Filling the Land Tax Void: New Zealand Standpoint

Abstract*

This paper investigates land taxation from a New Zealand perspective and examines the principles of economic efficiency and equity behind three common property valuation methods for taxation. The primary question is whether using land value as the base on which to assess property tax remains the most efficient and equitable tax mechanism compared to capital value tax on improvements and annual value tax on estimated income earned from the property. The paper briefly assesses the challenges confronting valuation and the impacts that may arise from a levy of property tax in different jurisdictions that differ across certain features. The paper concludes that while issues exist in the determination of any basis of value, it is asserted however, that there is a need for considering exemption provisions to implement a land value tax in New Zealand, which has a significant potential to compromise the principle of economic efficiency.

1.0 Introduction

"Whoever hopes a faultless tax to see, hopes what ne'er was, is not, and ne'er shall be."
Alexander Pope (1688-1744)

The tax system plays multiple roles. In addition to being a fundamental instrument to raise revenues that finance government expenditure, it also acts as an instrument to achieve the economic and social aims of government, and to redistribute income on a socially acceptable basis.

The New Zealand tax system is generally well-designed and has served the country over decades; however, it is not sustainable. The approaches to tax design and governance practices will need to change to meet global competition and technological development. The challenge for New Zealand tax authorities is to reform a legal and administrative environment while broadening the tax base. A narrow tax base is inefficient because there is the tendency to avoid participation in taxed activity, which forces the tax rate up on that activity. Therefore, the converse is true: by taxing different activities or new sources of revenue, tax rates can be kept comparatively low.[1] New Zealand relies heavily on the Goods and Services Tax and Income Tax.

Land tax, recommended by the Tax Working Group (TWG)[2] in 2010 to replace a number of existing taxes, is one of the biggest holes in the New Zealand tax regime. The Tax Working Group has indicated their belief that the current tax system is inefficient, stating that changes

* The author would like to thank anonymous referees for critical advice on an earlier draft of this paper which significantly improved this paper. Any remaining errors are naturally those of the author.

1 P Genschel, "Globalisation and the Transformation of the Tax State" (2005) 13 / Supplement S1 *European Review* 53-71, Cambridge University Press.

2 Victoria University of Wellington Tax Working Group, *A Tax System for New Zealand's Future: Report of the Victoria University of Wellington Tax Working Group* (Centre for Accounting, Governance and Taxation Research, Victoria University of Wellington, 2010) ('Tax Working Group').

are needed to enhance efficiency and reduce the barriers to productivity and growth. Unless exemptions are made, a land tax will have an impact on all land owners including non-residents, charities, local authorities, non-state schools, hospitals and others owning land in New Zealand at the time the tax is announced.[3]

A property tax is a proxy for income tax and is based on the assumption that a certain level of property holdings indicate a certain ability to pay taxes on a regular basis.[4] A property tax (which includes the value of improvements to land as well as land values) is less efficient.[5] Land tax is a tax levied solely on unimproved value[6] of the land.[7] Generally, the taxable value excludes improvements[8] and personal property located on the land.[9] It is a cost of owning land and taxes an immobile factor.[10] Further, it is the concept of elasticity[11] that makes the taxation of land unique amongst other taxes. Land values are the rising element in real estate prices and a land tax may encourage landowners to put their land into the most productive use[12] and reduce speculation in land and property sales. A land value tax is a fair way of making everybody benefit from community-created increases in land values. While the government did not act on the recommendation to implement a land tax as part of the reforms undertaken in 2010, a land tax targeting foreign buyers of residential real estate is now government's policy tool for

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3 A 1% p.a. tax on all non-government land could raise approximately $4.6 billion annually (rising to $6.7 billion annually by 2030 with 2% p.a. land inflation). A Coleman and A Grimes, "Fiscal Distributional and Efficiency Impacts of Land and Property Taxes" (2010) 44:2 *New Zealand Economic Papers* 179 -199.

4 S Kwak and J Mak, "Political Economy of Property Tax Reform: Hawaii's Experiment with Split-Rate Property Taxation" (2011) 70:1 *American Journal of Economics and Sociology* 4, quoted: Nobel laureate in economics W Vickrey observed: "The property tax is, economically speaking, a combination of one of the worst taxes – the part that is assessed on real estate improvements … and one of the best taxes – the tax on land or site value."

5 A Coleman and A Grimes, "Fiscal Distributional and Efficiency Impacts of Land and Property Taxes" (2010) 44:2 *New Zealand Economic Papers* 179-199.

6 The term "unimproved land values" refers to the value of bare land, that is, exclusive of the value of any man-made structures or improvements.

7 R F Dye and R W England, "The Principles and Promises of Land Value Taxation" Chapter 1 in R F Dye and R W England (eds), *Land Value Taxation: Theory, Evidence, and Practice* (Lincoln Institute of Land Policy, Cambridge, Massachusetts, 2009) 3-10 at 4.

8 The value of man-made structure, for example, residential or commercial buildings.

9 W J McClucksey and Riël C D Franzsen, *Land Value Taxation: An Applied Analysis* (Ashgate, England, 2005) 115-190.

10 T Dwyer, "The Taxable Capacity of Australian Land and Resources" (2003) 18:1 *Australian Tax Forum* 21-68 at 41 " … [in] a world that is mobile and labour supply is shrinking in line with demographic decline, an immobile tax base is the only tax base which makes economic sense."

11 Due to inelastic supply of land, no adverse side effects arise from tax. Land does not disappear when it is taxed. Elasticity is a measure of the responsiveness of demand and supply of a good or service to an increase or decrease in its price. In economics, the elastic product means that any change in price can result in changes in supply or demand. The inelastic product means that changes in price do not affect to a noticeable degree the supply or demand.

12 F E Foldvary, "The Ultimate Tax Reform: Public Revenue from Land Rent" (2006) *Civil Society Institute Policy Study* (Santa Clara University, CA).

addressing base broadening.[13] This idea is in line with a number of other recent proposals for reforming the income tax system and for solving the current steep increase in land values across Auckland[14] which presents a threat to the country's financial stability.[15]

One of the most famous advocates for a tax on land was Henry George, who in his 1879 work *Progress and Poverty* argued that the value of land was largely created by the community's economic activities.[16] Henry George so strongly believed in the strength of land tax that he even suggested all of a government's financing needs could be met by a sole land tax. While the revenue raising ability of the tax is clearly insufficient to replace all other forms of taxation today, it remains an important part of many taxation systems and has attracted much attention in New Zealand.[17] However, it is questionable whether land tax will generate sufficient revenue which is stable and predictable allowing local authorities to budget for expenditure.

Classical economist Adam Smith developed the principles (maxims) of a "good" tax system back in 1776.[18] These include equality (fairness in the distribution of tax burden), certainty (the tax system should be easy to understand), convenience of payment (the tax system should be easy to comply with) and efficiency (the lowest possible cost of tax collection). He proposed that any "good" tax system would comply with an appropriate mix of each of these principles. The underlying meaning of these four terms forms the backbone of tax policy and subsequent reforms. All nations have tried to apply Adam Smith's philosophy to their tax laws. However as evolution takes place, laws have to be modified to meet the requirements of the day. Smith's principles have been expanded by subsequent economists and writers, who have added

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13 http://www.stuff.co.nz/business/Tracy Watkins 24 April 2016. "Land tax could be slapped on foreign buyers, including Kiwis overseas, if new data shows overseas speculators are fuelling the residential property boom, Prime Minister John Key has hinted. Key said the Government was yet to make a call on a land tax but it was an option if foreign property speculation became 'a runaway train'." Also refer to http://www.stuff.co.nz/business/79271237/PM-hints-at-land-tax-to-rein-in-foreign-speculators

14 G Spencer, "Trends in the New Zealand housing market" (A speech delivered to Property Council of New Zealand by Grant Spencer Deputy Governor Reserve Bank of New Zealand on 15 October 2013). http://www.rbnz.govt.nz/research-and-publications/speeches/2013/speech2013-10-15

15 OECD, *OECD Economic Surveys: New Zealand 2015*. http://www.oecd-ilibrary.org/economics/oecd-economic-surveys-new-zealand_19990162;jsessionid=2gfre9qcocw1b.x-oecd-live-03

16 H George, *Progress and Poverty* (1879) (New and condensed ed. Published for the Henry George Foundation, Hogarth Press, London, 1953) chapter 19.

17 R D Keall, "New Zealand: Land and Property Taxation" (2000) 59:5 *American Journal of Economics and Sociology* 417-438. At 422. Keall noted, "The dismantling of the land tax in New Zealand took place over the course of many decades, often against the general public's preferences and in the context of a poor understanding of the key principles and advantages of the tax."

18 A Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, (first published 1776) in Edwin Cannan (ed), (Chicago, 1977, Book V, Chapter II, Part II).

concepts such as adequacy (raising sufficient revenue), sustainability (the ability to meet changing needs of government)[19] and simplicity.[20]

Since taxation generally is understood to be harmful for the economy,[21] it is worth discussing the balancing of these core principles for imposing a national land tax in New Zealand, a tax that was abolished in 1992.[22] Repealing the land tax was a progressive move and through the rating system the responsibility for collection of property tax[23] was passed onto local government.[24] New Zealand does not rely on income from transaction taxes imposed on property and a recurrent tax on property imposed through the rating system addresses this shortfall to some degree.[25] However, land tax, levied by national/state government, generally on the unimproved value of land at its highest and best use is viewed as a consolidated revenue tax by economists.[26]

The objective of the present study is to address the relevance of these core principles regarding the role of national land tax system to increase recurrent tax revenue from land and to encourage optimal use of land. Specifically, this paper will consider the principles of economy (commonly called efficiency) and equity, to critically assess whether the New Zealand environment would effectively sustain a land tax to fill in a gap in its tax base and encourage investments that better promote economic growth. Compliance with these maxims encourages public acceptance, essential for the effective operation of any tax system and deserves serious consideration by a national and local government. The findings of the present study may also shed some light on the role of various property tax bases. This study is important because there is limited attention from New Zealand tax and economics researchers on the role of these principles in operation of a land tax which inhibits our understanding on how to develop a good property tax system.

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19 Australian Government, *Australia's Future Taxation System Review (Henry Tax review)* (Australian Government, Canberra, 2010) at 17. The Henry tax review emphasised the importance of sustainability, where this is the ability to meet the changing revenue needs of governments, and consistency across tax laws and treatments.

20 R H Woellner, S Barkoczy, S Murphy, C Evans and D Pinto, *Australian Taxation Law* (26th ed, South Melbourne, Victoria: Oxford University Press, 2016). Certainty and convenience is the notion that taxes should be economical to collect and have been labelled by economists as simplicity.

21 A libertarian view. If we accept the reasons why government tax – to redistribute, to achieve various goals (such as discouraging young people from smoking) – then taxation is good; it is the price we pay for civilisation.

22 Land Tax Abolition Act 1990 (NZ) repealed the land tax with effect from 31 March 1992. See part 3.4 below.

23 Land tax is imposed on unimproved values of land whereas property tax is imposed on both improvement values and land values. Refer to R F Dye and R W England, "The Principles and Promises of Land Value Taxation" Chapter 1 in R F Dye and R W England (eds), *Land Value Taxation: Theory, Evidence, and Practice* (Lincoln Institute of Land Policy, Cambridge, Massachusetts, 2009) 3-10 at 4.

24 Local authorities may use land value (unimproved value), capital value (improved value) or annual value (imputed rental from improved land) for setting the rates. Refer to part 4.4 of this paper for more details.

25 Property is generally lightly taxed in New Zealand. Refer to Local Government Rating Inquiry, *Funding Local Government, Executive Summary* (2007) (Shand Report), Wellington New Zealand at 2.

26 V Mangioni, "Codifying Value in Land Value Taxation" (2013) 4:3 *Australian and New Zealand Property Journal* 248-257.

The paper proceeds as follows: Section 2 of the paper considers an analysis of implementation of the different methods (annual value, land value and capital value) of property taxation. Section 3 provides a succinct review of the literature relevant to the property tax system in New Zealand and different jurisdictions. Section 4 reviews the effect of the New Zealand environment on the implementation of a land tax. Section 5 discusses relevant exemptions in New Zealand in relation to a land tax. Finally, Section 6 sets out the conclusions emerging from this study and identifies areas for further possible research.

2.0 Theory of Common Property Tax Base

The desirable aspects of a good tax system are dependent on the method of taxation used to calculate tax liability. In the absence of vacant land sales the value determined and used to assess recurrent property tax in highly urbanised locations is an artificial construct.[27] There are different kinds of property tax valuation methods used overseas and must be considered to facilitate the application of national land tax in New Zealand. These include the following: annual rental value, a tax on estimated (not actual) income earned from the property; capital improved value, a tax on the total value of land, buildings and improvements; and land value or site value tax, a one-off tax on the existing wealth in the form of property that only targets land owners. The paper will now critically assess the implementation of the different property valuation methods for taxation, specifically focusing on principles of economy (commonly called efficiency) and equity in the implementation of a land value tax in New Zealand.

2.1 Annual Rental Value (ARV)

Annual rental value taxation is a tax on estimated (not actual) income earned from the property. Estimates are based on existing or current use of the property and fail to include the future earning potential of the land. This is the value created by the owner of the land. The rational for using rental value is that tax is paid from income and not from wealth. Assuming land is used at its best and highest use then the present value of all rental income will equal the capital cost of the property. However, this is not always the case in reality.

Rental value becomes less equitable when using hypothetical rent for properties not earning real income. There may be a divergence between assessed actual rental value and market rental valuation. Annual rental value is ideal for commercial or industrial property since property is more likely to be used to its maximum potential and actual rental value is closer to the market rental value. In this instance market rent will be ideal because it will capture the income that could be earned from the property. However, market rental value can also be distorted by annual rental value reductions, market intervention and rental controls to protect low income earners, as implemented in India.[28]

[27] V Mangioni, "Land Value Taxation and the Valuation of Land in Australia" (2014) 10:2 *Nordic Journal of Surveying and Real Estate Research* 82–98 at 87.

[28] W J McCluskey, M E Bell, & L J Lim, "Rental Value Versus Capital Value – Alternate Bases for the Property Tax" in R Bahl, J Martinez-Vazquez and J M Youngman (eds), *Challenging the Conventional Wisdom on Property Tax* (Lincoln Institute of Land Policy, Cambridge, Massachusetts, 2010) 120-133.

For efficiency, rental valuation should be valued using real income earned excluding the costs of repairs, insurance and other expenses involved in maintaining the property. This makes it more complicated to value because the expenses differentiate from owner to owner and would require a costly process of data collection, not to mention increased opportunity of tax avoidance. In situations where property is leased, it would be easier to collate data for tenancy agreements where the tenant is responsible for repairs and maintenance rather than the agreements where owners are required to maintain the property because owners can shift the burden through higher rent.

2.2 Capital Improved Value (CIV)

Capital improved value is a tax on the total value of land, buildings and improvements.[29] Taxation on capital value of property is a fair system because as population grows, so do subdivisions and the council's costs associated with servicing the community. Subdivisions add more value to capital value tax then land value tax. This means that new subdivisions will pay higher taxes because they are responsible for the growth, thereby reducing the burden on other rate payers. Under the capital taxing system, low valued land with high valued buildings such as apartment blocks will be paying similar rates as high valued land. This effectively brings two extreme situations closer together under the capital value taxing compared to the land value taxing. Capital improved value tax is more progressive and assumes that those with higher value buildings have more ability to pay tax. Capital improved valuation also allows local authorities to raise more revenue to fund infrastructure projects and other expenditure.

Considering the theory that tax should match the service provided, there is clearly an inequality in the taxing system when looking at properties with large areas of land. For example, farm land will incur high rates even after deductions. It receives the same services that a small block of rural land receives from the council. Property values differ on a property to property basis since the price people are willing to pay for it depends on many economic and geographic reasons. It is difficult to change the property values to match services but we can regulate services to the property.

Capital improved value taxation has a lower nominal tax rate which makes it politically acceptable and easy to understand by taxpayers. The administrative difficulties with collecting information on improvements can be lessened if there is a good record of sales data on land transfers.

2.3 Land Value (LV)

Land value or site value (SV) tax is a one off tax on the existing wealth in the form of property[30]and only targets land owners. At time of sale, a tax decrease will increase the market value of the property, allowing the owner to benefit from windfall gain. A tax increase will reduce the value of the property causing a loss borne entirely by the land owner. It is a tax on a certain form of wealth; for business it is a tax on capital assets and for private owners it

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[29] In fiscal revenue terms, a 0.5% property tax is approximately equivalent to a 1% land tax. A Coleman and A Grimes, "Fiscal Distributional and Efficiency Impacts of Land and Property Taxes" (2010) 44:2 *New Zealand Economic Papers* 179-199 at 179.

[30] A Coleman and A Grimes, "Fiscal Distributional and Efficiency Impacts of Land and Property Taxes" (2010) 44:2 *New Zealand Economic Papers* 179-199.

essentially targets savings. Those who do not own land will not be impacted by the tax directly. However, tax shifting opportunities are available for types of properties and industries. For example, business owners can pass on part of the tax burden to customers, suppliers or even employees in the form of reduced benefits or wage cuts. Apartment owners can increase rents. Owner occupied homes will bear all the costs.

Adam Smith's canon of economy states that "*every tax ought to be so contrived as to take out and keep out of the pockets as little as possible, over and above that which it brings into the public treasury of a state.*"[31] To satisfy a cost-benefit analysis, the tax system must be able to raise substantial revenue at a relatively low cost.[32] It is said that, "*For any given tax, the larger the price elasticities of demand and supply, the larger the change in consumption and production. Therefore, the larger price elasticities of demand and supply are associated with larger deadweight loss.*"[33]

Land tax is a tax levied on the unimproved[34] or rental value of land (but there are some variations that include improvements to land). Land tax is a cost of owning land, and taxes an immobile factor.[35] In a perfect functioning market with no transaction costs and a fixed supply of land, the full burden of the tax falls on the land owner at the time the tax is levied. This has been mathematically proven; the new market value for a piece of land is reduced by the tax. The purchaser is compensated for all future tax payments through a reduced purchase price for the land.[36] Any attempts by the land owner to increase property price will result in lower demand for the land and excess supply of land. Thus, market price is set by the purchaser rather than on the basis of expenses born by the land owner. The fixed supply of land enables high revenue from low rate.[37]

Land value taxation is a conceptually sound method because it is theoretically efficient and neutral.[38] Tax on improvements such as capital value taxing could impact a land owner's

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[31] A Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (first published 1776) in Edwin Cannan (ed), (Chicago, 1977, Book V, Chapter II, Part II).

[32] I Vlassenko, "Evaluation of the Efficiency and Fairness of British, French and Swedish Property Tax Systems" (2001) 19:5 *Property Management* 384-416 at 386.

[33] J P Cohen and C C Coughlin, "An Introduction to Two-Rate Taxation of Land and Buildings" (2005) 87:3 *Federal Reserve Bank of St Louis Review* 359-374 at 364. Deadweight loss (an excess burden) in economic terms is the measure of inefficiency.

[34] The term 'unimproved land values' refers to the value of bare land, i.e., exclusive of the value of any man-made structures or improvements.

[35] T Dwyer, "The Taxable Capacity of Australian Land and Resources" (2003) 18:1 *Australian Tax Forum* 21-68 at 41 " … a world that is mobile and labour supply is shrinking in line with demographic decline, an immobile tax base is the only tax base which makes economic sense".

[36] W E Oates & R M Schwab, "The Simple Analytics of Land Value Taxation", Chapter 4 in R F Dye and R W England (eds), *Land Value Taxation: Theory, Evidence and Practice* (Lincoln Institute of Land Policy, Cambridge, Massachusetts, 2009) 51-72 at 71.

[37] Victoria University of Wellington Tax Working Group, *A Tax System for New Zealand's Future: Report of the Victoria University of Wellington Tax Working Group* (Centre for Accounting, Governance and Taxation Research, Victoria University of Wellington, 2010) ('Tax Working Group') at 50.

[38] T N Tideman, "A Tax on Land Value Is Neutral" (1982) 35:1 *National Tax Journal* 109-111.

decision to develop property. Land tax will continue to apply post development and will be a fixed cost to owning land rather than a hindrance to development. The imposition of the tax will still result in a decline in price as consumers are mainly concerned with the out of pocket expense. However, this change in price is exactly proportional to the tax revenue collected with the notable absence of an excess burden on society. It is this feature that makes land tax more efficient and transparent than other forms of taxation, as Adam Smith argued: "Ground-rents are a still more proper subject of taxation than the rent of houses. A tax on ground-rents would not raise the rents of houses. It would fall altogether upon the owner of the ground-rent, who acts always as a monopolist, and exacts the greatest rent that can be got for the use of his ground."[39]

Adam Smith's canon of equity states that "*the subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities*". The significance of this early definition lies in the normative concept that the tax burden should be linked to the respective ability of the taxpayer to make those payments.

The value of land reflects access to public amenities (shopping centres, parks and libraries), income generating potential of the land and infrastructure (transportation, water systems and sewer systems) and value created by society (economic activity and population growth).[40] Land is only valuable because of the society that surrounds it, as Henry George said: "It is taking by the community, for the use of the community, of that value which is the creation of the community."[41] According to this argument, it is fair that those with high value land should be able to pay more tax because they receive greater benefits generated by the community. Therefore, a land value tax does not tax owner efforts but the unearned value of the land generated by population growth, infrastructure and economic growth.

Land value taxation in heavily built up urban areas becomes difficult to calculate compared to capital value taxation.[42] A residual method of valuation will require the value of improvements to be deducted from the capital value of land. This approach makes land valuation more subjective compared to capital improved value taxation.[43] Academics in tax and economics literature have typically come to use the principles of horizontal and vertical equity to provide a more principled approach to the definition of 'fairness'.[44]

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39 A Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (first published 1776) in Edwin Cannan (ed), (Chicago, 1977, Book V, Chapter II, Part II).

40 L C Walters, "Land Value Capture in Policy and Practice" (2013) 10:2 *Journal of Property Tax Assessment & Administration* 5-22.

41 G Henry, *Progress and Poverty* (first published in 1879) in Henry George Foundation (ed) (Hogarth Press, London, 1953).

42 M E Bell, J H Bowman and J C German, "The Assessment Requirement for a Separate Tax on Land", Chapter 8 in R F Dye and R W England (eds), *Land Value Taxation: Theory, Evidence, and Practice* (Lincoln Institute of Land Policy, Cambridge, Massachusetts, 2009) 171-194. This lack of simplicity and transparency had been defined as the rationale to the move to CIV in many international jurisdictions.

43 R W Bahl, "Fiscal Decentralisation, Revenue Assignment and the Case for the Property Tax", in M E Bell and J H Bowman, *Property Taxes in South Africa: Challenges in the Post-Apartheid Era* (Lincoln Institute of Land Policy, Cambridge, Massachusetts, 2002) 23-42.

44 I Vlassenko, "Evaluation of the Efficiency and Fairness of British, French and Swedish Property Tax Systems" (2001) 19:5 *Property Management* 384-416 at 386.

Horizontal equity can simply be defined as the equal treatment of equals.[45] In the context of a land tax, the system is considered to have achieved the horizontal equity principle if two pieces of land with the same value are taxed at the equal amounts. Assuming that the tax is low rate, broadly applicable, with no exemptions, this goal would be satisfied. However, the assessment of horizontal equity extends beyond a mere equality test to judge how the tax fits within the existing taxation system. Given that a land tax extends the tax base only to one type of wealth, while helping to solve the 'ability to pay' problem, it is discriminatory. Wealth may be stored in many forms, and the principle of horizontal equity requires them to be treated alike. The introduction of a land tax only taxes wealth stored in the form of land, and thus cannot be said to be equitable. Such discrimination cannot be justified, and is likely to result in public resistance due to its perceived "unfairness". A broader wealth tax, such as a capital gains tax on Real Estate Market,[46] may overcome this problem; however, it is beyond the scope of this research paper to set out the implications of capital gains tax in New Zealand.

Vertical equity requires the appropriate differentiation of unequal circumstances.[47] A tax system is considered fairer when a higher burden is paid by those that are most able to pay. While this principle is desirable in theory, its practical application can be difficult. The justification and definition of who has a better ability to pay is complex and somewhat subjective, the decision generally being made by politicians. It is then reflected in the workings of the tax system through the utilisation of exemptions, reliefs and progressive taxes.

Compliance with horizontal and vertical equity should be synonymous, not alternative. Together, they represent the broader principle of equity and essentially represent alternative sides of the same coin.[48] Without the appropriate differentiation of people (through vertical equity measures), horizontal equity is merely a tool to safeguard against capricious discrimination.[49] However, public perception of equity can at times make it difficult to implement vertical equity measures. While it is commonly accepted that those who earn more should pay more, it is somewhat less accepted that discrimination on certain policy grounds is tolerable. As a result, politicians are incentivised to engage in behaviour that blurs the objective standards of equity in favour of popular opinion.

It is clear that every tax method has a compliance cost. Therefore, it is difficult to isolate a distinguishing New Zealand perspective and study the suitability of a land value tax in a purely New Zealand context. The in-depth analysis of implementation of the different methods (land value, capital value and annual value) of taxation in different jurisdictions will assist to effectively stack these methods against the criteria of a good tax system. The following section discusses relevant property tax systems in a selected countries – namely, Australia, California (United States of America) and New Zealand.

3.0 History of Property Tax in Different Jurisdictions

[45] R A Mushgrave, "Horizontal Equity, Once More" (1990) 43:2 *National Tax Journal* 113-122 at 113.

[46] Capital gains tax is only levied when investors sell an asset and on the realized appreciation of the asset.

[47] R A Mushgrave, "Horizontal Equity, Once More" (1990) 43:2 *National Tax Journal* 113-122 at 113.

[48] R A Mushgrave, "Horizontal Equity, Once More" (1990) 43:2 *National Tax Journal* 113-122 at 117.

[49] R A Musgrave, *The Theory of Public Finance* (McGraw Hill, New York, 1959) 160.

3.1 Australia

Land value taxation is an important source of tax at the state level and the local government level in Australia. State tax is imposed on owners of land used for income producing purposes. The Australian Local Government Association website shows 563 local authorities that rely exclusively on the land value tax as own-source revenue. Australia has a long history of land value taxation which has achieved consistent results.

Table 1: Land value taxation at the state and local government level[50]

Australian States/Territories	State tax first introduced	State Government Land Tax	Local Government Council Rates
Australian Capital Territory	1987	Unimproved Value	Unimproved Value
New South Wales	1895	Land Value (replacing unimproved value in 1978)	Land Value
Northern Territory	None	None	Unimproved Capital Value
Queensland	1915	Site Value	Site Value
South Australia	1884	Site Value	Improved Value*
Tasmania	1910	Land Value	Gross Rental Value *
Victoria	1910	Site Value	Improved Value
Western Australia	1907	Site/Unimproved Value	Gross Rental Value*

* The option of assessing council rates on more than one basis across different Local Government Authorities'.

The table above, modified from Mangioni,[51] shows land value is taxed at the state level for all eight territories except Queensland which taxes only the raw value of land, excluding levelling and drainage (merged improvements). Local governments have a choice of methods with the exception of Australian Capital Territory. There is a growing preference for capital value as evidenced by the high number of councils choosing capital value taxation in South Australia and Victoria. In Tasmania, despite the choice of tax methods, rental value is the preferred method.

The evolution of land taxation in New South Wales provides an insight into the challenges confronting all cities when imposing a land value tax in increasingly urbanized locations. These

50 V Mangioni, "Land Value Taxation and the Valuation of Land in Australia" (2014) 10:2 *Nordic Journal of Surveying and Real Estate Research* 82–98 at 86.

51 V Mangioni, "Land Value Taxation and the Valuation of Land in Australia" (2014) 10:2 *Nordic Journal of Surveying and Real Estate Research* 82–98 at 86.

challenges have resulted in an additional layer of complexity which requires accounting for the added value of improvements in the valuation of land.[52]

3.2 California, United States of America

Another interesting study is the State of California where the acquisition 'value based' property tax system is used. Taxation is based on the purchase price of property plus a yearly allowance for inflation. Local governments in California had absolute anatomy in land taxation until tax payers began to protest the unprecedented rise in property taxation. Proposition 13 was introduced in the 1978 to cap increase in the property tax at 2 per cent per annum.

3.3 New Zealand

Property tax[53] has always been the main source of revenue for local authorities in New Zealand. Local Government Rates Inquiry Panel 2007[54] shows property tax accounted for 57.3 percent of revenue in 1994 and 56.1 percent in 2006. Statistics New Zealand 2010[55] showed the reliance of property tax had jumped to 92 percent of total taxation revenue for local governments. The investigation of property tax over a period shows that local authorities have favoured one method over another.

By 1842, during the early colonisation period in New Zealand, local authorities had the power to make and levy rates. This was fine-tuned by the passing of the Property Rate Ordinance of 1844 to include tax on property and income.[56] During the first 10 years of colonisation, the annual rental value method was preferred because it was the method used in Britain and ideal given the large areas of undeveloped land in New Zealand.[57] The Rating Act of 1882 made capital valuation compulsory with a few exceptions. All rural areas adopted capital value rating and urban areas adopted annual rental value. Undeveloped land had no rental value. Farm land

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52 NSW Ombudsman 2005, *Improving the Quality of land Valuations issued by the Valuer-General* Sydney, October 2005.

53 In New Zealand two types of property taxes are charged by local authorities: recurrent taxes on immovable property (rates) and non-recurrent taxes on property (development and financial contributions).

54 Local Government Rates Inquiry Panel, *Funding local government* (Wellington: Local Government Rates Inquiry, 2007). Retrieved from http://www.dia.govt.nz/Pubforms.nsf/URL/RatesInquiryFullReport.pdf/$file/RatesInquiryFullReport.pdf

55 Statistics New Zealand, *Government Finance Statistics (Local Government): Year ended June 2010*. Retrieved from http://www.stats.govt.nz/browse_for_stats/government_finance/local_government/GovernmentFinanceStatisticsLocalGovernment_HOTPYeJun10/Commentary.aspx

56 W J McClusky, A Grimes & J Timmins, *Property Taxation in New Zealand* (Lincoln Institute of Land Policy, working paper, 2002). Retrieved from http://scholar.google.co.nz.ezproxy.auckland.ac.nz/scholar?q=related:ThY8kpslyp4J:scholar.google.com/&hl=en&as_sdt=0,5

57 W J McCluskey, M E Bell, & L J Lim, "Rental Value Versus Capital Value – Alternate Bases for the Property Tax" in R Bahl, J Martinez-Vazquez and J M Youngman (eds), *Challenging the Conventional Wisdom on Property Tax* (Lincoln Institute of Land Policy, Cambridge, Massachusetts, 2010) 120-133.

improvements added more to annual rental value than capital value and capital valuation was a move towards a common valuation tax basis.[58] Together, these were the main reasons given for this change.

Land value tax was adopted in New Zealand for the first time in 1878.[59] Public expenditure and immigration contributed to the boom in land value before 1870 and peaked between 1874 and 1878, coming to an abrupt end in 1879.[60] Liberal thinkers believed wealthy land owners had greater taxable ability but a low tax burden compared to the working class who were generating the bulk of government revenue through tariffs. However, when the land values began to fall, the counter argument was that it was unfair to tax a group who was receiving no special benefits and whose growth was important to the growth of the economy. This was repealed a year later by the Property Tax Act 1879 (NZ) which taxed capital value only and then returned to unimproved land value in 1894.[61] Over the next century, the concept of land value taxation underwent numerous changes in an attempt to create a more equitable system and in the late 19th century a land value tax was a major source of the government's revenue.[62] At the same time, the Ross committee observed that "tax is no longer necessary or effective as a means of breaking up large land holdings".[63] The McCaw task force also noted that the land tax had "no perceptible redistributive effect" and was "not an adequate indicator of the taxable capacity provided by wealth".[64] Finally, the resulting exemptions and distortions rendered the tax uneconomic and inefficient,[65] leading to its abolishment in 1992.[66]

Overall, the study of different jurisdictions using different property tax methods shows that different jurisdictions have adopted different approaches and there is no perfect tax system. There are large variations in implementation strategies and resulting successes for a land value tax overseas. The effective operation of a tax system is influenced by legislative background,

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58 W J McCluskey & Riël C D Franzsen, *Land Value Taxation: An Applied Analysis* (Ashgate, England, 2005) 115-190.

59 The Land tax Act 1878 (NZ) made it compulsory to tax land value. The introduction of this land tax by treasurer John Ballance in 1878 was significant.

60 P Goldsmith, *We Won, You Lost, Eat That!: A Political History of Tax in New Zealand since 1840* (David Ling, 2008) 83; M King, *The Penguin History of New Zealand* (Penguin Books, 2003) 260-261.

61 W J McCluskey & Riël C D Franzsen, *Land Value Taxation: An Applied Analysis* (Ashgate, England, 2005) 115-190; *Taxation in New Zealand: Report of the Taxation Review Committee* (Government Printer, 1967) ('Ross Report') 410.

62 B F Reece, "The Abolition of Land Tax in New Zealand: Searching for Causes and Policy Lessons" (1993) 10:2 *Australian Tax Forum* 223-244.

63 *Taxation in New Zealand: Report of the Taxation Review Committee* (Government Printer, 1967) ('Ross Report') 415.

64 *Report of the Task Force on Tax Reform* (Government Printer, 1982) ('McCaw Report') 230.

65 McCaw Report noted that in 1960, land tax contributed 6 percent of direct tax revenues. In the same period, the land tax as a percentage of gross domestic product (GDP) fell from 0.9 percent to 0.2 percent at page 228.

66 Land Tax Abolition Act 1990 (NZ) repealed the land tax with effect from 31 March 1992. See McCaw Report: "In 1982, only five per cent of total land value was taxed, agricultural land being explicitly exempted and residential land effectively exempted by the exemption of $175,000 for all landowners", at 230.

environmental factors, social policies, values, beliefs and the culture of a country. Due to the highly sensitive nature of tax and the environment it is implemented in, a system which may work well in one country could be a complete disaster in another. Further, land tax has also led to avoidance and evasion, and costly challenges to valuations.[67] However, following the recommendations of the Tax Working Group to the New Zealand Government, the question of whether a land value tax is suitable for the New Zealand context is nonetheless pertinent.[68] Therefore, the paper will now consider how the New Zealand environment will affect the implementation of a land value tax and its influence on the canons of efficiency and equity.

4.0 A Land Value Tax - Some New Zealand Considerations

This section sets out the factors which must be taken into consideration while implementing a land value tax in New Zealand.

4.1 Lack of Tax Revenue from Property

Calista Cheung observed that a favourable taxation system, immature capital markets, migration patterns and "easy credit conditions" have made rental property an attractive investment option for New Zealanders.[69] The New Zealand Government under-utilises their ability to levy taxes on property.[70] As mentioned earlier,[71] in New Zealand, local authority rates – which can be based on land, capital or rental values of properties – have been the major source of revenue for local government. Central government, on the other hand, earns only an estimated 5% of its total tax revenue from property. This is well below the OECD average, [72] which is not surprising given New Zealand remains one of the last countries within the OECD which does not have a comprehensive capital gains tax (CGT). A partial CGT exists under subpart CB of the Income Tax Act 2007 but its application is rather limited. The current bright-line test for residential land (effective from 1 October 2015)[73] and the residential land

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[67] G Morgan and S Guthrie, *Tax and Welfare: The Big Kahuna* (Public Interest Publishing, 2011) 91. However, it may be argued that property owners cannot avoid a tax on land by producing less land and land cannot be moved from a high-tax jurisdiction to a low-tax jurisdiction.

[68] A one percent Land Value tax on all non-government land would raise revenue equivalent to 20 percent of current income tax revenue. Refer to A Coleman and A Grimes, "Fiscal Distributional and Efficiency Impacts of Land and Property Taxes" (2010) 44:2 *New Zealand Economic Papers* 179-199.

[69] C Cheung, "Policies to Rebalance Housing Markets in New Zealand" (Working Paper No 878, OECD Economics Department, 2011) 20.

[70] Under s EE 31(3) ITA 2007, from the start of the 2011-2012 income year, no deduction for depreciation can be claimed on most types of buildings, including investment properties. However, prior to the start of the 2011-2012 income year, only a 20percent loading was added to the depreciation rates for most new assets and did not apply to buildings.

[71] Refer to part 3.4 of the paper.

[72] P Vial, "The Sustainability of the New Zealand Tax Base: Are We at the End of the Road?" (2009) 15:1 *New Zealand Journal of Taxation Law and Policy* 17 at 24.

[73] Section CB 6A, ITA 2007. Any gain a person derives from disposing of residential land is income of the person if the property is disposed of within 2 years of acquisition, subject to some exceptions/exemptions, for example, land first acquired before 1 October 2015.

withholding tax (RLWT) regime (proposed to take effect from 1 July 2016)[74] are also designed to remove certain capital gains and bring them within the tax net. In 2008, the revenue from rates was approximately equal to 2 percent of GDP and was in line with the OECD average; however, the revenue as a percentage of aggregate housing value fell from 2.2 percent in 1980 to 0.65 percent in 2008.[75]

The relatively small reliance on property taxation increases pressure on the government to collect equivalent revenue from incomes/profits and consumption. From an economic point of view, such taxes are detrimental to the efficient operation of the market. An economic analysis of taxes shows a distortion in behaviour which leads to excess burdens on the society.[76] The resultant deadweight loss does not benefit the consumer, the producer or the government.[77] Given the inherent inefficiencies of the current tax regime, the introduction of a land tax might be beneficial. A land value tax may be used to reduce the existing reliance on income and consumption taxes and could steer investors to more productive areas of economy.[78] Such a shift would enable the tax regime to remain revenue neutral while reducing the excess burden on the society thus achieving a more efficient outcome. Clinton and Davis[79] proposed a land transfer levy to tax wealth accretions through property. According to them, the main purpose of the tax would be to correct the tax induced preference for investment in residential property in New Zealand. A one percent tax on all non-government land, using 2006 land values, was estimated to raise $4.6b annually.[80]

4.2 Fall in Land Prices

It is predicted that the introduction of a land value tax will result in an immediate fall in the value of land.[81] Coleman and Grimes estimated that the introduction of a 1percent land tax will amount to a 16.7 percent decline in the value of land.[82] This reduction is equivalent to the

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74 RLWT would apply only to residential land in New Zealand: acquired by an "offshore person" from 1 October 2015; sold after 1 July 2016; and sold within the 2-year bright-line period.

75 C Cheung, "Policies to Rebalance Housing Markets in New Zealand" (Working Paper No 878, OECD Economics Department, 2011) 20.

76 J R. Hines Jr, "Excess Burden of Taxation", working paper series, *Office of Tax Policy Research*, Michigan Ross School of Business, Product Number WP 2007-1, May 31, 2007.

77 R Arnott and R Petrova, *The Property Tax as a Tax on Value: Deadweight Loss* (National Bureau of Economic Research, 2002).

78 J Barrett and J Veal, "Land Taxation: a New Zealand Perspective" (2012) 10:3 *eJournal of Tax Research*, Atax, University of New South Wales 573-588 at 574.

79 C R Alley and M Davies, "A Land Transfer Levy with Equity as the Key: A Preliminary Examination into an Alternative Regime to Generate Broad-Based Tax Revenue" (2011) 17 *New Zealand Journal of Taxation Law and Policy* 309-346 at 338.

80 A Coleman and A Grimes "Fiscal Distributional and Efficiency Impacts of Land and Property Taxes (2010) 44:2 *New Zealand Economic Papers* 179-199 at 179.

81 Inland Revenue Department Policy Division and New Zealand Treasury "Land Tax" (Background paper for session 3 of the Victoria University of Wellington, Tax Working Group, September, 2009).

82 A Coleman and A Grimes "Fiscal Distributional and Efficiency Impacts of Land and Property Taxes (2010) 44:2 *New Zealand Economic Papers* 179-199.

present value of the future taxes due. Accordingly, the immediate fall in value largely places the burden of the tax on current land owners. As a result, current landowners are inequitably made to bear an unjust proportion of the tax.

A reduction in value benefits the potential purchasers of land and more people will be able to afford acquisition of their own home. Speculative land purchases will also reduce due to lower land values. A land value tax will reduce the existing high incentives of land investment, one of the main contributors to recent price increases in urban New Zealand. Lack of land value tax results in low holding costs of land. If land value tax is imposed, some investors will be put off by the capital requirements necessary to pay a land value tax each year and optimal development,[83] thus cooling the market and contributing to the affordability of home ownership.

However, while there is a clear government policy to help New Zealanders own their own homes,[84] if land value tax is adopted, it will come at a high cost to existing land owners. Accordingly, serious policy considerations must be given to the equity concerning the balancing of a benefit in the reduction of land prices, versus the loss to current land owners' investment.

4.3 Single Source of Wealth

As discussed earlier, the implementation of a land value tax places a significant burden on a single source of wealth. This results in a violation of the principle of horizontal equity, which promotes equal treatment of equals. Such discrimination might however be justified on policy grounds, and thus still satisfy vertical equity.[85]

It appears there are compelling policy reasons to discriminate for a tax involving land investment in New Zealand.[86] The policy to tax land value may be justifiable through the intended distortion of investment behaviour[87] – away from property transactions to investments that better promote economic growth. Investment in property, which is considered tangible and has historically produced substantial capital gains which are exempt from tax, have always been preferred by New Zealanders.[88] However, the imposition of a land value tax results in

[83] J Barrett, "Equity in Local Government Rating" (2007) 13:4 *New Zealand Journal of Taxation Law and Policy* 625-633.

[84] In New Zealand there are a number of schemes in place to support low to middle-income earners in buying their first home. Refer to KiwiSaver first home deposit and Welcome Home Loan in general.

[85] A Carter and S Matthews, "How Tax Can Reduce Inequality" (2012) 290/91 (Q1-Q2) *OECD Observer* 53.

[86] C R Alley and M Davies, "A Land Transfer Levy with Equity as the Key: A Preliminary Examination into an Alternative Regime to Generate Broad-Based Tax Revenue" (2011) 17 *New Zealand Journal of Taxation Law and Policy* 309-342 at 324.

[87] A Carter and S Matthews, "How Tax Can Reduce Inequality" (2012) 290/91 (Q1-Q2) *OECD Observer* 53.

[88] New Zealand does not have a comprehensive capital gains tax. *Estate Duty Abolition Act 1993* (NZ) s 3 abolished estate duty in respect of deaths occurring on or after 17 December 1992. The *Taxation (Tax Administration and Remedial Matters) Act 2011* (NZ) repealed gift duty effective from 1 October 2011. Also refer to C C Huang and C Elliffe, "Is New Zealand Smarter than Other Countries or Simply Special?" (2010) 16:3 *New Zealand Journal of Taxation Law and Policy* 269-306.

substantial burdens on existing owners and decline in land values which will "punish" investment in land. Such a tax, without exemptions, would be contrary to existing government policies[89] that promote home ownership and encourage agricultural activities.

4.4 Ease of Implementation

To achieve a successful implementation of a tax system, certain infrastructural requirements must be met in advance. In the case of a land value tax, the survey of land parcels and the records of ownership must be accurate to enable determination of the amount of tax payable and the identification of who is responsible for its payment. As discussed earlier, the implementation of a land value tax in developed countries, such as Australia has faced considerable challenges for this reason. In South Africa also, when land tax was implemented, it was found that there were many large parcels of land that had never been surveyed and it was sometimes difficult to identify the legal owner of the land.[90] Similarly, many complexities arose where land was identified as tribal land. Tribal land is generally not owned by a single person or entity as is custom in most developed cultures, but instead held under a less formal, communal ownership regime.

New Zealand, however, has an existing land registry which records essential information in regards to all land in New Zealand.[91] In creating the registry, nearly all land was surveyed, resulting in the records of parcel boundaries being reasonably accurate. Electronically completion of conveyancing improves the operational efficiency and integrity of New Zealand's land register. The pre-existence of such a registry would allow for the easy operation of a land tax in New Zealand. Both the size and owner of any piece of land is quickly and easily identifiable. Without these infrastructural details, however, the levy of a land value tax would be expensive to administer, reducing its efficiency, and may lack public acceptance due to uncertainties.

In addition, four of the main cities of New Zealand (Auckland, Wellington, Christchurch and Hamilton) all currently and periodically value land for rating purposes.[92] Local authorities may use land value (unimproved value), capital value (improved value) or annual value (imputed rental from improved land) for setting the rates.[93] The valuation provides a capital value and improvements value which provide an excellent framework to support the land valuations for

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89 Refer to KiwiSaver first home deposit and Welcome Home Loan in general.

90 M E Bell, J H Bowman & L C Clark, "Valuing Land for Tax Purposes in Traditional Tribal Areas of South Africa Where There Is No Land Market" (Lincoln Institute of Land Policy, Working Paper WP05MB1, Cambridge, Massachusetts, 2005).

91 The registry is run by Land Information New Zealand (LINZ, earlier it was called Land Transfer office) and records are available for a small fee from http://www.linz.govt.nz/survey-titles.

92 W J McCluskey, A Grimes, A Aitkin, S Kerr & J Timmins, "Rating Systems in New Zealand: An Empirical Investigation into Local Choice" (2006) 14:3 *Journal of Real Estate Literature* 381-397 at 389. *Local Government (Rating) Act 2002* (NZ) provides local authorities with powers to charge rates "in order to promote the purposes of the [Local Government] Act".

93 *Local Government (Rating) Act 2002* (NZ), s 13. New Zealand government comprises seventy-four local authorities and sixteen regions and there is no state uniform system of property taxation.

tax purposes.[94] The Tax Working Group suggested that the existing rating system could also be utilised to reduce the cost of collection[95] and further enhance efficiencies.[96]

Until 1985 land value was the preferred base on which to assess the property tax in New Zealand. However, by 2006–2007, capital value had become the tax base for the majority of local authorities.[97] At present in the four major cities of New Zealand (Auckland,[98] Wellington, Christchurch and Hamilton) rates are assessed on capital improved value (CIV),[99] while majority of regional authorities in New Zealand still imposes rates on land value.[100] Rates are the dominant source of revenue for local government across New Zealand.[101] Local authorities rates are determined at each local authority level on the basis of local budgetary requirements and include general rates on all property owners or specific rates imposed for a special purpose, eg for infrastructure improvements. Ordinary rates cover council's basic costs; special rates are charged for services provided by council or for special purposes viz water supply, sewerage and drainage. Ordinary rates can vary for different categories of land.[102]

4.5 Maori Land

The existence of Maori Authorities is another unique consideration for the implementation of a land tax in New Zealand. Maori Authorities, created in 1939, are trustees administering communally-owned Maori property – often in the form of land following Treaty of Waitangi settlements – on behalf of the individual owners.[103] The imposition of a land value tax would adversely affect the negotiated settlements. Maori Authorities would be subject to an inequitable and disproportionate share of the tax burden and the monetary value of their land would also fall. Māori freehold land is underdeveloped relative to general land, even after

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[94] The *Rating Valuations Act 1998* (NZ) provides for methods of land valuation.

[95] The rating system makes land tax convenient for government and taxpayers as well.

[96] Victoria University of Wellington Tax Working Group, *A Tax System for New Zealand's Future: Report of the Victoria University of Wellington Tax Working Group* (Centre for Accounting, Governance and Taxation Research, Victoria University of Wellington, 2010) ('Tax Working Group').

[97] R C D Franzsen, "International experience with Land Value Taxation", Chapter 3 in R F Dye and R W England (eds), *Land Value Taxation: Theory, Evidence, and Practice* (Lincoln Institute of Land Policy, Cambridge, Massachusetts, 2009) 27-50 at 37.

[98] Auckland City Council uses single rates system.

[99] W J McCluskey, A Grimes, A Aitkin, S Kerr & J Timmins, "Rating Systems in New Zealand: An Empirical Investigation into Local Choice" (2006) 14:3 *Journal of Real Estate Literature* 381-397 at 389.

[100] Local Government Rating Inquiry, *Funding Local Government, Executive Summary* (2007) (Shand Report), Wellington New Zealand.

[101] G Bush, "Local Government" in R Miller (ed), *New Zealand Government and Politics* (Oxford University Press, Melbourne, Third Edition, 2003) 161-170. At 164: In 2001 rates (excluding user charges) contributed an average of 57 percent of local authority revenue.

[102] There are four categories of land viz residential, business, farmland and mining.

[103] Inland Revenue Department, "Maori Authorities" (May 2011) IR 487.

taking into account differences in land quality and location and could have important equity implications on a land value tax.[104]

Maori land is culturally sensitive, possessing *Mana* (spiritual power) with some land being *Tapu* (sacred) and therefore while held by Māori Authorities will never be developed for commercial or residential purposes. This acknowledgement further contributes to an unfair burden of land tax on Maori Authorities. Given the above factors, it is likely the inclusion of land held by Maori Authorities within the taxable land definition will be strongly opposed. If land is valued on a basis of unimproved land value (highest and best use of the land), it will not reflect the fact that some land is culturally sensitive and therefore will not be used in an economic manner. Imposing a tax on an unrealistic value of land, given in settlement of past wrongs and in recognition of the cultural value of land, would be contrary to the underlying principles of the Treaty settlements and would result in an inequitable burden of tax on Maori Authorities. Therefore, it is suggested that an exemption (or other relief) must be used to avoid the inequities of this situation.

4.6 Land Use Considerations

The introduction of a land value tax has significant implications on the use of land. It is a tax on the unimproved value of the land which makes the tax seem cheaper if the land is put to its highest and best use. Assuming a broadly applicable land value tax covering all land in New Zealand is implemented (with the exception of parcels in government ownership), as discussed below, the effects will be different in urban cities to rural farmland.

A tax on land (including a split rate property tax) can be utilised as a policy tool to encourage denser developments in urban areas.[105] A land value tax removes the disincentive existing on the construction of buildings under a traditional property tax.[106] A land value tax is said to be neutral with respect to land use which promotes the development of land to its highest and best use.[107] Oates and Schwab Pittsburgh study suggests that some cities gain the beneficial effects of greater tax neutrality and land-value taxation alone was not the direct stimulus to the regenerative land uses in Pittsburgh, although it did assist to a lesser degree.[108] Further, their study of effects of Pittsburgh's tax system on housing development suggests that to induce new construction the property owners who redeveloped or renovated buildings on their land were not taxed for the first three years for the additional value from reconstruction.[109] The imposition

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[104] L Tímár, *Rural Land Use and Land Tenure in New Zealand* (Working Paper 11-13, Motu Economic and Public Policy Research, 2011) 36-37.

[105] H S Banzhaf and N Lavery, "Can the Land Tax Help Curb Sprawl? Evidence from Growth Patterns in Pennsylvana" (2010) 67 *Journal of Urban Economics* 169. Evidence from Pittsburgh shows this.

[106] L C Walters, "Land Value Capture in Policy and Practice" (2013) 10:2 Journal of Property Tax Assessment & Administration 5-22.

[107] W E Oates and R M Schwab, "The Impact of Urban Land Taxation: The Pittsburgh Experience" (1997) 50:1 *National Tax Journal* 1 at 17.

[108] W E Oates and R M Schwab, "The Impact of Urban Land Taxation: The Pittsburgh Experience" (1997) 50:1 *National Tax Journal* 1-21 at 18.

[109] W E Oates and R M Schwab, "The Impact of Urban Land Taxation: The Pittsburgh Experience" (1997) 50:1 *National Tax Journal* 1 -21 at 7. Also refer to M Weir and Peters E Lillian, "Development, Equity and the Graded Tax in the City of Pittsburgh" (1986) 5:2 *Property Tax Journal* 71-84.

of a land value tax will benefit rapidly expanding cities such as Auckland, where the local council has been investigating areas of sprawl to accommodate the growing number of residents.[110] Since more intensive use of land may lead to unduly dense development or the destruction of heritage buildings, as well as infrastructural and socio-economic problems, it is suggested that to be effective as an urban planning tool, a land value tax would need to be integrated with other planning mechanisms.[111]

However, the rural environment presents substantial hurdles to the implementation of a land value tax in New Zealand. In New Zealand, an estimated 55 percent of all land is put to agricultural use and the impact of a land value tax will be felt severely by those who rely on the use of agricultural land.[112] The farming and forestry industries in particular rely on substantial land holdings to conduct their business and a land value tax would adversely impact on the value of their land holdings and the cost of operating their business. Such land intensive activities stand to face an inequitable share of the tax burden and given the direction of existing policies, would likely result in mitigating measures being implemented.

While a land value tax is an *ad valorem* tax, meaning that the urban areas, on a per hectare rate, will face substantially larger taxes, the land intensive uses in rural areas will result in a higher tax burden on individuals and small companies.[113] Considering that the average plot size in suburbia is around 700m², the incidence of tax per owner will be significantly less than farmers who own many hectares of land.[114]

Thus the effect of a land value tax is inconsistent with current policy measures that protect farming in recognition of its importance to the New Zealand economy. The farming industry accounts for around 5 percent of New Zealand's annual GDP. Existing policy measures tend to stipulate special provisions applicable to faming and forestry which in general tends to be more favourable than the standard rules.

The study of unique considerations of a land value tax implementation in New Zealand context shows that there is a clear need of exemption provisions to ensure that the tax system is suitable. Therefore, the paper will now consider the provision of relevant exemptions.

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[110] See the Auckland Council Long Term Plan which highlights areas that the Council is investigating as potential sites of future Greenfield developments. The city's growth far outpaces the provision of infill housing through increased density.

[111] S C Bourassa, "The Political Economy of Land Value Taxation" Chapter 9 in R F Dye and R W England (eds), *Land Value Taxation: Theory, Evidence, and Practice* (Lincoln Institute of Land Policy, 2009) 195-210 at 196. Denser urban development may have general environmental benefits but it is uncontroversial that heritage buildings should be preserved.

[112] R C D Franzsen, "International experience with Land Value Taxation", Chapter 3 in R F Dye and R W England (eds), *Land Value Taxation: Theory, Evidence, and Practice* (Lincoln Institute of Land Policy, Cambridge, Massachusetts, 2009) 27-50 at 38.

[113] V Mangioni, "Transparency in the Valuation of Land for Land Tax Purposes in New South Wales" (2011) 9:3 *eJournal of Tax Research*, Atax, University of New South Wales.

[114] *Taxation in New Zealand: Report of the Taxation Review Committee* (Government Printer, 1967) ('Ross Report') 291.

5.0 Exemptions

Special interest groups such as farmers and Maori Authorities are likely to be amongst those that are given relief from the land tax.[115] The report of Tax Working Group noted that land tax imposition could particularly affect certain people, such as farmers, retirees and Maori authorities.[116] Land tax, a tax on unearned increment, possibly resulting in negative equity for highly geared properties. While their differentiation may be justifiable on the grounds of vertical equity, it renders the proposed land tax inefficient in its ability to raise large amounts of revenue at a low cost. The Tax Working Group's land value tax proposal was a broad base low rate tax. The Ross committee observed the effects on farmers' income of flooding or movements in international commodity prices and their ability to pay land tax.[117] These findings are relevant for policy-makers because the impact of the tax could drive some farmers off their land.[118] However, if agricultural, Maori Authority and Department of Conservation land was excluded, considering the remaining land tax base, the tax will be unable to raise the proposed revenue without a substantially higher land value tax being imposed. Furthermore, for charities[119] the special consideration may also be desirable from an equity point of view. Given that charitable organisations and churches are non-profit organisations, through land tax exemption it is important for the government to recognise and take the responsibility of the much-needed community and charitable services provided by them. [120] Land does not necessarily generate cash and land tax may create cash flow issues for charities. Socially, there is a need for relief from the payment of land value tax by pensioners and elderly property owners who may experience financial hardship due to the annual tax payments; or tax payments could be deferred and rolled up until they sell or bequeath their property.[121] The higher rate of a land tax is also unviable as it will increase the fall in land value and will result in further complications by straining the lending market and creating the risk land abandonment.

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115 Victoria University of Wellington Tax Working Group, *A Tax System for New Zealand's Future: Report of the Victoria University of Wellington Tax Working Group* (Centre for Accounting, Governance and Taxation Research, Victoria University of Wellington, 2010) ('Tax Working Group') 51. Under sections CB 12 and CB 13 farm land is exempt from income tax in New Zealand.

116 Victoria University of Wellington Tax Working Group, *A Tax System for New Zealand's Future: Report of the Victoria University of Wellington Tax Working Group* (Centre for Accounting, Governance and Taxation Research, Victoria University of Wellington, 2010) ('Tax Working Group') 51.

117 *Taxation in New Zealand: Report of the Taxation Review Committee* (Government Printer, 1967) ('Ross Report') at 291.

118 *Taxation in New Zealand: Report of the Taxation Review Committee* (Government Printer, 1967) ('Ross Report') at 219.

119 Land tax pre 1992, exemptions included farming land, sports clubs, local authorities, charities, customary Maori land, hotels, aged people's homes and hospitals, historic places Land used for religious worship, religious education or for charitable purposes are all classed as non-rate able under existing legislation by Local Government New Zealand (LGNZ)

120 Charities are also exempt from income tax. Refer to Income Tax Act 2007, subpart CW.

121 Richard W Lindholm, "Twenty-One Land Value Taxation Questions and Answers" (1972) 31:2 *American Journal of Economics and Sociology* 153. At 154-155 are different phasing-in options. Older people or superannuitants tend to own disproportionately expensive properties relative to their incomes.

It appears that the required exemptions to make land tax suitable for the New Zealand environment restrict the tax base too severely and it is unable to raise the forecast revenues. [122] In an attempt to achieve vertical equity, the principle of economic efficiency is sacrificed.[123] The resulting tax is reminiscent of the land value tax that was abolished in 1992.

6.0 Conclusion

This paper has reviewed the various bases of value on which the property tax is assessed and has carried out a critical analysis of the possible implementation of a land value tax in New Zealand. Property tax is the best way to align the benefits received to the taxes paid, which according to Henry George's concept is captured in the value of the property.[124] Every property taxation method has a compliance cost and works well in different environments in different jurisdictions. Annual value taxation works well in an environment where renting is predominant because of the subjectivity of rental estimates. Rental values can be artificially manipulated or limited through legislation. Capital value relies solely on sales data but improvements are on-going with behavioural implications and therefore less efficient. The full burden of the land value tax falls on the land owner at the time the tax is levied because of the inelastic supply of land. The paper demonstrates that none of the property taxation methods meets both horizontal and vertical equity objectives at the same time.

Given the theoretical merits of a land value tax system, it is evident that the unique features of land[125] amounts to land value taxation as economically the most efficient form of tax. At present rates are the dominant source of revenue for local government across New Zealand. However, the relatively low taxation of properties in New Zealand compared to OECD countries indicates that further revenue collections by national government from properties are beneficial, assuming that the nominal rate of a national land value tax is not the critical concern for taxpayers, who "may be prepared to endure high nominal rates if they are satisfied with effective tax rates and if they receive acceptable levels of government services in return".[126]

Beneficially, New Zealand does have the required infrastructural prerequisites needed for the smooth implementation of a land value tax by a national government. Overseas jurisdictions have experienced barriers to implementation where the survey of land and ownership status is unclear. This study shows that in New Zealand, utilisation of the local authorities existing rates valuation and collection systems would enhance the efficiency of a national land value tax system. The adoption of imposition of land tax by national government and collection by local government will encourage more intensive land use and will result in a higher level of

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[122] New Zealand Treasury, "The Role of Tax in Maintaining a Sustainable Fiscal Position New Zealand Treasury" (2013). At p 4 noted: "Historically, New Zealand has had a land tax but it had been weakened with exemptions and ultimately repealed, so its sustainability may be questionable."

[123] R Arnott and R Petrova, *The Property Tax as a Tax on Value: Deadweight Loss* (National Bureau of Economic Research, 2002).

[124] H George, *Progress and Poverty* (1879) in Henry George Foundation (ed) (Hogarth Press, London, 1953).

[125] The supply of land is inelastic and finite. Land does not disappear when it is taxed.

[126] J Barrett and J Veal, "Land Taxation: a New Zealand Perspective" (2012) 10:3 *eJournal of Tax Research*, Atax, University of New South Wales 573-588 at 586.

improvements to the land.[127] However, this study shows that at present in the four major cities of New Zealand capital improved value had become the tax base for local authorities,[128]but to impose national land tax land values need to be determined.

Overall, the New Zealand economic landscape requires unique consideration in the implementation of a land value tax and the use of exemptions to relieve the burden on disadvantaged groups is highly likely. The extent of the required exemptions will severely narrow the tax base resulting in loss of efficiency and may not depress land speculation. The desire to implement an equitable tax would lead to its demise through the reliance on exemptions to increase vertical equity. A land value tax is based on a single source of wealth and violates the principles of horizontal equity as the same level of investments are not treated similarly. Singling out real property owners, particularly farmers,[129] for special tax treatment would, indeed, appear to constitute a brave political move.

The precise form of a land tax and its design – for example, any exemptions – would determine whether the principles of a "good" tax were met, including its acceptance by most New Zealanders. The valuation process by the government must be consistently determined and must also be communicable to the taxpayer.[130] Although the resulting decreases in land values due to a land value tax may increase affordability of home ownership, it should not be achieved at the expense of existing land owners. As the New Zealand Productivity Commission noted, a land tax could have unintended effects on housing markets and housing affordability.[131]

As this paper has argued, while policy grounds exist for shifting investment behaviour from properties to investment vehicles that promote foundations of economic growth, the unique New Zealand environment is unsuitable for efficient and equitable implementation of land tax. Therefore, while some form of a tax on land investments might be suitable to help achieve greater sustainability for the New Zealand environment, it does not appear that a land value tax is.[132] In addition, a land value tax, should it be adopted, will need to apply to all investment

[127] J K Brueckner, "A Modern Analysis of the Effects of Site Value Taxation" (1986) 39:1 *National Tax Journal* 49-58.

[128] W J McCluskey, A Grimes, A Aitkin, S Kerr & J Timmins, "Rating Systems in New Zealand: An Empirical Investigation into Local Choice" (2006) 14:3 *Journal of Real Estate Literature* 381-397 at 389.

[129] *Australia's Future Tax System: Report to the Treasurer* (2010) ('Henry Report') noted that most land in lower-value use (including most agricultural land) would not face a land tax liability. Also refer to Victoria University of Wellington Tax Working Group, *A Tax System for New Zealand's Future: Report of the Victoria University of Wellington Tax Working Group* (Centre for Accounting, Governance and Taxation Research, Victoria University of Wellington, 2010). The Tax Working Group contemplated farms and forestry land being exempt from a land value tax.

[130] V Mangioni, "A Review of the Practices of Valuers in the Assessment of Land Value for Taxation in Australia Journal of Property Tax Assessment & Administration (2015) 12:2 *Journal of Property Tax Assessment & Administration* 5-15 at 15.

[131] New Zealand Productivity Commission, *Housing Affordability Inquiry* (New Zealand Productivity Commission, 2012) 101.

[132] W J McCluskey & Riël C D Franzsen, *Land Value Taxation: An Applied Analysis* (Ashgate, England, 2005) at 15, "Despite the apparent merits and demerits of a land value tax from a theoretical point of view, the choice of the tax base is more often based on the very specific circumstances faced by the relevant taxing authority. Socio-political views, historic factors, as well as practical realities seem to be the deciding factors."

housing, not just foreign owned property.[133] In the author's opinion, implementation of a land value tax is a knee-jerk reaction to the Auckland real estate bubble and could lead to an increased risk of significant political influences that would translate to exemptions as previously shown by the abolished land value tax in 1992.

Consequently, this study contributes to a call for further investigation into whether taxing all effective income from capital (Real Estate Market) and stamp duty or transfer tax[134]payable by transferee or purchaser at the time of conveyancing[135]will broaden the New Zealand tax base and will overcome the problem of equity and efficiency in the tax system. Unlike land tax whose impacts on property price have not been wildly discussed, transfer duty is deemed as an effective tax treatment on controlling property market, the imposition of transfer duty plays a great role in curbing real estate prices.

This points to a promising direction for future research.

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[133] Foreign investors are merely one of the many symptoms of a broader problem of the fiscal privileges enjoyed by land owners.

[134] The most recent example is Vancouver, British Columbia which just imposed a 15% transfer tax on purchases of real property by foreigners.

[135] Land Information New Zealand could act as the agent for collecting the transfer tax or stamp duty. Transfer duty will not give rise to cash-flow issues as it is only charged when the property is transferred.