

## Fractional Assessments—Do Our Courts Sanction Inequality?

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AN IMPORTANT chapter in California's tax history closed October 29, 1964, when the California Supreme Court denied petitions for rehearing in two cases<sup>1</sup> involving the constitutional mandate that "All property subject to taxation shall be assessed for taxation at its full cash value."<sup>2</sup> In both cases plaintiffs sought writs of mandate enforcing the constitutional command.

Two months before, the district court of appeal had refused to issue the writs, declaring that fractional valuations had been employed widely and long with court approval.<sup>3</sup> The decision by Justice Lillie was cautiously worded. At no point did it call fractional assessments constitutional. Nor did it even venture to call them "not unconstitutional." Its strongest words were:

In the face of the many decisions in this state herein referred to, we cannot say that the administrative construction resulting in the assessment of taxable property by a county at a uniform fraction of its full cash value is "erroneous or unauthorized."<sup>4</sup>

In a striking display of verbal virtuosity the decision found twelve ways to say that the courts knew about fractional assessments for seventy-five years but never struck them down.<sup>5</sup> The court also admitted that the validity of fractional assessments had not been at issue in any of the cases cited. The court did not lay down the precise quota of dicta requisite for repeal of a constitutional mandate, but its decision could become a useful precedent for settling that knotty question.

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<sup>1</sup> *Michels v. Watson*, 229 A.C.A. 497, 40 Cal. Rptr. 464 (1964), and *Hanks v. State Bd. of Equalization*, 229 A.C.A. 520, 40 Cal. Rptr. 478 (1964).

<sup>2</sup> CAL. CONST. art. XI, § 12.

<sup>3</sup> *Michels v. Watson*, 229 A.C.A. 497, 40 Cal. Rptr. 464 (1964); *Hanks v. State Bd. of Equalization*, 229 A.C.A. 520, 40 Cal. Rptr. 478 (1964).

<sup>4</sup> *Michels v. Watson*, 229 A.C.A. 497, 502, 40 Cal. Rptr. 464, 467 (1964).

<sup>5</sup> *Id.* at 502-08, 40 Cal. Rptr. at 467-70 (recognized, recited, indicated, referred to, permitted, accepted, approved, acknowledged, described, relied upon, was aware, did not question).

In a single dissent covering both cases, Justice Fourt took an uncomplicated view of the law:

It is Hornbook law that the provisions of the Constitution are mandatory . . . .

Nowhere is it indicated that the assessor need not comply with the provisions of the Constitution and the statutes. . . .

The meaning of "full cash value" has been determined by both legislative and judicial fiat. It has been held that "full cash value" is synonymous with "market value." . . .

The majority in this particular case in effect hold that the long continued, systematic and intentional violation of the law somehow constitutes or has developed into a right in the assessor to violate the specific provisions of the law. . . .

No amount of juggling, subterfuge, circumventions, evasions, deception, maneuvering, legalistic legerdemain or sorcery can change the plain and specific provisions of the Constitution. . . .

. . . [P]laintiff and many others in his position have suffered and do now suffer a detriment because of fractional assessing. . . .<sup>6</sup>

Those who share Justice Fourt's straightforward view of the law may be puzzled by the decision. Could there be extralegal considerations, not clearly visible, yet powerful enough to weigh in the balance? That there could be, indeed, is suggested by the indictment recently leveled by the Advisory Commission on Intergovernmental Relations:

. . . [F]ew officials feel under obligation to enforce the tax laws as written. In some states, in fact, *compliance by the assessors with the constitution and statutes would cause general consternation*.<sup>7</sup> The average assessor makes himself a sort of one-man legislature. He—not the state constitution and the state legislature—defines local taxing and borrowing power and determines the value of a veterans' or homestead tax exemption by the level at which he decides to assess property.<sup>8</sup>

The consternation that would swirl about their heads if assessors obeyed the law voluntarily might well ruffle the court that compelled them to do so.

<sup>6</sup> *Id.* at 509-14, 40 Cal. Rptr. 472-74 (dissenting opinion).

<sup>7</sup> "Special consternation" would be a more fitting term in view of the interests that would be offended (author's comment).

<sup>8</sup> 1 U.S. ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, THE ROLE OF THE STATES IN STRENGTHENING THE PROPERTY TAX 4 (1963). (Emphasis added.)

Why there should be consternation over a rise in the level of assessment puzzles some students of taxation. Superficially, the assessment level seems unimportant. Lower valuations simply compel higher tax rates. Tax bills, being the product of valuation and rate, seem unaffected. That more remains to be said should be suspected from the widespread practice of illegal underassessment. If the level makes no difference, overassessment should be as common as underassessment. A universal bias in one direction suggests anything but indifference.

It is easy to suppose that low assessment levels are only a side-effect of inflation, that assessors just cannot keep up with the inflationary rise of property values. The supposition is effectively countered, however, by the seventy-five years of fractional assessing cited by Justice Lillie.<sup>9</sup> In good times and bad, through inflation and deflation, fractional assessments have held their steady career.

A "long continued, systematic and intentional violation of the law"<sup>10</sup> is no accident. Its explanation lies in the interests it serves. What blocs are benefitted by fractional assessing? What interests stand in the shade of this ungainly plant that it should survive three-fourths of a century and subvert at last the constitution that stood in its way? These are the questions that must be asked and answered if underassessment is to be clearly understood. That they are seldom raised indicates not their irrelevance but the exact opposite. Crucial questions are often the most awkward to ask or answer.

### The Motives for Undervaluation

One explanation is that, consciously or unconsciously, assessors undervalue to minimize complaints. Bird explains the mechanics:

The taxpayer whose property is assessed at, say, 40 per cent of full value when the law specifies 100 per cent may think that he has a bargain; even if much other property is assessed at only 25 per cent or 30 per cent, usually he is not in a position to know this; and even if he feels discriminated against he is unlikely to complain when he realizes that his assessment potential is more than twice the existing level.<sup>11</sup>

But the self-interest of assessors alone cannot account for the extent and universality of fractional assessing. The supposed cause is too small to produce the known effect. Not only is the assessor but one

<sup>9</sup> 229 A.C.A. at 500 nn.1 & 2, 502 nn.3 & 4, 40 Cal. Rptr. at 465 n.1, 466 n.2, 467 nn.3 & 4 (dissenting opinion).

<sup>10</sup> *Id.* at 511, 40 Cal. Rptr. at 473 (dissenting opinion).

<sup>11</sup> F. BIRD, THE GENERAL PROPERTY TAX: FINDINGS OF THE 1957 CENSUS OF GOVERNMENTS 32 (1960).

official against a mass of taxpayers who elect him, but tax valuations continue to drop far below the levels that effectively discourage protests. Other potent forces are clearly at work.

One pressure group benefitted by fractional assessment is the veterans. The veterans' exemption shaves 1,000 dollars from the taxable value of a veteran's property if its total assessed value is less than 5,000 dollars.<sup>11a</sup> Thus a veteran owning a 20,000 dollar home, ineligible for exemption if the home were assessed at anything like full cash value, can slip under the wire with a twenty-three per cent assessment of 4,600 dollars. Also, the lower the assessment level, the greater the tax saving effected by reducing a veteran's assessment 1,000 dollars. But, again, the history of fractional assessment contradicts the notion that veterans are its prime beneficiaries. The practice was old when veterans began to cash in on it.

Recipients of welfare aid also benefit from fractional assessment, for it enables them to hold more property, yet stay eligible for assistance.<sup>12</sup> But few will suppose that welfare recipients or the welfare bureaucracy have had enough political muscle to account for the practice.

Assessment of property at levels well below the required "full cash value" began in days when the State itself levied a property tax.<sup>13</sup> The statewide rate was added to county tax bills. At that time no one was puzzled over why a county assessor trimmed his assessed valuations. He did it to shift the burden of the State tax from his own constituents to property taxpayers in other counties or to defend his constituents from similar shifts by other county assessors. Such competitive underassessment led to creation of the State Board of Equalization and gave it its name. To equalize the burden of the statewide tax rate, the Board was empowered to raise or lower the entire assessment roll in any county.<sup>14</sup> No statewide property tax has been levied since 1914; but, whenever a taxing district crosses county lines, the same motive for underassessment may be at work today.

The Riley-Stewart Plan of 1933 spawned another important motive for undervaluation by county assessors.<sup>15</sup> Before 1933, privately owned public utilities paid taxes to the State. After 1933, utility property was

<sup>11a</sup> CAL. CONST. art. XIII, § 1¼.

<sup>12</sup> CAL. WELFARE & INST'NS CODE §§ 450-55, cited by Justice Fourt, 229 A.C.A. at 514-16, 40 Cal. Rptr. at 474-75 (dissenting opinion).

<sup>13</sup> CAL. SENATE INTERIM COMM. ON GOVERNMENTAL ORGANIZATION, EQUALIZATION OF AD VALOREM TAX ASSESSMENTS IN CALIFORNIA 12 (1957).

<sup>14</sup> *Id.* at 12-13.

<sup>15</sup> *Id.* at 18-19.

assessed by the State but taxed on its assessed value by local governments at the regular local rates. This new arrangement opened the way for county assessors to shift more of the tax burden to utilities by setting their assessments at lower levels than those applied by the State Board of Equalization to utility property. In recognition of the unequal burden borne by utilities due to undervaluation by local assessors, the Board of Equalization in 1935 ordered thirty-one counties to raise their assessment levels, some by as much as eight-five per cent; three more equalization orders followed in 1936 and three in 1937.<sup>16</sup>

Since 1945 the distribution of State aid to school districts has presented county assessors with another motive for competitive underassessment. The formulas for State aid to so-called needy districts are tied to assessed valuations.<sup>17</sup> By undervaluing, an assessor can enable school districts in his county to show greater "need" and thereby get more money from the State. Uniform apportionment of school aid is one of the reasons for the equalization orders issued by the Board of Equalization since 1955.<sup>18</sup>

A last and most important motive for fractional assessment arises because of the tax and debt limits applying to local governments. Limits have been imposed by the legislature on general-law cities, school districts, and other taxing bodies; similar limits appear in the charters of some chartered cities.<sup>19</sup> The limits are always expressed as percentages of total assessed valuation. Every assessor in the State is under severe pressure from a certain body of real estate owners to assess as far as possible below the constitutional level in order to constrict the power of local governments to tax their holdings. This is the motive which drew sharp rebuke from the Advisory Commission on Intergovernmental Relations: "He—not the state constitution and the state legislature—defines local taxing and borrowing power. . . ."<sup>20</sup>

Illustrating the lengths to which this extralegal power can go,

<sup>16</sup> *Ibid.*

<sup>17</sup> CAL. ASSEMBLY INTERIM COMM. ON REVENUE AND TAXATION, TAXATION OF PROPERTY IN CALIFORNIA 124 (1964).

<sup>18</sup> CAL. SENATE INTERIM COMM. ON GOVERNMENTAL ORGANIZATION, EQUALIZATION OF AD VALOREM TAX ASSESSMENTS IN CALIFORNIA 38 (1957).

<sup>19</sup> The "Legislature shall have power . . . to limit the amount of taxes which may be imposed upon real and personal property . . . ." CAL. CONST. art. XI, § 20. For a summary of the various statutory limits and the California Code sections, see CAL. ASSEMBLY INTERIM COMM. ON REVENUE AND TAXATION, TAXATION OF PROPERTY IN CALIFORNIA 354-57 (1964).

<sup>20</sup> 1 U.S. ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, THE ROLE OF THE STATES IN STRENGTHENING THE PROPERTY TAX 4 (1963).

an assessor in a southern state admitted that he was "sitting tight" on assessed values in a certain school district because he was personally opposed to a new school and it could not be built so long as he kept his valuations down.<sup>21</sup> The thought is not confined to the Deep South. In 1961 a top official of one of California's largest farm organizations confidentially told the writer and a few others that he had had occasion to congratulate most of the assessors in California for their part in keeping down governmental extravagance. The writer asked if he were not really congratulating them for violating their oaths of office. "That," he gently replied, "is another way of putting it."

Undervaluation by county assessors does restrict local real estate taxes. Yet this is a very different thing from restricting expenditure. According to the report of the last Assembly Interim Committee on Revenue and Taxation, "These limits tend to place a straightjacket on local government and may cripple vitally needed services and preclude expansion and improvement of socially desirable services. *They result in further demands by local government for state assistance.*"<sup>22</sup> Declining assessment levels in California have been accompanied by rising per capita expenditures. Low assessments have restricted taxes upon land but the losses have been made up by State and local nonproperty taxes, mainly the four per cent sales tax. The end result has been not a reduction of expenditure but an increase, along with a shift of the burden to less articulate taxpayers.

### The Two Kinds of Victims

Undervaluation always has the effect and, we may suppose, the aim of relatively lowering the taxes on some or all property in an assessor's jurisdiction. Only in the very short run does the practice reduce expenditure. Immediately, or soon, other taxpayers make up the difference. But these other taxpayers who pick up the tab, these victims of underassessment, consist of two distinct groups—roughly speaking, property owners and nonproperty owners.

The undervaluation benefits enjoyed by property owners who pay a statewide or intercounty property tax injure other property owners who have to pay the same rate on a relatively higher assessed valuation in other counties. The undervaluation benefits enjoyed by vet-

<sup>21</sup> Taylor & Aull, Property Tax Problems in the Southeast, South Carolina Agricultural Experiment Station of Clemson Agricultural College Bulletin 414, at 21 (Southeast Regional Land Tenure Comm. Pub. No. 11, 1954).

<sup>22</sup> CAL. ASSEMBLY INTERIM COMM. ON REVENUE AND TAXATION, TAXATION OF PROPERTY IN CALIFORNIA 335 (1964). (Emphasis added.) See also F. BIRD, *op. cit. supra* note 11, at 8.

erans, like all exemptions, increase the taxes of other property owners in the same jurisdiction, through the increased property tax rates they necessitate. In either case, the tax shift is to other property owners.

But fractional assessments also shift taxes to nonproperty owners. When an assessor's arbitrary undervaluation causes tax and debt limits to strangle the fiscal powers of local governments and sends them to Sacramento and Washington for aid, it is nonproperty owners who pick up the tab in the form of higher sales and income taxes. This is necessarily so because the State of California<sup>23</sup> and the federal government levy no tax upon property as such.<sup>24</sup> When arbitrary undervaluation by a county assessor shifts taxes to the State-assessed utilities, it is again nonproperty owners who pick up the tab in the form of higher rates for utility services. The shiftability of property taxes on monopoly utilities is guaranteed by the Public Utilities Commission, which sets their rates.<sup>25</sup> Those who look with satisfaction upon the relative overassessment of utilities, who see in that practice the restraint of "big corporate monopolies," are uninformed. Utilities are not taxpayers, but tax collectors. Utility customers pay the tax.

### The Disparity in Political Power

Any experienced legislator will testify that shifting taxes to property owners and nonproperty owners are profoundly different undertakings. Insofar as the victims of underassessment are other property owners, they are political and economic peers of the beneficiaries and have the capacity to fight back through their own assessor, the legislature, the Board of Equalization and the courts. That they do fight back is shown by the perpetual concern over equalization. Most of the cases cited by Justice Lillie were, as the Justice said, equalization cases.<sup>26</sup> A recent report of the Commonwealth Club of California went so far as to declare that "the problem of equalization is the essence of

<sup>23</sup> With the exception of railroad cars not owned by railroad companies. CAL. CONST. art. XIII, § 14.

<sup>24</sup> The political and economic effects of taxes on the income from property differ from the effects of taxes on property.

<sup>25</sup> "Because taxes are a legitimate business expense, they, like all other legitimate business expenses, are reflected in the rates (passed along to consumers). It is basic, therefore, that the higher the taxes, the higher the rates, and conversely, the lower the taxes, the lower the rates." Letter From C. Lyn Fox, President of the Public Utilities Commission, to Glenn E. Coolidge, Chairman of the Joint Interim Committee on Assessment Practices, Aug. 7, 1958, in JOINT INTERIM COMM. ON ASSESSMENT PRACTICES, FINAL REPORT TO THE CALIFORNIA LEGISLATURE 136 (1959).

<sup>26</sup> Michels v. Watson, 229 A.C.A. 497, 508, 40 Cal. Rptr. 464, 470 (1964).

the entire question of assessment practices."<sup>27</sup> The veterans' exemption too—indeed, all property tax exemptions—are under constant scrutiny by politically powerful property owners who must make up the difference in their own tax bills.<sup>28</sup> If underassessment did no more than shift taxes from one property owner to another, such a wanton freak, brazenly contemptuous of statutes and constitution, could not have survived three-quarters of a century and won at last the implicit approval of our highest court.

The political strength of fractional assessments lies in their capacity to shift taxes to nonproperty owners. The burden of sales and income taxes and utility rates is diffused over such a large number of individuals, whose income sources require such constant attention and diligence, that political organization on the basis of self-interest is exceedingly difficult. By contrast, property owners, particularly the holders of valuable central and peripheral land, are relatively small in number and can well afford to defend their interests politically. They are as an organized army against a mob.

The reports of legislative tax committees abound with concessions to this difference. For example, the latest Assembly report calls it "obviously unfair" and "completely unjustified" that, owing to different assessment levels, "a [rapid transit] taxpayer in Contra Costa County with property worth \$100,000 would pay a tax on \$23,400 of assessed value while in San Francisco the owner of property worth \$100,000 would pay a tax on \$21,700 . . . ."<sup>29</sup> The report also complains that fractional assessments "confuse and mislead the taxpayer"<sup>30</sup> in his endeavor to obtain equity. But as for the tax shift to utility customers caused by overassessment of utility property, a shift now on the order of 150 million dollars a year,<sup>31</sup> the report on the same page declares:

<sup>27</sup> Kroeger, *Assessment Practices: Report of Section on Governmental Finance*, 56 TRANSACTIONS OF THE COMMONWEALTH CLUB OF CAL. 23, 26, published as 38 THE COMMONWEALTH (PART 2) 23, 26 (1962).

<sup>28</sup> The latest report of the Assembly Interim Committee on Revenue and Taxation devotes 40 pages to property tax exemptions, CAL. ASSEMBLY INTERIM COMM. ON REVENUE AND TAXATION, TAXATION OF PROPERTY IN CALIFORNIA 55-94 (1964). It recommends termination of veterans' exemption for all but disabled veterans, *id.* at 331.

<sup>29</sup> *Id.* at 98.

<sup>30</sup> *Ibid.* The taxpayer is ever the property taxpayer, another evidence of the difference being cited.

<sup>31</sup> The State Controller's Annual Report of Assessed Valuation and Tax Rates of the Counties of California for the Fiscal Year 1964-1965 reports county-assessed property, net of exemptions, totalling \$32,301,234,918 at an average ratio of 22.1% and State-assessed utility property totalling \$4,442,129,980. Richard Nevins, member of the Board of Equalization, stated on November 13, 1963, that utility property is assessed "somewhat in the neighborhood of 42 percent." CAL. ASSEMBLY INTERIM COMM. ON REVENUE

"An assessor is still wise to use low fractional assessment . . . . In a county with low fractional assessment and a high tax rate, the utilities will pay more taxes . . . ."<sup>32</sup> The unmistakable meaning is that fractional assessments, insofar as they injure property owners, are "unjustified," but insofar as they injure nonproperty owners are "wise."

The difference shows again in the grudging compromise won by the utilities about five years ago. Over a period of more than twenty years, local assessors had dropped their assessment levels so far that utilities were assessed by the State at about twice the level of county-assessed property.<sup>33</sup> Instead of proposing compensation to utility customers for the illegal burdens they had so long sustained, instead of proposing even to stop the illegal practice, the Joint Interim Procrustean Committee recommended that the law be changed to correspond to the practice.<sup>34</sup> "[T]he utilities," said the Committee, "pay over twice as much in property taxes as other taxpayers for every dollar of real or true market value. . . . [Y]et . . . utilities are not as oppressed as the above facts would indicate. . . . [T]he cost to the utility enterprise represented by property taxes is passed on to the consumer."<sup>35</sup> The utilities finally won an "agreement" that the Board of Equalization would reduce the utilities' assessment level—but gradually, so as to guarantee that property owners would retain their illegal advantage over utility customers as long as possible, minimizing the "disruption" of local finance always alleged to attend any restoration of legal rights to nonproperty owners. Whether still lower local assessments, commended as "wise" by the latest Assembly Interim Committee,<sup>36</sup> will maintain or worsen the discrepancy in levels remains to be seen.<sup>37</sup>

The same bias appears in the one-way attitude toward tax and

AND TAXATION, TAXATION OF PROPERTY IN CALIFORNIA 122 (1964). The present tax bill of California utilities is \$336 million. 1963-1964 CAL. STATE Bd. OF EQUALIZATION ANN. REP. 2. If county-assessed property were at the 42% ratio, it would total \$61.4 billion and the total assessment roll would become \$65.8 billion instead of the present \$36.7 billion. Utility taxes would become \$336 million multiplied by 36.7/65.8, or \$187.5 million, a reduction of \$148.5 million from the present figure.

<sup>32</sup> CAL. ASSEMBLY INTERIM COMM. ON REVENUE AND TAXATION, TAXATION OF PROPERTY IN CALIFORNIA 98 (1964). (Emphasis added.)

<sup>33</sup> JOINT INTERIM COMM. ON ASSESSMENT PRACTICES, FINAL REPORT TO THE CALIFORNIA LEGISLATURE 12 (1959).

<sup>34</sup> *Id.* at 15, 41.

<sup>35</sup> *Id.* at 49.

<sup>36</sup> Note 32 *supra* and accompanying text.

<sup>37</sup> The discrepancy indicated in note 31 *supra* (42% to 22.1%) remains close to double.



bond limits. That they will have to be tightened if assessment levels are raised is taken for granted.<sup>38</sup> But were they relaxed as assessment levels fell? They were not. Property owners were said to be paying "all the tax they could stand" and local expenses were shifted to non-property taxpayers through new and increased programs of state aid.<sup>39</sup> To tighten the limits when assessment levels rise is held to be an act of simple statesmanship. To relax the limits when assessment levels fall is unthinkable.

And who has not heard the dictum that equalization of assessments is more important than the level of assessment? Does the dictum not imply that the interests of property owners are more important than the interests of nonproperty owners? Unequal assessments shift taxes to other property owners. That is important. Low assessment levels shift taxes to nonproperty owners. That, according to the dictum, is less important.

### *Which Property Owners Benefit?*

Although the underlying purpose of fractional assessments is to limit property taxes, replacing them with sales taxes, income taxes and indirect taxes on utility customers, not all property owners benefit from this tax shift and not all property owners can be classified with the interest that promotes it. Further refinement is needed to identify the beneficiaries.

A property owner gains or loses money according to whether his property tax saving is more or less than the new tax burdens he must assume. For example, an apartment dweller whose personal property is on the unsecured assessment roll is a property owner in the literal sense, liable each year for a property tax. But only the most exceptional tenant owns enough property to save in property tax as much as he pays out in the taxes that replace it. One of the reasons advanced for

<sup>38</sup> "[A]djustments in tax rate limitations and bonding capacities would have to be made by the Legislature if assessors were to make full-value assessments." CAL. ASSEMBLY INTERIM COMM. ON REVENUE AND TAXATION, TAXATION OF PROPERTY IN CALIFORNIA 99 (1964). See also *id.* at 141.

<sup>39</sup> See McKay, *A Constructive Program to Reduce Government Cost: In Criticism of Certain Section Proposals*, 49 TRANSACTIONS OF THE COMMONWEALTH CLUB OF CAL. 148, published as 31 THE COMMONWEALTH (PART 2) 148 (1955), where the author, Assistant Executive Secretary, California Teachers' Association, says: "In 1946 the people wrote into the Constitution a requirement that not less than \$120 be allocated for each unit of average daily attendance. At every legislative session thereafter, until the Constitution was again amended in 1952, the Legislature not only reviewed that expenditure but increased the amount. By 1951 the Legislature had increased the amount to \$147—\$27 above the minimum set in the Constitution." *Id.* at 149.

new nonproperty taxes, in fact, is that they extract more money from those who own little property.

Most but not all homeowners are in the same position. The couple with two or more children who occupy a modest home in a residential neighborhood and have no other investment property share the tax status of an apartment dweller. The sales taxes they pay on clothing and household goods plus the tax increment in their gas, electricity, and telephone bills exceeds the property tax savings these substitute taxes bring them. They too are among the "owners of little property" who carry more of the tax load when fractional assessments produce a shift to nonproperty taxes.

In a different position, seemingly, are the owners of apartments and hotels, of commercial and industrial buildings, and of the valuable machinery, equipment, and inventories inside them. Here are large amounts of taxable property that can benefit from the tax shift produced by fractional assessment. But great buildings and large inventories also imply larger sales and income tax liabilities and higher utility bills. More important, it is elementary economics that the owners of buildings and their contents cannot keep long to themselves the benefit of a property tax reduction that also reaches their actual and potential competitors. Buildings, machinery, equipment, inventories—all are reproducible. If fractional assessment raises the profits that arise from such investments, capital flows in to share the higher profits and by its competition drives the profits down.<sup>40</sup> Untaxing such reproducible wealth spills benefits in at least three directions: "backward" to those who produce it, "forward" to those who consume it, and "sideways" to those who hold land; land users are willing to pay relatively higher rents because their use is not so heavily penalized in areas where the tax relief is enjoyed. Whatever benefit<sup>41</sup> fractional assessment of property brings to the owners of great buildings and their contents is only temporary and tends to diffuse. Any attempt to organize such investors to press for fractional assessment faces the same hurdles that beset the political organization of nonproperty owners: so many benefit, each by so little, and all are so busy.<sup>42</sup> Owners of reproducible property, like utilities, are largely tax collectors rather

<sup>40</sup> See G. BACH, *ECONOMICS—AN INTRODUCTION TO ANALYSIS AND POLICY* 612 (4th ed. 1963).

<sup>41</sup> But they also suffer, as will be shown, from the coincident untaxing of land.

<sup>42</sup> Buildings, equipment, and inventories generally earn a higher rate of return than the land where they stand, reflecting the greater management devoted to them by their owners.

than taxpayers. A tax policy that does unto others as to themselves kindles public spirits but is hardly a sure-fire business proposition.

Who then are the property owners whose political support lies at the root of the fractional assessment policy? If not apartment dwellers or homeowners or the owners of great buildings or valuable equipment or inventories, who does benefit from the shift to nonproperty and utility taxes?

The clearest beneficiary is the speculator in idle land. Idle land uses no gas, electricity, or telephone service. It supports no trade subject to sales tax. It yields no taxable income. The property tax is the only tax a land speculator pays while waiting for a rise. Thus he can only gain from these substitute taxes—any substitute taxes<sup>43</sup>—for the only tax he pays. And if the land carries lower taxes, thus costing less to hold, other investors see it as a better investment and are willing to pay more for it.<sup>44</sup>

Unlike the owner of buildings and other reproducible wealth, the investor in land need not fear that the tax relief which brings him higher profit will also bring competitors to drive his profit down to its old level. Granted that the same tax relief is enjoyed by competing landholders and that their land too is worth more, the supply of land is no greater. On the contrary, the supply competing in the market is less.<sup>45</sup> Tax relief, by facilitating the withholding of land, takes the pressure off land speculators. Fewer are compelled by taxes to erect "for sale" signs on their idle lots and acres.

Thus campaigns to relieve land of taxation are not handicapped by diffusion of benefit. The gains, reflected in higher rents and sale prices, are limited to those who hold land and must be paid for by all others. Land tax relief through fractional assessment is therefore unexceptionable as a business<sup>46</sup> proposition for investors whose portfolios are rela-

<sup>43</sup> Including capital gains taxes, which can be avoided by not selling.

<sup>44</sup> "Without a tax on property, the price of land would increase, perhaps significantly," CAL. ASSEMBLY INTERIM COMM. ON REVENUE AND TAXATION, TAXATION OF PROPERTY IN CALIFORNIA 337 (1964). A first approximation of the increase would be 20 times the annual tax reduction—a 5% capitalization. This potential enhancement of land prices by land tax relief is partly offset (with central sites probably fully offset) by (1) the higher nonproperty taxes and utility rates which land users must weigh in their bids, and (2) heightened speculation in land which robs downtown of its greatest asset, density. See generally *The Great Urban Tax Tangle*, Fortune, March 1965, p. 106, at 195.

<sup>45</sup> The conclusion is not altered by filling a bay or erecting taller buildings, for underwater sites and the sites on which tall buildings can be erected also share in the tax relief, rise in price, and drift into speculative hands.

<sup>46</sup> "Political proposition," though less familiar, would be more precise. "Business" retains a parity of meaning with busyness along productive lines and should not be confused with the busyness of special interests in enhancing their privileges.

tively heavy in land. They have much land to gain by, little else to lose by.

Not all land speculators benefit, of course, from the tax shift. Many have nonland interests through which they suffer more. The ratio of land to nonland interests that marks the cut-off point is commonly underestimated. For the gain is direct, immediate and visible; the injury so indirect, delayed and diffused that we respond to it as did Mark Twain's contemporaries to the weather of which they all complained. Sales taxes, utility bills, and taxes hidden in the things we buy are a prodigious but unfelt drain day after day, month after month. Property taxes, by contrast, strike twice a year, like the measured beat of a bass drum, keeping small homeowners awake and ready to march to the protest meetings land speculators organize when their assessor, often five years late, attempts to equalize their valuations.

### *The Sources and Signs of Power*

The restriction of benefit to a small circle who have relatively heavy investments in idle and underused land is not, as might be supposed, a political drawback. The fewer who share in the harvest, the easier it is to round them up and collect seed money for candidates and campaigns. The power of small, special interests to gain political ends needs no illustration.

What the beneficiaries lack in numbers they make up in affluence. For not only does affluence spring from successful land speculation but the permanence of land, coupled with centuries of political success in diverting taxes from it, gives land titles a reputation for security that attracts the affluent.<sup>47</sup> The circle affected with a strong land interest often includes the "leading families," whose grandparents or great grandparents arrived early and acquired strategic land.

Moreover, the beneficiaries of fractional assessment need not and naturally do not ask tax relief for land as such. As if in avoidance of an Anglo-Saxon obscenity, the four-letter word becomes "real estate" or "property." Relief is sought only for "homeowners" and "property owners," for "golf courses" and "farms." A holding may run to six or seven figures and rise by ten per cent a year, yet its holder will be only an overtaxed, sunburned farmer who wants to follow the plow. So prettily does the landed interest wear the mask of production<sup>48</sup>

<sup>47</sup> Not to mention the deductibility of property taxes and the 25% limit on capital gains tax, both of which drive speculative lands into the hands of investors in the upper-income brackets.

<sup>48</sup> Investments in reproducible tools and inventories are requisite to the existence

that one might readily suppose the landed interest had all but vanished in modern society, where wealth takes other forms.

One evidence of the extent of speculative landholdings is the 12,876,000 vacant lots reported in the 1962 Census of Governments<sup>49</sup>—enough already developed land (if not withheld at speculative prices) to last the homebuilding industry thirteen years at present construction rates. Speculative holdings lie most often on the fringes of developing areas—the fringe of downtown, beside a proposed transit station, near a new shopping center, at the city's edge. Any location that promises rising values attracts speculators who hold for a rise and block land use. Professor Gaffney has reported the immense quantity of speculatively held land that fragments the San Francisco Bay Area, giving us open space everywhere but where we want it:

Just how wide and how empty these territories are is startling to discover. The New York engineering firm of Parsons, Brinckerhoff, Hall & MacDonald surveyed land uses and potentialities in connection with its 1953-1955 report to the San Francisco Bay Area Rapid Transit Council. It found ample suitable acreage in the Bay area for the entire projected 1990 population of the whole State of California: 22 million to 31 million people—7 to 10 times the Bay area's population of 3 million in 1953-1955. This is allowing ample areas for recreation and industry.

The California State Water Resources Board surveyed the area independently in 1955, using aerial photographs, and published the findings in its Bulletin No. 2. For the 10-county Bay area metropolitan region, only 15 percent of the suitable urban land, or 10 percent of the gross land area, was actually developed for urban use in 1955.

In the crowded city of San Francisco itself, the Water Resources Board survey showed 23 percent of the usable land was undeveloped in 1955. Along the Bay side of San Mateo County (the "Peninsula"), which is often hastily described as having become "a solid mass of suburbs," 75 percent was undeveloped. On the Bay side of Alameda County, which includes Oakland and Berkeley, the survey reported 62 percent was undeveloped.

In the Santa Clara Valley (around San Jose), whose "total urbanization" is often forecast as imminent, 86 percent of the suitable land was undeveloped for urban use in 1955. The total suitable urban land in this valley, 155 thousand acres net of streets, exceeds the area used in 1955 in the entire Bay area (129 thousand acres, also net of streets).<sup>50</sup>

of such capital and add to the economy's total productivity. Investments in land add nothing to total output. See G. BACH, *op. cit. supra* note 40, at 540.

<sup>49</sup> U.S. BUREAU OF THE CENSUS, CENSUS OF GOVERNMENTS: 1962, VOL. II, TAXABLE PROPERTY VALUES 7 (1963).

<sup>50</sup> Gaffney, *Urban Expansion—Will It Ever Stop?*, in U.S. DEP'T. OF AGRICULTURE, YEARBOOK OF AGRICULTURE 503, 514-15 (1959).

If the affluent few who hold these promised lands flex enough political muscle to shift taxes to nonproperty owners through fractional assessment, that power must reveal itself in other ways. Do they perhaps shift their legal tax obligations to property owners too—to those whose assets are less in land and more in buildings? Last year the Statewide Homeowners Association surveyed 716 properties in 9 representative counties of California and found the following assessment ratios:<sup>51</sup>

Residential	19.3%
Commercial	18.8
Farms with Significant	
Capital Development	11.8
Low Improvement	8.6
Vacant Lots & Acreage	5.3

The figures show that holders of vacant land in California are assessed less than one third as much in relation to market value as the owners of residential or commercial property; the holders of low-improvement land less than one half as much. The study found that if the last two categories listed—such speculative holdings as Professor Gaffney reported—were equalized with homes, an additional 812 million dollars a year would be available for financing local governments with no increase in tax rates.<sup>52</sup>

The unequal assessment levels in San Francisco and Contra Costa County, which the Assembly Interim Committee called "completely unjustified" in their effect upon transit taxpayers,<sup>53</sup> were in the ratio of 1.078 to 1,<sup>54</sup> a difference of less than eight per cent. The difference in intracounty assessment levels found by the Homeowners Association study was in the ratio of 3.64 to 1, or 364 per cent.

Why was the Assembly Committee disturbed over an eight per cent discrepancy in intercounty level and untroubled over a much greater intracounty spread? Could the crucial difference be that among those injured by the eight per cent discrepancy are landed interests powerful enough to elect and recall, while the same interests only gain from the 364 per cent discrepancy in their favor? So far from protesting the unconstitutional undervaluation of speculative

<sup>51</sup> Statewide Homeowners Ass'n, Financing California's Public Schools by Property Tax Equalization—A Nine County Survey, Feb. 1964, p. 26 (mimeo). See also CAL. ASSEMBLY INTERIM COMM. ON REVENUE AND TAXATION, TAXATION OF PROPERTY IN CALIFORNIA 135, table XII (1964).

<sup>52</sup> Statewide Homeowners Ass'n, *op. cit. supra* note 51, at 26, 32.

<sup>53</sup> Text accompanying note 29 *supra*.

<sup>54</sup> Computed from figures in text accompanying note 29 *supra*.



landholdings, the Committee devoted twenty pages<sup>55</sup> to a sympathetic review of the problems of "farmers" in the urban-rural fringe and closed on the optimistic note that the State might give them the money to pay their taxes.<sup>56</sup>

### *Future Dangers*

It is a mistake to suppose that the landed interest will be satisfied with one more tax favor. Taxes on utilities are almost twice the average, yet assessors still are told it is "wise" to assess low because even more will be shifted to utility customers. Speculative lands are assessed at one third or one fourth the average, yet "farmers" on the city's edge demand further favors.

The landed interest is by nature implacable. The tax shift they champion went all the way in England between 1660 and 1800. It was advanced by a self-serving parliament in which only landholders could sit and for which only landholders could vote.<sup>57</sup> Throughout Britain today every vacant lot is still tax exempt, and land speculation reigns supreme. Most of Latin America is dominated by a landed interest that pays little or no tax. Will this American republic be next?

It is past time to ask whether this implacable power does not secretly strive for the total replacement of property taxes on land with income and sales taxes that fall on productive enterprise. The tax program currently offered by the Chairman of the Assembly Interim Committee would eliminate twenty-five per cent of the property tax for schools. Since schools use half the property tax revenue, this program goes one-eighth of the remaining distance toward complete tax exemption for California's landed interest. At least three times the Committee report gratuitously introduced the suggestion that the property tax might be swept away. So common is this mania for abolition that *Nation's Cities* in its March, 1955 issue entitled a special tax report "Are Property Taxes Obsolete?"

While moving as expeditiously as possible toward replacement of the only tax they pay, spokesmen for land speculators label those who resist them as theorists and advocates of change.<sup>58</sup> But they have

<sup>55</sup> CAL. ASSEMBLY INTERIM COMM. ON REVENUE AND TAXATION, TAXATION OF PROPERTY IN CALIFORNIA 204-24 (1964).

<sup>56</sup> *Id.* at 223-24.

<sup>57</sup> *Land Speculation and Land Taxation Are Hot Political Issues in England Again Today*, House & Home, Aug. 1960, Land—A Special Issue, p. 129.

<sup>58</sup> Speaking before the Commonwealth Club of California on February 19, 1965, Jesse M. Unruh, Speaker of the California Assembly, said: "Three weeks ago, a tax revision plan was released. . . . The most significant feature in the proposal is the \$728

a secret faith of their own, the theory of landlordism, that, directly or indirectly, labor should pay all taxes, because privilege is the only true property.<sup>59</sup>

million reduction in property taxes. . . . Our only opposition has come from county assessors and the single-taxers. . . . Although the single-taxers profess to be for property tax relief, I suspect they would like to see property taxes increase as long as land is the only form of property subject to taxation. I am sure the people of this State would prefer to see their property tax bills reduced substantially rather than to experiment with nostrums which have been rejected five times by a statewide vote of the people. However, these single-taxers have more front groups than the John Birch Society or the Communist Party. They are afraid to come out and call themselves single-taxers so they call themselves the 'California Homeowners' or 'The Incentive Taxation Committee' or some other pseudo title. I suspect that some are even here today—ready to use your club as a vehicle, if possible."

<sup>59</sup> See CAL. ASSEMBLY INTERIM COMM. ON REVENUE AND TAXATION, CALIFORNIA'S TAX STRUCTURE: 1964, at 121 (1964), where this faith is implied in the familiar vested rights argument referred to by Ronald Welch. The only reason wages cannot be capitalized into a vested right that taxation could impair is that their future existence is uncertain. Wages require work.