Benefits of Land Value Tax on New York and other Major Cities (Part 1)

By Lee Hachadoorian

In the United States, no major cities have land value taxation (LVT), although a number of cities in Pennsylvania (including Allentown and Harrisburg) have a two-rate property tax. But political economist Henry George ran twice for mayor of New York in the late 19th century, hoping that capturing the mayoralty of the greatest American city would help spread land value taxation across the U.S. and around the world. Instead, we got Robert Moses. And New York's major urban policy export of the 20th century became "urban renewal" in the form of superblock apartments and highways driven through the hearts of cities.

Is New York City now ripe for LVT or two rate taxation? The question arises as New York is once again discussing problems with inequities and inefficiencies of its unusual four-class property tax system. The four-class system was created in response to a 1970s lawsuit by commercial property owners regarding heavier assessment of commercial than residential property. The new system, which went into effect in 1983, locked in the disparity between commercial and residential property, while at least requiring proper valuation of the properties before applying different assessment ratios.

One odd feature of the four-class system was to separate owners in large multifamily buildings—cooperative or condominium owners—from owners of small residential properties, with different assessment ratios *and* different valuation systems for the classes.

Class 1 (1-3 family buildings) is valued using comparable sales, and has an assessment ratio of 6%. Class 2 (multifamily buildings, both rental and ownership) is valued based on potential rental income—even if the units are owner-occupied—and has an assessment ratio of 45%. The result is that Class 1 properties pay a net effective tax rate of 0.77%, while Class 2 properties pay 1.3%. A significant concern is that extremely high value condos/co-ops are difficult to accurately value using the income method, leading to penthouses in high-end buildings selling for more than the official assessed value of the entire building.

Land value taxation offers a host of benefits. How would land value taxation work for New York City, and how would it impact the city's residents? If New York were to implement LVT or two rate taxation, this would mean higher taxes on land, and lower taxes, or no tax, on the buildings that sit on that land. Increasing the tax on land would increase the holding cost of vacant land and spur its development. Reducing the tax on buildings would remove the disincentive for construction and property upkeep. Based on the experience of Pennsylvania cities with a two-rate property tax, New York could expect an increase in construction and development.

New Yorkers might immediately wonder how this will change the city, and how it will impact its residents. After all, isn't rampant development increasing housing costs in gentrifying neighborhoods? Isn't New York already short on open space, and why would we want to build on what little open space we have? Who is the burden going to fall on? Aren't property taxes regressive? How would this affect low-income homeowners? How would it affect elderly homeowners?

How a Tax Shift Would Affect Renters

With 64% of New Yorkers living in rental housing (source: American Community Survey 2019), there is a substantial concern about how a tax shift would affect renters. In theory, a tax on land value is absorbed by the landowner and cannot be passed on. A simple way of understanding this is that a tax falls on the party who is least able to change their behavior. Since land—the actual parcels that buildings sit on—can't be moved, or created, or destroyed, the landowner can't "get out of the way" of the tax. What about the building tax? Capital can move, but slowly, through lack of upkeep or the decision to build elsewhere. So, the building tax falls *mostly* on the building owner. A shift to LVT would reduce or remove even the small part of the building tax that is passed on to renters.

Discussions of the property tax often assume that the property tax is passed on to renters, and therefore that any reduction in property taxes would also be a benefit to renters. If, as theory indicates, the tax falls on landowners, this cannot be right. But this theoretical understanding is complicated by New York's inordinately complex tax system. Almost all new rental construction is tax abated (under the 421-a program), and older rental buildings are usually rent-stabilized. Rent stabilization means that property tax increases would not automatically lead to rent increases (though they can be taken into consideration by the Rent Stabilization Board, which sets the legal limit on rent increases).

Who benefits from the 421-a abatements? Without that program, some new construction would not happen, and the reduced supply would tend to raise rents on the existing housing stock—except that rent stabilization would block some of those increases. The impact of the property tax on renters in New York City is not well understood, so we can only say that there is no evidence for the claim that a property tax reduction will benefit renters, and that this claim flies in the face of public finance theory.

Part 2 will address how the Tax Shift would affect low-income and elderly homeowners.