that we can proceed to discuss the wider effects of a tax." See his *Shifting and Incidence of Taxation.* New York: Columbia University Press, 1921, p. 14.

There is almost no limit to what may fall under the heading of incidence if the term includes possible long-run effects of a tax on the entire economy. To illustrate, K. E. Poole writes about the "burden or incidence" of a tax, stating that the analysis of shifting and incidence "has to be related to the

In the case of a property tax the obligation to transfer funds from the private sector of the economy to the public authority falls on the property owner, but he may be in position to obtain all or a part of the amount of the tax from others. In that event, the tax is paid, in whole or in part, by non-owners of property as a consequence of a shifting process which has been made possible by the play of economic forces. Because it is often difficult to state precisely whose incomes are depleted by the payment of a specific tax,[27] pronouncements relating to effects may fall within the realm of speculation. The treatment of property tax incidence is especially troublesome because taxes are imposed on such a wide variety of properties.

To know whether property taxes are shifted or borne by property owners, it is necessary to view separately the levies imposed on each of several kinds of property. The broad classifications of property for purposes of analyzing shifting and incidence are (1) land in its natural state; (2) buildings and improvements on land; (3) personalty in the form of merchandise inventories, machinery, and other items used in the productive process; (4) durable consumer goods, aside from homes, such as furniture, jewelry, and musical instruments; and (5) intangibles in the nature of stock certificates, promissory notes, and bank balances. Does the monetary burden of payment of a tax on property in each of these categories remain at its point of impact, or may it be passed to another in whole or in part? Answers to questions pertaining to incidence as the term is used in this study lie in the operation of market and short-run, rather than long-run, economic phenomena.

true period in which we are interested." He contends that "indirect economic effects modify the process of tax shifting, so that unless they can be taken into account, an erroneous conception of the location of the burden of the tax may result." Therefore, "The incidence of the tax cannot be known . . . until all the direct and indirect effects have worked themselves out." When incidence is interpreted in this way to mean burden and effects over an indefinite period of time, its analysis is never ending. See his *Public Finance and Economic Welfare.* New York: Rinehart and Company, 1956, pp. 117-118.

[27] Empirical studies of incidence are tending to replace abstract analysis in this area of inquiry. For policy making purposes, these are probably necessary. In such studies, however, assumptions are frequently made concerning the final payer of the tax. In a recent and very useful study of the incidence of the tax structure, R. A. Musgrave draws some interesting conclusions concerning the effects of tax burdens on consumption. He contends that we must know something about incidence of taxes to appraise their effects on consumption, but he makes some assumptions about the incidence of particular taxes in his analysis of effective rates in various spending unit income brackets. See "The Incidence of the Tax Structure and Its Effects on Consumption," *Federal Tax Policy for Economic Growth and Stability.* Washington: Joint Committee on the Economic Report, 1955, pp. 96-113. He states that "we assume . . . that [personal] income-tax payments stay put with the taxpayer." (p. 100). He makes the further assumption that "two-thirds of the corporation tax [income] is borne by the shareholder while one-third is passed on to the consumer." (p. 100). Assumptions are made also in connection with the incidence of other taxes. In the hands of a skilled tax theorist who understands incidence problems, there is little danger in the practice of making certain assumptions to serve as a basis for empirical analysis. Musgrave maintains that "theoretical reasoning as well as empirical observation" support his conclusions. (p. 100). But another writer, by using different assumptions which are not based on an acquaintance with tax theory, might end an empirical study with results radically different from those which would be drawn by a competent theorist and analyst.

A tax is wholly or partially shifted if it causes a direct increase in the price of a good or a direct decrease in the price of a factor of production. A levy paid out of a surplus element of income, or that portion of a factor income beyond the amount necessary to keep the factor in constant supply, is not subject to shifting.[28] Traditional theory holds that a tax on land value, or economic rent, is a tax on surplus. No reduction in the supply of land or in the produce from land results from this tax. The disposable income of the land owner declines, therefore, by the amount of the tax. Furthermore, the owner at the time the tax is imposed will continue to bear the tax even after selling the property if the tax was capitalized before the sale price was determined. In other words, a bidder for land will be inclined to compute, at the going rate of return, the capitalized value of income equivalent to the existing annual tax, and offer less accordingly for the property. By this method, a new owner may compel the former owner to carry the load indefinitely, with the buyer paying the tax in future years out of income from the amount which he saved when purchasing the land. Thus a tax on land value, although not subject to forward shifting, may be shifted backward through the capitalization process.

Buildings and improvements on land have lasting qualities not found in all forms of property. They differ from land, however, in that their supplies do change over time. Some of the conditions which prevent forward shifting of a tax on land are also present in the taxation of buildings and improvements. In an analysis of incidence of taxes levied on the latter types of property, durable consumer goods and producer goods need to be considered separately.

An owner-occupier of a home cannot shift a tax on the house and improvements since he is not engaged in selling the use of the property. He is a consumer of living space, and the tax which he pays on property is similar to other levies on consumption.[29] If a tenant is occupy-

[28] J. A. Hobson supported strongly the interesting thesis that taxes should be paid out of surplus elements of income. See his *Taxation in the New State.* London: Methuen and Co., Ltd., 1919, Chap. II. This chapter of Hobson's work may also be found in E. D. Fagan and C. W. Macy, *Public Finance—Selected Readings.* New York: Longmans, Green and Co., 1936, pp. 199-214.

[29] A recent and exhaustive study of taxes on housing is W. A. Morton, *Housing Taxation.* Madison: University of Wisconsin Press, 1955. Like many other writers, Morton believes that effects of taxes cannot be clearly distinguished from incidence. Much of his study is devoted to a consideration of the long-run consequences of taxes on housing.

ing the house, the owner will attempt to shift the tax by including it in the rental charge. To the extent that the tax is shifted in this manner, it becomes a consumption levy on the tenant. The current demand for housing is the factor of major importance in determining whether the owner or tenant pays the tax, or whether they share the monetary burden. In a boom period marked by brisk demand, an owner may be able to exact all of the property tax from the tenant. In a depression, on the other hand, the owner may be forced to bear a large part of the burden. Perhaps taxes will discourage house construction and land improvement over the long pull. In that event, supply will be reduced, and an owner may then be in position to obtain a rental income high enough to cover the property tax. But the degree of his success in shifting today's tax on a house for rent is contingent on conditions prevailing in the current market for housing.

The conclusion with respect to the incidence of a tax on rental housing holds also for the incidence of a levy on another type of income-producing property, such as a factory, an office building, or a warehouse. A tax on property in this form is a business cost which will be recovered in prices charged for goods or services produced for sale only in case the market permits. Supplies of these buildings will be influenced by taxes in the long run. But pending long-term supply changes, which should be viewed as effects, the incidence of a tax on income-producing property is determined by the operation of market forces.[30] If a tax on buildings and improvements is not shifted forward, it may perhaps be capitalized in the same way that a prospective buyer will capitalize a tax on land before making an offer for it.

Taxes on personal property used in production, *e.g.*, merchandise inventories and machinery, are costs which must eventually be included in prices of goods if production is to continue. This does not mean, however, that market price of a commodity is always high enough to cover all costs involved in producing the good, including taxes on personal property. But the supplies of various kinds of personal property, in contrast to those of land, buildings, and improvements, may be altered in the short-run period. Therefore, holders of taxed personal properties are in position to make adjustments which are not possible for owners of productive properties in fixed supply. Under these circumstances, there is a strong tendency for taxes on personal property

[30] It has been stated that the incidence of a tax on some reproducible capital, *e.g.*, a building, rests eventually on all capital as a consequence of the movement of investment away from taxed capital to other areas. The resulting increase in the supply of capital which is not taxed will reduce the return on it, according to the argument, and thus all capital is affected by a tax on some of it. See Fagan and Macy, *op. cit.*, pp. 251-254, for reproduction of a section from M. S. Kendrick, *Taxation Issues*, which treats this matter. But if circumstances pertaining to saving and investment should cause a capital movement of this kind to take place following the imposition of a tax on certain types of capital, it would clearly be a long-run effect and have no direct bearing on incidence as the term is used in this paper.

used in production to be shifted forward to consumers in the short-run, particularly under full-cost pricing.

Consumer goods, such as household furniture and other personal items, are occasionally taxed. The direct monetary burden falls on the owner. There is no further transaction to follow the imposition of the tax, and no shifting is possible. This kind of property tax is simply another levy on consumption.

Taxes on intangible properties are not shifted, although they are likely to be evaded. A tax on a bond or note reduces the net rate of return to an owner on his investment. In the long-run, rates of interest may be forced up and prices of securities down by taxes levied on intangibles as property. But the incidence of such levies in the short-run is clearly on the owners. This issue has little more than academic interest now because the taxation of intangible property has been largely abandoned.

Regressivity of the Property Tax. A tax on property, whether levied on land, buildings and improvements, or personalty, tends to be regressive to income. The burden of monetary payment rests on the property owner, the tenant, or the consumers of goods and services which are produced with the aid of the taxed property. Under certain conditions, it is shared by persons in these groups. In no case, however, is the tax related directly to income.

Taxes on housing constitute a substantial portion of total taxes on property. Their incidence, as previously indicated, is on occupiers except when the demand for shelter is such that owners of rental housing units are forced to bear a part or all of the burdens. It is contended that "the smaller the income of a family the larger is the proportion of the income spent for housing."[31] In this situation, a tax on housing is regressive.

To the extent that taxes on business properties of various types are shifted to purchasers of goods and services, they become burdens on consumers and are regressive to income. If the incidence of these taxes is on owners in whole or in part, the levies are unrelated to incomes of taxpayers. This conclusion holds also for taxes on land which are borne by owners. And in the practice of levying taxes on durable consumer items which cannot be shifted, any positive correlation between taxes and income of those who bear the burdens is purely coincidental.

A recent empirical analysis of the incidence of taxes reveals that the property tax is regressive, "though less so at the upper end of the scale than that of excise and sales taxes."[32] This is a case of damning

[31] A. H. Hansen and H. S. Perloff, *State and Local Finance in the National Economy*. New York: W. W. Norton and Co., 1944, pp. 38-39. These writers state that owner-occupiers and tenants bear much of the burden of taxes on housing, and that levies on such property amount to specific taxes on an important item of consumption.

[32] Musgrave, *op. cit.*, p. 101.

with faint praise, but it does give credence to the widely-held belief concerning the regressivity of the property tax. The study records effective rates of property taxes in 1954 as varying from 4.2 percent of spending unit incomes of $2000 and less to 3.2 percent of unit incomes in the $10,000 and over bracket.[33] The decline in the effective rate is shown to be steady as unit income rises. Opinions of fiscal theorists concerning some aspects of the property tax differ, but the notion that this revenue measure is regressive meets little opposition.

The Property Tax and Economic Stability. More than one hundred thousand local units of government are operating in the United States today. Collectively, they receive each year in excess of $11 billion from property taxes. The states as a group obtain approximately $500 million annually from levies on property, an insignificant portion of total property tax receipts. In an examination of the property tax and economic stability, only local levies are important enough to warrant consideration.

On the basis of the volume of dollars involved, the amounts of local expenditures and supporting revenues from property taxes are sufficiently large to play roles of considerable significance in efforts to attain full employment and economic stability. Unfortunately, however, both local spending operations and the local property tax are ill-adapted to such roles.[34] Decisions relating to expenditures at the local level are seldom, if ever, based on their probable counter-cyclical effects. And there is virtually nothing about the property tax which makes it suitable as a means of counteracting the business cycle.

In actual practice, local spending is likely to aggravate cyclical changes occurring in the economy. Outlays tend to rise in a boom and fall in a depression, moving with the trend of general business. Borrowing as a means of raising funds for capital improvements is generally favored by a local public when economic conditions are prosperous, only to be opposed when production and incomes are falling. At a time when the federal government is pursuing fiscal policies designed to counteract certain forces at work in the private sector of the economic system, financial actions on the part of local governments, whether spending, taxing, or borrowing, may serve to offset, in part, the effects of the central authority's efforts. So long as the amount

[33] *Ibid.*, p. 98. It is stated in footnote 27 that Musgrave makes some assumptions concerning incidence in his study of effective rates of taxes on property. He writes: "The general principle, in estimating the incidence of this tax is that the part assessed on owner-occupied residences rests on the owner, the part assessed on the improvement component in business property (including rental housing) rests on the consumer, and the part assessed on the rent component of business property rests on the owner." p. 101. These assumptions are in general agreement with the conclusions reached in this paper.

[34] See Anderson, *op. cit.*, p. 132, for a statement on why the "possibilities of using the property tax as a counter-cycle instrument are quite negligible. . . ."

of spending by local governments is determined principally by local authorities and so long as the property tax remains as the main source of local tax revenue, the contribution to economic stability on the part of local governments will be inconsequential.

The local property tax tends to function in a rigid manner. It does not possess built-in flexibility. Assessment and collection practices allow little opportunity for adaptations of revenue receipts to cyclical changes in the economy. Alterations in assessed values of property are likely to be made only infrequently, even though market values are subject to rapid fluctuations. Effective tax rates tend, therefore, to rise in depression and to fall in prosperity. Millage rates may be increased or decreased from one year to another in order to bring more or less revenue to local governments, but usually there are various state-prescribed limits to local action in this area which place restrictions on local officials.

It is shown above that there is no observable correlation between property taxes and the incomes of those who bear the burdens of making the monetary payments. Taxes which are unrelated to income cannot function effectively as counter-cyclical measures. Thus in the light of theory as well as in administrative procedure, the property tax has almost nothing to offer as a device to assist in the promotion of economic stability. If federal, state, and local financial operations could be better integrated than at present, and if federal and state grants-in-aid to local units could be liberalized in a manner which would relieve local jurisdictions from their present heavy reliance on the property tax, perhaps local government financing could then assist in the attainment of economic stability.[35]

Property Tax Administration. Faulty administration of the property tax accentuates certain theoretical weaknesses of this fiscal device. If improvements in administrative practices could be effected, the shortcomings of the tax, as they are revealed when the measure is evaluated in the light of the canons of equity and economy, would be less pronounced. The problems of administration are many and varied. The most crucial issues revolve around appraisal and assessment of property. Only brief reference can be made here to these phases of property tax administration.

Frequently there is delay in placing properties, especially new buildings and equipment, on assessment rolls. This may be caused by inertia on the part of assessors' office personnel or to an inadequate number of appraisers. Some properties already on the rolls are likely

[35] These and other points on the property tax and economic stability are made in J. A. Maxwell, "Intergovernmental Fiscal Devices for Economic Stabilization," *Federal Tax Policy for Economic Growth and Stability.* Washington: Joint Committee on the Economic Report, 1955, pp. 807-817; and in a study by G. W. Mitchell, O. F. Litterer and E. D. Domar on "State and Local Finance," a chapter in *Public Finance and Full Employment.* Washington: Board of Governors of the Federal Reserve System, 1945, pp. 101-130.

to be underassessed in relation to others, causing certain segments of the economy to be unfairly treated and adversely affected as a result of lack of uniformity. This administrative fault can often be traced either to incompetence of appraisers or to differences in methods employed in seeking values to be used as a basis for making assessments.

Improvements in assessment procedures are most likely to occur in those states which place a substantial part of the responsibility for appraisal in the hands of well-trained employees of the state. It does not follow that local administrators are always ineffective. On the contrary, they may be highly competent. The nature of the job of appraising properties is such, however, that the state should cooperate with local governments in this important work. The entire job of assessing property should not be attempted either by a central agency, such as a tax commission, or by local officials. So long as a part of the task is performed locally, the advantages which arise from interest and understanding on the part of local officials will accrue. But the appraisal and assessment of public utilities, certain industrial plants, mines, timber, and perhaps additional properties, should be the responsibility of state officials. In addition, state appraisers should supervise the work of local officers and cooperate with them in an effort to attain uniformity in assessment of all properties. Fair and equitable appraisal of property for taxation purposes will eliminate one of the most glaring faults of the property tax as it has operated in the United States.[36]

The Rationale of the Property Tax

It is evident from the data presented above that the role of the property tax as a producer of revenue at the local level of government continues to be highly significant, even though its relative importance in the fiscal system of the country as a whole has declined in recent decades. This tax is shown to have many faults. It cannot be defended on grounds of the ability-to-pay principle, and its use can be only partially justified on the basis of benefits received by taxpayers. Its regressivity is acknowledged; its incidence is often uncertain; its failure to contribute to economic stability is recognized; and its administration results in frequent and serious injustices. In the face of these theoretical and administrative weaknesses, why is the property tax tolerated?

As a means of support for state governments, the property tax is gradually being abandoned in favor of other more suitable sources of revenue at this level. State levies on property are no longer warranted and the movement away from them needs to be encouraged. But as a local revenue producer, the property tax should remain in service. It cannot be discarded, principally because there are no wholly adequate substitutes for it ready to be employed. Some of the present objections to the property tax will probably disappear if the amounts of intergovernmental revenues increase in relation to local property tax collections and if an overhauling of property tax administrative machinery is effected. In later years, local governments should place less reliance on the property tax than they do at the present time, but they will not be in position to abolish it completely. They have an obligation, therefore, to improve its administration.

The bulk of property subjected to taxation has a high degree of permanency of location. When levies are imposed on these properties, the reasons are usually made clear to the public. Residents understand that property tax revenues are used primarily to pay for governmental services provided for their benefit. Consequently, a view tends to prevail that the burdens created by local property taxes are to be borne, in general, by local people in exchange for services rendered by the public authority. Thus the property tax has a peculiarly local flavor. This feature of the tax and its demonstrated capacity to produce substantial sums of revenue serve to explain its prominence in local fiscal systems of past years and the reasons why it will continue to function in the future. If the degree of dependence on this fiscal measure can be lessened, a case can then be made in favor of its retention as one of several means of acquiring revenue for local governments.

In considering the possibilities of reducing the emphasis on property taxation for local support, the nature of the alternatives must be given attention. They fall in categories of (1) other revenues raised locally, and (2) intergovernmental receipts to local units, particularly from states. Developments in these areas are now altering the picture of local government finance.

Aside from charges made for specific services, the major sources of locally-produced, non-property tax revenue are net income and general retail sales taxes. As stated above, these are not yet very important in the total scene, although they are quite prominent in certain localities. To the extent that local personal net income taxes are substituted for property taxes, granting their administrative feasibility, general welfare is likely to be enhanced. But the imposition of regressive local sales taxes as partial replacements for property taxes leaves much to be desired. The present inequities in the distribution of local tax burdens will not be diminished by shifting a part of the load from property taxpayers to buyers of goods and services whose sales are taxed, particularly if food is included in the tax base. The local sales tax as a response to demands for property tax relief is based on expediency rather than on principle.

[36] In some states, a concerted attempt is being made to improve appraisal and assessment of property by utilizing the services of state appraisers. Equalization is being gradually attained in Oregon, for example, by cooperative efforts of state and local officials. For discussions of this state's reappraisal program, see C. W. Macy, "Some Legal and Administrative Aspects of the Property Tax in Oregon," *Oregon Law Review*, Vol. XXXIII, April, 1954, pp. 179-187; also "The Theory and Practice of Central Assessment," *Proceedings of the Forty-Ninth Annual National Tax Association Conference*, 1956, pp. 501-510, by the same author.

In contrast to the dim prospects for a greater degree of equity in financing local governments through the channel of sales taxation, inter-governmental revenues, particularly in the form of state aid to local units, hold considerable promise of success. Many local services, especially in the areas of education and welfare, are broad in scope and costly to provide. Financial assistance from the states, with assurance that local autonomy will not be seriously jeopardized, is warranted as a means of reducing the burden on local property taxpayers. Notably in the field of education, the need for additional revenue to supplement and partially to replace local property tax receipts is great. Consequently, the movement to divert state revenues to local governments, now well underway, would, if expanded, be in the interests of over-all welfare. But as this movement develops, the states have an obligation to obtain their revenues in a way which will distribute total tax burdens in an equitable manner.

It seems apparent that the property tax as a source of revenue for the support of local government must continue to play a significant part in the fiscal scene. The key to its betterment lies in aggressive action (1) to improve its administration, and (2) to integrate state and local revenue systems under a plan which will transfer large amounts of state revenues, raised in accordance with the canon of equity, to local units of government. To the extent that these steps are taken, many of the present objections to the property tax as one segment of local revenue systems will be dispelled.

FACULTY STUDIES IN BUSINESS ADMINISTRATIO

SCHOOL OF BUSINESS ADMINISTRATION

University of Oregon

Eugene, Oregon

REPRINT SERIES

1. Degree of Progression: The Income Tax, by Richard W. Lindholm. *The American Economic Review*, September, 1954.
2. A Case Against the Idea of an All-Purpose Concept of Business Income, by Charles E. Johnson. *The Accounting Review*, April, 1954.
3. The Growth Factor in Railroad Stock Analysis, by O. K. Burrell. *The Analysts Journal*, August, 1955.
4. The Business Activities Tax, by Richard W. Lindholm. *Michigan Tax Study Staff Papers*, 1958.
5. The Coming Crisis in External Convertibility in U. S. Gold, by O. K. Burrell. *The Commercial and Financial Chronicle*, April 23, 1959.
6. Industrial Adaptation, by O. K. Burrell. *Business Topics*, Spring, 1959.
7. The Property Tax in the Fiscal System, by C. Ward Macy. *Proceedings of the Fifty-First Annual Conference on Taxation sponsored by the National Tax Association*, 1958.