University of Chicago Law School

Chicago Unbound

Journal Articles

Faculty Scholarship

1947

Tax Subsidies for Rental Housing

Walter J. Blum

Norman Bursler

Follow this and additional works at: https://chicagounbound.uchicago.edu/journal_articles

Part of the [Law Commons](#)

Recommended Citation

Walter J. Blum & Norman Bursler, "Tax Subsidies for Rental Housing," 15 University of Chicago Law Review 255 (1947).

This Article is brought to you for free and open access by the Faculty Scholarship at Chicago Unbound. It has been accepted for inclusion in Journal Articles by an authorized administrator of Chicago Unbound. For more information, please contact unbound@law.uchicago.edu.

TAX SUBSIDIES FOR RENTAL HOUSING

WALTER J. BLUM* AND NORMAN BURSLEY†

NUMEROUS proposals have been advanced for dealing with the housing shortage. Almost all of them entail the subsidization of private interests by the government. Few, if any, of the plans have called for subsidies in the form of outright grants. It has been the more indirect and inconspicuous kinds of subsidies which have caught the fancy of groups interested in promoting the subsidization of private housing. This is understandable inasmuch as direct grants now tend to be unpopular and vulnerable to political attack.

Of the many plans for indirect subsidization of private rental housing, perhaps the largest single class has consisted of benefits to be conferred through the taxing systems, both federal and local. On the federal level the income tax has been the favorite vehicle for such subsidies in formulating the proposed plans. On the local level the general or real property tax has been similarly preferred. The operation and implications of these two broad classes of possible tax subsidies for rental housing are considered in this article.

I. THE FEDERAL INCOME TAX AND RENTAL HOUSING

The proposals for tailoring the federal income tax system to encourage additional investment in rental housing may be grouped into three basic plans, each involving subsidies in that the recipients of the special benefits would bear a smaller share of the total federal income tax burden than taxpayers who in all other respects are similarly situated. One plan calls for the elimination of the corporate income tax on income from rental properties; a second would permit state and local property taxes to be credited against the net federal income taxes of the property owners; and a third provides for drastically shortening the income tax amortization period for rental dwellings. It may well be that the need for more and better housing cannot be satisfied without some type of governmental assistance. But a critical appraisal of the various income tax subsidy schemes compels the conclusion that they should be rejected. None of them is well designed to promote the development of the kind of housing for which the need is greatest. Each would further complicate the income tax system and

* Assistant Professor of Law, University of Chicago Law School.

† Research Associate, University of Chicago Law School.

leave gaps in its structure or otherwise cause serious inequities. All of them partake, at least in part, of the major drawbacks which inhere in income tax subsidies generally.

The case for removing the corporate income tax on income derived from rental housing is presented by Randolph Paul and Miles Colean in a study prepared for the National Committee on Housing.¹ In substance they argue that real estate corporations should be exempted from the tax because their yield to investors after taxes is low and unstable relative to that of other business corporations—"especially in view of the long time necessary for the return of capital and the managerial responsibilities involved over that long period." Real property is burdened with heavy local property taxes so that the corporate income tax acts as "a third tax" on rental property income. Yields after payment of property taxes and corporate and personal income taxes are so low that "the possible field for new rental housing investment is narrowed to those who can afford the higher rents." Investors in rental housing furthermore are tempted to "seek to recover [their capital] in the early years before the corporate income tax becomes hazardous in effect," commonly "substituting to the fullest possible extent mortgage financing for equity financing" in order to maximize the deduction for interest in computing the corporate tax. This practice is "a source of instability and hazard and a temptation first to 'milk' the property and then to unload it on the mortgagee or an unsuspecting purchaser."

The corporate income tax is thus shown to hamper and distort the flow of capital and encourage investment in senior securities in place of equities. These conclusions appear justified by the data compiled. One may nevertheless question the soundness of a proposal to immunize only a single kind of business from the tax. An argument very similar to that presented on behalf of real estate corporations could be made for railroads and public utilities and any other industry in which yields have been relatively low or unstable. Were all such industries whose output of goods or services is considered inadequate exempted from the corporate tax, that levy would become primarily a tax on industries with relatively high yields. It would then serve as a fuzzy kind of excess profits tax which tended to penalize efficiency. If the corporate income tax is generally a sound levy, it is as much so for depressed as for prosperous industries.²

¹ Paul and Colean, *Effect of the Corporate Income Tax on Investment in Rental Housing* 5, 8, 9 (1946). See 86 *The Architectural Forum* 132-36 (March, 1947) for a review of this book.

² It is interesting to note Mr. Paul's own position on the advisability of retaining the corporation income tax. "I believe that a substantial tax should be imposed upon corporations which may be classified as economic entities distinct from their stockholders. A corporation

The relief of an indispensable but depressed industry is then not to be sought in exempting it from the tax but through other means which will enable it to flourish within a sound system of taxation. If, on the other hand, the corporate income tax itself is unsound, why undertake its repeal on a piecemeal basis?

Exemption of realty companies from the corporate income tax would leave many gaps in the personal income tax structure.³ It would aggravate the difficult problem of treating undistributed earnings of realty corporations and raise the closely related problem of taxing capital gains on realty investments. Unless steps were taken to insure proper inclusion of such corporate earnings in the base of the personal income tax, they could be long shielded from income taxation, be distributed when the tax situation was most favorable to the controlling shareholders, or be transformed into long-term capital gains taxable at reduced rates. Exemption of realty ventures would also frame squarely the issue of how best to cope with windfalls thereby accruing to owners of equities already in existence.⁴ Without proper safeguards, old equity investments would gratuitously share in the increased attractiveness which exemption from the tax was designed to confer on investments in new equities. These are the problems which would have to be faced on a broader scale if the corporate income tax were eliminated entirely; and the lack of practicable solutions has been a barrier to repeal. There can be no justification for abrogating the tax in part, by exempting realty corporations, without resolving these issues.

Since housing is imperative it may be argued that realty corporations should be exempted immediately from the corporate income tax with the understanding that resulting gaps in the tax structure are to be patched up at a later date. This position seems untenable where alternative means of stimulating building are available and some selection is necessary. The price of exempting realty corporations from the corporate income tax would be outrageous if, in addition to the loss of revenue, huge windfalls were conferred on owners of existing equities and undistributed corporate income were in whole or part immunized from the personal income tax.

It is improbable, moreover, that the plan to withdraw realty corpora-

tax is justified by the economic advantages these corporations enjoy and by revenue considerations which dictate that no potential source of revenue should be left untapped." Paul, *Taxation for Prosperity* 371 (1947).

³ Individual income tax payments in 1946 amounted to \$17,883,601,388, as compared with collection from corporate income taxes of \$11,046,568,029.

⁴ See Treasury Department, Division of Tax Research, *the Post-War Corporation Tax Structure* (1946). The arguments for and against the corporate income tax are examined in some detail in this study.

tions from the corporate income tax would achieve its stated objective of stimulating new investment in rental housing. The total size of the subsidy seemingly would be small in relation to the quantity of additional investment required to satisfy housing needs. For the five years 1938 to 1942 inclusive, "the average corporate income tax yield for all types of urban realty corporations averaged only \$30.5 million per year."⁵ The annual tax paid in the past does not conclusively demonstrate the size of the proposed yearly subsidy, but it is some indication that the contemplated incentive is apt to have a light impact at best. In any event much of the subsidy would be dissipated in the form of windfalls to owners of equities in existing dwellings. Individual and partnership ventures in rental housing, which are not subject to the corporate income tax, have failed to call forth sufficient new capital to fill the housing need. There is no reason to believe that combining the tax advantages of partnerships with the tax and other advantages of corporations would produce a substantial inducement to investment in rental properties. More likely, the combination would encourage existing ventures to incorporate.

It is also doubtful whether the plan would accomplish its implied secondary objective of introducing greater stability into the real estate market. The proponents of the plan apparently believe that it would lessen foreclosures, bankruptcies, and reorganizations of rental properties by reducing the proportion of debt to equity financing. The corporate income tax, by allowing a deduction for interest payments in the computation of the net tax base, unquestionably has increased the attractiveness of debt financing. But this influence of the interest deduction is probably less significant in the rental housing field than elsewhere. Rental dwellings, including the many not owned in corporate form, generally have been financed through mortgage commitments. This pattern stems from several factors not connected with the income tax system. Investments in rental properties are represented mainly by fixed assets which are highly specialized as to use. Invested capital often cannot be readily withdrawn without loss. The comparatively speculative nature of the real estate market compounds the risk attached to long-term investments in rental properties. These factors constitute strong inducements for the realty operator to lessen his own capital at risk, and gain financial leverage, by obtaining borrowed capital. Exemption of realty corporations from the corporate income tax would not diminish the force of these inducements.

The second income tax subsidy frequently proposed is the scheme to permit landlords to credit state and local property taxes against their net

⁵ Paul and Colean, *op. cit.* *supra* note 1, at 19.

personal income taxes. Under the present personal income tax, property taxes may be deducted from the gross income of the taxpayer. Since property taxes are a price paid for governmental services, there is an air of seeming plausibility to the suggestion that such taxes be offset against the tax on income, which also is paid for the support of the government. An analogy to this relationship is said to be incorporated in the provisions of the federal estate tax. Herbert Nelson, Executive Vice-President of the National Association of Real Estate Boards, alluded to the apparent resemblance in testifying before a subcommittee of the United States Senate: "It would be applying the same principle which the Government has already adopted in permitting State inheritance taxes paid to be offset against the Federal estate tax." To this point he linked the observation that "such a policy would clearly recognize the great role of real property in financing local government."⁶

In fairness to the advocates of the tax credit scheme one might assume that they would limit the credit to cover only property taxes on rental housing constructed in the future, although the specific proposals are not always so restricted. By means of this assumption it is possible to confine discussion of the scheme to situations in which the credit might actually serve as an incentive to new investment in rental housing and not as a mere windfall.

The ultimate condemnation of the tax credit is that it would lead to the worst kind of discrimination among taxpayers in substantially similar economic circumstances. Under the current provision of the personal income tax allowing property taxes to be deducted by the landlord from his gross income, levies on rental dwellings are treated as any other operating cost. Net operating income from rental property enters into the landlord's income tax base and in that respect is added to the income tax measure of his "ability to pay." Changing the deduction for property taxes into a credit against the landlord's net income tax means, in terms of apportioning payment according to ability, that property taxes would represent a part of his "payment" rather than a reduction in his "ability to pay." To approve of this relationship is to hopelessly confuse the ad rem property levies with the personalized income tax. It may well be urged that property taxes by their very nature violate the ability-to-pay principle

⁶ Hearings before the Senate Subcommittee on Housing and Urban Redevelopment of the Special Committee on Post-War Economic Policy and Planning pursuant to S. Res. 33, 79th Cong. 1st Sess., Part 14, at 2010 (1945). Mr. Nelson suggested 1) that income invested in new construction be taxed at the capital gains rate, and 2) that "real estate taxes paid locally . . . be offset against the net Federal tax due on the part of an individual or corporation up to a certain percent, say half, of the taxpayer's liability to the Federal Government." These proposals are discussed at 261, *infra*.

that those in similar economic circumstances (as measured by income) should be taxed equally. But given the continuance of property taxes, the credit scheme necessarily undermines the very qualities of progressivity and equality which distinguish the income tax as uniquely fitted for a democratic private enterprise society.

A simple illustration is sufficient to demonstrate that the credit device would distort the impact of the income tax. Consider the cases of two individuals: one receives \$15,000 income yearly in the form of net profits from his unincorporated apartment building on which local property taxes are \$8,500 annually; the other has an identical income from net profits of his merchandising proprietorship. At the present time presumably the two parties pay the same amount of federal income tax—approximately \$4,000. But this equality in the treatment of the two businessmen would immediately disappear upon replacing the deduction for property taxes on rental structures with a tax credit. There would be no change in the tax on the merchant's income. On the other hand, the taxable income of the apartment-house owner would increase by \$8,500 (the amount of the property taxes no longer deductible) and his net income tax before the new credit would rise to about \$8,200. Applying the \$8,500 credit for property taxes, the landlord would end up with no income tax to pay—and perhaps even a negative tax to be carried over into subsequent years! What more could any taxpayer ask?

But perhaps the tax credit would confer additional benefits on the owners of rental housing. During the testimony in which he advanced a tax credit proposal to the Senate subcommittee, Herbert Nelson also cautioned that those who blame private enterprise "for not building at lower rentals" forget "that one-fourth of the rent dollar consists of [property] taxes." This seems to be a shorthand way of stating the economic principle that eventually the burden of property taxes on rental properties is shifted to the tenants through higher rents. To the extent that the shifting principle is valid, the tax credit device has a curious implication. The landlord can reduce his personal income tax by the property taxes which his tenants pay! And he can do this whether or not his income subject to taxation was derived from his activities as landlord!

The variety of almost irrational tax consequences stemming from a tax credit suggests that in no event should a subsidy involve a tricky formula. Preferable to the credit formula is the more direct method of granting a potent tax subsidy through exempting rental income of new structures from income taxation entirely. This alternative at least would simplify analyzing the ramifications of the subsidy and prevent ownership of rental

dwellings from serving to reduce taxes on income from other sources. New rental dwellings would then occupy a status comparable to tax-exempt securities, except that the usual defenses for retaining that exemption would be missing. So much effective criticism has been directed against exempting income from any particular form of investment from the income tax that further comment is unnecessary. What might be important in this connection is that the most deplorable aspects of tax exemption would be greatly magnified in the case of income from rental property. Of particular concern should be the invariable tendency for the ownership of tax-exempt property to be concentrated in the hands of persons with large incomes.⁷ To them the tax-exempt property has proportionately greater value because the size of the benefit varies directly with the highest rate at which the beneficiary is taxed.

Between the tax credit scheme and the idea of exempting income of new rental dwellings from the personal income tax there have been numerous variations on the same themes.⁸ Essentially the modifications are pared-down subsidies effectuated by means of a tax credit or tax exemption. The proposal to tax income from rental property at the bargain rate for long-term capital gains is merely another plan for granting a partial tax exemption to such income. Similar in nature are the suggestions that income from new rental property be eliminated from the income tax base for a limited number of years and that income on bonds issued against improvements be exempted from taxation. The device of allowing a partial credit for property taxes against the landlord's net income tax is simply a qualified form of the tax credit scheme.⁹ To the extent that any of these or other compromise measures resembles the undiminished model of the subsidy, it is subject to the same infirmities as the original. To the degree that the compromise departs from the basic version, its vices may be attenuated but only at the expense of proportionately reducing the effectiveness of the incentive intended.

Shortening the income tax amortization period for new rental dwellings, the last income tax incentive considered here, is an old standby

⁷ See Simons, *Personal Income Taxation* 170-84 (1938).

⁸ In connection with recent discussions of housing and the federal income tax there, of course, has appeared the old argument that progression in income tax rates destroys incentive. For example, Thomas Buck, writing in the *Chicago Sunday Tribune*, § 1, p. 11, col. 1 (Feb. 23, 1947) states: "The present income tax laws have discouraged some builders from expanding operations, inasmuch as the larger volume of business places them in the higher tax brackets, which in turn reduces their profit margins on each new house completed." It seems obvious that profits after taxes would be reduced by progression regardless of how these builders invested their surplus capital (unless tax-exempt securities were purchased).

⁹ Note 6 *supra*.

that has been revitalized by the wartime tax program concerning so-called emergency facilities. On the ground that facilities acquired specially for war production would become obsolete at the end of the emergency period, war contractors were permitted to amortize such facilities over a span of five years, or in less time if the emergency ended before expiration of five years.¹⁰ Proposals that similar benefits be extended to new rental housing invariably cite the war measure as a precedent and usually adopt its five-year interval with enthusiasm.¹¹ This reference is a warning signal. Accelerated wartime amortization was but a part of the government's program to pay for the whole cost of running the war. Will stepped-up amortization for new rental dwellings result in the government's paying for the cost of apartment houses which are to be privately owned throughout their long useful life?

The accelerated amortization plans can be divided neatly into two types which, though similar in appearance, entail markedly different consequences. Under the first type the deduction for depreciation could be offset exclusively against income from the building whose cost is so amortized. Accelerated depreciation in any year consequently could not exceed the net income of the building in that year before depreciation is taken into account. No part of an excess of allowable depreciation could be offset against other income of the taxpayer, but an excess might be carried over and used as a similarly limited deduction in future years. A new building thus could be amortized in five years only if during the initial five years of operation the net income from it (exclusive of depreciation and income taxes) at least equaled the cost of the structure. Should such net income for five years fall short of cost, the amortization period, by virtue of the carry-over arrangement, would then total the number of years required for net income to match the cost of the building.

Whether the incentive to new construction provided by the limited type of accelerated amortization would be effective is largely conjectural. Landlords have complained that rental dwellings in the aggregate have not returned very satisfactory yields to investors over extended periods of time. These returns generally have been computed after subtracting a yearly depreciation charge presumably averaging about $2\frac{1}{2}$ per cent of cost. The privilege of limited acceleration of depreciation in effect frees operating profits from income taxation until the dwellings return their cost. It is questionable whether this limited exemption of, or postpone-

¹⁰ Int. Rev. Code § 124 (1946), 26 U.S.C.A. § 124 (1945).

¹¹ N.Y. Times, p. 3, col. 8 (Feb. 19, 1947). See also Rosenman, *The Racket in Veterans' Housing*, *The American Magazine* (Sept. 1946).

ment of tax on, the allegedly limited yields in the past would have been an appreciable stimulus to investment in rental housing. The prevailing relatively high income tax rates might be expected to augment the force of the stimulus since the amount of tax saved or postponed varies with the rates. As to the future, one can merely speculate whether the combination of income tax rates and comparative yields from rental housing would render this type of subsidy effective.

The accelerated limited amortization plan should also be considered with reference to its impact on parts of the income tax not primarily concerned with depreciation. To the extent that the income of a rental enterprise during its initial five years of operation approximates the total amount of allowable accelerated depreciation, the architecture of the income tax as presently constituted appears inadequate in several respects. The purchaser of building takes as a new basis of regular depreciation his cost of acquiring the structure.¹² If the original owner recovers his cost (tax free) in five years through accelerated amortization and then sells the property at its original cost less actual physical depreciation, the normal depreciation deductions thereafter claimed by the purchaser will approximate a second tax-free recovery of the initial investment. This situation occurs now under the depreciation rules when there is a sale of property which has sufficiently appreciated in value; but accelerated amortization would tend to make it a common pattern rather than an exception. Accelerated amortization would also provide another avenue for converting income into capital gains in order to take advantage of the bargain rate at which long-term capital gains are taxed.¹³ If a new rental dwelling were held by a single person throughout its operational life, accelerated amortization would not materially reduce his total income taxes during that period provided the tax rates and his annual aggregate income remained fairly constant. The acceleration would reduce his taxable income during the early years of the building's operation and increase it in later ones. After exhausting his allowable depreciation in five years, however, the original owner would find it more profitable to sell the building and with the proceeds purchase a substantially similar structure, thus establishing a new basis of depreciation equal to his purchase price. By selling, the original owner would be taking advantage of the acceleration provision to convert the income of the building into capital gain. The difference between normal depreciation and amortization completely accelerated during the initial five years is income to the owner but it is not taxed. This dif-

¹² Int. Rev. Code §§ 113, 114 (1946), 26 U.S.C.A. §§ 113, 114 (1945).

¹³ Int. Rev. Code § 117 (1946), 26 U.S.C.A. § 117 (1945).

ference also is represented by the *actual* depreciated value of the building after five years, assuming no change in the price level of such property. When the building is sold for its *actual* depreciated value after five years, the price paid is all capital gain to the seller since his adjusted basis for computing gain (cost less amortized depreciation) is zero.¹⁴ The substance of the transaction is thus simply a transformation of the untaxed income received during the first five years of operation into a long-term capital gain upon sale at the end of that period.

There is a sort of hopelessness in pointing out the tax loopholes lurking in the current system of taxing capital gains. The transformation of income into capital gain is now a well established industry and new embellishments for its product have the same status as pre-war annual alterations in the styles of automobiles. Even so, there should be some hesitancy about giving the fabricators a whole new set of tools with which to work. Those who propose the adoption of accelerated limited amortization for new rental housing at least might study and reveal its implications as to the further creation of capital gains.

Practically all criticisms of accelerated limited amortization are equally applicable to the second or unlimited type of acceleration. The two types differ solely in that the latter would permit annual accelerated depreciation in excess of the building's net income (before depreciation) to be offset against any other income of the owner. Regardless of the earnings of the building, its entire cost could be amortized in the accelerated period provided only that the owner had sufficient aggregate income against which the recovery of cost might be offset. Unlike the limited plans, the unlimited ones give promise of being adequate incentives for additional investment in rental housing. They do so, however, at about the same high price as that involved in allowing property taxes to be credited against the landlord's personal income tax. Persons with large incomes from various sources could secure complete immunity from the income tax by acquiring a sufficient number of new rental dwellings earning less than the allowable accelerated depreciation charges. Unlimited acceleration, like the tax credit, would shred the pattern of equality and progression which gives strength to the income tax and at the same time assure a greater concentration of ownership of real property among the higher income groups.

To those interested in both satisfying our housing needs and preserving (if not enhancing) the merits of our income tax system, all the proposals here considered may well be cause for dismay. Some of the proposals have

¹⁴ Int. Rev. Code § 113 (1946), 26 U.S.C.A. § 113 (1945).

been shown to serve neither the cause of better housing nor sound taxation, while the others would increase the supply of dwellings at the expense of justice and fair play in taxation. Because housing needs are vital, there might be a temptation to sacrifice temporarily the more remote yet sustaining ideals of our society. Before this allurements becomes too strong, it is well to consider the drawbacks of income tax subsidies in general and then take another critical view of the proposed tax subsidies and their variants.

Of the many kinds of lawful subsidies—meaning grants or aids extended to undertakings to which the public interest is imputed—those effectuated through an income tax are probably least suited for a democracy. It is invariably difficult to subject proposals for such subsidies to thorough examination. An income tax subsidy is so indirect that relatively few persons can understand its operation. Analysis of a suggested tax subsidy tends to become confused in discussions concerning the technical aspects of taxation. The aggregate size of a prospective income tax subsidy usually defies calculation because too many unknowns are involved. For the same reason the public cannot be informed as to the probable distribution of the benefits. In these respects the adoption of an income tax subsidy is suggestive of secret diplomacy.

Even after enactment of such a subsidy the public remains shielded from appraising it intelligently.¹⁵ The special benefits conferred on private parties are accomplished without either open payments or publicity. The ultimate cost of the subsidy is buried in the over-all allocation of the income tax burden. Thus the operation of the subsidy is so camouflaged that its very existence is sometimes forgotten except by those who receive its special advantages. The absence of administrative safeguards makes this result doubly probable. An income tax subsidy is never administered by an agency concerned with the particular problem giving rise to the subsidy. To the revenue department it is largely another complication in policing the collection of revenues. The tax gatherers are not interested

¹⁵ The federal income tax has long provided another subsidy-like advantage to those who own and occupy their homes. No part of the annual use-value of an owner-occupant's home is considered to be income for purposes of the tax. The homeowner accordingly pays a smaller tax than renters with equivalent effective income since that part of their income which is spent for rent is taxable. Though treated as not receiving taxable income from use of his home, the owner-occupant is nevertheless permitted to deduct from his taxable income the payments made for interest charges and state and local taxes on his property. (Int. Rev. Code § 23 (b), (c) [1946]). In effect, he is allowed to deduct from his taxable income some of the costs of enjoying a form of income—the use-value of his home—which is itself exempt from tax. This combination near-subsidy, enjoyed by approximately 20 million homeowners, scarcely draws attention and rarely is appraised. See Simons, *Personal Income Taxation* 110-24 (1938) for a discussion of the exemption of income in kind from income taxation.

in how well the subsidy performs its function of providing a specific incentive, but only in seeing to it that taxpayers comply with the law in taking advantage of the benefits. No official reports need be rendered on the operation or distribution of the subsidy, and the fiscal agents are likely to limit their suggestions for improvement to matters of tax administration. Under these circumstances an income tax subsidy becomes a series of private and inflexible transactions between the government and the preferred taxpayers, with each individual deal isolated from critical scrutiny.

An income tax subsidy, moreover, by virtue of being comparatively inconspicuous and painless, is likely to become a fixture that is highly resistant to termination or change. It tends to survive even though it fails to provide the incentive giving rise to its enactment. Where this happens the subsidy may become a continuing windfall to private parties without furthering a public interest. The very fact that the subsidy remains extant conceivably might be used as a makeweight for not adopting really effective incentives.

There are other dangers in focusing too narrowly on the suggested income tax subsidy plans. Any subsidy is practically equivalent to a cash expenditure by the government for goods and services. Like a prospective cash purchase, it is to be weighed against other possible expenditures to determine how value can best be received by the government—or the public—at the prices demanded for goods and services. A given housing subsidy patently is not a wise investment for the government merely because it results in additional housing. An informed economic decision as to adoption of a subsidy must take into consideration whether the sum involved could better be spent in other ways to secure the desired housing. Discussions of a suggested tax subsidy usually omit reference to relevant comparisons. No attempt at comparisons can be undertaken here, but a reminder is in order that money invested in a tax subsidy could be otherwise utilized to produce additional housing.

The value to be received by the public from a prospective subsidy should also be assessed in terms of how well the subsidy will meet the need it is designed to satisfy. In regard to housing, there is substantial agreement that the most pressing need is for dwellings that families with moderate and low incomes can afford.¹⁶ The proposed tax subsidies might make

¹⁶ For purposes of this discussion, families with moderate income are those able to afford between \$20 and \$40 a month for rental or purchase of a dwelling; families with a low income are those unable to afford more than \$20 a month. This classification appears in S. Rep. 1131, 79th Cong. 1st Sess. (1946), which accompanied the Wagner-Ellender-Taft Bill, S. 1592, 79th Cong. 1st Sess. (1946). Under this classification, moderate income families represented 38 per cent and low income families represented 28 per cent of the total number of families.

investments in new rental ventures more attractive, but capital presumably would be channeled into the most profitable types of residential construction. In the past and at present the most lucrative rental construction is that designed to accommodate families with relatively high incomes. Even if the tax subsidies made all new residential building more profitable, there is no reason to assume that the existing hierarchy of profitability would be altered. The tax subsidies in effect would provide greater incentives to build the kinds of structures that private enterprise finds most remunerative to construct without subsidies. Rental dwellings for families with low and moderate incomes would still be relatively less profitable after enactment of the subsidies. Is there not something strange about subsidies to encourage construction of the kind of dwellings for which the need is least urgent?

In the background of every subsidy lies the arrangement for apportioning its cost to society. The proposed tax subsidies are not exceptions. The burden of these subsidies of course can be distributed in a variety of patterns, and the distribution of burden is unavoidably an integral part of the subsidy plans. Those who propose huge tax subsidies do not make it plain how the cost is to be apportioned. This omission is particularly serious when it is proposed to subsidize principally the high income groups in order to confer an indirect benefit on large numbers of taxpayers in the lower income ranges. In view of our present arrangement for apportioning the aggregate cost of government, there is ground for suspecting that the cost of such indirect housing subsidies will be borne in large measure by the very persons most in need of better housing. If that is the case, and if a tax subsidy is warranted, should we not consider bestowing one directly upon the families whose housing needs require attention?

This is not to imply that the housing situation can be improved by subsidizing rent payments through the income tax. All subsidies linked to income taxation should be avoided for the reasons already explored. In regard to housing they confuse the real issues and misplace emphasis. "No matter how much our shortage of adequate housing can be laid to a maldistribution of income in the social structure as a whole, the effect of wastes, inefficiencies, and traditionalisms upon the price of housing must still be considered to be at the heart of the housing problem."¹⁷ At worst, the proposed tax subsidies either are ineffective or disrupt our federal income tax structure. At best, they fail to get at the roots of our housing

¹⁷ The Twentieth Century Fund, *American Housing Problems and Prospects* 325 (1944). The wastes and inefficiencies are clearly reflected in the building codes which in large measure are a product of the building industry as a whole. See 33 *Fortune*, No. 4, at 262 (April, 1946).

problem. In the words of Thurman Arnold, "There are two ways of filling a hundred bottles, of different shapes and sizes, with water. One is to put them in the center of the room and throw water at them with a dipper. The other way is to hold one bottle at a time under a faucet."¹⁸ The proposed income tax subsidies, whether or not effective, are more apt to give us a shower than the houses we need.

II. THE PROPERTY TAX AND RENTAL HOUSING

Property tax subsidies occupy a prominent position in current planning for improving urban housing conditions through private construction. Several states already have adopted legislation authorizing exemption of private redevelopment projects from local property taxes.¹⁹ Others are preparing to enact similar statutes. These measures have been supported by groups with widely diverse economic and political views. The outlook at present is that property tax subsidies are to play an increasingly important role in the drive to attract private capital into the housing field.

Much of the recent attention to property tax subsidies stems from the use made of them lately by New York State and City. The New York State "Redevelopment Companies Law," enacted in 1942 and amended in 1943, permits a city to condemn property, sell it to a private redevelopment corporation, and exempt from taxation for a period of years that part of the project's value which exceeds the assessed valuation of the land and buildings before redevelopment.²⁰ Two projects—"Riverton"²¹ and "Stuyvesant Town"—are at present being undertaken in New York City under this law, both by the Metropolitan Life Insurance Company. Stuyvesant Town, which covers seventy-five acres or eighteen city blocks, has thirty-five separate twelve and thirteen story apartment houses containing 8,755 apartments. The tax-exemption subsidy granted for it by the city, estimated on the basis of existing tax rates and assessed values, will

¹⁸ Arnold, *The Bottlenecks of Business* 274-75 (1940).

¹⁹ See, for example, Mass. Ann. Laws (Supp., 1946) c. 121A, § 10; Mich. Stat. Ann. (Henderson, Supp., 1946) § 5:3058(12); N.J. Rev. Stat. (1946) § 55:14e-11; Wis. Stat. (Brossard, 1943) § 66.405.

²⁰ N.Y.L. 1943, c. 234, § 26, N.Y. Unconsolidated Laws (McKinney, Supp., 1947) § 3426. See also the New York Urban Redevelopment Corporations Law, N.Y.L. 1941, c. 892, § 12, N.Y. Unconsolidated Laws (McKinney, 1942) § 3312.

²¹ Metropolitan's Riverton Project, intended primarily for Negroes, will house 1,232 families (about 3,500 persons) in seven thirteen-story buildings. Although Riverton rents were originally planned to average \$12.50 per room, Metropolitan subsequently asked that they be increased to \$14.00, because of a 50 per cent increase in construction costs over the original estimate.

in time aggregate in the neighborhood of \$50,000,000.²² This sum is more than 50 per cent of the total cost of the project. It has been said that the investment of private capital in Stuyvesant Town or Riverton would not have been undertaken without tax subsidies. Whether or not this view is correct, the two projects undoubtedly have stimulated renewed interest in property tax subsidies for private housing.

Even if construction of the New York projects were induced by property tax subsidies, it does not follow that such subsidies are desirable means of bettering housing conditions. Local public assistance to improve housing can be furnished in numerous ways. Property tax abatement is to be compared not only with an absence of local subsidies for housing but, more pointedly, also with other means of subsidization. The choice of methods in conferring public assistance is not illusory. New York, for example, doubtless could have subsidized Stuyvesant Town by cash payments instead of tax benefits. It is therefore necessary to consider the cost and utility of property tax subsidies in order to be in a position to balance them against alternative "purchases" available to the government, particularly those in the field of housing.

All property tax subsidies for private housing consist essentially of special dispensations from the local property tax. The subsidies are conferred through exemptions from the tax. In broad terms, the subsidy may consist of a full exemption or a partial exemption from the tax for the life of the buildings involved, or a full exemption or partial exemption for a specified time. The limiting terms of a partial exemption may be defined in many ways.²³ A ceiling might be placed on the total dollar amount of benefits to be derived from the exemption; or rates might be pegged lower than prevailing levels; or the exemption might be restricted to a percentage of

²² Plaintiffs' Brief in Support of Motion for Temporary Injunction, *Dorsey v. Stuyvesant Town Corporation*, Supreme Court of the State of New York (July 9, 1947): "The cost of the project is conceded to be 90 million dollars. . . . The cost of the land was about 17 million dollars. . . . The total tax exemption over a twenty-five-year period granted to Stuyvesant Town Corporation is thus about 3 per cent on the improvement cost (90-17 millions) or well over 50 million dollars, which is about three times the cost of the land." In arriving at the figure of 50 million dollars, Charles Abrams, attorney for the plaintiffs, apparently based his calculations on the current tax rate and the assessed valuation which probably would have been used in the absence of the subsidy, a combination amounting to approximately 2 million dollars annually for over twenty-five years. The present value of the total subsidy might more accurately be calculated by discounting the amount of exemption for future years.

²³ Herbert U. Nelson, Executive Vice-President of the National Association of Real Estate Boards, has suggested, for example, that "any owner who tears down an old structure and puts up a new one . . . be allowed to deduct the value of the old building from that of the new for local tax purposes." Nelson, *Tax Incentive for Rebuilding Blighted Areas*, 56 *The American City*, No. 4, at 107 (Sept., 1946). This is probably the worst form of the property tax subsidy, since it will encourage the destruction of buildings with high, rather than low assessed values.

assessed values; or assessment values might be frozen as of a particular date.²⁴ All varieties of property tax subsidies have one thing in common. The subsidized ventures are taxed less than they would be in the absence of the subsidy.

In analyzing the cost and utility of property tax subsidies for private housing, four aspects of their operation deserve attention. These are: 1) what kind of housing will be produced; 2) who will bear the cost of the subsidies; 3) who will receive the subsidies; and 4) how will the subsidized accommodations be allocated. These matters are considered in the order given.

What kind of private housing will property tax subsidies promote? If the subsidy were a tax exemption given *carte blanche* for all new rental dwellings, the answer to this inquiry would be simple. Private enterprise would construct the kind of apartment buildings which it would find most profitable (or least unprofitable) to build without any subsidy. The *carte blanche* property tax subsidy, like the various proposed income tax subsidies for housing, would merely increase the remunerativeness of all new rental dwellings; it would not rearrange the hierarchy of profitability. This means that as the subsidy accelerated the flow of private capital into the rental housing field, it would provide additional new accommodations for the income classes which regularly occupy new apartment buildings. These consist of families in the upper portion of the income scale.

The experience of New York following the first world war bears out this analysis of what the *carte blanche* form of tax subsidy yields. In 1920 New York State authorized municipalities to grant tax exemption for private housing "with *no* requirement as to standard beyond those which apply to all new dwellings and without the faintest attempt to limit rent or selling price."²⁵ New York City chose a rather liberal version for its subsidy plan. "The subsidy, for those who obtained the full ten years' exemption and were able to keep construction expenses within the exempt limits, amounted to one-third of capital cost."²⁶ The story of who could afford to occupy

²⁴ Most of the contemporary redevelopment plans call for pegging assessment values at the level existing prior to redevelopment. Under this arrangement, the annual amount of tax on the subsidized development will vary with the tax rate. The aggregate amount of the subsidy in time—that is, the difference between the amount of taxes due and the amount which would have been due from the development were it not subsidized—also depends on the tax rate. Property tax subsidies for private housing conceivably might be coupled with so-called payments in lieu of taxes. Such a feature would not affect the validity of the positions developed in the text.

²⁵ Wood, *Recent Trends in American Housing* 107 (1931).

²⁶ *Ibid.* The New York City ordinance, as first enacted, limited the exemption to \$5,000 on a single-family house, \$10,000 on a two-family house, and \$1,000 per room with a maximum

the subsidized structures is succinctly told in the history of the rents charged. "Rents in the new buildings, unaffected by rent restrictions, soared happily. Nearly half the new suites built in 1924 rented for \$20 per room per month and up. About 17 per cent rented for \$15 per room per month or less. The rest were in between. . . . The newspapers carried advertisements indicating that those who invested in the new apartment houses could recover their capital in three years. Probably they could not, but the suggestion portrays a mental attitude."²⁷ Clearly the *carte blanche* tax exemption for housing became "a subsidy to the building industry rather than to health and welfare."²⁸

The *carte blanche* form of a substantial property tax subsidy for private housing is not likely to gain acceptance today. Interest has been centered on property tax subsidies only as parts of more or less comprehensive redevelopment plans. Under these the enterpriser must satisfy various requirements to qualify for the tax subsidy. The most significant limitations relate to the rental which can be charged and the profits which can be drawn out of the projects by their owners. In theory these restrictions are designed to make available apartments which carry lower rentals than those built with unsubsidized capital. The primary aim of the limitations is to channel the public assistance into subsidized lower rents instead of into subsidized higher profits.

It seems highly improbable that rent and profit controls, in the foreseeable future, will bring tax-exempt private accommodations within the means of more than half of the nation's urban families. The Stuyvesant Town project is an indicator for this pessimistic outlook. Its twenty-five year tax exemption subsidy is very large, being equivalent (in time) to a subsidy of about \$5,700 on each apartment in the development.²⁹ The limitation on profits which may be earned by the proprietor is not unreasonably generous, the maximum being 6 per cent per annum on investment during the period of tax exemption.³⁰ Rents are also subject to con-

of \$5,000 per family unit on an apartment house. Later the ordinance was re-enacted, limiting the exemption on multiple dwellings to \$15,000 per building. In effect the maximum period for the exemption was ten years, 1921 to 1931.

²⁷ *Ibid.*, at 111.

²⁸ *Ibid.*, at 107.

²⁹ Average subsidy per unit computed by dividing the total estimated amount of subsidy—50 million dollars—by the number of units in the project.

³⁰ During the twenty-five year period of partial tax exemption, Metropolitan "may not take out of the project any more than operating costs and 6 percent a year to cover interest and amortization. All other income goes to the city." Windels, *Private Enterprise Plan in Housing Faces First Test*, 32 *National Municipal Review* 286 (June, 1943). However, ". . . there is no prohibition against accumulating a substantial reserve which would not be paid

trol, being arranged by agreement between Metropolitan Life Insurance Company and New York City. Despite these factors, monthly rentals on the apartments, which contain three, four, or five rooms, now range from \$50 to \$91 per month.³¹ This scale is to be contrasted with the ability of families to pay such rentals. The Housing Census of 1940 showed that fewer than 23 per cent of New York's tenant families paid more than \$50 a month rent in that year. Average monthly rental was \$41.26, and half of all New York tenants paid less than \$36.71 a month.³² Family income is somewhat higher now. Nevertheless, using the latest family income data available from the census, and assuming that a tenant can afford a monthly rental equal to one week's wage, the average apartment in Stuyvesant Town would still be beyond the means of more than one-half of New York's families of two or more persons.³³

The inability of Stuyvesant Town to serve families in the lower half of the income scale is easily explained. Rentals that are high relative to average incomes are needed to enable the private capital invested in the enterprise to yield a satisfactory return. The subsidies granted, although large, simply do not bridge the gap between high building costs and average family incomes. This is the key to foreseeing what kind of private housing developments property tax subsidies are likely to foster even when they are accompanied by rent or profit controls. Two factors will tend to hold down the amount of such subsidies to a point where comparatively low

to the city but which the company could ultimately add to future profits and distribute in unlimited earnings on its tiny equity." Buttenheim, *A Few Warnings on Private Enterprise Housing Plan*, 32 *National Municipal Review* 385 (July, 1943).

³¹ N.Y. Times, p. 12, col. 3 (April 25, 1947), N.Y. Times, p. 15, col. 1 (Aug. 8, 1947).

³² Sixteenth Census of the United States, 1940, Housing, Vol. II, General Characteristics, Part I, United States Summary, Table 87, at 152 (Contract Monthly Rent for Tenant Occupied Units in 1940).

³³ Median income for urban families of two or more related persons for the year 1945 amounted to \$2,994, or approximately \$57 a week. Bureau of the Census, *Report on Family and Individual Money Income in the United States: 1945 and 1944*. Series P.S. No. 22, May 8, 1947. Comparable data is not available for New York City for 1945. However, in 1939, when comparable data was available, New York's median family income of \$1,654 was 14.5 per cent greater than median urban family income for the country as a whole. Bureau of the Census, *Report on Population, Family Wage or Salary*, Table 1, p. 7 and Table 10, p. 10 (1940). If New York maintained its 14.5 per cent lead over the rest of the country during the war years, which is not at all certain, median family income in New York City in 1945 would have amounted to \$3,428, or approximately \$66 weekly. On this basis, half of New York's families could not afford Stuyvesant Town's two-bedroom apartments at approximately \$68 monthly. Assuming that a family can afford to pay one-fourth of its income for rent, which is questionable in view of the sharp increase in the cost of living during the past year, accommodations in Stuyvesant Town would require a minimum annual income of \$2,912 for the lowest priced one-bedroom apartment; \$3,526 for the two-bedroom apartment, and \$5,784 for the highest priced accommodations.

rentals are not possible. The first is that a subsidy which is large in terms of the property tax is probably insufficient to close the gap between present high building costs and average family incomes. This relationship is demonstrated by the arrangements concerning Stuyvesant Town. The second factor is that property tax subsidies for private housing are generally regarded primarily as means of attracting private capital into housing, rather than as means of securing low-cost housing. For this reason it is likely that such subsidies will not be much larger than the minimum needed to augment the flow of private capital into the housing field. In any case the emphasis is not apt to be on furnishing accommodations which families with low incomes can afford.³⁴

Who will bear the burden of property tax subsidies for private housing? As phrased, this question presupposes that subsidies involve a burden. It has been argued, however, that they are costless if exemption from tax is confined to the extra value added by the subsidized new housing. The additional value would not have been brought into being, the argument runs, unless exempted. Therefore, the extra value—that in excess of values existing prior to the new development—could never have become part of the property tax base. By this reasoning it can be shown, for instance, that the tax exemption granted Stuyvesant Town will not reduce the revenues obtained by New York City from its property tax.³⁵ The reasoning also lends itself to a demonstration that revenues relative to municipal expenditures might be increased by the exemptions. This neat effect is accomplished by predicting that the subsidized redevelopments which replace slums will reduce city expenditures by lessening the cost of police, fire, and health protection.³⁶

The something-for-nothing defense of tax exemption rests on an assumption which is not always explicitly stated in full. In its shortened version the assumption is that the value of the site prior to construction of subsidized buildings on it would not have been augmented by private

³⁴ There is another feature about the kind of housing promoted by property tax subsidies to private parties which merits notice. The most popular form of such subsidies today is a tax exemption on the value added by redevelopment work. This type of exemption influences the intensity with which the redeveloped land will be used by the recipient of the subsidy. Specifically, the limited exemption will encourage intensified utilization of land because in this manner the exempt portion of the project is increased relative to its entire value. This perhaps is one of the factors accounting for the extreme concentration of tenants in Stuyvesant Town. The project is designed to house 8,755 families—almost three times the number that were physically accommodated in the slums which the development replaced.

³⁵ Rosenberg, *Tax Exemption of Public Housing*, 23 *Taxes* 605 (1945).

³⁶ The assumption that municipal expenditures will be reduced in this manner may be summarily dismissed. There is no reason to believe that a subsidized relatively high-rental project will be more effective in eliminating slums than an unsubsidized high-rental project.

capital in the absence of the subsidy; that is, private enterprise would not have increased the value of the site at any time during the period for which the subsidy is granted. In the case of Stuyvesant Town, for example, the abbreviated form of the assumption is that without subsidization private capital would not have added to the total value of the site throughout the twenty-five year tax abatement period. The short version of the assumption, however, is misleadingly simple. In order to validate the something-for-nothing argument in favor of tax exemptions for private housing, a more comprehensive assumption is needed. It must be assumed that the subsidized project will not discourage private capital from investing in whatever new construction it would have undertaken had not the subsidized buildings been erected. The terms of this assumption must extend to the entire rental market area affected by the subsidized project in question. Again taking Stuyvesant Town as an example, the full assumption behind the something-for-nothing argument necessarily is that the project, throughout its life, will not discourage private capital from entering into construction work in Greater New York City. Should the project encourage some kinds of private building (such as commercial structures) and discourage others, the assumption requires that the values lost through the discouragement not exceed those gained through the encouragement.

Spelled out in this manner the full assumption, which underlies the argument that property tax subsidies for private housing are costless, appears to be unrealistic. The unrealism is seen most easily in the case of *carte blanche* tax subsidies given for all new apartments constructed within a fixed period, say five years. It has been pointed out that under such subsidies private enterprise would build for the markets it would most likely supply in the absence of subsidies. This means that *carte blanche* subsidies would accelerate the construction of accommodations for families at the upper end of the income scale. If the subsidies are effective, more apartments will be built during the five years than if no subsidies were granted. At the end of that time, the demand for modern apartments (by high income families) accordingly will be more nearly satisfied because of the subsidization. To the extent that tax-exempt buildings supply the needs of those who can afford modern apartments, new unsubsidized ventures in residential construction become less attractive to capital. In other words, because both subsidized and unsubsidized new buildings would aim at drawing tenants from high income families, the competition would discourage construction of new unsubsidized accommodations. The assumption that the subsidy would not discourage capital from

entering into unsubsidized residential building thus is realistic only if it be further assumed that private capital is no longer interested in providing housing even for those with relatively high incomes. Such pessimism does not seem warranted today.³⁷

A similar analysis is applicable to property tax subsidies coupled with rent or profit controls. These subsidy plans, it has been shown, might result in rentals below those that would obtain in comparable new apartments without subsidization, but the plans cannot be counted on to reduce rentals drastically. The experience with Stuyvesant Town indicates that, by and large, the subsidized accommodations can be afforded only by those in the upper half of the income scale. It is for this reason that investment in projects like Stuyvesant Town potentially compete with investment in unsubsidized rental housing. The competition might extend in two directions. On the one hand, those who can afford the subsidized accommodations are sufficiently high on the income scale to be viewed as potential customers of unsubsidized new apartments. A relatively small drop in building costs, for example, might turn this group into ready customers if satisfactory subsidized housing were not available to them. On the other hand, some occupants of the subsidized projects doubtless could afford to pay the higher rentals which would make new ventures attractive to unsubsidized capital. The availability of comparable subsidized accommodations would tend to remove them from that market.

These propositions may be illustrated in terms of two housing projects of the Metropolitan Life Insurance Company. Subsidized Stuyvesant Town already has been described. A few blocks away Metropolitan is completing its Peter Cooper project. This is an unsubsidized nineteen-acre development containing 2,500 units. Monthly rentals range from \$85 to \$130, as compared with \$50 to \$91 for Stuyvesant Town. The differential between the two rental scales is accounted for in part by the subsidy granted to Stuyvesant Town. It is also due to the fact that Peter Cooper is a "luxury" project while Stuyvesant Town is not. Despite their differences, however, the two projects probably compete with each other to the extent that some tenants of the subsidized project could afford the rental charged in the unsubsidized development. Moreover, the existence of Stuyvesant Town is likely to lessen the attractiveness of under-

³⁷ It has been suggested that subsidized private housing projects will stimulate construction of new commercial structures, and that the existence of these would counteract the shrinkage in the tax base. Here again it seems unreasonable to assume that subsidized private housing projects would be a greater stimulant to commercial construction than unsubsidized housing projects. The contrary might be true since some of the Metropolitan projects are more or less self-contained, including appurtenant commercial facilities.

taking another unsubsidized project having accommodations comparable to it.

The fact that subsidized private capital tends to drive out unsubsidized private capital has an important bearing on the distribution of the burden of a property tax subsidy for private housing. Most American cities obtain the bulk of their revenues from a tax on real property. Because existing structures are constantly deteriorating, new improvements are relied upon to maintain the base of that tax. Without new improvements the base would automatically shrink as existing buildings wore out. The same effect will be produced by property tax subsidies for housing. Through discouraging unsubsidized developments they will act to contract the base of the tax itself.

To maintain revenues in the face of a shrinking property tax base, local governments will have to increase existing taxes or seek new sources of revenue. Experience strongly indicates that, following the lines of least resistance, it is politically more feasible to hike up established taxes than to introduce new levies. The record also shows that when receipts from a property tax fall, the usual reaction is to raise assessed values or the rate of the tax. Thus it is reasonable to predict that a shrinkage in the tax base caused by exemptions for private housing will be compensated by increases in the effective rate of the property tax. These increases, in turn, would be an added deterrent to the investment of unsubsidized capital in the construction of residential housing. They thereby would tend to further impair the property tax base.

Under the circumstances outlined, the burden of increased property tax rates would fall upon several groups. It would fall directly on those who already own their own homes. Annual overhead charges of home-owning would be enlarged; and, because this would make home-owning less attractive, the sale values of homes would decline. In short, the increase in taxes could not be shifted by homeowners. The new effective rates would also apply to unsubsidized landlords, but a substantial part of the increase probably could be passed on to tenants. These relationships contain an interesting implication as to who will bear the burden of real property tax subsidies for private housing if cities do not develop new sources of revenue. The vast majority of unsubsidized tenants are families with moderate or low incomes; and a large proportion of homeowners are families with moderate incomes. It is they who will be called upon to carry a larger share of the property tax burden in order to provide the subsidized housing—even though a large portion of them might not be able to afford the subsidized new apartments.

Thus it is apparent that the distribution of the burden of property tax subsidies for housing is intimately linked with the kind of housing which will be fostered by the subsidies. "When . . . exemption is extended to private development for a higher income tenantry, the city is deprived of the potential revenue which would have accrued to it when private enterprise in the normal course of events got around to providing dwellings for that group."³⁸ This loss of revenue, if it is to be offset, very likely will place an added burden on the regressive municipal tax systems. Indirectly, the inequities and undesirable characteristics of these systems would be further aggravated. On the other hand, when "the city exempts low-rent housing projects from tax on the improvements . . . it loses no potential revenues since the low-income families are not prospective customers for the potential private enterprise market."³⁹ Where this is so the subsidy raises no special problems regarding the distribution of its cost.

Who will be in a position to receive property tax subsidies for private housing? A *carte blanche* exemption of all new improvements from the tax would not particularly favor any single class of potential investors. Those who invested in housing and received the subsidy by and large would be the kinds of investors who would be most likely to invest in housing in the absence of a subsidy. The subsidy would merely make the investment more attractive to them. It already has been noted, however, that contemporary property tax subsidies for private housing are almost always tied in with comprehensive redevelopment schemes. These plans generally call for large-scale housing projects. Consequently, it becomes necessary to venture large amounts of private capital in order to qualify for the subsidy. This requirement in part accounts for the fact that each of the subsidized developments in New York has been undertaken by a large insurance company. Few existing organizations except the largest insurance companies and banks have the resources for investing in sizeable redevelopment projects. New independent corporations organized especially for redevelopment work are not likely to be in a position to advance the necessary capital. The present prospect is that unless the investments were guaranteed by a governmental unit—another kind of subsidization—great difficulty would be encountered in raising funds

³⁸ Abrams, *The Future of Housing* 336 (1946).

³⁹ *Ibid.* "Therefore, such exemptions on public housing, while technically they may be subsidies, represent no out-of-pocket loss. The tax exemption on such projects represents a dollar loss only to the extent that payments in lieu of taxes run less than the taxes paid on the site prior to its reconstruction and here it must be matched against the social and economic gains resulting from rehousing." Abrams, *The Subsidy and Housing*, 22 *Journal of Land and Public Utility Economics* 139 (1946).

from the public, which apparently has not forgotten the collapse of the real estate bond market in the twenties.

It is not to be implied that ownership of apartment houses, particularly large projects, by insurance companies or banks is necessarily undesirable. In the past a substantial portion of all residential mortgages was held by these organizations. Apart from subsidies there has been a tendency for institutional investors to become landlords rather than financiers of rental housing. The change from ownership of debts to ownership of equities may prove to be without significance as far as the over-all housing problem is concerned. What merits comment here is that property tax subsidies accompanying private redevelopment plans are accelerating the trend toward more complete institutional control of residential property. Already the world's largest privately-managed corporation, the eight billion dollar Metropolitan Life, has become the world's biggest private landlord. Upon completion of its projects presently under construction the corporation will fully own apartment buildings housing 31,566 families, or about 100,000 persons.⁴⁰

There is a paradox to be found here. It seems almost certain that tax subsidies for private redevelopment projects will be received primarily, if not entirely, by large institutional investors. The subsidized projects not only will narrow the market for new unsubsidized housing, but will tend to depress rentals in existing unsubsidized structures. The subsidies thus will reinforce the movement of large institutions to displace individuals and small corporations as metropolitan landlords, and, simultaneously,

⁴⁰ Testimony of Mr. George Gove, Vice-President of the Metropolitan Life Insurance Company:

"The Metropolitan Life Insurance Co. has built housing in four cities (New York, Los Angeles, San Francisco and Alexandria, Va.) for 19,084 families. The company is now engaged in building three more communities (in New York) for 12,482 families.

"When the work now under way is completed in 1947-48 the company will have built apartment homes for 31,566 families or approximately 100,000 persons and will have invested upward of \$200,000,000. The housing is distributed as follows:

Project	Location	No. of Apts.
Long Island City.....	New York (Queens)	2,125
Parkchester.....	New York (Bronx)	12,272
Parkfairfax.....	Alexandria, Va.	1,684
Parklabrea.....	Los Angeles	1,316
Parkmerced.....	San Francisco	1,687
Stuyvesant Town*.....	New York (Manhattan)	8,755
Riverton*.....	New York	1,232
Peter Cooper Village*.....	New York	2,495
Total.....		31,566

* "Under construction." Hearings before the Senate Committee on Banking and Currency, on Bills pertaining to National Housing, 80th Cong. 1st Sess., at 340-41 (1947).

undermine the values of their properties. Moreover, the exemption from taxation of each additional new privately-owned building will tend to increase the tax burden of those who bear the cost of municipal services. In spite of these prospects, the associations representing the property owners who will be adversely affected by the adoption of redevelopment tax subsidies have lent their support to these measures. As if to complete the paradox, these same associations continually oppose subsidization of housing for those who cannot afford to pay an economic rent.

How will private accommodations subsidized by means of a property tax exemption be allocated? If the subsidy were divorced from rent and profit controls, the price system would effect the allocation. When demand at prevailing rentals exceeded the supply of apartments an increase in rents would theoretically equate the two. But, as has been observed, rent and profit controls are usually central features in redevelopment plans embodying property tax subsidies. The controls presumably are designed to keep actual rentals below what the market would bear. If they succeed in this function, the demand for subsidized apartments will exceed supply and it will be necessary to ration the accommodations. This predicament already has occurred in Stuyvesant Town. Even before the buildings were ready for occupancy, applications outran apartments better than ten to one.

There is little likelihood (especially in peacetime) of general agreement on what principles should govern in distributing subsidized living quarters. The Federal Public Housing Authority repeatedly has encountered opposition to, and dissatisfaction with, the system of priorities it has followed in allocating low-rental dwellings. There is likely to be even less agreement on the general principles which ought to be employed in rationing subsidized housing among families with moderate or high incomes. The needs of such applicants are not as obvious or measurable as in the case of those at the bottom of the income scale, and no other basis of priority seems acceptable. Under these circumstances, rationing becomes all the more arbitrary and subject to abuse.

The power to ration housing is especially important because its exercise has a tremendous effect on the lives of those interested in the accommodations. Whether a family lives in subsidized or unsubsidized housing is likely to determine both the type of environment in which it settles, and the share of its income which is devoted to housing (and, therefore, the balance available for other things). If the power is so vital that one hesitates to entrust it to governmental officials, should not one pause even longer before delegating it to private institutions which qualify for a prop-

erty tax subsidy? The dangers implicit in private rationing of housing are highlighted by the attitude of the proprietors of Stuyvesant Town on racial segregation. Soon after the project was announced, the chairman of the board of Metropolitan Life made the pronouncement that: "Negroes and Whites don't mix . . . perhaps they will in a hundred years. . . . If we brought them into this development, it would be to the detriment of the city, too, because it would depress all the surrounding property."⁴¹ The attempt to exclude Negroes from the project led to passage of a New York City ordinance prohibiting discrimination because of race, creed, or color in the selection of business or residential tenants for any future properties built by private enterprise when tax exemption is used under the State Redevelopment Companies Law.⁴² The dangers of private rationing are thus officially recognized. But of equal or greater significance is the fact that at least some of the potential proprietors of future subsidized redevelopments do not like the policy of the ordinance—and it is they who will be in charge of any rationing programs made necessary by subsidization.

With the power to ration subsidized accommodations placed in private institutional hands, the property tax subsidy—as part of the typical private redevelopment scheme—fosters a curious matrix of relationships. The cost of the subsidy probably will be borne in large part by families with low or moderate incomes. It foreseeably will be used to build accommodations that few of these families can afford. The subsidy will most likely be given to insurance companies and other large investment institutions. And the selection of occupants who are to enjoy the subsidized rentals presumably will be undertaken by the institutional owners.

This matrix brings into clearer relief what the public purchases with property tax subsidies for private housing. If the tax subsidy is accompanied by rent or profit controls, it may be effective in keeping rents below what they might otherwise be. But the reduction in rents is not likely to be great enough to bring the subsidized accommodations within the reach of half of all urban families. The combination of tax subsidy plus rent or profit controls probably will suffice only to lessen the amount of rent which some families in the upper half of the income scale will pay, or enable them to occupy more attractive accommodations. On the other hand, omitting rent or profit controls from private redevelopment plans might well result in the same amount of capital being attracted into the rental

⁴¹ Abrams, *The Future of Housing* 322 (1946).

⁴² N.Y. Local Law 45 (1947). See also T 41-1-2 Administrative Code of City of New York, Local Law 20 (1944).

housing field through a smaller tax subsidy. In effect, the higher rentals leading to satisfactory profits would take the place of the larger tax subsidy. This arrangement would avoid the need for rationing subsidized accommodations. It would, moreover, underline the most critical aspect of property tax subsidies for private housing: they are not calculated to lead to the production of housing accommodations for the average American family.

Perhaps the most unfortunate aspect of this conclusion is that property tax subsidies for private housing thereby become a part of an old tradition of the housing industry. The tradition is not easily articulated. Its essence, however, seems to be contained in the following exchange of thoughts between Senator Ellender, an advocate of public housing, and Mr. Farr, a past president of the National Association of Real Estate Boards:

SENATOR ELLENDER: And your method . . . is to tear [the blighted buildings] down and let the people who live in there live in the older houses that would be vacated by those who would be fortunate enough to build on this new ground, supplied partly by Federal aid and State aid, and maybe city aid. That is your plan, isn't it?

MR. FARR: That has been the custom for years and years.⁴³

⁴³ Hearings before the Senate Committee on Banking and Currency on S. 1592, A Bill to Establish a National Housing Policy and Provide for its Execution, 79th Cong. 1st Sess. Part 1, at 450 (1945).