Chapter 5 Taxation of Real Estate

5.1 Introduction

Taxation of real estate is the main issue in property owning, selling and buying, renting and leasing, marketing and administrating. Taxation of profit of real estate is part of this issue.

The profit derived from land and buildings is considered as a direct and indirect profit, a present profit that is gained on selling or letting land or building, as well as a future profit by owning it. The state and the local authorities participate in this profit by various taxes, duties, levies, and rates. These compulsory payments affect the value of the land, the accessibility to the commerce, the free market of real estate, the prices of products that depend on land i.e., agriculture, industry, commerce, and dwelling, and the life style of the community.

In this thesis, I will present the arguments among economists and philosophers about the taxation of profit of real estate since the time of the industrial revolution up to now. I will take a glimpse into the ancient world, and will discuss the equilibrium between the needs of the community that impose compulsory payments versus the sacredness of the private property in this era.

Once, such an equilibrium is violated by a greedy ruler, it may cause a crisis in the community and even a military revolution or a mutiny. It happened in Boston,[1] in India[2] and elsewhere. Once a wise ruler achieves such equilibrium, the economy flourishes, as well as the welfare of his people.

Kings and governments consider themselves as "partners" of their citizens, and therefore partners to their income, property, and other commercial or personal activities. Various taxes[3] and duties are imposed in order to "share the wealth" among people, financing the services of the country, the state, and the city, or merely to support the lifestyle of those that their occupation is to rule.[4]

Income tax is imposed on the income. Property tax and capital net tax are imposed on the owners of property. Purchase tax and stamp duty are imposed on purchasing goods and real estate, and selling tax is imposed on selling them. Value additional tax is imposed on the additional value of the production process and on services. Development levies, duties, and rates are imposed on the owner of land for developing the area. Betterment levy is imposed on the increased value of real

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1 The Boston Tea Party (Dec. 16, 1773), incident in which 342 chests of tea belonging to the British East India Company were thrown from ships into Boston Harbor by American patriots disguised as Mohawk Indians. The Americans were protesting both a tax on tea (taxation without representation) and the perceived monopoly of the East India Company.

2 Mohandas Karamchand Gandhi declared a boycott on the British textile, and he encouraged the people of India to spin their own cloth.

3 A "tax" is payment that is imposed by a public authority, (state, local authorities, and others) for which there is no exchange given by the authority to the payer of the tax. The legal definition for "tax" is - "a compulsory payment imposed by a law". The definition of *tax law* - "body of rules under which a public authority has a claim on taxpayers, requiring them to transfer to the authority part of their income or property". "Tax Law", Introduction, Encyclopaedia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=115311 A donation that is given voluntarily by a citizen to a public authority is not a tax. A tax is only that which is imposed. The legal obligation to pay a tax to the state treasury or a local authority is inherently different from the legal obligation to pay, which has been drawn up by contractual agreement. While the obligation for payment by agreement is taken on voluntarily by the person, the obligation to pay taxes is steeped in the law that creates this obligation and imposes it upon the taxpayer. Therefore, tax, levy, fees, duty, custom, excise, toll, tariff, and rate are known as compulsory payments.

4 In 1504 Henry VII levied a feudal aid (tax) to pay for the knighting of his son--who had been knighted 15 years before and had been dead for two. "United Kingdom", Financial policy, Encyclopaedia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=120044&tocid=44835#44835.toc

estate and capital gain tax (land appreciation tax) is imposed on the profit from selling the property. War tax and emergency tax are imposed during war and luxury tax is imposed on the luxury lifestyle during peace. Employment tax is imposed on the employer. Duties, tariffs, and customs are imposed on imported goods and fees are imposed on exporting goods. Various rates and fees are imposed on government's services that may not be delivered by the free market due to a law. Entertainment tax is imposed on movies. Capitation tax and poll tax are imposed on the privilege to live under the regime of the ruler. Inheritance tax and estate duties are imposed on the transfer of estate from the deceased to the living and gift tax is imposed on the transfer of estate from the living to the living.[5]

Whether man lives or dies, owns property, buys it or sells it, whether one produces goods, imports or exports them, saving his money or spending it, in health and in sorrow, in war and in peace -- he pays taxes, duties, customs, tributes, levies, fees, excises, tolls, tariffs and rates. The creativity of the ruler takes place by finding new words and names to entitle new compulsory payments, and in democratic regimes to justify it's noble purposes.

5.1.1. Taxes on Property

The ownership of real estate, the various uses of property, and the profit resulting from the sale of property was utilized in history as a good excuse to impose taxes by a ruler on his subjects.

The various taxes imposed on the owners of land and buildings were always the favorite of the rulers because it is difficult to hide the ownership of real estate and any kind of transaction. It is impossible to eliminate land; therefore, it is easy to collect the taxes by selling the land by the tax collector should the taxpayer fail to fulfill his duties.

"While property remains in the possession of the same person, whatever permanent taxes may have been imposed upon it, they have never been intended to

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5 "Salt is a very ancient and a very universal subject of taxation. It was taxed among the Romans, and it is so at present in, I believe, every part of Europe." Smith, Adam. The Wealth of the Nations, Book 5, chapter II, Article IV - Taxes upon Consumable Commodities, p 1173. The Electric Book company, http://www.elecbook.com/admsmith.zip

diminish or take away any part of its capital value, but only some part of the revenue arising from it. But when property changes hands, when it is transmitted either from the dead to the living, or from the living to the living, such taxes have frequently been imposed upon it as necessarily take away some part of its capital value."[6]

Taxation of real estate is one of the reasons whether or not to sell a property, or to exchange it with other property.[7] To analyze this, one should be aware of the various taxes and levies imposed on real estate.

Adam Smith opposed a direct taxation upon the wages of labour, and suggested sharing the burden of taxation between the consumable commodities and the rent of land. Smith advocated that a direct tax upon the wages of labour must, in the long run, cause a greater reduction in the rent of land, and a greater rise in the price of manufactured goods than would have followed from imposing the same amount of taxes partly upon the rent of land, and partly upon consumable commodities.[8]

David Ricardo suggested that the effects of taxation on the necessaries of life tend to diminish capital and production.[9] Various scholars have shown the tendency to

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6 Smith, ibid., Book 5, chapter II, appendix to Articles I and II - Taxes upon the Capital Value of Land, Houses, and Stock, p. 1151.

7 "The financial analysis of whether or not to sell a property should include several components. Tax Considerations. The complex tax code can make it risky to calculate after-tax yields. However, because code provisions allow for tax deferral on exchanges, tax consequences must be considered when comparing hold, sell, or exchange options. An exchange permits the use of pretax dollars as a down payment, but it extracts a penalty in the amount of depreciation that can be taken on the property received in the exchange. A pretax comparison is not merely misleading -- it is patently wrong. If substantial suspended losses exist, they could offset the gain on an outright sale. In this event, investors should be careful not to inadvertently create an exchange." Bierschenk, Letty M., CCIM, Bierschenk, Kurt R., CCIM, Bierschenk, William C., CCIM. Hold, Sell, or Exchange?, in Commercial Investment Real Estate, March/April 2000, http://www.ccim.com/JrnlArt/20000405.htm

8 Smith, Adam. The Wealth of the Nations, book 5, chapter II, Article III - Taxes upon the Wages of Labour, pp. 1159-1164. The Electric Book company, http://www.elecbook.com/admsmith.zip

9 "I by no means agree with Adam Smith, or with Mr Malthus, respecting the effects of taxation on the necessaries of life. The former can find no term too severe by which to characterize them. Mr Malthus is more lenient. They both think that such taxes, incalculably more than any other, tend to diminish capital and production. I do not say that they are the best of taxes, but

shift all taxes to land.[10]

Thomas Malthus opposed heavy taxes: "It is, therefore, of great importance, that these prices should be increased as little as possible artificially, that is, by taxation. But every tax, which falls upon agricultural capital, tends to check the application of such capital, to the bringing of fresh land under cultivation, and the improvement of the old. It was shown, in a former part of this inquiry, that before such application of capital could take place, the price of produce, compared with the instruments of production, must rise sufficiently to pay the farmer. But, if the increasing difficulties to be overcome are aggravated by taxation, it is necessary, that before the proposed improvements are undertaken, the price should rise sufficiently, not only to pay the farmer, but also the government. And every tax, which falls on agricultural capital, either prevents a proposed improvement, or causes it to be purchased at a higher price."[11]

In another essay, T. Malthus states: "Every diminution of price not fully and immediately balanced by a proportionate fall in all the necessary expenses of a farm, every tax on the land, every tax on farming stock, every tax on the necessaries of farmers, will tell in the computation; and if, after all these outgoings are allowed for, the price of the produce will not leave a fair remuneration for the capital employed, according to the general rate of profits and a rent at least equal to the rent of the land in its former state, no sufficient motive can exist to

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they do not, I think, subject us to any of the disadvantages of which Adam Smith speaks in foreign trade: nor do they produce effects very different from other taxes. Adam Smith thought that such taxes fell exclusively on the landholder; Mr Malthus thinks they are divided between the landholder and consumer. It appears to me that they are paid wholly by the consumer." Ricardo, David. An Essay on Profits, 1815, footnote no. 20. London: Printed for John Murray, Albemarle St., McMaster University, Faculty of Social Sciences, http://socserv2.socsci.mcmaster.ca/~econ/ugcm/3ll3/ricardo/profits.txt

10 "Locke, Quency, Adam Smith and others have shown a tendency to shift all taxes to land, whatever the nominal base or event, assuming elastic supplies of labour and capital." Land tax, Etwell, John (ed). The New Palgrave a Dictionary of Economics, volume 3, p. 123, the Macmillan Press Limited, London, 1987.

11 Malthus, T. R. An Inquiry into the Nature and Progress of Rent, and the Principles by which it is regulated, 1815, p. 43, Electric Book Company, http://www.elecbook.com/malrent.zip

undertake the projected improvement."[12]

5.1.2 The Burden of Taxation

Even though taxation in various forms existed since the first man became a ruler or a chief of his fellows, the development of tax laws as a comprehensive general system is a recent phenomenon. One reason for this is that no general system of taxation existed in any country before the middle of the 19th century. In traditional essentially agrarian societies, government revenues were drawn either from non-tax sources such as tribute, income from the royal domains, and rent derived from land or to a lesser extent from taxes on various objects such as land taxes, tolls, customs, and excises.

Levies on income or capital were not considered an ordinary means for financing government. They appeared first as emergency measures. The British system of income taxation, for example, one of the oldest in the world, originated in the act of 1799 as a temporary means for meeting the increasing financial burden of the Napoleon wars.

Another reason for the relatively recent development of tax laws is that the burden of taxation and the problem of definite limits to the taxing power of public authority became substantial only with the broadening in the concept of the proper sphere of government. This approach has accompanied the growing intervention of modern states in economic, social, cultural, and other fields.[13]

The best way to visualize the incidence of a tax is to think of it as a wedge.[14] For example, taxes on cigarettes, liquor, and telephone calls introduce a wedge between the price paid by the buyer and the price that is received by the seller.

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12 Malthus, T. R. The Corn Laws, Observations on the Effects of the Corn Laws, and of a Rise or Fall in the Price of Corn on the Agriculture and General Wealth of the Country, 1814, p.18, Electric Book Company, http://www.elecbook.com/malcorn.zip

13 Tax Law, Introduction, Encyclopaedia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=115311

14 Harberger, Arnold C. 'Corporate and Consumption Tax Incidence in an Open Economy', in ACCF (American Council for Capital Formation) Center for Policy Research Special Reports, June 1994, http://www.accf.org/Harberger.htm

Prior to the development of general equilibrium analysis, in which Professor Harberger was a pioneer in the 1960s, economists maintained that part of the corporation income tax was borne by labor, part by consumers, and part by shareholders (or by capital). That led to the thinking that the worst that could happen is that capital would bear the entire tax, Professor Harberger observes. In contrast, general equilibrium analysis leads to the conclusion that capital can bear less, an equal amount, or more than the full burden of the corporate income tax.

5.1.3 The Resistance of the Taxpayers

In 1798, after the American Congress had passed its first direct tax on housing, the government cooked up a scheme to count and measure the windows on every taxpayer's house, in order to calculate how much to charge. But German settlers in eastern Pennsylvania would have none of it. They organized into small bands, armed themselves, and scoured the countryside for assessors who were seized, assaulted, and driven across county lines. When some of the rebels were arrested, an auctioneer named John Fries marched on the courthouse and freed them. President John Adams called out the militia. Fries was arrested, tried for treason, and sentenced to be hanged.

It was hardly the first tax revolt in American history. From the Boston Tea Party to the Whiskey Rebellion to the Fries Rebellion, the late eighteenth century in America was full of armed violence in response to hated taxes. The Fries Rebellion was also far from the last of its kind.

Throughout its history, America has been home to a series of little-known tax rebellions. These rebellions have played major roles in the presidencies of George Washington, John Adams, Thomas Jefferson, and many of their successors. They have helped bring about the Civil war, the birth of the Ku Klux Klan, and, ironically, the birth of the Internal Revenue Service. When the old Internal Revenue Bureau was strengthened to control moonshiner tax rebels in the Appalachia, it started a "Second Whiskey Rebellion" that continues even today.

"We have overthrown the tyranny of British taxes, Federalists' taxes, the Tariff, and the Revenuers' system. Has the tyranny of the Income Tax finally had its day?"[15]

"To cheering crowds, politicians announce plans to dismantle the IRS as we know it and replace it with flat taxes and consumption taxes. But if we burn our 1040 forms, will we really be better off?"[16]

Americans are being literally taxed to death. At work or out shopping, upon marriage or even after death, they are paying more in taxes than ever before. The average family with two wage earners is now seeing almost 40 percent of its money go to local, state, and federal taxes. "The greedy hand of government" first described by American revolutionary Thomas Paine, is greedier than ever, creating a situation ripe for tax reform, if not revolt.

"We think of our forefathers who felt compelled to rebel against the Crown for 'imposing taxes on us without our consent'. We know we live in a democracy, and so must have chosen this arrangement. Yet nowadays we find ourselves feeling that taxes are imposed on us 'without our consent'."[17]

"Long ago, the philosophers who inspired our country's founding and early years anticipated this dilemma. They laid out powerful images that depict the forces affecting our pocketbooks to this day. Adam Smith described the 'invisible hand,' the hand of free commerce that brings magic order and harmony to our lives. Thomas Paine wrote of another hand, all too visible and intrusive: 'the greedy hand of government, thrusting itself into every corner and crevice of industry.' Today, the invisible hand is a very busy one. Markets are wider and freer than ever, and we profit from that by living better than before. But the 'greedy hand of government' is also at work. Indeed, in relative terms, the greedy hand has grown faster than the invisible hand."[18]

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15 Adans, Charles. Those Dirty Rotten Taxes: The Tax Revolts that Built America, in New York: Free Press, 1998.

16 Graetz, Michael J. The Decline (And Fall?) of the Income Tax, In New York: W.W. Norton & Company, 1997.

17 Shlaes, Amity. The Greedy Hand: How Taxes Drive Americans Crazy and What to Do About It, Random House, 1999. http://www.booknotes.org/chapter/fc041199.htm

18 Ibid.. Chapter 1.

5.2 History of Taxation[19]

5.2.1 Administration of Taxation

Patterns of taxation throughout history can be explained largely by administrative considerations. Because it is easier to tax imports than to tax domestic output, import duties were among the earliest taxes. Similarly, the simple "turnover tax", levied on gross sales, long held precedence over the conceptually preferable "value-added tax", which allows credit for tax paid on purchases. As for personal taxes, it is easier to identify real property than other assets, and a "head tax" is even easier to implement. It is not surprising, therefore, that the first direct levies were head and land taxes.

Taxes played a relatively minor role in the ancient world. Taxes on consumption were levied in Greece and Rome. Tariffs, taxes on imported goods, were often of considerably more importance than internal excises so far as the production of revenue went. As a means of raising additional funds in time of war, taxes on property would be temporarily imposed. For a long time, these taxes were confined to real property, but later they were extended to other assets. Real estate transactions also were taxed. In Greece, free citizens had different tax obligations from slaves. In Rome the tax laws distinguished between the Roman citizens from the residents of the conquered territories.

In Rome, along with consumption taxes and customs duties, there were certain direct taxes. The principal of these was the "tributun" paid by citizens and usually levied as a head-tax. Later, when additional revenue was required, the base of this tax was extended to real estate holdings. In the time of Julius Caesar a 1% general sales tax was introduced. The provinces relied for their revenues on head tax and land tax. The land tax consisted initially of fixed liabilities regardless of the return from the land, as in Persia and Egypt. Later, the land tax was modified to achieve a certain correspondence with the fertility of the land, or, alternatively, a 10% of the produce was collected as a tax in kind (the "tithe"). It is noteworthy that at a relatively early time Rome had an inheritance tax of 5%, later 10%. However,

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[19] Taxation, History of Taxation, Encyclopaedia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=115309&tocid=72007#72007.toc

close relatives of the deceased were exempted.

For a long time the tax collection was left to middlemen or tax-farmers, who contracted to collect the taxes for a share of the proceeds. Under Caesar, collection of taxes was delegated to civil servants.

In the Middle Ages many of these ancient taxes, especially among the direct levies, vanished and gave way to a variety of obligatory services.

The main indirect taxes were transit-duties and market-fees. In the cities, the concept developed of a tax obligation encompassing all residents. The burden of taxes on certain foods and beverages was intended to be borne partly by consumers and partly by producers and tradesmen.

During the latter part of the Middle Ages, some German and Italian cities introduced several direct taxes: head-taxes for the poor and net-worth taxes or occasionally crude-income taxes for the rich. The income tax was administered through self-assessment and an oath taken before a civic commission. The use of land taxes and taxes on houses gradually spread.

Taxes have been a major subject of political controversy throughout history, even before they constituted a sizable share of the national income. A famous instance is the rebellion of the American colonies against Great Britain when the colonials refused to pay taxes imposed by a Parliament in which they had no voice; hence, the slogan, "no taxation without representation." Another instance, is the French Revolution of 1789, in which the inequitable distribution of the tax burden was a major factor.

Wars have influenced taxes much more than taxes have influenced revolutions.[20] Many taxes, notably the income tax (first introduced in England in 1799) and the turnover tax (Germany, 1918) or purchase tax (Great Britain, 1940) began as temporary war measures. Similarly, the withholding method of income tax collection began as a wartime innovation in France, the United States, and Britain. World War II converted the income taxes of many nations from upper-class taxes

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[20] "Let them march all they want so long as they continue to pay their taxes." General Alexander Haig.

to mass taxes.[21]

It is hardly necessary to mention the role that tax questions play in peacetime politics, where the influence of powerful, well-organized pressure groups is great. Arguments for tax reform, particularly in the area of income taxes, are perennially at issue in the domestic politics of many countries.

War Tax Resistance in U.S.A. is a movement of peace activists who refuse to pay all or a portion of their income tax, or who make a conscious decision to live simply and reduce their income to below-taxable level. The War Tax Resistance movement claims that war taxes comprise that portion of income tax directly contributed to military and weaponry in the Federal Budget.

5.2.2 Modern Trends

The development of taxation in recent times can be summarized by the following general statements: The authority of the sovereign to levy taxes in a more or less arbitrary fashion has been lost, and the power to tax now generally resides in parliamentary bodies.

The level of most taxes has risen substantially and so has the ratio of tax revenues to the national income. Taxes today are collected in money, not in goods. Tax farming has been abolished; taxes are assessed and collected by civil servants. There has been a reduction in reliance on customs duties and excises. Many countries increasingly rely on sales taxes and other general consumption taxes.

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21 "Nation-states in the modern world, - regardless of professed ideology - consistently work to maintain and expand their own power. No country does this more consistently, more ruthlessly, and more successfully than the United States. Over half of U.S. tax dollars go to military spending. Not to housing, education, environmental protection, or any of the other desperately needed social programs, but to killing people to maintain state and corporate power, expand wealth, and enforce racism, sexism, homophobia and xenophobia. The U.S. military does not, as it claims, protect us from people who would take what is rightfully ours; instead it protects them, the people who take what is rightfully ours, from us. One of the best ways to challenge that power is to refuse to fund the system that maintains it. Consider, and encourage your friends to consider, refusing to pay taxes for war and military spending - and redirecting refused tax money to positive uses." War Tax Resistance and Anarchism, in National War Tax Resistance Coordinating Committee, http://www.nwtrcc.org/issues.htm

An important late 20th century development has been the replacement of turnover taxes with value-added taxes. Taxes on the privilege of doing business and on real property have lost ground and are important today mainly as revenue sources for local communities. The absolute and relative weight of direct personal taxation has been growing in most of the developed countries, and increasing attention has been focused on payroll taxes and value-added taxes.

Income taxes, both of individuals and of corporations, payroll taxes, general-sales taxes, and in some countries property taxes occupy leading positions in modern tax systems. The income tax has ceased to be a rich man's tax. The general populace now pays it, and in several countries it is complemented by the net-worth tax.

The emphasis on the ability-to-pay principle and on the redistribution of wealth, which led to graduated rates, especially in the case of income taxes, appears to have peaked and been replaced by greater concern for the economic distortions and disincentives caused by high tax rates. A good deal of fiscal centralization has occurred, as reflected in the kinds of taxes levied by central governments. The latter, now control the most important taxes from a revenue-producing point of view: income taxes and corporation taxes, payroll taxes, and value-added taxes. Various ways have been found to allow lower-level governments and local authorities to share in the tax revenues of central governments.

Developed countries usually rely more heavily on individual income taxes than do developing countries but less heavily on corporation income taxes. Among developing countries, reliance on income taxes, especially on corporate income taxes, generally increases as the level of income rises. The poorest countries rely more heavily on taxes partly because they lack the administrative capacity to implement more sophisticate taxes on income. A relatively high percentage of the total tax revenue of industrialized nations comes from domestic consumption taxes, especially the value-added tax rather than the simpler turnover tax. Social security taxes, commonly payroll taxes, are much more important in developed countries and the more affluent developing countries than in the poorest countries, reflecting the near lack of social security systems in the latter countries.

Taxes in general represent a much higher percentage of national output in developed countries than in developing countries. In many respects the tax systems of the developing countries with the highest levels of income resemble those of developed countries more than those of the poorest developing countries.

5.3 The Philosophy of Taxation

5.3.1 The Essence of Tax

A "Tax" is a payment that is imposed by a public authority, for which there is no direct monetary exchange given by the authority to the payer of the tax. Public authorities are the state and local authorities. A tax is only that which is imposed. A donation that is given voluntarily by a citizen to a public authority is not a tax. The legal obligation to pay a tax to the state treasury or a local authority is inherently different from the legal obligation to pay, which has been drawn up by contractual agreement. While the obligation for payment by contractual agreement is taken on voluntarily by the person, the obligation to pay taxes is steeped in the law that creates this obligation and imposes it upon the taxpayer. Therefore, taxes, levies, fees, duties, customs and rates are known as "obligatory payments".[22]

Tax is intended to finance the general activities of the public authorities, and the taxpayer is entitled to a service in return for the taxes he has paid. However, the exchange is not meant to stand in direct relation to the amount of tax that said taxpayer has paid. Hence, for example, citizen "A" earns a large income and pays a large sum in income tax, and citizen "B" earns a small salary and pays no income tax at all - but both are entitled to the same services given by the state. Citizen "C" pays a considerable amount of property tax for quite a few expensive properties in his possession, but is not eligible, in exchange for this significant sum, for any special services that citizen "D" is not entitled to, even though citizen "D" pays no property tax at all. Citizen "E" pays VAT for the purchase of an expensive home and citizen "F" pays a small amount of VAT for the purchase of an inexpensive apartment or no VAT at all if he does not purchase an apartment, but both are entitled to the same government services.

Compulsory payments which are imposed by legal statute include taxes but do not

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22 The legal definition for tax is a compulsory payment imposed by a law.

entitle the taxpayer to any exchange in direct relation to the sums imposed upon him, including those assorted fees imposed for the purpose of carrying out specific and defined activities. The government authorities impose specific compulsory payments, called fees, in exchange for which the subject is entitled to a service that is directly relative to the fee which he has paid.

Fees are a combination of tax and price. Tax, because the fee is imposed legally and not according to any agreement and the rate is not susceptible to negotiation. Price, because the rate of the fee is meant to be a reasonable exchange for he who pays it, and the provision of a service or other product is directly proportional to the services or other products provided.

"Taxation is the form of socialization used in market economies. Choosing what to tax is choosing what to socialize. Rather than socialize labour or repel capital it is possible to tax land… The entire value of land, now and forever, is here regarded as benefit received from government. This is consistent with Alfred Marshall's concept, 'the public value of land', where value is the product of three things: nature; government; and spillover values from development of adjoining and linked lands. All these values, being unearned by the individual landholder, are fit to be taxed… Land taxes are *in rem*… Avoiding land taxes is next to impossible, even though collection enforcement is limited to seizing the land, not the person or any other asset."[23]

Tax law is concerned only with the legal aspects of taxation, not with its financial, economic, or other aspects. The making of decisions as to the merits of various kinds of taxes, the general level of taxation, and the rates of specific taxes, for example, does not fall into the domain of tax law; it is a political, not a legal, process.[24]

"The reason why the consumer pays a tax upon any manufactured commodity, or an advance in the price of any of its component parts, is because, if he cannot or will not pay this advance of price, the commodity will not be supplied in the same

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23 Land tax, Etwell, John (ed). The New Palgrave a Dictionary of Economics, volume 3, p. 122, the Macmillan Press Limited, London, 1987.

24 Tax Law, Introduction, Encyclopaedia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=115311&tocid=0

quantity as before; and the next year there will only be such a proportion in the market, as is accommodated to the number of persons who will consent to pay the tax."[25]

5.3.2 Tax Epistemology

Real estate is an asset which is not only considered to be "consumer goods" in all levels of the population, but is also a preferred objective for many investors. Real estate can be marketed by means of tax shelters incentives. The significance here is the sophisticated consumer who will buy property by these means will not have to share the resulting profit with the government. Thus, a tax shelter is one of the more important factors to be considered by the potential consumer when the time comes to invest. When the consumer is ready and able to purchase "consumer goods" which can take advantage of this tax shelter, the advantage is that he alone will enjoy the fruits of the property that he has purchased.

This thesis presents and analyzes two tax shelters that enable the consumer to enjoy the profits of sale with significant tax benefits.

The sophisticated investor who has taken advantage of knowledgeable legal advice at his disposal knows that the purchase of real estate that turned a profit at time of sale is exempt from taxes. The public or the middle classes that invest their money and pay their taxes at which time their property has turned a profit do not generally know this information. Marketing real estate by means of this tax shelter incentive is targeted mainly at this large section of the population. The assumption is, of course, that a person who is looking to invest his capital in property will prefer to do this by methods that will enable him to enjoy the resulting profits without involving the state treasury.

5.3.3 Purposes of Taxation

In modern economies, taxes are the most important source of governmental

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25 Malthus, T. R. The Corn Laws, Observations on the Effects of the Corn Laws, and of a Rise or Fall in the Price of Corn on the Agriculture and General Wealth of the Country, 1814, p. 8, Electric Book Company, http://www.elecbook.com/malcorn.zip

revenue. Taxes differ from other sources of revenue in that they are compulsory payments and are unrequited. While taxes are presumably collected for the sake of the welfare of taxpayers as a whole, the liability of the individual taxpayer is independent of any benefit received. There are important exceptions to this characterization. Payroll taxes are commonly levied on labour income in order to finance retirement benefits, medical payments, and other social security programs. Because there may be some link between taxes paid and benefits received, payroll taxes are sometimes called "contributions". Nevertheless, the payments are commonly compulsory and the link to benefits is usually quite weak.

During the 19th century, the prevalent idea was that taxes should serve mainly to finance the government. In earlier times, and again today, governments have utilized taxation for other than merely fiscal purposes. One useful way to view the purpose of taxation is to distinguish between objectives of resource allocation, income redistribution, and economic stability.

The re-distributive objective is to lessen inequalities in the distribution of income and wealth to the extent they are considered excessive and unjust. The stabilization objective, which tax policy shares with government expenditure policy under the rubric of fiscal policy and monetary policy, is the maintenance of high employment and price stability.

Tax is an instrument to share the wealth among people.[26] According to this concept, members of the community that earn more, spend more, possessing more, and dying richer, should pay more taxes than the members of the community that earn less, spend less, possessing less, and dying poorer. This ideology is obviously embraced by the poor and middle classes and therefore by politicians in democratic countries that needs the votes of the majority. The opposers point, that this attitude does not encourage people to work harder and to contribute more to the society that supports them.

Tax is an instrument to finance the services of the state, i.e. army, foreign office, and welfare, in spite of that most of the taxpayers would rather give up those

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[26] Dunkiel, Brian M. Hamond, Jeff. Motavalli, Jim. Sharing the Wealth, If We Shift the Tax Burden From Work to Waste, Everyone Benefits, in E-magazine, http://www.emagazine.com/march-april_1999/0399feat1.html

services. And finally, tax is an instrument to finance the lifestyle of the chosen ones and their civil servants that assist them to stay in power.

Tax may be an instrument to achieve environmental goals. The industrial revolution and the growing population caused a massive usage of land characterized by environmental damages. If the plant makes $1,000 worth of its product at a cost of $2,000 in environmental damage, it nets $1,000, meaning the pollution's victims are subsidizing the polluter. Even more perversely, a conscientious factory owner who wanted to buy equipment to cut the pollution couldn't, since the cost would put him at an economic disadvantage to his competitors. It's a bizarre, unfair situation. British economist Arthur Cecil Pigou recognized this inequality in the 1920's and advocated environmental taxes that would make polluters pay the real costs of their activities. He's as right today as 80 years ago.[27]

5.3.4 Economic Goals

The primary goal of a national tax system is to generate revenues to pay the expenditures of government at all levels. Because public expenditures tend to grow at least as fast as the national product, taxes, as the main vehicle of government finance, should produce revenues that grow correspondingly. Income, sales, and value-added taxes generally meet this criterion; property taxes and taxes on nonessential articles of mass consumption such as tobacco products and alcoholic beverages do not.

Tax policies can promote economic growth. In order to obtain it, the state should avoid measures preventing growth and emphasize measures stimulating it. This approach may imply a qualitative restructuring of the tax system or special tax advantages to stimulate saving, labour mobility, research and development, etc. It implies the need to avoid high marginal tax rates and the tax-induced diversion of resources into relatively unproductive activities.

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27 Pigou, Arthur C. 'Wealth and Welfare', 1912, London: Macmillan, quoted in 'Greening the Tax Man' in The progress report, http://www.progress.org/archive/shift03.htm

5.3.5 Shifting and Incidence

The incidence of a tax rests on the person whose real net income is reduced by the tax. It is fundamental that the real burden of taxation does not necessarily rest upon the person who is legally responsible for payment of the tax.[28]

Business firms pay sales taxes but most of the burden is assumed to rest upon those who buy the goods that are taxed. In other words, the tax is shifted from the business to the consumer.

Taxes may be shifted in several directions. Forward shifting takes place if the burden falls entirely on the user, rather than the supplier of the commodity or services in question e.g., if an excise tax on luxuries increases their price to the purchaser. Backward shifting occurs when the price of the article taxed remains the same and the cost of the tax is borne by those engaged in producing it e.g., through lower wages and salaries, lower prices for raw materials or a lower return on borrowed capital. Finally, a tax may not be shifted at all; for example, a tax on business profits may reduce the net income of the owner of the business.

Tax capitalization occurs if the burden of the tax is incorporated in the value of long-term assets e.g., if the price of land declines by an amount that offsets an increase in property taxes. In this case, the present owner of the land takes a capital loss when he sells the asset. Its price will be lower by the capitalized value of the tax.

The direction and extent of tax shifting is determined basically by one principle. The user of a tax object can avoid the tax burden to a greater or lesser extent the easier or the more difficult it is for him to find non-taxed or less-taxed alternatives or substitutes for the tax object. The supplier of a production factor that is taxed itself can avoid the tax burden to a greater or lesser extent the easier or the more difficult it is for him to find equivalent non-taxed or less taxed alternative employment opportunities for this factor.

Because the demand for substitute goods will increase, their prices may rise, thus benefiting the producers of such goods and placing part of the tax burden on those

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28 Shifting Gears: Rethinking Property Tax Shift Relief, Legislative Analyst's Office, February 2, 1999, http://www.lao.ca.gov/020299_property_tax_shift.html

individuals who used them before the tax was imposed. Likewise, the productive factors that seek alternative employment's to avoid the tax will tend to receive lower returns in those employment, thus placing part of the burden on individuals who supplied the factors in those sectors before the tax was imposed.

For example, if wine is taxed while beer is not, these two beverages are regarded as perfect substitutes, and the price of beer does not rise with increased demand, the tax burden will fall on the owners of land used for viticulture and on the workers engaged in it. It will fall mainly on the landowners if the soil is specific to wine growing and if labour has alternative employment possibilities. If, on the other hand, wine drinkers are determined to drink only wine, they will bear most of the tax burden. If some substitution of beer for wine takes place, the price of beer rises somewhat, both, wine and beer drinkers will bear the burden, and owners of resources specialized to the production of beer will benefit.

The extent of shifting may vary over time, depending on how long it takes to adjust consumption patterns, reallocate land and capital, and re-train labour. Those users and suppliers who have the most difficulty in adjusting will bear the largest burden.

The kind of tax that is imposed affects tax shifting. The broader/narrower the tax bases, the higher/lower his tax burden, since the range of non-taxed or less-taxed substitutes at his command is narrower/wider. Thus, an excise tax on only a few alcoholic beverages allows partial shifting through a change in the consumption pattern, while a tax on all such beverages does not.

The smaller the jurisdictional unit imposing the tax, the easier it tends to be for a user to obtain non-taxed or less-taxed substitutes from outside the jurisdiction and for a supplier to find non-taxed or less-taxed outside employment opportunities for his goods and services. Thus, a medium-size city that imposes a high property tax that is likely to be borne by suppliers of commodities. This is particularly relevant to the determination of the incidence of city property taxes that are often to be exported out of city by moving the industry or shopping centers to other cities. In small communities, the only really immobile factors are likely to be real estate, certain local services, and poor families.

5.3.6 Classes of Taxes

Taxes are most commonly classified as either direct or indirect, an example of the former type being the income tax and of the latter the sales tax. It is usually said that a direct tax is one that cannot be shifted by the taxpayer to someone else.

Direct taxes - direct taxes are primarily taxes on persons; they are aimed at the individual's ability to pay as measured by his income or his net wealth. The main types of direct taxes are the following.

Individual income taxes are commonly levied on total personal net income in excess of some stipulated minimum. They are also commonly adjusted to take into account the circumstances influencing the ability to pay of the individual, such as family status, number and age of children, and financial burdens resulting from illness. They are often levied at graduated rates, that is, at rates that rise as income rises.

Taxes on net worth are levied on the total net worth of a person, that is the value of his assets minus his liabilities. As with the income tax, the personal circumstances of the individual can be taken into consideration.

Taxes at death take two forms: the "inheritance tax", where the tax object is the bequest received by the person inheriting, and the "estate tax", where the object is the total estate left by the deceased. Inheritance taxes usually allow for the personal circumstances of the taxpayer, including his net worth before receiving the bequest and his relation to the donor. Estate taxes are generally graduated according to the size of the estate, and in some countries they make allowance for the number of children involved.[29] In order to prevent the death duties from being circumvented, any rational and efficient tax system has to include a "gifts tax" between living persons, particularly those deemed to be made in anticipation of death.

"Spending taxes", are taxes on all income that is not channeled into savings. In contrast to indirect taxes on spending, such as the "sales tax", an expenditure tax can be adjusted to an individual's ability to pay by allowing for marital status, age,

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29 Saxton, Jim. The Economics of the Estate Tax, in Join Economic Committee Study, U.S. House of Representatives, http://www.house.gov/jec/fiscal/tx-grwth/estattax/estattax.htm

number of dependents, etc.

Indirect taxes - Indirect taxes are levied on objects and services or transactions. They include general and selective taxes on sales of consumer goods, value-added taxes, taxes on goods in the process of production, taxes on legal transactions, and import or customs duties.

"Sales taxes" are levies that burden a substantial portion of consumer expenditures. The same tax rate can be applied to all taxed items, or different items can be subject to different rates. Single-stage taxes can be collected at the retail level, or they can be collected at a pre-retail (manufacturing or wholesale) level. Multistage taxes are applied at each stage in the production-distribution process. Value-added taxes, one of the most important fiscal innovations of the second half of the 20th century, are commonly collected by allowing the taxpayer to deduct a credit for tax paid on purchases from liability on sales. Such taxes have largely replaced turnover taxes, a defective form of tax in which tax was collected at each stage, with no relief for tax paid at previous stages.

Taxes on specific commodities are called excises, as distinguished from sales taxes and other general consumption levies. Generally applicable sales taxes sometimes exempt necessities in an effort to reduce the burden on low-income households. Excises and customs duties are levied on almost everything, from necessities such as bread, meat, and salt, to nonessentials such as cigarettes, wine, liquor, coffee and tea, to luxuries such as jewels and furs.

Some excises and custom duties are specific i.e. they are levied on the basis of weight, length, volume, and other specific characteristics of the tax object. Other taxes are ad valorem, levied on the value of the goods as measured by the price.

Taxes on consumer durables formerly were applied to luxury commodities such as pianos, saddle horses, carriages, and billiard tables. Today the main tax object is the automobile, largely because registration requirements facilitate administration of the tax.

Taxes on intermediate goods and production factors are levied on raw materials, intermediate goods, machines, or labour.

Taxes on legal transactions are levied on the issue of shares, on the sale of houses and land, and on stock exchange transactions. For administrative reasons, they are frequently levied in the form of stamp duties, that is, the legal or commercial document is stamped to denote payment of the tax.

Proportional, progressive, and regressive taxes - Taxes can also be distinguished on the basis of the effect they have on the distribution of income and wealth. A proportional tax is one that imposes the same relative burden on all taxpayers i.e., where tax liability and income grow in equal proportion. A "progressive tax" is characterized by a more than proportional rise in the tax liability relative to the increase in income, and a "regressive tax" is characterized by a less than proportional rise in the relative burden.[30] Thus, progressive taxes reduce the inequality of income distribution and regressive taxes increase it.

Examples of taxes that are generally considered progressive are income taxes and death duties. Income taxes that are nominally progressive may become less so in the upper income categories. On the other hand, in the lower income categories to which a proportional tax rate applies, some progression is introduced through the personal exemptions.

Sales taxes and excises tend to be regressive, even though they may be nominally proportional, because the share of personal income spent on a specific good decline as the level of personal income rises. Poll taxes, levied as a fixed amount per capita, obviously are regressive.

Because of uncertainty about the shifting of corporate income taxes and property taxes, it is difficult to know whether such taxes are progressive, regressive, or proportionate. This uncertainty is confounded by the fact that determining on whom the burden of such a tax falls depends on whether a national or a state tax is being considered.

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30 "The solution is to make the regressive taxes pinch landowners. The income tax, when new, was designed to do exactly that. Georgists like Congressman Henry George, Jr. and Warren Worth Bailey took the lead in shaping it to do so. Over time, though, it has changed into mainly a payroll tax, and as it changed it became increasingly popular with landowners. It served their greed and became the clarion call of their constant clamor for 'property tax relief'." Gaffney, Mason. Property Tax Reform Priorities, part 9, Priority #5: Make Landowners Pay Their Taxes, in The Progress Report, http://www.progress.org/archive/gaffne09.htm

5.4 Principles of Taxation

The 18th-century philosopher Adam Smith attempted to systematize the rules that should govern a rational system of taxation, and he set down four general canons:[31]

I. The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state…

II. The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor and to every other person…

III. Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it…

IV. Every tax ought to be so contrived as both to take out and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state…

Although they need to be reinterpreted from time to time, these principles especially the first and last, retain remarkable relevance. From the first can be derived both of the leading views of what is fair in the distribution of tax burdens among taxpayers. These are the belief that taxes should be based on the individual's ability to pay, known as the ability-to-pay principle, and the benefit principle, the idea that there should be some equivalence between what the individual pays and the benefits he derives from governmental activities.

The fourth of Smith's canons can be interpreted to underlie the emphasis many economists place on a tax system that does not interfere with market decision making, as well as the more obvious need to avoid complexity and corruption.

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[31] Smith, Adam. The Wealth of the Nations, book 5, Chapter II, part II - of taxes, pp. 1103-1106. The Electric Book company, http://www.elecbook.com/admsmith.zip

5.4.1 Distribution of Tax Burdens

The principle of horizontal equity requires that people in the same or similar positions so far as tax purposes are concerned will be subject to the same tax liability. In practice, this equality principle is often disregarded, both intentionally and unintentionally.

Intentional violations are usually motivated more by politics than by sound economic policy *e.g.,* the tax advantages granted to farmers, homeowners, or members of the middle class in general; the exclusion of interest on government securities. Much of recent debate over tax reform has centered on whether deviations from "equal treatment of equals" are justified.

5.4.2 The Ability-to-Pay Principle

The ability-to-pay principle requires that the total tax burden be distributed among individuals according to their capacity to bear it, taking into account all of the relevant personal characteristics in such a way that the relative loss in economic capacity resulting from the tax is equal.[32]

The primary indicator of ability to pay is commonly agreed to be income. Some theorists include wealth in the ability-to-pay criterion. Indirect taxes such as excise, sales, turnover, or value-added taxes can be adapted to the ability-to-pay criterion only to a limited extent, for example, by the taxation of services, the exemption of necessities, or the differentiation of tax rates according to "urgency of need."

The argument is that because of differences in talent and other accidents of birth and because of various restrictions and monopoly elements, the market mechanism does not necessarily distribute income and wealth according to effort and merit. Moreover, poverty may result from some work disability or from an unfavorable social or family background. The latest view is that taxes should not be used for re-distributive purposes, because of the disincentives and distortions that high tax rates create.

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32 See on this topic: Tax Equity: Benefit and Ability to Pay Principles, The World Bank Group, http://www1.worldbank.org/publicsector/tax/tax_equity.htm

5.4.3 The Benefit Principle

Under the benefit-principle, taxes are seen as serving a purpose similar to that of prices in private transactions. That is, they help determine what activities the government undertakes as well as who pays for them.

If this principle could be implemented, resource allocation would be directly responsive to the wishes of citizens as consumers of public services, not just as voters. To the extent that the demand for public services does not rise in proportion to income, benefit-related taxes would be regressive.

In fact, it is difficult to implement the benefit principle for most public services because citizens generally have no incentive to pay the tax and reveal their preferences for publicly provided activities, unless they can be excluded from enjoying the benefits of the service if they fail to pay.

The benefit principle is utilized primarily in the financing of roads and highways through levies on motor fuels and road user fees. Payroll taxes used to finance social security may also reflect a link between benefits and "contributions," but this link is commonly weak.

5.5 The Influence of Tax Rates on the Land Value

An income tax imposed on the rent of land is a direct instrument to share the income between the landlord and the state treasury. A property tax imposed on the ownership of land is an indirect instrument to share the potential income between the landlord and the state Treasury or the exchequer of the local authorities.

As long as the rates of those taxes are reasonable, one may consider them as a payment to the state in exchange to the protection they supply him by the legal system (courts and police force) to enjoy the benefits of his property. This kind of relationship may be described also as a "partnership" between the landlord and the government, in which the landlord takes the direct care of the real estate and its fruits, and the government, the "silent partner", is responsible to maintain a system that supports this practice.

If the rates of those taxes are not reasonable, and the "silent partner" is claiming too big a portion of the benefits, it may be considered as a continuing process of confiscating the equity of the owner. While confiscation of land is a compulsory selling and the confiscator should pay for the property, in the continuing process of confiscation the owner gets no payments. Actually, high rates of taxation reduce the value of land, because the landlord gains a small portion of its benefits.

Tax capitalization occurs when the burden of the tax is incorporated in the value of long-term assets e.g., if the price of land declines by an amount that offsets an increase in property taxes. Capitalization can result where there is forward shifting, backward shifting, or no shifting e.g., an increase in the price of gasoline resulting from higher motor fuel taxes may reduce the value of high-consumption automobiles. In such cases, the present owner of the asset takes a capital loss since, when he sells the asset, its price will be lower by the capitalized value of the tax.

Early empirical studies based on the traditional view found the property tax to be regressive in its pattern of incidence. Treating the tax burden on housing as proportional to annual housing expenditure and consumption as a proportion of measured annual income fall with the level of income, the property tax must be regressive. Later studies, however, employing a permanent-income concept and other improvements in measurement procedures, cast serious doubt on the regressing of the tax.[33]

5.6 The Structure of the Tax Law

All tax laws and other compulsory payment laws has a similar legal structure, because they have the same purposes - to impose a compulsory payment upon the tax payer and collecting money to the state Treasury or to the exchequer of the local authorities.

It has no significance which legal system imposed the tax. It has no significance if it is a law that was legislated in the year 2001, in Rome or among an ancient primitive society - in all these laws one can find the same legal structure that is the result of the same purpose those laws try to achieve.

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33 Property Taxation, Etwell, John (ed). The New Palgrave a Dictionary of Economics, volume 3, p. 1034, the Macmillan Press Limited, London, 1987.

I have found in tax laws 12 basic fundaments. Sometimes, a tax law contains all of them and sometimes most of them -

A. **The authority** - the state, local municipality or other authority that is entitled to impose the tax.
B. **The tax-subject** - the taxpayer.
C. **The tax-object** - the object that is the cause to impose the tax upon the taxpayer.
D. **The tax event** - the event that creates the abstract obligation of the taxpayer.
E. **The payment day** - the date when the abstract obligation of the taxpayer becomes a debt, which the tax collector is entitled to collect the tax.
F. **The tax rates** - the sums, the percentages, and the rates of the tax.
G. **Exempts and reductions** - the terms to reduce the sum of the tax or to exempt the taxpayer of paying it.
H. **Declaration and self-assessment** - the duty of the tax payer to declare upon various details regarding the relevant data i.e. his name, tax-object, tax event, tax rates, exempts and reductions etc. In some tax laws his duty to prepare a self-assessment and to submit it to the tax officer.
J. **Tax assessment** - the duty of the tax officer to prepare the tax assessment, and to submit it to the taxpayer.
I. **Appeal** - the rights of the taxpayer to object the tax assessment, and the ways to implement the objection.
K. **Tax enforcement** - the legal ways by which the tax collector is entitled to collect the tax debts should the taxpayer fail to pay it after the payment day.
L. **Interest, fines and penalties** - the interest the fines and the penalties imposed on the taxpayer if he fails to fulfil his duties i.e. declaration, self-assessment and paying the tax on the due date.

5.6.1 The Authority

Any tax law defines which authority is entitled to impose the tax. Usually, the tax authority is the government, but it may be as well the state or canton governor, a local municipality, a planning committee, the social security bureau, or any other authority that is entitled by the law to impose the compulsory payments.

5.6.2 The Taxpayer

The subject of the tax is the taxpayer. The tax is imposed on the taxpayer and he is obliged to pay it. Most of the tax laws are not using the exact formulation and they say that the tax is imposed on the object, i.e. the income tax is imposed on the income, the property tax is imposed on the property etc.

A tax law should define punctually who are the taxpayers that should carry the burden. The tax officer that prepares the assessment is obliged to certify that the assessment the notification is issued to the correct name of the taxpayer including his identification number.

A taxpayer should be a legal entity - human or corporation. One cannot impose tax upon a commercial name i.e. Coca-Cola for the simple reason that nobody will pay it, therefore, an assessment that is issued to Abraham the shoemaker is invalid. An authority that is issued to a wrong name may lose the tax. The result is that the subject of the income tax is the one who had income, the subject of the property tax is the owner of the land, and the subject of the V.A.T is the one who sells goods or services.

5.6.3 The Tax Object

The tax-object is the object that is the cause to impose the tax upon the taxpayer. The tax is not imposed on the object because an object has no legal entity. The income is the cause to impose income tax, selling goods or submitting services is the cause to impose V.A.T., owning property is the cause to impose property tax, buying or using luxury products or services is the cause to impose luxury tax, and death is the cause to impose inheritance tax.

5.6.4 The Tax Event

The tax event is an action that is performed by the taxpayer or by other, or timing specified by the tax law. The tax event creates the abstract obligation of the taxpayer. At the moment of the tax event, the debt of the taxpayer is not yet crystallized because no tax assessment has been prepared at this time.

The timing of the income is the tax event of income tax. At that time, the obligation of the taxpayer to pay income tax is abstract because the fiscal year was not ended and the income is calculated on the income of the whole year.

The tax event of the capital gain tax (land appreciation tax), the purchase tax, and the selling tax happens at the day that the parties sign the selling contract. At that moment the obligation of the taxpayers to pay capital gain tax, purchase tax, and the selling tax is abstract because the tax assessments have not yet been prepared, and the amount of the taxes have not yet been calculated.

The tax event of the betterment levy is the day that the zoning plan becomes valid and it raises the value of the land. At that day, the obligation of the taxpayers to pay the betterment levy is abstract because the tax assessment has not yet been prepared.

The tax event of property tax is the first day of the fiscal year i.e. the first of January in many countries. The obligation of the taxpayers to pay the property tax will be crystallized when the tax officer will prepare the tax assessment.

Should the taxpayer submit an appeal against the tax assessment, the final debt will be crystallized on the day that the court or the appeal committee will issue its verdict. The outcome is that the tax event creates only an abstract obligation of the taxpayer to pay his taxes, and his timing is significant to various matters i.e. calculation of interest on the tax and bankruptcy.

5.6.5 The Payment Day

The payment day is the date when the abstract obligation of the taxpayer becomes a debt, which the tax collector is entitled to collect the tax.

In some tax laws, the payment day is right after the tax event i.e. property tax, but usually the tax payer is entitled to pay his debt in a few rates during the fiscal year. In some tax laws, there are several payment days i.e. income tax that obliges to pay advance payments every month even though the tax assessment will be issued much later. The payment day of V.A.T is usually the month following the month that has been assessed.

5.6.6 The Tax Rates

The tax rates are the sums, the percentages, and the rates of the tax. Each tax has a rate and most of the taxes have several rates. The tax rates can be imposed in the main law or in regulations. The tax rates can be defined in fixed sums, in progressive or regressive scales, in percentages of the sum that is part of the tax event i.e. income, turnover, betterment, capital gain or value. The tax rates can be defined in proportion to weight, size, space, number of items etc.[34]

In order to defer the rates, the tax law should define various parameters. Those parameters can relate to characters of the taxpayer i.e. his trade, and of the tax object i.e. land or building.[35]

The sum of the tax is counted usually by multiplying the rate with the amount of the weight, the size, the space, or the number of items.

5.6.7 Exempts and Reductions (Discounts)

The exemptions and rate structure that exist in a tax system are an expression of

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[34] At Hamburg every inhabitant is obliged to pay to the state one-fourth per cent of all that he possesses; and as the wealth of the people of Hamburg consists principally in stock, this tax may be considered as a tax upon stock. Every man assesses himself, and, in the presence of the magistrate, puts annually into the public coffer a certain sum of money which he declares upon oath to be one-fourth per cent of all that he possesses, but without declaring what it amounts to, or being liable to any examination upon that subject. This tax is generally supposed to be paid with great fidelity. In a small republic, where the people have entire confidence in their magistrates, are convinced of the necessity of the tax for the support of the state, and believe that it will be faithfully applied to that purpose, such conscientious and voluntary payment may sometimes be expected. It is not peculiar to the people of Hamburg. Smith, Adam. The Wealth of the Nations, book 5, chapter II, Article II - Taxes on Profit, or upon the Revenue arising from Stock, p. 1139. The Electric Book company, London, http://www.elecbook.com/admsmith.zip

[35] In the different poll taxes (capitation tax H.R.) which took place in England during the reign of William III the contributors were, the greater part of them, assessed according to the degree of their rank; as dukes, marquisses, earls, viscounts, barons, esquires, gentlemen, the eldest and youngest sons of peers, etc. All shopkeepers and tradesmen worth more than three hundred pounds, that is, the better sort of them, were subject to the same assessment, how great soever might be the difference in their fortunes. Their rank was more considered than their fortune. Smith, ibid., book 5, chapter II, Article IV - Taxes which, it is intended, should fall indifferently upon every different Species of Revenue, p. 1165.

social policy toward institutions that are to be favored, including marriage, schools, charities, churches, and redistribution of wealth and income. Exemptions or low rates on gifts and bequests to spouse and children represent a social policy in favor of the family unit. Provisions in tax laws that favor educational, religious, and charitable organizations reflect a desire to encourage private support of these institutions.

Tax exemptions and rate structure also serve as an instrument for redistributing wealth and income. But, as in the case of the income tax, the methods of avoidance must be considered before any conclusion is drawn concerning the actual impact of death and gift taxes on the distribution of wealth and income.

Almost all tax laws include exempts and reductions. The exempt and the reduction are irregular to the rule of the abstract obligation of the taxpayer that is created at the tax event. Each one of the exempts and the reductions has one or more terms that should exist to imply the exempt or the reduction on the taxpayer. I will define four of the most common terms' groups that occur in most of the tax law to imply the exempts and reductions.

A. Exempt and reduction based on the character of the taxpayer - many exempts and reductions depend on the character of the taxpayer. In Israel, a blind person is exempt from income tax on his salary, public institute is exempt from income tax and land appreciation tax, and elders receive a reduction in their municipal general rate.

The main idea behind these sort of exempts and reductions is that in each society there are members who should pay less taxes or not pay them at all. Ironically, these members may be belonging to the poor class or to the rich.

B. Exempt and reduction based on the character of the tax object - there are tax-exempts and tax reductions, which are granted due to the characters of the tax object. For example, the selling of an apartment has an exempt from capital gain tax (land appreciation tax) in most of the countries.

C. Exempt and reduction based on the geographical location - some exempts and reductions are gratitude for the geographical location of the tax event. There is no V.A.T in Eilat because the government decided to encourage the economy in the southern city in Israel. Citizens that live close to the borders have reductions in income tax. Residents in poor neighborhoods are exempted from a betterment tax.

The idea behind these sorts of exemptions and reductions is that in each country there are areas and zones that the tax attached to them should be less than the rest of the country.

D. Exempt and reduction based on the mixed characters - there are exemptions and reductions that require few conditions, i.e. an exempt from property tax is granted to a tax payer who owns only one apartment, that its' value is less than a certain amount set by the law. This exempt requires three conditions: a tax payer who owns only one apartment, a property that is defined as an apartment, and a price of the apartment which should be less than a certain sum.

Income tax rates could be lowered one-third with no resulting reduction in the amount of money raised if all income were subject to tax and the personal deductions were pruned to the essential items.[36]

5.6.8 Declaration and Self-Assessment

Some tax laws impose a duty on the taxpayer to submit a declaration about various details concerning his tax assessment. Some tax laws, i.e. income tax, impose a duty on the taxpayer to submit a self-assessment that means to calculate the sum of the tax he is obligated to pay. There are tax laws that grant the choice to the taxpayer whether to submit a declaration or a self-assessment.

5.6.9 Tax Assessment

The tax event imposes an abstract obligation to the taxpayer. In order to calculate the sum of the tax that the taxpayer is obligated to pay, a tax assessment must be conducted. The assessment process is an implementation of the abstract concepts, which are included in the tax laws, according to the database of the taxpayer, tax object, tax event, and any other relevant data.

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[36] Pechman, Joseph A. The author of 'Who Paid the Taxes, 1966-85?', quoted in 'The Need for Tax Reform', in The Progress Report, http://www.progress.org/archive/gard05.htm

The tax officer that is called many times by mistake the "tax collector" has to assess the amount of tax that is imposed on the taxpayer. Some tax laws impose a duty on the taxpayer to submit a self-assessment, such as income tax, V.A.T, and inheritance tax.[37]

The income tax, and also other taxes on the transfer of property, such as the inheritance tax, the taxpayer submits a tax return providing information as to his occupation, his real and personal property, his professional expenditures, and other pertinent matters. A corporation supplies, additionally, copies of the balance sheet, profit and loss statement, and minutes of the general meeting that approved these financial reports.

Most tax systems also collect information in other ways, in order to inform the authorities as to potential tax liabilities. Records are kept of such matters as the allocation of income by partnerships, trusts, or estates, and the payment of fees, interest, dividends, and other sums exceeding a certain minimum amount.

The second phase in levying taxes is the calculation of the amount to be paid. In the U.S. self-assessment method, the liability for income tax is primarily established by the taxpayer himself. The final computation of taxes levied on income, on inherited property, or on the transfer of property is made by the tax administration. Sales taxes and value-added taxes are calculated by the taxpayers.[38]

The tax announcement - The assessment process turns the abstract obligation of the taxpayer into a certain sum. Following the assessment process, the tax officer sends the tax announcement to the taxpayer.

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37 "The canton of Unterwald in Switzerland is frequently ravaged by storms and inundations, and is thereby exposed to extraordinary expenses. Upon such occasions the people assemble, and every one is said to declare with the greatest frankness what he is worth in order to be taxed accordingly. At Zurich the law orders that, in cases of necessity, every one should be taxed in proportion to his revenue—the amount of which he is obliged to declare upon oath. They have no suspicion, it is said, that any of their fellow-citizens will deceive them... But it is impossible that they should continue to do so for any considerable time; and if they did, the tax would ruin them so completely as to render them altogether incapable of supporting the state. Smith, ibid., book 5, chapter II, article II - Taxes on Profit, or upon the Revenue arising from Stock, p. 1140.

38 Tax Law, Assessment, Encyclopaedia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=115311&tocid=71937#71937.toc

The tax announcement should contain all the details of basic fundaments, such as the name and identity number of the taxpayer, the description of the tax object, description of the tax event, the tax rates, the tax sum, the sums of the exempts and the reductions, and the payment day. In most countries, the tax announcement should contain a note about the rights of the taxpayer to appeal against the tax assessment, to which court or tax appeal committee it should be submitted, and within the time period to submit such an appeal.

5.6.10 Appeal

Any tax law that allows the authority to impose taxes allows the taxpayer to appeal against the imposing of the tax at all, or to appeal against the rates and the sums of the tax that were set in the tax assessment.

Usually, the first stage the taxpayer files an appeal to the tax officer himself. After the tax officer gives his decision to such an appeal, the taxpayer has the right to appeal against this decision to the court or to a tax appeal committee.

The tax appeal committee conducts the legal process of the dispute between the tax officer and the taxpayer. These committees usually contain a chairman, who is a judge or a lawyer, and two other members who are experts in the said tax law. Such committees conduct the process in a similar way of court, hear witnesses, collect documents and experts opinions, and submit its decision.

On the decision of the tax appeal committee, both the taxpayer and the tax officer may appeal to an appeal court, and usually its verdict is final.

5.6.11 Tax Enforcement

Should the taxpayer fail to pay his taxes on the payment day, and if there is no appeal pending against the tax assessment, the tax collector is entitled to collect the debt.

Usually, the collection of tax debt is being carried out via a particular law that grants the tax collector the rights and the power to put enclosure on the property of the taxpayer, and to take any other measures against the person, i.e. arrest, or his assets.

5.6.12 Interest, Fine and Penalties

If the taxpayer fails to pay within the legally prescribed period or within a very short time afterward, the authoritative tax officer is allowed to collect the amount due.

In addition to interest charges on the amount due, various kinds of coercive measures are available to ensure payment. Civil penalties consist generally of a fine when the violation is the result of negligence rather than of willful neglect or bad faith. Examples of negligence are the failure to file a required declaration or self-assessment on time and understatement or underpayment of the tax liability without intent to mislead. Civil penalties are fixed by assessment, so that the procedural remedies of the taxpayer are identical with those provided for the assessment of the tax itself.[39]

In proceedings against the taxpayer, the tax administration is not in the position of an ordinary creditor suing an ordinary debtor. The law grants the tax administration a privileged position on the other creditors of the taxpayer.

5.7 Income Tax

5.7.1 Classification of Profits and Taxes on Profit

The difference between capital gains and profit earnings can be illustrated by an example drawn from the natural world. Fruit trees bear fruit every year, and picking and eating them does not hurt the tree itself. Yearly rental fees from a piece of property are similar to the fruit of a tree, and the use of the rental fees for the needs of the property owner does not harm the property itself.

However, just as the farmer must water the tree, fertilize the ground from which the tree is growing and spray the tree against pests, so the property owner must continuously look after and maintain the property in good order.

When the owner of a grove of fruit trees sells the land or fells the trees to a paper

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[39] Tax Law, Enforcement, Encyclopaedia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=115311&tocid=71939#71939.toc

manufacturer, he loses all at once any chance of enjoying the fruit that the tree will produce in the future. When a property owner sells his assets in this same way, he will also lose, all at once any and all future rental income from said property.

The profit gained by selling a capital property is called "capital gains". When an owner of property leases a property for the use of others, he receives a rental fee in exchange and this income is considered profit earnings.

5.7.2 Income Tax on Profits of Real Estate

Income tax is also imposed on profits of real estate. In the calculation of this profit, the devaluation of the rented property is subtracted from the income received from said property. The amount of the devaluation is meant to reflect the drop in the value of the property for as long as the property has existed. The quality of the materials used in the construction and what the property is used for determine this. In fact, the tax law itself determines the annual devaluation rate for tax purposes, and there is no practical importance of this matter during the expected life span of the rented property.

There is a standard depreciation period for most buildings, determined by each income tax law, i.e., in Israel the depreciation is 2% per annum of the construction costs, exclusive of land cost. That is to say that the entire price that was paid for the construction of the building devaluates in periods over 50 years. According to other tax laws, a different annual depreciation rate was set such as 4% per annum, and the full price of the construction is devalued during only 25 years. With regard to industrial properties, their devaluation rate is more significant, assuming that the life span of these properties is shorter than properties that are used for residential, office, or merchandizing.

When a taxpayer purchases a plot of land and builds a structure on it, the value of the land is not devalued as far as the taxes are concerned only the building. After all, the life expectancy of the land is forever. However, when a taxpayer buys an existing structure, the tax law establishes a legal presumption, according to which a fixed portion of the price refers only to the building, and the devaluation for the tax assessment is calculated on this portion. For this purpose there is no significance with regard to the market value of the land itself or to the cost of constructing a similar building.

From the income received from the lease of land the taxpayer is entitled to deduct the interest he pays on the loans he has taken in order to purchase the property. This benefit encourages investors to finance a large part of the cost of purchasing the land with long-term bank loans. The interest rate of the bank is influenced by the inflation rate of the same period, in other words, by the deflation of the buying power of money, plus the profit that the banks are asking for the use of the money.

If there occurs a period of time during which the inflation is very high, the yearly interest rate is liable to increase to the same amount as the yearly rental fees of the property. This still allows the property owner to keep his entire income without paying tax at all. In countries where inflation is rampant, income tax laws are amended on a regular basis because the rate of annual inflation is to be deducted from the interest rate that is recognized by the tax authorities as an expense. In this way, only when an interest rate surpasses the inflation rate it is recognized as an expense. The basic concept here is that real estate always retains its real value and its market value is not influenced by inflation.

Tax purposes dictate that ongoing maintenance and repair fees are also to be deducted from rental income, as well as management fees and collection expenses. For the calculation of taxable yearly profit, the following are deducted from the rental income: recognized devaluation rate, interest paid on the loan used to purchase the property and the expenses incurred from the collection of rent. Income tax is paid on the balance.

5.7.3 Corporation Tax

Federal state or local government imposes on the corporation an income corporation tax. The separate taxation of the incomes of corporations and their shareholders follows the legal principle that they are distinct entities.

A tax may have to be assessed on corporations to prevent shareholders from escaping current taxation on undistributed profits. Their shares appreciate in value, converting this income into capital gains, which in most countries either are taxed at lower rates than ordinary income or are free of income tax.

A corporation income tax also enables a country or state to tax profits earned within its borders by corporations whose shareholders reside elsewhere. Corporation income taxes are mainly flat-rate levies, rather than extensively graduated taxes with rates rising according to income as in the typical individual income tax.[40]

In 1909 the federal government imposed an excise tax on the net income of U.S. corporations. That tax was superseded by a corporation income tax after the Sixteenth Amendment (1913). In Great Britain, in 1920 a tax was levied on corporations, including foreign companies of limited liability doing business in the United Kingdom, but exempting the profits of corporations receiving income from other corporations already taxed. In both the United States and Great Britain, excess profit tax has generally been imposed only during wartime.

5.7.4 Capitation Tax

An ancient form of income tax is the capitation tax that was diminished in the 20th century. The capitation tax was a major direct tax in France before the Revolution of 1789, first established in 1695 as a wartime measure. Originally, the capitation was to be paid by every subject, the amount varying according to class.

While the rates of the income tax are progressive, the rate of the capitation tax is imposed indifferently upon every different type of revenue, the rent of the land, the profits of the stock, or from the wages of the labour.

"Capitation taxes, if it is attempted to proportion them to the fortune or revenue of each contributor, become altogether arbitrary... This assessment, therefore, must in most cases depend upon the good or bad humor of his assessors, and must, therefore, be altogether arbitrary and uncertain."[41]

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40 Income tax, corporate, rationale of the corporation tax, Encyclopaedia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=115313&tocid=71960

41 Smith, Adam. The Wealth of the Nations, book 5, chapter II, article IV - Taxes which, it is intended, should fall indifferently upon every different Species of Revenue, p. 1164. The Electric Book company, http://www.elecbook.com/admsmith.zip

5.7.5 The Negative Income tax

The idea of a negative income tax has been considered in the United States as a method of providing very low-income families with a stable subsistence level of income in the form of government payments geared into the personal income tax structure. It is viewed as a possible substitute for public assistance or as an alternative to family allowances.

The basic idea behind this is to guarantee a minimum level of income adjusted to the size and composition of the family unit. It has to guarantee a tax rate to be applied to the difference between the family's income and some specified amount, and a break-even level of income at the point at which the tax liability equals the guaranteed allowance.

The earned income tax credit in the tax law of the United States amounts to a form of negative income tax, but it is available only to those who are employed and supporting dependent children.[42]

5.8 Capital Gains Tax (Land Appreciation Tax)

When the owners of real estate sell the properties at a higher price than that which was paid for, the profit is considered capital gains. In many countries there is a capital gains tax[43] on this profit.

In order to calculate the profit which results at the time the property is sold, the cost of the property, plus the expenses incurred in the upgrading of the property, obligatory payments of any kind, and sometimes also the interest that the owner pays on the loan taken in order to purchase the property, are deducted from the price of the sale of said property.

This rule encourages investors to finance a large part of the cost of the property with long-term bank loans. Obviously, the expenses cannot be claimed twice, meaning, in the assessment of taxable income regarding a rental property and also

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42 The Negative Income tax, Encyclopaedia Britannica, Britannica.com editors, http://www.britannica.com/bcom/eb/article/0/0,5716,115312+9,00.html

43 Known also as a Land Appreciation Tax.

in the calculation of capital gains at the time of sale of this same property.

There are countries in which the holding of property for a period of a few years relieves the seller of the capital gains tax, i.e. Germany and Poland. Generally, in these countries a property tax is imposed on the net capital, and sometimes combined with a gift tax and an inheritance tax.

The taxation of capital gains and losses presents a special set of problems to which different countries have found different answers. An increase in the value of a capital asset, a share of stock, a corporate or government bond, or real estate, increases the net worth of its owner, and thus, it can be seen as a form of income. There is a problem, however, of valuing all of the capital assets a taxpayer may own so as to be able to determine how much his net worth has increased or decreased during the taxable year. In practice, this difficulty has usually been avoided by taking into account only those gains and losses that have been realized in the form of cash or its equivalent.

Even realized capital gains may present a problem of valuation. During an inflationary period, an increase in the monetary value of an asset may not mean that there has been an increase in the real inflation-adjusted value of the asset. The conceptually correct solution to this problem is to adjust the cost of the asset for inflation.

The knowledge that capital gains are subject to very heavy taxes upon realization can deter individuals subject to high-bracket rates from making investment decisions that are socially desirable. This difficulty is usually handled by taxing such gains at a relatively low rate or by excluding a stated percentage of the gain from taxable income. In either case, this special treatment applies only to long-term gains involving assets that have been held for a minimum length of time.

Some countries, including Canada, France, and Germany, do not tax capital gains unless they arise out of a business. The line between a business transaction and a personal one is not easy to draw. Moreover, the exemption of capital gains provides tremendous pressure to re-characterize ordinary taxable income as exempt capital gains.

Countries that do not, in principle, tax individuals on their capital gains also do not allow capital losses to enter into the determination of taxable income. Those that do tax capital gains ordinarily take capital losses into account only as offsets to capital gains. Even then, deductions of losses are usually limited to prevent abuse.

In Israel, there is a capital gains tax on the sale of moveable possessions and property at the same rate as income tax except for those instances in which the property was purchased on or before March 31, 1961.[44]

In order to calculate the profit, which results at the time the property is sold, one should consider the following components -

A. The cost of the property, plus the expenses incurred in the upgrading of the property.
B. Compulsory payments i.e. purchase tax, property tax, and betterment levy.
C. The interest that the owner pays on the loan had taken in order to purchase the property.[45]

5.9 Taxes on Turnover

5.9.1 Purchase Tax

Purchase tax is imposed on the buyer of real estate, and its' rate is usually between 1% up to 5% of the property price. The tax rate can be a flat rate and it may be regressive one. Sometimes this sort of compulsory payment is known as stamp tax and it may be a combination of both of these taxes. When an entrepreneur or contractor purchases land and sells apartments, purchase tax is paid twice - once in each transaction.

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44 Israel Law Book, Land Taxation Law (Appreciation, Selling, and Purchasing), 1963, article 48; Income Tax Ordinance, chapter 5.

45 The cost, the compulsory payments, and the interest may be deducted from the price of the sale of said property. This rule encourages investors to finance a large part of the cost of the property with long-term bank loans. Obviously, the interest cannot be claimed twice - in the assessment of taxable income regarding a rental property and also in the calculation of capital gains at the time of sale of this same property.

5.9.2 Selling Tax, Stamp Duty

Selling tax is imposed on the seller of real estate, and its' rate is usually between 1% to 2.5% of the property price.

"The transference of stock, or movable property, from the living to the living, by the lending of money, is frequently a secret transaction, and may always be made so. It cannot easily, therefore, be taxed directly. It has been taxed indirectly in two different ways; first, by requiring that the deed containing the obligation to repay should be written upon paper or parchment which had paid a certain stamp-duty, otherwise not to be valid; secondly, by requiring, under the like penalty of invalidity, that it should be recorded either in a public or secret register, and by imposing certain duties upon such registration."[46]

5.9.3 Value Added Tax - V.A.T

The value-added tax is a government levy on the amount that a business firm adds to the price of a commodity during production and distribution of a good. Three major types of value-added tax have been identified, depending on the deductions allowed, but only one--called the consumption type--is widely used today.[47]

Calculation of the value-added tax of the consumption type can be made in any of three different ways, but virtually every country imposing the tax uses the "invoice," or "credit," method of computation. Using this method, each seller first calculates the sum of all the taxes that he has collected on goods sold. He then totals the sum of all the taxes that he has paid on goods purchased. His net tax liability is the difference between the tax collected and the tax paid.

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46 Smith, Adam. The Wealth of the Nations, book 5, chapter II, appendix to articles I and II - Taxes upon the Capital Value of Land, Houses, and Stock, p. 1151. The Electric Book company, http://www.elecbook.com/admsmith.zip

47 “The impossibility of taxing the people, in proportion to their revenue, by any capitation, seems to have given occasion to the invention of taxes upon consumable commodities. The state, not knowing how to tax, directly and proportionably, the revenue of its subjects, endeavours to tax it indirectly by taxing their expense, which, it is supposed, will in most cases be nearly in proportion to their revenue. Their expense is taxed by taxing the consumable commodities upon which it is laid out”. Smith, ibid., Article IV - Taxes which, it is intended, should fall indifferently upon every different Species of Revenue.

It is generally assumed that the burden of the value-added tax, like that of other sales taxes, falls upon the final consumer. Although the tax is collected at each stage of the production-distribution chain, the fact that sellers receive a credit for their tax payments causes the tax, in effect, to be passed on to the final consumer, who receives no credit. Most countries have at least partly avoided this effect by applying a lower rate to necessities than to luxury items. [48]

In 1954 France was the first country to adopt the value-added tax on a large scale. In 1968 West Germany adopted the value-added tax, and since then most other western European nations have followed suit, largely as the result of a desire to harmonize tax systems.

5.10 Luxury tax

The luxury tax is an indirect tax, similar in that way to the V.A.T. The luxury tax is imposed on products that are defined by the law as "luxurious" ones. The idea behind this tax is implicated in many states in the different rates of the V.A.T. that imposes higher rates upon so called luxurious articles and services, while the common ones benefits lower rates.[49]

The consumers of the commodities finally pay the luxury tax, and it falls indifferently upon the wages of labour, the profits of stock, and the rent of land. One may say that this tax is finally paid partly by landlords in the diminished rent of their lands, and partly by rich consumers, whether landlords or others.

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48 Value added tax, Encyclopaedia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=76704&tocid=0

49 "It is otherwise with taxes upon what I call luxuries, even upon those of the poor. The rise in the price of the taxed commodities will not necessarily occasion any rise in the wages of labour. A tax upon tobacco, for example, though a luxury of the poor as well as of the rich, will not raise wages. Though it is taxed in England at three times, and in France at fifteen times its original price, those high duties seem to have no effect upon the wages of labour." Smith, Adam. The Wealth of the Nations, book 5, chapter II, article IV - Taxes upon Consumable Commodities, p. 1170. The Electric Book company, http://www.elecbook.com/admsmith.zip

5.11 Custom, Import Tax

The custom is imposed on imported commodities, and it is also called tariff. Governments since ancient times have used tariffs, although they were originally sources of revenue rather than instruments of state economic policy. Early customs duties consisted of payments for the use of trade and transportation facilities, including ports markets, streets, and bridges.

Custom may be distinguished from other taxes in that their predominant purpose is not financial but economic not to increase a nation's revenue but to protect domestic industries from foreign competition. For that reason, advocates of free trade, oppose protective tariffs.

"They seem to have been called customs as denoting customary payments, which had been in use from time immemorial. They appear to have been originally considered as taxes upon the profits of merchants."[50]

5.12 Property Tax, Capital Net Tax, Land Tax

5.12.1 Property Tax

Property tax is imposed on the owner of real estate. The property tax of the ancient world was originally a land tax based on an area rather than on value. Eventually, the product of the rural land came to serve as the base of the tax.

In some countries the property tax is imposed on the general property value. Yet to reach movable property effectively for taxation purposes has always been difficult, and taxing intangible forms of wealth has proved even harder.

The assessed value is what the taxing authority (county, city or town) uses to determine how much tax is due. In some cases, the assessed value might be the same as market value, but typically it is a percentage, called the assessment ratio.

Property tax is a levy that is imposed primarily upon land and buildings. In some countries, including the U. S., the tax is also levied upon business and farm

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[50] Smith, ibid., p. 1179.

equipment and inventories. Sometimes the tax extends to automobiles, jewelry, furniture, and even to such intangibles as bonds, mortgages, and shares of stock that represent claims on, or ownership of, tangible wealth. The amount payable is based not on a person's or a company's total net wealth but on gross value without regard to debts.[51]

"In its most comprehensive form, the property tax would encompass within its base the value of all property including land, any structures on the land, producer and consumer durable goods, business inventories and holding of government bonds and cash."[52]

In some countries, i.e. Germany, the property tax is imposed on the net capital, meaning, on the value of the capital assets minus the loans, which were taken for the purpose of purchasing these assets.

5.12.2 Land Tax

The land tax is a sort of a property tax, which is imposed on real estate assets owned by the taxpayer.[53] "A land tax is a fixed periodic charge. It is based on qualities inherited in the land with few concessions to the landholder's personal illiquidity weakness, setbacks, or aging. 'Use it or sell it' is the message, which many consider too harsh… The land tax may be based on the current potential rent, or on value. In most countries other than Britain it is the latter. Values are not simply proportional to rents because many land values are elevated above that by expected higher future rents."[54]

The land tax was basically imposed in the ancient society on rural land. It may have the form of tax or a form of rent paid by the farmers to the landlord. That kind of rent could not be interpreted as rent nowadays, because the vast country

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51 Property tax, Encyclopaedia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=115315&tocid=0

52 "Property taxation", Etwell, John (ed). The New Palgrave a Dictionary of Economics, volume 3, p. 1034, the Macmillan Press Limited, London, 1987.

53 See paragraph 4.5 on "single tax".

54 Land tax, volume 3, p. 123, ibid..

belonged to few noble families, counts and dukes, and there was no free market for rural land.

In many countries, a separate assessment procedure has been organized for income from real property; such is the case in the various European countries in which the French system of land register was introduced at the end of the 18th century. The theoretical income of each piece of real property is then determined by the administration of the land register and remains fixed for a relatively long period, except when important changes are made in the property.[55]

In Israel, property tax is imposed only on land, which is not built up. The rate of this property tax is generally 1%-2.5% from the market value or from the assessed value of the property, and the loans taken are not deducted. This tax has been abolished on January 1, 2000.

5.13 Estate Tax, Inheritance Tax, Gifts Tax

5.13.1 Estate Tax (Death Tax)

Estate tax, inheritance tax and gift tax are levies imposed on gratuitous transfers of property--that is, transfers made without compensation in either money or its equivalent. In this respect, they differ from sales taxes imposed on transfers made in exchange for something of value, from property taxes and capital levies that are based on the mere ownership or possession of property and from income taxes levied on earnings.

Death in many countries is considered to be a tax event, one that prompts the imposition of a levy by the state. Death taxes are of two kinds: those imposed on the property left at death are known as estate tax and those imposed on the acquisition of property from a person who has died is known as inheritance tax. The two kinds of death taxes are sometimes both used in the same system.[56]

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55 Tax Law, Assessment, Encyclopaedia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=115311&tocid=71937#71937.toc

56 Death and gift tax, Encyclopaedia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=115317

Estate tax is a levy on the value of property changing hands at the death of the owner, fixed mainly by reference to its total value. Estate tax is generally applied only to estates evaluated above a statutory amount and is applied at graduated rates.

The main argument against death tax rests on its possible negative effects on incentives. The argument is that the person building up an estate will be less inclined to do so if he knows a large part of it will never go to his heirs. An economic limit to the usefulness of death taxes may be said to exist when the accumulation of wealth is discouraged to the point of hampering the growth of the economy.

5.13.2 Inheritance Tax

Inheritance tax is a levy on the property accruing to each beneficiary of the estate of a deceased person. Reference to the amount received and the relationships of the beneficiary to the deceased usually calculate the inheritance tax. In some systems, the value of the property already owned by the beneficiary also enters into the calculation.

Inheritance tax may be more difficult to administer than estate tax because the value passing to each beneficiary must be fixed, and this often requires complex actuarial calculations.[57]

The economic effects of inheritance tax are unimportant by the usual criteria. There is little reason to believe that a person will alter his consumption patterns because of the prospect of inheritance tax. The main effect of inheritance and gift taxes has been to encourage estate planning and the employment of legal devices to minimize taxes rather than to change behavior.

A significant effect that is often overlooked is that on business structure and practices. This stems from two problems that exist in death taxation. One of these is that of setting a valuation on the estate for tax purposes. Another is the problem of liquidity i.e., getting the cash with which to pay the taxes.

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[57] Inheritance tax, ibid., http://www.britannica.com/eb/article?eu=43382&tocid=0

The valuation of an estate suffers from the same problems as the valuation of any property. There may not be an active market in the various assets involved. The assets may be unique in some sense. Appraisers may be called in to set a value on the property, but their evaluations may vary widely.

Even if there were certainty in the valuation of an estate, there remains the problem of paying the taxes. The gravity of this problem depends partly on the nature of the assets in the estate. If they are shares of stock that are traded on a national stock exchange there is relatively little difficulty. If a family-owned business or a major portion of any business is involved, serious losses, including a change of control of the business, may result from attempts to liquidate the ownership interest in order to obtain cash. Thus, the problem of liquidity presents a major consideration in estate planning.

In spite of all efforts to mitigate the impact of estate taxes, there is a strong temptation for an owner to convert his assets into a highly marketable, easily evaluated form while he is alive. This may require their sale to another company, either for cash or for nationally traded securities. The result is a merger or absorption of the smaller company and an increase in the concentration of economic power, the opposite of what the taxes are meant to achieve.[58]

The inheritance tax exists in many European countries and in the U.S. The American government announced in the year 2000 that the inheritance tax would gradually abolish in the following five years. In Israel, the inheritance tax has been abolished since 1981.

5.13.3 Gift Tax

The gift tax is imposed on gratuitous transfers of property. This tax is common. In the tax systems of many nations, gift tax is integrated to some degree with a death

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58 "The 'Vicesima Hereditatum', the twentieth penny of inheritances imposed by Augustus upon the ancient Romans, was a tax upon the transference of property from the dead to the living. Dion Cassius, the author who writes concerning it the least indistinctly, says that it was imposed upon all successions, legacies, and donations in case of death, except upon those to the nearest relations and to the poor." Smith, Adam. The Wealth of the Nations, book 5, chapter II, appendix to articles I and II - Taxes upon the Capital Value of Land, Houses, and Stock, p. 1152. The Electric Book company, http://www.elecbook.com/admsmith.zip

tax. In some nations[59] the explicit rationale for gift taxes, is to avoid the use of gifts as a means of avoiding death taxes.

Nevertheless, a moderate gift to relatives may be exempt from a gift tax, so the taxpayer is able to transfer part of his assets to his heirs during some period of time without paying a gift tax or inheritance tax.

5.14 Municipal Levies

Local authorities are entitled by the law to legislate tax laws. The main purpose is to enable the local authorities to finance their own budget without the support of the state Treasury. Each one of the local authorities is responsible to balance its budget by calculating the amount of the taxes and expenses. That autonomy causes different rates of taxes among the local authorities.

State compulsory payments are named as tax and duty while local authority compulsory payments are named as levy and rate. Those compulsory payments may be alike in nature and purpose, but the different names should indicate the difference in the sort of the authority that imposes those compulsory payments.

"In the spirit of the Tiebout model (1956), individuals 'shop' among these communities and select as a jurisdiction of residence the community offering the most attractive fiscal package. In this framework, the property tax becomes a kind of price or 'tax-price' for the consumption of local public goods. Higher taxes here reflect a higher output of local services."[60]

In most of the local authorities, one can find three sorts of taxes -

A. **Municipal Property Levy** - Imposed mainly on the owners of land and structures within the jurisdiction of the local authority, and is similar to the property tax.

B. **Betterment Levy** - Imposed mainly on the owners of land within the jurisdiction of the local authority, due to finance the budget of the

59 Canada, Sweden, Germany, and France.

60 Property taxation, Etwell, John (ed). The New Palgrave a Dictionary of Economics, volume 3, p. 1035, the Macmillan Press Limited, London, 1987.

constructing department of the local authority and the general development expenses, and is similar to the land appreciation tax.

C. **Development Levies and Rates** - Imposed mainly on the owners of land and structures within the jurisdiction of the local authority, and is due to finance the budget of specific development expenses.

The sum of the land tax that is raised by the state is divided in many countries between the state Treasury and the local authorities. Most of the land tax in the country is laid upon its' rural land, and in towns it is assessed upon buildings.

5.14.1 Municipal Property Levy

The municipal property levy is a form of land tax imposed by the local authority on the owners of the land and structures within the jurisdiction of the local authority. The municipal property levy may be imposed in addition to a state property tax or instead of it.

The municipal property levy rate is due to the market value of the land, and it causes many appeals against the tax assessments by the taxpayers. The rates of the property levy vary among jurisdictions therefore entrepreneurs and capital will tend to migrate from high to low-tax jurisdictions. High rates in a city may reduce the income of the real estate owners and decrease the value of the property. High-taxed local authority may collect more taxes at the beginning, but in the long run, entrepreneurs and capital will move to a low-tax jurisdiction, and the high rates will be imposed on a much smaller volume of equity.[61]

In Israel, there is no municipal property levy and instead there is a municipal general rate.[62] This rate is imposed on the person that uses the land or the building whether this person is the tenant or an owner who uses his own real estate. This levy is imposed on structures and on land that is used for commercial or rural purposes.

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61 Ibid..

62 This property levy is named "arnona" and is the main source of the budget of the local authorities. There are different rates for each kind of use of the structures and land and different rates in any local authority. Rostowicz, H. Municipal General Rate, Oryan publishing (1995), IV ed., pp. 125-171.

5.14.2 Betterment Levy

The betterment levy, also known as a re-zoning tax, is a levy on the property that its value grew by the zoning process, and it is mainly imposed on the owner of the land. It is calculated by real estate appraisers that appraise the value of the land before and after the zoning or rezoning process. The added value of the land is a sort of profit, and the tax is imposed on it.[63]

Zoning is the legislative method of controlling land use by regulating such considerations as the type of buildings (*e.g.,* commercial or residential) that may be erected and the population density. It is applied primarily to urban areas, and is accomplished by dividing land area into zoning districts, each having specific conditions under which land and buildings may be legally developed and used. In combination with other city-planning techniques, zoning is a major instrument for gaining greater physical order in cities.[64]

5.14.3 Development Levies and Rates

In order to develop modern urban zones, the local authorities should commit the environmental works. Environmental works are the infrastructure that provides cities and towns with water supply, waste disposal, and pollution control services. They include extensive networks of reservoirs, pipelines, treatment systems, pumping stations, and waste disposal facilities. The local authorities should build the roads within their jurisdiction.

To finance these costs, the local authorities impose fees on the owner of the land that are located in the area of the development zone. The rate of these fees should be proportional to the costs of the development expenses.

5.15 Tax Shelter

Tax shelter, which is known as tax haven, is the goal of the taxpayer and the nightmare of tax collector. Tax is a compulsory payment imposed by a law. There

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63 Rostowicz, H., Gladkov, P., Kamil, A., Friedman A. Betterment Levy, Oryan Publishing, 1996.

64 Zoning, Encyclopaedia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=80546&tocid=0

is no perfect law, and each one has its loopholes. Finding these loopholes creates the tax shelters, and once the legislator amends the tax law, new loopholes are usually created, and new tax shelters requires new amendments.

In the shrinking modern economic world, international corporations can easily transfer profits into low rate income tax countries and into offshore companies and avoid income taxes. Inheritance tax can be avoided by gifts and funds, i.e. in the U.S., and custom can be significantly reduced by importing components instead of final products, and by using treaties that allow duty free import from nominated countries.[65]

Taxes imposed on real estate are the most difficult to avoid. Owner of real estate can not avoid property tax neither can he move his plot into a low rate property tax country or register it in an offshore dominion. Land appreciation tax, if exists, is impossible to avoid once the tax payer sells his real property, and purchase tax can not be avoided by the buyer.

This thesis tries to deal with diminishing and avoiding land appreciation tax, and purchase tax, by pointing to two legal methods of irregular selling and buying of real property directly and indirectly. These methods can be used as marketing strategies to perform economic activity in the real estate market via tax shelters.

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65 "The vitality of the sales tax as a critical state and local government revenue source has been eroded in recent years by the rapid growth in mail order and Internet sales. Sales taxes are due on mail order and Internet purchases just as they are on purchases in stores. But a large majority of the sales taxes due on mail order and Internet purchases made by individual consumers and a significant share of the taxes due on purchases made by businesses are effectively uncollectible. States and localities are unable to collect these taxes because the Supreme Court has prohibited states from requiring mail-order and Internet merchants to charge the customer for the tax and remit it to the customer's state *unless* the merchant has a physical presence or "nexus" within the state's borders. This means that although an Internet merchant like Amazon.com presumably has customers in every or nearly every state, it can only be required to collect sales tax from customers in its home state of Washington and a handful of other states in which it has built warehouses or stationed personnel." Mazerov, Michael. Should the Internet Remain a Sales Tax Haven? Center of Budget and Policy Priorities, http://www.cbpp.org/12-13-99tax.htm