Common Ground OR-WA

Transition to a Land Value Tax

Minimizing the adverse impacts while converting to LVT

We have proposed three steps to ease the transition from Oregon's conventional equal rate tax to a split-rate LVT and to address unnecessary hardships that may result.

Steps in the Transition to LVT

1. **Close the assessment gap** over a 5-year period
2. **Graduated split-rate LVT** over a possible 10-year period
3. **Homestead exemption** for hardship cases

Many jurisdictions are facing a familiar problem when property assessments have over time fallen short of true value. The first step in transitioning to a land value tax is to make certain that assessments are accurate and up-to-date. An immediate full introduction of real market assessments (RMV) will be a shock to most property owners whose taxable assessments (MAV) fall short. Enacting an assessment phase-in rule will gradually bring land & building values to the level needed to correct lagging assessments. We suggest a **buffered phase-in**, a simultaneous phase-out / phase-in yielding annual values reaching the target RMV in year five.

The next step is to **phase in the split-rate** LVT option over about a 10-year period. The question is: do we undertake this process simultaneously with the MAV to RMV phase-in period? In the beginning years we are still using assessments that fall short of the up-to-date RMV; yet we do not want to base the new LVT rates on under assessed values (MAV), distorting the desired incentive effects. On the other hand, we do not want to delay the transition to LVT when a county or city has chosen this option. The optimal choice is to phase in both RMV and LVT simultaneously.

In the first year of transition, it is important to maintain revenue neutrality, a policy objective that perhaps most legislators would insist upon. The split rate LVT applied to the new RMV assessment produces the same jurisdiction-wide revenue the MAV levy would have yielded. The LVT tax rate will gradually decrease as the RMV assessment increases.

Our solution is to begin with "LVT light": introducing the differential rates on land and improvement assessments, beginning with a small rate differential gradually increasing. The standard method is to express the split rate as the percentage of the total tax rate applied to land assessments. Start with a low ratio, for example 55/45, where 55 percent of the total rate is on RMV land assessments and 45 percent on improvements. This differential would then be increased to 65/35, and eventually to 95/05. Both phase-in steps, MAV to RMV and LVT tax rate differential, would proceed concurrently.

From the second year onward, the split rates are set to collect a predetermined target revenue. Land value taxation as it is conceived is 'revenue agnostic'. It takes no stance on the overall size of government. Some jurisdictions will aim for a larger tax slice of the economic pie, others for a smaller one. The resulting tax shift is compatible with both positions. LVT's reform agenda is not about the size of the slice but how the pie is cut.

Even during a gradual transition, there may be hardship cases where a single year change to RMV may result in an excessive financial burden. This obviates the need for some form of **targeted homestead exemption**, a legislatively approved program that relieves qualified individuals or organizations full or partial exemption from property taxes. Oregon has over 100 exemption programs, several cited in (ORS) 307. Examples are the Enterprise Zone Exemption, the Homestead Exemption under the Family Financial Protection Act, the Multiple Unit Property Tax Exemption, and the Nonprofit Low-Income Rental Housing Exemption. In Enterprise Zones, new buildings or structural modifications and additions are exempt but not land. Our proposal for eligibility would include property owners for whom the tax increase resulting from the conversion to a land value tax exceeds a *specified percentage* over what would be the tax levy from the previous year under the conventional tax.

However, because the long term trend in real estate shows substantial land price increases, most homeowners have been seeing significant equity build-up. The land value portion of private property yields an *unearned increment*, a public benefit received. As the principal contributor to land value, a local public jurisdiction is entitled to recapture most of this value through property taxation.

Thus, we prefer a property **tax deferral** rather than a broad-based exemption. This will achieve the dual objectives of returning to the public realm revenues in proportion to benefits received (from accumulated land rent), and retaining the financial incentives built into the LVT system as this land-based tax remains applicable to the property independent of the owner. Also, revenue losses can be avoided if a relief measure were in the form of a deferral. The accumulated tax liability accrues as a lien against the property to be paid out of sale proceeds or transfer of ownership.