



Testing the Legality of LVT

Is land value taxation legal in Oregon?

A classic **land value tax** (LVT) levies a tax on the value of the land itself, instead of the structures or improvements upon it. This alternative to the ad valorem tax system raises the cost of holding onto property that could otherwise be developed, contributing to a city's housing stock. It accelerates the development of underutilized lots. The split-rate variation of LVT applies a low rate to the improvement value, offset by a high rate to the underlying land value, starting with a revenue-neutral phase-in.

Given that the split-rate LVT applies different rates to land and improvement assessments, the highest hurdle to achieving legality may be the constitutional provision of uniformity. Most states include this clause in their constitutions; Oregon is no exception. Article IX, Section 1 declares, "All taxes shall be levied and collected under general laws operating uniformly throughout the state."

It remains unclear whether "uniform" taxation necessitates a single rate throughout the state, thereby rendering a split-rate LVT unconstitutional. Curiously, Measure 50, an outcome of Oregon's property tax revolt in 1990, is itself incompatible with the principle of uniformity. By [limiting the annual growth rate](#) of taxable property value to three percent of the assessed value, M-50 separated maximum assessed value (MAV) or taxable values from real market values. It permanently locked in assessed value imbalances, allowing similarly valued properties to pay dramatically different property tax amounts. Uniformity is lost when false assessments replace real market values.

The Legislative Revenue Office (LRO) released Research Report 4-10 in September 2010 analyzing assessment data from four Oregon counties. It found that [horizontal inequities](#) did in fact exist in all four counties studied. "One of the core principals of tax policy is what economists call 'horizontal equity,' which is that similarly situated taxpayers should pay similar amounts. Obviously this Measure 50 violates that." Relating the language of the constitution to the evidence of horizontal inequity, M-50 clearly violates this meaning of uniformity.

Yet there was no claim that the replacement tax system violated the Oregon constitution's uniformity clause. Subsequently an appeal was filed in the Oregon Tax Court asserting that such a disparity in tax burdens for the same government services violated the Equal Protection Clause of the Fourteenth Amendment to the U.S. Constitution. Countering this position, a brief was filed in Tax Court. Judge Carl N. Byers opined that the proration method for reducing property taxes that exceed Measure 5's limits did not violate the federal Equal Protection Clause. He wrote: "Plaintiff's claim is without merit. The [legislative power of the state](#) in matters of taxation is entitled to great deference by the courts...taxpayers may pay a greater proportionate share to a particular taxing unit, but overall they are not treated unequally."

Measure 50 added a section to the Oregon Constitution (Article XI, Section 11) that [exempts itself from the uniformity requirements](#). As a result we have a perverted property-tax system that hits some neighborhoods far harder than others. Depending on where you live, you might be paying more than another home across town that's worth the same amount. Both Measures 5 and 50 have had an enormous negative impact on the ability of cities and other local governments to meet the basic service needs of their citizens. These changes baked into the constitution significantly reduce city revenues by detaching property taxes from market value and setting

arbitrary limits on local taxation. M-50, by separating assessed value from market value, virtually assured that horizontal equity would be violated.

Now if the state grants an exemption for a replacement tax system that is arbitrary and inequitable, could it likewise exercise great deference in matters of taxation when deciding on a reform that is designed to be fair and equitable? First, LVT is based on real market value assessments, not on arbitrarily fabricated assessments. Secondly, economic theory holds that a tax imposed tends to diminish its value; therefore what is desired should be taxed less, and what is not desirable should be taxed more. Capital investment in buildings fuels economic growth thus should be taxed less. Excessive consumption of land by land-holding and speculation does not, thus land should be taxed more. Economic principle states that value belongs to the creator of that value. Together these two antecedents lead to a tax regime that taxes unearned value and un-taxes value that is earned. No other tax does this.

LVT is compatible with the principle of uniformity. Taxpayers with equally valued property pay the same amount of taxes. Equal treatment is one condition of constitutional uniformity; another concerns the question of property class. Article I, Sec. 32, states: "all taxation shall be uniform on the same class of subjects within the territorial limits of the authority levying the tax." Our understanding of this clause is that all classes of real property within a taxing district shall be taxed at the same rate. But what aspect of real property defines class?

One rendition is that land and improvements are two different classes. On the face of it this leads to a flawed interpretation of uniformity. Land and improvements are two components of property; all parcels have these two parts to which the appraisal process assigns a value. A more reasonable interpretation would be that classes refer to categories of land use, e.g. residential, commercial, industrial, vacant. This clarification holds that classes of land use cannot be taxed at different rates. Some states do allow the classification of residential property differently from commercial property and tax them at different rates (New York City, for example). In an Oregon interpretation this appears to be a breach of uniformity. Therefore we believe the legislature should abide by this mandate and ratify a version of LVT that taxes all properties at the same split rate, a high rate for land and a low rate for improvements.

In the LRO Research Report # 4-10, the Task Force on Comprehensive Revenue Restructuring proposed two remedies to violating uniformity: (i) Eliminate maximum assessed value calculation and return to market based assessments. (ii) Repeal Measure 50's exemption for constitutional requirements of uniformity in taxation. The proposed Land Value Tax reform would do precisely that; it is consistent with the uniformity in taxation principle.

- (i) Measure 50 requires that the tax base consist of MAV assessments and a permanent tax rate. If any part of M-5 and M-50 is retained within the reform regime, the LVT system would simply be unworkable. A permanent rate could not be split because that would necessitate imposing a rate greater than the permanent rate on one component of the property [land] in order to achieve revenue neutrality. Changing to a land value tax will require an exemption from M-50 (ORS 308.146). We believe that a split rate can be achieved through a local option LVT, although implementing legislation would be necessary.
- (ii) Given the perverse effects resulting from M-50 assessment limits, there is good cause to revoke its exempt status. There are more appropriate uses of exemption even within the strict interpretation of uniformity. Exemptions from property tax laws are commonplace in Oregon, a state with over 100 [exemption programs](#). A property tax exemption is a

legislatively approved program that relieves qualified individuals or organizations from all or part of their property taxes.

Two of the more common exemption programs available are the Disabled Veteran or Surviving Spouse Property Tax Exemption and the Enterprise Zone Exemption, a statewide program where qualifying commercial and industrial businesses in certain areas of the state can receive a property tax exemption on new or remodeled property. Other state authorized programs reverse the financial consequence through “special local assessments” which charge property owners for upgrades that increase property values (e.g. right-of-way improvements). These charges are not ad valorem property taxes, and thus not subject to the uniformity clause.

Is this a legal avenue for LVT? Can a reformed tax system exempt a threshold amount of assessed value from taxation? For example, “A local government may exempt a uniform amount of building value from taxation, not to exceed \$xxxx.” This is already achieved through tax abatement programs such as the Construction-in-Process Enterprise Zone Exemption in which qualified property includes buildings, not land. The same effect can be achieved by applying differential tax rates on land and improvements: a low rate on buildings as an exemption, a high rate on land as a special assessment. Similarly, another version of LVT: the universal exemption of specified building value + replacement land tax*, is a form of tax abatement plus special assessment.

In conclusion, the M-5 / M-50 replacement tax system violates the Oregon constitution’s uniformity clause; it is arbitrary and inequitable, yet it has been granted an exemption. The authors were aware that inequities of tax incident would compound over time. Is the decision to allow inequities to stand attributed to the state’s consent to exercise great deference in matters of taxation, or is it that a more recent constitutional insertion should take precedence over an older provision?

In stark contrast, the LVT reform tax system is designed to be fair and equitable, and [tax incidence studies](#) have shown that it is. The LRO tax restructuring task force has recommended the changes that a land value tax will achieve. We expect a new constitutional amendment will be needed to preempt Article XI, Section 11, that exempts jurisdictions electing to adopt the local option LVT from those requirements. Following this, the legislature should be able by statute to specify the required features of a local option land value tax.

If legal opinion agrees that land and improvements are two components of property, not different classes, this uniformity feature should not create a hindrance to the adoption of a split-rate LVT. The state legislature should also view the local option LVT as harmonious with existing tax abatement and special assessment programs. The split-rate tax rate structure within the ad valorem tax system is therefore an appropriate reform measure.

*Note: See Assessment Exemption on Improvements (AXI) in the brief: “Three Variations of a Land Value Tax”

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