

# eJournal of Tax Research

Volume 10 Number 3

November 2012

Land taxation: a New Zealand proposal  
tax criteria are then applied to land tax proposals  
substitute for capital gains tax, which New Zealand  
radical alternative to income tax, a national land v

#### 1. INTRODUCTION

Land taxes have a long theoretical pedigree and, historically, a parti

abolished,<sup>6</sup> a national land tax might contribute to promoting equality.<sup>8</sup> Second, from the perspective of the Harbison comprehensive income model,<sup>10</sup> the New Zealand tax system has a significant gap in its tax base, inasmuch as capital gains are not generally taxed. A land tax might go some way to filling this gap. Furthermore, property is, in general, lightly taxed in New Zealand.<sup>11</sup> Third, due in part to the lack of a capital gains tax (CGT),<sup>12</sup> investment in New Zealand is heavily skewed towards residential property.

altogether and taxes only land values. A graded, ~~date~~, or split rate property tax applies a lower rate to improvement values. The term land tax valuation is used to represent both its pure and partial forms.

Broadly, a property tax is a proxy income tax and, rightly or wrongly, presumes that a certain level of property holdings indicate a certain ability to pay taxes on a regular basis. In contrast, an LVT about the land itself its scarcity, immovability and centrality to human activity

## 2.1 Theory

Among others, William Petty<sup>16</sup>, François Quesnay, Adam Smith, David Ricardo and John Stuart Mill have supported versions of land taxation<sup>17</sup>. For Quesnay and the Physiocrats, taxing land value 'was justified because [of the] productiveness of land ... since all taxes had to be paid out of rent, it would be sensible to replace all other taxes by a single tax on rent'<sup>18</sup>

which set out George's proposal for a single land tax on the 'unearned increment',<sup>25</sup> attracted much attention in New Zealand.<sup>26</sup> As in California and Victoria, a practical scarcity of land in colonial New Zealand arose as a consequence of speculation.<sup>27</sup> Furthermore, contrary to 'the vision several leading Liberals had for New Zealand as a thriving rural economy populated by yeoman farmers',<sup>28</sup> possibility of a landed 'aristocracy' forming as a consequence of land aggregation was feared, particularly by settlers whose families had experienced the Highland Clearances.

William McCluskey and Riël Franzsen argue that George's ideas influenced 'the politicians of the day in New Zealand, Australia, South Africa, Jamaica and Kenya to introduce such a tax',<sup>29</sup> but Gareth Morgan and Susan Guthrie observe that, despite being well known, George's views 'had little impact', with Mill appearing to have been more influential.<sup>30</sup> Nevertheless, Paul Goldsmith concludes that the first Liberal government, led by John Ballance, while not persuaded to implement George's radicalism, did wish to 'recover for the state at least a portion of the 'unearned increment' through a land tax'.<sup>31</sup> This wish was reflected in the Progressive Land and Income Tax Assessment Act 1891 (NZ), which 'had the specific purpose of breaking up the large estates (so property ownership could be more evenly spread throughout the community)'.<sup>32</sup>

## 2.2 Legislative History

Notwithstanding an experimental property tax levied in the colonial period,<sup>33</sup> New Zealand's first direct tax was a land tax enacted in 1876.<sup>34</sup> This was succeeded in 1879

---

<sup>25</sup>

by a property tax, which included personal property in its base<sup>35</sup>, although a substantial exemption of £500 applied<sup>35</sup>. The rate of tax in the first year was 1d/£1 (0.4 per cent). The property tax was repealed by the Land and Income Tax Assessment Act 1891 (NZ). This Act provided for a tax 'on land and all mortgages held on land and also for a tax on income from business<sup>36</sup> and emoluments<sup>36</sup>'. Initially the tax was levied on a split rate basis<sup>37</sup>: the ordinary land tax was levied at a rate of 1d/£1 (0.4 per cent) on the capital value of land owned less the value of improvements up to £3,000 and less the amount of any mortgages<sup>37</sup>. The graduated land tax was levied at rates

taxing income and land under the same legislation ended when the separate Income Tax Act 1976 (NZ) and Land Tax Act 1976 (NZ) were enacted. Finally, the Land Tax Abolition Act 1990 (NZ) repealed the land tax with effect from 31 March 1992.

Why did the land tax, which was originally such a major source of national government revenue and, indeed, an important instrument of social engineering, become so insignificant? To a great extent, successive governments allowed tax to fail. Philosophically, a policy shift from taxing Georgian 'unearned increment' to taxing comprehensive income in terms of the Rawls principle can be discerned.<sup>50</sup> Thus, from the 1940s, around the world, income tax brought many more people into the tax net and, as a consequence, grew exponentially in importance for government revenue.<sup>51</sup> With the ascendancy of income tax, no incentive lay in formulating a better land tax.<sup>52</sup> Another narrative is that of the unwillingness of New Zealand governments since the 1980s to tax capital.<sup>53</sup> In practice, the land tax was undermined by exemptions: 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'.<sup>54</sup> Furthermore, it was thought that effective use of a national LVT was limited because local property rates constitute the principal source of local authority revenue.<sup>55</sup>

### 2.3 Contemporary Land Taxation

The Local Government Act 2002 (NZ), which introduced significant changes to local government in New Zealand,<sup>56</sup> empowers local authorities to pursue their communities' social, economic, environmental and cultural wellings.<sup>57</sup> Through processes of community consultation and deliberation, local authorities must formulate community outcomes, derived from these four wellings. A long-term plan, which a local authority must have at all times,<sup>58</sup> is an evolving and rolling blueprint for achieving those community-specific outcomes. The Local Government (Rating) Act 2002 (NZ) invests local authorities with powers to charge rates 'in order to promote the purposes of the [Local Government] Act'.<sup>59</sup> The four types of rates that

<sup>50</sup> This is not to suggest that the New Zealand government evoctrposesw Z(l)5([11(r)-4r3)-13(r(ol)a-11(t)

may be charged are: a general rate, chargeable against all rateable land<sup>60</sup> and a fixed amount, universal annual general charge (UAGC), payable in respect of each rateable unit,<sup>62</sup> a targeted rate for particular activities identified in a local authority's funding impact statement, such as waste removal<sup>63</sup> and a targeted rate for water supplied.<sup>64</sup> The aggregate of targeted rates (excluding the water rate) and UAGCs may not exceed 30 per cent of a local authority's total rates revenue.<sup>65</sup> Differentiated rates may be charged for different categories of land<sup>66</sup>

In setting the general rate, local authorities may use land value (unimproved value), capital value (improved value) or annual value (imputed rental from improved land). While land value is traditionally thought to be the 'natural' base for rural authorities, and capital for urban areas,<sup>68</sup> some urban authorities use a land base and some rural authorities a capital base.<sup>69</sup> At the risk of imputing a degree of theory that may not in practice inform local authorities' decisions in this regard,<sup>70</sup> capital value rating may be seen as a proxy income tax and a land base as an LVT that incentivises optimal development.<sup>71</sup>

McCluskey and Franzsen observe that '[h]istorically, as the primary focus of local  
a.085 /TT1 (a)f01(s)23(a15EMC / Tw 6.96 05347731.0Tj EMC /P <</MCID 4 >>BD14 0 T



ratepaying and enjoyment of basic services.<sup>73</sup> Does the close connection between local property taxes and locally provided services preclude a national LVT?

Since local rating and a national land tax ran parallel for a century in New Zealand, the idea that property taxes are the unique preserve of local government is not historically plausible. Australia continues to provide an example of different tier political subdivisions sharing the same basic tax base.<sup>74</sup> Indeed, given the shift towards capital value taxation in rating,<sup>75</sup> it might be argued that an LVT would have a different base from rates. As many other countries,<sup>76</sup> property is, in general, lightly taxed in New Zealand. Although the rates yield of an amount approximately equal to two per cent of GDP (in 2008) is in line with the OECD average, yield as a percentage of aggregate housing value fell from 2.2 per cent in 1980 to 0.65 per cent in 2008. Furthermore, between 1991 and 2002, aggregate land value grew at 4.8 per cent a year, while per capita growth in GDP was approximately two per cent over the same period.<sup>78</sup> Since rates are 'somewhat regressive in their impact',<sup>79</sup> scope exists not only for making existing 'property taxes both fairer and less distortive',<sup>80</sup> but also to accommodate a low rate national LVT.

### 3. IS A NATIONAL LVT DESIRABLE ?

Andrew Coleman and Arthur Grimes present a plausible national LVT model for New Zealand. A one per cent LVT on all government land would raise revenue equivalent to 20 per cent of current income tax yield.<sup>81</sup> Adopting, in part, the Coleman-Grimes model, a majority of the Tax Working Group recommended an LVT.<sup>82</sup> Smith famously proposed equity, certainty, convenience and efficiency as the four 'maxims with regard to taxes in general'.<sup>83</sup> We have already noted that, having

<sup>73</sup> Local Government Act 2002 Amendment Bill 2012-12 proposes a new iMTC -0.E-1 0 0 T-13(a)-2(v)11(7.3e((2)3T

applied these criteria, Smith favoured a ground rent<sup>84</sup>. However, in this part we apply anew Smith's maxims and other relevant considerations to LVTs in a contemporary context. The Coleman model indicates that a national LVT is economically plausible but is it otherwise desirable for New Zealand?

### 3.1 Equity

LVTs are premised on a radical conception of equity. 'George argued that taxes on land promote fairness because the value of the land is determined by community rather than individual efforts.<sup>85</sup> Since the economic rent arising from land value is considered an unearned surplus brought into existence by the activities of the community in general, rather than anything the owner has done, it is eminently taxable. Furthermore, the burden of an LVT falls entirely on landowners. Equity in this fundamental sense is plausible, but people have been inured to the idea that ability to pay during the assessment period, which lies in horizontal equity (fairness in the tax base) and vertical equity (fairness in tax rates), is the badge of equity. Vertical equity issues are less relevant for LVTs than for, say, income tax because LVT rates tend to be low,<sup>88</sup> although not as low as property tax rates, and are likely to draw less attention if they are flat.<sup>89</sup> However, horizontal equity is a more contentious issue. As Elizabeth Plummer observes, '[i]f land value as a percentage of net wealth increases as household income increases, then a land value tax will be progressive ... [but] land value as a percentage of net wealth decreases as wealth increases, which suggest that a land value tax might be somewhat regressive.<sup>90</sup> Older people, often on fixed incomes, would be significantly affected by a shift to property taxation since, even though inequities between taxpayers seem to be far greater where capital value, rather than land value is used,<sup>91</sup> superannuitants tend to own disproportionately expensive properties relative to their incomes. However, '[d]ifferences in land ownership

---

(horizontal, vertical and intergenerational), and simplicity were key, and t



vitiates the advantages of an LV<sup>104</sup> Jeffrey Chapman and his co-authors argue that such claims are overstated<sup>105</sup> and, despite, say, a paucity of vacant lots in urban areas to act as comparators, skilled assessors can develop plausible valuation techniques.<sup>106</sup> Thus Alan Carter and Stephen Matthews observe that 'out-date values for tax purposes often distort the efficiency of property markets (by discouraging individuals

underdeveloped relative to general demand, even after taking into account differences in land quality and location. These findings are relevant for policymakers because they could have important equity implications.<sup>114</sup> The Georgian LVT came to prominence at a time when indigenous peoples were being displaced from their lands by European settlers; the idea that a contemporary LVT might have the effect of driving tangata whenua (original people of the land) from their current land holdings is politically unimaginable.

### 3.5 Other Considerations

#### 3.5.1 Steering Investment

Personal investment in New Zealand is heavily skewed towards residential property. 'New Zealanders have twice as much capital sunk into houses (and the land underneath) as they hold in financial assets such as bank deposits and managed funds. They've been encouraged to do this by the tax system.<sup>115</sup> As Morgan and Guthrie observe, these tax preferences have 'grossly distorted how wealth has been invested and has led to a considerable waste of capital.<sup>116</sup> The OECD argues that the omission of 'imputed rents and capital gains from the NZ tax base contributes to diverting household portfolios towards housing ... measures [taken so far] should be accompanied by higher property or land taxes that could be designed to achieve the same objectives as a tax on imputed rent.<sup>117</sup>

Clinton Alley and Michael Davis propose a land transfer levy to tax wealth accretions through property: the main purpose of the tax would be to correct the tax induced preference for investment in residential property in New Zealand.<sup>118</sup> The authors observe: 'It does require political intent to make the change for the betterment of future generations in this macroeconomic marketplace. The abiding question is, who has the will to plant the seed for New Zealand's future by introducing a low rate land transfer levy reforms?<sup>119</sup> Political preference lies at the root of property taxes in New Zealand. Singling out real property owners, particularly farmers, for special tax treatment would, indeed, appear to constitute a brave political move; however, both the Labour and Green parties, which might plausibly form a future government,

<sup>114</sup> Levente Tímár, *Rural Land Use and Land Tenure in New Zealand* (Working Paper 1-13, Motu Economic and Public Policy Research, 2011) 36-37.

<sup>115</sup> Morgan and Guthrie, above n 30, 137 (n omitted). However, it would be wrong to suggest that favourable taxation is the sole or principal reason for New Zealanders' 'obsession' with property investment. Immature capital markets, migration patterns and 'easy credit conditions' have made rental property an attractive investment option. See Cheung, above n 7.

<sup>116</sup> See Morgan and Guthrie, above n 30, 122.

<sup>117</sup> See OECD, *OECD Economic Surveys: New Zealand* (OECD, 2011) 116. This is not a proposal for an LVT proper, rather for a limited form of wealth taxation. It should also be noted that New Zealand does not extend any form of mortgage relief to home owners.

<sup>118</sup> Clinton R Alley and Michael J 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.

<sup>119</sup> *Ibid*, 338.

<sup>120</sup> In its recommendations for broadening the base of Australian land taxes, the Henry Report, above n 88



### 3.5.3 Visibility

Unlike, say, income tax deducted on a pay as you earn (PAYE) basis, property taxes, are egregiously visible to taxpayers.<sup>130</sup> The 'ritual' of paying local rates usefully focuses the minds of taxpayers on the services they receive from their local authorities,<sup>131</sup> but visibility can present psychological barriers, particularly, to property taxes.<sup>132</sup> Because LVTs tend to require higher nominal rates than property taxes, they are 'politically highly visible and possibly less acceptable to property owners'.<sup>133</sup> Conversely, as Roy Bahl and Sally Wallace observe, taxpayer resistance may also arise when 'visible, high value structures' are not taxed. Ultimately, consistent with the Tiebout hypothesis,<sup>134</sup> we may assume that the nominal rate of a





