

THE TAX SYSTEMS
OF
AUSTRALASIA

BY

JAMES H. GILBERT

UNIVERSITY OF OREGON
EUGENE, OREGON

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PREFACE

WHILE the author of this book was still a graduate student at Columbia University he became interested in the British dominions in the South Seas. The novelty of their economic experiments aroused his curiosity and prompted then the desire to study their operation in the environment that gave them birth. A leave of absence from academic duties at the University of Oregon from July 1940 to January 1941 made it possible for him to spend three months in Australia and New Zealand, and to make an intensive study of the tax systems of Australasia.

Much has been written about taxes in Australia and in New Zealand. With few exceptions, however, these studies are specialized and deal with certain aspects only. The more comprehensive works, moreover, appeared some years ago and throw no light on recent developments, especially sweeping changes that have been made in response to the demands of war finance.

Another reason for the present study is the conviction that there is room for a book on the revenue problems of Australasia as seen by an American writer. In fact, an appropriate title for this book would be "Australasian Taxes through American Eyes." Frequent reference will be made in the ensuing pages to American practice in comparison and in contrast with the tax systems and revenue sources of New Zealand and Australia. The study is consciously intended to throw light on some of the current problems in American finance. Especially interesting to American economists and tax administrators alike should be the assessment methods employed in connection with the Australasian land taxes and the various bases for assessing local rates. The highly centralized systems of assessment, the continuous revision of tax rolls, the employment of reliable sales data, and the use of qualified appraisers and experts all suggest possible ways for meeting some of the unsolved problems of property taxation in American commonwealths.

Much of the information was obtained from books, periodicals, and government reports found in the Parliamentary Library at Canberra and the General Assembly Library at Wellington. In both Australia and New Zealand, however, the perusal of documents was supplemented by numerous interviews with tax officials, the staffs of valuation departments, past ministers of finance, and taxpayers and citizens at large, all of whom were found to "speak a various language" when it

came to controversial issues such as the excess-profits tax or the levy on unimproved value.

The subject matter of this volume falls naturally into two divisions. Part I will deal with the tax system of Australia and Part II with that of New Zealand. Since the tax systems of the two dominions have many features in common, the treatment will call for frequent comparisons and some contrasts. The parallel treatment of the two tax systems will involve some repetition. But only by giving separate attention to the revenue arrangements of the two countries can unity and coherence be attained and the reader enabled readily to identify a particular departure or experiment with the country of its origin.

The author is particularly indebted to Mr. Kenneth Binns, of the Parliamentary Library at Canberra, and Dr. G. H. Scholefield, of the General Assembly Library at Wellington, and to their able and efficient staffs of officials and employees. Without their intelligent and helpful cooperation it would have been impossible to crowd into a short period of time the examination of the most significant publications relating to taxation, assessment, and administration. The librarians mentioned above were not only attentive to the author's needs so far as collections were concerned but went out of their way to arrange important interviews with tax officials and finance officers. Particularly helpful were conferences with Mr. H. H. Treblecoe, of the Commonwealth Tax Department at Canberra, and Mr. Bill Stewart, head of the Valuation Department at Wellington. Hon. William Downie Stewart, of Dunedin, who has held numerous cabinet positions in the New Zealand government and is, with Professor James E. Le Rossignol, joint author of books on *State Socialism in New Zealand* and *Taxation in New Zealand*, gave generously of his time to clarify some of the issues involved and to interpret popular attitudes toward the land tax and the rating on unimproved value. Mr. Henry Valder, of Hamilton, public-spirited businessman with a keen insight into social problems, contributed much to the understanding of economic and financial conditions in New Zealand. To these and scores of others who helped to make this study possible the author makes grateful acknowledgment.

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PART I. THE TAX SYSTEM OF AUSTRALIA

CHAPTER I

CUSTOMS DUTIES AND INTERNATIONAL TRADE POLICY

THE AMERICAN student of Australasian tax problems is immediately struck by the prominent place which customs duties occupy in the revenue systems of the dominions. A decade after the establishment of the Australian Commonwealth or Federation in 1901, we find that customs duties accounted for £9,505,855 out of a total tax revenue of £11,593,165, or nearly 83 per cent. If excise taxes are added to customs duties, moreover, the two sources account for 97 per cent of tax revenues. On the eve of the first World War about 57 per cent of total tax revenues arose from the operation of import duties.

The yield of tariff duties is of course adversely affected by wars and depressions, and this effect is very noticeable in the fiscal history of Australia. In the midst of the great struggle (1915), moreover, the Commonwealth government introduced its first income tax, and from that time on the indirect taxes declined in relative importance. By the end of the war the yield from customs duties represented but 25 per cent of the total. The *Official Year Book of the Commonwealth of Australia* says that "the striking fall in the customs returns [was] due probably to the diminution of imports caused by the scarcity of tonnage."¹ By the end of the World War the income tax and the customs duties were nearly equal in importance as revenue producers. The resumption of normal trade relations in the postwar period greatly increased the yield of import duties but, on account of the increase in total expenditures, the percentage traceable to customs was not materially affected.

With the more prosperous years of the twenties customs revenue and foreign imports both showed a marked increase. This is attributed "to a considerable extent to heavy borrowing abroad by the Commonwealth and State governments."² One sees here an interesting analogy to American experience during the twenties and thirties of the last century. This was the era of internal improvements financed largely by loan of British capital. The sale of bonds and stocks abroad yielded increasing balances against which American importers drew freely to pay for a rising volume of imports. Even with the moderate tariffs then in effect, treasury receipts, swelled somewhat by revenues from the

¹ *Year Book No. 12*, p. 749.

² *Year Book No. 17*, p. 367.

sale of public lands, were more than adequate to the needs of the national government, made possible reductions in the bonded debt, and paved the way for the ill-starred venture in the distribution of the surplus. Nearly a century later Australia was in a similar phase of economic development with like results affecting imports and the yield of tariff taxes.

The analogy may be carried further. Our American panic of 1837 finds its counterpart in the Australian reaction which began in 1927. Customs revenues showed a marked decline for the fiscal year 1927-28, a decline accounted for "by the reduced imports of 'luxury' goods (ales and spirits, silks, vehicles, tyres, musical instruments and jewellery and fancy goods) owing to a temporary depression."³ The depression turned out to be more than temporary and the effects on external trade and revenues were far-reaching. In a single year (1929-30 to 1930-31) tariff revenues fell from £30,157,000 to £18,224,000, and forced the Federation to introduce its first general sales tax. Excise and sales taxes were soon to equal in yield the proceeds from customs duties.⁴

The recovery in Australia came more promptly than in America, and by 1933-34 business conditions and revenues from import duties showed satisfactory improvement. By 1939 the import duties accounted for 42 per cent of total tax revenues, with sales and excise taxes yielding 34 per cent. The income tax, which yielded 16 per cent of Dominion revenues, was the only other important source.

An interesting point of contrast may be drawn between the national revenues of Australia and those of the United States. The American import duties, which speaking roughly were the chief fiscal reliance down to the War of the Rebellion and which between 1865 and 1914 shared responsibility with the excise taxes on tobacco and alcoholic liquors, have dwindled in relative importance to the point where they supply less than 5 per cent of total tax receipts. In Australia just before the outbreak of the second World War customs duties accounted for 42 per cent of the total and yielded nearly twice as much as any other single source.

It is interesting to note the shifting importance of specific classes of articles in the yield of customs revenues. In the early years of the Commonwealth tariff system, stimulants and narcotics yielded quite constantly about 40 per cent of external taxes. Other principal sources were apparel and textiles, agricultural products, and metals and machinery.⁵ By the beginning of the first World War revenue from

³ *Year Book No. 22*, pp. 349-350.

⁴ *Year Book No. 26*, p. 372.

⁵ *Year Book No. 2*, p. 801; *No. 3*, p. 790.

stimulants and narcotics had declined in relative importance to one-third of the total.⁶

Just before the outbreak of the second World War oils and paints had risen to first place as revenue producers under import duties and accounted for nearly £10,000,000; primage followed with £4,000,000, while narcotics had fallen to third place. The growth of the textile and iron and steel industries in Australia is clearly indicated by the fact that apparel and textiles fell to fourth place and metals and machinery to fifth place in rank order of revenue production.⁷

The importance of tariff duties in the revenue systems of Australia seems surprising in the light of the fact that 97 per cent of the Australian population are of pure British descent, and that the traditional policy of the United Kingdom since the middle of the nineteenth century has been one of resolute free trade and her influence in international affairs has been steadfastly exerted in the direction of maintaining open markets throughout the world. The imposition of import duties, it must be remembered, is not inconsistent with a policy of free trade, as the example of the mother country so well exemplifies. In Australia, however, excise taxes, which have been used effectively in England as offsets to customs duties, have been until recently confined to beer, tobacco, spirituous liquors, starch, and sugar. Even after the introduction of the general sales tax (in a sense a general excise), the rates on domestic transactions were modest as compared with the import taxes on corresponding items. The effect of internal taxation, therefore, has not been to neutralize or even mitigate, except in slight degree, the protective influence of customs duties.

Another reason for expecting that import duties with protective influence would be distasteful to the Australian public is the pre-eminence of agriculture and the extractive industries in the economic life of the Commonwealth. Even after industry had been fostered by decades of protection, agriculture in 1933 still gave employment to 36,000 more people than all branches of manufacture combined, and the extractive industries gave sustenance to 145,000 more persons than manufacture.⁸

From the beginning the bulk of exports have been in wheat, wool, dairy products, and frozen meats. Restrictions on trade will operate inexorably to curtail the outlet for staple exports and compel those engaged in the extractive industries to pay a higher price for necessary manufactures. Australia had, especially in the earlier period, the same reasons for supporting a free-trade policy as the Old South and the

⁶ *Year Book No. 8*, p. 693.

⁷ *Year Book No. 32*, p. 833.

⁸ *Year Book No. 28*, p. 551.

commercial interests of New England in the days before the Civil War. Students of American history will recall that concessions to the policy of protection were made necessary in the first tariff bill of 1789 by infant industries that owed their existence to the artificial restrictions incident to the Revolution and to retaliatory duties freely resorted to in the "critical period." These industries were localized largely in the middle states, whose influence was exerted in the direction of protection until the West and Southwest were won over by Henry Clay and his home-market argument.⁹ In Australia, in like manner, although there was not the same sectional segregation, the commercial interests were allied with the farming class in their efforts for freedom of trade.¹⁰

It might be expected also that the case for protection in the Dominion would have been weakened by the sheer distance of Australia from centers of manufacture and sources of supply. The original cost of production, plus the freight charges on heavy and bulky articles, should insure a price high enough to stimulate home production without the fostering influence of customs duties. This would be so unless the Australian continent were materially lacking in natural resources and aptitudes for particular lines of production.

In the light of the foregoing facts, it is somewhat difficult to explain why the principle of protection was early established and strongly entrenched in the several Australian states, with the exception of New South Wales, even before the Commonwealth government came into being on January 1, 1901 and the several state systems were superseded by the uniform duties imposed by the Federation in the same year.

In the process of fostering the principle of protection in the days before the Federation, the Colony of Victoria undoubtedly exerted a commanding influence. Some writers¹¹ attach considerable importance to the influence of a publication called *The Age*, which persistently harped on the necessity for trade restrictions as means to industrial expansion and a greater measure of prosperity. In the early years of colonial development the spirit of provincialism was rife, distances were great, and the need for immediate sources of supply seemed manifest. Moreover, Australian communities, more than any other part of the world, have been too frequently afflicted with panics and ensuing depressions with widespread evils of unemployment. The argument that manufacturing industries, promoted and fostered by protection, would insure more stable conditions of employment and open up new fields for absorbing the unemployed gained easy acceptance. This was

⁹ Cf. Frederick Jackson Turner, *The Rise of the New West*, pp. 236-244.

¹⁰ Cephas D. Allin, *Australasian Preferential Tariffs*, p. 44.

¹¹ Stephen Mills, *Taxation in Australia*, pp. 200 *et seq.*

particularly true in the period following the collapse of the mining boom in Victoria with the resulting evils of unemployment. Besides public works as temporary devices for relief, a need was felt for the opening up of permanent fields of employment by expanding private enterprise.

It must not be assumed that the policy of protection found universal acceptance. Some of the smaller and less populous states viewed with alarm the development of trade restrictions in Victoria and elsewhere. At first these smaller states seemed inclined to try a policy of retaliation; but the "native hue of resolution" failed them when they contemplated the consequences of a tariff war with the larger and more powerful states.¹²

Some efforts were made also under the leadership of Tasmania to foster intercolonial preference. This island state even proposed in 1865 that free intercolonial exchange of products should be accepted as a working principle, but concurrent action was at that time impossible.

While Victoria stood steadfastly for the principle of protection, New South Wales took pride in championing the cause of free trade. Her increasing prosperity and expanding fields of employment were held out as evidence of the salutary effects of free trade. Her manufacturers complacently took pride in the fact that they were able to meet competition in their own markets despite the lack of protection. From the fiscal standpoint New South Wales was in a more favorable position than the other Australian states and better able to dispense with revenues from import duties. She had at her disposal more marketable crown lands than any other colony. Even as late as 1900 New South Wales was getting nearly as much from sale of public lands as she collected in taxes from her customs for revenue and the compensatory excise taxes.¹³

Utter lack of uniformity in the tariff policy of Australian states created a problem of no mean proportions when the Commonwealth government, under a grant of exclusive power to levy customs and excise,¹⁴ sought to establish a uniform system of import duties to displace the existing state legislation and to establish freedom of trade within the Federation. Prevailing rates of taxation on imports ranged all the way from 17 per cent in New South Wales to 47 per cent in Tasmania, and these duties were offset in varying degrees, or not at all, by local excises. Moreover, the revenues that accrued to the several states from existing tariff systems exhibited an equally wide range of productivity and were, in some cases, out of proportion to population,

¹² Allin, *Australasian Preferential Tariffs*, p. 45.

¹³ Mills, *Taxation in Australia*, pp. 204 *et seq.*

¹⁴ Constitution Act, 63 & 64 Vict., ch. 12, sec. 90.

functions of the states, or necessity for federal expenditure within a given territory. While New South Wales with her more moderate policy obtained but £5,000,000 from customs, Queensland regularly received £11,000,000 and Western Australia as much as £19,000,000. Even smaller and less populous Tasmania got from tariff duties more than twice as much as New South Wales.¹⁵

It was obvious that the task of reconciling conflicting interests and even fundamental theories with respect to policy would call for numerous compromises. Indeed, framers of the Constitution Act had anticipated the difficulties and laid the foundation in part, at least, for acceptable solutions. Since free traders and protectionists alike had to be pacified, the first tariff act of October 1901 had to embody some features of "moderate protection, particularly avoiding unnecessary destruction of existing industries whose magnitude and suitability render them worthy of fiscal protection."¹⁶

Actual rates exhibited a wide range, running from 181 per cent on narcotics and 145 per cent on stimulants down to 17 per cent on textiles and 14 per cent on paper. The prevailing rates were around 20 per cent, and the general average, excluding narcotics and stimulants, was 23 per cent. The new tariff proved to be unsatisfactory to both camps but more so to the sponsors of freer trade. Unable to secure any general reductions, advocates of a more liberal trade policy called attention to the desirability of increasing trade with England and suggested the possibility of preferential arrangements. It was not until 1906, however, that the principle found recognition in the tariff system of the Commonwealth and even then it was accomplished not by reducing duties on English products but by imposing an extra 10 per cent on non-British imports. Schedules of the original act remained in effect so far as goods of English origin were concerned. Even articles hitherto admitted free were subjected to a 10 per cent tax unless they were produced or manufactured in England.

The year 1907 is generally taken as marking the end of any effective movement for freedom of trade. In that year the issue was raised in a fundamental way by a divided report of a tariff commission. In an effort to insure adequate representation of both sides the commission had been composed of an equal number of protectionists and free traders. Viewpoints proved to be irreconcilable except on minor issues, and two reports were submitted. The Cabinet, backed by a protectionist majority of two to one, chose to regard the report favoring further trade restrictions as the official one. General increases in rates were

¹⁵ Mills, *Taxation in Australia*, pp. 204 *et seq.*

¹⁶ *Ibid.*

made effective on raw materials and on articles not produced in Australia. The feature of English preference was preserved, but the differential in her favor was reduced to 5 per cent and confined to a limited number of articles. Even within this restricted field of preference the beneficial effect was partly neutralized by upping the rates from which the 5 per cent reduction was made. From now on it was assumed that protection was the settled policy of the Australian Commonwealth and the only question was the level of rates and the degree of protection extended.

The fundamental issue of free trade or protection was not the only one raised by the new uniform-customs act which superseded pre-existing state systems. As stated above, the colonies had found their tariff duties an indispensable source of revenue for local purposes, and some of these state systems produced revenue out of all proportion to population and even fiscal needs. The Australian states were naturally jealous about their sources of revenue; and industries, long protected under state auspices, were reluctant to yield up their special privileges. The Constitution Act itself had provided that, until uniform duties were imposed by the Commonwealth government, the state systems should remain in effect although the administration was to pass to the executive government of the Commonwealth.¹⁷ The Commonwealth government came into being on January 1, 1901 and the first uniform-customs act was not passed until October of the same year. Moreover, a special concession was made in the Constitution Act to Western Australia which was permitted, for five years following the imposition of uniform import duties by the Federation, to levy "duties of customs on goods passing into that State and not originally imported from beyond the limits of the Commonwealth; and such duties shall be collected by the Commonwealth."¹⁸ These duties were to be reduced, however, by one-fifth for the second year, two-fifths for the third year, and so on for successive years until they disappeared altogether at the end of the fifth year.

This provision for extending the lifetime of certain duties in Western Australia was apparently thought necessary to induce the state to enter the Federation. The reader will recall that Western Australia was somewhat remote from the more populous states of New South Wales and Victoria, and on account of its isolation had fostered the ideal of political and economic independence. It is significant that the section quoted above contains the qualifying clause, "if that State [Western Australia] be an original state [of the Commonwealth]." When the act

¹⁷ Constitution Act, 63 & 64 Vict., ch. 12, secs. 86, 88, 89, 93.

¹⁸ *Ibid.*, sec. 95.

was first framed, the political aloofness of Western Australia was apparently contemplated as a possibility.

It should be noted that Section 95, under which this concession was made to hesitant Western Australia, was in the nature of an exception to the principle laid down in Section 92 that "on the imposition of uniform duties of customs, trade, commerce and intercourse among the states . . . shall be absolutely free." Evidently Western Australia industries, long fortified by extreme protection, feared, even more than foreign competition, the invasion of their markets by other Australian producers. The reprieve period of five years would allow for readjustments made necessary by changing conditions of internal trade. The act itself provided for a tapering-off process under successive reduction of rates.

The revenue problem was equally difficult. To avoid financial embarrassment to the states until other sources of revenue might be developed, it was provided that the proceeds of the uniform customs duties should be shared with the states in the ratio of three-fourths for colonial treasuries, one-fourth to the Federation. An elaborate and somewhat unworkable formula was set up for the distribution among the several states. Prior to the inception of the federal law, the amount arising under state laws allowed to remain in force was to be credited to the state of origin. Against this credit were to be charged the cost of maintaining within the state any department transferred from the state to the Commonwealth and a proportionate share "according to the number of people" of other expenditures incurred by the new federal government. Following the introduction of uniform duties, and for a period of five years, three-fourths of the proceeds of these federal duties should be distributed to the states. The formula for apportionment was still further complicated by an attempt to allocate revenues between the states in accordance with the final incidence on the ultimate consumer. This made it necessary to follow up goods imported into the port of Sydney, but later shipped to a market in Western Australia or Victoria, through the devious channels of internal trade and the various agencies for distribution until they entered some locality for consumption. In the language of the Constitution, the revenue "shall be taken to have been collected not in the former [i.e., New South Wales] but in the latter State [e.g., Victoria]."

As stated above, the issue of protection was virtually settled after 1907. The sole remaining question was the extent or degree. In Australia, as in America, periods of depression have exerted a powerful influence in the direction of raising the level of protection to home industry. In the period of postwar depression the fear of dumping, as

in America, promoted emergency tariff measures. Significantly enough, the antidumping legislation of 1921 took the title of the "Industries Preservation Act." In addition to the general increase on dutiable articles from an average of 21.1 per cent to 25.86 per cent,¹⁹ it was provided that special duties might be imposed when investigations of the tariff board showed that importation of goods "might be detrimental to an Australian industry." The formula for applying the principle was not so easy of application. The special duty was to be equal to the "difference between the price at which the goods were sold and a fair market price." The problem of determining a fair market price for imported goods from some remote source of production is one which calls for unusual insight if not divination. The antidumping legislation also called for special duties on goods imported under disguised subsidies in the form of unduly low freight rates, or from countries with depreciated currencies.

Another step was taken in the direction of emergency increases under the tariff acts of 1929, 1930, and 1931, all "prompted by the desperate economic condition of the country."²⁰ In addition to material increases in rates, certain classes of imports were definitely prohibited. It will be recalled that the prosperous years of the twenties had been attended by extensive borrowing abroad and financial commitments to foreign security holders had to be met if the credit of the Commonwealth were to be preserved. Reference has already been made to the sweeping reduction in revenues from customs during the depression period of the early thirties. The unavoidable decline in consumption and restriction on imports were primarily responsible.

"The central idea in all Commonwealth tariffs, increasingly true in recent years, has been the protection of home industries and home standards of living."²¹ The addiction to the policy of protection has made more difficult the policy of maintaining friendly trade relations with Britain. The United Kingdom has been and will remain the most important outlet for Australian exports. In the thirties of the present century approximately one-half of Australian staples found their way to the markets of the British Isles. If other parts of the British Empire are included, the figure approximates 60 per cent. Aside from Japan no other country accounts for as much as 10 per cent. Until recent departures from England's traditional policy of free trade, the markets of Britain have been open without restriction to foods and raw materials

¹⁹ *Year Book No. 15*, p. 503.

²⁰ V. F. Cleary, *British Imperial Preference in Relation to Australia*, p. 12.

²¹ *Ibid.*, p. 11.

from all parts of the world with, of course, no preference to the products of the colonies or dominions. The buying power of the British people is clearly conditioned by access to foreign markets and the ready sale of her staple manufactures. Pure economic considerations, as well as bonds of race and nationality and established habits of consumption, would seem to favor the freest possible admission of British imports into Australian markets. When we reflect, however, that upwards of 40 per cent of Australian imports come from the British Isles, and another 15 per cent from other parts of the British Empire, it is difficult to reconcile these last-named considerations favoring freedom of trade with the mother country with the established policy of protection to home industry. Once untrammelled British competition is admitted, further attempts at protection are futile and ineffectual. A brief history of British preferential policy affecting Australia will make clear the difficulties of extending substantial preference to England while pacifying industrial interests whose hold on the market would be rendered precarious by marked reduction of duties.

Before the adoption of England's policy of free trade Australia was largely a pastoral country, depending for the livelihood of its people on the export of wool, wheat, and raw materials. In the days before Richard Cobden and the more liberal trade policy, it was the practice to grant material preference to Australian products; in return the Australian colonies, then directly subject to the Crown, were required to give preference to English goods. After the advent of free trade as an established British policy, however, the Australian colonies were not allowed to give preferential treatment to any foreign country or even to articles imported from other Australian colonies. This restriction remained in effect until the creation of the Commonwealth government in 1901. With the advent of the Federation and the passage of the uniform act of customs, trade between the constituent states, with the exception already noted, was entirely free. Any barriers set up against the trade of other countries of course amounted to a preference toward products of domestic origin.

As already indicated, the principle of British preference received half-hearted endorsement in the tariff legislation of 1906; but the beneficial effects were neutralized in part by a concurrent increase in rates from which modest reductions were made on imports of English origin. In the postwar period Australian industries, artificially fostered by war conditions, were confronted by the possibility of resumed competition and demanded a further extension of protection. Rates were increased and a margin of preference preserved for British manufactures. An intermediate tariff was set up midway between the stand-

ard rates and the level of duties applicable to English goods. It was provided that the intermediate schedules might be extended to other parts of the British Empire or by special negotiations to countries outside the Empire.

A new impetus toward preferential arrangements was given by the postwar decline of British trade due to the erection of tariff barriers against British manufactures. From this situation sprang the Empire crusade sponsored by Lord Beaverbrook and Lord Rothermere. The central idea underlying the crusade was a demand for free trade within the Empire and protection from without. The widespread division of labor between sections of the Empire and the resulting interdependence and solidarity of interest might, in the end, pave the way for concessions from other countries in return for reciprocal reduction of duties. In a word, the bargaining power of England would be immensely strengthened by the possibility that concessions granted might open the markets of colonies and dominions as well as those of the United Kingdom.²²

The first conference on the proposed Empire policy was held in London in October 1930, with disappointing results. The Conservative party, committed to a policy of protection to English industries, won the home election in October 1931. The result was a series of acts which represented a marked departure from the long-established free-trade policy of Britain. From these increased duties, however, dominion products were exempt, at least provisionally and pending the outcome of the Ottawa Conference scheduled to take place in 1932.

Concurrently with the victory of the Conservative party in England, the United Australian and Country parties commanded a majority in the Australian election of December 1931. Both elements in what was destined to become the coalition government in the Dominion had advocated a more liberal trade policy and more moderate tariffs. In New Zealand one year later a coalition government replaced the Laborites, and it was assumed that the new government would be more friendly toward preferential arrangements. In Canada the Conservative party (in power since 1930) and the prime minister favored a policy of imperial preference. All these changes seemed to promise some tangible results from the Ottawa Conference.

But, despite these favorable indications, all was not to be smooth sailing. Committed as they were to a policy of imperial preference, there was still plenty of room for disagreement with regard to method. The dominions wished to increase the level of duties still further and leave room for more substantial reductions in favor of British imports. This would amount, in effect, to discrimination against nations outside

²² *Ibid.*, p. 14.

the circle of British influence. The mother country at this critical stage in her foreign-trade relations sought strongly to avoid further increases in tariff schedules against outside countries, lest this policy should invite retaliation.²³ As Stanley Baldwin put it very clearly, there were two alternative ways of achieving further preference, "by lowering barriers among ourselves or by raising them against others." He went on to say that "we should endeavor to follow the first rather than the second course." Any action taken, he said, "was bound to have its reactions elsewhere."

With this fundamental difference in viewpoint between Britain and the dominions, it seemed at times doubtful whether any tangible results would come out of the Ottawa Conference. In August 1932 an agreement was reached which, however, embodied results far less important than sponsors of the movement had hoped for. England's paramount need for cheap food and raw materials naturally influenced her tariff policy. These were the very articles produced in abundance in Australia, New Zealand, and Canada; but the dominions could not be expected to supply the entire demand. To make possible effective preference for wheat and frozen meat and dairy products *from dominion sources*, duties must be imposed on similar products from other parts of the world. Britain naturally feared retaliatory duties in Argentina and Russia.

While the dominions wished to keep the British markets open for their staple products, they were reluctant to make any material reduction of duties if the change of policy would endanger the prosperity of industries at home. Under the agreement of August 1932, Britain undertook to continue the preference already established under recent tariff legislation for dominion products but reserved the right to impose new duties on certain foreign imports. Moreover, she reasserted her right to continue intact the 10 per cent *ad valorem* duties on products entered from certain parts of the world and stipulated that these mild barriers against non-Empire products would not be reduced except by consent of the dominions. Under the new agreement poultry and dairy produce from Australia, New Zealand, Canada, and Rhodesia were allowed free entry into English markets; and 10 per cent duties on wheat, maize, and specified fresh and dried fruits operative against other countries would preserve at least a measure of preference for dominion products in the same class.

In return for these concessions to the dominions, England received a doubtful, or at least an undefined, advantage. The dominions merely agreed to limit protection to industries "that have a reasonable hope of

²³ *Ibid.*, p. 15.

success." Tariff boards in the dominions were to revise existing duties and bring them into conformity with the established principle. Note that the measure of preference enjoyed by British exporters was to be left to the discretion of tariff boards in conformity with a principle which was susceptible of many and varied applications. The new policy was severely assailed by the Labor and Liberal press of Great Britain. It was pointed out that, in return for a very doubtful advantage in export trade, Britain had imposed duties on food and raw materials that would operate to increase the cost of living and the cost of manufactured articles, thus increasing the difficulties of meeting competition in foreign markets. The converse of preference is discrimination, and opponents of the Ottawa agreement saw in some of the provisions an invitation to retaliation. This would curtail and restrict trade and react unfavorably on industry at home.

Certain contemporaneous developments helped to strengthen the case of opponents in Britain. British exports to Australia and New Zealand, which had been declining since the beginning of the century, showed no tendency to increase. Widespread depression throughout the world and the growing spirit of nationalism still further reduced the market for British exports. Despite British preference, moreover, there was no marked increase in Australian exports to England, since population in the British Isles was tending toward a stationary level and the closure of foreign markets to her staple exports reduced the purchasing power of her people. One of Australia's most important staples has always been wool,²⁴ and English weavers had supplied the chief market. But the markets for English woolens was rapidly being closed by tariff barriers elsewhere and by the development of textile industries to supply local markets. So far as the Australian market was concerned, the demand for two of the British staples had been shrunken by the development of textile and iron and steel industries within the Commonwealth.

Curiously enough, the United States, which enjoys no preference at all under Australian tariff laws, had been, in the period before the second World War, sending increasing quantities of electrical appliances, motor cars, petrol, gramophones, and photographic supplies for sale on the Australian market. In the prosperous years 1923-27 Australian markets absorbed American products valued at £34,000,000, while Australian exports to the United States amounted to approximately one-fourth of that amount.

British preference seems to have had a beneficial effect on Austra-

²⁴ Australia has a total of 113,000,000 sheep and annually exports £42,000,000 of wool.

lian exports in certain restricted lines, especially in dried fruits, wines, and sugar. Some of these were accorded preference under English laws as early as 1919, and the preference was still further extended by acts of 1925 and 1926. It is, of course, hard to estimate the precise effect of preference in enlarging exports of dried fruits to Britain. The progress in this direction may be due, in no small degree, to the conscious encouragement to fruit raising through government-fostered irrigation and the policy for the settlement of soldiers on the land in the period following the first World War. Discharged soldiers devoted themselves in large numbers to the raising of fruit. In the case of wines, the exports were helped by bounties paid by the Commonwealth government since 1924. But both wine and sugar exports showed a noticeable tendency to increase in response to favorable British legislation between 1924 and 1928.

CHAPTER II

EXCISE AND SALES TAXES

THE SAME section of the Constitution Act (Section 86) which gave the Commonwealth government the right to levy uniform duties of customs also conferred a similar power with respect to excises. Section 90 of the document made this power exclusive as soon as uniform duties of customs had been imposed by the Dominion Parliament. It was not at all surprising, therefore, that in the early history of the Dominion customs and excises should be almost the sole fiscal reliance. As already indicated (page 3), these two sources once accounted for 97 per cent of total revenues from taxation.

At one time the opinion prevailed that the Constitution had not conferred upon Parliament any power to levy a direct tax except in time of emergency.¹ Whatever the intention of the framers may have been, however, the language of the organic law does not support this contention. Section 51, in enumerating the powers of the Commonwealth Parliament, confers the "power to make laws for the peace, order and good government of the Commonwealth with respect to . . . (ii) taxation but so as not to discriminate between states and parts of states." Subject to this one limitation (the equivalent of the requirement contained in Section 8 of the United States Constitution, that "all duties, imposts and excises shall be uniform throughout the United States"), the Commonwealth Parliament has no restrictions placed on the exercise of its taxing power.

With the exception of import duties and excises, however, the jurisdictions of state and federal governments in Australia are concurrent. In the matter of income and property taxes, therefore, state and Commonwealth governments have both provided for levies with resulting lack of uniformity and possibilities of double taxation that strongly suggest the undesirable situation in America.

In the period before the first World War excise revenues represented a fairly constant percentage of total taxes, about 16 per cent. During the war period the revenue from excises was greatly increased, and in 1919-20 nearly £8,000,000 were derived from excise taxes, the rates of which had been greatly increased by the legislation of September 1918. The introduction of the land tax, the income tax, and the

¹ *Year Book No. 1*, p. 648.

war-profits tax had, however, greatly swelled the total revenue of the Commonwealth and the percentage due to excises (19 per cent) had not materially changed.² The yield from specific items in the semiluxury class showed a striking increase between 1913 and 1918. The increase in revenue from tobacco was 30 per cent; the yield from the beer tax more than doubled; and spirits were now producing 90 per cent more than in prewar years.

In 1925-26, on the eve of the depression, excises produced £11,358,000, or 20 per cent of tax revenues. Even in the depth of depression, 1930-31, the revenue from excises fell but slightly; in that year it represented an even 20 per cent of tax proceeds. According to the latest figure available,³ the old-line excises, excluding the sales tax, yield £18,994,600, or 21.9 per cent of total tax receipts. These figures illustrate in a striking way a fact well known to economists and tax administrators, namely, the greater stability of revenues from internal taxes as compared with customs duties. In a period in which the yield from import duties fell off nearly one-half in Australia, the excises showed a decline of about 10 per cent. The explanation lies in the character of the chief revenue-producing articles in a typical excise-tax system. They belong to the class of conventional necessities of life, and consumption is less sensitive either to price changes or to varying degrees of economic prosperity.

The importance of excise-tax revenues in the Australian system must not be taken to mean that a large list of consumable articles were taxed. One finds in the Australian system support for the principle so strongly urged by C. F. Bastable, that productivity under an indirect tax may be insured with a relatively small number of articles, provided they are properly chosen. The original list of taxable commodities included beer, spirits, starch, sugar, and tobacco. Later starch and sugar were eliminated. From the inception of the system down to the time of the first World War, three classes of commodities—beer, spirits, and tobacco—yielded between 64 and 73 per cent of all excise revenues.⁴ By 1923-24 the yield of these three staples in the excise system had increased to more than 99 per cent of the total. By 1933-34 a number of other articles had been added, of which petrol and cigarette tubes and papers were the most important. Beer, spirits, and tobacco still account for 92 per cent of the total excise revenues.⁵

One of the wisest provisions of the Commonwealth Constitution

² *Year Book No. 14*, p. 668.

³ *Year Book No. 33*, p. 846.

⁴ *Year Book No. 2*, p. 803; *No. 3*, p. 792; *No. 4*, p. 807.

⁵ *Year Book No. 23*, p. 447.

was that which gave the federal government exclusive power to levy excises. This provision at once insures uniformity throughout the Commonwealth and avoids the confusion and conflict which is so manifest in the United States, where the power to levy excise taxes is exercised concurrently by federal and state authorities. With the return to legalized liquor traffic in America, the federal government immediately imposed a uniform excise tax on whisky. Superimposed on this uniform federal tax are some thirty-two state taxes, ranging in rate from 40 cents a gallon in Massachusetts and Nebraska to \$1.60 a gallon in Colorado. Some thirty states in the Union have sales taxes in some form, but rates vary and the inclusion of taxed articles is seldom the same. Twenty-eight states have tobacco and cigarette taxes at varying rates, while the remaining states leave taxation of tobacco to the federal government alone. The gasoline tax is universal in American states, but the rates range all the way from 2 cents in the District of Columbia and Missouri to 7 cents in Florida, Louisiana, and Tennessee.

The exclusive right of the Commonwealth Parliament to levy excise taxes insures in Australia a uniform scheme of excise taxation and precludes the possibility of state interference. Some of the states and cities were apparently inclined to question the exclusive power of the Federation and to assert their assumed right to lay excise taxes for local purposes. The question at issue was, however, definitely settled by two decisions in 1925 and 1926.

South Australia had provided in 1925 a tax on vendors of motor spirits at the rate of 3*d.* on the excess over ten gallons brought into the state for consumption. The framers of the act had attempted to conceal the real nature of the duty by regarding it as an income tax on gross receipts from the sale of petrol. The tax, they contended, "was not imposed on petrol but on the sale of petrol and only on intrastate sale of petrol." In answer to the contention of the Commonwealth government that it was an unlawful interference with interstate trade, since the tax was upon motor fuels brought into the state, South Australia contended that it did not interfere with foreign or interstate commerce, for these had ceased before the tax operates. "The tax affects not the movement of goods into the state but a transaction respecting the goods when within the state."

The court held that it "would pay no attention to a label," that, despite the misleading name, the measure was not an income tax but an excise tax, and that a state legislature had no right to impose such a tax "by whatever name it is called." If the state's right to levy a tax of this kind were conceded, there would be no limit to state excise taxes and

interference with trade which states might, in their own interest, impose.⁶

This principle was still further fortified in the case of *Fairfax and Sons v. New South Wales*,⁷ involving the legality of a half-penny tax imposed by New South Wales on each newspaper sold to the public. A group of newspapers published in Sydney brought suit to annul the tax on the ground that it was a tax on goods sold, and levied with the intention that it should be passed on to the buyer and was therefore properly classed as an excise tax. The Commonwealth alone had the power to impose such a tax. The defendant state raised the interesting question whether such a tax was properly regarded as a tax on commodities or a form of tax on communication. The newspaper's sole value resides in the fact that it is a source of information. The state referred at this point in its brief to the distinction drawn between the two forms of taxation by such eminent economists as John Stuart Mill and C. F. Bastable.

The court held that the tax in question was on a "concrete article produced for the purpose of sale," a "visible and tangible article, the material piece of paper with printed matter upon it." The court pointed out that the paper was issued and sold, transported to other places and vended like other commodities. The levy in question had all the requisite marks of an ordinary excise tax and the principle laid down in the *Commonwealth Oil Refineries Case* applied here with equal validity. With the decision in these two cases, efforts by states and localities to levy excise taxes came to an end. It was made clear by the court that the plain provisions of the Constitution could not be circumvented by camouflage or subterfuge.

As indicated above, internal taxation of commodities was, down to 1930, confined to a severely simple system of excises on a few selected articles. In the majority of cases, too, the choice of commodities for taxation was strongly influenced by sumptuary considerations. A sales tax more general in its application dates from August 1930, and was a part of the budget proposals for the fiscal year 1930-31. This new departure in taxation in Australia owes its origin to the same set of circumstances which gave rise to the epidemic of sales taxes in American states following the disaster of 1929 and the resulting depression. Although the yield of the customs duties had been about normal for the year 1929-30, there were, at the time the budget was under consideration, unmistakable indications of the decline which resulted in a reduc-

⁶ *Commonwealth and Commonwealth Oil Refineries v. State of South Australia*, 38 C.L.R. 408 *et seq.*

⁷ 39 C.L.R. 139.

tion from £30,157,000 in 1929-30 to £18,224,000 in 1930-31. While the yield from the income tax was actually increased from £11,120,000 to £13,604,000, other sources of revenue in general were expected to show a shrinkage.

The sales tax was therefore brought forward as the best means of meeting a threatened deficit. Even with the modest rate of 2½ per cent, the new measure was expected to produce £6,500,000, or £5,000,000 for the ensuing ten months of the fiscal period. The full effect of the current depression in trade, however, had been underestimated and the actual collections for the ten month period amounted to £3,472,000.⁸ With recovery in business and subsequent increase in rates, however, the sales tax became increasingly more productive and by 1933-34 was contributing a revenue of nearly £9,000,000. According to the latest available figure for the fiscal year 1939-40, the yield of the sales tax was £12,196,175 and represented 13.5 per cent of total tax receipts.⁹

The Australian sales tax is of the manufacturers, wholesalers, and importers type. The twofold object of this type is to simplify the administration and at the same time obscure the final incidence. To facilitate the administration of the tax, all manufacturers and wholesalers were required to register with the Commonwealth Tax Department. Such registration, while rendering the registrant liable for the payment of the tax on his volume of business, at the same time enabled him legally to claim exemption on certain types of nontaxable transactions. The tax paid by the wholesaler is, of course, controlled by the volume of business at the wholesale price. If the manufacturer sells directly to the retailer, this volume of business is reckoned at the wholesale level. Questions arose quite early in the history of the act with regard to liability of the taxpayer in case the proprietor mixed wholesale and retail business. An early ruling of the tax commissioner determined the status of such taxpayers on the basis of the proportion between the two types of business. If more than 50 per cent of the proprietor's business was properly classed as wholesale, he was required to register as a primary taxpayer.

The original act applied not only to outright sales but also to articles obtained under hire-purchase agreements. "Where goods are leased under a hire-purchase agreement . . . to a lessee the sale value of those goods shall, for purposes of this act, be the amount, which, at the time the lease is effected, is the fair wholesale value of the goods."¹⁰ Subsequent sections of the act indicate that this provision was introduced to

⁸ *Year Book No. 25*, p. 281.

⁹ *Year Book No. 34*, p. 846.

¹⁰ Sales Tax Act No. 9, 1930-31.

prevent evasion through the substitution of a hire-lease agreement for an outright purchase.

Taxes are assessed and collected on the basis of a statement made by the taxpayer within twenty-one days following the close of the month. A penalty of 10 per cent is provided for deferred payment of the tax; but the commissioner is given discretionary powers to remit the penalty when such remission is consistent with a just administration of the act. In case of disputes between the Tax Department and the taxpayer, the latter may within thirty days request the commissioner of taxation to refer the case to a board of review. The taxpayer in presenting his case to the appeal body is limited to the grounds already stated in presenting his case to the Tax Department. No new considerations can be introduced. The board of review has power to reduce, increase, or vary the amount as a basis for final settlement. In event the government or the taxpayer is still dissatisfied with the decision of the board, and a question of law is involved, appeal may be taken by either party to the High Court, whose decision is conclusive.¹¹

Failure to comply with the terms of the act, or to make correct statements, is penalized by heavy fines ranging from £2 to £100. If intent to defraud is present, the maximum penalty is £500.

Although the intention was not made clear in the act itself, wholesalers and manufacturers were expected to pass the burden on to the retailer, and he in turn to regard the added burden as an item in the cost of doing business. Apparently the wholesalers found difficulty in shifting the burden; inability to pass the charge on resulted in violent protests from the interests affected. The feeling was intensified when the Commonwealth government, after the first year's operation of the act, announced that the financial emergency left no alternative except to increase the rate to 6 per cent. Wholesalers united to demand that the shifting be made mandatory. Retailers in the main opposed the mandatory provision, but Parliament was inclined to recognize the justice of the primary taxpayer's plea. The tax was made collectible as a part of the bill rendered by wholesaler to retailer and by the same legal process.¹²

In practical operation the Australian sales tax stands in bold contrast to the prevailing type of sales taxes in America. The majority of American sales taxes aim to apply to the ultimate sale to consumers, and in most cases the shifting is made mandatory and the tax is allocated to and collected on each specific sale even to the last fraction of the cent. The Australian tax paid by manufacturers and wholesalers is absorbed

¹¹ Sales Tax Act No. 9, 1930-31, part VII.

¹² *Fourteenth Report, Commissioner of Taxation*, p. 14.

into and made a part of the costs of doing business. Although the ultimate incidence may be the same, the burden is disguised and the consumer is spared the irritation of repeated reminders of successive inflictions.¹³

One of the most striking features of the Australian sales-tax law concerns the policy of exemptions established under the original act and expanded by successive amendments to stupendous proportions. The principle underlying the first legislation seemed to be to favor agriculture and primary production. It will be recalled that the sales tax owed its origin to the depression of the early thirties. In times of deep depression agriculture and primary production invariably suffer most from the slump. Exemption from the sales tax was therefore advocated as a sort of subsidy to basic industries. Not only were primary products left free from taxation but machinery and equipment used in agriculture, mining, fishing, and pearling were also favored by exemption. The principle was even extended to include equipment used in irrigation, water supply, and drainage projects.

Experience has shown that the principle of exemption, once introduced, tends to extend and aggravate itself. Other industries and transactions set up equally valid claims for consideration. Even under the original act, transactions exempt exceeded those that were subject to taxation. The gross amount of taxable sales was £145,805,000, while exemptions covered £170,433,000. Scarcely a session of Parliament passed, moreover, when fresh additions were not made to the list of exempt articles and transactions. In a single session of 1934 the list of added exemptions covered nearly five pages in the text of the law. The elaboration of the exemption feature of the sales-tax act by successive amendment naturally led to confusion in the minds of taxpayers and immensely increased the difficulties of administration. Frequent appeals were made to the Tax Department and the courts to determine whether a given article belonged to the exempt class or must pay the tax.

At the session of 1935 Parliament passed a consolidated sales-tax exemption act which was intended to bring together in a single statement all exemptions hitherto authorized. Following the enactment of this measure, the Tax Department compiled for the convenience of the taxpayer a list of exempted articles arranged in alphabetical order.¹⁴ The commissioner of taxation in 1938 summarized sales-tax legislation from 1930 to 1938 and listed the main classes of exempted articles.

¹³ The author of this study, residing in Australia and New Zealand for several months, never encountered a suggestion of a sales tax in any purchase made. But for his study of tax laws, he would have remained wholly ignorant that any sales tax was in operation.

¹⁴ *Eighteenth Report, Commissioner of Taxation*, p. 19.

Besides the primary products and the equipment used in connection with extractive industries, exemption extended to foodstuffs, beverages, tobacco, drugs, medicines, surgical goods, fuel, power, light, books, printed matter, paper, scientific, educational, and religious goods, works of art, goods sold to the government and public bodies, building materials, containers, and manufactures of small businesses. The Tax Department was apparently given discretionary power to define the term "small manufactures" "when the tax amounted to only a few shillings a month." It was assumed that in such cases the cost of administration would exceed the proceeds from the tax.¹⁵

The Tax Department, in its effort to clarify the provisions of the act and facilitate administration, has from time to time issued sales-tax manuals. In one of these publications the list of exempt articles and the rulings affecting the same occupy 342 closely printed pages. Those who still cherish the notion that a sales tax can be simple and easily administered will find publications of this sort highly instructive.

The list of exemptions, already great, was still further augmented by the legislation of 1939 under which exemption was extended to certain defense supplies and the machinery, plant, and equipment by which they were produced. Uniforms, badges, and military kits and apparel were placed on the list of favored articles. With the exemption list swollen to such proportions, it is not surprising that exempt transactions far exceed those that remain taxable. For the last year preceding the coming of the second World War (1938-39), taxable sales amounted to £183,296,000 and those exempt to £280,282,000. Transactions to which exemption had been extended exceeded taxable sales by nearly £100,000,000!¹⁶ This fact goes far to explain why the Australian sales tax, despite the high rate, is not more productive of revenue. The Commonwealth sales tax at a rate of 6 per cent has produced in recent years approximately £10,000,000 or, at the present rate of exchange, \$32,500,000. California, with a population substantially the same as that of Australia, makes a 3 per cent sales-tax yield \$89,000,000 (1939). California with half the rate obtains two and one-half times as much revenue. It must be remembered, of course, that the California tax is upon retail transactions instead of wholesale, and that the Golden state stands high in per capita income and purchasing power.

It is not at all surprising that a piece of legislation as complex as the Australian sales tax should call for frequent interpretation by the courts. Since the levy is upon manufacturers and wholesalers, disputes naturally arose regarding the precise nature of manufacturing or

¹⁵ *Fourteenth Report, Commissioner of Taxation*, p. 15.

¹⁶ *Twenty-first Report, Commissioner of Taxation*, p. 74.

wholesaling. One of the early cases concerned the importation of interchangeable parts which were assembled in finished form after their introduction at Australian ports. Did such a process amount to manufacture? Under the transaction in question motorcycles had been manufactured and tested with old tires in England, then knocked down and shipped to Australia where they were again assembled and, with new tires attached, offered for sale on the domestic market. The court held that the reassembly of a product that had been manufactured in practically completed form elsewhere did not amount to manufacture, and that the defendant company was not liable for the tax.¹⁷ Another case calling for similar interpretation was the famous "*Fish and Chips*" Case. This litigation concerned the classification of the process of cooking fish and potatoes (a favorite combination in British dominions) and the sale of the same to the public. It was held by the court that the process of cooking and preparing fish, and its sale in conjunction with fried potatoes, did not constitute a process of manufacture and did not subject the dealer to taxation.¹⁸

Two later cases are somewhat difficult to reconcile with the "fish and chips" decision. The first of these concerns the nature of the process of developing and printing films. The defendant was engaged in the process of developing and printing photographs from films exposed by amateurs. A charge was, of course, made for the service. The court held in this case that the prints were "goods manufactured in Australia" within the meaning of the law and that their sale was a taxable transaction.¹⁹ The second case concerns the making of concrete piles to be used later in the construction of a bridge for a highway company entitled to charge tolls. The piling in question were fabricated on shore, and later driven into the bay and used for the support of auxiliary construction. The court held that, although the piling were not sold but fabricated for the construction company's own use, the process was one of manufacture and the value of the resulting product was taxable.²⁰

Since the tax is reckoned on the basis of wholesale prices, the precise inclusion of the term called for judicial interpretation. In some cases articles were quoted and sold subject to delivery, and the seller assumed the cost of transportation to the consignee. The situation was still further complicated by the fact that the distance covered by the delivery was variable and the cost of transportation seldom the same. A defendant company contended that the basis of the tax should be the

¹⁷ *Irving v. Munro and Sons, Ltd.*, 46 C.L.R. 279.

¹⁸ *Federal Commissioner of Taxation v. Rochester*, 50 C.L.R. 225.

¹⁹ *Federal Commissioner of Taxation v. Butcher*, 53 C.L.R. 82.

²⁰ *Hornbrook, Pty., Ltd. v. Federal Commissioner of Taxation*, 62 C.L.R. 272.

ultimate price minus the cost of delivery. The court held, however, that the prices subject to the tax refer to *completed* transactions. The contract was an agreement to sell *and deliver*; in event of a suit to collect from the customer, the seller would sue for the price *plus the cost of delivery*; the last-named constituent in the final price had not been separately stipulated.²¹

Since exemptions were, as indicated above, extended to numerous articles and since broad classes of exempt articles were not precisely defined, this phase of the law naturally produced much litigation. Typical among numerous cases of this kind was one which called for a judicial definition of "sponge" and its relation to cake. The original act had exempted "pastry but not including cakes or biscuits." The appellant company manufactured and sold extensively throughout the Commonwealth a product described as "sponge", which it contended was neither cake nor biscuit and therefore belonged in the exempted class. The court found that the product in question was a mixture of eggs, sugar, flour, and water, baked either in round tins or as oblong blocks and contained the same essential ingredients as a light cake which differs from common cake only in the use of a smaller quantity of fatty substances. Sponge could not therefore claim exemption on the ground that it differed from cake.²²

Besides the excise taxes and the sales tax, two other forms of indirect levy deserve a brief mention. The first of these is the flour tax, a measure which strongly suggests the ill-starred processing taxes in America, and which was intended to serve the same purpose, namely, relief to the wheat growers. At the end of a long period of industrial stagnation the price of wheat was unduly depressed, and in 1933 stood at 2s. 2d. (approximately 50 cents) a bushel on country sidings, a figure represented to be below the cost of production. The act of December 1, 1933, effective December 4, imposed a tax of £4 5s. a short ton on all flour produced in Australia or held in stock on December 4, 1933. The tax did not apply to products made from wheat which were unsuited to human consumption, and flour manufactured for export was exempt from taxation. The provision affecting the tax on flour stored on or before December 4 was to prevent evasion of the tax by manufacture and storage prior to the time when the law became effective. The policy underlying the flour tax had been long under consideration and the temptation to avoid a tax as heavy as that imposed was difficult to resist.

²¹ Commonwealth Quarries, Pty., Ltd. v. Federal Commissioner of Taxation, 59 C.L.R. 111.

²² Herbert Adams, Pty., Ltd. v. Federal Commissioner of Taxation, 47 C.L.R. 222.

In the period of financial distress that affected the wheat growers the government had decided on measures of direct relief involving £3,000,000, and naturally sought to recover some of the added expenditure from the consumers of wheat products. The flour tax was expected to make a contribution of £1,600,000 to this end. Beneficiaries were to be wheat farmers who did not, during the year 1932-33, receive incomes high enough to subject them to an income tax, or who, receiving such incomes, were entitled to relief because of special circumstances surrounding the case. The flour tax was at first intended to be a temporary measure and automatically expired on May 31, 1934. But the emergency that called it into being persisted and the levy was again imposed in December 1934 but at a lower rate, £2 12s. 6d. per ton; this measure remained in force until February 24, 1936. The flour tax was again imposed in December 1938 in a form intended to be permanent but at a variable rate to be determined by the wheat Stabilization Advisory Board; the amount of the levy, "gazetted" from time to time, was to depend upon the prevailing price of wheat f.o.r. at Williamstown, Victoria.²⁸ The maximum rate was fixed at £7 10s. a ton; actual rates have varied between £5 and £6.

The second of these special excise taxes was more simple in form and more specific in purpose. In the light of the paramount importance of wool production in the economic life of the country, increasing production in the face of restricted markets was a matter of general concern to the Australian public. It was believed that the situation might be improved by closer attention to quality of the product and by judicious advertising abroad. The cost of this program of supervision and promotion would be considerable, but the majority of wool growers seemed willing to foot the bill—hence the wool tax of May 1936, which imposed a tax of 6d. per bale, 3d. per fadge or butt, and 1d. per bag on all wool grown in Australia and shorn after July 1, 1936. The money arising from the operation of the tax was placed in a "wool publicity and research fund" to be administered by the Australian Wool Board and applied to the purposes indicated above.

The method of collection involved an interesting application of the principle of stoppage at source. Wool brokers, dealers, and middlemen were held responsible for payment of the tax and were required to furnish quarterly statements of the amount of clip that passed through their hands. The amount advanced to the government was in turn deducted from the amount paid producers. Difficulties arose in connection with the administration of the tax because of the existence of small

²⁸ *Twenty-first Report, Commissioner of Taxation, pp. 25 et seq.*

producers who sold in limited lots to hawkers who later sold to export dealers or to the trade. These transactions were hard to trace, since they came from widely scattered sources and assumed various forms.²⁴ The annual yield of the wool tax in recent years has been £75,000, of which £43,000 is contributed by growers in New South Wales and Victoria.

Before leaving the field of indirect taxation, a word should be said about the nonfiscal or regulatory use of the taxing power. Australia seems to have made less use of the taxing power as a regulatory device than the American governments. One reason for this is the fact that the Commonwealth Constitution, although modeled after the organic law of the United States, made a more liberal and comprehensive grant of power to the central government. The Australian Parliament is able to accomplish by direct regulation objectives which in America might call for an indirect approach through taxation.

One case, however, presents a precise parallel to American practice. An act of 1910 imposed a tax of 10 per cent on all notes issued and reissued through private banks; and "thus was prevented competition with federal note issue." This measure is, of course, an exact duplicate of the American act of 1865, imposing a 10 per cent tax on state bank notes, which measure was upheld by the Supreme Court in *Veazie Bank v. Fenno*. The constitutionality of the Australian act does not seem to have been questioned; in event of litigation it would have been sustained, since Section 51, Subsections xii and xiii very definitely place the control of coinage, currency, legal tender, and banking in the hands of the Commonwealth Parliament.

Another attempt at regulation through the exercise of the taxing power strongly suggests an American parallel. An excise act passed during the first year of the Commonwealth's existence (1901) had imposed a penalty tax of £100 "with respect to each of said manufacturers" on any producer who failed to comply with satisfactory labor conditions. This measure clearly suggests the second attempt at the regulation of child labor by our federal government. The Australian act suffered the same fate as the American experiment, and the reasoning of the court in rejecting its constitutionality parallels the reasoning of our Supreme Court in 1922. The Australian court held that the act in question was not a legitimate exercise of the taxing power and was intended to accomplish by indirect means the regulation of conditions of employment within the states. Powers of the Commonwealth Parliament in matters of labor legislation were confined to the arbitration of labor disputes "extending beyond the limits of one State."²⁵

²⁴ *Eighteenth Report, Commissioner of Taxation*, pp. 21 *et seq.*

²⁵ Constitution Act, sec. 51, subsec. xxxv.

To concede the power to regulate conditions of employment beyond this and through the miscellaneous exercise of the taxing power would invade the powers of the state and interfere with industry in a manner not contemplated by the Constitution.²⁶

One noteworthy aspect of the Australian tax system is the excessive share of the total burden which is sustained by indirect taxes and the extent to which these levies are regressive. In recent years the progressive taxes—income, estate, and land taxes—have yielded but slightly more than 20 per cent of the total tax revenues, while the remainder is made good by customs, excises, the sales tax, and miscellaneous indirect levies. While complaints are loud and frequent about the steeply progressive scale imposed on incomes and estates, the fact remains that four-fifths of the total burden is sustained by taxes which are shifted in such a way as to become regressive in effect. Moreover, some 80 per cent of the excise taxes are contributed by beer, spirits, and tobacco, all of which are conventional necessities of life and consumed as largely by the common people as by the well-to-do. The regressive nature of the tax system is surprising in the light of the influence of labor in Australian politics.²⁷ The explanation may lie in the fact that, under the Australian system, the burden of indirect taxes is more effectually disguised than elsewhere, and the goose submits to plucking with the minimum amount of squawking.

²⁶ *Rex v. Barger*, 14 A.L.R. 374.

²⁷ In the election of September 1940 the Laborites returned the same number of members as the United Australian and Country parties combined, and the Menzies government retained control only through the help of two independents. In October 1941 the Laborites assumed control of the government.

CHAPTER III

INCOME AND ALLIED TAXES

IT IS ONE of the anomalies of fiscal-history that income taxes are seldom introduced except under the stress of a financial emergency. One recalls the experience of England, where the first income tax resulted from the stress of the Napoleonic War. The present British income tax dates back to the sweeping change in tariff policy during the forties of the last century. The American Civil War gave us our first national income tax, and the abortive trial at income taxation in 1894 came from a tariff revision in the midst of the depression following the panic of 1893. The present national income tax sprang from the revision of the tariff in 1913, and the resulting loss of revenue from the extension of the free list, the removal of the duty on wool, and the reduction of the duty on sugar.

For fourteen years following the establishment of the Commonwealth government in Australia, the customs duties, even when generously shared with the states, plus the receipts from the excise taxes, were adequate to meet the expenditures of federal functions. The participation of British dominions in the first great World War created a financial emergency which made imperative the resort to income taxation. Accordingly, the income-tax act of 1915 became a part of the revenue system of Australia.

The inclusion of the term "income" was defined very broadly and applied to gains and profits received by foreigners from Australian investments or earned during their residence in Australia. Certain types of income were, however, designated as nontaxable. Among these were the salaries of the Governor General and state governors, income from Commonwealth securities, revenue of municipal corporations, income of religious, charitable, and educational institutions, and the receipts of friendly societies and trade unions.¹

The provision of the original income-tax act which required visitors to pay on that proportion of their income earned while in Australia has given rise to some embarrassing situations. Three distinguished English journalists visited the Commonwealth in 1920 in connection with the visit of the Prince of Wales, and remained in Australia from May to August. All three were assessed upon that portion of their income

¹ *Year Book No. 9*, p. 725.

which accrued during the time of their visit. Only one of the three showed up at the Tax Department and paid the tax before leaving. The others were later assessed and the tax collected under public protest. The Tax Department explained that it was acting in "conformity with the law". Later amendments specified certain exemptions on income earned by foreigners. Consuls and diplomatic representatives are not required to pay, and similar exemption is extended to representatives of any educational, scientific, religious, or philanthropic society attending international or Empire conferences or visiting Australia for the purpose of carrying on investigations or research for such societies or associations. Another subsection of the present law also extends exemption to "income derived by a resident from sources out of Australia where that income is not exempt from income tax in that country where it is derived." To forestall possible avoidance of the tax by visitors and temporary residents, however, all citizens of foreign countries embarking for passage must obtain a tax-clearance certificate showing that all taxes due and payable have been satisfied.²

The first act of 1915 provided in rather simple form for standard deductions permitted in the calculation of net income. These original provisions have been greatly elaborated by rulings of the Tax Department that were apparently written into the law at a later date. Among the deductions allowed are for losses incurred in the sale of property, operation and maintenance costs, depreciation (a term now elaborately defined to prevent abuses), bad debts definitely written off, commissions allowed in collecting income, interest on borrowed funds *necessary to produce taxable income*, certain contributions to pension funds, and gifts to charity exceeding a specified sum. A member of Parliament is allowed to deduct necessary expenditures in securing election to his seat. Farmers, in addition to ordinary expenses, may deduct sums spent in the eradication of pests, in the preparation of land for cultivation, and for fencing against animal pests.

One of the unique features of the Australian income tax is the provision for concessional deductions which extend to many items not properly regarded as expenses and which are not ordinarily allowed in American income taxes. The allowance of £50 for support of a spouse is extended to include a similar sum for a relative of a widower caring for children. An allowance is made to the extent of £50 for physician, nurse, chemist [druggist], or hospital expenses for the care of the taxpayer, spouse, or child under 16 years of age during a period of illness. And,

² The author of this book obtained such a certificate on the ground that his income accruing during his brief sojourn in Australia did not exceed the exemption of £250.

in event such ministrations fail, an allowance not exceeding £20 is made for funeral expenses at the death of spouse or child under 21 years of age. Payments made to insurance companies or superannuation benefit funds to the extent of £100 annually are also allowed as deductions.³

Provisions for exemption under the first income tax of 1915 seem complicated to an American student of taxation. In American income-tax legislation a specified exemption is deducted from the net income regardless of size. This practice has been criticized, especially by British economists, for the reason that, as the income rises into higher brackets, the significance of exemption and the necessity for it disappear altogether. The Australian income tax from the outset has followed the British practice of allowing a specified exemption on incomes below a stipulated amount, then diminishing abatements until the whole income becomes taxable at a certain level. In the case of incomes derived from personal exertion, the act of 1915 provided for an exemption of £156 in case the total income did not exceed £500. This exemption was then reduced by £3 for every £10 by which the income exceeded £500. The exemption would therefore vanish with an income of £1,020. A different scale of diminishing abatements was provided in case of incomes derived from property. The exemption of £156 was reduced by £2 for every £5 by which the income exceeded £156 and would therefore vanish when the property income reached £546. A clear intention is here discerned to differentiate service and property (earned and unearned) incomes even in the lower brackets.

The exemptions were lower than those in America during the same period and approximately on a par with the prewar exemption of £160 in the British income tax. At the prevailing rate of exchange (August 1915), the American equivalent of £156 would be \$720. Once America had entered the war in 1917 the exemption for single persons was forced down to \$1,000. In comparing exemptions, moreover, allowance should be made for a difference in price levels and scale of incomes. The Australian worker of 1915 received on the average 56s. to 60s. a week, or, at the prevailing rate of exchange, an equivalent of \$13.83. The average for American wage earners at the same time was at least twice that amount. The relative level of money wages has remained approximately the same in the postwar and depression periods.

In response to increasing fiscal needs the exemptions in Australia were soon forced down to £100 for a single person; but for married persons an additional allowance was made and the deduction for dependent children was increased from £13 to £26. The abatements in

³ Income Tax Act, 1936, sec. 79.

the case of both personal-exertion and property incomes were made to decline more steeply, and vanished at £780 for service incomes and £497 for property incomes. The rates were also increased by 25 per cent, and a minimum tax of £1 was provided for single men with no dependents.⁴ As a consequence of the change in abatements and rates, the yield of the income tax increased from £3,932,000 for the fiscal year 1915-16 to £5,621,000 in 1916-17.

In the period following the first World War the exemptions were raised somewhat; but the awkward distinction between personal-exertion and property incomes was retained and a different level of exemptions for each was prescribed. In 1932 the exemption for service incomes had been increased to £250, while property incomes took an exemption of only £200. An elaborate formula was prescribed for calculating the legal exemption in the case of incomes derived in varying proportions from property and personal exertion. This method tends to confuse the taxpayer and increase the cost of administration. The Royal Commission on Taxation (1932-33) recommended (page 24 *et seq.*) that the distinction between the two types of income, so far as exemptions were concerned, should be dropped and a uniform figure stipulated regardless of source.

A peculiar type of exemption crept into the Australian income-tax law of 1938. By this amendment to existing law all income derived from primary production, mining, or fisheries in Northern Territory by residents of this political subdivision was made exempt; this exemption was extended for a period of ten years.⁵

The Tax Department of Australia has, from the outset, encountered great difficulties in applying the income tax to the incomes of farmers and pastoralists. Australian farmers, like those of other countries, are seldom expert in keeping accurate accounts and the commissioner of taxation in his *Seventh Annual Report* (page 65) deplores the fact that "farmers are not keeping simple and accurate records of their business transactions." He goes on to say that the "attitude of the makers [of returns] when called upon by the Department to furnish reasonably correct particulars is astonishing." Some branded the department as "robbers and incompetent administrators"; and they "enlist powerful aid in order to relieve themselves of work which other taxpayers cheerfully perform."

⁴ *Year Book No. 10*, p. 729.

⁵ *Twenty-first Report, Commissioner of Taxation*, p. 10. This exemption based on sectional grounds, it would appear, might be contrary to the spirit if not the letter of the Constitution. Sec. 51, subsec. ii confers on Parliament the power of taxation "but so as not to discriminate between states or parts of states." Apparently the term "states" was taken to exclude Northern Territory.

Another set of difficulties affecting the assessment of farmers' incomes arises out of the fluctuating returns from agricultural enterprise. Not only are farm incomes affected drastically by periods of depression, but in Australia the rainfall is always uncertain and droughts are of too frequent occurrence. The postwar depression, aggravated by shortage of rainfall, brought the question of fluctuating incomes forcibly to the attention of officials and led to the suggestion that the incomes of farmers and pastoralists be assessed on an average of several years. The House of Representatives passed a resolution endorsing in a general way the principle of averaging as applied to the incomes of primary producers. The commissioner of taxation was inclined to oppose that experiment on the ground that it would greatly increase the difficulties and costs of administration. The suggestion was made that the question be investigated by the Royal Commission on Taxation then recently appointed.⁶

In 1922, following the report of the Royal Commission on Taxation, provisions were made for assessing the incomes of primary producers on a five-year basis. For the first year following the passage of the act, the single-year basis was retained, and thereafter a year was to be added successively until the average of five years would be reached. The five-year basis was then preserved by adding the current year and dropping the first year included in the previous reckoning.⁷

But farmers and primary producers are not the only ones whose incomes are subject to fluctuation. An amendment of the act extended the principle of assessment on average incomes to all taxpayers except corporations in 1922-23. Difficulties were immediately encountered in determining the period for averaging in the case of new taxpayers included, and administration was still further complicated by the question of including or excluding bonus shares for purposes of averaging. These windfalls, of course, represent an occasional or irregular type of income and the profits against which such stock is issued may have accrued during periods of uncertain or indeterminate duration.⁸

Growing dissatisfaction developed over the complexities and possible inequities involved. Moreover, with more settled conditions affecting industry and commerce, the reasons for retaining the practice of averaging were not clear except perhaps in industries still subject to the vicissitudes of nature. Accordingly, the law was amended in 1936 to abandon the practice of averages except as applied to the income of primary producers.⁹

⁶ *Seventeenth Report, Commissioner of Taxation*, p. 57.

⁷ *Eighteenth Report, Commissioner of Taxation*, p. 15.

⁸ *Ninth Report, Commissioner of Taxation*, p. 24.

⁹ *Eighteenth Report, Commissioner of Taxation*, p. 16.

Bonus shares in Australian tax system have presented a knotty problem for Parliament and tax administrators alike. The original practice was to tax bonus shares as ordinary income, provided such securities were issued against profits accumulated after 1914. A decision of the High Court in 1922 (*Webb v. The Commissioner of Taxation*) upset the practice and compelled resort to different treatment. Following an adverse report of the Royal Commission on Taxation (1922), the government announced that no further attempts would be made to tax bonus shares as current income.¹⁰

The controversy over the taxation of bonus shares was not, however, a settled issue. Considerable attention was given to the question by the Royal Commission of 1932-33.¹¹ The argument against taxing such bonus shares was here clearly stated. The receipt of such shares did not represent an addition to current income. The stockholders had merely received a specific title to what he, as "proprietor in part" of the corporation, had already possessed, i.e., his share of accumulated reserve or undistributed profit. On the other hand, it may be asserted that the recipient of bonus shares has received an asset usually convertible in cash without jeopardizing or depreciating the value of his other investments. The commission, after reviewing the arguments pro and con, reached the conclusion that the policy with regard to taxation of bonus shares should be decided with reference to the source out of which reserves or surpluses have been accumulated. If bonus shares merely transfer title to a surplus arising from nontaxable income, it is clear that exemption should be accorded. If the surplus accrued from income normally taxable, the bonus shares, as evidence of earnings hitherto withheld from taxation, should then make contribution to current revenues. There is a logic behind the commission's contention but it presents a principle that is most difficult of application in practice.

Australia, like other countries making use of an income tax, has struggled with the problem of taxing corporate income and the problem of avoiding double taxation where corporation dividends become a part of personal incomes. The principle of stoppage at source has not been as extensively applied in Australia as under the British income tax. From the outset the Australian scale of progression was more elaborate and was recognized as being inconsistent with a comprehensive program of stoppage at source. In the case of corporations, however, enterprise had invited the investment of foreign capital and the easiest method of reaching the income of nonresident investors was clearly through a tax on corporate earnings.

¹⁰ *Ninth Report, Commissioner of Taxation*, p. 27.

¹¹ *Report, Royal Commission on Taxation, 1932-33*, p. 18.

So far as domestic shareholders were concerned, however, the principle of progression demanded that the scale of graduated rates be made to apply to the whole income of the taxpayer, including other sources as well as interest on bonds and dividends on stock. If the fund from which dividends were paid had already been taxed, it was a clear case of double taxation. The Melbourne Conference of Commonwealth and State Officials in 1917 placed as their first recommendation that profits of the company should be taxed at the source and *per contra* dividends be exempt. This of course raised the question whether the principle of progression could legitimately apply to corporate earnings. Economists have united in condemning a graduated rate as applied to corporations. The ability to pay depends not on the aggregate income of the enterprise but upon the size of the share distributed to individual stockholders. A corporation with an enormous income may have a body of stockholders so numerous that few, if any, of their incomes run into the upper brackets. Ability to pay cannot be disassociated from the individual, and his taxpaying ability will be determined not by the size of the corporation's earnings but by the amount of his share—or, more accurately perhaps, by the size of his total income into which dividends enter as a constituent.

This last statement makes it clear that a progressive tax cannot well apply to corporate earnings. Quite apart from the inequities that may result, a steeply progressive rate on companies may discourage the formation of corporations and the investment of capital in necessary enterprises. On the other hand, a flat rate on corporation income cannot be accepted as a substitute *in full* for the tax on personal income. This could be true, at any rate, only where the normal rate on corporate income was adjusted to the minimum rate on personal incomes, and all of the incomes of the stockholders fell in the lowest brackets.

The Australian law attempted to meet the problem by taxing the income of corporations and including dividends as a part of the individual's income subject to taxation at a progressive rate. To compensate for the double taxation involved, the personal taxpayer was to receive a rebate equal to the normal tax he would have paid on an income represented by the size of the dividend. The system came to involve complexities and no little irritation to the taxpayer.

The Royal Commission on Taxation (1932-33) considered numerous proposals for change but found objections to all of them, and ended by recommending retention in substance of the prevailing method found not only in the Commonwealth income tax but also in the laws of the constituent states. The income of a company was to be taxed at a flat rate and the shareholder on his total income at a graduated rate. The

rebate necessary to prevent double taxation was to be governed by the relative rates paid by the corporation and the individual shareholder. If the rate paid by the individual shareholder is higher than the company rate, the rebate will be allowed at the company rate; if the individual rate is lower, the rebate will be controlled by the rate he pays.

Another complication arose, however, because dividends to individual taxpayers might be paid out of earnings that were exempt under existing law. Dividends traceable to such sources were, of course, exempt from personal income taxes. This, however, left a loophole through which a corporation might secure exemption for its stockholders by declaring dividends out of *gross* earnings belonging to the *exempt* class and charging all operating expenses to *taxable* earnings, to the diminution or complete extinction of the latter. Amendatory legislation of 1938¹² was intended to correct the evil. The law was changed so as to carry out the original intention and make possible exemption to the stockholder only in case of *bona fide* net exempt earnings.

In general the policy of the Australian law is liberal with regard to the deduction of losses. It is true that, in the early history of the act, deductible losses were rather narrowly defined and must be incurred "by the taxpayer in the income year upon the sale of any property or from carrying on or out of any scheme or operation, the profits from which (if any) enters into assessable income." The amended acts of 1936-37, however, greatly extended the scope of deductible losses and included, besides losses on the sale of property or those incurred in doing business, a miscellaneous list of other losses. Losses were broadly defined as including "a situation where allowable deductions (not including concessional deductions) exceed the assessable income plus the net exempt income."¹³ Moreover, the laws of 1936-37 permitted the taxpayer to deduct losses incurred during any one of the previous four years, not allowed as deductions before, to be carried over for subtraction from the income of the current fiscal period.

An abuse had crept in through the practice of offsetting losses only against receipts of taxable income while the taxpayers enjoyed ample incomes from exempt classes. An amendment now in effect requires that losses claimed shall first be offset against *exempt* income; only the excess, if there be any, can be used as a deduction from taxable income arising from business or profession.¹⁴

Originally deductions for depreciation were allowed only on equip-

¹² Act. No. 46, 1938; *Twenty-first Report, Commissioner of Taxation*, p. 10.

¹³ Stevenson, *Income Tax Acts of 1936-37*, p. 105.

¹⁴ *Twelfth Report, Commissioner of Taxation*, p. 11.

ment, machinery, or plant actually used in producing assessable income. An amendment of 1924, however, extended somewhat the scope of depreciable items. Henceforth the law allowed the taxpayer to deduct a fixed sum each year over the estimated lifetime of the plant, whether equipment or machinery were actively used in connection with the production of income or not. To facilitate the administration of the act, the commissioner of taxation has prepared and published schedules of depreciation for various types of machinery and plant. If at any time property against which depreciation has been charged is sold for more than its depreciated value, the excess must be reported as taxable income for the year in which sale is made.¹⁵

It is difficult to deduce from court decisions how far, if at all, the assumption of continued sovereignty of the separate states interferes with the taxation of necessary instrumentalities. The original act specifically exempted from federal income tax the salaries of the Governor General and state governors, the income from Commonwealth securities, revenue of municipal corporations, etc. Two cases arose in connection with the Commonwealth government's power to tax public employees, but in both instances the persons involved were employed in ordinary commercial enterprises owned and operated by state and local governments. In both cases¹⁶ the High Court upheld the right of the federal government to tax the salaries of employees of steamship and railway enterprises publicly owned. The incomes in question had not been specifically exempt and the power to tax was subject only to the limitation that federal tax laws must operate uniformly as between the states. In the *Davoren Case*, the court took cognizance of a New South Wales act which provided that the "taxation by the Commonwealth of salaries earned by state officials after July 1, 1918, shall not be an [unlawful] interference with the exercise of power by the State if the rate is not higher than the rate on other salaries within the Commonwealth." While the act of New South Wales is cited to show that the condition stipulated is met by the Commonwealth income tax, it is nowhere indicated in the language of the decision that permissive legislation by the state is a prerequisite to taxation of state employees by action of the Commonwealth Parliament.

One phase of Australian income-tax policy is most instructive to America, namely, the former lack of uniformity between Commonwealth and state income taxes and the struggle for uniformity. It must be remembered that exclusive powers of taxation are granted to the

¹⁵ *Ninth Report, Commissioner of Taxation*, p. 16.

¹⁶ *Amalgamated Society of Engineers v. Adelaide Steamship Company*, 26 A.L.R. 337; *Davoren v. Commonwealth Commissioner of Taxation*, 29 A.L.R. 129.

Commonwealth Parliament only with respect to customs and excises. In all other fields of taxation, the powers of Commonwealth and state governments are concurrent. Before the Commonwealth government, under the stress of financial emergency, came to the taxation of income in 1915, all of the separate states had established income taxes. South Australia had enacted the first law in 1884, New South Wales and Victoria in 1895, Queensland and Tasmania in 1902. Western Australia followed in 1907.

Apart from the fact that all of these colonial acts were influenced in a general way by the English model, there was no uniformity in state legislation. With the introduction of the Commonwealth act in 1915 "confusion was worse confounded." It was proposed at the time of consideration that the act be made to conform as nearly as possible to existing state laws, thus avoiding any added element of confusion or conflict. To make Commonwealth legislation conform to six separate state laws that had grown up under different conditions and exhibited plenty of individual differences was, of course, out of the question and the necessity for uniformity was not keenly felt by the party in power. But, as wartime demands resulted in increasing rates and elaboration of sources, the problems of complexity and double taxation were greatly aggravated.

It was then that the need for concurrent action on the part of states and Commonwealth governments became manifest. Conferences were held between ministers of the several states between 1916 and 1921, looking toward possible revisions in the direction of uniformity, but little was accomplished. It is true that a uniform income-tax bill was formulated and recommended in 1917, but its provisions were not adopted by any of the states and only in part by the Commonwealth government. The only tangible outcome of these repeated conferences was a joint arrangement for collection of both taxes by a deputy commissioner representing both grades of government.

Disparity between state and Commonwealth income-tax laws remained, despite the arrangement for joint collection. With the advent of the depression of 1930, the problems of double taxation became worse and taxpayers became more restive under the "intrusions" of both state and national authorities. Before 1930 neither Commonwealth nor state governments had attempted to tax incomes arising outside their respective jurisdictions. Under the stress of the financial emergency no accessible source of additional revenue was likely to be overlooked. In 1930 the Commonwealth government began taxing incomes that arose outside the states if not taxed elsewhere, and constituent

states began reaching out for the taxation of incomes derived from sources in other states. Thus came into being in aggravated form the problem familiar to American tax authorities, the problem of multiple taxation.¹⁷ Naturally the lack of uniformity between state and Commonwealth laws did not tend to cure itself by the passage of time. Rather the differences were accentuated by process of amendment as concrete situations, administrative difficulties, or court decisions called for changes in the laws.

The Royal Commission on Taxation (1932-33) paid particular attention to the lack of uniformity and the necessity for concurrent action. A masterly analysis of Commonwealth and state income taxes revealed the fact that there was fundamental agreement on many points. Where state and Commonwealth laws were at variance, the commission indicated what was considered sound and acceptable practice. Following the report, a measure was formulated which embodied the provisions of a uniform tax bill. The proposed legislation, at least in substance, was soon adopted by the Commonwealth Parliament and by the states.

As a safeguard against the recurrence of the old problem in new form after a "substantial measure of uniformity in income tax law had been achieved," it was decided that, as a means of consolidating the gains, no government would amend its income-tax law without prior consultation with the other governments involved.¹⁸

In pursuance of this agreement, a conference of tax officials was held in Canberra in May 1938 to consider defects in the model income-tax laws which had been in operation since 1936, and to meet new situations that had arisen in the meantime. The conference recommendations were of a technical nature affecting mainly administrative procedure, and did not alter in any material way the essential form of existing laws.

Thus, by persistent effort and concurrent action, Australia has reached a solution of the problem which still exists in such an aggravated form in America. In Australia, state and federal tax returns are practically identical and the taxpayer resorts to a single agency for payment of both state and Commonwealth income taxes. An incidental advantage has been the issuance of tax manuals and guides with directions, analyses, and explanations that apply with substantial uniformity to Commonwealth and state income-tax laws alike.¹⁹

¹⁷ *Second Report, Royal Commission on Taxation*, p. 65.

¹⁸ *Twenty-first Report, Commissioner of Taxation*, p. 9.

¹⁹ See Baldwin and Green, *Income Tax Laws of Australia*; Stevenson, *Income Tax Acts of 1936-37*.

THE TAXATION OF ESTATES

The separate colonies of Australia established death duties in some form long before the Commonwealth government came into being in 1901. Some of these (e.g., New South Wales and Tasmania) date back to 1865. These state laws had been modeled after the laws of Great Britain but amendments ranging over a period of 70 years had resulted in wide divergence. Most of the state laws might be described as succession duties or inheritance taxes. Exemptions were generally low. As fiscal needs were accentuated by depressions and special emergencies, the rates were pushed up and state succession taxes became sources of considerable revenue.

The Commonwealth government did not introduce any tax on property passing by inheritance and bequest until the year 1914, in December following the outbreak of the first World War. It took the form of an estates tax in preference to a duty on successions or separate shares. If the decedent was a resident of Australia, all real and personal property, minus debts, became a part of the taxable estate. In case the owner was a resident of a foreign country, the tax applied only to real estate and such personal property as had a definite situs in the Commonwealth. Gifts *inter vivos* made within one year before the grantor's death were taxable as an estate.

An exemption of £1,000 on each estate was allowed; the tax began with a rate of 1 per cent on estates between £1,000 and £2,000, after which the rate increased by one-fifth of a pound for each additional £1,000 or part thereof; but the graduation of the rate stopped at 15 per cent, no matter how large the estate might be.²⁰

An estates tax is of course open to objection, in that it fails to take account of the number of shares into which the fortune is divided and the size of each respective share. Ability to pay is not governed by the size of the estate from which one's inheritance is derived, but by the amount of fortuitous income that accrues to the taxpayer. An estates tax also fails to allow for varying exemptions according to degree of relationship and the dependence of the heir upon the fortune of decedent for his support. Likewise, graduation according to degree of relationship becomes impossible if a single levy on the estate takes the place of a tax on the several classes of heirs.

An attempt was made in a feeble way to meet the last-named objection by the remission of a part of the burden in the case of heirs in direct line of descent. In case the estate passed to widow, children, or grandchildren, the duty was payable at two-thirds of the ordinary rate.

²⁰ *Sixth Report, Commissioner of Taxation, pp. 923 et seq.*

Despite the manifest objections to estates taxes the 1932-33 Royal Commission on Taxation favored the retention of the estates tax by the Commonwealth government; if uniformity is sought in the matter of death duties, the Commission recommended that state taxes should be converted to the estates-tax principle. Considerations that influenced the commission were the greater simplicity, convenience, and ease of administration.

As in the case of the income tax, the Royal Commission on Taxation pointed out the divergences between Commonwealth and state laws and indicated grounds of possible agreement leading to uniform legislation. In the case of death duties, however, there was not the same compelling reasons for uniformity. Fewer people were affected by succession taxes and the calculation of the taxable base involved fewer complexities. Moreover, it was pointed out that state laws affecting death duties had been of longer standing than either income taxes or land taxes, and had been widely differentiated by provisions thought to be necessary in each state. Officers with long experience had learned to administer these laws in accordance with precedents and a body of official rulings. The administrative machinery was working freely and smoothly and authorities were reluctant to disturb or upset the established practice.²¹

The Commonwealth estates tax has not been productive of large revenues, despite the increases in rates which have come in times of emergency. In the fiscal year 1938-39 the yield was £1,909,000. The Royal Commission on Taxation in its fourth and final report stated that only 8,000 out of 47,000 estates were large enough to call for death duties, even with an exemption of £1,000, which would be considered unduly low in America. Even in 1938-39 only 9,085 estates were large enough to be taxable under the Commonwealth law, the average *dutiable* value of estates was £5,431, and the average duty paid was only £204.²² On account of lower exemption limits in several states, the combined yield of state death duties was about three times that of the Commonwealth.

²¹ Cf. *Report of Commonwealth and State Tax Officials*, 1917, pp. 26-27.

²² *Fourth Report, Royal Commission on Taxation, 1932-33*, p. 188; *Year Book No. 32*, p. 837.

CHAPTER IV

THE LAND TAX—HISTORY, ANALYSIS

THE MOST unusual feature of the Australian system, and a departure which has been of special interest to American students of fiscal practice, is the land tax. In America, of course, the property tax is too much used as a source of state and local revenue, and, on account of evasion, exemption, or taxation at a nominal rate, personal property has come to be of diminishing fiscal importance. The brunt of the burden has, therefore, been assumed by real estate; but the levy is upon improvements along with site value. In Australia and New Zealand, on the other hand, both national and local property taxes rest mainly upon unimproved value. The system represents a concession to the philosophy of Henry George and the single-tax movement.

Although this study is primarily concerned with the Commonwealth land tax which dates from 1910, the steps taken by the Commonwealth Parliament can best be explained by reference to state land taxes, some of which, like that of Victoria, antedated the Federation land tax by more than thirty years. The Parliament of Victoria was the first to impose a land tax in 1877. It should be noted that this experiment preceded the appearance of *Progress and Poverty* by two years. Although the influence of Henry George was clearly manifest in shaping the land-tax movement after 1890, following his visit to Australia, it cannot be said that the "Messiah of the single-tax movement" in any way influenced the first ventures in land taxation.

It may be, as Garland assumes,¹ that the teachings of David Ricardo and John Stuart Mill helped to shape an opinion that crystallized into law long before *Progress and Poverty* was "thumbed by the proletariat." Mills' *Principles of Political Economy* had been for some time the standard text in Australian universities; the perusal of his book and the reading of Ricardo and the writings of the Physiocratic school all contributed to a better understanding of rent as a form of "unearned" income. Mill, in particular, had made clear that rent accrues without specific exertion or sacrifice by the owner and that landlords, especially in the cities, are "progressively enriched by the natural course of events." If the state undertook to appropriate all or a large part of the rent, it would not be unjustly depriving anyone of a deserved

¹ J. M. Garland, *Australian Land Taxation*, p. 2.

income but merely taking, for the benefit of society, what would otherwise remain as an unearned increment to the owner.

The sounder view, however, seems to be that economic conditions in Australia shaped the opinions of thinking men in the same way that like conditions in California molded the economic philosophy of Henry George. The land policy of early Australia had been loose, undefined, and carelessly administered. Huge tracts of fertile land had been acquired at little cost and held for speculation or used for sheep runs of hundreds of thousands of acres. With increasing population, the extension of railways, and the growth of cities, speculators unloaded their lands at greatly enhanced value, and vast tracts of land held for sheep pastures stood in the way of more intensive cultivation. One discerns at this time a growing antagonism toward the sheep raisers and their extensive holdings. "They [the pastoralists] had seized upon vast tracts of land and gathered them into huge estates."² This class of landlords, in the years following 1850, became politically powerful, like the plantation owners of the Old South in pre-Civil War days.

The discovery of gold in Australia in 1851 attracted a new class which was at first disdainful of opportunities for agricultural enterprise. As in California, the richer deposits were soon exhausted and the newcomers began to cast about for chances to cultivate the soil. In many parts of the continent they found the door to land ownership closed and "land nurtured sheep to the exclusion of men." The rising tide of democracy threatened the vested interest of the landlord class and naturally favored equality of opportunity and access to the land for intensive cultivation.

According to the Victoria law of 1877, a valuation of land was to be made and all freeholds over 640 acres valued at more than £2,500, whether the land was in a single block or in separate pieces not more than five miles apart, should be taxed at the rate of $1\frac{1}{4}$ per cent on capital value in excess of £2,500. Curiously enough, the dominance of pastoral industry was clearly indicated in the method of assessment. The basis of valuation was in terms of sheep-carrying capacity. Land capable of supporting less than one sheep per acre was valued at £1, while land with a sheep-carrying capacity of two or more was valued at £4 an acre. In the discussion of the time one sees the same purposes underlying the Victoria act of 1877 as those that lay back of the land taxes of a later date. While the need for revenue was an important consideration, other purposes held clearly in mind were the "resumption of the unearned increment" and the "desire to break up large estates."

² Garland, *Australian Land Taxation*, p. 17.

Once Victoria had supplied the example, the movement for land taxes spread to other parts of the continent. In 1880 South Australia imposed a flat rate on *unimproved* value. In New South Wales in 1886 a similar measure passed the legislature but was held up by the council. A second trial made in 1888 met with a similar fate. After the dissolution of the New South Wales Parliament and an election in which popular sentiment seemed to favor income and land taxes, a land-tax measure was actually passed in 1895. In 1906 an act made it obligatory for local authorities to levy a general rate on *unimproved* value within their boundaries, and the state land tax was limited in the operation to properties not touched by the local rates. In Western Australia there were three unsuccessful attempts at land taxes, but the measure was not finally passed until 1907. In Queensland action was delayed until after the Commonwealth government entered the field.

It should be remarked that all of these state land taxes were levied at a *proportional* rate and that in all cases except Victoria the revenue consideration was uppermost. After the federal land tax of 1910, however, with its progressive feature attached, an impetus was given to the taxation of land values at a graduated rate. The clear intention from that time on was to penalize and make unprofitable holdings too large for intensive cultivation. In singling out unimproved value as the basis and in the application of graduated rates, Australian policy after 1890 was profoundly influenced by the teachings of Henry George and his apostles.³

Henry George visited Australia in 1890 on a lecture tour. Although he was thought by many to be arrogant, obstinate, and fanatical, the American economist left behind a substantial following; and a number of newspapers, some of them widely circulated, popularized and urged the adoption of his program. Of these Garland believes the *Beacon* (1893-1900) was the most influential, though *Progress* continued publication for a longer time. Following 1893 the Labor party platforms of Queensland and Tasmania and of the Commonwealth began to carry endorsements of a progressive tax on unimproved value. It seems that the Liberal party was the first to introduce the idea of "penalty taxes on large holdings of unimproved property"; but the Laborites favored a more drastic application of the principle. Their influence was especially felt in the Queensland act of 1915, in which the avowed purpose was that of "making holding of large aggregations of land in any part of the country unprofitable."

The Commonwealth government, despite excursions into the field of land taxation by the states, delayed the general land tax until 1910.

³ Garland, *Australian Land Taxation*, pp. 25 *et seq.*

As indicated elsewhere, the share of customs revenues left to the Commonwealth, plus the yield of excise taxes, was adequate for the fiscal needs of the new government, and there was a vague impression, at least, that direct taxation should be left to the states except in time of severe emergency. But influences had been shaping in the direction of a land tax of general application; and the Labor government which came to power in 1908 did not waste much time in launching a movement in compliance with platform pledges. The party favored the land tax at a progressive rate with a liberal exemption, as a means of inducing settlement on the land and multiplying opportunities by causing the subdivision of large estates. The change in government, however, delayed action; but Mr. Fisher, on his return to power in 1910, regarded the outcome of the election as a mandate for the land tax. He said, "Every seat in the Senate was won by candidates who supported the principle of this bill [the land tax] . . . The principle has been affirmed by every state of the Commonwealth and by the Dominion of New Zealand."⁴ The influence of Henry George and his followers is seen in Fisher's reference to "monopoly of land in the form of large estates", and in the contention that the heavy tax on unimproved value "would make lands available on more reasonable terms for the people who desire to use them." One recalls here the frequent references of Henry George to the landlord as a "dog in the manger."

In the act of 1910 certain exemptions were set up, including land owned by public bodies, land owned and used for religious, charitable, and educational purposes, public libraries, cemeteries, and public gardens [parks in America], and land used primarily for sports or exercise, except race courses and golf links.⁵ The owner of land was defined as a proprietor in fee simple, or one entitled to receive rent either directly or through a tenant who leases and uses the premises. Improved value was defined as capital value or the amount which would be realized by sale to a *bona fide* buyer. In calculating unimproved value, which was to be taken as the basis of taxation, the value of improvements was to be deducted from capital value. Improvements were elaborately defined to include buildings, fencing, clearing, the destruction of timber or suckers, the laying down of pasture, and the extermination of animal pests, so far as these efforts contribute to the productivity of the land. The act made clear that value of improvements meant *present unexhausted value, not original cost*.

Absentee landlords were singled out for special treatment. The

⁴ Mills, *Taxation in Australia*, pp. 232 *et seq.* New Zealand had adopted the land tax as a permanent policy in 1891.

⁵ Land Tax Act of 1910, sec. 13.

absentee was defined as one who resided elsewhere for more than six months during the year. Taxable value in the case of the absentee included the sum total of unimproved value of each parcel of land. For resident owners an exemption of £5,000 was allowed.⁶ It was later held by the High Court that only one exemption could be claimed by the resident taxpayer, i.e., the deduction must be made from the aggregate value and not successively from each separate parcel of real estate.

The rates on taxable income began at a penny in the pound, and this modest rate obtained until taxable value exceeded £7,500. The rate was then graded upward until it reached 6*d.* in the pound or 2½ per cent on values in excess of £75,000. This schedule of rates applied to resident taxpayers. Since the absentee enjoyed no exemption, the tax on his first £5,000 was a penny in the pound. The rate was then graduated upward until it reached a maximum of 7*d.* or 2.9 per cent.

Immediately after the passage of the land-tax act, a commissioner was appointed to administer it, and a land-tax office was created with branches in each state. At the very outset the existence of the program was threatened by litigation due to a feeling that "the Federal government in entering the field of direct taxation, had exceeded the powers entrusted to it by the Constitution." A case carried to the High Court (*Osborne v. The Commonwealth*) resulted in action favorable to the government.⁷

The Australian land tax has now been in effect for thirty years. It is only natural that the original act should have been amended in many particulars. One of the chief occasions for such amendment was the policy with reference to assessment of lessees' interest in properties leased from the government. Instead of alienating crown lands, Australia and New Zealand have retained ownership in vast tracts and turned them over to tenants under terms of a long-time lease. If the specified rental in the lease were equal to the full economic rent, there would be no surplus value or unearned increment accruing to the tenant. Under long-time leases, however, the increasing value of the land and its annual "producers' surplus" might exceed the contract rent and the leasehold might take on considerable worth of unearned increment, a socially created value. This was the very type of interest which the land tax was designed to reach.

The original act had provided for taxation of leasehold values along with ownership in fee simple, and the settled policy had come to be to estimate the taxable value on the basis of excess of economic rent over contract rent, the surplus being capitalized at the current rate of

⁶ Land Tax Assessment Act of 1910, No. 22.

⁷ *Year Book No. 5*, pp. 797-798.

interest. The rate of interest used was 8 per cent and it was complained that this yielded a valuation too low. An adverse decision of the High Court made this method of assessment inapplicable in case the leased land were liable to resumption by the government or in case the value of the land and the annual rental were subject to reappraisal and readjustment during the term of the lease. This called for amendatory legislation by the Commonwealth Parliament, which made crown lands held under leases subject to taxation; the measure was made retroactive to the passage of the land-tax assessment act of 1914.⁸

Another piece of amendatory legislation concerning the same problem of assessable leaseholds had its origin in the depression period of the thirties and an attempt at relief of crown-land tenants through reduction of rents. Since, according to the prevailing practice, the basis of assessment was excess of economic rent over contract rent, an act reducing the latter would subject tenants on crown lands to heavier land taxes and nullify the relief measure, in part at least. An amendment of 1934 specified that, despite the reduction of rent in crown-land leases, the liability of the tenant for land taxes was to remain unaffected.⁹

To ease the burden on all classes of land-taxpayers during the period of depression, a reduction of one-third in the rate of taxation was made in 1932. By this act the minimum rate, which had been .9*d.* in the pound on the first £5,000 of taxable value, was cut to .6*d.*¹⁰ Further reductions, made effective the following year, cut the rates to one-half of those that applied in the predepression period. These reductions were allowed to remain in force until the fiscal year of 1938-39.¹¹ Even with the restoration in part that took place in 1938-39, the rates were only one-half of the tax provided under the original act which had remained in effect from 1910 to 1914.¹²

Considerable light is thrown on problems of land-value taxation by judicial interpretation of the act. As indicated above, amendatory legislation was sometimes made necessary by court decision, and the act was clarified and elaborated by judicial construction. One of the early cases questioned the validity of the land-tax act imposing a progressive rate on unimproved value.¹³ The plaintiff in this case was owner of holdings of unimproved value extensive enough to subject him to a tax. In addition he held valuable leaseholds and, as a stockholder in a corporation, was liable for his proportionate share of the tax on corporate

⁸ *Thirteenth Report, Commissioner of Taxation*, p. 7.

⁹ *Seventeenth Report, Commissioner of Taxation*, p. 10.

¹⁰ *Fifteenth Report, Commissioner of Taxation*, p. 8.

¹¹ *Sixteenth Report, Commissioner of Taxation*, p. 9.

¹² *Year Book No. 32*, p. 837.

¹³ *Osborne v. The Commonwealth*, 12 C.L.R. 321.

holdings. The chief contention of the plaintiff was that the land tax did not represent primarily an exercise of the taxing power, but was a measure intended "to prevent persons resident in the Commonwealth from holding and owning large areas of land and to prevent persons not resident within the Commonwealth from holding and owing land within the Commonwealth." As such the land-tax acts interfered with the right of the state to regulate the ownership of land. The measure might properly be termed an "act to regulate land ownership."

The history of land-value taxation in Victoria and later in Queensland, the history of the Commonwealth land tax of 1910, and the arguments currently urged in favor of adoption lend support to the plea of the plaintiff. The progressive feature of the tax, the added penalty on absentee owners, and the oft-repeated purpose of "breaking up large estates", "putting idle land to use", and "making possible intensive cultivation in smaller tracts" all suggest a conscious aim to alter existing conditions of land tenure. The court held, however, that "the acts in question were in substance and in form acts imposing taxation." The court also put a stamp of approval on the feature of the law which collects from each shareholder of a corporation a tax on land value held by the corporation proportionate to the share of the stock held. Such security holders "had a beneficial interest in the land subject to the tax although they were not owners in the ordinary sense."

In another case in which the constitutionality of the land tax was questioned, a constituent state was a party.¹⁴ The company involved was a large freeholder and also used land leased from the Crown through the state of Queensland. In the distribution of powers between the federal government and the state, the prior right of preexisting colonies was recognized and the disposition of lands left to the latter. In this case it was contended that the imposition of the land tax imposed by the Commonwealth government interfered with the proper sale and disposal of remaining crown lands. The new fiscal device was in reality an attempt to control the disposition and tenure of crown lands. The progressive feature of the tax was intended to regulate the size of holdings and, since it applied to leaseholds as well, it interfered with the assignment of lands under lease. In reality it amounted to a federal tax on a state's instrumentalities.

The opinion of the court held that the tax applied to the lessee's interest in leased lands, "an interest clearly akin to that of an owner in fee simple." Especially was this true in the case of long-time leases. Moreover, the court specifically rejected the contention that the Com-

¹⁴ Attorney General of Queensland v. Ex Rel. v. Attorney General of Commonwealth and Commissioner of Land Tax, 21 A.L.R. 221.

monwealth land tax applied to property of the state. The lessee's interest in the land "can not in any relevant sense of the term be called 'property of the state.'"

Since the tax was upon unimproved value and implied the full exemption of improvements, disputes naturally arose as to the precise inclusion of unimproved value and the meaning of improvements. In difficult cases the court was called upon to decide where the line should be drawn between the two. One of the early cases involved the Albion Park Race Course, built upon swamp land which was bought and filled in at a cost of £7,000. The land, originally designed for other uses, finally fell into the hands of a racing club and a license was obtained from the Queensland Turf Club. This license to conduct racing (a favorite sport of the Australian public) apparently greatly enhanced the value of the property. When the defendant acquired the property he paid £31,000 for it, including, of course, the license considered appurtenant to the property.

The Land Tax Department had assessed the property on the basis of "what the land may reasonably be used for." The possession of the license, it was assumed, made this a "unique property and the value of surrounding properties was immaterial." "Suitableness for a particular purpose must be the controlling consideration in making individual assessments." The defendant argued that the license, which might be revoked at a given time, was merely a factor in good will, not inherent in the land and not properly regarded as a part of unimproved value. The court held that the license attached to the property gave the defendant a sort of monopoly which enhanced the value of the land, and put its stamp of approval on the principle underlying the assessment, namely, that present and not *primitive* value should be the controlling consideration and that appurtenant privileges and social factors could not be ruled out in arriving at the assessment.¹⁵

The broadest meaning was given by the court to the term "improvements" in a case¹⁶ which involved varied and extensive improvements made in the past on a tract of land in northeast Victoria that, after passing through the hands of a succession of owners, was now used by defendants as a sheep station. Soil heavily timbered had been cleared, trees ring-barked, fences constructed, tussocks burned off, residence and station buildings constructed, and water supply established. The defendants insisted that improvements deducted from selling value should include all that man had done in the past to enhance the value of the land, even changes wrought by previous owners that allowed nature

¹⁵ Commissioner of Land Tax v. Nathan, 16 C.L.R. 654.

¹⁶ Morrison et al. v. Federal Commissioner of Land Tax, 17 C.L.R. 498.

to labor along with man and improve the quality of the soil. The court, while insisting that present or unexhausted value of improvements must be the criterion, nevertheless held that improvements include all those things that make up "the difference between the value of land as jungle and its value in the condition in which it is found." This included "not only the immediate acts . . . but all operations of nature which could not take place without the prior operations of man." "The only questions," said the court, "therefore are: what would be the value of the land if it had continued in a state of nature and what is its value now?" The court in this case went to extreme lengths in admitting as man-created value, in part at least, the improved condition of soil and grazing opportunities due to accidental fires, on the ground that, to achieve the same result, money would have been spent in setting and controlling fires. The clear import of this decision was to force assessment on the basis of "original and indestructible qualities of the soil" and return to "the jungle value". This would clearly rule out of consideration the enhanced value of land due to social factors, the very type of unearned increment which advocates of land-value taxes are anxious to reach.

Another case involving the definition of the term "improvement"¹⁷ raised the question whether large expenditures made by the land owner to prevent the spread of prickly pears to keep his lands from becoming "thickly infested" should be reckoned as a deductible improvement. The Land Tax Department had disallowed, at least in part, the claim for such deduction set up by the appellant, who had claimed that the expenditure for the eradication of this pest was an "operation of man that enhanced the value and continued to add to the worth of the property." The government contended that the expenditure for control of pests, instead of being an investment in the land, was a regular and recurring outgo incidental to grazing operations and should be properly regarded as an item in maintenance. The court, basing its decision largely on the *Morrison Case*, held that eradication of prickly pears was an investment in the land which enhanced its value and continues to exert its influence for an indefinite period. The judges saw a close parallel between arresting the spread of prickly pears and the removal of suckers and sprouts which sprang up in clearings, an operation clearly enumerated in the land-tax act as an improvement.

Another case seems in principle hardly consistent with the *Nathan Case* referred to above, in which a license to conduct a racing course was held appurtenant to the land and a contributing factor to unim-

¹⁷ *McGeogh, Appellant v. Federal Commissioner of Land Tax*, 43 C.L.R. 277.

proved value. The *Toohy Case*¹⁸ involved the inclusion of the value of a license to sell liquor and conduct a hotel as a part of unimproved value. The Land Tax Department, apparently depending on the decision in the *Nathan Case*, had taken the value of the established business with the land it occupied and deducted the value of buildings only. The residue, representing unimproved value, had included the liquor license, which, because of restriction on the number granted, was a material factor in influencing value. The court held in this case that the license did not enhance the value of the land because it could only be granted in connection with the building. The Land Tax Department was directed "to make a valuation of the land itself as it at present stands . . . viewed as bare land without any building upon it and without any consideration of the value of the subject as including *de facto* licensed premises."

One other case remains to be examined.¹⁹ It involved a method of evasion by subdivision of properties to claim double or even multiple exemptions operating in favor of each of the joint owners. In the case in question two partners had subdivided a joint holding, each acquiring a separate interest, but at the same time had entered into an agreement to continue the use of the land in common for a partnership enterprise. The court held that the partition actually established separate ownership and that each of the partners was entitled to an exemption of £5,000. The language of the law regarding owners who transferred property but remained in possession and use did not apply in this case. The commissioner was compelled to accept the decision of the court, but sought from Parliament remedial legislation calculated to forestall this easy method of escape from taxation. It appears that no remedial legislation was passed.

¹⁸ A.C. 439.

¹⁹ *Jamieson and Hillas v. Land Tax Commissioner*.

CHAPTER V

THE LAND TAX—SPECIFIC PROBLEMS, ASSESSMENT PROCEDURES

IN THE preceding chapter attention was called to the early origin of state land taxes and to the fact that, at the time the Commonwealth land tax was passed, all of the constituent states, with the exception of Queensland, had such laws in force. As in the case of the income tax there was an utter lack of uniformity. Definitions of unimproved value differed widely, and exemptions ranged all the way from £250 in Victoria to only £50 in Western Australia. In Tasmania there was no exemption at all. In all states except Tasmania (and Queensland later) the rates were proportional or uniform. The federal land tax with its more careful definitions of unimproved value, its higher exemption, and its progressive rates served to emphasize still more the lack of uniformity.

Attention was given to the problem of discrepancy between state and federal laws at the conference of state and federal officers at Melbourne in 1917. It was evident that the officials and delegates present favored uniformity so far as essentials were concerned. This was manifestly true in regard to the definitions of "improved value", "value of improvements", and "unimproved value". Assessments could then be made on a common basis and by a single authority. In fact, a recommendation was made that "an office be established in each state for the purpose of determining land values for Commonwealth and state purposes."¹

Apparently there were few tangible results from the conference, however, for the Royal Commission on Taxation (1932-33) gave considerable space in its report to the lack of uniformity between Commonwealth and state laws affecting the taxation of land. The laws differed, not only in form but, in some cases at least, in fundamental purpose. State laws with low exemptions and flat rates were apparently influenced primarily by revenue considerations, while Tasmania, Queensland, and the Commonwealth, with their progressive rates, were aiming at the subdivision of large estates. An analysis by the commission of existing differences showed that uniformity could not be secured except through sweeping changes in state laws or a "radical alteration either in the principle of the Commonwealth act or of all the state

¹ *Conference of Commonwealth and State Tax Officials, Melbourne, p. 4.*

acts." They expressed the opinion that "no government would give the slightest consideration to a radical proposal of this kind" and that complete standardization was "neither practicable nor desirable."²

Notwithstanding this, however, the commission believed that agreement and concurrent action with respect to certain features should be encouraged. All of the states should endeavor to write into their land-tax acts a uniform and acceptable definition of unimproved value, and the dates at which assessments are made by the several taxing jurisdictions should be synchronized. Better coordination of the machinery for assessments should be brought about.

It has long been recognized by students of American tax problems that justice in property taxation can be attained only by greater care in the matter of primary assessments. In a sense the American task of assessing real estate is vastly simplified as compared with the undertakings of Australian officials. In the United States selling value of land *and improvements* is the prescribed basis, while, under the Commonwealth act and those of the several states, separate assessment of *unimproved* value must be achieved. Improvements must be, to use the language of Australian courts, either "abstracted or subtracted." Value due to natural or social factors must be sharply distinguished from that which is due to the industry of man. This problem, inherently difficult as it is, has been still further complicated by court decisions enunciating principles that are difficult of application and not always consistent with previous opinions.

To approximate solutions of these difficult problems Australian officials have been compelled to perfect new types of organization, devise scientific methods, and utilize assessment data more fully than is common in American states. A study of assessment machinery, methods of procedure, and results achieved should throw light on the problem of improving American assessment practices.

So far as the Commonwealth government is concerned, the machinery for assessment, although it is concerned with an area as large as the continental United States, is highly centralized. The Land Tax Department maintains a valuation division under a chief valuer. In each state there is a staff of valuers under the direction of a senior valuer, all of these officials being ultimately responsible to the commissioner of taxation with his central office in Canberra. But, despite frequent recommendations for better coordination of state and federal machinery for assessment, no considerable results have been achieved with the exception of the arrangement in Western Australia, where Commonwealth and state assessment offices are consolidated and results are

² *Report of Royal Commission on Taxation*, p. 215.

used as a basis for both levies. Elsewhere assessments are made for state and Commonwealth purposes by separate and distinct organizations. The fact that different procedures are followed and assessment dates are not synchronized results in valuations that show, at times, considerable discrepancies.³

Suggestions have been frequently made that uniformity and economy in the matter of assessment could be secured by having the states accept federal valuations as the basis of local levies. This would amount to a solution only in part. It will be recalled that the federal land tax provides an exemption of £5,000 while state exemptions are more commonly as low as £240 to £300, and that Tasmania provides no exemption at all. This means that thousands of properties are reached under state laws which are entirely exempt under the law of the Commonwealth. Assessments made by the central government would have to be extensively supplemented by state valuations. It was this consideration that led the Royal Commission on Taxation to conclude that complete consolidation of assessment machinery under a single authority was beyond the range of possibility.

Throughout the whole history of the Australian act, land owners have been required to file with the valuation division a statement of essential data as the basis for an estimate of capital or sale value, the value of improvements, and the resulting unimproved value. It was soon found, however, that reliance could not be too strongly placed on information supplied by the taxpayer. The evidence submitted by the owner had to be supplemented by information with regard to the sales price of similar properties in the same community. "The effort throughout is to arrive at a value corresponding to the price the land would bring in the open market if divested of improvements."⁴ In the process of checking the accuracy of the taxpayer's statement, apparently not much reliance could be placed on estimates made by state authorities or "other assessing bodies." The commissioner has pointed out that the whole basis of valuation differs widely in different states and that the definition of unimproved value contained in state laws is often at variance with the provision found in the Commonwealth act.

The Land Tax Department found difficulty at the outset in getting an understanding on the part of taxpayers with regard to the meaning of the term "unimproved value." "The vagueness of the general understanding as to what is implied by the term 'unimproved value' has been responsible for most of the technical breaches of the law."⁵ There were,

³ *Fourth Report of Royal Commission on Taxation*, p. 220.

⁴ *First Report, Commissioner of Taxation*, p. 10.

⁵ *Ibid.*, p. 11.

of course, at the outset some deliberate attempts at evasion. Since the exemption was high and the rate progressive, the evasion of the tax involved the process of fictitious subdivisions and transfers. Even the *First Report of the Commissioner of Taxation* referred to the fact that "family arrangements entered into with the obvious desire to lessen or escape the tax are not uncommon." Such arrangements were of course carefully scrutinized and the commissioner insisted on evidence of separate titles and separate enjoyment of revenues before recognizing the claim to separate assessment.

Efforts were made to check and discourage attempts at evasion both by penalties and by unwelcome publicity. The *Second Report of the Land Tax Commissioner* (page 15) lists the names of landowners "it has become necessary to prosecute." Sixteen names appear in alphabetical order with the nature of the offense and fines assessed by the court. One of these penalties runs as high as £20.

The crucial problem of assessment under Australian land taxes, as indicated above, is the separation of unimproved value from capital value. Early definitions by tax officials and the court stressed the fact that unimproved value was to be taken as selling value at a voluntary sale, assuming in the case of improved properties that the land were divested of the improvements. "Unimproved value is the sale value of the land, presuming that it is divested of the improvements due to the efforts or expenditure of the owner or his predecessor in title."⁶ At the same time early definitions of unimproved value emphasized the fact that social factors and environmental influences were not to be neglected. "It is presumed, however, that the property under valuation has its present day environment and is subject to all communal influences that affect its value."⁷

Uncertainty arises, however, with regard to the inclusion of the term "improvements" that are to be "abstracted" or "subtracted" from selling value. Properties are sold with improvements attached, not "abstracted". According to one definition, improvements include the added value given to the land by tangible investments in, on, or under the land and "embrace any hotel, wine, or other license." As already indicated elsewhere, this definition, so far as it refers to liquor licenses, had to be revised in the light of the court decision in the *Toohy Case*.

Assessments are made for a triennial period. If transfers for a consideration take place within the three years intervening, however, the commissioner is expected to alter or revise the valuation in the light

⁶ *Ibid.*, p. 13. See also *Toohy Case*, A.C. 439.

⁷ *Ibid.*

of any new facts revealed, and reapportion the tax according to the change of ownership. An appeal may be taken from assessments by taxpayers by carrying their cases to the Valuation Board for review. This body consists of three members appointed by the Governor General for a term of seven years, but removable on appeal from the two chambers of the legislature. In case the taxpayer objects to the assessment, however, his first appeal must be to the commissioner, who may allow or disallow his claim for adjustment. The Valuation Board on appeal to it has full power to revise the assessment in question; and, if the taxpayer is still unwilling to accept, he may appeal the case to the High Court or the Supreme Court. The decision of the Valuation Board or of the court becomes, in effect, the decision of the commissioner.

It might appear from the above statement that the law is unduly solicitous about the interests of the taxpayer, and might open up the possibility of prolonged litigation and uncertainties so far as the Commonwealth revenues are concerned. Section 48 of the land-tax act, however, makes provision "for the protection of revenue against the undervaluation of land." If, in the opinion of the commissioner, a given plot of land is undervalued to the extent of 25 per cent or more, and the owner insists on the retention of the low assessment, the Land Tax Department then may appeal to the High Court for a declaration that the Commonwealth is entitled to acquire the land under the terms of the act. If the judiciary determines that the land is in fact underassessed by 25 per cent and that the low valuation was influenced by owner's desire to evade the tax, the commissioner may declare the land vested in the Commonwealth. The owner receives a sum equivalent to his estimate of unimproved value and 10 per cent more than the valuation of improvements. The 10 per cent bonus is added "by way of an allowance for compulsory dispossession." The land thus acquired may be transferred to the state in which it is situated or retained for the use of the federal government. The fact that both the states and the Commonwealth are extensive owners of land, and neither is averse to extending its holdings, makes the above provision a wholesome check on the owner's insistence on low assessments.

For purposes of administration each state is divided into valuation districts, each separate municipality or shire constituting a unit. A district valuer is assigned to each division. To provide for the freest possible exchange of information and to promote the perfection of techniques, members of the valuation staffs have organized an association, the Commonwealth Institute of Valuers, for the purpose of holding conferences and publishing a quarterly under the title of *The*

Valuer. The scope of the questions discussed may be judged by the contents of the July 1940 number of this publication. "Court Decisions" (affecting valuation), "Somers' System of Valuation", "The Valuation of Orchards", "Compensation for Land Resumed", "The Valuation of Shops for Rating Purposes" are some of the titles that appear in the table of contents.

The article referring to the valuation of orchards contains a thoroughgoing analysis of the four factors that enter into the process. Apparently the author favors the capitalization method of approach. The net income is to be estimated from the probable gross, minus the probable expense of operation including depreciation of trees. Condition of the soil must be examined and the probability of deterioration or exhaustion estimated, climatic factors given weight, the cost of water for irrigation carefully appraised. The value of land and trees being separately estimated as a criterion for the distribution of income between the two, the net income assigned to each is then capitalized at 5 or 6 per cent for the land and 10 or 12 per cent for the trees. It is explained that the added expectation of return on the trees is due to excessive risk attaching to this form of investment — "and," some American orchardists would add, "the probability of early obsolescence."

On the basis of long and varied experience, the Land Tax Department has prepared and published manuals, guide books, and other aids to assessment for distribution among its staff.⁸ So far as the assessment of country properties is concerned, typical instructions concern the necessity for the preparation of maps, the compilation and use of sales data, the classification of lands, and the capitalization of rents as a basis for estimates of selling or capital value. It appears that suitable outline or skeleton maps of the district are supplied from the central office; but the district valuer must keep them revised to date by making proper notation of any essential fact in regard to title, change in tenure, or transfer of ownership. The district valuer must not only keep a record of sales and considerations involved but must make memoranda of any facts that indicate special considerations bearing on the determination of market price. District valuers are also asked to classify agricultural lands and pastoral holdings according to the nature and fertility of the soil, character of forage, and accessibility to railway and transportation facilities. They are instructed to ascertain rents, especially those determined by long-time leases, and estimate selling value through capitalization at the current rate of interest. In the case of unimproved

⁸ Typical among these is *Handbook for the Guidance of Valuers*.

properties the imputed rent must be estimated by indirect method. Typical unimproved parcels should be selected and the cost of a suitable scheme of development estimated as nearly as possible. The next step is to forecast the probable rental value of a property so improved. The imputed rent is then capitalized at the current rate of interest, and from the capital value is deducted the cost of the projected improvement. The remainder is unimproved value.⁹

A study of these handbooks gives one a confused impression of the precise methods by which the three elements—capital value, improvements, and unimproved value—are arrived at and related to one another. In some cases the instruction (as in the instance last cited) seems to favor the method of subtraction. The stress placed upon sales data and the capitalization of rent suggests that capital value is to be the starting point and that unimproved value is to be arrived at by deducting estimated value of improvements. In other instructions the method of addition or combination is the accepted procedure. Capital value is to be built up by combining the value of land and the improvements, each of these constituents being separately estimated. "The value of land should be the foundation on which to build up the capital value of the property, not the reverse." "In New Zealand where a similar valuation act has operated for the past seventeen years this distinction has been recognized."¹⁰

Perhaps the actual process may be somewhat clarified by the description given to the author by the deputy tax commissioner for New South Wales and the chief valuer of the evaluating of a typical piece of rural property (a sheep station). The initial step is taken by the owner, who, at the request of the Land Tax Department, records essential information on a form. The landlord or lessee states his estimate of the value of land and improvements, the capital value, and the unimproved value. In the case of improvements, detailed and itemized statements are called for; but, not infrequently, a close inventory is not made but all improvements of whatever kind are lumped together into one composite whole. With this statement as a starting point, the district valuer collects information on sales of similarly situated properties. In Australia such data are far more significant than in most of our American states; for the law there requires that parties to a real-estate transfer shall insert the true consideration. The district valuer compiles information on sales from the records that are accessible to him.

Armed with these data on sales, maps showing land classification, and a field book conveniently arranged for recording his judgments, the

⁹ *Handbook for the Guidance of Valuers*, p. 6.

¹⁰ *Instructions to Valuers*, Valuer General of New South Wales, p. 11.

district valuer goes to the property for survey and inspection in person. He passes judgment on soil condition, nature of grass, and availability of water, and lists improvements in detail, including wells, tanks, storage facilities, fences, houses, barns, and outbuildings. This inventory of improvements must include an estimate of the amount spent in clearing, ring-barking, drainage, etc. If the land is used primarily for pasturage, the valuer must make an estimate of sheep-carrying capacity and arrive at a unit, say 95s., which is then multiplied by the acreage to determine the value of the tract.

The uncertain factor in all this process of appraising unimproved value is the estimate to be placed on improvements that are made in clearing, drainage, and fertilization. These elements tend in the course of time to be merged in and become an indistinguishable part of the soil. Ring-barking, specifically mentioned in the law, is also hard to allow for. Most of the Australian land suitable for grazing was originally covered with a profuse growth of gum trees, which flourish even where the rainfall is inadequate. Such timber growth not only tends to sap the soil and exhaust the moisture, but through its dense shade also prevents the growth of useful forage. The pastoralist's first task is to deaden the trees by ring-barking, after which they cease to sap the soil or intercept the sun's rays. Ultimately these trees fall to earth and decompose upon the surface and, as the Australians express it, "add manure to the soil." It will be recalled that court decisions, as well as the text of the law and the rulings of the department, require an estimate of improvements, not on the basis of initial expenditure but on the basis of the extent to which improvements made in the past *continue to influence favorably the value of the land*. This is the crux of the problem that faces the district valuer in rural sections.

In cities the process of fixing a value on lots involves fewer complications, for improvements are tangible and visible. Moreover, city valuation departments like that in Sydney have developed and applied techniques which embody some of the best features of the Somers system and the Danish system employed in Copenhagen. Perhaps the chief difference between the Australian method for valuation and the Somers system is that the former relies less on conference and consultation with the public and places more confidence in the work of expert appraisers. But certain features of the Sydney system, as observed firsthand by the writer, strongly suggest the essential steps in the Somers plan. In the first place, comprehensive skeleton maps are drawn for all sections of the city, showing blocks, streets, alleys, and arcades. The purpose, as under the Somers system, is to arrive at an estimate of

unit value which by the process of multiplication can be used to compute the value of lots in various sizes.

The estimate of these unit values is made, as under the Somers system, in terms of a single foot of frontage. The first estimate, written on the street line in pencil, is tentative and frankly subject to revision. In the process of revising the estimate, various data are brought to bear. Sales information is collected and analyzed, pedestrian counts are extensively employed, and every significant influence that may shape the value of the property is given full consideration. When all data have been assembled and evaluated, a group of experts revise the tentative figure, which is now recorded in red as a final unit to be used in the assessment of individual properties. In the heart of Sydney the highest unit value, as observed by the writer, was £1,950, equivalent at the present rate of exchange to \$6,337. A property with a frontage of 100 feet would therefore take an unimproved value of \$633,700.

The valuation department has encountered difficulties in applying the unit formula in Sydney and perhaps in other of the older cities of the Commonwealth. Only limited sections of Sydney have been laid out in rectangular form. The early bullock trails were allowed to determine the locus of what are now the principal streets of the third largest city in the British Empire. When this great city was a village irregular pieces of property, fenced in as garden patches or to protect springs or water supply, established title to parcels of real estate which are now centrally located lots in the heart of the metropolitan area. A glance at the map of central Sydney, prepared for assessment purposes, reveals lots of varying sizes and representing polygons of every conceivable description. A unit of one-foot frontage and of standard depth fits only a limited number of situations. The independent judgment of appraisers, therefore, plays a more important part than would be the case in situations that lend themselves to standardization.

The process of applying standard units is still further complicated by the presence of so many arcades in the downtown areas. This device for increasing outside frontage and ground-floor entrance to retail shops is used in Australia to an extent entirely unknown in America. The activity one sees in an arcade running through the middle of the block is a revelation to an American visitor. In fact, pedestrian counts have shown a traffic through these arcades as high, or almost as high, as in open streets in the same area. Just how to estimate the value of properties fronting on the arcade as compared with frontage on an adjacent thoroughfare is a problem that has puzzled tax authorities and real-estate appraisers alike.

Because of the irregular shape of lots in the older sections of

Australian cities, it has been difficult or impossible to apply either the Somers or the Danish formula for varying depth or for corner enhancement. Even where the Somers system is followed in a general way, its formula is seldom applied without sweeping modifications "based on Australian experience." In the state system of New South Wales, for example, normal depth is taken as 100 feet and the first 50 feet is assumed to represent two-thirds of the value, the second 50 feet the remaining one-third. Beyond the 100-foot line the value is assumed to increase by 9 per cent for the first 25 feet; the second 25-foot zone adds 8 per cent, the third 7 per cent, and the fourth 6 per cent.¹¹ One wonders how a scale, expressed in such easy mathematical form, could be "based upon Australian experience." It is also recognized that corner enhancement is difficult to calculate in the case of irregular and misshapen lots and intersecting streets of varying importance. Instructions also take account of the fact that corner enhancement is less for residential properties than for those occupied for business purposes. The instructions recommend that, in the case of a business location, a street of equal importance should enhance the value over intrablock situations by 50 per cent, while under similar conditions residence properties would be enhanced by only 25 per cent.

This account of organization and assessment machinery, and frequent references to the necessity of drawing the line between improvements resulting from the industry of man and natural or social factors affecting the value of the land, may suggest the possibility of very costly administration. On the whole, however, the cost of assessing and collecting the Commonwealth land tax, despite the extent of the area covered and the difficult problems involved, has not been unduly expensive. In the early years of the federal land tax, when apparently more reliance was placed on the taxpayer's own statement, the cost of administration fell as low as 1.12 per cent of collections. As newer and more efficient techniques were developed and applied, the percentage cost of assessment and collection tended to rise somewhat, and has averaged between 3 and 4 per cent—a figure that compares favorably with the cost of assessing and collecting the American property tax. It should be remembered also that, under the Australian system, an estimate of improvements may be necessary to arrive at a value of the land, though *unimproved* value alone is the basis of taxation. In contrast with the American practice, the assessment of improvements in Australia is required for the computation of that part of capital value that is allowed to go free from taxation and the remainder that is subject to levy.

¹¹ *Instructions to Valuers*, Valuer General of New South Wales, p. 22.

CHAPTER VI

THE LAND TAX—AN APPRAISAL

CONSIDERABLE space has already been given to the land tax as compared with other features of the Australian system. The author believes that this apparent lack of proportion is justified by the unique nature of the tax on unimproved value and the interest it has for the American student of taxation. Extravagant claims have been made for the beneficial effect both by Australian advocates and by those with single-tax leanings in America. It is worthwhile, therefore, to devote this concluding chapter to a general appraisal of arguments pro and con, and to an attempt to evaluate some of the actual results of the tax, which has been in effect for more than thirty years.

In the first place, it should be remembered that, although the influence of Henry George was plainly evident in shaping both state and Commonwealth land taxes, none of these can be properly characterized as a single tax of the Georgian type. At most, the Australian plan represents only a minor concession to single-tax principle. Previous chapters have made clear the prominent place which indirect taxes in the form of customs duties and excise taxes play in the revenue system of Australia. When to the yield of customs, excises, and sales taxes (both general and special) we add the receipts from the federal income tax and the estates duty, 97.7 per cent of Commonwealth revenues are accounted for. The land tax has in recent years, even before the advent of the second World War, provided but little more than 2 per cent of total tax revenues. The land tax therefore falls far short of being the single or sole source of revenue. It is not even one of the important sources. Only the flour tax and the entertainment taxes have in recent years yielded less than the land tax.¹

The explanation of the restricted yield of the land tax reveals another reason for refusing to classify it as a single tax. The exemption is high and the rates for the vast majority of taxpayers have been extremely moderate. Even in Australia, a land of large holdings, comparatively few estates will rise above the £5,000 (\$16,250) of unimproved value. In fact, in the first year of the Commonwealth land tax, only 14,210 landowners were subject to the tax. And even for the limited

¹ In the case of state governments, only 4.4 per cent of revenues are traceable to land taxes.

number touched the rates were moderate except for holdings with an unimproved value of £80,000 or more.² *Year Book No. 32* (page 837) gives a convenient summary of the trend of minimum, medium, and maximum rates which have been applied since the inception of the tax. Rates reached their highest level during the period 1918-1922, when the range was from 1.2*d.* in the pound to 12*d.* The present range of rates represents less than one-half the schedule of 1918-1922. The maximum rate of 12*d.* (applicable only to unimproved value in excess of £80,000) is an even 5 per cent or, in terms of American tax terminology, 50 mills. It must be remembered, however, that the American rate applies to an assessment averaging perhaps 50 per cent of cash value, while the Australian rate is applied to selling value rather closely and accurately appraised. It is estimated that, in the case of very large holdings, state and federal land taxes may absorb one-half of the rental value of the land; but even in this limited field of application the tax falls short of Henry George's ideal by at least 50 per cent. Assessed value in excess of the £5,000 exemption amounted to £329,521,000 in 1939. The economic rent corresponding to this figure should be at least £16,000,000. The yield of the land tax has been in recent years approximately £1,300,000. Even disregarding the economic rent arising on exempt holdings, not one-twelfth of the producers' surplus is appropriated by the land tax.

The point of closest kinship between the Australian land taxes and the single tax lies not in form or effect so much as in the underlying philosophy and justification. Supporters of the land tax, especially since the visit of Henry George in 1890, are continually stressing the fact that land, unlike any other form of property, is a gift of nature and owes its value to social factors such as the creation of markets, the extension of transportation facilities, the making of public improvements, the founding of schools, and cultural advantages.³ From this premise it was easy to reach the conclusion that the unimproved value of land is socially created and that any increase in this constituent of real-estate value is, from the standpoint of the owner, an unearned increment. The situation in Australia gave point to the argument. The population was too much concentrated in the cities, which grew at a very rapid rate, and urban lands showed a startling increase in value even within a single decade. In the country districts vast holdings acquired at a nominal cost had, with little attention from the owner and

² At a normal rate of exchange this would represent \$388,000. When it is remembered that this does not include the value of improvements, it may be estimated that the higher tax impinges only on estates valued at perhaps \$500,000.

³ *Fourth Report, Royal Commission on Taxation*, p. 180.

with no costly improvements, grown into million-dollar estates. No injustice could be done to the owners if a large share of the value due to the growth of the Commonwealth and the development of its resources should be appropriated for public purposes.

It was only natural, on the other hand, that, in a country where the landholding class was influential and where settlement had been so largely induced by the "lure of land ownership," stubborn opposition should be voiced against a land tax which seemed to discriminate against the landlord class. The chief argument was that the tax ignored the principle of ability to pay, which is the only sound basis of taxation. The validity of this argument of course would be unquestioned if the land tax had been the sole or even the most important element in the fiscal system. However, with revenue from the land tax limited to 2 per cent of the national revenues and 98 per cent derived from other sources, the argument loses its cogency.

Opponents of the progressive feature of the land tax called attention to the apparent conflict between the two objectives involved in the system. It was intended to raise revenue and at the same time to break up large estates. To the extent that the latter aim was achieved and landed estates fell into the lower brackets, or even into the exempt class, the revenues would suffer. But, from current discussion at the time the state and federal land taxes were enacted, it would appear that the desire to compel subdivision was uppermost. As Garland very aptly puts it, the sponsors were "content to lose the golden egg provided it strangled the goose."⁴

A second line of argument in favor of taxing unimproved value, frequently heard in Australia, was based on the assumption that a tax on labor products tends to penalize industry and discourage improvement. Conversely, to remove the tax from improvements and lay the land tax on unimproved value alone would promote development without reducing the supply of land, which is always fixed and limited in quantity. In a new country like Australia, with vast undeveloped resources, anxious to invite and encourage the investment of outside capital, this argument was bound to make a powerful appeal.

On the other hand, opponents claimed that the tax on unimproved value tended to discourage the expansion of business if the enlarged enterprise called for the use of more land. In cities, too, opponents pointed to the undesirable effects of a tax on unimproved value in bringing about the undue subdivision of lots and the use of very restricted areas for building purposes, with a resulting neglect of proper architectural and aesthetic considerations. When the burden rested on

⁴ Garland, *Australian Land Taxation*, p. 159.

land alone, land users sought to minimize the annual tax burden by using as little land as possible.⁵

Supporters of the tax held that the undesirable effects of the tax on unimproved value in promoting congestion and crowding were greatly exaggerated. In the first place, the Commonwealth land tax, even when combined with state and local taxes on the same basis, represented a burden so slight as to have no considerable effect. In fact, under the Commonwealth land tax the exemption of £5,000 would cover practically all sites which were used for residences and small business structures. Even with a much heavier burden on rent or unimproved value, the effect of this nonshiftable tax would be to reduce the net income expected and depress the capital value. With a tax of 100 per cent, as advocated by Henry George, the value of unimproved land would disappear altogether. Those who were bent on land use would be encouraged to buy more freely and to extend their holdings. Reduction in the initial outlay for land would compensate for the increase in the annual tax burden.⁶

As indicated in previous sections, the prime objective of the land tax was to break up large holdings of land and open the way for closer settlement and intensive cultivation. During his stay in Australia the writer of this study observed a certain widespread concern about the maldistribution of population between urban and rural sections. A country teeming with new and undeveloped resources has but little more than one-third of its total population classed as rural. Moreover, during the interval between the last two census years, the metropolitan population increased 32 per cent while the rural population rose only 17 per cent. It was thought that, in spite of the land tax, immense holdings, acquired at nominal cost in the period of liberal land policies and held tenaciously for huge sheep runs or cattle ranches, lay at the bottom of the difficulty. Many of these colossal aggregations of land were vested in absentee landlords who took toll in the form of rent from Australian industry.

Later land policy had substituted long-term leases for ownership in the further distribution of crown lands and had regulated the size of leaseholds. The change in policy could not, however, undo the evils of the past and, to many at least, the obvious solution was to penalize and make unprofitable the holding of landed estates "swollen to unhealthy proportions."

⁵ *Fourth Report, Royal Commission on Taxation*, pp. 191 *et seq.*

⁶ See Garland, *Australian Land Taxation*, pp. 121 *et seq.* Garland here maintains that the progressive land tax did depress the value of large holdings, but, since small holdings were exempt or taxed but lightly, a premium was placed upon the purchase of less valuable tracts and their selling price actually increased.

In the early history of the Commonwealth land tax, the influence of the measure (fortified somewhat by progressive rates under state taxes in Queensland and Tasmania) was to force the subdivision and sale of many large holdings. In fact, evidence seems to support the view that, in anticipation of "discriminatory taxes," large landowners, especially those in the absentee class, had sold out and cleared out in order to escape the penalty. The *Fourth Report of the Commissioner of Taxation* says: "The land tax continues to exercise a noticeable effect in reducing the holdings of taxpayers to lower points in the taxable scale or driving them out of the taxable field."⁷ Even in this connection, however, the commissioner mentions his suspicions with regard to certain transfers between relatives, and doubts whether the grantors really divested themselves of the beneficial interest in the property transferred. In a later report the commissioner estimated that, during the first seven years' operation of the land tax, "an aggregate of unimproved value amounting to £62,973,000, had passed out of the taxable field owing to the subdivisions of estates."⁸

By 1925 an aggregate of unimproved value of £125,002,000 had passed from the taxable field owing to subdivision of large holdings.⁹ The trend toward subdivision seems to have been very marked during the period 1918-1922, when the maximum rate on holdings valued at more than £80,000 approximated 5 per cent of capital value. With subsequent reduction in rates to approximately 50 per cent of the 1918-1922 level, the effect on subdivision would naturally be less noticeable. Successive reductions in rates by Parliament seem to have been influenced mainly by two considerations, namely, the desire to afford a measure of relief to farmers and pastoralists, hard hit by the depression, and a feeling that the progressive land tax had already induced subdivision as far as it was expedient to go.

Students of Australian tax problems may legitimately raise the question how far the trend toward smaller holdings may have been influenced by other factors and how far subdivisions may have been fictitious and devised for the purpose of escaping or reducing the tax. The trend in newer countries, after the era of appropriation has been passed, is always toward intensive cultivation. Moreover, among pioneer settlers large families are the rule and under a gavelkind system of inheritance large estates are split up between a number of heirs. Moreover, in the period following the first World War, it was the policy to encourage the settlement of returning soldiers upon the

⁷ *Fourth Report, Commissioner of Taxation*, p. 17.

⁸ *Seventh Report, Commissioner of Taxation*, p. 14.

⁹ *Twelfth Report, Commissioner of Taxation*, p. 14.

land. Irrigation enterprises were constructed, fruit raising and diversified farming consciously encouraged. We have observed in another place the effect of this changing type of agriculture upon the character of Australian exports during the twenties of this century. These factors would go far to account for the movement of land holdings into lower brackets and the tendency of unimproved value to "pass out of the field of taxation" with an exemption limit as high as that provided by the Commonwealth act.

In spite of the watchful oversight of the Tax Department over fictitious subdivision and the "diffusion of nominal ownership," examples of this sort are frequently referred to in the reports of the commissioner of taxation. To the extent that this method of evasion was practiced, it resulted in a loss of revenue without accomplishing the main objective contemplated by framers of the act. In spite of subdivisions both real and fictitious, the burden of the tax fell very heavily on holders of large estates. The *Fifth Report of the Commissioner of Taxation* (page 799) pointed out that 116 resident taxpayers held land which had an unimproved value of £100,000 (\$486,000) or more. These 116 persons paid £715,000 or 40.5 per cent of the total. At that time "practically half of the tax assessed to residents was paid by 186 out of 12,084 owners or slightly over 1.5 per cent."

It is, of course, natural that in a country like Australia large holdings of land should persist in spite of punitive measures. Not only were such holdings easy to acquire but climatic and natural conditions favor their perpetuation. The total area of land under cultivation in Australia is only half the size of Illinois. This is due to the lack of rainfall and the semiarid nature of the country, factors which favor pastoral enterprise. "More than one-third of Australia is complete desert, and another one-third has too little rain for agriculture. No other continent is so badly handicapped by the lack of water."¹⁰ Except in limited areas where irrigation makes possible intensive use of the soil and diversified farming, wheat raising and pastoral industries reign supreme. This type of agriculture naturally lends itself to large-scale enterprise and the use of extensive holdings. Some critics of the land tax hold that the progressive feature of the system may have compelled the subdivision of estates where economic considerations might have favored their retention intact.

Economists have often speculated upon the question of how the burden of taxes would be redistributed and ultimately borne if all property taxes were based upon unimproved value and improvements were exempt. A topic of special interest concerns a possible shift in the

¹⁰ Whitbeck and Finch, *Economic Geography*, pp. 521-522.

relative burden that would be borne respectively by urban and rural districts under such an arrangement. Any attempt to forecast the results from available assessment data in America yields no reliable conclusions. Although assessors are usually required to assign separate values to land and to improvements, the work is seldom done with anything that approaches precision.

In Australia, as indicated in the previous chapter, assessment methods have been perfected to the point where separate estimates of unimproved value should be fairly reliable. Unfortunately for our purpose, however, an exemption limit of £5,000 leaves most of the unimproved value beyond the scope of the law and inclusion in assessment data. Within the restricted field of assessment, however, early figures show in an unmistakable way that most of the unimproved value lay in the rural districts. The *Third Report of the Land Tax Commissioner* (page 40) pointed out that rural lands bore 60.6 per cent of the burden under the land tax while the cities contributed only 39.4 per cent. The *Fifth Report of the Land Tax Commissioner* (page 100) gave the proportion as 60 and 40 per cent, respectively. For reasons indicated, it must not be assumed that these figures reveal the relative amounts of unimproved value in rural and urban districts. In cities, with smaller holdings as a rule, a larger share of the unimproved value would naturally fall under the exemption limit. It may merely signify that, at the period indicated, a larger share of the unimproved value in rural districts was concentrated in more valuable holdings.

Nothing is more striking than the shift in relative proportion of assessable unimproved value between rural and urban districts that took place between 1914-15 and 1928-29. At the latter date the urban areas had more of unimproved value than the country districts. With the prosperous years of the twenties and the rapid development of manufacture and trade, the cities had outdistanced the rural districts in growth. The subdivision of large tracts in the rural districts, moreover, had thrown many of the holdings into the exempt class and they had "passed out of the field of taxation."

Some critics of the land tax have attempted to raise the question of constitutionality on the ground that it discriminates between states or parts of states and is therefore in conflict with Section 51, Sub-section ii of the Constitution. Although the question tended to recur in later years, it was definitely settled, so far as legal aspects were concerned, by the decision in the *Osborne Case*.¹¹

It is significant, as bearing on the final incidence of the land tax, that, with the exception of a class of undifferentiated "property

¹¹ *Osborne v. Commonwealth*, 12 C.L.R. 321.

owners", pastoralists make the largest contribution to revenues.¹² But more significant, perhaps, than figures showing the amount of unimproved value in rural and urban districts is the distribution between site value and improvements within each of these areas. Followers of Henry George have frequently represented that most of the unimproved value, which would bear the burden under the single tax, is concentrated in the cities, and that a change from a real-estate tax to the proposed new basis would increase the burden on urban owners and ease the burden on the farming class. Professor Seligman has taken pains to refute this statement in his able treatment of the single-tax issue.¹³ Superficially at least, the Australian figures seem to bear out the single taxer's contention. Under the Commonwealth land-tax assessments, recent figures show that in urban areas 73 per cent of capital value is represented by site value, while in country districts only 51 per cent of the total is so classified. It might be, however, that the inclusion of small properties with unimproved values under £5,000 would greatly alter the proportion between improvements and site value in the cities and towns. In the case of residence properties, most of which are exempt under the Commonwealth land tax, the ratio of investment in buildings and planting is high as compared with the value of the lot. In the rural districts also, improvements would figure more prominently in the case of smaller holdings where drainage, irrigation works, fertilization, fencing, and buildings would represent a larger percentage of capital value than in the case of extended sheep runs and cattle ranches. Political considerations, of course, dictate the maintenance of a high exemption limit; but the statistician and the student of tax problems would prefer to have these assessment figures all-inclusive.

It is perhaps a fair conclusion when Garland says that, so far as the Commonwealth land tax is concerned, the results are very "drab and ordinary as compared with the claims of single taxers and advocates of land value taxation."¹⁴

¹² *Twenty-first Report, Commissioner of Taxation*, p. 34.

¹³ E.R.A. Seligman, *Essays in Taxation*, pp. 86-97.

¹⁴ Garland, *Australian Land Taxation*, p. 159.

PART II. THE TAX SYSTEM OF NEW ZEALAND

CHAPTER I

CUSTOMS DUTIES AND INTERNATIONAL TRADE POLICY

IN 1865 the Treasurer of New Zealand remarked that within a period of six years the per capita tax had increased from £2 16s. 6d. to £4 9s. 11d. and spoke of the New Zealand people as a "population ground down by taxation."¹ He went on to add the pertinent observation that the increase in per capita contribution was not due to any advance in rates but to an expansion in the volume of consumption. The consuming capacity of the colony had nearly doubled in six years and "the fair dame who only wore cotton formerly now dresses in silk; and the settler who was contented with beer now affords himself the luxury of wine." Two years later the same official, foreseeing a deficit, raised the question of a possible increase in taxation to meet the situation. His verdict was against it. "The opinion of the Government is that it [i. e. taxation] can not [be increased] and that there is no use looking for relief in that direction in order to make both ends meet." He went on to propose certain economies on the expenditure side, including a reduction in military forces used for home defense and in the amount spent in the administration of native affairs.²

In 1939, just before the outbreak of the second World War, the Dominion government of New Zealand derived from taxation a per capita revenue of £23 8s. 9d., or more than five times the level of 1865, when taxes were assumed to have reached their limit. It is interesting to compare the per capita tax burdens of Australia and New Zealand. The Commonwealth government of Australia was at the same time (1938) collecting in taxes a per capita revenue of £10 13s. 9d., or less than one-half as much as the Dominion government of New Zealand. Too much importance may be attached to a statement of this kind unless allowance be made for the varying degrees of centralization. Frequent reference has been made in the earlier part of this study to the parallel in political organization between Australia and the United States of America. In both cases the national government represents a federation of states. In New Zealand, on the other hand, the government is unitary in form. Since the abolition of the provinces in 1876, there has been

¹ *Treasurer's Report*, 1865, p. 11.

² *Treasurer's Report*, 1867, p. 4.

nothing in New Zealand that corresponds to the Australian states. Local governments in New Zealand are directly creatures and administrative subdivisions of the Dominion, and the functions of counties, towns, and boroughs are prescribed, supervised, and in a large measure financed by the central government. If the tax revenues of Australian states are added to those of the Commonwealth, the per capita figure rises to £16 18s. 2d. and the discrepancy does not seem so great.

A significant comparison can be made between national and local tax revenues in New Zealand and in the United States. In this country before the defense program called for colossal increases in national taxes, there was no marked difference in amount between national tax revenues and those of state and local governments. In New Zealand, on the other hand, local governments derived from taxation but £4 10s. 9d. per head, or a little less than one-fifth of Dominion receipts from the same source. If the local tax revenues are combined with those of the Dominion government of New Zealand, the total per capita burden is £27 19s. 6d. or the equivalent, at the ruling rate of exchange, of \$111.88 in terms of American money. National, state, and local governments in the United States were spending at the same time approximately \$132 per capita.³ It must be recalled in this connection that the per capita income of the New Zealander, although relatively high among the nations of the world, is considerably below that of the American. So far as it is possible to make comparisons, therefore, taxpayers are about equally burdened in the two countries so widely separated from each other and so different in their stage of economic development.

In New Zealand as in Australia, the largest single source of revenue is represented by the customs duties. Just before the outbreak of the second World War and before the tax system of New Zealand was distorted by the demands of war finance, the customs duties gave rise to £10,650,000 out of a total tax revenue of £37,764,000, or a little more than 31 per cent. It will be noted that customs duties are considerably less important than in Australia but vastly more important as a source of revenue than in America. Only one other source in New Zealand approximates in importance the customs duties, namely the income tax with an annual yield of £9,303,000.

Because of the unitary character of the New Zealand government, in contrast with the federation of Australian states, the history of customs duties in New Zealand presents a different aspect. Until the establishment of the Commonwealth government in 1901, the levy of customs duties was regarded as a function of the Australian states and

³ Fairchild, Furniss, and Buck, *Elementary Economics*, vol. 2, p. 73.

the tariff systems of constituent colonies exhibited a wide variety. In New Zealand, on the other hand, the control and regulation of foreign commerce was from the outset regarded as a function of the colonial government. The present tariff system of Australia dates back to 1901, when the uniform customs act displaced the tariff laws of the states; the tariff history of New Zealand began with the first customs act of 1841.

Prior to the passage of this act duties had been collected at New Zealand ports under terms of an ordinance of New South Wales. The controlling consideration in the first act was that of revenue. The brunt of the burden was to be borne by spirits, wines, tobacco, cigars, tea, and sugar. With the exception of spirituous liquors, all imports from New South Wales and Van Diemen's Land were exempt. Even on distilled spirits preference was shown to the extent of 20 per cent in case shipment originated in the United Kingdom, British possessions in North America, or Van Diemen's Land. While the duties on spirituous liquors were specific, the levy on wines and tobacco, flour, rice, and cereals took the form of an ad valorem duty. The first tariff act of 1841 provided heavy penalties for smuggling, including the forfeiture of the vessel in which the smuggled goods were carried.⁴

In 1844 most of the duties were increased as revenue needs became more pressing, and the principle of British preference was abandoned. To increase the yield still further duties were imposed at the rate of 5 per cent on items not specifically listed. An abnormally high rate of 30 per cent was imposed on firearms and ammunitions—to discourage the import and sale of weapons to natives whose resistance to the encroachment of European settlers had been so stubborn.⁵

Except for slight changes in the direction of more elaborate schedules and a tendency toward greater reliance on ad valorem duties, the customs duties remained practically unchanged until 1858. Revisions in that year were made necessary by the increasing demand for revenue. In form the new tariff remained much the same but rates were readjusted. But, even with the increases in rates which affected mainly spirits, cigars, tobacco, wine, ale, tea, and a modest list of specific duties widely distributed, the new tariff was said to be moderate as compared with the colonial duties in effect in Australia. It is true that some duties, namely those on tea and wine, were considerably higher than the prevailing schedules in Australia, but the general level was lower and represented a more tolerant attitude toward international trade. In the mind of the Treasurer the alternative to higher duties on imports would have

⁴ *Year Book*, 1916, pp. 447 *et seq.*; New Zealand Ordinances, 1841-1853, No. 3.

⁵ *Year Book*, 1916, pp. 447 *et seq.*

been a tax on checks and receipts, which he thought would have been more objectionable.⁶

An interesting aspect of early tariff legislation is a proposal contained in the Treasurer's report of 1869, which was clearly prompted by the fiscal policy of one of the Australian colonies. The recommendation was for a duty on wheat and flour "to be levied when price of these articles does not exceed a maximum to be stated, which maximum will represent the price at which they [i.e., flour and wheat] can be produced in the colony without loss."⁷ The Treasurer went on to justify his proposal by saying, "The fiscal policy of a neighboring colony, Victoria, seems to force on us this course. There, irrespective of the ruling price, a duty is levied."

In the early seventies of the last century when customs duties were the chief reliance, the treasury was embarrassed by a marked decline in revenues, which was attributed to the prevailing depression. Reduction in the price of staple exports left the colony with restricted purchasing power in the markets abroad, property was falling in value, public works were being suspended, and shrinkage in military expenditures made by Great Britain in the colony all contributed to the business stagnation. Despite unmistakable signs of approaching deficits, however, the Treasurer did not advocate increases in taxation, lest the effect might be to retard return to normal business conditions. Deficiencies were to be cared for out of the revenues of succeeding years.⁸ The Treasurer did, however, suggest certain changes in the duties on cereals made necessary by the fiscal policy of neighboring colonies "which had practically culminated in the exclusion of our cereals from their ports." The proposed duties for New Zealand were intended to make clear to their Australian neighbors that they had "entailed upon us the necessity of finding a market for our grain within our own limits."⁹

The Treasurer proposed certain changes in tariff schedules in his 1873 report, not for the sake of producing more revenue but to meet some objections encountered in the too extensive use of specific duties. "We propose," said Mr. Julius Vogel, "to substitute ad valorem duties for duties based on measurement." He pointed out that New Zealand and Tasmania stood alone in the extensive use of measurement duties. Admitting that there are objections to ad valorem duties, "measurement duties not only afford facilities for fraud but they involve the gross unfairness of subjecting coarse and inexpensive articles to heavier

⁶ *Treasurer's Report*, 1864, p. 6.

⁷ *Treasurer's Report*, 1869, p. 10.

⁸ *Treasurer's Report*, 1871, p. 5.

⁹ *Ibid.*, p. 17.

taxation than that to which fine and expensive articles are liable."¹⁰

Preference for ad valorem duties was apparently not justified in the light of subsequent experience. At any rate, we find the Treasurer in his report of 1878 calling for a violent reversal of policy. Under the mass of ad valorem duties proposed and adopted in 1873, revenues had shown no increase notwithstanding the "unprecedented prosperity of the Colony." During the same period all other items in the system of taxation had shown an increase, but tariff revenues had fallen off by £33,000 between 1875 and 1878. Articles subject to specific duties, such as tea and sugar, had yielded an increase. The Treasurer suspected that duties had been held down by undervaluation of imports and recommended a return to specific duties calculated to yield the same amount but representing a more certain source of revenue.¹¹

Besides the change in administrative methods, the finance officer proposed certain changes made possible by returning prosperity and prompted by a desire to reduce the cost of living and to stimulate industry. Certain duties had been found to bear too heavily on the necessaries of life and others were thought "to clog the wheels of industry or render more complex and costly the system of collection."¹² Accordingly the tariff of 1878 abolished the duties on grain, flour, maizina, corn flour, sago, bacon, and hams, and reduced the rates on sugar and tea. The change in the duty on tea was estimated to save £28,000 annually to tea drinkers in New Zealand. The Treasurer adds: "Tea being a *universal* beverage I have not estimated any recovery [of lost revenue] from increased consumption." In the language of the economist the demand for tea among the British consumers is an inelastic demand. To remove certain impediments to industry duties were withdrawn from tools, steel and iron, fencing wire, paints, cart shafts and spokes, and photographic supplies. The reduction of one-half in the sugar duty was apparently made with some misgivings in the light of the "need for some protection to the infant sugar producing industry."¹³ A part of the loss from more liberal trade policy was apparently to be recouped by heavier taxation of certain luxuries. While recognizing the advantage in reciprocity with Australia where wine production had been increasing, the Treasurer nevertheless increased the wine duty from 4s. to 6s. a gallon.

Additions had been made to the tariff from time to time and the methods of assessing and collecting had been subject to frequent revi-

¹⁰ *Treasurer's Report*, 1873, p. 24.

¹¹ *Treasurer's Report*, 1878, p. 11.

¹² *Ibid.*, p. 13.

¹³ *Ibid.*

sion, and in 1882 an attempt was made at clarification and coordination in the customs-duties consolidation act of that year. The range of dutiable articles was extended somewhat. Apparently not all the anomalies had been removed from the customs duties, and in 1885 we find the Treasurer again calling for extensive revisions on the ground that the present tariff was "too complicated and had lost besides its elastic character."¹⁴ In this same report we discern for the first time a marked leaning toward at least limited protection of local industries "in preference to outside production." The Treasurer calls attention to the prospect that the local producer may, in the long run, "be able to supply it [i.e., the commodity] . . . much more cheaply and satisfactorily." Notwithstanding this endorsement of the protective principle, however, the new tariff was framed primarily in the interest of revenue and administrative simplicity. Duties were increased on spirits and on tea but not on sugar. It was recognized that sugar had become an important constituent in preserving and canning and, revenue considerations aside, the government would have welcomed an opportunity to reduce the rate on an article of such general consumption. The new tariff made more liberal use of ad valorem duties, which was one of the contributing causes of the decline in revenues during the ensuing years. At this time, too, authorities noted a falling off in the consumption of wines and spirits and a growing sentiment in favor of prohibition, which called for a substitute for the tax on intoxicants.

The persistent decline in tariff receipts and threatened deficits led to an increase in duties under the act of 1888. Tea, with the inelastic demand, again became the elastic element in the system. The tea duty was increased by 2*d.* on the pound, but the sugar duty remained unchanged because sugar had become an article of wide use and entered into manufacture in a variety of ways. Other ad valorem duties were increased from 15 to 20 per cent, and some were advanced to 25 per cent, while corresponding adjustments were made in the few remaining specific rates.

Prior to 1891 practically the sole reliance, so far as colonial revenues were concerned, was on indirect taxes in the form of customs and excises. As we shall see at a later point in the study, internal taxation of commodities was of little importance, since the beer duty alone proved productive. In 1891 came two important changes embodied in one measure, namely, land and income taxes. These two new sources of revenue were soon yielding about 20 per cent of total tax receipts, and dependence on customs duties became less important.

¹⁴ *Treasurer's Report*, 1885, p. ix.

The prevailing depression of the early nineties, however, demanded an expanding program of public works as a means of unemployment relief. Despite the desire of the government to reduce duties on necessities of life, it was recognized that the public works program demanded that revenues be sustained.¹⁵ The government, besides sustaining revenues, was inclined to favor increased duties on "those articles that can be manufactured by our own people."

At the session of 1893 the government reasserted its intention to lower the duties on necessities of life and to remove some of the anomalies contained in existing schedules. It reported that a large amount of evidence had been collected "with the view to an adjustment of the tariff and the removal of some of the admitted anomalies that exist therein," but doubted the advisability of undertaking comprehensive revision in the closing days of an expiring Parliament.¹⁶ At the next session revision was again postponed. The government was deterred from taking vigorous action on account of the complicated nature of the problem and the conflicting interests involved.¹⁷ Some reductions were made, however, in the duties on the necessities of life. The Treasurer took considerable pride in the fact that as a contribution to the reduced cost of living he had "been able to see my way to reduce the duty on bulk tea [by] 1*d.* per pound."¹⁸ As an aid to New Zealand industry the rates were reduced on wool packs, butter paper, tubular woven cloth used in meat packing, certain drugs used in manufacture, paper used in making stationery, and wooden handles for tools. It will be noted that the aim was to assist local industry by reducing the cost of raw materials instead of increasing duties on finished products.

It was not until 1907 that a general revision of the tariff was undertaken. The Treasurer, recognizing that complexity of the tariff had been an occasion for considerable complaint, set up as one of his primary aims the simplification of schedules. Articles of wide general consumption were placed on the free list, e.g., sugar, molasses, currants, raisins, figs, dates, prunes, maizina, corn flour, almonds and nuts with the exception of walnuts. Tea was also admitted free of duty if grown in British possessions. As a concession to certain industries, fencing staples, sheet lead, and gas, electric, and water meters were added to the free list. To recoup in part the loss of revenue, medicines, drugs, candles, paraffin wax, hosiery, cash registers, iron pipes, mouldings, and panels were subject to increased impositions. The Treasurer expected a reduction of

¹⁵ *Treasurer's Report*, 1892, pp. 14-15.

¹⁶ *Ibid.*

¹⁷ *Treasurer's Report*, 1895, p. xxviii.

¹⁸ *Ibid.*, p. xxix.

£375,000 annually in revenue from the tariff changes, but expressed the hope that increasing trade would bring about a restoration. The growing conviction that protection was necessary to domestic industries was evident in the attitude toward proposals for the removal of the duty on flour. The government feared that competition from South Australia might result in wiping out New Zealand mills "employing hundreds of hands and investing much capital." This argument for maintaining protection for vested interests has a familiar sound to an American economist.

While the government in 1912 was "sensible of many anomalies" in existing tariffs and recognized a widespread popular demand for added stimulus to engineering trades, iron and steel, and other branches of manufacture, it was daunted somewhat by the intricacy of the subject and the far-reaching possible importance of certain proposed changes, and pleaded for caution and more time for consideration.¹⁹ As a means of clarifying the issue somewhat, it was suggested that a conference be held between New Zealand, Canada, Australia, and South Africa to formulate, if possible, some principles that should control their foreign-trade policy in the future. Apparently the conference was not held, but the Minister of Customs in 1913 visited Australia and negotiated a reciprocal trade treaty with the Commonwealth government. A change in the "position of political parties" in the Commonwealth shortly thereafter made it impossible to take definite action until the policy of the new Australian Parliament had been formulated and disclosed.²⁰

Frequent changes had been made in rates and specific schedules, the proportion between specific and ad valorem duties had been varied, and minor administrative alterations had been made; but down to 1913 the principle underlying the customs act of 1882 had not been materially affected. The government therefore recognized that "this most important act had become to a certain extent out of date," and that the time had arrived for a new consolidated act, "more modern, more equitable, and in its administration, more elastic."²¹

This consolidated act of 1914, more systematic and orderly in its provisions, came into operation on the eve of the great World War, and its beneficial effects were soon obscured by the complete stoppage of imports from Germany, Austria, and Turkey, and greatly reduced trade with other European countries. Even where foreign sources of supply were not closed, the import trade began to suffer from shortage

¹⁹ *Treasurer's Report*, 1912, p. xix.

²⁰ *Treasurer's Report*, 1913, p. xxi.

²¹ *Ibid.*, p. xxii.

of merchant ships, exceptional war risks, and prohibitive insurance rates.²² Revenues did not suffer as much as one might expect, however; for losses were partly compensated for by increasing rates and, under the prevailing method of charging at ad valorem rates, the rising price level compensated in part for the decline in physical volume of imports.²³ Wartime increases under the tariff of 1915 affected mainly spirituous liquors, beer, gas and oil engines, and motor cars of foreign origin (i.e., from outside the United Kingdom or British possessions). Other luxury items were added and rates on intoxicants and tobacco products still further increased in 1917. With the adjustment of rates to a higher level and the compensatory rise in prices, the Treasurer was able to report in 1918²⁴ that the customs revenues had exceeded expectations and that the treasury had actually realized "a good average year." Despite the fact that customs duties showed no marked decline, however, their relative contribution to total tax receipts showed a downward tendency. This was due to the increase in wartime taxes and to an increased reliance on the income tax which, as we shall see later, was made more steeply progressive and took a considerable portion of high incomes, some of which were swollen to unhealthy proportions by abnormal conditions and rapidly mounting price levels. Because of these factors, customs duties in 1917 accounted for only 38 per cent of the total while the levy on incomes had risen to first place with a contribution of 40 per cent. By 1918, when the war came to a close, the customs and excises taken together yielded but 29 per cent of total tax receipts. In the period before the war these two sources had accounted for 60 per cent of the total.²⁵

The financial policy of the government in the period following the World War was conservative and far-sighted. With the resumption of normal trade relations and with a market understocked on foreign imports, the high rates imposed in wartime began to yield a surplus. The announced policy of the government, however, was to allow surplus revenues to accumulate against the inevitable drop during the period of postwar depression.²⁶ Some adjustments were made in the postwar period to protect infant industries that had grown with the wartime stimulus of interrupted trade. British preference, to which special attention is given later in this chapter, made its appearance in a definite form in the tariff of 1921. This measure provided three schedules designated as "general", "intermediate", and "British preferential". The duties on

²² *Treasurer's Report*, 1915, p. xiii.

²³ *Treasurer's Report*, 1916, p. vi.

²⁴ *Treasurer's Report*, 1918, p. iv.

²⁵ *Year Book*, 1918, p. 715.

²⁶ *Treasurer's Report*, 1921, pp. 3-4.

English goods remained at the old level and the "general" scale was arrived at by adding a certain percentage to the basic rate applicable to British imports. The "intermediate" scale lay midway between the two. This intermediate schedule was expected to form a basis for bargaining on reciprocity arrangements. As we shall see later, no immediate use was made of this provision.²⁷ Some additional duties were imposed for the sake of protection to the lumber industry, leather manufactures, glass-bottle production, wrapping paper, and paints and oils.

One of the inevitable features of postwar tariff legislation is the appearance of antidumping provisions. We have seen how Australia sought to avoid ruinous competition through her "industries preservation acts." The New Zealand legislation of 1921 is strikingly similar. A "special dumping duty" might be imposed by the Minister of Customs on goods imported into New Zealand "of a class or kind produced in New Zealand if the selling price to an importer is less than the current domestic value of the goods and will have a prejudicial effect on an industry established in the Dominion."²⁸ The special duty, it was stipulated, must not exceed the difference between the selling price of foreign producers and the current domestic figure. Anyone who has given serious thought to the problem of comparative price levels and the generalized cost of production will immediately sense the difficulties in the adjustment of special dumping duties as provided by the New Zealand law. The act of 1921 also imposed special duties on goods from countries with "depreciated rates of exchange." These punitive rates ranged from 2½ per cent to 25 per cent, depending on the degree of currency depreciation.²⁹

The depression following 1930 immediately had adverse effects on the revenue receipts of the government, and called for additional taxes in times "when business is not as prosperous as it might be." Additional excise taxes were imposed, especially on beer and petrol. As deficits persisted and tax revenues were slow to respond, in spite of increasing rates and expanding base, certain reserves were drawn upon to make ends meet and temporary loans were contracted "to be liquidated sooner or later."³⁰ As a means of meeting the emergency, the government hypothecated certain mortgages received under the postwar arrangement for the settlement of discharged soldiers, and the land-title insurance fund was drawn upon to the extent of £60,000.³¹ The financial emergency was still further aggravated by the disastrous earthquake

²⁷ *Year Book*, 1923, pp. 290 *et seq.*

²⁸ *Ibid.*, p. 291.

²⁹ *Ibid.*

³⁰ *Treasurer's Report*, Supp., Oct. 1932, pp. 8. *et seq.*

³¹ T. R. Smith, *Budget Problems 1929-1935*, pp. 46-47.

in the Hawkes Bay district in 1931, and the complete destruction of the town of Napier with an estimated loss of 1,000 lives. The destructive effects of the catastrophe not only reduced revenue possibilities but also called for relief measures on a larger scale.

Under the stress of the financial emergency, engendered and aggravated by a combination of factors, it was natural that the government should seek to repair the fiscal losses in part by increased import duties. It was, however, hampered somewhat in this particular by the established policy of British preference. If British imports continued to enjoy their favorable treatment, revenue possibilities from increases affecting non-British imports would not be impressive. In the tariff of 1930 the rates affecting British imports were left practically unchanged and increases were sought through the device of surtaxes applied to "foreign" imports only. In time of depression increase of customs duties finds additional support from the desire to stimulate home industry and help to solve the problem of unemployment. The lumber industry was thus favored by added duties on "rough sawn, and sawn dressed timber . . . to the extent of 2s. 6d. per 100 superficial feet."³² The increase reckoned in terms of American money was upwards of \$4.00 per 1,000 feet, board measure. Besides the general increases affecting non-British imports, automobiles were subject to specially heavy impositions, in some cases running as high as 40 per cent.³³

Despite the presence of aggravating causes, the recovery of New Zealand from the depression of the early thirties was more rapid and satisfactory than in America, and the Treasurer was able to report in September 1935 that "conditions are better and the trend is definitely upward." "Continued progress toward recovery in Great Britain provides a hopeful augury for the future." He added, however, a note which seems, in the light of subsequent events, to be prophetic. "Unless the horizon becomes unduly clouded with the danger of *international complications* the prospect of continued recovery in our main market seems most heartening." In the same report the Treasurer says: "As a result of stern measures adopted we have repaired budgetary stability without a legacy of accumulated debt which is a point that will doubtless be noted with envy by some of our less fortunate neighbors."

Reference has been made to the policy of New Zealand toward British preference in the matter of import duties and to efforts at reciprocity arrangement with other parts of the British Empire. A more detailed treatment of the steps by which these ends were served is now in order. As we have already seen, New Zealand, so distinctly British

³² *Treasurer's Report*, 1930, p. 31.

³³ *Year Book*, 1931, p. 318.

in its origins and affiliations, introduced the principle of preference in its earliest tariff legislation. This policy, it is true, was temporarily abandoned in the tariff of 1844 but was reestablished in 1846. Unspecified articles from outside of Britain took a duty of 12½ per cent while similar goods from Britain paid only 10 per cent.⁸⁴

The principle of British preference was further extended and more firmly established by the acts of 1903 and 1907. In 1903 a surtax was imposed on a specified list of articles which were not the produce of some part of Britain or the dominions. The number of articles affected by this type of discriminatory treatment was greatly extended by the act of 1907, and in 1912 as many as 193 of 483 items included in tariff schedules were affected. Since the major share of New Zealand's imports came from the United Kingdom and the dominions, the surtax came to apply to only 13 to 17 per cent of total importations.

Elsewhere in this study extended mention was made of the Ottawa Conference of 1932 and its effect upon Australian tariff policy and the movement of her exports and imports. It will be recalled that New Zealand, along with the other dominions, was a party to the Ottawa Conference and a signatory to its provisions. The first effect of this agreement was to lead to the abandonment of surtaxes on goods produced in the United Kingdom or any part of the British Empire except Canada, the Union of South Africa, the Irish Free State, Newfoundland, and India. This provision became effective from October 1932.⁸⁵

As indicated elsewhere, the terms of the Ottawa agreement, resulting as they did from compromise, left the reciprocal obligation of the dominions and their foreign-trade policy in a state of uncertainty. Duties were to be maintained by the dominions against the United Kingdom only so far as necessary to insure the success of local industries with a fair prospect of survival. Somewhat inconsistently with this principle, a level of duties had to be fixed that would enable producers of the United Kingdom to "compete on the basis of relative costs of economical and efficient production."⁸⁶

In passing judgment on adjustments made in New Zealand's tariff policy following the Ottawa Conference, it is necessary to keep in mind the consistent trend in tariff legislation toward a more pronounced policy of protection. As in the case of Australia one finds it somewhat difficult to understand this movement when we consider the dominance of British elements in the population of New Zealand, the paramount importance of agriculture and the pastoral industries in the economy of

⁸⁴ *Year Book*, 1916, p. 447.

⁸⁵ *Year Book*, 1934, p. 238.

⁸⁶ *Year Book*, 1936, pp. 742-743.

the islands, and the distance (greater by the accustomed routes than Australian ports) from European sources of supply. High freight rates add so materially to the cost of imports that domestic manufactures, unless seriously handicapped by natural conditions, should be able to meet the requirements of survival. In the light of these influences, therefore, the trends of tariff legislation in New Zealand are in some degree surprising. It will be recalled that the early tariffs enumerated only a limited list of articles and the prevailing rates were 5 and 10 per cent on dutiable goods. In the year 1938, we find the list of taxed articles so far extended that 51.3 per cent of all imports are subject to duty and only 48.6 per cent are retained on the free list. Moreover, the average rate on dutiable goods had increased to nearly 32 per cent and the average rate for all imports (including the free list) was 16.36 per cent of total value.⁸⁷

For the same year 60.6 per cent of imports into the United States were admitted free of duty. The ad valorem rate, calculated on the basis of total imports, was 15.4 per cent, while dutiable goods paid at the average rate of 39.3 per cent. Compared with New Zealand, a somewhat larger share of American imports came in free of duty. The average rate on all imports does not differ materially in the two countries, but on articles taxed the American scale is 7 per cent higher.⁸⁸

It will be seen from this comparison that the trade policy of New Zealand is nearly, if not quite, as protective as that of the United States, which is considered one of the protectionist nations of the world. On account of the greater cost of transportation to New Zealand markets from European centers of production, a somewhat lower level of duties might prove equally effective. Since the established policy of New Zealand has been to maintain protection for home industry, this principle had to be reconciled with any measure of preference shown to the mother country from which nearly two-thirds of New Zealand's imports are obtained. Any considerable relaxation of duties on British imports might undermine protection to local industries. The competition most to be feared was competition from English industry.

After an extended investigation and report by a tariff commission, some revision of tariff schedules was undertaken in 1934. Duties were removed from stock foods, nails, iron and steel pipe, constituents in paints, and maizina and corn flour in small packages; and reductions were made affecting preserved milk, baking powder, coffee essence, confectionery, soap, hats and caps, boots and shoes, and certain types of construction materials, including oil engines. On the other hand, pro-

⁸⁷ *Year Book*, 1940, p. 295.

⁸⁸ *Statistical Abstract*, 1939, p. 467.

tective duties were increased on maize, either ground or crushed, on porcelain enameled baths, and on gas meters. The separate duties long maintained on car bodies were abolished. The aim was apparently to encourage the importation of parts and the industry of assembling motor vehicles in New Zealand.³⁹

Reciprocity through trade agreements was specifically authorized by the act of 1895. The act itself provided for freer trade relations with South Australia and the government was given power to extend the principle to other Australian colonies.⁴⁰ It was not until 1922, however, that a comprehensive trade agreement with Australia was negotiated and ratified. It affected as many as 129 separately enumerated items. The reductions provided for in some cases exceeded the degree of preference shown to imports from the United Kingdom; in some cases such concessions to Australia were less. In the latter cases the local desire for protection proved to be the controlling consideration. This Australian agreement provided for free trade in lumber and dairy machinery. Following the adoption of the new trade agreement, there was no discernible influence on the volume of New Zealand exports to Australia. "Since the reciprocal arrangements were entered into between the two countries New Zealand exports to Australia have increased substantially although the advance is due mainly to *items outside the agreement*."⁴¹ From the same source we learn that imports from Australia had fluctuated from time to time "without any definite indication of permanent increase," and here, too, the most noticeable increases had been in items not especially covered by the reciprocal tariff, such as flour and wheat and hardwood logs.

Reciprocity with Canada underwent a temporary trial following 1925 but ceased in 1930. In 1932 another agreement was negotiated and has been renewed from time to time. These agreements have provided for favorable rates on New Zealand's staple exports, such as butter, cheese, lamb, and mutton, and free admission to Canadian markets of skins, wool, apples, seeds, kauri gum (a constituent in varnishes), and New Zealand flax used in the manufacture of cordage. In return Canada received favorable treatment on salmon, silk or artificial silk stockings, electric cooking and heating appliances, agricultural implements, and timber. Canadian exports not specifically enumerated were given the advantage of British preferential rates. New Zealand's staple exports, mainly in the form of foods and raw materials, were exchanged on more favorable terms for typical Canadian manufactures. The agree-

³⁹ *Year Book*, 1936, pp. 742-743.

⁴⁰ *Year Book*, 1916, p. 448.

⁴¹ *Year Book*, 1929, p. 351.

ment has proved mutually advantageous.⁴² Incidentally the concession of lower rates on Canadian timber has placed American lumbermen at a disadvantage in New Zealand markets, where rapidly failing forest resources demand heavier importations of building materials.

New Zealand negotiated a favorable trade agreement with Belgium in 1933 and the provisions of this treaty were extended by order in council to apply to Argentina, Brazil, China, Czechoslovakia, Egypt, Finland, Germany, Hungary, Italy, Japan, Norway, and Spain. Sweden was added in 1935, and Greece in 1936. Direct trade agreements have been concluded with The Netherlands and Switzerland.⁴³ New Zealand, like the United States, has adhered to the policy of protection but has sought to extend her export and import trade under favorable conditions by resort to reciprocal trade agreements.

⁴² *Year Book*, 1939, p. 937.

⁴³ *Year Book*, 1940, pp. 301-302.

CHAPTER II

EXCISE AND MISCELLANEOUS INDIRECT TAXES

THE EXCISE tax plays a far less important role in New Zealand's system of taxation than it does in Australia. Until the introduction of a sales tax, somewhat general in scope, in 1933 and the multiplication of miscellaneous stamp taxes, internal taxation of commodities was largely confined to beer and malt liquors. The study of excise taxation in New Zealand, during the earlier period at least, largely resolves itself into a study of the beer duty. It may surprise the reader that other forms of intoxicants are not included, as in Australia and elsewhere, under the scope of excise taxes. The explanation lies in the peculiar policy of New Zealand with reference to the distilling industry. The manufacture of spirituous liquors is forbidden by law and the people of New Zealand, rather heavy consumers of strong drink, use only the products of foreign countries. These imports of alcoholic liquors are heavily taxed under the customs duties. In fact, down to the time of the first World War, customs duties on alcoholic liquors and tobacco accounted for approximately 40 per cent of total receipts from external taxation.

The suggestion of an excise tax on beer was brought forward as early as 1878 when the Treasurer proposed a tax of $1\frac{1}{2}d.$ on each gallon of beer manufactured and sold on the domestic market. He admitted that the incidence would be ultimately upon the consumer; but the revenues were expected to be stable and dependable. "He [the consumer] may certainly save his tax by drinking so much less beer but, as the habit of indulgence is stronger than self-denial, there is no ground to anticipate in that respect an appreciable falling off."¹ At that time the new tax was protested as a tax on a necessary of life. Gisborne argued that among certain classes a daily potion of beer was regarded as a necessary of life. He added, "just as necessary as a cup of tea," to which certain honorable members responded, "Hear, Hear."

The beer tax stood alone among excises until the tax on the manufacture of tobacco and perfumery in bond was added by the act of 1881.² It appears that the home production of tobacco was of slow growth and, until the eighties of the last century, domestic production was thought to be too insignificant to tax. Even as late as 1912 the excise

¹ *Treasurer's Report*, 1878, p. 17.

² *Year Book*, 1916, p. 448.

tax on tobacco of New Zealand manufacture gave rise to an annual revenue of only £844. The list of taxable commodities of home consumption was greatly extended under the stress of wartime demands. In 1916-17 culinary and flavoring extracts, medicinal preparations, toilet preparations, and various derivatives from tobacco manufactures were added to the list, in addition to beer and tobacco. The rate was now raised to 1s. per pound on tobacco and 4s. per pound on cigars and snuff. The excise duty on cigarettes was made to depend upon the conditions of manufacture. Machine-made cigarettes were taxed at 5s. 6d. per pound, while the handmade product was favored by a 4s. rate. Despite the elaboration of schedules, however, the system of internal taxation did not yield heavily. For the year 1917 excise taxes produced but £200,000, of which £189,000 could be credited to the duty on beer.³

The law makes special provision for the enforcement and collection of the beer and tobacco taxes. All beer is manufactured under strict licensing provisions and the Minister of Customs is given large powers of revocation. Before granting a license the qualifications of the person or corporation must be carefully scrutinized.⁴ The rate of taxation is made to depend on the specific gravity of the worts in incipient fermentation. The prevailing rate in recent years has been 1s. 3d. per gallon on beer where the specific gravity of the wort does not exceed 1,047. Where the specific gravity of the wort exceeds 1,047 the rate of taxation is stepped up by one-sixteenth of a penny for every unit of specific gravity in excess of the basic figure. By a recent enactment in 1939 the tax was raised to 2s. a gallon for the first class and the same scale of increase applied to the second class.⁵

Under the tobacco excise the subject of taxation is very broadly defined to include all possible means of manipulation by which tobacco is prepared for human consumption whether in the form of cigars, cigarettes, smoking tobacco, or snuff.⁶ To facilitate administration the Minister of Customs is required to approve the premises where tobacco may be lawfully manufactured. All tobacco grown in New Zealand must be delivered to licensed warehouses or manufacturing plants *by the shortest route*. The grower must keep the Minister of Customs informed regarding the movement of his product to market and heavy penalties are provided for failure to comply. Warehousemen and manufacturers must keep a record of all receipts of tobacco at licensed premises and their books must be open to inspection by officers of the

³ *Year Book*, 1917, p. 364.

⁴ Public Acts of New Zealand, vol. 7, pp. 263 *et seq.*

⁵ Statutes 1934, No. 14, p. 80.

⁶ Public Acts of New Zealand, vol. 7, pp. 231 *et seq.*

customs. Officers may enter and search premises and seize tobacco manufactured in violation of the act. Fines for violation may range as high as £100.⁷ The law also takes precautions against the adulteration or admixture of deleterious substances in the process of manufacture. Producers are forbidden to "cut, color, manufacture or prepare or have in his possession any leaves, wood, herb, vegetable or other material or any harmful thing to imitate or to be mixed with tobacco." Materials found on premises of the manufacturer may be seized and forfeited to the Crown and the offender is liable to a fine of £50⁸. Evidently the common man in New Zealand likes his tobacco in pure and unadulterated form. The adulterants are apparently assigned to the Crown!

Under the act of 1934 the ruling rate on tobacco (cut or uncut), cigars, and snuff was quite uniformly 1s. a pound. On cigarettes the rate of tax was made to depend upon the weight per thousand. The rates after November 1, 1934 were fixed at 13s. 6d. per thousand weighing less than 2½ pounds, and 5s. 6d. per one thousand weighing more than 2½ pounds per thousand. The scale of rates was clearly intended to favor the producer of heavier cigarettes.⁹ This scale of rates was stepped up by 25 per cent under the act of 1939.

In New Zealand the financial support of the highway program is largely a responsibility of the Dominion government. A special fund is created for highway construction and maintenance, to which is credited the receipts from customs duties imposed on rubber tires, inner tubes, and rubber for the manufacture of pneumatic tires, all receipts from licensing of motor vehicles, and the proceeds of the tax on motor spirits imposed under the act of 1927.

The rate originally imposed on petrol was 4d. per gallon; this was increased to 6d. in 1930 and finally to 8d. The 1930 rate of 6d. amounted at the prevailing rate of exchange to approximately 12 cents in American money, and the present 1940 rate of 8d., at the reduced rate of exchange, is the equivalent of 11 cents. At the outbreak of the second World War an added tax on petrol was imposed to help finance the war program. The government justified this measure on the ground that the tax would reach either directly or indirectly every section of the community and compel everyone to make his contribution to national defense. It was claimed also that the tax had the merit of pressing "much more lightly on large families than other forms of indirect taxation and a great deal of it is in the nature of a luxury tax."¹⁰ In

⁷ *Ibid.*, p. 233.

⁸ *Ibid.*, p. 237.

⁹ Statutes 1934, No. 14, p. 81.

¹⁰ *Finance Minister's Report (Premier Savage for Walter Nash)*, 1939, p. 14.

normal times the petrol tax would be productive of considerable revenues, for New Zealand ranks high in automobile ownership; but as a device for raising additional revenues in wartime it proved to be a weak expedient. In order to conserve American exchange for the purchase of war supplies and essential materials, including aviation gasoline, it became necessary to ration petrol to car owners at the rate of eight gallons a month for each machine. Even at the high rate of taxation in force, the revenues from the tax on motor spirits proved to be a negligible item.

Another indirect tax, which owed its origin to the first World War but became a permanent part of the revenue system, is the amusement tax, the equivalent of the American tax on admissions. First introduced in 1917, the act defined very broadly the subject of taxation as admission charges to any entertainment, "exhibition, performance, amusement, game or sport to which persons are admitted for payment."¹¹ Shows promoted by agricultural or horticultural societies and shows for educational, religious, or charitable purposes and for nonprofit organizations and operations are exempt. To facilitate administration of the tax the Governor General is given full power to make all necessary regulations for enforcement, and officers may enter any place of amusement at any time to ascertain whether terms of the act are complied with. Collections are made through stamps or stamped tickets, and promoters and managers who fail to comply with the terms of the act are liable for a fine of £50. A graded scale of taxes, depending on the price of admission, was provided by the original act. Up to 1s. 6d. of admission charge (at present, 25 cents) no tax is levied. Between 1s. 6d. and 2s. the charge becomes 3d. From this basic charge the rate rises to 5d. on a charge for admission between 3s. and 3s. 6d. Above that figure one penny is added for every shilling of additional admission charge.¹² The amusement tax has yielded in recent years upwards of £90,000.

To meet the emergency resulting from the depression a new excise on film rentals made its appearance. Motion-picture films are supplied entirely by overseas companies, since there is no commercial production in New Zealand. It was claimed that foreign distributors fixed the rental price so high that little profit accrued to local exhibitors and that it was necessary to devise a tax to reach the foreigner. An equivalent of an ad valorem duty was calculated by an ingenious process and a tax of a fixed percentage was applied. Monthly reports are required of all distributors of films which show the gross rental charges collected in

¹¹ *Year Book*, 1940, p. 593; Public Acts of New Zealand, vol. 7, pp. 476-480.

¹² Public Acts of New Zealand, vol. 7, p. 481.

the Dominion. From this gross item are deducted the expenses incurred in carrying on business and also that portion of gross rental on which income tax is paid. The remainder constitutes the taxable base; the rate of taxation for English firms is 10 per cent while foreign films (mainly American) take a higher rate of 25 per cent. Although New Zealanders are not addicted to the cinema in the same degree as Americans, the film-hire tax yields an annual revenue of £85,000.¹³

A curious revival of mercantilism is seen in the gold-export duty of New Zealand provided for in an act of 1908.¹⁴ The export duty applied to gold in its natural state, or to a substance containing gold whether wrought or unwrought, but exception was made for coins from the mint of London or any branch thereof and for minted coins of any foreign state. Jewelry or ornament actually worn upon the person or made outside of New Zealand might leave the country untaxed, "if worn without intent to defraud the revenue." The original act imposed a tax of only 2s. on every troy ounce of 20-carat fineness and a proportional tax on gold of varying weight and fineness. Under the terms of the 1908 legislation the tax applied only to gold produced on the North Island and required the buyer for export to ascertain the precise locality where the metal was produced. Failure to secure such information subjected the exporter to a fine of £10. The yield of the gold duty was to be distributed back to local authorities at the point of production.¹⁵ Secret shipment of gold by any means renders it liable to forfeiture, and false and fraudulent statements are punishable by a fine of £500.

By an amendment in 1932-33 provisions of the gold duty were extended to include all gold wherever produced and whether exported from the North Island or not. The export duty was upped to 12s. 6d. per ounce of 20-carat fineness. This was equivalent to \$2.50 in terms of American money; the high rate of taxation was influenced both by the emergency demand for revenue and the desire to check the export of gold resulting from a relative decline in New Zealand exchange. The proceeds of the gold duty instead of being turned back to the locality were now retained in the consolidated fund of the Dominion.¹⁶ The outbreak of the second World War in September 1939 brought further changes in the gold duty act apparently prompted by the wartime situation affecting exchange relations. In addition to the high duty imposed by the act of 1932-33 an added export duty was imposed equal to 75

¹³ For provisions of film-hire tax see *Treasurer's Report*, 1930, p. 32; Smith, *Budget Problems, 1929-1935*, p. 42.

¹⁴ Public Acts of New Zealand, vol. 7, p. 264, Act of 1908, No. 70.

¹⁵ *Ibid.*, p. 268.

¹⁶ Statutes 1932-1933, No. 35.

per cent of the excess of London value of the gold (expressed in New Zealand currency) over the value of the gold computed at the rate of £9 5s. 8d. (New Zealand currency) for every troy ounce of gold of the fineness of 24 carats. For the purpose of computing the taxable difference, New Zealand's currency value was fixed by the ratio of £100 English sterling equals £125 of New Zealand money. In the last fiscal period preceding the second World War the gold duty yielded a revenue of £100,000, indicating, despite the deterrent influence of the duty, a considerable export of the precious metal.

One of the most interesting aspects of New Zealand's tax system is the extensive use of taxes on transfers and instruments. So elaborate is the system of stamp taxes that it becomes difficult to give in brief space an adequate impression of its many features and the interesting problems, legal and practical, that arise in connection with its administration. The system of stamp taxes gave rise in 1939 to a revenue of £1,589,000.

For the sake of clarity and brevity special attention will be given to taxes on conveyances, on certain types of instruments and negotiable paper, and on certain operations associated with the business of corporations. Conveyances subject to taxation under the act are broadly defined as transfers for a consideration. The act providing for such taxes¹⁷ specifically enumerates a whole host of such transactions and prescribes the rate; but, in order to make the system general if not universal in its application, all transfers for a consideration not specifically mentioned are taxable at 11s. for each £50 of value or fractional part thereof. Mortgages (in a sense conditional transfer of title), debentures, and things in action or interest in a trust fund are taxable at the rate of 4s. 6d. for every £100 of value involved. Transfers of shares of stock in a corporation involving a change of ownership or interest therein are taxed at the rate of 3s. 6d. for each £50 of value, and a transfer of mining property or interest therein takes the same rate.

A transfer of title to land, a taxable transaction, is accomplished in New Zealand by a method somewhat different from the American practice. The transaction does not involve the making, acknowledgment, and recording of a deed. Under the land-transfer act of 1915, the transfer is made on the books of the registrar of land titles and a certificate is issued to the new owner. Such transfers of title, which are from the outset a matter of public record, pay the conveyance tax.¹⁸ Leases, which are recognized as means for transferring real estate for use and

¹⁷ Public Acts of New Zealand, vol. 7, p. 424.

¹⁸ *Ibid.*, p. 430.

occupancy for a definite period of time, are taxed like other conveyances. In this case the consideration that becomes the basis of the tax is the maximum specified rental payable each year and the rate is 3s. 6d. for every £50 or fractional part thereof.¹⁹ Agreements to lease or to increase rentals under existing leases are subject to taxation at the same rate.

As in the case of most stamp and transfer taxes, numerous exceptions and exemptions are made that complicate the administration and call for frequent adjudication by the courts. On page 425 of the stamp-tax act will be found enumerated at least eleven distinct classes of transactions that fall within the exempt class. Some of the more important exceptions are: chattels transferrable by delivery only, transfers from one trustee to successor, transfers of shares in estate by executor or administrator, crown-land transfers, conveyances of property to be held in charitable trust, and transfer of policy of assurance. Moreover, transfer of corporate shares, normally taxable, become exempt when the commissioner of stamp duties is satisfied "that the conveyance is merely a necessary incident in a scheme for the reconstruction of a company."²⁰

An important section of the stamp-tax measure has to do with transactions involving the use of negotiable instruments. In a sense these transactions are in the nature of transfers, but concerned not with tangible property or corporate interests but with that intangible something called credit. The chief classes included under this head are bills of exchange, promissory notes, and bank notes. Bills of exchange and promissory notes payable on demand are taxed at a uniform rate of 2d. regardless of the amount involved. This tax, like the American tax on bank checks, is open to the objection that it is an unequal tax and regressive in effect. Time bills of exchange pay at the rate of 1s. for each £50. On promissory notes not payable on demand the rate varies from 6d. on sums below £25 to 1s. on sums from £25 to £50 and 1s. for each added £50. The tax originally imposed at the rate of 22s. 6d. on each £100 of bank-note circulation was repealed in 1936.²¹

With certain exceptions agreements are subject to tax if the amount involved in the agreement exceeds £20. The rate imposed by the original act was 1s. 6d. Another type of instrument extensively used in New Zealand commerce is the bill of lading. Where shipping and foreign commerce assume such proportions as in New Zealand bills of lading would naturally prove an inviting source of revenue. Such bills are,

¹⁹ *Ibid.*, p. 435.

²⁰ *Ibid.*, p. 433.

²¹ Statutes 1936, No. 16, sec. 27.

according to the terms of the act, written on stamped paper and the tax on each instrument is 1s.²²

A group of New Zealand stamp duties of special interest to American students concern the operations of corporate enterprise. They are substitutes apparently for American license taxes on the privilege of incorporation and the right to do business, wrongly called in some states a franchise tax. Under the New Zealand law certificates of incorporation are taxed according to the size of capital stock. The fee is £10 for a company the nominal capital of which exceeds £5,000; in every other case the duty is fixed at £6. It should be noted that this tax on the privilege of incorporation tends to be regressive in effect instead of rising by gradations in proportion to stock issue, which is the more common practice in America. In New Zealand the certificate of incorporation is transmitted to the commissioner of stamp duties for the affixing of the stamp before its issue is authorized.

As in most of our American states, New Zealand requires every corporation to obtain a license annually as a condition of carrying on business. Domestic corporations are favored by a relatively low rate of 1s. for each £100 of nominal capital. Foreign insurance and banking corporations pay a flat rate of £300 for the privilege of New Zealand business. Other foreign corporations pay at the rate of 6d. for every £100 of capitalization if they employ only a part of their capital in New Zealand; if they employ all of their capital in New Zealand the rate is the same as that prescribed for New Zealand companies, except that a minimum of £10 is fixed.

A fairly productive but somewhat irritating feature of the tax on instruments is that imposed on ordinary receipts for sums paid to creditors. The tax applies only when the amount involved is £2 or more; the rate is a uniform 2d., the payment of which is attested by affixing an adhesive stamp or by writing the receipt on specially prepared and stamped paper. A curious feature of this stamp tax is that a passenger ticket sold for more than £2 is regarded as a receipt for the fare and is taxed as such.

Special provisions are made for enforcement of the various stamp taxes. Instruments unstamped and passing through the hands of public officials are "impounded" until the tax is paid. There are penalties for delay in payment and fines, commonly £50, are attached for specific violation. Instruments unstamped may be denied validity by the courts in case they figure in legal processes.

Provisions are made for safeguarding the interests of taxpayers by

²² Public Acts of New Zealand, vol. 7, p. 446.

appeal first to the commissioner and later to the Supreme Court. Fees are attached to each of these procedures; but in case the commissioner or the court ultimately sustains the objection of the taxpayer all fees involved are refunded to the complainant.²³

It is only natural that an act as complicated as the stamp-duty measure, with as many exceptions, exemptions, and qualifications, should give rise to legal questions that call for adjudication by the court. Although, under the terms of the later act, corporations in general were required to pay the privilege taxes under the first stamp-tax act of 1882, certain types of enterprises deemed worthy of encouragement and promotion were entirely exempt. Among these was the business of manufacture. Relying on the provision of this act, the New Zealand Refrigerating Company, Ltd. laid claim to exemption from the £20 tax on the ground that its business was in the nature of manufacture. The attorney for the government contended that the process of refrigeration is no more manufacture than boiling an egg is manufacture or packing butter in cases is manufacture. No real change has taken place in the thing to which the freezing process applies and manufacture always involves a process of reshaping. In a word, the essence of manufacture, as the economist would put it, is the creation of form utilities.²⁴ The government's contention was upheld.

Under the terms of the 1882 statute, also, exemption had been extended to mining companies organized exclusively for that purpose. The Progress Mines of New Zealand, Ltd. laid claim to exemption. The government contested the claim on the ground that the charter of the company extended to functions not associated necessarily with mining. Articles of association had conferred the right to "acquire landed and other property, claims and rights and develop and turn the same to account in such manner as the company may think fit," to enter into partnerships or other arrangements for sharing profits, and to promote the company's interest in a variety of ways. The scope of its activities, the court held, was too broad to conform to the requirement that it was organized exclusively for mining purposes and it was therefore liable to the annual tax for the privilege of doing business.²⁵

This principle was even more emphatically stated by the court in a case involving the Magnetic Gold Dredging Company, which had been given extensive powers to buy and sell mineral lands, to acquire and hold shares, and to promote and assist other corporations having similar objectives in mind. The court in this case held that a company

²³ *Ibid.*, p. 412.

²⁴ 13 N.Z.L.R. 685.

²⁵ *In re Progress Mines of New Zealand, Ltd.*, 15 N.Z.L.R. 567.

to be entitled to exemption must be formed *exclusively* for mining operations. "The law requires not only that it [i.e., gold mining] should be the paramount object but the exclusive object of the company."²⁶

An interesting case, involving the application of the tax on instruments to a written request to advance the sum of £15, accompanied by a pledge that the drawer "would be answerable for the repayment of the same after six months," was carried to the court for final settlement although the tax, on any interpretation of the law, would have been nominal. It was contended by the defendant and drawer of the bill that it was not a check because a check presumes the availability of a deposit to meet the request on demand; the document was not a promissory note although it did set up an obligation to pay at a future date. Even though the document were held to be an agreement, it would still be exempt; for the amount specified was below the minimum figure at which agreements become taxable. The court held that the instrument in question was not a letter of credit or a check or bill of exchange and did not fall under the definition of taxable documents contained in the law.²⁷

Next to the income tax and the customs duties, the most productive element in the New Zealand revenue system is the sales tax. As in the case of most sales taxes, this new departure owed its origin to the financial emergency of the early thirties, the shrinkage in revenues from other taxes, and the mounting demand for relief and the promotion of public works as means of meeting the problem of unemployment. Although the sales tax was not formally adopted until February 1933, it was evidently given more than incidental consideration as early as 1922, which was of course in the period of postwar depression. The Treasurer in his annual report called attention to the turnover taxes in use in Canada and elsewhere, and said that these experiments were worth considering. It should, if adopted, be used not to produce additional revenue but to obtain relief from existing taxes. It should receive consideration solely from the standpoint of a "better and more equitable distribution of the taxation load at present borne by the country."²⁸

Although early interest in the sales tax seemed to center in a turnover tax, the measure actually adopted was not in any sense of the term a turnover or transaction tax, but a once-for-all tax levied so far as possible at the point where goods pass into the hands of the retailer.²⁹ Like the Australian sales tax already described, the New Zealand tax levied a rate of 5 per cent on wholesale transactions. The measure seems

²⁶ *In re Magnetic Gold Dredging Company*, 16 N.Z.L.R. 318.

²⁷ *Meirs v. Bett*, 20 N.Z.L.R. 367 *et seq.*

²⁸ *Treasurer's Report*, 1922, p. 14.

²⁹ *Year Book*, 1940, p. 595; *Ibid.*, 1934, p. 435.

far less complicated than the Australian sales tax, and more compact and coherent in its provisions.³⁰

The act defines the taxpayers and the types of transactions to which the tax applies. Included along with wholesalers are manufacturers who exercise the middleman's functions, including the manufacturing retailer who manufactures goods for sale through his own organization to the ultimate consumer. Sales are defined to include barter transactions, disposal with the right to purchase, and contract sales for future payment in installments or otherwise.³¹ The sales-tax measure is administered by the Customs Department, an arrangement which insures close coordination between the machinery for the enforcement of internal and external commodity taxation. To facilitate administration, those discharging the wholesale function are required to obtain a license from the collector and pay a fee not exceeding £1. The tax at the rate of 5 per cent applies to all transactions of wholesalers and manufacturing retailers and also to goods imported by other than licensed wholesalers for sale to retailers.

We have seen how the exemptions under the Australian sales tax gave rise to far-reaching complications. The New Zealand measure also provides for a rather extended list of exempt transactions affecting mainly articles of primary production, articles used in primary production, machinery for use in manufacture, and certain kinds of food stuffs for household consumption. Gold and motor spirits are exempt from sales taxes because subject to special levies. The New Zealand list of exempt articles is, however, far less comprehensive than that in the Australian act, and from the outset has been conveniently set forth in the text of the law with the exempt articles arranged in alphabetical order, e.g., "animal fats and oils, bags, bees, bells for use in churches only", etc.³²

A peculiarity of the New Zealand act is that it permits the Governor General to issue an order in council exempting additional items or eliminating articles or transactions included in the first schedule of exemption under the original act.³³ Apparently this method of handling exemptions has led to fewer complications than one which allows the legislature to intervene at the instance of pressure groups. The Governor General and the Council have in the main refrained from making extensive changes in the scheme of exemptions as originally provided.

It is conceivable that goods may be imported directly for home con-

³⁰ Statutes 1932-1933, No. 33, p. 334.

³¹ *Ibid.*, p. 334.

³² *Ibid.*, p. 361.

³³ *Ibid.*, p. 338.

sumption and therefore not pass through the hands of those normally held liable for paying the sales tax. Something akin to the use taxes employed by American states to reach articles bought in nonsales-tax states has been provided under the New Zealand act. Such articles of import for home consumption are liable for a tax and the law itself provides the method of evaluation to arrive at the taxable base. The equivalent in New Zealand currency of the value of imported goods as appraised for customs duties is taken as the starting point. To this is added any customs duties due or payable on such goods and an additional 25 per cent apparently intended to match the markup that would intervene if the consumer, instead of importing his goods, had bought them through the channels of wholesale and retail trade.⁸⁴

The New Zealand act is unusually strong in provisions for enforcement. Evasion and fraud are punishable by heavy fines, and penalties are provided for assisting or inciting a taxpayer to escape a lawful levy of the tax. False declarations are indictable offenses and are punishable by imprisonment for a period of two years. To insure the payment of taxes accrued, the government is made preferred claimant in the case of bankrupt concerns. This principle was definitely upheld by the court in a case involving a company in liquidation which had insufficient funds to pay all debts. The court held that the comptroller of customs was a preferred claimant to the sums necessary to pay in full all sales taxes due at the time of the "commencement of its winding up."⁸⁵

As T. R. Smith has pointed out,⁸⁶ most of the new taxes imposed under stress of the financial emergency of the thirties were indirect and regressive in their effect. Some of them have become more so by increase in rates. The sales tax, originally levied at 5 per cent, was soon increased to 6 and then to 10 per cent. Taxes levied for unemployment relief also assumed a regressive form. At the present time, the only progressive elements in the New Zealand tax system are the income tax, the land tax, and the death duties. All other constituents in the system, with the bare exception of the film-hire tax, are properly classed as indirect and regressive in their ultimate incidence. The three graduated taxes account for a little less than 30 per cent of the total revenues, the miscellaneous indirect taxes for 70 per cent. When we recall that New Zealand's customs duties are distinctly protective in their intention and effect, and that all protective duties impose a burden vastly in

⁸⁴ *Ibid.*, p. 339.

⁸⁵ *In re Burney's Glass Co., Ltd.*, 57 N.Z.L.R. 92; J. P. Kavanagh, *Sales Tax Legislation*, pp. 39-40.

⁸⁶ *Budget Problems 1929-1935*, p. 87.

excess of the revenue obtained, the figure mentioned above does not indicate the full extent of regressivity. In a country which has, with the exception of brief intervals, been so largely dominated by the Laborites and where, according to widely accepted opinion, the trend has been so consistently toward state socialism and welfare arrangements, it is a matter for surprise that the tax system has been and continues to be one that imposes disproportionate burdens on the lower-income classes.

CHAPTER III

INCOME-TAX HISTORY—DEFINITION OF INCOME

THE COLONY of New Zealand, as indicated in previous chapters, relied in its early history very largely on indirect taxation. A temporary trial of the land tax in 1878 met with stubborn opposition from the landholding classes and, on account of restriction in the franchise, they were able to exert a decisive influence. With the repeal of the land tax in 1879 a property tax, not unlike the American model, was substituted as a source of colonial revenue. Although the rate on property was not high, the levy proved to be unpopular. It was characterized by John Ballance, the brilliant financier, as "grossly unjust in its operation imposing, without discrimination, burdens on capital whether productive or unproductive, and discouraging investments necessary to industrial progress."¹ Ballance proposed to substitute for "this obnoxious form of taxation" an income tax modeled after the English pattern, resting on companies and individuals alike and levied at the rate of a shilling in the pound or 5 per cent. A land tax passed at the same time, in fact as a part of the same measure, was regarded as a substitute for the income tax so far as individual or corporate income derived from land was concerned.

In the Parliamentary debates while the measure was under consideration, Ballance stated very clearly the fairness and beneficial effect of substituting an income tax for a property tax so far as new business ventures are concerned. "What is the position of every new company? It has a struggle to go through before it begins to earn an income. The companies which have not been able to pay dividends have had to pay heavy taxation under the property tax and that has been a confiscation of their capital. We do not [under the proposed program] ask them to pay a single penny until they have begun to earn money and then we only ask them to pay income tax upon their profits at the end of the year."²

Ballance recognized, long before the English act of 1910, the necessity for differentiation between earned and unearned incomes. Referring to professional incomes, he pointed out that they "depend entirely upon the health and continued capacity of the individual. If his health fails or he dies, his income dies with him; but incomes from trade and

¹ *Treasurer's Report*, 1891, p. 13.

² *Parliamentary Debates*, vol. 73, p. 100.

commerce especially in regard to large firms in which money is invested, do not stand on the same basis."³

The income-tax law of 1891 contained a very broad definition of income. The taxable base was defined as "income derived from business, gains or profits derived or received in New Zealand from any trade, manufacture, adventure or concern in the nature of trade whether the same shall be carried on in New Zealand or elsewhere." Deductions allowed included all losses and "outgoings" actually incurred, but sums spent on repair of premises occupied for purposes of business or employment were nondeductible. Sums spent for "supply of or repairs to or alteration of utensils, machinery, etc." were also nondeductible items. Bad debts might be deducted in case they are proved to be such to the satisfaction of the commissioner. The exemption in the original act was fixed at £300 (\$1,358), a rate considerably above the exemption permitted under the English income tax at the same time (£160). The high exemption, coupled with the fact that the income from land received by owner or occupier made no contribution under the income tax, may account for the disappointing yield during the early period of income taxation. "Under both systems [i.e., land and income taxes] the largest contributions were by graziers, sheep farmers, farmers, dairymen, etc., that is, by country lands."⁴

It does not appear that the principle of graduation, which has been applied in such a pronounced way in later income taxes, was applied until 1909, when the Treasurer proposed a new scale which was expected to yield an extra revenue of £80,000 and equalize the difference in rates between firms and persons and companies. The new schedule of rates ran from 6*d.* in the pound (2½ per cent) on the first £100 up to 1*s.* 2*d.* in the pound (6 per cent) on sums in excess of £2,000.⁵ The exemption for individuals was retained at the former figure of £300. In 1911 the Treasurer, in answering the charge that New Zealand "was the most heavily taxed country in the world," called attention to the fact that the British income tax allowed an exemption of only £160 and in Japan the exemption ran as low as £30. A New Zealander with an income of £1,000 would pay £29 11*s.* 8*d.*, while an Englishman with the same income would pay £47 18*s.* 4*d.* At Frankfort-on-the-Main an income of the same size would contribute the equivalent of £96 a year. Even in nearby Tasmania the exemption was limited to £80, and no exemption was allowed under the land tax similar to the one in force in New Zealand.⁶

³ *Ibid.*

⁴ *Report, Commissioner of Taxation, 1893, p. 2.*

⁵ *Treasurer's Report, 1909, p. xxv.*

⁶ *Treasurer's Report, 1911, p. xxv.*

If the New Zealander considered himself overtaxed in 1911 he was soon to be overwhelmed by wartime increases and the multiplication of taxable objects. Reference has been made already to adjustments affecting customs and excise taxes; and the income tax had, of course, to assume its share of the burden. In 1915 the Treasurer recommended a new schedule of rates starting at a minimum of 1s. 4d. (6 2/3 per cent) and rising to 2s. (10 per cent) on incomes of £5,600 or above. To these rates were added a supertax of 33 1/3 per cent. The government did not at the outset consider, even under the stress of wartime emergency, any reduction in personal exemptions. The Treasurer explained that the lower brackets make their contributions through indirect taxes and that the cost of living due to wartime inflation was on the increase.⁷ In 1916 the Treasurer again referred to the fact that New Zealand's exemption of £300 was "the highest in the world;"⁸ although he did not propose to reduce the exemption, he admitted that this exemption policy "will become a serious question for consideration if the war continues beyond the end of next year."⁹

In 1917, as war demands increased, more revenue was sought from the income tax by stepping up the scale of progression and by changing the basis for deduction allowed to landowners. The new scale of progression now reached 3s. in the pound (15 per cent) on incomes in excess of £6,400. It will be noted that the maximum rate was reached at a much lower level than under American schedules in force at the same time. Landlords in New Zealand, in calculating their taxable incomes, had hitherto been allowed to deduct 5 per cent of capital value of land and improvements used in producing the income. The deduction of 5 per cent on *capital* value seemed inconsistent with the practice of taxing land only on the *unimproved* value; the deduction in many cases wiped out the taxable income altogether. Henceforth the deduction was confined to 5 per cent of *unimproved* value alone.¹⁰ The schedule of rates was soon increased by 50 per cent; at the end of the war incomes in the upper brackets were being taxed as high as 35 per cent.¹¹

Despite the increases in rates that had been made effective during the war and were allowed to remain in effect for some time thereafter, the income-tax revenues suffered from the postwar depression; but the influence of shrinking incomes on current revenues was somewhat retarded because of the fact that the tax was assessed on the returns

⁷ *Treasurer's Report*, 1915, p. xxvi.

⁸ This statement is open to question, since at this time a single man in America was exempt on the first \$2,000.

⁹ *Treasurer's Report*, 1916, p. xxiii.

¹⁰ *Treasurer's Report*, 1917, p. xxiv.

¹¹ *Ibid.*, p. xxv.

of the previous year.¹² Recovery was prompt and satisfactory, however, and by 1923 the influence of returning prosperity on revenues was easily discernible. Some remission of the burden of income taxation was made possible by the removal of a 20 per cent supertax which had been imposed for emergency purposes.¹³

With improvement in the revenue situation the government turned its attention to some needed changes in income taxation. While the principle of a graduated rate seemed now a settled policy, the extreme application of progression under the influence of wartime and emergency demands had led to a revival of objections to the principle itself. The Royal Commission on Land and Income Tax in 1924 pointed out that many objections had been raised to the graduated rate on companies. It was considered not only unjust in certain quarters but was held to have the effect "of preventing the embarkation of capital in new commercial undertakings." The commission favored the abandonment, as soon as possible, of the existing system of company taxation and recommended holding the security holder alone responsible for the tax.¹⁴

The commission took a rather surprising stand on the question of differentiation. "It is wrong in principle to vary the rate of taxation according to the source from which it is derived . . . Graduation or differentiation of the rate . . . should be according to the size of the income and not according to the source from which it is derived. The only exception should be income from tax-free war loans in connection with which the state has made a definite contract."¹⁵ The commission also urged a novel formula for determining the scale of progression. Authorities should determine a rate "at a level that will not cause an outflow [or check an inflow] of capital from New Zealand. Having fixed the maximum rate the graduation downwards should be on a scale that will enable the required sum to be raised . . . and in such a way as not to be oppressive on the taxpayer of small means."¹⁶ It will be seen at a glance that the formula would necessitate "weighing the imponderables" and would not lend itself to easy application.

As indicated above, land- and income-tax measures were conjoined in the act of 1891. Parliament has had to cope with the continually recurring problem of coordinating the two. It will be recalled that the original act did not apply the income tax to the income of either owner or occupier of land. Later, deductions were allowed (calculated at a

¹² *Treasurer's Report*, 1922, p. x.

¹³ *Treasurer's Report*, 1923, p. vii.

¹⁴ *Report, Royal Commission on Land and Income Tax*, p. 3.

¹⁵ *Ibid.*, p. 4.

¹⁶ *Ibid.*, p. 5.

fair percentage of land value) before arriving at the taxable income. In 1929 this subject underwent still further revision. Henceforth farmers were required to pay on the income from land if the unimproved value exceeded £12,500 but were to be allowed a "set-off" equal to the land tax paid on land used for farming purposes. As the Treasurer expressed it: "In effect this means the payment of a land tax or an income tax, whichever is the greater . . . This proposal is intended to ensure that the large farming incomes will contribute to the national revenues in the same ratio as the income from other occupations, which is only just and equitable."¹⁷

A year later this provision underwent further change. The law now provided for a straight income tax on farm income if improved value exceeded £7,500. The deduction of land tax paid even on productive holdings was repealed. The farmer's income was to be assessed "on the same basis as other classes of the community." The deduction of 5 per cent on unimproved value was allowed in calculating the taxable income of the agriculturist and landowner.¹⁸

The income tax in New Zealand, as in the mother country, is used as the elastic element in the fiscal system. When the emergency showed itself in declining revenues in the early part of the decade 1930-1940, successive increases in income-tax rates were relied on to recoup the losses and keep the finances on a sound basis. A surtax of 10 per cent, imposed in 1930, was raised to 30 per cent in 1931. Exemptions were also lowered from £300 to £260, to be diminished by £1 for every £3 between £260 and £560 and £2 for every £3 between £560 and £800, abatements ceasing at the latter figure.¹⁹ Believing that the company rate was "the highest in the world" and the New Zealand income tax among the lowest, the Conservative government left the rate on corporate income unchanged. By this device investments would not be discouraged and primary production would be assisted. While the deduction of 10 per cent hitherto allowed on earned incomes below £2,000 was repealed, the principle of differentiation was conserved by imposing an extra one-third on unearned incomes. Revenues were also increased by including all exempt income in the calculation of the total as a basis for determining the rate. An extra flat rate tax of 4*d.* in the pound was imposed on all income in excess of £500. It was expected that these changes would produce an extra revenue of £230,000.²⁰

¹⁷ *Treasurer's Report*, 1929, p. 26.

¹⁸ *Treasurer's Report*, 1930, p. 33.

¹⁹ *Ibid.*, p. 34; *ibid.*, 1931, p. 24.

²⁰ *Treasurer's Report*, Supp., Oct. 1931, p. 6.

Some of the changes hastily made during the depression years of 1930-1934 complicated income-tax schedules unduly. With the passing of the immediate emergency attention could be given to the task of revision and "overhauling." The minimum exemption was fixed at £210 but added allowances were made for wife and dependents. A married man with two children was to pay only on the excess over £360. The rate structure, which had become a patchwork of original rates, emergency levies, and surtaxes, was now reduced to a simple scheme of increases by fractions of a penny for each pound in excess of a stipulated amount. The range of rates was from 8 to 40 per cent, the maximum figure being reached on £8,950 (\$36,000). The principle of differentiation was recognized by an extra levy of 33 1/3 per cent of calculated tax on unearned incomes. It should be observed that differentiation was accomplished by adding to the tax on unearned incomes instead of remitting a part of the tax on unfunded or service incomes.²¹

The emergency of the second World War broke upon New Zealand with tragic suddenness in September 1939. With characteristic determination, sweeping changes were made in the tax system to meet the expanding demands of national and Empire defense programs. Naturally the income tax was expected to bear the chief burden. Under the new program an extra £1,000,000 was to be secured from the income tax alone, death duties were to be revised upward by £200,000, and an additional £1,300,000 was to be obtained from beer and petrol. The minimum rate under the income tax was pushed up to 2s. in the pound or 10 per cent, the exemption for a single man was forced down to £200, graduation was more steeply applied in the upper brackets, and the maximum rate of 8s. 7d. was reached at a lower level.²² As a concession to those entering military service, all pay and allowances earned in service were to be exempt, and employers were allowed to deduct from taxable incomes any allowances made to absent employees in active service.²³

As New Zealand approached the second year of participation in the war, it became apparent that even greater sacrifices would have to be demanded of the taxpayer. The government was apparently determined "to pay as we go for the war to the limit that is practicable." "The limit," the Finance Minister went on to say, "is fixed by the necessity already explained of keeping the economic system intact and functioning to capacity . . . It is, of course, sound in principle to restrict borrowing as far as possible to productive purposes and thereby avoid a rela-

²¹ *Finance Minister's Report*, 1936, p. 16.

²² *Finance Minister's Report* (Premier Savage for Walter Nash), 1939, p. 13.

²³ Statutes 1939, No. 34, pp. 464-465.

tively increasing burden of debt charges for the future." The able Finance Minister goes on to emphasize the necessity of avoiding expanding credit and inflation. "It is infinitely better for everybody that the measure of sacrifice required from each and everyone to carry on the war should be made out of current income either by way of taxation or saving. We must think in terms of goods and services and not in terms of money."²⁴

With this determination in mind the government began pushing up the income tax to the limit. The minimum rate was raised to 2s. 6d. on the first £100. The rate was then stepped up by 3d. for each £100 until a rate of 8s. was reached at a comparatively low level of £6,600. Mr. Nash spoke with apparent irony of the "consideration" shown large incomes when he pointed out that "the aggregate effect of income tax at unearned rates, social security charges, and national security taxes will in no case exceed 17s. 6d. in respect of any one pound of income." This is slightly less than 90 per cent!

Even with income and other taxes pushed to the limit, the government, facing rapidly mounting expenditures, was compelled to resort to borrowing on a large scale and came in October 1940 to compulsory loans assessed upon each person in proportion to income. The bonds which taxpayers were forced to buy bear no interest for a period of three years (estimated duration of the war) and thereafter at 2½ per cent. These bonds at the time the forced loan was decreed were worth but 79 per cent of face value, and the loan therefore represented an added income tax equal to 21 per cent of the bonds the taxpayers bought.

An important provision of any income-tax law is that which deals with accretions to capital or increase in value of property acquired and held during the income-tax period. The revised income-tax act of 1939 pays particular attention to "trading stock" and its treatment in income-tax returns. Trading stock is defined as "anything produced or manufactured and anything acquired or purchased for purposes of manufacture, sale or exchange and also includes livestock but does not include land."²⁵ As a basis for reckoning income the starting point is the value of the trading stock at the beginning of the year. In case trading stock has been acquired during the year, cost price is taken as the basis for reckoning from the beginning of the income period. The valuation placed on trading stock at the end of the year may be either cost, market price, or cost of replacement. When the value of the trading stock at the end of the year exceeds that at the beginning of the year, the excess

²⁴ *Finance Minister's Report* (Walter Nash), June 1940, p. 2.

²⁵ Statutes 1939, No. 34, pp. 473-474.

shall be included in assessable income for the period. If the value is less at the end of the year, the difference shall be allowed as a deduction in computing the net assessable income. If the trading stock is sold or disposed of during the year, the sales price is taken as an indication of value.²⁶

One of the most difficult problems in any system of income taxation concerns the treatment of gains and profits from buying and selling and the increase in value or appreciation of property. Where the increase in value is associated with land ownership or the possession of capital assets, it may be held that the increase represents an accretion to capital, not current income in the ordinary sense. On the other hand, it may be contended that it represents an increase in the net worth of the business which is in the larger sense a form of income. If, moreover, the gains derived from the purchase and sale of goods, chattels, and property be excluded from the definition of income, there would be no way of reaching the taxpaying ability of wholesalers, retailers, speculators, and middlemen in general. It is generally conceded that, if the increase in value, whether disclosed by a sale or not, takes place within the income period, it is properly regarded as gross income. If, however, accretions have taken place over a long period of time and are merely *revealed* by a sale during the year, the income which has taken a long time to accrue cannot properly be allocated for taxation to the year of the sale.

The complications of the questions affecting treatment of income arising from appreciation in the value of property make it inevitable that they will frequently call for administrative consideration and adjudication by the courts, no matter how carefully the definition of income may have been formulated by the legislature. Many New Zealand court opinions have a bearing on these questions. Space can be given to only a few typical decisions. The New Zealand law makes profit from the sale of property taxable, (1) if the business of the taxpayer or company involved specifically includes the buying or selling or dealing in property, or (2) if the property was acquired for the purpose of selling or otherwise disposing of it for a profit. It should be noted, in the first place, that *sale or disposal at a profit* is the first requisite to inclusion in gross income, and, in the second place, that the assets disposed of must have been acquired with an *intention* to sell at a higher figure and for the sake of gain. Now the intent of a taxpayer is most difficult to determine. He may buy property with the expectation that it will be used for production; but a subsequent rise in value or

²⁶ *Ibid.*, p. 474.

a fortunate opportunity may tempt him to sell. In case the government sets up the contention that the property was acquired with intent to sell, the burden of proof is then, according to law, thrown on the taxpayer.²⁷

It is interesting to an economist to note that the court, in deciding some of these cases, has set up a distinction that played such an important part in the economic thought of the classical school, namely, the difference between fixed and circulating capital. The court decisions have in some cases turned upon the question whether the property was held in possession to produce an income or made to produce an income by circulating through the hands of the owner. In the former case income is produced through possession, in the latter case by acquisition and disposition.²⁸

An early case, involving the sale of land at a profit, was one which concerned a company organized for a variety of functions such as conducting a steam ferry, acquiring land, developing recreation centers, conducting hotels and boarding houses, furnishing electricity, water, and gas. Among other powers conferred upon the company was the power to "buy and sell, lease and deal in land." The company in the course of time disposed of its ferry business and proceeded to subdivide and sell at a profit some of the land originally acquired and still in its possession. The commissioner of taxes demanded payment of income tax on profit arising from the sale of land. The court held that the business of buying and selling land had been specifically granted under the terms of the charter and that these operations, yielding a profit, constituted "dealing in land" under terms of the income-tax act and the gains arising therefrom were taxable.²⁹

The principle here established was reasserted in another case involving an association or syndicate which bought up a large tract of land and, under agreement entered into previously, subdivided and sold to a number of buyers. The court held that the fact that the profitable operations in land were carried on by an association and not a company was immaterial, and that the fact that the transaction involved a single purchase followed by a number of sales was likewise irrelevant "so long as the object was profit."³⁰

In order that the profit from the sale of land shall be taxable, however, dealing in land must be one of the major functions of the company

²⁷ On this point see Cunningham and Dowland, *Land and Income Tax Law*, pp. 183-184.

²⁸ *Ibid.*, pp. 186-187.

²⁹ *Wellington Steam Ferries Company v. Commissioner of Taxes*, 29 N.Z.L.R. 1028-1029.

³⁰ *Commissioner of Taxes v. Bolton and Others*, 30 N.Z.L.R. 1006.

or a definite intention of sale at a profit must be present at the time of the purchase. This principle was definitely established in the case of Marainanga Estates Co., Ltd., formed first as a partnership but later converted into a limited company. The primary purpose of the partnership and corporation had been to carry on the business of sheep farming. Not only was a large estate purchased but the company was given power to acquire other properties and to realize upon them wholly or in part. The steeply progressive land tax then in force threatened to make large land holdings unprofitable and the company in 1908 sold out its holdings at a marked advance over the cost of acquisition. The court refused to allow the collection of the tax on the ground that the company's main business was not dealing in land and that the profit derived from sale was not income from business. "The dominant object was the sheep farming business; other operations were incidental or auxiliary thereto."⁸¹ A similar case involving an admitted profit of £52,000 (\$252,000) was decided on the same grounds.⁸²

Next to land, sheep and livestock are among the most important forms of New Zealand property. The court has held that the sale of such livestock any time during the income period at a price in advance of value agreed upon at the beginning of the year represents a profit and a taxable form of income. In the first of these cases it was contended by the owner that he was not dealing in sheep, merely purchasing rams for breeding purposes, and that the increase in value revealed by his clearing sale was an accretion to capital, not income. "The flock in the present case," he argued, "is in the precise position of a producing plant." The court, on the other hand, identified livestock with circulating capital, holding that the sheep "are his [i.e., the sheep farmer's] *stock in trade* just as truly as is the merchandise of a shopkeeper." The court went on to say that it is a matter of no consequence "whether a taxpayer's stock in trade is sold all at once by way of a clearing sale, or otherwise, in connection with a transfer or a winding up of the business." Sheep owners had been permitted, with the concurrence of the commissioner, to fix a standard value on their livestock at the beginning of the income-tax period; any excess of sales price over the standard value represented a gain.⁸³

⁸¹ Marainanga Estates Co., Ltd. v. Commissioner of Taxes, 30 N.Z.L.R. 417.

⁸² Whiterock Estates Co., Ltd. v. Commissioner of Taxes, 30 N.Z.L.R. 405.

⁸³ Anson v. Commissioner of Taxes, 41 N.Z.L.R. 330; the same question was decided in Dalgety and Others v. Commissioner of Taxes, 31 N.Z.L.R. 260.

CHAPTER IV

PRACTICAL PROBLEMS OF INCOME TAXATION

NO MATTER how fully and carefully the allowable deductions are defined under an income-tax measure, disputes will arise and some of these are bound to reach the court for adjudication. In one New Zealand case the taxpaying company, a brewing concern, had spent more than £2,000 in combating a prohibition amendment that had been up for consideration, and insisted that sums spent were legitimate deductions. Their contention was that such outlays were necessary to insure "perpetuating the life of the company for a further period." The court denied the validity of this deduction on the ground that such expenditures, even though they might be on a sound commercial basis, were not properly regarded as an expense involved "in producing an income."¹

It appears that, because of a definite provision of the New Zealand law, a land tax paid by a farmer or sheep raiser is not deductible. Here a contrast may be drawn between New Zealand and Australian practice. In a case which came up in 1913 before the High Court of the Commonwealth government, it was held that the payment of the land tax was a necessary incident to the conduct of farming operations and was therefore chargeable to the cost of doing business.²

The terms of the income tax in the New Zealand statute, as well as in decisions of the court, make it clear that interest due and payable is a deductible item only when the "Commissioner is satisfied that it is payable on capital employed in the production of assessable income."³ As the court put it in this case, "It [i.e., interest] must go to the debit of the profit and loss account just as clearly as rent must or wages."

An expenditure made in defending a valuable patent right is not deductible, because it is not properly classed as a trade expense but rather an outlay "for keeping intact the capital of the company." "The motive involved was to retain the power to earn these additional profits."⁴

It will be recalled that for many years the owner and user of land was allowed to deduct 5 per cent on the unimproved value of his land

¹ Ward and Co., Ltd. v. Commissioner of Taxes, 40 N.Z.L.R. 934.

² Moffatt v. Webb, 16 C.L.R. 120; see also Cunningham and Dowland, *Land and Income Tax Law*, p. 248.

³ Cunningham and Dowland, p. 265; see also 12 N.Z.L.R. 521.

⁴ Commissioner of Taxes v. Ballinger and Co., Ltd., 23 N.Z.L.R. 188.

from his income before arriving at the net. In a case involving a timber company owning extensive tracts of reserve forests, it was held that the 5 per cent was deductible "only on that part of its forest lands used continuously in the process of cutting and storing the timber."⁵

The language of the law, the rulings of the tax department, and the decisions of the court make clear the conditions under which depreciation is an allowable deduction. Loss of value in premises, implements, utensils, or machinery, whether caused by fair wear or tear or due to obsolescence, is a deductible item *provided the properties in question are used in connection with the production of income*. One of the leading cases bearing on this point involved a claim for depreciation on a residence of a sheep station, left vacant and unused since the death of the former proprietor. The court rejected the claim for depreciation on the ground that the trustees in charge made no use of the vacant structures "in the ordinary course of sheep-farming operations."⁶

A curious anomaly existed in early New Zealand income-tax law regarding the practice of allowing for depletion of natural resources. The original act had included in the estimate of gross income the profit "from the extraction, removal, sale or treatment of *minerals, timber, or flax* whether by the owner of the land or by any other person, etc." Moreover, an express provision contained in Section 87 of the statute read as follows: "No deduction shall be made in respect to the following items . . . (c) investments of capital, expenditure of capital, loss of capital, etc." The question for allowance of depletion came up to the court in the case of *Taupo Totara Timber Company v. Commissioner of Taxes*.⁷ This concern, as well as the Kauri Timber Company jointly involved in the dispute, had acquired extensive tracts of timber which were being exploited and cut for sale on the market. They laid claim to deductions equal to the value of stumpage cut. The court took cognizance of the apparent inconsistency involved in existing provisions of the law which allowed the manufacturer to deduct the cost of his raw material and the merchant the cost of the stock acquired, while denying the timber owner the privilege of deducting the value of his own resources exhausted in the process of lumber manufacture. The court nevertheless maintained that, under the existing law, no such deduction was permissible. Prior to 1907 standing timber had been subject to the graduated land tax; but in that year timber was made exempt and, in view of the remission of the tax on standing timber, it was thought unnecessary to allow for depletion; the income tax should apply to the "gross proceeds."

⁵ *Commissioner of Taxes v. Kauri Timber Co., Ltd.*, 24 N.Z.L.R. 18 *et seq.*

⁶ *Hunter and Others v. Commissioner of Taxes*, 56 N.Z.L.R. 782.

⁷ 31 N.Z.L.R. 617 *et seq.*

The policy of New Zealand with regard to earned and unearned income has been fluctuating and at times uncertain. It will be recalled that the Royal Commission on Land and Income Tax in 1924 recommended the complete abandonment of the principle of differentiation. Two years before another commission had also agreed that the distinction between earned and unearned income was difficult to maintain, especially in the case of pensions and retirement allowances granted on the basis of lifelong service and in the case of incomes resulting from the investment of savings from wages, salaries, and professional earnings.⁸

Notwithstanding these protests, however, the New Zealand government has adhered rather consistently to a program of differentiation, which since 1930 has been accomplished by an added surtax of 33 1/3 per cent on unearned incomes. The increase in rates made necessary in the depression period of the thirties and more recently by the war has strengthened the case in favor of differentiation. Earned incomes are defined as "wages, salaries or allowances . . . including all sums received or receivable by way of bonus, gratuity, extra salary or emolument of any kind in respect to employment or service of the taxpayer." Earned income is also defined as "all other income derived from any source by a taxpayer by reason of personal exertion."⁹ In a recent case involving the payment of income by a trustee to a nonresident heir, such income being derived from investments in sawmills and other properties left by the decedent, the court held that the income was entirely unearned since the factor of personal exertion was not involved.¹⁰

Under the New Zealand act as elsewhere, the question of taxing corporations and the treatment of dividends and stock dividends under income-tax schedules have been a matter of long-standing controversy. The Commission on Taxation in 1922 took a strong stand against any kind of a tax on corporations and stood definitely in favor of laying the burden entirely on the individual. The commission very clearly indicated the injustice of a progressive tax as applied to a corporation, since small and large investors alike pay at the same rate, through a uniform reduction in the rate of dividends. Fearing that the abandonment of the corporation tax might prove impossible, it urged as an alternative the reduction of the rate to 5s. in the pound to encourage the investment of capital in New Zealand.¹¹

Notwithstanding objections, however, the New Zealand tax at a

⁸ *Report, Commission on Taxation, 1922*, p. 14.

⁹ *Public Acts of New Zealand*, vol. 7, p. 304.

¹⁰ *Stewart v. Commissioner of Taxes*, 58 N.Z.L.R. 154.

¹¹ *Report, Commission on Taxation, 1922*, p. 5.

steeply progressive rate continues to apply to corporations, and the individual is exempt on dividends from taxed corporations. This does not apply, of course, to dividends received from companies not taxable in the Dominion. Moreover, dividends are now reckoned as a part of total income, as other forms of exempt income are, for the determination of the rate which shall apply to individual taxpayers.¹²

Until recently, stock dividends or bonus shares were not taxable as income. Here the policy of New Zealand stood in sharp contrast to that of Australia. However, the New Zealand land and income-tax amendment act of 1939 specifically included in the scope of taxable income "all sums distributed in any manner or under any name to shareholders." Any valuable consideration distributed to shareholders without adequate compensation in money or its equivalent must be included in the taxpayer's estimate of gross income. Specific mention is made of "the value of any shares allotted by the company to any of its shareholders."¹³

DEATH DUTIES IN THE NEW ZEALAND SYSTEM

Death duties were early made a part of New Zealand's tax system, but down to 1920 they consisted of an estates tax only. The exemption was £500 and the scale of rates ranged from 1 per cent on the first £500 of taxable interest to 15 per cent on the largest amounts. The act of 1921 superimposed a succession tax on the estates tax, changed exemptions, and greatly increased the scale of progression. The rates under the act of 1921 ran upward to 20 per cent. In 1930 the maximum was lifted to 30 per cent on estates in excess of £100,000. The succession duty applies, in the case of surviving wife, only to the excess over £5,000, provided that the exemption shall not exceed the difference between the final balance of the estate and the sum of £10,000. Down to the year 1939 when certain wartime changes were made effective, life-insurance beneficiaries to the extent of £1,000 were not taxed.¹⁴

Under the succession duty the range of rates for direct heirs was not extreme. The tax began at 1½ per cent for surviving spouse on the minimum amount, and rose to 5 per cent on sums in excess of £20,000. For father, mother, brother, or sister the range was from 5 to 12 per cent. Several classes of heirs were recognized and the more distant heirs or strangers in blood took a rate ranging from 12 to 25 per cent on sums in excess of £20,000. A possible criticism of the New Zealand tax on successions lies in the fact that too many classes of heirs are recognized

¹² Cunningham and Dowland, *Land and Income Tax Law*, pp. 201-202.

¹³ Land and Income Tax Amendment Act, 1939, No. 34, p. 477.

¹⁴ *Year Book*, 1940, p. 589.

and rates are too definitely differentiated. This practice merely complicates the administration with no substantial gain in justice or equity to compensate. The exact relative claims of distant heirs cannot be distinguished with enough precision to require so many classes of beneficiaries. The tendency under American succession or inheritance taxes is toward simplification. More than three classes of heirs are seldom recognized.

The basis of the estates tax is rather broadly defined. The beneficial interest is made to include all property of the deceased situated in New Zealand except that held by him as trustee; the final balance must also take account of all property disposed of by gift made by deceased within three years of his death, and all gifts made *causa mortis*. All sums received by the beneficiary under terms of a life-insurance policy and property committed to a trust for the benefit of someone in lieu of a bequest are a part of the gross estate. From the gross amount represented by the sum of these items debts are deducted to arrive at the "final balance."¹⁵

To insure payment the administrator, executor, or trustee is held liable and is authorized to sell, lease, or mortgage property to obtain funds for payment of the tax. Penalties and interest begin to operate after a delay of three months. Duties are paid by means of stamps affixed to documents used in effecting the transfer. In case of landed estates the precise value of which is in doubt, the commissioner of taxes may ask the valuer general to appraise the properties involved and the decision of his department is final.¹⁶ A measure of reciprocity with foreign jurisdictions is provided for in the act. Duties paid upon the same properties in foreign countries are deducted from the amount due and payable in New Zealand, the first deduction being made from the estates duties and the residue, if there be any, from the succession taxes.¹⁷

A certain partiality is shown toward landed estates passing to Maori heirs under order made by the native land court. No estates duty is due upon such properties, but the beneficiary pays a uniform rate of 2 per cent in lieu of succession taxes that would be paid by a European heir or legatee.¹⁸ In event of death during military service or from wounds or disease contracted during period of enlistment, there is no tax on the estate. As an added concession the wife's share in the estate is exempt up to £5,000 in all cases.

¹⁵ Public Acts of New Zealand, vol. 7, p. 356.

¹⁶ *Ibid.*, p. 388.

¹⁷ *Ibid.*, p. 374.

¹⁸ *Ibid.*, p. 392.

New Zealand has attempted, like other countries with estates and succession taxes, to stop the gap by enacting a gift tax affecting any beneficial interest acquired in any other way except by will or bequest or devolution. Various types of conveyances are mentioned, such as creation of trusts, lease or mortgage with interest to diminish the value of donor's estate, and increase of the estate of another without adequate compensation.¹⁹

Just before the second World War the estates, succession, and gift taxes were producing a revenue of £1,817,000 annually. Considering the wide diffusion of property in New Zealand and the fewness of large estates that take the maximum rate, the yield is surprisingly great. Since the beginning of the war the estates tax has been called upon to assume an even larger burden. In September 1939, the scale of estates, succession, and gift taxes was increased by 20 per cent, the exemption to surviving widow was reduced from £5,000 to £3,000, and the exemption under the succession tax to a widow was reduced from £10,000 to a maximum of two-thirds of this amount. The former exemption of £1,000 of life insurance was now withdrawn.²⁰

EXCESS-PROFITS TAXES IN NEW ZEALAND

In the light of the war situation and the recent enactment of the American excess-profits tax, a word should be said about New Zealand's war-profits tax of 1916 and the revival of the same method in 1940. Treatment of this topic appropriately finds a place in the chapters on the income tax, for the original act of 1916 defined the new tax as "a duty by way of income tax." The abnormal or excess profit was defined as the "amount by which the assessable income of the taxpayer . . . exceeded his 'standard income'." Means of computing "standard income" was open to election by the taxpayer from a number of alternatives set down in the measure itself. It might be the average assessable income of any one or two of the previous three years (i.e., prior to March 31, 1914) or the average for the entire three-year period. Or again the taxpayer might assume a return of $7\frac{1}{2}$ per cent on capital invested in producing the income, plus an allowance fixed by the commissioner of taxes, but not exceeding £600, as compensation for services as manager. It will be noted here that, in the opinion of the New Zealand Parliament, $7\frac{1}{2}$ per cent was a fair return on investments and the maximum compensation for management should not exceed £600 (\$2,400).

¹⁹ *Ibid.*, pp. 376 et seq.

²⁰ *Finance Minister's Report* (Premier Savage for Walter Nash), 1939, p. 14.

The choice of the property-return basis naturally opened up the question of method for estimating capital invested. April 1, 1915 was taken as the date for determination of capital assets employed in producing the income, and from these tangible resources were deducted the liabilities incurred in producing the income. Land included in estimating assets was valued at the figure fixed by the Dominion Valuation Department. The commissioner was given a certain latitude in calculating the standard income of a new business venture with capital requirements below the normal. In such cases the "Commissioner may compute the standard income in such manner as, having regard to all the circumstances of the case, he deems just and reasonable."²¹

The excess profit calculated by subtracting the standard income from the assessable income of a given year was then subject to a uniform tax of 45 per cent, but no excess-profits tax was chargeable if the assessable income of the taxpayer was less than £300; and in any event the profits tax could not exceed the amount by which the assessable income rises above £300. The evident aim was to leave a margin of £300 free from encroachment.²²

The excess-profits tax was not very productive as a source of revenue, and we find the Treasurer complaining in 1917 that the revenue from this source fell far short of expectations. He went on to explain that conditions in New Zealand were quite different from those in the mother country, where the war-profits tax had proved so productive. Munitions manufacturing, ship building, and maritime enterprises had in England yielded much profit. In New Zealand primary industries producing food and raw material were favorably affected, but little remained to be taxed as excess profit without undesirable hardships and repression of enterprise.²³

Notwithstanding the disappointing results from the first experiment, an excess-profits tax was again enacted in 1940 to begin on April 1, 1941 and to run for each "subsequent year that commences not later than one year after the termination of the present war with Germany."²⁴ Provisions of the act resemble in most particulars the law of 1916, differing mainly in additional options the taxpayer may exercise in calculating his standard income. The option may include: (1) a fixed sum of £500; (2) the highest income of any of the three years prior to March 31, 1937 or the average of the three years plus 30 per cent, whichever is the less; or (3) a return of 6 per cent of the value

²¹ Statutes 1916, No. 7, p. 66.

²² *Ibid.*, p. 68.

²³ *Treasurer's Report*, 1917, p. xxiii.

²⁴ Statutes 1940, No. 36.

of assets used in producing the income, plus an allowance of £500 to £1,000 for personal exertion of the manager. With the exception of a slightly lower rate of return allowed on invested assets, the terms of the option are more favorable to the taxpayer than those of 1916.

The determination of the value of invested capital, in case the taxpayer elects to choose the third option, is left to the commissioner of taxation with the possibility of appeal to an Excess Profits Committee composed of three members appointed by the Governor General. Between two limits that may be widely separated, namely, the amount assessed by the commissioner and the amount admitted by the taxpayer, this committee is given wide discretion in fixing the actual payment on the basis of the estimated excess of taxpayer's income over "the amount which the taxpayer might reasonably expect to derive under peace-time conditions of trade and industry, having regard to the nature of the taxpayer's business or occupation to the special circumstances of the case and to all other relevant considerations." By giving a certain elasticity to the administration of the act, framers intended to remove one of the prime objections to excess-profits taxes, namely, the tendency to standardize methods of computation and apply them with Procrustean rigor without regard to circumstances.

The rate is somewhat higher than the 45 per cent tax of the first World War; but the 60 per cent rate of 1940 applies only to the residue remaining after the income taxes due and payable, and social-security and national-security taxes paid on the same basis, have been deducted. The simplicity of the New Zealand act of 1940 stands in sharp contrast to the recent excess-profits law of the United States.

CHAPTER V

THE LAND TAX—HISTORY, PROVISIONS

ONE feature of the New Zealand, as of the Australian tax system has attracted world-wide attention, namely, the taxation of unimproved value of land and the exemption of labor products. Because of its connection, real or supposed, with the single tax as advocated by Henry George, it has been the subject of intermittent attention on the part of economists ever since the inception of the movement. In a sense, New Zealand was not the originator of the land tax. The colonial land tax of New Zealand made its appearance in 1878, but had been antedated by one year in the Victoria land tax of 1877, the provisions of which were known to the New Zealand Parliament at the time the act of 1878 was under consideration. In the Parliamentary debates frequent reference was made to the Victoria act, for purposes of both comparison and contrast.

Notwithstanding the priority of the Australian legislation, however, the New Zealand act of 1878, although it was short-lived, exerted a far-reaching influence in land-value taxation, and became the model for later legislation in New Zealand and in Australia. What is more significant still, most of the arguments in favor of land-value taxation, both in New Zealand and elsewhere, found clear and forcible expression in the report of finance officers and in Parliamentary debates in connection with the experiment of 1878. A subject immensely interesting to economists, moreover, is that Mr. Ballance and his associates gave expression to all the essential elements in Henry George's *Progress and Poverty* which made its appearance at least a year later.¹ The great single taxer, destined in the course of time to make converts by the millions, was anticipated in most of his doctrine by New Zealand statesmen whose treatment of the subject was given full expression when the founder of the modern single-tax movement was an obscure newspaper reporter in San Francisco.

In the year 1878 Edward J. Wakefield in a little pamphlet, *The Taxes in New Zealand*, seriously arraigned the tariff system, then the chief source of revenue, and advocated the substitution of land and income taxes. In answer to the objection that the proposed plan would

¹ The manuscript of *Progress and Poverty* was finished in March 1879. Private printing took place sometime during the year. The Appleton edition appeared in 1880.

discourage enterprise and limit the field of employment, Wakefield replied that "the present holders would either make that improved use of the land which would enable them to pay the tax cheerfully or they would part with a portion of their vast estates at a reasonable rate to many smaller proprietors, who would employ more labor and derive a larger aggregate income from the land." He refers to holders of large estates as "land monopolists" playing the part of a "dog in the manger", keeping the land "in a state of pasturage," "calling for little employment of labor." These sound strangely familiar to one who has dipped into contemporary single-tax discussion in America. Although Wakefield had anticipated the single taxer in his stock arguments, his concrete proposal differed from that of the orthodox follower of Henry George. Instead he proposed a uniform acreage tax of 2s. 6d. (60 cents) an acre on land regardless of fertility or situation. The concept of land-value taxation seems to have escaped him altogether.²

Although, as we shall see presently, the arguments of Wakefield were pushed further and more elaborately stated in the Parliamentary debates of 1878, we must not overlook the fact that the fiscal device found additional support, apart from theoretical argument, in the movement, soon to culminate in success, to abolish the provinces and centralize governmental functions in the colonial departments. This unavoidably involved an increase in national expenditures and suggested the necessity for sources supplementary to the customs duties.³ As influences that paved the way for the land tax of 1878 in New Zealand we must also not overlook factors so strongly present in the early history of land taxes in Australia, namely, absentee landlordism, aggregations of large estates, the growing scarcity of land accessible in small holdings, and an ever-increasing hostility to the property tax for which the land tax was regarded as a substitute. Economic thinkers were appealed to to give "a moral halo to an insistent clamor for land and a revision of taxation."⁴

The Treasurer of the colony, Mr. Ballance, gave convincing expression to the economic philosophy of land-value taxation in his report of 1878. He referred to extensive programs of public works which had left New Zealand burdened with debt and cumbered with an annual interest charge. The value of all property, especially land, had been markedly increased by the extension of railways and means of communication, and by the growing population, helped on by assisted immi-

² Wakefield, *The Taxes in New Zealand*, pp. 38-39.

³ See *Treasurer's Report* (Major Atkinson for Vogel), 1875, pp. 15-16.

⁴ Greig, *Rural Land Taxation in New Zealand*, p. 15.

gration. "We believe that no form of wealth is more legitimately called upon to contribute a portion of the public revenues of the Colony than the *value of land minus improvements* which for brevity I call the *unimproved value* as no other commodity increases so rapidly in value from the increase of population and the natural progress of the country."⁶ Here one finds a clear conception of site value, as enhanced by public improvements and growing population, and definite appreciation of "socially created value."

Still more striking is the statement, so utterly Georgian in meaning and phraseology: "By exempting improvements we award a premium to industry and discourage a system of speculation which thrives on the labor of others." Referring to the Victoria system, which the reader will recall based its value on *sheep-carrying capacity*, Mr. Ballance says that this experiment, although "simple and easy of application," is open to serious objection since it does not recognize the "*position value* of urban and suburban property or sufficiently distinguish between the capacity of the holder of poor land and the holder of rich land to contribute the tax; between property in proximity to railways and roads and property isolated from arterial lines of communication."⁸

Here again is the familiar contention of the single taxer that a tax on improvements puts a penalty on industry; and here again is found a clear statement of situation and differential advantage as a factor affecting taxpaying ability. In the same passage, we find the conception of unearned increment ("increment of unimproved value") "which takes place between one period and another." The Victoria system is indicted because of its failure to reach this automatic increase in value due to nothing the landlord has done. Mr. Ballance calls for a tax which will take account of value due to "position and quality," "accessibility to market," "situation in towns and suburbs," "the productive capacity of soil and other natural advantages." He proposes to tax the "natural increase in wealth . . . due to general prosperity of the country apart from the enhanced value which labor gives to the land itself." Note the antithesis between socially created value and the value due to the industry of man.⁷ By exempting labor products Mr. Ballance contends that "a man making improvements will know that he is not at the same time swelling the exactions of the tax gatherer but that the reward of his industry is all his own."

In the Parliamentary debates that followed, Colonel Whitmore referred to "unearned increment" and cited examples of rapidly rising

⁶ *Treasurer's Report*, 1878, p. 15.

⁸ *Ibid.*, p. 15.

⁷ *Ibid.*, p. 16.

value of land in Wellington and Dunedin. "There is in the city of Dunedin," he said, "a half of a quarter acre which the other day was estimated to be worth £40,000 [\$194,400] without buildings. Now what have owners of that land done to bring about such an enormous increase in the value of the property?"⁸ He says further that "many owners have gone away and forgotten all about their land only to return and find that it had increased in value by thousands of pounds. It is not through any industry of theirs that it has acquired so great a value." He points to the injustice of taxing buildings and improvements which through industry and exertion have improved the district, attracted population, and enhanced the value of holdings in possession of absentee landlords.

Objections in the ensuing debate were aimed mostly at specific defects of the measure, such as the exemption of £500 of unimproved value. While admitting the necessity of exempting small incomes, Mr. Bonar⁹ contended that the majority of landowners with holdings of unimproved value below £500 were well able to "maintain their families and to bear taxation." Others pointed to the difficulty and expense of laying the tax on unimproved value when the local assessments had been made to include value of improvements. This would necessitate "a separate valuation of every property in the Colony."¹⁰ Curiously enough the opposition to the tax, mild as it was, stressed the fact so frequently urged in a new country against any change in the system of taxation, namely, interference with the enlistment of foreign capital and retarded development of industry.¹¹

Some attention should be given to the provisions of the 1878 measure although its existence was temporary. As indicated before, the measure strongly influenced the form of subsequent legislation in both New Zealand and Australia. Improvements, which were to be exempt, were elaborately defined as including houses and buildings, fencing, planting, draining of land, laying down in grass and pasture, and any other improvements the benefits of which are unexhausted at the time of valuation.¹² The tax was made to apply not only to freeholds but to interests in crown lands leased for occupancy from the colony or any public body. Native lands were specifically exempt. Exemptions also extended to lands used and occupied by public bodies, schools, churches, cemeteries, sites used for libraries, reserved for public gardens, domains, and recreation, and lands used as a location for a public charitable institution.

⁸ *Parliamentary Debates*, vol. 30, p. 719.

⁹ *Ibid.*, p. 721.

¹⁰ Gisborne in *Parliamentary Debates*, vol. 29, p. 13.

¹¹ Dr. Grace in *Parliamentary Debates*, vol. 25, p. 722.

¹² Statutes 1878, No. 18, p. 60.

Lands taxable to private individuals were allowed an exemption of £500 and the remainder of unimproved value was taxed at the modest uniform rate of a half penny in the pound (less than 2 mills). Although mention was made of the "bursting up process" in the *Parliamentary Debates*,¹³ it is difficult to understand how large holdings could be affected by a rate of 2 mills and a uniform rate at that on unimproved value only, with *all* improvements exempted.

On the side of administration the 1878 act provided for the appointment of a land-tax commissioner and for each district a deputy land-tax commissioner. Working under deputies was a force of valuers charged with the responsibility of ascertaining the value of all lands subject to taxation under the act "and the value of such lands without improvements." They were authorized to enter premises and ask any pertinent questions.¹⁴

In the light of the fact that the rate of taxation was so moderate and the measure calculated to yield only £100,000 for the entire colony, one finds it difficult to understand why opposition should develop. The explanation lies probably in the fact that the landlord class, who were not "menaced at once" by the measure, feared that it might be an entering wedge for something more formidable. The suffrage was also restricted largely to property owners and the influence of the landholding class was comparable to that of the plantation and slaveholding aristocracy in the Old South prior to the Civil War. At any rate, "a great outcry of opposition" arose. Within a year after the passage of the land tax, a new ministry came to power, the land tax was swept away, and a general property tax, not unlike the contemporary form in our American states, took its place.

However, by 1885 we find the criticism of the property tax finding forcible expression. Particularly, it was asserted that the property tax fell with unusual weight on the farming class. Not only was the land taxed but "machinery and agricultural improvements" shared the burden.¹⁵

The growing unpopularity of the property tax lent support to the movement for the reestablishment of the land tax; an intention to revive it was clearly discernible in the Treasurer's report of 1887. The adoption in 1890 of universal suffrage with property qualifications removed increased the political influence of the landless class.¹⁶ It is true that the Liberal party that came to power in 1890 derived its support very heavily from the small farmers. But even the small farmers shared the

¹³ Stout in *Parliamentary Debates*, vol. 29, p. 42.

¹⁴ Statutes 1878, No. 18, p. 62.

¹⁵ *Treasurer's Report*, 1886, p. 11.

¹⁶ Boswell, *Local Authority Rating in New Zealand*, p. 8.

hostility to large estates and were expecting the incoming ministry to do something to "break down the land monopoly."¹⁷ Frequent references are found in contemporary literature to "a soil in the grasp of speculators," "a people huddled in towns dependent on public works for subsistence," and land sales at speculative values "rather than its value for use."¹⁸

Another factor which gave rise to dissatisfaction and even alarm was the outward migration from New Zealand in the latter part of the decade 1880-1890. The population was sustained only by the excess of births over deaths. Although the migrations were due in some degree to the cessation of public works, the discovery of gold "in a neighboring colony," and the unusual prosperity of Victoria, it was explained in some quarters at least by the aggregation of large estates and the lack of accessible lands for intensive farming.¹⁹

In the light of these circumstances it is not at all surprising that Mr. Ballance, who had sponsored the act of 1878, and who was now in a position to reassert his convictions, should bring forward the tax on unimproved value in more drastic form, this time coupled with a progressive rate consciously designed to cause the subdivision of large estates. Although Ballance had anticipated Henry George in his arguments in the debates of 1878, we find him eagerly reinforcing his case for the land tax in 1891 by frequent references to the founder of the single-tax movement whose masterpiece was now well known and widely read in Australasia. In fact, in the Parliamentary debates attending the passage of the 1891 land tax, Ballance was taunted for his slavish adherence to the views of Henry George, "a man whose doctrine is that the individual possession of land is robbery." Mr. Ballance replied that he could not follow Henry George in some particulars, but he did "most implicitly follow his theory that the taxation of land should be on the unimproved value or economic value of the land. I go even further than he does, and I say that the state *should own all land*. I believe in the nationalization of land."²⁰ In fact the single tax in its unqualified form had some support even in surprising quarters. The Auckland Chamber of Commerce had adopted a resolution which was forwarded to Parliament, asking for the adoption of the single tax as advocated by Henry George. Sir George Fowlds, then president of the Auckland chamber, was an ardent disciple of Henry George and had apparently converted that body to the cause of single tax.²¹

¹⁷ John B. Condliffe, *New Zealand in the Making*, pp. 181-182.

¹⁸ *Treasurer's Report*, 1889, p. viii; *ibid.*, 1892, p. 18.

¹⁹ *Treasurer's Report*, 1889, p. x; G. M. Fowlds, *Land Value Taxation in New Zealand*, p. 3.

²⁰ *Parliamentary Debates*, vol. 73, pp. 351 and 373.

²¹ *Ibid.*, pp. 101 *et seq.*

The land tax under consideration was assailed on the ground that it was prompted by political motives and that "the apparent principle of the bill is to make a class tax. It is certainly intended to tax the few for the supposed benefit of the many. It has been said that the proper object of taxation is not to reduce inequalities of fortune but to provide for the requirements of the state. In this bill there is an attempt to reduce the inequalities of fortune, and there is a very uncertain attempt to provide for the requirements of the State."²² The same speaker pointed out that the progressive tax levied on sums in excess of £5,000 of unimproved value would reach but 272 persons in the colony. "Two hundred and seventy-two persons are selected as victims because they are reputed to be wealthy . . . and for the sake of getting at these people we are to submit to this monstrous system of taxation."²³ He was also convinced that the land tax, and the income tax conjoined with it, would drive out capital—New Zealand's chief need. If capital is discouraged, he insisted, capitalists will cease to employ labor. "Directly, therefore, you reduce capital, you reduce wages."²⁴ The influence of John Stuart Mill and his wages-fund theory are clearly discernible in this statement.

The land-tax measure of 1891 resembled in many particulars its forerunner of 1878. Besides its progressive feature, the chief difference lay in the fact that the act of 1891 did not exempt all improvements but only to the extent of £3,000. Mr. Ballance explained the decision to retain the tax on improvements in excess of £3,000, for the time being at least, on the ground that "the necessities of our finance require that we should do what we have done."²⁵

Definitions of actual value and of improvements contained in the act were almost identical with those of 1878. The list of exempt properties showed some variation in statement but little in substance.²⁶ The act also exempted any lands owned and occupied by natives. If, however, the property were in the hands of a trustee, and a native received an income therefrom, it was then assessable at one-half the rate chargeable to Europeans. It was further stipulated that the tax assessed on native lands should not exceed one-tenth of the total income received during the previous income year.²⁷ Lands purchased from the Crown on credit or deferred payments and leaseholds were taxable to the extent of the interest or equity involved. Mortgages were taxable to the mortgagee

²² Pharazyn in *Parliamentary Debates*, vol. 74, p. 3.

²³ *Ibid.*, p. 5.

²⁴ *Ibid.*, pp. 7-8.

²⁵ *Parliamentary Debates*, vol. 73, p. 100.

²⁶ Public Acts of New Zealand, vol. 7, p. 296.

²⁷ *Ibid.*, p. 298.

but were not subjected to the graduated rate that applied to the tax upon land. In the case of corporations owning land, each stockholder paid a proportional share of the tax, depending upon the number of shares held. In case the taxable interest of the individual so determined fell below the exemption limit, there was no tax to pay.²⁸

When the unimproved value of the holding did not exceed £1,500, a deduction of £500 was allowed. This abatement then diminished by £1 for every £2 of excess over £1,500 until the exemption disappeared altogether at £2,500. In case the income of the landowner did not exceed £300 and he was incapacitated from supplementing his earnings from other sources, the commissioner was authorized to allow a deduction not exceeding £2,500. In case of a widow with dependent children, the exemption might extend to £4,000.²⁹

The scale of rates provided in the original act was moderate. The uniform tax was one penny in the pound; the graduated tax began with a rate of one-eighth of a penny on the first bracket (£5,000 to £10,000) and rose by successive steps of one-eighth of a penny until the maximum of $1\frac{3}{4}d.$ in the pound was reached on values in excess of £210,000. In the case of an absentee owner there was a penalty tax of 20 per cent, soon increased to 50 per cent. An absentee was defined as one who had not been present in New Zealand for at least one-half of the time during the previous year.

The administration of the act was entrusted to the land-tax commissioner with a sufficient force of deputies to assist in assessment and collection. A board of review was provided to hear appeals with regard to assessments. A safeguard against unduly low assessments was provided in Section 30 of the original act of 1891. If the landowner insisted on a valuation too low and was unwilling to submit to a fair estimate by the commissioner, the Governor in Council was authorized "to purchase and take for Her Majesty any land or any interest therein . . . and may pay to the person or company making such returns and to whom the said property or the interest therein belongs, the sum at which such land is valued in such return *together with ten pounds for every one hundred pounds of such value.*" It's a poor rule that won't work both ways and Section 31 of the same act provided for a check against arbitrary assessment on the part of colonial authorities. If an owner believed his assessment too high he might challenge the commissioner to reduce to a figure set by the taxpayer or else purchase the property at the valuation set by assessment officers.

²⁸ *Ibid.*, p. 289.

²⁹ *Ibid.*, p. 286.

The New Zealand land tax has now been in continuous operation for a period of fifty years; naturally amendments have been made as changing conditions demanded. One of the first of these major changes was to extend exemption of improvements beyond the £3,000 provided for in the 1891 act, and to make such exemption universal. It will be recalled that Ballance had favored complete exemption from the outset, but had refrained for fiscal reasons only. In 1893 the Treasurer recommended that the change be made "to remove what supporters of the present system regard as a blemish." "The system," he said, "will be sounder and more scientifically correct when we cease to levy land tax on improvements."⁸⁰ He went on to say that the change would encourage large owners to make improvements with the double advantage of an increasing demand for labor and increasing productivity of land. To repair in part the loss of revenue from added exemptions, he proposed increasing the graduated rate of taxation on large holdings.

The fact most characteristic of the land tax was a tendency toward increasing rates as a means of accomplishing one of the avowed purposes of the act, namely, the breaking up of large estates. During the first World War rates, already high, were still further increased to meet the emergency demand. The increase was applicable to mortgages as well as unimproved value of land. The range of rates, which under the original act had been from 1*d.* to 7*d.* in the pound, was in 1917 raised by 50 per cent, the maximum being 10½*d.* in the pound. It should be recalled also that an added penalty tax of 50 per cent applied to holdings of absentee owners. The largest holdings, therefore, if owned by an absentee, would take a rate of nearly 16*d.* in the pound or 6 2/3 per cent. This would normally absorb the full rental value of land and, within this limited field of application, would approximate the program of the single taxer.

High rates resulting from the wartime impositions served to stir up criticism of the land tax in the period of postwar depression. The Royal Commission on Land and Income Taxation in 1924 called attention to the fact that the land tax was originally designed to break up large estates, and asserted that its influence in that direction was no longer needed, and that the land tax was preventing the development of large areas "requiring a considerable amount of capital expenditure to break in." The commission reached the conclusion that the graduated land tax "serves no good purpose." The Treasurer's report of 1931 also indicted the graduated land tax on the ground that it was "operating

⁸⁰ *Treasurer's Report*, 1893, p. 16.

with extreme hardship . . . both on rural and urban lands. It is not based on any principle of ability to pay."³¹

The coalition government that came to power in 1931 proceeded to abolish the graduated land tax "to assist farmers and also the recovery of trade and industry." The uniform rate of a penny in the pound was allowed to remain in force. An attempt was made to recoup in part the loss of revenue by repealing the deduction of 5 per cent of land value from taxable incomes derived from land ownership.³²

It was true that there was much hardship among the rural population, but it may be questioned whether the land tax imposed any special burden on the farming class. The commission appointed in 1930 to enquire into cases of hardship arising under the land tax asked for submission of evidence supporting requests for relief. In the majority of cases taxation in any form was not the aggravating factor but general depression in agriculture. Prices of wool and sheep were down while interest charges and operating costs remained high.³³ The commission did, however, recommend in several cases the remission or reduction of land taxes as relief measures.³⁴

In 1935 the Labor party came back into power and Walter Nash, Minister of Finance, at once recommended restoration of the graduated land tax. The point at which the graduated rate began to apply was £5,000 of unimproved values. Owners of encumbered properties were allowed to deduct the mortgage, which was separately taxed. Up to £5,000 of net unimproved value, the penny rate applied, and beyond that the rate was increased by 1/8000 part of a penny for every £1 of taxable value in excess of £5,000 until the maximum rate was 6*d.* or 2½ per cent on values in excess of £45,000. The aim lying back of the land tax at a progressive rate was to apply the "minimum taxation on the working farmer and home owner with increasing rates on abnormally large holdings and other areas held . . . for speculative profit instead of for use in production."³⁵ In the ensuing Parliamentary debates Nash declared the intention of the government to take by taxation the socially created values not due to labor or investment of capital—"an increase created by the Government will be taken by the Government."³⁶

As in the case of the Australian land taxes, the New Zealand system frequently gave rise to litigation; and judicial interpretations tended to

³¹ *Treasurer's Report*, Supp., Oct. 1931, p. 3.

³² *Ibid.*

³³ *Report of Commission to Enquire into Cases of Hardship, etc.*, 1930, p. 5.

³⁴ *Ibid.*, p. 6.

³⁵ *Finance Minister's Report*, 1936, p. 17.

³⁶ *Parliamentary Debates*, vol. 246, p. 627.

clarify the meaning of the act at certain cardinal points. As indicated in connection with the Commonwealth land tax, there was much uncertainty regarding the method of determining the unimproved value. It might be arrived at by a method of evaluation of real estate and subtraction of improvements, or the unimproved value might be separately and independently estimated. The valuer general's office has in the main apparently followed the latter method. The court, on the other hand, in the *Nightcaps Coal Company Case*³⁷ has apparently placed legal sanction on the method of subtraction, i.e., ascertain the unexhausted value of improvements and subtract from capital value.

American single taxers have leaned to the view that the franchise value of a public service corporation is a form of socially created value and should be taxed at the same rate as natural gifts. This view seems to have been taken by early court decisions in New Zealand; and the valuer general, relying on judicial precedents, assessed the franchise or right to lay gas mains in the street enjoyed by the Auckland Gas Company at the sum of £99,000. The court overruled the valuer general, holding that the right to lay mains in the streets is not a right to land but a right to the *use* of land. Until the right is exercised by the actual laying of mains, there is no value. The court apparently regarded the laying-down process as an *improvement*. "There is no unimproved land to value."³⁸

Many cases arose under the New Zealand land-tax act regarding the liability of a tenant or lessee to pay land taxes. It will be recalled that the language of the act intended to tax the tenants' interest (if the value were in excess of the rental paid) as if he were part owner. One of the most interesting cases bearing on this point was *Commissioner of Taxes v. Kauri Timber Company, Ltd.*³⁹ This milling company had acquired under terms of a lease the right to cut timber and remove the same from lands owned by a group of natives. The commissioner, assuming that the Kauri Timber Company was virtual owner of the land and that which gave it value, proceeded to assess its interest as unimproved value. Since the law very clearly indicated that the holder of a lease on valuable property shall be assessed "according to the value of the interest therein," the court held that the intention was to confine the incidence of the tax "to owners of or any leasehold estate in land."

In another case⁴⁰ the court held that a lease on property with an agreement to purchase at the expiration of the lease and at a stated sum

³⁷ 25 N.Z.L.R. 977.

³⁸ Valuer General v. Auckland Gas Co., Ltd., 42 N.Z.L.R. 194-195.

³⁹ 17 N.Z.L.R. 696 *et seq.*

⁴⁰ Yule v. Commissioner of Taxes, 37 N.Z.L.R. 890.

“made the lessee virtual owner of the premises for purposes of taxation even before the purchase price is paid and the transfer of title provided for.”

Since the New Zealand land tax from the outset levied penalty taxes on absentee owners, court decisions were necessary in doubtful cases to determine the precise residential status and resulting liability of title holders. In one case, an attempt had apparently been made to escape this special liability by having a large estate cared for by an agent in the absence of the owner. The agent was given full power of attorney, rendered annual statements to his principal, and complied with requirements of the tax department in making returns. The court held in this case⁴¹ that Curling, the principal and real owner, was unquestionably absent during the previous year, and the fact that the owner was represented by an agent with various duties to perform did not make the owner present. “The act contemplated *personal* absence [or presence] whatever his business arrangements.”

In another case⁴² an estate was jointly owned by four persons, two of whom were absent, the others *bona fide* residents of New Zealand. The commissioner had assessed the estate, divided into four equal shares, and added a 50 per cent tax on the two absent owners. The court sustained the action of the commissioner. The two nonresidents were clearly liable for their share of the tax normally chargeable to a New Zealand resident and an added burden of 50 per cent for absenteeism or foreign residence.

Questions were bound to arise regarding the liability of shareholders in what Americans would call a holding corporation, if the parent concern and subsidiaries all possess land. Under a graduated land tax with a steeply rising rate, the tax sustained by each shareholder will be greatly increased if all these separate holdings are lumped together and the rate determined by the combined value. The law had attempted to deal with the situation by providing for combined assessment in case two or more companies “consist substantially of the same shareholders” and by affixing the criterion that companies should be adjudged substantially the same if as much as half of the stock in one were held by the other. A test case, *Union Steamship Company of New Zealand, Ltd. v. Commissioner of Taxes*, clarified and fortified the provisions of the law and resulted in joint assessments for affiliated companies.⁴³

It was held, rather inconsistently with this principle, however, that

⁴¹ Andrew v. Crombie, 12 N.Z.L.R. 726.

⁴² McLean and Others v. Commissioner of Taxes, 31 N.Z.L.R. 469 *et seq.*

⁴³ 45 N.Z.L.R. 801.

a trustee for two estates, even when owned by the same person, could not be assessed on the combined value of the two to determine the rate under the graduated tax. Curiously enough, the court added as *obiter dictum* that, "if Mrs. Campbell were assessed as the 'owner' under the act of the two estates, she would have to pay graduated tax on the whole fee simple of both estates."⁴⁴

A decision of the court in one case⁴⁵ opened up the possibility of evasion through partition of large estates which continue in common use after separate ownership has been established. Four brothers were partners in a sheep business and tenants in common of an estate consisting of 27,731 acres. The lands were partitioned but with a definite understanding that the estate should continue to be used for a sheep run managed in common as before. The commissioner had assessed it as a unit with a considerable graduated tax to pay. The court overruled the commissioner on the ground that "the land had never been a part of partnership capital, and that from the date of the agreement to partition, notwithstanding the agreement to continue the partnership, the respondents were separate owners and should have been so assessed."

⁴⁴ 14 N.Z.L.R. 438.

⁴⁵ 26 N.Z.L.R. 961 *et seq.*

CHAPTER VI

PRACTICAL PROBLEMS OF LAND TAXATION—THE EVALUATION PROCESS

WE HAVE already seen how in Australia the sheer magnitude of problems in taxation of unimproved value placed exceptional emphasis on assessment organization and practice. It is not at all surprising, therefore, that in New Zealand, where the Dominion land tax has been in force for half a century, methods of land valuations have reached a high stage of perfection. The lesson of paramount importance to America that we may gather from New Zealand's experience is that efficiency and equity in assessment methods can be achieved only by centralized administration.

During the first few years of land-tax experience, assessments and valuations were made by officials of the tax department and the magnitude of the task was soon appreciated. Assessments for local purposes and for administration of the colonial property tax had been made on the basis of capital value; the new land-tax measure of 1891 imposed the responsibility of separating the value of improvements and the unimproved value of land. The 1892 report of the commissioner of taxation called attention to the magnitude of the task and referred to the fact that as many as 214 assessors were employed, some being occupied for as long as three months to complete the job. In all there were 208,459 separate valuations to be made. It would appear that the task was not systematically and accurately done. In all, 19,461 complaints from taxpayers were recorded, of which the commissioner was compelled to admit approximately one-half as valid.¹

It will be recalled, too, that the act of 1891 imposed an income tax at the same time the land tax was enacted. The resources of the department were apparently overwhelmed by the new problems thrust upon it; the commissioner reported in 1893 that the time of his staff had been so exclusively occupied with the assessment of land that it was not possible during the year 1892 to make a critical examination of income-tax returns. The growing demands upon the tax department and resulting criticism of its work paved the way for the creation in 1896 of a separate and independent Valuation Department. As it will appear later in this study, the year 1896 marked a new departure in local taxation. Rates which had hitherto been levied either on capital value or annual

¹ *Report of Commissioner of Taxation, 1892, p. 1.*

value might now, at the option of local communities, be levied upon unimproved value, based on assessments by the central agency. The government policy of disposing of remaining crown lands under long-time leases and the fixing of quit rents on the basis of value also necessitated a more accurate appraisal.

The Treasurer in his report of 1896 discussed the desirability of a separate Valuation Department, "the duties of which would be to value the lands for each of the lending departments of the government, the advances to settlers department and the land and income tax department, and these valuations would be open to the public on payment of a small fee, and to local authorities free of cost."² The department, as constituted, was highly centralized with the valuer general as responsible head, assisted by a force of district valuers who "shall be persons of reputed local knowledge of land values."

The aim at the outset was apparently to create a cooperative organization which should be "self-supporting" in the sense that it would make no demand upon the consolidated fund. It was expected that counties, boroughs, and local bodies using data supplied by the Valuation Department for local rating purposes would meet one-third of the cost. This part of the financial program met with an obstacle, since many of the localities still rate upon annual value and find estimates of capital and unimproved value of no service to them. Another one-third of the expense was to be borne by the Land and Income Tax Department, which makes largest use of official figures, and the remaining one-third by the Loan Department of the colonial government. Because localities rating on annual value made no contribution to the expense of the Valuation Department and political pressure was exerted in the direction of reducing the contribution of other departments, a considerable share of the expense is actually borne by the general fund.

The present valuer general, Bill Stewart, strongly favors a central organization to make valuations for a variety of purposes. This avoids duplication of effort and secures satisfactory results with the minimum of expense. Some people, it is true, favor different valuations for different purposes. The valuer general contends, and rightly, that one valuation made with sufficient care can serve a variety of purposes. Starting from standard valuations, any modifications can be made that seem to be required by special circumstances.³

The valuations made under direction of the department ascertain the value of land, value of improvements, and combined capital value.

² *Treasurer's Report*, 1896, p. xix.

³ Interviews with Bill Stewart supplied much of the information contained in these sections.

The land must be carefully described as to location boundaries, physical features, nature of soil, and total area, the improvements must be itemized in detail, and the combined value computed. The return must indicate the person in active charge of properties whether trustee, owner, occupier, tenant, etc.

As a starting point for the work of valuation an annual statement is required of the taxpayer on a form prescribed by the commissioner, setting forth a "complete statement of all land in respect whereof he is assessable for land tax as owned by him at noon on the first day of March in the preceding year."⁴ As an index of capital or selling value, land transfers are extensively used by the Valuation Department. The New Zealand law, both as a general policy and as a basis for assessing transfer taxes, requires a statement of the true consideration as a condition of a valid title. Moreover, in all transfers of title to real property, a definite record is made with the register of land titles in the appropriate district. The valuer has these figures regularly reported to him as a basis for estimating the selling value of the property. They are generally considered trustworthy as a guide. In some cases, it is true, livestock are sold with the land and the new owner in stating the consideration may seek to manipulate the division between chattels and land and underrate the value of the latter. Such cases are, however, closely watched by the district valuer.

Valuers are required also to make frequent inspections of properties and by conference with owners ascertain information regarding land, condition of soil, physical features, available water supply, and results of agricultural enterprises as indications of earning power.

Sales data and supplementary information obtained by interview and conference may serve as a guide to selling value; but the more difficult part of the problem is to ascertain the value of hidden or disappearing improvements. Since Dominion land taxes rest entirely on unimproved value and since many local bodies now use the same data as a basis for assessing rates, it is of prime importance that the dividing line be properly drawn between the bounty of nature on the one hand and the industry of man on the other. Herein consists the most difficult problem of the Valuation Department. Improvements in land tend to vanish from sight, to be merged in and become an indistinguishable part of the soil. "Drainage, permanent grassing, subsoiling, prolonged treatment with lime and fertilizers may all vastly improve productivity and yet be largely disregarded in arriving at the value of improvements."⁵

The law requires that any such investments, the value of which has

⁴ Public Acts of New Zealand, vol. 7, p. 275.

⁵ Greig, *Rural Land Taxation in New Zealand*, p. 28.

not yet been exhausted and which still continues to influence the productivity of the land, shall be classified as an improvement. When improvements are of many years' standing, an accurate estimate of their influence on present value of land is obviously not easy. The bill submitted to Parliament in 1891 had at the outset a provision calculated to obviate a part of this difficulty. It provided that "no deduction shall be allowed for such improvements or such part thereof as shall have been made or effected more than ten years prior to the date at which the assessment is made." An objection was at once raised that clearing, drainage, etc. produce effects that are not exhausted in ten years and continue to influence favorably the value of land for an indefinite period. Evidently Parliament was unwilling to set a limit of time at which the statute of limitations would run on improvements, and the Valuation Department must do the best it can in estimating the present value of hidden improvements, even those of ancient origin.

It is precisely at this point that the New Zealand Valuation Department is most subject to criticism. One gets the impression from interviewing owners of land, especially of large estates, that the valuers make meager allowance for clearing, stumping, underground drainage, and repeated applications of fertilizers such as superphosphates so freely used to improve grazing lands. Failure to recognize these invisible improvements and allow for them leaves too large a share of capital value ascribed to the bounty of nature, too little to the industry of man. The Valuation of Land Commission of 1915 found that comparatively few complaints were recorded on the ground that the estimate of *capital* value was too high. Objections usually took the form that an inadequate allowance was made for improvements. Under the Dominion land taxes and in communities rating on unimproved value, allowance for improvements, of course, measures the taxpayer's degree of exemption; in the interest of equity, the value of improvements should be accurately made.

Many persons interviewed on the North Island complained that the nature of the country in its original state as compared with certain parts of the South Island had been responsible for a steady discrimination against North Island owners when compared with lands of the same productivity, say, on the Canterbury plains or central Otago. In the last-mentioned sections the land was originally prairie, presenting few obstacles to cultivation or pasturage. Except for buildings, fences, and visible structures easily allowed for, there were no other improvements of consequence. On the North Island, however, the settler was confronted with dense forests, underbrush, blackberry briars, gorse, and Scotch broom which had to be removed before the land could yield to

cultivation or the establishment of pastures. The tendency of the Valuation Department was to place two pieces of property of the same productivity and selling value on the same footing, and to overlook the hidden expenditures on North Island property necessary to bring it to a par with South Island properties of the same earning power.

It must not be inferred that all the complaints concerned agricultural or rural lands and the failure to allow for disappearing investments in the soil. The Valuation of Land Commission of 1915 found frequent complaints referring to suburban lands which had been subdivided for residence purposes, but of which only a few lots in extensive tracts had been sold and occupied. The remainder was used for agriculture or truck farming, but appeared on valuation rolls as city property with an unduly high estimate placed on its value.⁶ The commission also recorded the protest that "mixed properties" were frequently assessed at a rate too high. A few business structures interspersed in residence sections caused surrounding or adjacent lots to be assessed according to supposed potentialities for business use.

One of the complaints most frequently voiced against the Valuation Department is that inequities arise because of infrequent valuations which fail to keep pace with sweeping changes in relative values in the interval between revisions of the rolls. The original act required triennial valuations. But, generally speaking, comprehensive revisions are made by sections or districts and at irregular intervals. In progressive and rapidly developing communities the revision of the rolls are made more frequently; but in more backward communities a general revision of values may not be made for a dozen or even fifteen years. While a statistical publication of the department⁷ shows that valuations in the main have been recently revised—in 111 out of 139 local communities since 1930—the same source reveals the fact that general revisions in 28 of the districts have not been made since 1930, and that three of them date back to 1898.

One suspects that the tendency of the department is to economize and to avoid fresh controversies over revised values. Once values have been settled and adjudicated, the disposition is to allow them to stand until there is some compelling reason to undertake a general revision. It should be noted that the term "general revision" has been used in referring to assessment practices. It must not be inferred that no changes have been made in individual valuations in districts where no comprehensive revaluation has been undertaken for a long time. The rolls are in constant revision as sales transactions, regularly reported to the

⁶ *Report of Value of Land Commission*, p. ix.

⁷ *Valuation Statistics*, 1939.

Valuation Department, reveal significant changes in selling value. Moreover, at the request of other departments served by the valuer general, up-to-date appraisals are made on special order and become a matter of record. This piecemeal revision of the rolls may, of course, result in inequalities as between different properties. In rapidly growing communities properties sold on an advancing market are revised upward, while others experiencing the same rise are left untouched because no sales transaction has disclosed the increase. Furthermore, the varying frequency of general revisions has unquestionably resulted in inequities between different districts. These valuations are "of greatly divergent ages, some . . . made in a slump, and others in a boom with consequent inequitable treatment of different taxpayers."⁸

Since complaints are frequently lodged against the work of the department, it is pertinent to enquire what provision has been made for individual review and revision. A taxpayer, dissatisfied with his assessment, makes an appeal first to the valuers in his own district. If the complaint seems valid, either wholly or in part, adjustments are usually made and the appeal goes no further. In the early history of the land tax appeals were numerous; but, with more scientific techniques and trained and experienced valuers, the volume has markedly declined. The chief assistant in the valuer general's office cited a district in which 3,000 revised valuations were made with only 15 appeals. This is exactly one-half of one per cent. Evidently assessments had been accepted in 99½ per cent of all valuations.

If the taxpayer fails to get satisfaction from the district valuer he may, within fourteen days following the notice of assessment, appeal the case to an assessment court. This body consists of three members, one of which must be a barrister or solicitor of the Supreme Court. He is appointed by the Governor in Council who also names a second member; the third member is named by the local authorities where the case is pending and where the rolls are under revision. If objections of the taxpayer are sustained by the assessment court, valuations are revised to conform. Decisions of the assessment court are final except where questions of law are involved, in which case appeal may be taken either by the taxpayer or the commissioner to the Supreme Court, where the series of appeals comes to an end.⁹

Scattered through the whole history of land taxation in New Zealand are complaints against the unsympathetic attitude of the assessment courts. The Valuation of Land Committee of 1915 heard complaints

⁸ Greig, *Rural Land Taxation in New Zealand*, p. 29; see also *Parliamentary Debates*, vol. 252, p. 314.

⁹ Public Acts of New Zealand, vol. 7, p. 1038.

throughout the Dominion that taxpayers refrained from presenting claims they considered valid, having learned by experience that such a course was useless. Chief criticism was aimed at the composition of the court. Taxpayers believed, rightly or wrongly, that members of the courts, owing their appointment to the Governor General and the local authorities, were subconsciously influenced by the desire to maintain values on which taxes are levied. There was an "unconscious bias" in favor of supporting interests of authorities appointing them.¹⁰

Similar views were strongly expressed in the Parliamentary debates attending passage of the consolidated land-tax act in 1925.¹¹ The fact was stressed that assessment courts, as composed, lacked representation of taxpayers and as a consequence possible appellants had lost confidence. "So sick are the landowners of these assessment courts that, rather than bother their heads and go to the trouble of attending, they submit to valuations that are made. They know it is a waste of time and money appearing before the court." Many taxpayers held that both valuers and assessment courts were inclined to assign too much of total worth to unimproved value as distinguished from improvements.

The Valuation of Land Committee recommended that the courts be reconstructed with a permanent president for the Dominion as a whole and that the government should name an assessor, an expert on property appraisals, as a second member. The third, instead of being chosen by the local authorities, would be named by the rate payers. The president would represent the whole Dominion and therefore insure uniformity, and would hold the "balance of power as between the two assessors appointed by the government and the rate payers respectively."¹² The committee also recommended that in all cases the taxpayer should have the right to be represented by a barrister or solicitor, or by a regularly designated person with authority to act. "Every reasonable facility should be given to property owners in the matter of presenting their case to the assessment court."¹³

Another subject against which complaints were frequently leveled was the provision already referred to that the government, as a check on valuations unduly low, may, if the taxpayer objects to a fair valuation, purchase the property at the owner's valuation plus 10 per cent. The taxpayer's refusal to sell at the department's valuation is usually accepted as a confession that the figure is not unduly high; but owners

¹⁰ *Report, Valuation of Land Committee, 1915, p. iv.*

¹¹ *Parliamentary Debates, vol. 208, p. 661.*

¹² *Report, Valuation of Land Committee, 1915, p. v.*

¹³ *Ibid., p. vii.*

may often refuse to sell at a fair market valuation because the place has been for a long time the family home and a sentimental interest exists to which it is difficult to assign a pecuniary value. This factitious value is not properly a basis for assessment and taxation. The property should be assessed at the commercial value, not at the figure at which the owner is prepared to sell.¹⁴

In like manner the objection is raised that it is unfair to require the owner to sell at his valuation. The injustice in taxation at which he complains is often not the fact that the estimate of *capital* value is too high, but that the valuer general has assigned too much of the total to unimproved value, too little to improvements. The 1915 committee made a constructive suggestion on this point, namely, that an objecting taxpayer be required to state not only the *capital* value but his own estimate of *unimproved* value and *improvements* and then challenge the government to buy at *his* estimate of unimproved value—the value of improvements, following government purchase, to be determined by arbitration.¹⁵ There are some who minimize the importance of government purchase as a check on underassessment. In the early history of land taxation and in the postwar period of soldier settlement, the government was eager to acquire additional land and it was considered dangerous on the part of taxpayers to tempt the authorities by insisting on low valuations. In recent years, particularly in depression times of the thirties, the government has, on account of failing finances, virtually ceased to purchase landed properties and the threat of forced sale at taxpayer's own appraisal is nominal rather than real.¹⁶

Under the land-tax act of 1878 one assessment only was made, in which unimproved value was roughly distinguished from improvements. Just how much reliance can be placed upon these figures it is difficult to say. Later data are fairly reliable as indices of relative values of improvements and land. In 1878 the "bounty of nature," "the original and indestructible qualities of the soil," the gift-of-nature factor represented 62.6 per cent of the total value of real estate. In 1891, when the second land tax became effective, the total capital value was £122,225,000 and unimproved value £75,832,000 or 62 per cent. By 1911 capital value had grown to £293,117,000 and unimproved valuation to £184,062,000 or 63 per cent of the total. The approximate identity of these percentage figures representing unimproved value at widely separated dates is notable. Even by 1930 there had been no sweeping change in proportion between unimproved value and total selling value of real

¹⁴ *Ibid.*

¹⁵ *Ibid.*, p. xvi.

¹⁶ On this point see Condliffe, *New Zealand in the Making*, p. 245.

estate, the former representing 58.2 per cent of the total. Between the years 1930 and 1932 total values showed a slight but inconsiderable decrease. However, improvements had now grown to 56.6 per cent of the total capital value, and unimproved value declined to 43.4. Unimproved value had not only declined relatively but absolutely from £338,887,000 in 1930 to £282,806,000 in 1939. In New Zealand, where data on unimproved value are perhaps more reliable than anywhere in the world, the trends do not support the oft-repeated claim of the single taxers that land values rise with the progress of economic society, and that land rents absorb an increasing share of the social income.

CHAPTER VII

AN ECONOMIC APPRAISAL OF THE NEW ZEALAND LAND TAX

ACCORDING to many students of New Zealand's economy, it was land speculation and the evils associated therewith that gave major support to the tax on unimproved value, particularly in its graduated form. New Zealanders, like most pioneering peoples, had a highly developed gambling instinct. "They have perhaps the greatest relative development of horse racing in the world, and statistics of 'investments' on the totalizer are regarded as one of the most reliable indices of economic activity."¹ Speculation in stocks (in reality a form of gambling for most participants) was not carried so far in New Zealand as in the neighboring colonies of Australia. Assumption of risk was most manifest in the field of land speculation. Speculative buying of land, which was held idle for indefinite periods of time, naturally attracted attention and called for remedial legislation.

In response to a widespread demand for something to check land speculation, compel subdivision of large properties, and induce closer settlement, the graduated land tax became a part of New Zealand's general land policy. The tax was studiously designed to place the principal burden on large holdings. The rate of one penny in the pound on holdings barely above the £500 exemption limit was the equivalent of a 4-mill tax, a burden so mild and modest that nothing much could be expected in the way of economic consequences. Precisely because the tax fell so lightly on small holdings, it is said to have encouraged dairying and more intensive forms of agriculture as compared with sheep raising, which required the use of more land. It is a curious fact that, at the time the land tax was under consideration in 1891, it was argued that the graduated tax would overburden the "small and struggling" farmer. A speaker referred to contemporary political upheavals in America caused by the fall in farm prices, the increasing burden of the McKinley tariff, and the growing dissatisfaction of the agricultural class, and expressed the hope that New Zealand might avoid a similar "revolution."² The plea for the "cockatoos" seems badly misplaced when we recall that it has been a consistent policy from the outset to

¹ Greig, *Rural Land Taxation in New Zealand*, pp. 120 *et seq.*

² McLean in Council, *Parliamentary Debates*, vol. 74, p. 3.

exempt £500 of unimproved value from land taxes altogether, and to tax holdings barely in excess of that at one penny in the pound. At one time as many as four-fifths of the land owners were entirely exempt from taxation under the land tax.

It was of course during hard times that the farmers complained most loudly against the land tax—as they would against any form of taxation. Many were losing thousands of pounds yearly on large-scale farm enterprises, and the annual tax on unimproved value went on regardless of shrinking incomes. In such times taxes based on “capacity of the individual to pay” and “according to income” are turned to as the only “just and equitable forms of taxation.”³

The graduated feature of the land tax was avowedly chosen as a means of breaking up large holdings and paving the way for a more intensive use of the land. There were those who questioned the efficacy of this device even from the outset. Sir J. Hall, speaking in opposition to the 1891 land tax, said: “I do not think it will burst up estates. Not that the owners of estates are not willing that they be burst up but because there is not in the Colony the material to burst them up—there is not the money to buy them.”⁴ Careful students of New Zealand’s system find it difficult to estimate the effect of the graduated land tax on the size of holdings; but the generally accepted view is that, for the first fifteen years in the history of the land tax, there is little evidence that it was responsible for splitting up large estates and the promotion of closer settlement. During this period, and even until the sharp increase in rates in 1917, the graduation was too modest to matter much and there were numerous devices frequently employed for evasion. After 1907, when legislation had forestalled customary means of evasion, the movement toward subdivision went on rather rapidly but it is most difficult to estimate the separate influence of several factors operating in the same direction, of which the progressive land tax was only one.⁵

In a country of increasing population, large families, and gavelkind inheritance, the natural tendency is to subdivide vast holdings in order to accommodate increasing numbers in the rural districts. This same tendency was helped on in New Zealand by the deliberate policy of the government to acquire large estates, subdivide, and sell for actual settlement. Partly because of these causes, partly because of fictitious transfers for the sake of evading the land tax, the number of large holdings in New Zealand declined rapidly. Collusive sales and leases, nominal

³ Downie Stewart in *Parliamentary Debates*, vol. 230, p. 229.

⁴ *Parliamentary Debates*, vol. 73, p. 350.

⁵ Condliffe, *New Zealand in the Making*, pp. 243, 244, and 249; Rodwell, *Agricultural Organization in New Zealand*, p. 215.

gifts, and subdivisions among members of the family were resorted to with increasing frequency until remedial legislation in 1907 put an end to many such practices.

A case of collusive sale and leases, referred to frequently in the literature of the time, concerns a landlord with £50,000 worth of unimproved value who divided and "sold" to each of five shepherds in his employ £10,000 of land value. Each of the "buyers" paid down £5 and gave back to the original owner a mortgage for the remainder of the purchase price, i.e., £9,995. The land thus became the nominal property of the shepherds, subject to a mortgage that offset the value of land and left it tax free. The shepherds then leased back to the original owner their separate tracts of land and the enterprise went on as usual under the same auspices.*

Nominal gifts and subdivisions among members of the family accomplished the same purpose. The legislation of 1907 by several provisions sought to put an end to familiar methods of evasion. Henceforth, tenants were to be assessed as owners. Shareholders in a corporation owning land were to be assessed in proportion to their holdings of corporate shares. No transfer of property was to be considered valid as long as original possession and use of the land remained undisturbed. An estate in process of settlement was taxed as a unit to the trustee. Mortgagees in possession of mortgaged lands in process of foreclosure were to be liable as owners. The registration of mortgages was made compulsory for purposes of taxation.

With these changes in the law, a new impetus was given to subdivision and evidence of subsequent years seems to point to the steady trend toward smaller holdings. In March 1910 there were 171 owners with freehold estates whose individual holdings reached 10,000 acres or more. A total of 3,509,000 acres were included in this class. "An examination of the assessments of these same owners on the 31st of March, 1912 . . . showed that no less an area than 811,202 acres have been disposed of during that period." Details are lacking for the year 1913 but the Treasurer reported that "from present indications, I think, I am warranted in saying that the process of subdivision has been of late considerably accelerated."† In 1903 there had been five holdings in excess of 100,000 acres; by 1911 all holdings in excess of 100,000 acres had disappeared. During the same period holdings over 10,000 acres had been reduced from 216 to 171. Allowance must be made for the fact that during the period 1907-1911 the Minister of Lands, under

* Greig, *Rural Land Taxation in New Zealand*, p. 38.

† *Treasurer's Report*, 1913, p. xviii.

authority conferred upon him, had purchased for closer settlement an area equal to 266,872 acres.⁸

The graduated land tax, with the continual threat of an increasing rate on large holdings, facilitated the purchase operations of the government. The willingness of large land owners to part with their holdings was also helped on by the drastic increase in rates imposed under the war revenue acts of 1917. In fact, in the years immediately following the war, we hear complaints from various sources that the land tax has accomplished its purpose and that the graduated feature, at least, should be abandoned. Instead of fostering development as originally intended, it has the opposite effect. The commissioner of taxation said in 1922: "A great deal of our hill land in New Zealand can not produce more by close settlement; in fact, it often produces less in that way at increased cost to the country for roading, etc."⁹ The commissioner favored the ultimate abandonment of the graduated land tax in favor of a flat rate. "The graduated income tax," he said, "provides a sufficient surcharge on the largeholder."

The same view was supported by the chief valuer in an interview with the writer at his Wellington office. He pointed out that, in some parts of New Zealand, especially the South Island, there are large sheep stations carrying as many as 40,000 sheep. The land they occupy should not be further subdivided, for the present size of holdings is most economical. This is particularly true where upland range lying next to the mountains is combined with flat land for cultivation and production of forage for winter feeding. Where large holdings of this kind have been reduced by alienating the bottom lands, the upland pastures have fallen into disuse. In his opinion also, urban and suburban lands are too much subdivided through the combined effect of the Dominion land tax and the local rating on unimproved value, a policy made possible by the legislation of 1896 and now widely used by local bodies.

An opinion strikingly similar to this view was expressed by Mr. Coates¹⁰ when he called attention to the "murderous" effects of the graduated tax when unimproved value reaches £45,000 or more. He knew of "hundreds of thousands of acres that had been put out of useful occupation by sheep owing to the imposition of the graduated land tax . . . Country of that kind is only fit for [sheep] runs." Here we find the argument against the progressive land tax hinging on the principle that it is undesirable to regulate the size of holdings either directly or by the exercise of the taxing power. The Royal Commission

⁸ *Treasurer's Report*, 1911, p. xxi.

⁹ *Report, Commissioner of Taxation*, 1922, p. 12.

¹⁰ *Parliamentary Debates*, vol. 246, p. 342.

on Land and Income Tax in 1924 reached the conclusion that "the weight of evidence was against both land tax and graduated land tax and in favor of abandoning both and substituting the graduated income tax."¹¹

One criticism of the tax on unimproved value concerns application of the measure to land in seaboard cities that has been created by building sea walls, dredging, and filling what were formerly useless tide flats. In this way harbor facilities were deepened and improved, and land adjacent thereto took on considerable value. Since such land was created in Wellington, Auckland, and Dunedin by the industry of man, owners contended that there was no *unimproved* value and the whole of it should be classed as *improvements*. On the other hand, the valuer general's office, while not ignoring the factor of improvements, insisted that the value of the converted tide flats had been greatly increased by the sheer growth of the city and was therefore a form of socially created value. To admit that such land should be assessed at present at the capital value (all represented by labor cost) which it had at the time it was made available would demand that, in the interest of equity, all land in the city should be valued at a figure corresponding to its worth at the time when these sea walls were constructed. Although the enterprise and labor of particular individuals created the land at the outset, society had greatly enhanced its value through the construction of public improvements and provision for markets and cultural advantages.

A problem of valuation which presented the precise antithesis of converted tide flats or made lands in seaboard cities was presented by the uplifting of some 5,000 acres of land from the bay by the earthquake at Napier in 1931. This land, adjacent to the city, when subjected to drainage and treatment (neither involving considerable expense) proved to be valuable asparagus and garden lands. Here was a case involving a "gift of nature" and the whole of the original value was properly regarded as assessable under the terms of the act.

Scattered throughout the discussion of New Zealand's land tax one finds many references to an economic consideration frequently urged by opponents of the single tax in America. The government in its eagerness to reach and appropriate the *unearned increment* may overlook the fact that there is often in land an undeserved decrement. As indicated elsewhere, the unimproved value of land in New Zealand fell from £338,887,000 in 1930 to £282,806,000 in 1939. Greig, reviewing the trend in unimproved value between 1925 and 1935 and finding a decline of £46,000,000, raises the question: "Is it legitimate to assume from

¹¹ *Report, Royal Commission on Land and Income Tax, 1924, p. 3.*

this that we have reached the limit of rural expansion and that decrements rather than increments will continue?"¹² The same question was raised in insistent form in a debate on the land tax in 1878. "If the state takes the rise in the value of property not due to the effort of the individual proprietor, then, on the other hand, the state must reimburse the individual for a fall in the value over which he has no control." The speaker went on to cite instances of such fall in value in several parts of the colony.¹³

In connection with the debate over restoration of the graduated land tax in 1936, Mr. Hamilton raised the question of decrease in value and challenged Mr. Nash, Finance Minister, to make known his policy with regard to it. The Finance Minister replied that the decline was a temporary phenomenon and that he was satisfied that in the long run "the land values of the country can not decline. They must go up. They have gone up about £100,000,000 in the last twenty or thirty years. They declined approximately £18,000,000 during the depression but I am certain they will go up very much more than that during the next ten years."¹⁴ The discussion in this precise form seems more or less irrelevant when a land tax of the New Zealand type is under consideration. Although questions concerning the unearned increment and its appropriation by society repeatedly thrust themselves into reports and Parliamentary debates, the New Zealand system never remotely resembled an increment tax. The tax was upon unimproved value, not the *increase* in unimproved value taking place between purchase and sale. Had an increment tax of the German type been under consideration, questions of this kind would have been pertinent to the issue involved.

Discussion of the single tax in America has frequently raised the question of possible effect of a shift from a property tax to a tax on unimproved value as affecting relative burdens of urban and rural communities.¹⁵ Figures bearing on the distribution of unimproved value between urban and rural sections in New Zealand, where the distinction between the two is more carefully drawn than anywhere in the world, may throw some light on the possible effect of such a shift, were the program made effective in American states now using the property tax.

In the early history of New Zealand's experiment, assessment data showed a great preponderance of unimproved value in rural districts. In 1903, for example, country lands accounted for approximately

¹² Greig, *Rural Land Taxation in New Zealand*, p. 87.

¹³ *Parliamentary Debates*, vol. 14, p. 18; see also Kelly in *Parliamentary Debates*, vol. 19, pp. 17-18.

¹⁴ *Parliamentary Debates*, vol. 246, p. 627.

¹⁵ See E. R. A. Seligman, *Essays in Taxation*, 9th ed., pp. 86-97.

£50,000,000 of unimproved value while the corresponding figure for urban lands was only £21,000,000.¹⁶ Figures referring to the year 1913 show in a striking way that the burden of the graduated land tax fell more heavily on the country districts, where large estates were common and the value of these aggregations placed them in the upper brackets. For the fiscal year 1912-13 rural lands paid £180,000 of graduated land tax while urban lands contributed but £71,000.¹⁷ Even as late as 1922 the country districts were still contributing a slightly higher portion of the land tax than urban communities, although the difference was beginning to narrow. In that year seven-sixteenths of the land tax was paid by towns and nine-sixteenths by country districts.¹⁸ The commissioner deplored the fact that the burden rested so heavily on the large pastoral estates and said that it was "practically impossible under the present graduated system of taxation to carry on farming and pastoral operations in a large way." "The resulting depression of agriculture," he remarked, "was especially unfortunate at a time when heavy interest charges on foreign-held bonds must be met by export of agricultural produce."

In recent years the rapid growth of cities and the trend toward manufacture, industry, and commerce have caused the proportion of unimproved value to shift markedly in the direction of city lands; and the burden of the land tax now falls more heavily on urban communities in proportion to unimproved value. Condliffe estimates that in recent years farming and allied pursuits have paid 8s. 6d. on every £100 of unimproved value, while manufacture and industry have paid 10s. 5d., banking has paid 52s. 5d., and commerce and trading have paid 14s. 6d. If these figures are to be trusted, it is apparent that the burden of the land tax is sustained very heavily by urban and suburban lands and industries. As Condliffe puts it: "It [i.e., the land tax] has in fact intercepted for the state some portion of the unearned increment and as an instrument for so doing it is sound public finance."¹⁹

Recent statistical reports have apparently not attempted to supply the ratio between unimproved and capital values in urban and country districts, respectively. Inferences may be drawn, however, from figures that are available. The latest available figure (1938) for the Dominion as a whole shows a total capital value of £636,362,000 of which £282,326,000 is represented by unimproved value, or 44.5 per cent of the total.²⁰ If similar figures are taken for the four large cities of New Zea-

¹⁶ *Report, Commissioner of Taxation*, 1903, p. 3.

¹⁷ *Report, Commissioner of Taxation*, 1913.

¹⁸ *Report, Commissioner of Taxation*, 1922, p. 11.

¹⁹ Condliffe, *New Zealand in the Making*, p. 248.

²⁰ *Year Book*, 1940, p. 672.

land, Auckland, Wellington, Christchurch and Dunedin, it is found that unimproved value in Auckland represents 45.2 per cent of capital value, in Wellington 40.6 per cent, in Christchurch 40 per cent, and in Dunedin 31.4 per cent. The average ratio of unimproved value to total value of real estate for the four cities is 40.6 per cent.²¹ It will be seen from these figures that the proportion of unimproved value is considerably lower in the large cities than for the country as a whole. Auckland approaches the Dominion average.

Percentage data on total value and unimproved value by counties and by boroughs, respectively, seem to point to the same conclusion. In New Zealand counties, which are predominantly rural,²² is found 51.2 per cent of all capital value of land for the Dominion and 60.3 per cent of the unimproved value. In boroughs, predominantly or exclusively urban, the percentages are 48.8 per cent of capital value and 39.7 per cent of unimproved value. It will be noted that the figure for unimproved value in country districts runs far above that for capital value while the opposite is true in urban areas. By combining figures here given with the total capital value and unimproved value for the Dominion, one reaches the conclusion that in counties 53.3 per cent of real-estate value is unimproved, while in boroughs unimproved values fall to 36.1 per cent.²³

It would appear that unimproved value represents a markedly higher proportion of total value in rural areas than in cities. If the same general ratio obtains in America, a shift from a property-tax basis to a tax on unimproved value would increase the relative burden on the farming class.

In a sense, Condliffe's conclusion that city industries in New Zealand are more heavily burdened by the land tax than farming industry is undoubtedly true. Although figures for 1930 show²⁴ that rural properties paid £700,000 in land taxes while urban lands and business sites paid only £440,000, the *ratio* of these taxes to unimproved value on which they were assessed runs very much higher in the city than in country districts. Unimproved value in the cities paid at the rate of .66 per cent while the corresponding rate on rural lands was only .42 per cent. The explanation seems to be that *value* rather than *size* of holdings determines the bracket to which a piece of land belongs and the corresponding rate under the scale of graduation. More of the city properties rise

²¹ *Ibid.*, pp. 675-676.

²² It must not be assumed that counties are entirely rural; but under New Zealand's organization of local government they are much more so than in America where large cities either *are* counties or included in county areas.

²³ *Year Book*, 1940, p. 673.

²⁴ *Year Book*, 1932, p. 651.

into the upper brackets and are therefore taxed at the higher rate.

The New Zealand experiment in land-value taxation has been hailed by advocates in America as an application of single-tax principles, the benefits of which have been entirely manifest. The impression received from official documents and interviews with New Zealand taxpayers, however, leads one to question the statement that the effects have been wholly beneficial. The truer conclusion is that both advocates and critics of the single tax are inclined to exaggerate the effects of the tax on unimproved value on the economic life and development of the Dominion.

In the first place, it must be kept in mind that the land tax has never been, and is not now, a major source of revenue for the national government. In the next chapter it will be shown that in approximately one-half of the local communities the rating on unimproved value is in force and that in these communities chief reliance is placed on this form of taxation. It is true also that in the early history of the land tax it often produced as much as 10 to 12 per cent of total tax revenues. Increasing demand for revenue, however, and the development of other sources, such as stamp taxes, sales taxes, and an income tax increasingly more progressive, have led to a decline in the relative importance of land-tax revenues. For the fiscal year ending in 1939 the land tax produced a revenue of £1,058,000 out of an aggregate tax revenue of £37,764,000, or 2.8 per cent of the total. When other sources are relied upon to the extent of 97.2 per cent, the land tax can scarcely be regarded as "single."

It should be noted that the New Zealand land tax is more productive than the Commonwealth tax in Australia. An attempt was made in 1922 to estimate the relative per capita burden of land taxes in Australia (Commonwealth and state included) and in New Zealand. The figure for Australia was 11s. 8d. and for New Zealand £1 5s. or more than twice as much.²⁶ The reader will recall that the exemption under the Commonwealth land tax is £5,000 and only larger estates are reached and taxed. New Zealand's land tax begins from a much lower level, with an exemption of £500 and diminishing abatements between £1,500 and £2,500 of unimproved value. But in neither country does the land tax assume enough importance in a fiscal way to give it any special significance.

The New Zealand system seems to have been more consciously aimed at large holdings than the Australian tax, and the graduation of rate has been throughout its history somewhat steeper than in

²⁶ *Report, Commissioner of Taxation, 1922, p. 11.*

Australia. Even at the peak period at the end of the first World War, however, the New Zealand rate with surtaxes and penalties added never reached a figure above $6 \frac{2}{3}$ per cent of unimproved value; and this fair estimate of economic rent was collected only on the very large holdings owned by absentees. Neither from the standpoint of revenue contribution or share of economic rent taken does the New Zealand land tax qualify as a single-tax measure. Disciples of Henry George in New Zealand have been critical of these features of the New Zealand system, the graduation of the rate with its moderate tax on small holdings and the exemption of all properties with an unimproved value under £500. The consistent follower of Henry George would leave no economic rent untouched by the tax, even in the smallest holdings. Where, as in Oregon, "single tax, limited," has been submitted to popular referendum with an exemption feature attached, the concession to small property owners has been influenced by considerations of political expediency.

Rodwell states very well the final verdict on the New Zealand experiment: "The graduated land tax may perhaps be fairly summed up by saying that it hindered the growth of land aggregations; contributed in an unassessable degree to the breakup of large estates while avoiding, through its exemptions, all tax obstacles to the development of small farms. As a revenue device it has little importance."²⁶ To this may be added a quotation from Greig: "Neither as a fiscal tax nor as a social weapon has the New Zealand land tax been particularly successful, but that element of failure robs it in no wise of its fascination."²⁷

²⁶ Rodwell, *Agricultural Organization in New Zealand*, p. 219.

²⁷ Greig, *Rural Land Taxation in New Zealand*, p. 136.

CHAPTER VIII

LOCAL RATING IN NEW ZEALAND

THIS study has, up to this point, been primarily concerned with dominion systems, with only incidental references to local taxation. In the consideration of the Australian tariff system it became necessary, however, to trace the history of customs duties in force in several states as a means of understanding the uniform customs act of 1901. In the treatment, too, of the Australian land tax it was found desirable to relate the history of state systems in force before 1910 and the economic philosophy that lay back of them. Because of the intimate connection between the New Zealand land tax and the system of local rating on unimproved value, it seems desirable to devote a chapter to local rates in the Dominion.

The system of rating on unimproved value, made optional with local bodies under the colonial act of 1896, approaches more clearly in theory and practice to the single-tax program than does the Dominion land tax. As indicated already, the adoption of rating on unimproved value is optional with ratepayers in the locality; unless this system is specifically authorized by vote of the property owners, one of two traditional systems continues in effect, namely, rating on annual value or on capital value.

The latter of these two systems does not differ materially from our American property tax, which has degenerated or evolved into a tax on real estate. The former system, based on income or rental value of real estate, presents some features of novel interest to American students of taxation. Although rating on annual value is common in all British countries, it is practically unknown in the United States.

It should be noted at the outset that local taxes in New Zealand are far less important than in America. As explained elsewhere, the government of New Zealand is much more highly centralized than is the case in American commonwealths. Local governments in the United States raise by taxation almost exactly three times as much as the states, and approximately the same amount as the national government before the program of national defense compelled sweeping increases in federal taxes. In contrast, New Zealand local governments in 1937 collected £6,624,000 by taxation, or about one-fifth as much as was gathered in for Dominion purposes.

Local governments rely almost entirely on rates levied on real estate to meet all obligations. Three classes of local rates are recognized, depending on the purpose for which the expenditure is made. There are general rates for the discharge of ordinary and traditional functions, special rates for the construction of public works, and special rates for the payment of public debts. As stated above, these rates, whether general or special, may be levied on one of three bases: (1) on capital value, (2) on annual value, or, where the community by a vote of rate-payers exercises the option, (3) on unimproved value. In rare cases, especially in country districts, acreage may be the basis of the levy; special rates levied for rabbit control are often on the basis of number of sheep or cattle owned.¹

Annual value is calculated as letting or leasing value less 20 per cent in the case of houses and perishable property (evidently an allowance for insurance and depreciation) and less 10 per cent in the case of land. In no case, as the law specifies, is the annual rateable value to be less than 5 per cent of the value in fee simple.

It must not be assumed that all *revenues* in New Zealand communities are from taxes. Licenses and permits of various kind supplement regular taxes to some extent; and more than £3,000,000 annually accrues as earnings from commercial enterprises, examples of which are electric lighting and power, tramways and busses, and gas works. Waterworks, although publicly owned, do not contribute to commercial revenues, since the cost of water service is assessed on real estate in the form of rates.²

Counties and boroughs are the principal rating authorities; but, as in America, various districts are formed for rating purposes to defray expenses of specialized service. There are electric-utility districts, drainage districts, flood-control districts, and rabbit districts to control the spread of rabbit pests. Local authorities may adopt any basis for rating without submitting to a referendum, except where a change to rating on unimproved value is contemplated. In this case a petition from ratepayers, followed by an election, is necessary. In case the locality levies its local taxes on capital or on unimproved value, the assessment rolls are made up, not by local authorities, but in the central office of the valuer general. It will be recalled that local bodies were expected to contribute to the expense of the Valuation Department and in return were entitled to receive assessment rolls complete and ready for use. Valuations on individual properties are revised in response to informa-

¹ *Year Book*, 1940, p. 656.

² *Ibid.*, p. 660.

tion received, transfer data, or first-hand estimates made by valuers in the field. These revised estimates are segregated according to the district to which property belongs, and at the appropriate time the revised rolls are forwarded to local authorities.

At this point a contrast should be drawn between assessment practices in American states and those of New Zealand. In America where the state governments still rely on property taxes for a part of their necessary revenues, assessments are, with few exceptions, made up by local elective officers subject only to general supervision of central authorities such as the tax commissions. This practice lacks uniformity. And assessors, subjected to varying degrees of pressure, underassess property at widely different percentages of true cash value. Even with the best efforts at equalization, a general levy by the state may involve inequalities between minor subdivisions. In New Zealand the whole process is highly centralized.

Valuation rolls received by local officials are placed in some convenient place and are open to inspection by the taxpayer, who may examine, study, and transcribe any portion. Taxpayers who are displeased or aggrieved by assessments may file objections in writing on a form provided for this purpose, and may bring their cases before the assessment court, the composition and powers of which have been described in a previous chapter. The court has power to correct any value in the rolls "which it is proved to the satisfaction of the court ought to be altered, inserted or erased as the case may be." The decision of the assessment court as to facts of the case is final and not subject to appeal.³

If the community chooses to rate on annual value, the basis of assessment is not supplied from the Valuation Department or from any Dominion authority. Local councils or boards choose their own valuers; estimates of annual value may be made yearly or once every three years at the option of the locality.⁴ If the rental figures are too low, the local authorities are permitted to choose as an alternative base 5 per cent of capital value. With the increasing popularity of rating on unimproved value and the availability of assessment rolls from the central office, one is surprised to find so many local bodies that still cling to rating on annual value, which requires separate and independent action in preparing the rolls. However, the system unquestionably has some advantages, if rentals are carefully estimated and checked for all accessible data. Annual value represents at least an approximation to ability to

³ Public Acts of New Zealand, vol. 7, pp. 988 *et seq.*

⁴ *Ibid.*, p. 982.

pay and has the advantage of being a nonshiftable tax, while rates levied on capital value, including improvements, are shifted in part at least to consumers of goods and services.⁵

In the early history of local rating the law specified exemption for native lands owned by Maoris. This exemption was a constant source of criticism. It was pointed out in 1880 that 11,000,000 acres of land were owned by 41,300 Maori men, women, and children, and "not one half-penny in the way of rates has been imposed upon the natives . . . for the construction of roads and bridges . . . by which their lands are being enormously increased in value . . . The whole Maori property, too, is exempt from taxation under the [colonial] property assessment act."⁶ The report went on to say that the time had arrived "that all Maori property in boroughs shall be subject to taxation to the same extent as property of their fellow citizens." The step was not taken at once, but at present Maori property is subject to rating in the same way as property of Europeans. Only customary lands, burial grounds, and five-acre tracts for native meeting houses are exempt.⁷

A peculiarity of the rating system of New Zealand is a provision for remission or refund in part of rates in case a dwelling house or other building has remained vacant and unoccupied at least six months during the year. In such cases the owner is required to pay only one-half of the annual rates or, in case payment has already been made, a corresponding refund is made to the owner. Curiously enough, the court has held that the provision for remission of one-half of the annual rates applies in case rating is upon unimproved value. In a case that came up from Northcote Borough, the local authority contended that only in the case of rating on annual value or capital value was the property unoccupied for half a year entitled to partial remission of rates. Under both systems income is the basis of the levy and absence of income entitles the owner to consideration. Rating on unimproved value is in the nature of a land tax and not an income tax in any sense of the term. The intention is to levy on site value alone; buildings and improvements are specifically ruled out of consideration, hence the question of occupancy or vacancy is irrelevant. The court held that the law providing for reduction of rates on unoccupied property antedated the act authorizing a change in rating base to unimproved value and, in the absence of repeal or amendment, it applied, "no matter what the system or basis of rating might be."⁸

⁵ See Boswell, *Local Authority Rating in New Zealand* (a thesis), p. 40.

⁶ *Treasurer's Report*, 1880, p. 8.

⁷ Boswell, *Local Authority Rating in New Zealand*, p. 26.

⁸ *Northcote Borough Council v. Buchanan*, 49 N.Z.L.R. 798.

This case set New Zealand practice in local rating violently in conflict with the accepted views of Henry George and his followers with regard to the treatment of unimproved properties. Such properties, they have always assumed, would be taxed at the same rate as improved and occupied properties utilizing land of equivalent area and situation. Only by imposing a stiff tax on unoccupied lands can the proper incentive be supplied to improve the land and furnish employment to labor. Apparently no amendatory legislation has been passed since the decision in the *Northcote Case*. The principle laid down by the court was allowed to stand, and the practice is still to grant a half rate on property unoccupied for six months or more, even when the basis of rating has been shifted to unimproved value.

Conditions of occupancy, according to the court, may consist in the residence of a caretaker in a dwelling even though no rent is paid by the occupant. The words "vacant and unoccupied" are to be taken in the ordinary sense of the term; when a caretaker resides in a house which is for the time being his home, "the house is neither vacant nor unoccupied and such premises are liable to the payment of the tax at the full annual rate."⁹

Although local rates in New Zealand are very moderate, the general rating act has given rise to a great mass of litigation. New Zealand law reports are crowded with decisions interpreting and applying provisions of the rating act. Many of these court cases concern the eligibility of properties devoted to certain uses for exemption from local rate charges under the terms of the law. The New Zealand rating act carries the customary exemption for religious, charitable, and educational institutions, but places the emphasis rather heavily on the *use or purpose* to which the property is put and not the mere fact of ownership or right to receive the income.

A building in the city of Dunedin was used largely for commercial purposes but one floor in four was used exclusively for church purposes by a religious sect called the "Brethren". The court held that the law exempted *land* used for church purposes, not the *building*, and that the land is a "part of the material forming the surface of the earth." The building and land occupied was not used solely for church or chapel and it could not therefore be exempt.¹⁰

In another case¹¹ it was held that a separate lot occupied by a Sunday

⁹ *Brewer v. Papatoetoe Town Board*, 53 N.Z.L.R. 774.

¹⁰ *Perpetual Trustees Estate and Agency Co. of New Zealand, Ltd. v. Mayor of Dunedin*, 34 N.Z.L.R. 877.

¹¹ *Invercargill Borough v. Deacons Court of St. Paul's Presbyterian Church*, 43 N.Z.L.R. 207.

school conducted in connection with the church was not exempt under provisions of the rating act that referred to "land occupied by a church or chapel." "An important part of the work of Christian churches is done in Sunday schools but that does not make a Sunday school building a church building."

To entitle the property to exemption the use for church or chapel must be continuous, and when such occupancy ceases the property becomes rateable. This is the principle established in a case involving a church building so badly damaged by fire that the congregation gave up hopes of resuming worship on the premises and advertised the property for sale as suitable for "auction mart or garage." The court held that after the fire the building was "not a church but the ruins of a church" and "had lost its sacerdotal character and the land and buildings were in the defendant's hands as a property for sale." As a building not used for church purposes the premises were subject to rates.¹²

A hospital for the aged, supported in part by surrender of property and assignment of pensions made by inmates who enter the institution, is not entitled to exemption. Since those entering the home gave up money or assigned pension rights as a condition of entrance, it was not a public hospital; and, since inmates were contributing to their own expense, the place could not be termed a charitable institution.¹³

The assumption that active use for purposes enunciated and not mere ownership makes property eligible for exemption runs through numerous decisions affecting the ownership and use of school properties. Only a few of the leading cases can be referred to in this chapter. The Southland Boys' and Girls' High School in Invercargill had been granted endowment funds for purposes of education; and out of the income from this endowment the board had acquired certain lands which were, prior to 1927, improved and used as sports grounds, but since that time had not been used as sports grounds or for any other purpose. The school admitted that the grounds were not used for educational purposes, but set up a claim for exemption because the circumstances surrounding acquisition indicated that the lands were held by the board by or on behalf of the Crown, and were therefore exempt from local rates. While the court admitted that lands used in the service of the Crown or for the discharge of public functions should be exempt, the Southland board was "not by its origin or history so closely associated with the Crown that it might be regarded as an *emanation* from the Crown as in England are the great departments of state." More-

¹² Thames Borough Council v. Congregational Church Trustees, 48 N.Z.L.R. 525.

¹³ The Bay Town Board v. Verndon and Others, 32 N.Z.L.R. 613 *et seq.*

over, the board was not created for the purpose of dealing with and controlling crown property. "It may be said that the Board was created for public purposes but not . . . for governmental purposes." Since the board's primary purpose was that of conducting a school, any property not in active use in connection with its educational program was liable for local rates.¹⁴

Exemption does not extend to property used as an endowment and connected in slight degree with an educational program. This principle was clearly asserted in connection with a case involving a Mormon school for the instruction of Maori boys, ostensibly in agriculture, for the institution bore the name of an agricultural college. The school had been established with an American contribution of \$100,000 and the deficit in operation was made up from contributions from the Mormon church in America. Tuition of £16 a year was charged but "prepayment was not insisted on and, owing to the notorious difficulty of getting money from a Maori, a good deal is lost." Instruction was given mainly in the cultural branches and, despite the name of the college, little attention was given to systematic work in agriculture. The school claimed exemption on an extensive farm property as a part of the school plant. "In this case," said the court, "the farm is more like an endowment for the school than an adjunct to it. There must be some more intimate connection between the farm and school to justify exemption."¹⁵

On the other hand, a large tract of land (680 acres) used for instruction in agriculture by a Methodist training school was held exempt. In this instance the court found that there was extensive instruction in agriculture, gardening, orchard work, beekeeping, poultry management, dairying, breeding of stock, and the whole of the area was in the nature of a laboratory for the teaching of agricultural subjects. Since one of the principal activities of the school was instruction in agriculture and the farm was a necessary adjunct thereto, the board could properly claim exemption from rates.¹⁶

The court, moreover, insists on deciding what constitutes education and makes an institution a school in the sense in which the term is used in the rating act. This attitude was clearly indicated in the case affecting St. Johns College, which was "founded for the education of candidates for the holy orders." Although instruction was given in Latin and Greek and there was tutorial work in English, the bulk of the instruction was in the Old Testament, church history, dogmatics, pastoral work, etc. Some students attended classes at Auckland College but

¹⁴ Southland Boys' and Girls' High School Board v. Invercargill City Corporation, 50 N.Z.L.R. 881.

¹⁵ Hawkes Bay County v. Welch 38, N.Z.L.R. 474.

¹⁶ Franklin County v. Wesley Training College Board, 45 N.Z.L.R. 515 *et seq.*

practically all were candidates for holy orders. The college, in supporting its claim for exemption, quoted from an American definition of a school as "a place where systematic instruction in useful branches of learning is given by methods common to schools and institutions of learning," and went on to claim that the "College [St. Johns] conforms to this definition; the subjects taught are useful branches of learning." The judge held, however, that "school" refers to a general educational program in contrast with institutions for special purposes. "The school contemplated by this act is a general educational institution in which teaching in secular subjects is regularly conducted . . . The scope of the curriculum [in St. Johns College] is clearly particular and not general." The property was not entitled to exemption.¹⁷

It has been established in two cases that, if properties are used in connection with the educational program, even as dormitories, the physical separation of the property from the campus will not invalidate the claim for exemption.¹⁸ In *Riccarton Borough v. Canterbury College* the property purchased by the defendant college, and used for an hostel where 43 out of 439 of the students enrolled in the institution resided, was somewhat removed from the regular campus, in fact in an adjacent borough. In both cases students resident in the dormitories were under the supervision of a member of the staff who exercised discipline, regulated conduct, and enforced study habits and attendance at church services. The court held in both cases that the land occupied by the dormitory and hostel was a part of the college plant and entitled to exemption.

Even a large tract held for use in teaching ordinary subjects or for recreation, gardening, cow pastures, playgrounds, etc. may be exempt from local rates if the property is actually used for teaching and auxiliary operations.¹⁹

One of the most interesting cases involved the joint or alternative use of premises for church purposes and for a school which was carried on for gain or profit. The property was originally a dwelling house intended for a vicarage but was later dedicated as a chapel where services were held on Sundays. On week days the building was let gratuitously for a school. The court held that exemption did not apply; the school was carried on for pecuniary gain and the property could not be exempt as a church because it was not used exclusively for that purpose.²⁰

¹⁷ *Auckland City Corporation v. St. Johns College Trust Board*, 54 N.Z.L.R. 934.

¹⁸ *Christchurch v. Canterbury College*, 38 N.Z.L.R. 663; *Riccarton Borough v. Canterbury College*, 39 N.Z.L.R. 657.

¹⁹ *Rameura Road Board v. Smith and Others*, 32 N.Z.L.R. 895.

²⁰ *Mayor, etc. of Miramar v. Devoy and Others*, 34 N.Z.L.R. 1072.

It appears from this case that in England provision has been made for exempting *part* of a building used for church purposes and taxing the remainder. No such provision has been made in New Zealand law, however, and the court pointed out that it would be difficult to do under a system of rating on unimproved value.

A New Zealand case of special interest to American students of taxation involved the question whether a franchise held by a gas company was property subject to rating by local authorities. The court held that the company's right to place its mains and pipes under streets of a city, being one of a permanent nature, is a tenement and a hereditament vested in the company, and is therefore rateable property.²¹ This decision is in line with the terms of the Ford special-franchise tax law enacted by New York state in 1899. By the terms of this act the right to lay mains and pipes in the public streets was designated as a form of real estate. It may be remarked in passing that the taxation of franchises is a matter of relatively slightly importance in New Zealand because of the prevalence of public ownership. It will be recalled that in a later decision²² the court refused to admit these franchise values to assessment under the land tax, holding that the right to lay mains in the streets is not a right to land but a right to the *use* of land.

When, in 1896, the colonial Parliament passed the law making it optional for local bodies by a vote of the ratepayers to adopt rating on unimproved value, the single-tax issue was injected into the debate, as in case of the land-tax measure in 1891. It was said to be a case of applying single-tax principles to municipal taxation. The speaker challenged the Premier "to be honest about it" and move to abolish the income tax. "The single taxer will tell you the income tax is a wrong tax and that all taxation must be levied on what is called prairie value of land."²³ Mr. O'Regan, then a member of Parliament, and an ardent advocate of land-value taxation, corrected the statement of Mr. Stout by saying "No, the *unimproved* value of land," to which Stout replied, "It is the same thing."

Adoption of the rating on unimproved value must be on petition from a certain percentage of the ratepayers. The required number of petitioners ranges from 15 to 25 per cent of ratepayers in the district—the smaller the number of ratepayers the higher the percentage required. The petition is delivered to the chairman of the local body, who must arrange for an election not less than twenty-one clear days following the receipt of petition and not more than twenty-eight days.²⁴ The ques-

²¹ *Auckland City Corporation v. Auckland Gas Company*, 37 N.Z.L.R. 1028.

²² *Valuer General v. Auckland Gas Co. Ltd.*, 42 N.Z.L.R. 194-195.

²³ Stout in *Parliamentary Debates*, vol. 93, p. 617.

²⁴ *Public Acts of New Zealand*, vol. 7, p. 993.

tion is submitted to ratepayers in the simple form: "That the rating on unimproved value act of 1896 be adopted in district, and that henceforth property be rated on the basis of unimproved value thereof." The eligible ratepayer votes either for or against; at the present time a majority of the votes cast is sufficient to decide. Originally the participation of at least one-third of the ratepayers was necessary to a valid election, but this provision has been repealed.

The result of the poll must be announced to the public through the *Gazette* and one or more newspapers circulating in the district. If a majority of ratepayers have approved, the measure becomes effective after the March 31 following its adoption.²⁵ After such an election, the issue must remain settled for a minimum period of three years. If the proposal is defeated, it cannot be resubmitted within a three-year period; if adoption results, no move to rescind is possible for three years.

In the original act the scope of rating on unimproved value was somewhat restricted. "This act shall not apply to water rates, gas rates, electric light rates, sewage rates or hospital and charitable aid rates."²⁶ A valiant attempt was made by O'Regan to remove the limitation and make the application universal. All attempts at amendment were, however, defeated by decisive majorities. By an amendment in 1911, however, the limitation was not only removed, but it was definitely stipulated that the system wherever adopted should apply to the very type of rates formerly excepted from its application.²⁷ In one case, at least, the town council made the mistake of levying water rates on the basis of annual value in the year following the decision to rate on unimproved value. The court declared the levy unlawful.²⁸

The definition of improvements and of unimproved value now contained in the rating act are identical with the terms of the land-tax act and, as indicated elsewhere, the rolls for local rating purposes are supplied from the valuer general's office.

It is notable that the adoption of rating on unimproved value must be by a vote of *ratepayers* affected. In this particular the New Zealand practice contrasts sharply with that of America. Where single-tax proposals have been submitted to popular referendum, as in Oregon, any voter, whether he be a taxpayer or freeholder or not, has been entitled to vote. This makes it possible (although it has not so far been done) for the landless class, if they be in the majority, to vote the taxes

²⁵ Statutes 1896, No. 15, p. 12.

²⁶ Statutes 1896, No. 5, p. 16.

²⁷ Public Acts of New Zealand, vol. 7, p. 1015.

²⁸ *Souter v. Mayor, etc. of the Borough of Mosgiel*, 32 N.Z.L.R. 1273.

onto the landholding minority. In New Zealand the ratepayers themselves decide whether they prefer to be rated on unimproved value or upon one of the two alternative bases.

The optional feature of the law was unpopular with members of Parliament who had been tinged with the single-tax philosophy of Henry George. Sir G. S. Whitmore objected on the ground that the measure did not make resort to the new basis of taxation compulsory. He assailed the speculators who buy up a section (i.e. lot) of city property "which they hold until they have attained a certain value through the enterprise and industry of other people and then . . . sell at a huge price." He cited cases of property increases that came with the growth of the community and claimed that the "difference did not come from any industry on the part of the original purchaser."²⁹ In 1901 Richard Seddon, then at the height of his power, brought forward an amendment to make rating on unimproved value universal and compulsory. The bill did not for some reason proceed beyond second reading and the original act still continues in its optional form.

Although the system of rating on unimproved value depends on local option, it has been extensively adopted throughout New Zealand. Nearly 46 per cent of the counties, 64.5 per cent of the boroughs, and 46 per cent of the towns apply this method. Although only 43 per cent of the local bodies have changed to unimproved value, 58 per cent of the people in the Dominion live in communities that follow that system.³⁰ A cynical view is sometimes expressed by critics of the system. The affirmative vote is said to be prompted by "human nature and self interest." Voters record their verdict according to their estimates of the way their local taxes will be affected, "and the moral or ethical grounds are little considered. Everything is right providing the other man pays."³¹

However this may be, it is evident that the act of 1896 was passed in response to a widespread popular demand. Richard Seddon in his opening statement said that the principles contained in the proposed measure had been discussed on every platform of the country. "It is our present system in respect to general taxation—we tax on the unimproved value." Apparently a similar bill had been passed by the House four times and as often rejected by the Legislative Council. Mr. Seddon expressed the hope "that the Legislative Council would see when the representatives of the people pass a bill due respect should be paid."³²

²⁹ *Parliamentary Debates*, vol. 93, pp. 226-227.

³⁰ *Year Book*, 1939, p. 552.

³¹ T. H. Crosbie, *Merits and Demerits of Rating on Unimproved Value*, p. 3.

³² *Parliamentary Debates*, vol. 92, p. 615.

The votes during the early years of the system were overwhelmingly in favor of the new basis of rating. The commissioner of taxes reported in 1899 that the proposed change to rating on unimproved value had been submitted in twenty-three local districts, and that four rejections were recorded—one of these on the technicality that less than one-third of the ratepayers had voted. In the remaining nineteen communities the affirmative vote was impressive, often running as high as 16 to 1.

One of the contributing factors to the support of rating on unimproved value has been the attitude of labor, influenced by the belief that removal of the tax from improvements would lower rents.³³ Just what effect, if any, the rating on unimproved value has actually had on the level of rents is most difficult to determine. As Boswell puts it: "Too many factors operate to make possible a reliable comparison . . . boroughs advance or decline [in prosperous times or the reverse] irrespective of their rating systems."³⁴ Not being able to make inductive studies of rents and their correlation with rating systems, supporters are prone to fall back on the theory that the exemption of improvements stimulates building operations and increases the supply of housing facilities. Rents would naturally come down. One finds in popular discussion in New Zealand little if any reference to the sounder economic view that in growing communities a tax on houses is shifted and therefore adds to rents. To substitute for a shiftable tax one that is not normally shifted would obviously tend to lower rents.

In curious contradiction to the view that unimproved-value taxation lowers rents, one finds in Wellington, where rating is on unimproved value, the complaint that rents are too high because of high local rates that are collected.³⁵ Perhaps it is too much to expect that businessmen, even in a country of unusually high intelligence, should fully understand the shifting incidence of changing systems of local taxation.

One of the most common claims for rating on unimproved value is that it will make unprofitable the holding of unused sites and encourage holders to "develop and redevelop" in order to make them "pay their way on the tax rolls." Thereby we provide a wider field for the remunerative employment of labor and capital. "The land value rates will also reduce the price of land. This will facilitate the acquisition of land both for public and private purposes."³⁶ Conversely rates levied on improvements tend to penalize and discourage the making of improvements. The tax on a building is a "fine annually assessed" which tends to

³³ Boswell, *Local Authority Rating in New Zealand*, p. 46.

³⁴ *Ibid.*, p. 43.

³⁵ *Parliamentary Debates*, vol. 230, p. 229.

³⁶ F.C.R. Douglas, *The Rating of Land Values*, pp. 28 *et seq.*

"discourage citizens and firms who want to improve the aesthetic aspect of the city."⁸⁷

Advocates of rating on unimproved value will cite examples of cities with that system that have grown more rapidly in population and general development than similar communities retaining the old system of rating on annual or capital value. In fact, figures seem to bear out the contention so far as comparison between the two classes of communities are concerned. On the other hand, it is argued that it is not economical in the long run to encourage overbuilding. In building operations it is best to wait until time is ripe for construction—the demand for housing facilities should precede the supply.⁸⁸

Advocates of land-value taxation in New Zealand have based their theoretical case, as have single taxers in America, on the benefit principle as "more fundamental than ability to pay." "It [i.e., land-value taxation] is based upon the benefit received from the community in the shape of a value which is altogether created by the community." On the other hand, Crosbie and other critics of the system invoke the ability theory and point to the fact that a man who builds a £5,000 house on a lot of the same size and situation pays no more than a poor man who builds a modest home costing £1,000. His adherence to the ability-to-pay principle leads Crosbie to favor annual or letting value as the basis for local rating. He admits that this system puts a premium on speculation and the idle holding of urban lots. The evil could be avoided, however, by a penalty tax on urban lands held idle and unused.⁸⁹

One of the fiscal defects frequently referred to in New Zealand discussion is that rating on unimproved value results in a stationary or even a declining basis for the levy of rates. When improvements are made, the land values are not affected, or at least the increase in value only slowly affects the tax rolls. A partial explanation of this may be found in the fact already mentioned, namely, the infrequency with which general revisions of valuations are undertaken by the central office. Valuations in Wellington, a rapidly growing city, were made in 1914, 1921, 1929, and 1935. In one borough (Masterton) it has been twenty years since the last general valuation was made. Buildings and improvements are ignored in a community rating on unimproved value; yet these structures may make new demands upon water supply, sewage disposal, garbage collection, etc. Theoretically at least, it is even con-

⁸⁷ Sir George Fowlds in a tract, *A Modern Building and an Old Tax System*. The situation which gave him the text was the construction of a new life-insurance building on Queens Street, Auckland, where rating is on annual value.

⁸⁸ Crosbie, *Merits and Demerits of Rating on Unimproved Value*, p. 2.

⁸⁹ *Ibid.*, p. 14

ceivable that the tax on unimproved value, being a nonshiftable tax, will reduce net income and depress the value of land. This possible defect of the system leads Douglas to favor a tax on the economic rent of land—in preference to capital value of land, a value which tends to reflect the net income from ownership and is unfavorably influenced by anything that absorbs a part of income.⁴⁰

One criticism, aimed not so much at the system as the method provided under the New Zealand system for its adoption, is that it tends to facilitate too frequent changes in local rating to the detriment of business and the disturbance of property values. Crosbie cites an extreme case—Wanganui City, which began with the rating on annual value, changed to unimproved value, then switched back to annual value and, after three years, returned to unimproved value again. Cases of this kind are exceptional; for the record shows that local bodies, once having adopted rating on unimproved value, seldom abandon that basis. Where frequent change does occur, of course, the results may be very undesirable.

One of the objections to rating on unimproved value heard very frequently in New Zealand is that it leads naturally to crowding and congestion, and furthers the development of slum areas. Reasoning from an *a priori* standpoint, one would expect this result. When the tax is laid entirely on land, the only way to mitigate the tax burden is to minimize the use of land. A house on a 25-foot lot in the same section will pay half as much tax as one that has a 50-foot frontage. Superficially, at least, this view has statistical support. Auckland and Dunedin, rating on annual value, have respectively 5.7 and 4.3 persons per acre; Christchurch and Wellington, rating on unimproved value, have 9 and 7.2 persons respectively for each acre.

The low figure for Dunedin is possibly explained by the fact that it is a city of magnificent parks and gardens. Pioneer founders reserved a vast belt of native "bush" surrounding the city on the landward side and this heritage has been kept free from settlement. In addition, the city has developed parks and botanical gardens that occupy great uninhabited spaces. The ratio of total population to area within the city limits would be naturally low. In the downtown section of Dunedin settlement seems to be as dense as elsewhere in the Dominion.

Wellington's high average of human beings per acre may be accounted for, in part at least, by the topography of the city and its surroundings. Wellington harbor had no extensive area of flat land adjacent to the water's edge. Hills rise steeply from the shore and a

⁴⁰ Douglas, *The Rating of Land Values*, pp. 44-45.

large portion of the business section, as indicated elsewhere, is built on made land deposits of silt and dredgings behind a sea wall pushed out into the bay. Practically all the older section of the city is built on converted tide lands below Lambton Quay, which is backed up against the hill. As the city grew residence properties utilized the steep hillsides rising to a level of 800 to 1,000 feet above the harbor. Concrete retaining walls, deep excavations, and street improvements created accessible and usable land at considerable cost. If such costs have to be borne by the abutting properties according to frontage, superficial area, or value, the occupant is naturally encouraged to utilize land sparingly and get along with the smallest possible space. In a word, land for business sites and for residences was scarce and costly, and its intensive use followed as a natural course.

Supporters of rating on unimproved value call attention to the fact that a nonshiftable tax of this kind tends to depress selling value and may therefore encourage people to buy more for a specific purpose. Carried to the extreme advocated by Henry George, the appropriation of the full economic rent would reduce selling value to zero. Land might be acquired for nothing, subject, of course, to the obligation of paying the rack rent annually. If the value of a site is reduced by piling the tax on the land alone, the cost of acquiring the lot and building may be less, and better houses surrounded by more extensive gardens may be acquired for the same initial outlay.⁴¹ Douglas characterizes the argument that rating on unimproved value tends to promote overcrowding as "a complete fallacy." The added tax one has to pay on the land is compensated by reduced capital outlay when site is acquired; and it is susceptible of mathematical proof, at least, that the amount saved on the purchase price forms a sort of endowment out of which the tax can be met by annual payments.

Even if the tendency of rating on land values alone is toward overcrowding and the undue morselization of land, this evil might be easily checked by local ordinances, zoning, and city-planning arrangements. Minimum size of residence sites, at least in certain sections of the city, can preserve the open spaces and leave room for lawns and gardens in keeping with the beauty of a well-planned city.

Here again one is prompted to enter the caution that both advocates and critics of the New Zealand system are inclined to exaggerate the economic effects of rating on unimproved value, even where all rates are upon land value alone. As indicated elsewhere, local taxes are mild when compared with the levy in a typical American city. If the whole

⁴¹ *Ibid.*, pp. 28-29.

burden of local taxation in such an American city were thrown upon site value alone, the rate would rise to alarming proportions. In Wellington, capital city of New Zealand, where local rating is upon unimproved value and the tax covers the cost of water service in addition to general functions, the ruling rate has been around 8*d.* in the pound, the equivalent of 33 mills in terms of American tax notation. This is the equivalent of a 66-mill tax on a 50 per cent valuation—pretty close to the ruling rate in American cities. It should be kept in mind that the Wellington rate applies to site value alone, while the American rate would apply to buildings and improvements and tangible personal property. If Wellington rated on capital value, following the practice of American cities, the rate would be 3.4*d.* in the pound, or 14.3 mills. The shifting of so mild a rate from one basis of levy to another can scarcely be responsible for any far-reaching economic consequences.

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