TESEV BRIEFS

Channeling Urban (Land) Rent Back into the Public Sector through Taxation

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Following the March 31, 2019 local elections, the indebtedness of local governments has once again emerged as a subject of public debate in Turkey. Local government expenditures took center stage in these debates, yet much less attention has been paid to potential sources of revenue for local governments. Generation of internal sources of municipal revenue is no less important than the issue of expenditures as it pertains to the relative financial independence of municipalities from the central government. Among potential sources of municipal revenue, a significant one is taxation on urban (land) rent which occurs as a result of a few distinct processes: transformation of agricultural land into urban land due to population increase, migration, industrialization; zoning change that renders the property more valuable due to a number of potential factors such as greater proximity to parks, attractions, or highway systems. In this piece, I will emphasize the need to bring urban rent revenue back into the public budget in Turkey –especially when the urban rent is due to zoning change– with the understanding that the public sector is the actor responsible for the value increase itself. I will then offer improvements to the Turkish Tax Law for this purpose.

The term "rent" can be used to refer to any economic return to a property owner or a service provider in excess of the minimum required for maintaining the property or the service. However, in common usage, urban (land) rent refers specifically to a significant increase in the value of land/property based on speculative action which quickly brings large returns to the owner.

As such, economic gains made through urban rent can be categorized as “unearned increment”. In economics, the term “rent” has been used more generally to refer to the return that nature (as a factor of production) receives from the process of production. Indeed, 19th century debates on ending income inequality have centered around the very idea of taxing land rent.

These 19th century debates largely conclude that all land rent must be taxed at a standard rate. Early 20th century social democratic and progressive political movements argued for heavier taxation on direct incomes, as opposed to indirect taxes levied on wage labor and the working poor. This idea was advocated as a systematic mechanism to ensure a just income distribution. In the 1980s, along with the increased speed of globalization and the consolidation of finance, capital accumulation has transformed qualitatively and broadened in its scope. Resulting urban sprawl has ended up transforming agricultural hinterlands into urban landscapes, creating a new type of economic rent to be extracted from these areas: “urban rent”. As capital expanded its area of influence and gained more mobility, it began significantly influencing cities in their spatial organization as well as in their governance structures through various mechanisms such as decisions regarding where to invest. Following the establishment of a free market regime in Turkey with “The Economic Stability Measures” of 1980, “The Mass Housing Law” of 1984 has transformed urban land into an object of investment, and thus rendered it a tool for addressing the crises of capital accumulation. Through amendments to zoning laws and exclusionary zoning ordinances, cities effectively and continuously create greater increase in urban rent. Furthermore, new infrastructures required by such developments are built with the use of public funds. Thus, the act of zoning and infrastructure development by the public sector itself is responsible for excess capital accumulation in the form of urban rent. Therefore I define “urban rent” as the unearned income that property owners collect without any labor or capital input in the process. In this line of thought, I make the case that the excess capital accumulation generated through actions of the public sector should be given back to the public –its rightful owner.

There exist many different examples of urban rent tax. It takes various names such as “Land/ Site Valuation Tax”, “(Land) Speculation Tax”; and it is currently implemented in various countries including Colombia, Switzerland, Austria, Australia, Denmark, New Zealand, Estonia, and in certain states in the USA. In those countries where it is collected, urban rent tax constitutes a significant source of public revenue. The implementation of this tax ensures greater social justice in taxation while limiting unearned increment to be collected solely by property owners at the expense of public interest. In New Zealand, for example, over 50% of local government revenue comes from property taxes which include land valuation taxes.[1] If implemented in Turkey, it is possible to generate a significant source of revenue for local governments simply by taxing urban rent.

Certain steps were taken towards implementing such a tax. The 2015-2017 Medium Term Programme of the Ministry of Development included the following statement: “Insufficient taxing on real estate value hikes, a remarkable real estate rent created by public improvement regulations and public services, and insufficient share on this rent received by the government have caused the resources to shift considerably to unproductive areas”. Similarly, in the Country’s 2015-2017 Medium Term Fiscal Plan it was stated that in order to strengthen the fiscal health of local governments, continued efforts will focus on making use of urban rent while also increasing other internal sources of revenue such as real estate tax. One of the reports that came out of the 2017 Urban Planning Symposium organized by the Ministry of Environment and Urban Planning of Turkey called for the preparation of regulations for collecting an urban rent tax. In the 2019 Annual Programme of the Presidency, it was stated that measures were to be taken for making use of urban rent in efforts to increase the revenue base of local governments. New measures on taxing real estate were introduced in the 11th Development Plan of the Republic of Turkey. Despite all this, no regulations are currently in place to return urban rent to the public. The main mechanism to achieve this is taxation; and although no tax on urban rent is currently in effect in Turkey, historically there have been a number of practices within the Turkish Taxation System that resemble –in principle– to an urban rent tax.

Some of these "predecessors" are the following:

- Valuation through Public Services Implementation: In effect from 1948 through 1978, this tax law defined property valuation, if and only if due to one of the following scenarios, as taxable gain: increase in real estate's value due to increased proximity to public amenities, or due to greater access to public roads that results directly from public investment or eminent domain.[2]
- Real Estate Valuation Tax: In effect from 1970 (Law no. 1318) through 1982 (Law no. 2588), the focus of this tax was on urban rent and land speculation. Due to difficulties in estimating real estate market values and associated taxable gains, this tax was replaced by title fees in 1982.
- Valuation Gains: Articles 80 and 81 of Law no. 193 regarding income tax (that is in effect since 1960) were revised in 2007 with Article 5 of Law no. 5615 to establish the following rule: if a real estate is sold within five years of purchase, the price difference is taxable gain. If the real estate is sold after the five year time frame, the gains are not taxable.
- Real Estate Tax: Going into effect in 1972 with the passing of Law no. 1319, this is a simple real estate tax to be paid by the title holder. It is calculated separately for the land and the building(s) owned.
- Participation Fee in Public Expenditures: Goes into effect in 1981 with Articles 86-94 of Law no. 2464, and introduces a participation fee to be paid by owners of real estates that gain value as a result of public investments in the area. This fee, however, is often not applied.
- Reorganization Participation Fee: This fee was first introduced in 1985 under Law no. 3194 (Article 18). Under this law, municipalities hold the right to reorganize privately owned land (without permission of the owner), and charge a fee based on the valuation in the property as a result of such reorganization. As it pertains to charging of a fee based on public-sector led valuation in private properties, this fee resembles an urban rent tax.

Although all of the above reviewed laws introduce some sort of mechanism to collect fees on urban rent, none of them clearly delineate a definition of urban (land) rent that is the result of zoning regulations. First and foremost, an "urban rent tax" must be introduced to make public-sector led gains in private property available to the public. Only through such a model that is based on the net wealth increase of real estate owners that a meaningful taxation system on urban rent can be established. Such a model would serve as a potentially significant source of revenue for local governments while creating a more just system of taxation.

Another way to implement an urban rent tax would be through changes in the current Income Tax Law. First, the current five-year time frame that exempts real estate valuations from taxation must be removed. Currently, those who sell their property within five years of purchase are not liable to pay property valuation tax, and this causes certain valuations that are due to public investments to go untaxed. Another way otherwise collectable tax gets lost in this process is through taxation based on values less than the actual transaction price. To determine the actual transaction prices in property sales, valuation commissions must be established. The right to appeal valuation commission decisions must still be available to parties involved. If the real estate valuation in question occurs at a residential unit that has been occupied by owners as permanent residence for a substantial amount of time, then there should be options available to pay the urban rent tax in smaller sums (as installments spread over a longer period). But those properties bought and sold for purposes of speculation must be taxed progressively based on the amount of time the property is held in possession.

In the Turkish case, suggested changes in the tax law that will effectively introduce an "urban rent tax" will provide a much-needed source of revenue to municipalities –thus giving them increased financial independence from the central authority. Especially the urban rent tax on the wealthy (calculated based on the wealth increase due to urban rent) will serve towards a more just taxation system which will redistribute the economic gains of urban rent to the general public in the form of improved public services.

An indirect benefit of potential implementation of an urban rent tax is that it may serve as a disincentive to speculative action. By preventing speculative action, lower real estate prices may be achieved, and thus lower-income families can more easily meet their residential needs. Revenue from urban rent tax may also be used for providing housing (as a right) to those in need.

Despite all the social benefits of implementing an urban rent tax, care must be taken to prevent this tax from further marginalizing and displacing lower income groups. With an ad hoc application, an urban rent tax may run the risk of increasing real estate value in urban neighborhoods, thus making these areas unaffordable to certain groups. Another risk is that property owners may tend to reflect the cost of this tax in more frequent rent increases, thus shifting the burden of the tax to lower income groups. Therefore, in addition to the implementation of the urban rent tax itself, mechanisms to prevent its potentially deleterious "side effects" must be introduced in the law.

Urban rent tax is a type of tax that is collected to limit unearned financial gains (those made without labor or capital input) and which serves the social good by creating a more just redistribution system. There is no urban rent tax currently implemented in Turkey. After carefully studying successful examples from other countries, and after detailed planning, an urban rent tax mechanism must be introduced into the Turkish taxation system such that this tax must serve as a source of revenue to local governments who must then use these resources for the social good. At the same time, the five-year window of exemption from property valuation tax must be repealed in order to curb speculative trading in real estate. In all implementations of urban rent tax, measures must be in place to prevent potential "side effects" that may end up further marginalizing the urban poor.

[1] https://commongroundorwa.org/LVT_england_final.pdf (p.13)

[2] In 1979, re-introduction of this tax with some changes was vetoed by the president, and then rejected in the parliament. This tax was not included under Law no. 2464 regarding Municipal Revenues that went into effect in 1981.

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