TAXING SPECULATIVE LAND GAINS: THE VERMONT EXPERIENCE*

*R. LISLE BAKER***
*STEPHEN O. ANDERSEN****

I. INTRODUCTION

Proponents of land conservation have become increasingly concerned about escalating land prices and the rapid conversion of open space for more intensive land use. This concern has caused a renewed interest in taxation as a technique of land use control.[1]

Since 1973, Vermont has used taxation for land use control by imposing a stiff graduated tax[2] on capital gain realized from certain

** Professor of Law, Suffolk University Law School, Boston, Massachusetts.

*** Professor of Economics, The College of the Atlantic, Bar Harbor, Maine.

1. *See generally*, D. HAGMAN AND D. MISCYNSKI, WINDFALLS FOR WIPEOUTS: LAND VALUE CAPTURE AND COMPENSATION (1978); LINCOLN INSTITUTE OF LAND POLICY, TAX POLICIES TO ACHIEVE LAND USE GOALS (Lefcoe and Woolery eds. 1978); Currier, *Exploring the Role of Taxation in the Land Use Planning Process*, 51 IND. L.J. 45 (1975); Delogu, *The Taxing Power as a Land Use Control Device*, 45 DEN. L.J. 279 (1968); Gurko, *Federal Income Taxes and Urban Sprawl*, 48 DEN. L. J. 329 (1972); Zimmerman, *Tax Planning for Land Use Control*, 5 URB. LAW. 639 (1973).

Conservationists (aided by tax counsel) can use the taxing power to preserve open space and valuable land for future generations. For a series of case studies of three such efforts, *see* BERGIN, PARTIAL DEVELOPMENT FINANCES OPEN SPACE PRESERVATION IN LINCOLN, MASSACHUSETTS; CHERINGTON, BARGAIN PURCHASE OF LAND BY AN EXEMPT ORGANIZATION: A VERMONT CASE STUDY; EMORY, CONSERVATION EASEMENTS PRESERVE AN ISLAND ON THE MAINE COAST (Browne ed.), available from the New England Natural Resources Center, Boston, Massachusetts.

2. VT. STAT. ANN. tit. 32, §§ 10001-10 (1973).

short-term[3], high-profit sales[4] of Vermont land. Known as the land gains tax, its rate varies depending upon two factors: the transferor's gain as a percentage of basis and the amount of time the transferor has held the land prior to sale. The Vermont tax does not apply to land held for more than six years, small primary homesites, or gain derived from structures on the land.

This article summarizes a much lengthier, two-volume report[5] on

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3. The statute only taxes profits on land that the owner acquires and then sells within six years. *Id.* at § 10003. For a review of the full tax schedule, *see* note 37 and accompanying text *infra*.

4. The Vermont legislature specifically placed the legal burden of complying with the statute on the seller because it sought to regulate the seller's behavior in the land market. VT. STAT. ANN. tit. 32, § 10006 (1973). The seller, however, may try to avoid the economic impact of the tax by shifting the burden to the buyer in the form of higher sales costs, but with uncertain results. For further discussion of the land gains tax burden, see notes 39-73 and accompanying text *infra*.

5. To evaluate Vermont's experience in taxing speculative land gains, the National Science Foundation awarded a grant in 1976 to the Environmental Law Institute. The Lincoln Institute of Land Policy, Cambridge, Massachusetts, provided supplementary assistance in 1979. This article summarizes the report of that analysis, Taxing Speculative Land Gains: The Vermont Experience. Interested readers may obtain the full, two-volume report from the Environmental Law Institute, 1346 Connecticut Ave., N.W., Washington, D.C. 20036. The authors developed much of the study from the theoretical and analytic foundation published in Baker, *Controlling Land Uses and Prices by Using Special Gain Taxation to Intervene in the Land Market: The Vermont Experiment*, 4 ENVTL AFF. 427 (1975).

The authors based their study on the results of several research methodologies. First, Vermont residents, attorneys, legislators, and other public officials evaluated the land gains tax in comprehensive interviews. Second, the Vermont Department of Taxes provided a sample of 1,000 land gains tax returns correlated to taxpayer income where possible but with protections for taxpayer identity. Third, over 600 purchasers or subdividers of Vermont land from 1968-78 participated in a nationwide telephone survey. Fourth, the study compared open land prices in three sets of Vermont and New Hampshire towns. Finally, the authors did conventional library research. Their report, conclusions, and recommendations are their own, and do not necessarily represent the opinions of the sponsoring agencies.

This report was a collective enterprise. Professor Baker was Principal Investigator and primary author of the introduction, tax administration, law, and conclusion sections of the main report. Dr. Andersen was primarily responsible for drafting the analysis of the land gains tax as a revenue-raising device, and evaluating the impact of the tax on land prices. In collaboration with the authors, Dr. Floyd J. Fowler, director of the Center for Survey Research, Boston, Massachusetts, prepared the survey section of the full report. All three have worked to condense much of that discusson into this article.

The authors summarize in the full report the advice and supervision of others who made extemely valuable contributions that benefited the study. Those deserving of special mention here include: Dr. Richard Liroff, now with the Conservation Foundation, who conducted many personal interviews; Jonathon Brownell and John Ewthe land gains tax in an effort to provide a greater understanding of certain issues involved with the law, especially for legislators who believe their states might benefit from such a measure.[6] The authors discuss four major aspects of the Vermont experience: (1) the background of the tax;[7] (2) how Vermont administers the law;[8] (3) whether the tax accomplished its goals;[9] and (4) its constitutional and legal implications.[10]

II. Background of the Vermont Land Gains Tax

A. *Origin of the Land Gains Tax*

Vermont's population of less than 500,000 is scattered throughout small towns and an unusually scenic countryside that Vermont citizens, and more recently, out-of-state visitors have come to appreciate. Fearing that land speculators and developers might disrupt Vermont's character by rapidly converting open space to more intensive uses, Vermont passed two laws designed to stem such uncontrolled development. In the early 1970's, the legislature passed a statewide development permit system called Act 250.[11] In 1973, Vermont

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ing of the Vermont Bar, who provided helpful background information on their state's land market; Robert Lathrop, formerly Vermont's Tax Commissioner, and Henry Ferry, who headed Lathrop's Land Gains Tax Division; Kingsbury Browne, who practices federal tax law in Boston; Professor Oliver Oldman of the Harvard Law School; and Barbara Searles who prepared much field data. The authors acknowledge in the full report numerous other professionals, including Professor Daniel Mandelker of the Washington University School of Law, and are grateful for their assistance. Finally, many students at Williams College, Suffolk University, and the College of the Atlantic provided invaluable assistance to the authors.

6. The Vermont law has generated much interest in other states. Legislators in Hawaii, Maine, Massachusetts, Montana, and Washington have proposed similar taxes. Washington, D.C. has enacted a housing speculation tax that one might consider an urban version of the Vermont land gains tax. *See* D.C. CODE ANN. § 47-3301 *et. seq*. (Supp. 1980).

England and New Zealand have also enacted laws similar to Vermont's. For a discussion of land speculation taxes in other countries, *see* D. HAGMAN & D. MISCZYNSKI, WINDFALLS FOR WIPEOUTS: LAND VALUE CAPTURE AND COMPENSATION 437-69 (1978).

7. *See* notes 11-23 and accompanying text *infra*.

8. *See* notes 24-73 and accompanying text *infra*.

9. *See* notes 74-82 and accompanying text *infra*.

10. *See* notes 83-144 and accompanying text *infra*.

11. VT. STAT. ANN. tit. 10, §§ 6001 *et. seq.* (1970), *amended*, 1979. While Vermont heavily regulates private land development, Act 250 is the most significant land use control. It requires an owner to obtain a permit for any proposed subdivision or

passed the land gains tax[12] in response to the apparent public support for the law as reflected in the successful election campaign of Governor Thomas Salmon, who advocated increasing state property tax relief with revenue generated from a transfer tax on speculative land sales. While no scientific polls of the attitudes of Vermont citizens concerning the tax are available, informal surveys reflect popular support for the land gains tax, though the latest poll is now five years old.[13] At the same time, the Vermont Association of Realtors and other members of the Vermont real estate community have consistently lobbied to reduce the impact of the tax. These lobbying efforts have had some success by achieving three amendments to the

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development likely to have a significant environmental impact or if the land is located in a Vermont town that has no local zoning or subdivision control. *Id.* For a further discussion of the permit process and land use plan, *see* F. BOSSELMAN AND D. CALLIES, THE QUIET REVOLUTION IN LAND USE CONTROL 54-108 (1971); HEALY, *et al.*, LAND USE AND THE STATES (2d ed. 1979); MYERS, SO GOES VERMONT (1974); Walter, *The Law of the Land: Development Regulation in Maine and Vermont*, 23 ME. L. REV. 315 (1971).

Vermont also employs virtually all known forms of taxation for raising necessary revenue. Those levies that most directly affect the land market are the state personal and corporate income taxes, VT. STAT. ANN. tit. 32, §§ 5811 *et. seq.* (Supp. 1980); the local property tax that each town assesses and collects, *id.* at §§ 3401 *et. seq.*; and the small property transfer tax that the state applies to virtually every transfer of real property, *id.* at §§ 9601 *et. seq.*

Vermont also administers a program that lessens the impact of property taxes on open space, *id.* at §§ 3751 *et. seq.* For further discussions of open space tax exemptions, *see generally* COUNCIL ON ENVIRONMENTAL QUALITY, UNTAXING OPEN SPACE (1976); Currier, *An Analysis of Differential Taxation as a Method of Maintaining Agricultural and Open Space Uses*, 30 FLA. L. REV. 821 (1978); Keene, *Differential Assessment and the Preservation of Open Space*, 14 URBAN L. ANN. 11 (1977); Malone and Ayesh, *Comprehensive Land Use Control Through Differential Assessment and Supplemental Regulation*, 18 WASHBURN L.J. 432 (1979); Roberts, *The Big Giveaway Called Differential Assessment: Some Thoughts on the Integration of Tax and Land Use Policy*, 2 URB. L. & POL'Y 65 (1979).

12. The land gains tax became effective in May, 1973. The Vermont legislature has subsequently amended the law three times. A modification in 1974 expanded the exemption for sales of primary and residential homesites from one to five acres. In 1976, Vermont extended the primary homesite exemption to transactions involving a purchaser who promises to build a primary residence on the parcel. A third amendment in 1978 increased the primary homesite exemption from five to ten acres and also eliminated the requirement that the parties to a transaction file certain certifications. For a further discussion of the primary homesite exemption, see notes 61-62 and accompanying text *infra*.

13. During the mid-1970's a Vermont state senator informally polled constituents

statute.[14]

B. *Purposes of the Tax*

The Vermont land gains tax has two primary purposes. The main goal is to deter landowners from transferring (by sale or other exchange) land held for a short period of time, where the principal economic return realized comes from increased value rather than rental or other income.[15] The other chief reason for the tax is to generate revenue for the state's property tax relief program.[16] Vermont recognized the difficulty of accomplishing both objectives at the same time. A fully effective regulatory tax dissuades people from undertaking the taxable conduct, costing the state tax revenue it would otherwise collect. The legislature, however, apparently believed Vermont would benefit from a law that accomplished either goal.[17]

Two secondary regulatory consequences may result if a land gains tax successfully deters speculation in land in which the purchaser anticipates a short holding period. First, the tax may reduce the rate of subdivision of productive agricultural and other lands into recrea-

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participating in statewide town meeting day on a variety of public issues. Citizens responded favorably when asked specifically about the land gains tax:

1974: Do you support the Vermont Capital Gains Tax on Land Sales?

Yes: 50% No: 28% Undecided: 22%

(based on approximately 7,000 returns from Vermont's 14 counties).

1977: Should the Vermont gains tax on short-term sale (six years or less, nonresidential) be repealed?

Yes: 2,159 No: 5,058 Undecided: 1,161

Public opinion questionnaires prepared by Sen. William Doyle, Washington County, Vermont. (March, 1974, and March, 1977).

14. *See* note 12 *supra*.

15. The Vermont Supreme Court upheld the constitutionality of the land gains tax in Andrews v. Lathrop, 132 Vt. 256, 315 A.2d 860 (Vt. 1974). The court held that the legislature may lawfully enact such a tax as a means to deter land speculation. While the law treats taxpayers differently depending upon the amount of gain they realize on a land sale, the court held that the state's legitimate interest in deterring land speculation justified the tax. *Id.* at 256, 315 A.2d at 863. For a further discussion of the legal issues involved in the land gains tax, see notes 83-144 and accompanying text *infra*.

16. The legislature furthered two important tax policies by creating this new source of revenue. First, the state uses the additional income it derives from the land gains tax to ease the property tax burden on poorer landowners. Second, the law allows the state to collect revenue from nonresidents who realize a gain on land sales in Vermont. The tax has not, however, produced a revenue windfall for the state. *See* section IV-B *infra*.

17. *See generally* notes 74-82 and accompanying text *infra*.

tional second home lots. Arguably, one way of achieving swift land value appreciation is to divide a large economy-size land parcel into smaller ones that individuals can afford.[18] Thus, to the extent that subdivision requires a quick sale to be profitable,[19] the land gains tax should cause the incidence of subdivision to abate—at least as long as the subdivision does not involve primary homesites that are exempt from land gains taxation.[20] Second, if the land gains tax induces a reduction of speculation, it may lessen the rapid escalation of land prices, though the effect of speculation on land prices is an unresolved issue.

Advocates of an unrestricted development market attribute rising land prices to the demands of increasing populations and incomes. They contend that speculators merely help the market function properly by bringing together present sellers with future buyers, or by opening up old land areas to new demand, with a rate of return justified by the risks involved.[21]

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18. TASK FORCE ON LAND USE AND URBAN GROWTH, CITIZENS' ADVISORY COMMITTEE ON ENVIRONMENTAL QUALITY, THE USE OF LAND: A CITIZENS GUIDE TO URBAN GROWTH 264 (1973) [hereinafter cited as TASK FORCE].

Vermont has focused the regulatory impact of the land gains tax on these second-home lot developments. The state exempts from taxation transfers of primary homesite property. VT. STAT. ANN. tit. 32, § 10002(b) (1973). *See also* notes 61-62 and accompanying text *infra*.

19. Vermont assesses the land gains tax on transfers of land the owner has held for six years or less. *See* note 37 and accompanying text *infra*.

20. Thus, to the extent that more Vermont open space remains in unbroken parcels until it is ripe for development, planners may better develop a land plan that successfully integrates the parcel with subsequent construction. Without such planning, a poorly designed subdivision may do more than environmental harm than ugly buildings that developers construct on it. In other words:

> If past experience is any guide, many of the lots now being created will never be used at all: in this case, it is, "lots first, buildings never." The lot lines will remain on the record books, though, and land titles will become even more clouded as decades pass. Tough for the land buyers? Yes. Tough also for the environment as is shown by any number of "dead subdivisions" created forty or fifty years ago. If a few scattered lots are built upon, the subdivison may become a sparsely settled rural slum . . . . Once the countryside has been given over to quarter acre or 1-acre lots (and most recreational lots sold in 1971 were one-quarter to 1-acre in size), you can forget thoughts of clustering, variable densities, common open spaces, and the like . . . . The lot lines will survive to block sensitive use of the land.

TASK FORCE, *supra* note 18, at 275-76. For additional discussion of the environmental problems of poor land planning, *see* I. MCHARG, DESIGN WITH NATURE (1969); Toner and Thurow, *Let Nature Decide the Land Use*, 40 PLAN. 17 (Jan. 1974).

21. One author has argued that speculators play an important role in any land

Proponents of government intervention to control land speculation take a different view of the impact of speculation on land prices. They argue that speculators artificially increase land prices in different (and sometimes inconsistent) ways: (1) by withholding some land from resale, awaiting even higher prices; (2) by bidding up the prices of land they do not yet own; or (3) by short-term holding of other land, fostering an accelerating turnover of properties that amplifies the cost-push inflation of significant land transfer expenses. Arguably, these price increases cause higher tax assessments for landowners reluctant to sell.

While this study does not attempt to resolve this theoretical dispute underlying the impact of land speculation upon land prices, it does attempt to assess the impact of the land gains tax on land prices. One can hypothesize that the impact of the land gains tax on land prices depends upon the interaction of two factors. First, how much land did owners withhold from the active real estate market in order to avoid paying the gains tax? Second, how much land was not purchased by prospective buyers who decided not to enter the Vermont land market because of the tax deterrent? All things being equal, if the first factor exceeds the second, land prices will increase. Conversely, if the second factor exceeds the first, land prices will decrease. One can hypothesize even further that the absolute amount of land transferred will probably decline because the tax discourages both buyers and sellers from entering the land market.[22]

To the extent that the introduction of the land gains tax diminishes land transfers, a real income loss will occur to those intermediaries in the land market, such as brokers, bankers, and attorneys, whose live-

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market system, acting as insurers who assume the risk of volatile land prices. *See* L. ROSE, TAXATION OF LAND VALUE INCREMENTS ATTRIBUTABLE TO REZONING 42 (1971). Others say speculators properly act as "land bankers," acquiring property in advance of need and later releasing it during periods of high demand. *See* Elias and Gillies, *Some Observations on the Role of Speculators and Speculation in Land Development*, 12 U.C.L.A. L. REV. 789 (1965). Others argue either that short-term speculation serves no banking function, or that it is inherently inflationary. *See* ONTARIO MINISTRY OF ECONOMICS AND INTERGOVERNMENTAL AFFAIRS, THE LAND SPECULATION TAX (1974); Note, *State Taxation—Use of Taxing Power to Achieve Environmental Goals: Vermont Taxes Gains Realized from the Sale or Exchange of Land Held Less than Six Years—Vermont Statute Ann. tit.* 32 §§ 10001-10 (1973), 49 WASH. L. REV. 1159, 1163 (1974).

22. For a more elaborate theoretical analysis of these land market issues, *see* Baker, *Controlling Land Uses and Prices by Using Special Gain Taxation to Intervene in the Land Market: The Vermont Experiment*, 4 ENVTL AFF. 427 (1975).

lihood depends upon an active and high value land market. Slower land turnover and smaller price increases will also diminish state revenues from transfer taxes. At the same time, to the extent that the land gains tax produces a general reduction in the land prices of developable land, it may facilitate the entry of low and moderate income individuals into the land market. Lower prices may, however, produce a loss in appreciation income to the landowners from whom such individuals would buy. In other words, price inflation is a potential benefit for current landowners but a burden on those who would become landowners in a more open market.[23]

In summary, the land gains tax had two primary purposes: to raise revenue and to regulate speculation in Vermont land. Within the regulatory purpose of deterring speculation, one can hypothesize two possible regulatory consequences: controlling subdivision and controlling land prices. The remainder of this article examines two questions of particular importance to those considering enacting a land gains tax. First, how did Vermont design the statute to accomplish these purposes? Second, did the tax accomplish these goals and hypothesized secondary impacts?

III. Tax Administration and Statutory Design

We have examined the conditions that prompted Vermont to enact its land gains tax, and the purposes the state hoped to achieve through the law. We now review the operation of the statute. This section describes how the tax due is computed, analyzes the chief components of the problems of tax formula, and summarizes the tax collection process.[24]

A. *Computing the Tax*

The Vermont land gains tax is a stiff, graduated tax on capital gain realized[25] from the transfer of Vermont land[26] held six years or less.[27] A land sale is usually a relatively straightforward transaction, and

23. *Id.*

24. The authors gathered the information in this section from interviews with officials of the Vermont Tax Department and 15 Vermont attorneys specializing in real estate.

25. For an example of how Vermont calculates taxable gain, *see* note 37 and accompanying text *infra*.

26. VT. STAT. ANN. tit. 32, § 10002(a) (1973).

27. *See* note 37 *infra*.

Vermont applies its land gains tax accordingly.[28]

The authors of the tax borrowed heavily from the terminology of federal tax law. These elements have effectively the same meaning for land gains tax purposes as for federal tax purposes, and comprise the basic formula the state uses to compute the tax due on a land transaction.[29] First, the state determines the basis, or adjusted cost of purchase of the property.[30] Second, the state computes the taxable gain that the owner realizes at the time of sale or exchange[31] by subtracting the basis from the sale or exchange price.[32] Third, the state uses a graduated schedule to determine the tax rate on the gain; the tax burden is heaviest on owners who hold property for short periods of time, and whose gain as a percentage of basis is high.[33]

Vermont does not always realize revenue from land transfers that are subject to this computation. As discussed previously,[34] Vermont will sacrifice tax receipts as a matter of public policy to achieve its regulatory goal of deterring the taxable event—quick land sales. Two important exemptions from the land gains tax complement this regulatory objective. First, Vermont only taxes the gain allocable to land that is sold or exchanged, exempting gain allocable to structures

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28. The authors of the law also intended the tax to apply against more complex types of sales. The "option grant" is one such transfer mechanism. An option is a land transaction that delays transfer of possession; for a price, the owner instead grants a purchase option to a potential buyer. The buyer then has additional time to investigate the availability of financing, permits, and other matters, and to more carefully evaluate the basic purchase decision. While the buyer ponders, the seller may not solicit other purchasers until the option period ends. While the seller does not transfer possession of the property during this period, he or she is liable under the land gains tax. Vermont treats the granting of an option as a taxable event, just like a normal sale or exchange of land.

29. Vermont drew from federal tax law many terms within the land gains tax, benefitting land gains taxpayers and tax attorneys, especially nonresidents who are already familiar with the language and rules attendant to computing gain taxable under federal law.

30. The statute incorporates by reference the definition of basis in the Internal Revenue Code. VT. STAT. ANN. tit. 32, § 10005(a) (1973). Basis is the buyer's tax cost for acquiring the property, but basis may increase or decrease during the subsequent holding period. Adjustments in basis ultimately affect the owner's land gains tax liability at resale. *See* notes 39-43 and accompanying text *infra*.

31. VT. STAT. ANN. tit. 32, §§ 10005(b), (d) (1973).

32. *Id.* § 10005(c).

33. *See* note 37 *infra*.

34. *See generally* notes 11-23 and accompanying text *supra*.

on the parcel.[35] Second, Vermont exempts a property transfer from land gains taxation up to an acreage limit if the land is a primary homesite.[36] It is immaterial whether the site is the seller's or the buyer's principal residence, or whether the owner sells the lot to a builder of a principal residence.

A simple example illustrates the land gains tax in operation. A subdivider buys a 100-acre parcel of property for $200,000; this purchase price is the buyer's basis. Eight months later, the subdivider sells lots without structures for $350,000 to buyers who will not build their principal homes there. The subdivider has realized a gain of $150,000 during the holding period, and the state calculates the tax due from the following schedule:

Years Land Held By Transferor	Gain, as a Percentage of Basis[37] (Tax Cost)		
	0-99%	100-199%	200% or more
Less than 1 year	30%	45%	60%
1 year, but less than 2	25%	37.5%	50%
2 years, but less than 3	20%	30%	40%
3 years, but less than 4	15%	22.5%	30%
4 years, but less than 5	10%	15%	20%
5 years, but less than 6	5%	7.5%	10%

Thus, this seller would pay a thirty percent tax on the $150,000 gain realized, or $45,000. The remaining $105,000 would also be subject to federal income or federal capital gains taxation.

The schedule reflects one purpose of the tax—deterring quick land sales and exchanges.[38] The tax on reduced gains decreases for each year the owner holds the property. In the above example, the seller could have eliminated tax liability by holding the property for six years, rather than eight months, before selling it.

Often the land gains tax does not operate as easily as it did in the

35. VT. STAT. ANN. tit. 32, § 10002(a) (1973). *See also* notes 53-59 and accompanying text *infra*.

36. *Id.* at § 10002(b) (1973). *See also* notes 61-62 and accompanying text *infra*.

37. VT. STAT. ANN. tit. 32, § 10003 (1973). This report accepted the interpretation of the Vermont Department of Taxes that the tax schedule is flat, not graduated. For example, the Department contended that the statute taxes a six-month 300% gain at a 60% rate. In *Langrock v. Dep't of Taxes*, 139 Vt. 108, 423 A.2d 838 (1980), the Vermont Supreme Court rejected the Department's interpretation. The court held that the state must apply the tax on a graduated scale. In our example, the tax would be 30% on the first 100% of gain, 45% on the second 100%, and 60% on the remainder. *Id.* at 110, A.2d at 839.

38. *See* notes 15-17 and accompanying text *supra*.

example. The computation becomes more difficult if the seller can adjust the basis, modify the gain, or take advantage of the exemptions. Thus, the components of the land gains tax deserve careful scrutiny.

B. *The Components of the Tax Formula and Problems of Statutory Design*

1. Calculation of Basis

Basis is the first key determinant of an owner's liability for a taxable land transfer; it is the "base line" from which the state measures any taxable gain.[39] The original basis, the price that the owner paid, can be adjusted during the subsequent holding period. If the owner sells the property within the taxable holding period he or she will benefit from an increased basis because the statute determines the ultimate tax liability by subtracting the basis from the sale or exchange price. Thus, the higher the basis, the less taxable gain the seller realizes.

One way the original basis can be adjusted upward is through improvements in the land.[40] For example, if a developer buys a parcel for $50,000 and spends $20,000 on roads, sidewalks, and sewer and water systems, the property's new basis is $70,000. If the developer subsequently sells the property during the taxable holding period for $100,000, the gain subject to tax liability is $30,000 (sale price less adjusted basis).

Basis also changes when the landowner dies and the property passes through the estate. In that case, the basis is the value of the land at the time of death rather than the price the decedent originally paid.[41] Thus, the estate will avoid considerable land gains tax liability if the parcel had appreciated in value from the time the decedent purchased the land to the time of death.

For example, a subdivider acquires a 100-acre parcel of property for $100,000. One year later, the owner dies after subdividing the parcel but before selling any lots. During that year the subdivided

39. VT. STAT. ANN. tit. 32, § 10005(c) (1973).

40. VT. STAT. ANN. tit. 32, Regulation No. 1. 10005(a)-1 (1976). Vermont's Department of Taxes promulgated a series of such interpretive regulations pursuant to enabling authority the legislature provided in the statute. VT. STAT. ANN. tit. 32, § 10009(a) (1973).

41. *Id.* at § 10005(f). *See also* VT. STAT. ANN. tit. 32, Regulation No. 1. 10005(a)-3 (1976).

property substantially appreciated in value. The executor values the land at $210,000 at the time of the subdivider's death and the Internal Revenue Service accepts this finding for federal estate tax purposes. The parcel's basis consequently has "stepped up" from the purchase price by $110,000. Six months after the owner's death, the estate sells the subdivided lots as a block of second homesites[42] for $250,000. Thus, the taxable gain realized after sale is not $150,000 but $40,000 (sale price less adjusted basis), and the land gains tax liability is accordingly lower.[43]

This seemingly favorable tax result has also produced a dilemma for taxable estates. Executors and administrators can minimize both federal and Vermont estate taxes by arguing for a low value on capital assets in the estate. Under-valuation, however, lowers the basis of the property, resulting in stiff land gains tax liability if the estate disposes of the property within the six-year taxable holding period.

This result seems inconsistent with the regulatory purpose of the land gains tax. An estate has a short holding period because of the owner's death rather than short-term speculation. Thus, the estate should not be subject to land gains tax liability because no conduct is deterred. Ironically, the threat of a stiff land gains tax might encourage estates to more realistically value property, providing the state with an enforcement mechanism for accurately calculating estate taxes. We believe the land gains tax law should allow the estate to "tack on" the owner's pre-death holding period, and to calculate gain from the decedent's original basis or purchase price. This would give estate planners more flexibility, and allow Vermont to treat all short-term property ownership the same.

2. Determining Total Taxable Gain

The second key determinant of land gains tax liability is the taxable gain the owner realizes from the sale or other transaction.[44] Ver-

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42. If the decedent had intended the property to hold *primary* homesites, the estate would be exempt from land gains tax liability when subsequently selling the lots. *See* note 36 and accompanying text *supra*.

43. The statute would tax the realized gain of $40,000 at 30%. *See generally* note 37 *supra*.

44. Vermont assesses a land gains tax to transactions where the owner passes title to property in return for consideration. VT. STAT. ANN. tit. 32, § 10004(a) (1973). *See also*, Harden v. Vermont Dep't of Taxes, 134 Vt. 122, 125, 352 A.2d 685, 687 (Vt. 1976) (a "taxable event" occurs when a property owner transfers or invests title to another person, and when an optionee transfers an existing option to a third party).

mont designed the statute to tax net sale proceeds as capital gain instead of treating the gain as taxable income, which, if the federal tax model were followed, would allow the deduction of uncapitalized costs of ownership such as property taxes and mortgage interest payments. In the ordinary case, the seller cannot deduct these costs in the Vermont scheme that taxes gain, rather than the profit realized from ownership, unless he makes a section 266 election.[45] The owner can deduct incidental ownership costs servicing the land, such as the price of land use permit applications, only if he or she pays others to perform these duties. The owner cannot decrease net taxable gain if he or she does the work.

The taxpayer cannot deduct costs of ownership, but he or she can report other expenses that reduce net sales proceeds, resulting in reduced taxable gain and lower tax liability. Specifically, the law allows the seller to deduct certain costs of sale.[46] Vermont land gains tax regulations provide that legal fees, surveying costs, sales commissions, and other costs can reduce taxable gain "to the extent directly related to the sale of a particular parcel . . . ."[47] The Vermont De-

45. I.R.C. § 266 (West Supp. 1980). Normally, land ownership costs (as opposed to costs associated with acquisition and sale) are not relevant for purposes of determining taxable gain. Vermont's treatment of these costs departs from federal law, where a taxpayer may deduct such expenses from ordinary income when determining income tax liability.

Vermont does provide an alternative means for the taxpayers to take advantage of ownership costs to reduce land gains tax liability. A taxpayer can capitalize such costs under the Internal Revenue Code in order to increase the basis of the property for federal purposes. At the same time, he may capitalize these costs to increase basis and subsequently lower his Vermont land gains tax liability. The chief of the Land Gains Tax Division said, however, that most taxpayers do not capitalize these costs. Thus, without such an election, the Vermont Department of Taxes disallows adjusted increases in basis for costs such as taxes and interest payments.

46. VT. STAT. ANN. tit. 32, § 10005(b) (1973).

47. VT. STAT. ANN. tit. 32, Regulation No. 1. 10005(b)-1(a) (1976).

Two of the most important costs are broker and attorney fees. Vermont real estate brokerage commissions range from six percent of the sale price on improved properties to 10% of the sale price of open land. The Department of Taxes will probably accept taxpayer returns that disclose payments falling within these ranges. The Department more closely scrutinizes higher reported commissions to determine if they are accurate, or if the taxpayer inflated the figure to reduce land gains tax liability.

While the Department allows deductions for reasonable attorney fees that a taxpayer reports as a cost of sale, the Department disallows seller's attempts to deduct fees they allegedly paid to themselves when acting as an attorney in a land transaction.

partment of Taxes has closely scrutinized, and in some cases, rejected the validity of certain costs that a seller claims are "directly related" to sale. For example, it disallowed a developer's claim that certain promotional expenditures were a cost of sale of individual parcels in a large project. The developer did not appeal the ruling.[48]

The average seller should not expect to lower net taxable gain by spending more money on costs so as to decrease net sale proceeds.[49] The one exception to this general rule occurs when an average seller falls into a higher bracket because a sale resulted in an unusually large gain. The increased costs involved in such sales would reduce the seller's gain, and ultimately the land gains tax rate. This seller would partially achieve the same goal[50] by either lowering the sales price or holding the property longer before selling.

3. Tax Exemptions

While the authors of the Vermont tax wrote into their statute federal tax terms such as "basis", "sale or exchange", and "gain," they departed from this federal model when they determined which land transactions the law would tax. Specifically, Vermont exempts from taxation gain that is: 1) allocable to buildings or other structures on the property,[51] and 2) allocable to land that is a principal residential homesite.[52] These exemptions make administration of the tax complex.

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48. The case involved the Quechee Lakes Development Corp. The Land Gains Tax Division believed the Department of Taxes' denial of a deduction for promotional costs deterred developers of large subdivisions from using high pressure sales tactics. We interviewed several lawyers who disagreed with this contention. They believed that a taxpayer's inability to increase basis by adding on promotional and other remote costs does not deter development because Vermont does not attract such sophisticated investors. These attorneys believe the land gains tax itself, rather than its components, provides the disincentive to development.

49. *See* note 37 and accompanying text *supra*.

50. In Langrock v. Dep't of Taxes, 139 Vt. 108, 423 A.2d 838 (1980), the Vermont Supreme Court placed limits on the benefits sellers may realize from changes in holding periods and sales prices, by interpreting the rate schedule as progressive. *See* note 37 and accompanying text *supra*.

51. *See* VT. STAT. ANN. tit. 32, §§ 10002(a), 10005(b) (1973). Former Vermont Tax Commissioner Robert Lathrop said allocating realized gain between taxable land and tax exempt buildings on the property is one of the Department's most difficult administrative problems.

52. *Id.* at §§ 10002(a), (b).

a. *Allocating Gain Between Land and Buildings*

Many of Vermont's landowners have built structures on their properties. Thus, in many taxable land transactions, sellers may take advantage of the provision that exempts the value of these structures from the taxable gain realized on the sale of the land.[53] This additional calculation of land gains tax liability makes it more difficult for the state to administer the tax.

For example, suppose a resident of New York bought a second home in Vermont in 1975 and sold it within four years for a gain of $20,000. Part of this $20,000 would be allocable to the exempt structure while the remainder would be allocable to the non-exempt taxable land. The land gains tax statute provides that gain realized shall be allocated between land and buildings on the basis of "fair market value".[54] The statute neither elaborates on the meaning of "fair market value" nor explains when it is determined.

Theoretically, the exemption should not necessarily make tax administration complex. If landowners would value land and buildings separately upon acquisition and disposition, they could isolate the land value at sale to determine its appreciation over the term of ownership. Unfortunately, few landowners make such calculations of value at purchase and sale. Indeed, in most situations they would face an extremely difficult task if they tried to reconstruct the allocations after the fact. Instead, Vermont allocates taxable gain between land and buildings in proportion to land value at the time of sale. Determining the taxable gain, however, is not impossible because the owner can take advantage of several allocation techniques.

1.) Methods to Determine Allocation

A) *Assessments*. Vermont property taxpayers may rely on the local tax assessor's allocation of value between land and structures to determine the gain realized at sale. These assessors, or "listers", calculate separately the values of the land and the structures on the parcel in order to levy local real property taxes.[55] The State Department

53. *Id.* at § 10002(a).

54. VT. STAT. ANN. tit. 32, § 10005(b) (1973).

55. Returning to our example, the New York second home seller realized a total gain of $20,000 for allocation between the building and the underlying land. The owner might look at the property tax bill for the house and land, and allocate the gain on the basis of the local lister's determination. He might find that the lister had allocated one-fourth of the value of the property to the land, and the remainder to the

of Taxes often will accept such allocations as evidence of current values of the land and buildings. The Department believes this method of valuation promotes simplicity in tax administration. This valuation, however, may be misleading if the lister's analysis of the relative value of land and buildings occurred earlier than the date of sale.

B) *Town Land Value Tables*. A second alternative for taxpayers trying to calculate the value of structures is to examine town land value tables. The Department of Taxes prepares these summaries to equalize state aid to local governments. The tables seek to determine the "tax effort" of each town, so that communities that undervalued property for local tax purposes do not receive an unfair benefit in local aid because they appeared "poorer". Both the taxpayer and the state may use these tables as a guide to the values of real property.[56]

C) *State Assistance*. The State of Vermont has not ignored the allocation problems. The Department of Taxes responded in 1977 by establishing certain "presumptions" depending on the location of the land. First, for property in the City of Burlington, it allocated to the land alone twenty-five percent of the total fair market value of a parcel that included a residential building. Second, it made a similar calculation of eighteen percent for lots in villages and other communities. Finally, it allocated eight percent to land containing condominiums. These calculations are somewhat arbitrary, but they do offer a guide to the seller who can exempt the value of structures from the taxable gain realized from a land transfer.

2.) Depreciable Property

Depreciable property is a separate problem for sellers trying to allocate realized gain between exempt and non-exempt taxable sources.[57] Annual deductions for depreciation decrease the prop-

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structure. Following such an appraisal, the state would tax one-quarter or $5,000 of the $20,000 total gain for land gains tax purposes.

56. For example, assume the land value table lists an average acre of property at $325. If an owner sold a 300-acre parcel for $120,000, he would multiply 300 by $325 by .95 (a factor the drafters of the table designed to represent adjustments in per acre prices depending on the size of the parcel). The resulting total land value would be $92,625. If the taxpayer had allocated to the land only $60,000 of the total sale price and attributed the remainder to structures on the property, the Department of Taxes would question how the taxpayer made the allocation.

57. Depreciable property is real estate, such as an apartment building or vacation

erty's basis from the original purchase price level. This lower basis results in stiffer land gains tax liability for the seller.[58] The taxpayer, however, may recapture this lost value attributable to depreciation because of federal tax treatment of resale.

For example, assume that a rentable vacation house[59] and land cost $50,000, and the house has a useful life of forty years and a "cost" of $40,000. In a simplified example, the taxpayer could deduct $1,000 per year against rental income, representing the straight-line depreciation of the house (not the land) spread over its useful life. If the taxpayer chose instead to sell the property in the fifth year of ownership, the depreciation would have reduced the cost basis in the house from $40,000 to $35,000. If the owner sells the whole property for $70,000 he or she would realize a federally taxable gain of $35,000, including $15,000 of depreciation recapture.

Vermont, however, disregards depreciation costs when it calculates a seller's land gains tax liability. The Department of Taxes relies exclusively on the original cost basis to determine total gain, then allocates that gain, based on the current fair market value, between the land and structure. In the example, Vermont would ignore the $5,000 depreciation recapture on the structure, and treat as taxable only the $20,000 of gain that would then be allocated between the taxable land and the exempt building.

3.) New Construction

The previous section demonstrates some of the problems inherent in distinguishing the value of land from existing structures when calculating taxable gain. Vermont has adopted a separate administrative procedure for the analogous problem of valuing new construction. The Department of Taxes allocates gain on new construction in proportion to its basis, or relative cost.

For example, assume a builder of a second home purchases a lot for $10,000, erects a structure at a cost of $40,000, and then sells both

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house, that produces federally taxable income. A property owner determines this income by deducting operating expenses, and a yearly "depreciation" amount that spreads the cost of the building over its useful life. Land does not depreciate.

58. *See* notes 39-43 and accompanying text *supra*.

59. A land transfer involving a vacation homesite is subject to gains tax liability. The parties' transaction would be exempt from taxation if they intended that the property be used for a primary homesite. *See* notes 61-62 and accompanying text *infra*.

within a year of acquisition for a net return of $20,000. Department regulations would allocate the $20,000 gain between land and buildings in proportion to basis. The building has contributed $40,000 worth of basis compared to $10,000 for the land. Eighty percent of the $20,000 gain realized would be allocable to the structure, and therefore exempt. The remaining $4,000 would be taxable land gain. This allocation process means that if land has appreciated significantly since acquisition, owners may erect structures that assist in "sponging up" otherwise taxable gain. On the other hand, if a lot does not appreciate significantly, the Department's formulas may capture gain that really results from new construction.

4.) Evaluation of Structural Exemption

The problem of allocating gain between land and buildings is the most difficult job in land gains tax administration. As noted earlier, Vermont could have avoided much administrative difficulty by adopting the federal capital gains model and taxing all gains derived from real estate. Instead, it accepted such difficulty in order to achieve a more focused regulatory objective.[60] The problem of allocating gain between land and structures might dissuade another jurisdiction from imitating this feature of Vermont's law, where revenue, not deterrence of land speculation, is that jurisdiction's only concern.

Significantly, we found little evidence of developers undertaking construction on their newly-built subdivisions just to take advantage of regulations on allocating gain between land and buildings. The economic incentive to build may produce such small savings that it is a marginal consideration. Alternatively, developers may still be relatively ignorant of the potential land gains tax savings they might realize by erecting a structure that can "sponge up" the gain on the underlying land.

This allocation problem may also be exaggerated. Such situations do not seem to be a significant portion of the total tax population. Where buildings do exist on the land, many may be the owner's primary residence. This leads to an examination of a second aspect of

60. One criticism of the Vermont tax is that it is not focused enough, applying to sales of downtown commercial property where the environmental impacts of short-term transfers are minimal. Taxing gain on commercial structures not only raises the problem of depreciation recapture, but also deters transfers of commercial property that are arguably not within the purpose of the Vermont law.

the Vermont land gains tax—exemption for transfers of land containing the seller's primary homesite.

b. *Tax Exemptions of Primary Homesites*

Jurisdictions considering a land gains tax should closely scrutinize the Vermont provision that exempts transfers of primary homesites. Vermont apparently believed this exemption to be good public policy.[61] The legislature expanded the primary homesite each time it amended the law,[62] although lawmakers may also have been responding to political pressures from people facing land gains tax burdens.

Politics, however, fails to totally explain the expansion of the primary homesite exemption. Vermont legislators also did not intend the tax to have an impact on people who make a commitment to use land for residential purposes. The state aims the tax at a different population—those who buy and sell land to make a profit, and not to live on it.

For example, a subdivider acquires a 100-acre parcel in 1977 for $100,000. Eighteen months later, having subdivided the parcel into lots, he sells a lot. The buyer certifies that he will build his principal residence on the lot, or that he will sell to someone who will make the structure his principal residence. The seller pays no tax, because the buyer has shown a willingness to live on the property rather than profiting on it at resale. The purchaser's failure to meet these conditions within the time period specified in the law can result in his pay-

61. Since April 17, 1978, Vermont has made it easier for a purchaser to claim the principal residence exemption. The purchaser need only disclose the exemption in the property tax return, dispensing with the original requirement that the purchaser file certifications that the land will be used or modified to serve as a permanent residence. Failure to disclose under the old regulations subjected the purchaser to the liability of the seller, who had presumably avoided the land gains tax by transferring the property to a buyer who promised to use it as a primary residence.

62. Originally, the exemption applied only if the owner was selling a principal residence of up to one acre. The legislature passed a series of amendments making more parties to a land transaction and larger homesites eligible for the exemption. *See* note 12 *supra*. These changes, however, did not alter the filing and certification process for a seller who seeks to avoid the tax through sale to a builder. The builder must certify that construction will begin within a year of the sale of a principal residence, that construction will be completed within two years, and that a buyer will purchase the homesite within three years. The seller must make certifications throughout this process, or the builder/purchaser is liable for the tax. VT. STAT. ANN. tit. 32, § 10002(b) (1973).

ing any tax that the subdivider-seller would otherwise have paid on the sale.

c. *Conclusion*

The structure and primary homesite exemptions decrease the amount of property subject to land gains taxation. In return for this lost revenue, Vermont obtains a more focused tax designed to regulate the short-term landowner[63] who buys a large parcel of open land with no intent to build a primary home on the land. The experience in Vermont also suggests that many of these people are often investors from out-of-state. The land gains tax effectively then becomes as "extraction" tax as these speculators remove a piece of Vermont's resources to other places.

Vermont's decision to exempt transfers of land that are primary homesites while taxing similar transactions involving secondary homesites seems logical. The large second home subdivision may leave many lots unused or unsold, resulting in land that never fulfills its potential economic purpose as a second homesite.[64] Consequently, the land can serve no alternative, productive use.

Other jurisdictions worried about land speculation may be concerned over more than speculation in large parcels, or in second homesites. Vermont's primary residence exemption might be inappropriate in these locations. For example, the District of Columbia passed its new anti-speculation ordinance largely because speculation caused a rapid turnover in housing.

Consequently, any jurisdiction considering a land gains tax should be careful before it copies the Vermont law verbatim. Legislators should evaluate the Vermont law, its subsequent modifications, and their own local needs. The Vermont model may not be effective if lawmakers apply it to their particular land market conditions.

C. *How the Tax is Collected and Processed*

The authors of the land gains tax may have borrowed heavily from the language of federal tax law, but they departed from the federal model to set up their own system of filing returns. Vermont does not require the seller of a land parcel to file a land gains tax return with

63. *See* note 37 *supra*.

64. *See* note 20 *supra*.

the state income tax return at the end of the taxable year. Instead, Vermont collects the tax at the time of the taxable land transfer.[65] Generally the seller reports information to the state that would appear on federal Form 1040, Schedule D: sale price, transfer costs, cost basis, and so forth.[66]

The law is flexible. If the seller does not have the money to pay the tax at the actual time of transfer, he or she may pay within thirty days of transfer. The seller must pay the full tax in advance, or else the buyer must withhold ten percent of the transfer payment attributable to land and remit the withholding and a proper form to the state.[67] Exempt transactions are not subject to withholding. The seller then has the burden to settle with the state by filing a land gains tax return and remitting a balance due or filing for a refund of excess withholding paid. This procedure uses the land sale closing process to deter taxpayer avoidance of the law.[68] The land gains tax is also a personal debt of those liable to pay or withhold it, and may constitute a lien in favor of Vermont "upon all property and rights to property, whether real or personal, belonging to the persons liable for the tax or for the withholding."[69]

The Department of Taxes screens each return for unusual tax circumstances and determines if it should further scrutinize a transaction or filer. This "desk audit" compares the price and land use

65. VT. STAT. ANN. tit. 32, § 10007(b) (1973).

66. The Internal Revenue Service does not require advance disclosure of potential tax liability for a capital gains transaction. (The IRS makes an exception for advance payment of estimated taxes.) The IRS instead allows such liability to be disclosed when the taxpayer files a Form 1040, Schedule D, federal income tax return. Thus, the taxpayer has up to three and one-half months after the close of the taxable year (or longer if the I.R.S. grants extensions) to pay a federal income tax on any gain a taxpayer realized from the sale or exchange of a capital asset owned.

67. *See generally* VT. STAT. ANN. tit. 32, § 10007 (1973). The authors of the District of Columbia speculation tax, D.C. CODE. ANN. Section 47-3301 *et. seq*. (Supp. 1980) chose to require filing of a return and payment of any tax due within 30 days after the taxable transfer. Newspaper accounts, however, indicate widespread early non-compliance with the tax.

68. VT. STAT. ANN. tit. 32, § 10007 (1973). The chief of the Land Gains Tax Division reports that realtors are now accustomed to the tax and regularly follow the withholding procedure. About 20% of the sellers filing returns through June, 1977, obtained a certificate from the Division stating the exact amount due. The purchaser withholds only that amount at the closing of the transfer.

69. *Id*. § 10007(e). Wilful evasion of the land gains tax carries a penalty of up to one year in prison, or a fine of $10,000 or five times the amount of tax evaded (whichever is larger), or both. *Id*. § 10010 (1973).

information with earlier land transfer tax returns and land gains tax returns. The Department staff[70] makes a mathematical check after the desk audit. It will not audit an exempt transaction.

States considering passage of their own land gains tax should note that Vermont can improve its tax collection process. The land gains tax form is difficult for the lay taxpayer to understand without professional assistance.[71] The state could further help taxpayers by following the federal lead and offering a supplementary guide of tax calculation examples. Vermont could also keep its citizens more current on developments in the tax law and regulations by publishing rulings on frequently recurring issues.[72] Finally, aside from the mechanics of filing, Vermont might find it can process the tax returns accurately by investing in computerized audit and data storage.

These procedural recommendations could help Vermont to achieve the regulatory goals of the land gains tax. An improved form would help the lay taxpayer who cannot afford professional advice to better understand his tax liability.[73] Also, while audit procedures often

70. Three people staff the division: its chief, an auditor, and a clerk-typist. A field examiner and property appraiser provide part-time assistance, and the tax department offers service such as legal assistance. The division's substantive work includes answering taxpayer questions, designing the land gains tax form, and scrutinizing returns involving installment sales, easements, foreclosures, divorces, and special cases.

Vermont's small size allows it to keep its tax administration informal, and efficient. The staff and the private bar quickly developed a degree of personal trust and confidence that bureaucracies in larger states might not be able to develop. We cannot underestimate the importance of efficient tax administration in evaluating its success. Vermont attorneys interviewed had few complaints about the state's administration of the law.

71. We found it difficult to evaluate the cost to the private sector of calculating tax liability and filing returns. Several attorneys did say that the forms are difficult to prepare, despite the department's efforts to explain the federal tax concepts and terms that are incorporated into the state forms. Filers were also concerned about the difficulty in calculating the tax. We performed a random, computerized check of 1,000 returns filed over a three year period, and found some inconsistent entries, mathematical errors, and apparently unnecessary use of the complicated tax calculation schedules. The process may be needlessly unfair to the lay taxpayer. *See* notes 73-74 and accompanying text, *infra*.

72. The Land Gains Tax Division currently limits itself to occasional advisory opinions. These opinions are usually oral, for an individual's assistance, and not binding on the tax department. The Vermont Administrative Procedure Act does provide for the issuance of binding, formal rulings. No taxpayer has requested such a ruling, but the former deputy tax commissioner believes such a procedure would help the department and taxpayers solve specific problems.

73. Another important reason for simplifying the tax form and calculations is that

catch questionable returns that professional investors and sophisticated taxpayers may file, few taxpayers chose to attempt clever tax avoidance devices; most potential investors opted instead not to buy.[74]

IV. An Evaluation of the Impacts of the Vermont Land Gains Tax

What has been the impact of the land gains tax in Vermont? Who pays the tax? What has it done to land prices? What has it done to the Vermont land market? After a brief discussion of the study's methodology, this section attempts to answer these crucial questions.

A. *Methodology*

Several factors contributed to the difficulty in accurately evaluating the impact of the Vermont land gains tax. The tax was introduced into a relatively active regulatory environment. In addition, the Arab oil embargo and the national economic recession beginning in 1973 put a strain on the Vermont real estate market, especially for second homes. At the local level, Vermont's short ski seasons in 1973 and 1974 led to poor sales in the second home market. Thus, the study had to use a methodology that could isolate the impact of the land gains tax independent of these extraneous factors.

Professional social science researchers and experts on Vermont's real estate community helped to develop four different methodologies for evaluating the tax. As indicated earlier, these methodologies consisted of personal interviews, an analysis of sample Vermont land gains tax returns, a nationwide telephone survey[75] of a sample of over 600 individuals who bought or subdivided significant parcels of

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taxpayers can negotiate their land use gains tax. The tax differs from other taxes such as the estate tax that does not automatically exempt small transactions. Thus, taxpayers who did not consult a tax attorney or other expert might logically presume that the formula for the tax computations, the apportionment between land and buildings, and the deduction of holding and selling costs were not negotiable. Unsophisticated and first-time sellers, or those who lack the skill or means to negotiate their tax liability will likely pay more tax than is necessary.

74. *See* notes 15-23 and accompanying text *supra*.

75. The Lincoln Institute of Land Policy in Cambridge, Mass. provided the financial support to enable the undertaking of the survey.

Vermont land from 1968 to 1977, and land price comparisons of comparable sets of Vermont and New Hampshire towns.

The first research technique was a series of one to two hour personal interviews with approximately seventy Vermont individuals likely to be well-informed about the Vermont land gains tax or the Vermont land market. These included investors, developers, real estate brokers, lawyers, public officials, legislators, and bankers. These interviews revealed widely conflicting opinions about what had been the impact of the land gains tax. While a useful source of background, these interviews demonstrated the need for three supplemental methodologies to reach an evaluation of the revenue and regulatory impacts of the tax.

A second research technique analyzed a sample of 1,000 Vermont land gains tax returns received in the period from 1973 through 1976. The Vermont Department of Taxes protected the identity of the taxpayers by withholding names and location of the property. The Department made all other information on the form available for study, including: the type of parcel; length of holding period; purchase price; sale price; brokerage commission paid; attorney fees; and the amount of land gains tax due. Additionally, the Department provided information about the income disclosed on Vermont income tax returns for those individuals whose names appeared on the land gains tax return sample as either the seller or the buyer. The Department disclosed the unidentified seller's or buyer's reported total adjusted gross income (net business income or wages and investment income prior to personal deductions for such costs as medical expenses, home property taxes, etc.). Corporations and many non-resident buyers and sellers were excluded from this income profile because the Vermont Department of Taxes did not have this personal income information. Moreover, adjusted gross income is not a complete index of household income, wealth, or property holdings. Even within these limitations, however, the data were sufficient to show the distribution of the tax according to individual income. This tax return analysis forms the basis of the revenue-raising impact section[76] immediately following this methodological introduction.

The third research technique was a nationwide telephone survey of key Vermont land market participants conducted by the center for

76. *See* Section IV-B and accompanying text *infra*.

Survey Research in Boston, a joint facility of Harvard, the University of Massachusetts, and the Massachusetts Institute of Technology.

This group was defined as those who had purchased a parcel of Vermont land, of at least 100 acres, sometime between 1968 and 1978 when the survey was done. A sample of such returns was drawn from public records to produce interviews with approximately 150 purchasers in each of three time periods: before Act 250, between Act 250 and passage of the land gains taxes, and after passage of the land gains tax, or 1968-70, 1970-73, and 1973 respectively. In addition, the survey team interviewed a supplemental sample of about 250 individuals who filed for a subdivision permit during 1968-1977 and analyzed their responses.

Because the survey was relatively novel, the questionnaire received both a customary pre-test and a pilot survey of forty-five interviews in order to produce the final questionnaire form. Carefully designed to avoid calling attention to the land gains tax *per se*, the questionnaire focused on the land market in general. The questions asked of the purchaser included: what kind of land was purchased; what the purchaser intended to do with it; what did he actually do with it; what was his understanding of the land gains tax, Act 250, and subdivision regulations; and to what degree he felt these factors influenced his decision to buy this particular parcel. With computer assistance, researchers analyzed this information as a function of time to see if notable changes in the Vermont land market occurred since the enactment of the tax. In addition, the survey included direct questions about the land gains tax. Researchers analyzed the answers to these questions to determine any links to changes in the Vermont land market.

The survey analysis also involved asking why the purchasers bought the land. Based on these responses, the study divided the respondents into two groups: those who purchased land to live on, and those who purchased property as an investment. This categorization allowed for further analysis of each group.

Finally, the fourth methodology was an analysis of land prices, which is described in more detail in that section, below.

B. *Revenue Raising Impact*

As previously discussed, one reason behind the enactment of the land gains tax was to generate revenue to fund a statewide property tax relief program. This section seeks to evaluate the effectiveness of the tax in meeting this goal by examining two issues. First, how much revenue did the tax raise? Second, who paid the tax? This second question is significant in view of the legislative intent to redistribute the property tax burden from primary homesite owners to speculators.

Vermont has not reaped a revenue windfall from the land gains tax. The state only received between $500,000 and $1,100,000 annually between 1973 and 1977. Other states can conceivably obtain significantly more revenue if they structure the tax differently. In attempting to narrowly focus the regulatory impact of the statute through the primary homesite and structure exemptions, Vermont made the policy choice to forego this potential revenue. Other states obviously may make a different policy judgment. In addition, other states may receive more revenue depending upon the prices and the activity in their land markets.

After determining how much revenue the land gains tax raised, the study used the tax return sample to determine who paid the tax. Specifically, we looked at such taxpayer characteristics as: filing status, residency, and income.

Filing Status and Residency

Vermont residents paid the bulk of the land gains tax. Individual residents accounted for half of the revenue, and corporations paid an additional ten to twenty percent. Non-resident investors provided the rest of the state's land gains tax income. Out-of-state revenues

TABLE 1

WHO PAID THE VERMONT LAND GAINS TAX?
(by fiscal year, tax status, and residency)
(Source: random sample of 1,000 land gains tax returns)

fiscal	Percent of Land Gains Tax Revenue						
	Vermont			non-resident			
year	individual	corporate	estate	individual	corporate	estate	total*
1973-74	52	9	1	30	6	—	98
1974-75	55	16	3	14	4	—	92
1975-76	50	8	11	27	3	—	99
1976-77	55	23	3	16	3	—	100

* Total does not add to 100 percent because the land gains tax return gave incomplete information, and due to elimination of the foreign residency category on this table.

from twenty to forty percent annually might be welcome, because these sums represent revenue the state might not otherwise receive. This policy choice also means that in-state residents will shoulder the bulk of the tax burden.

Taxpayer Income

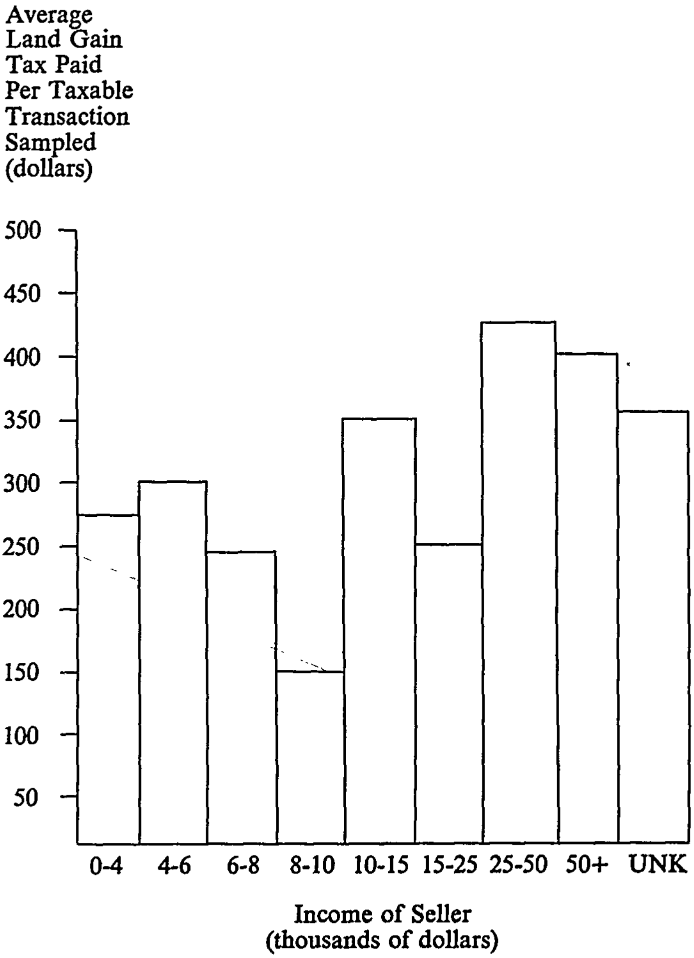
The tax return analysis disclosed a limited correlation between land gains tax paid and income. The analysis presents average adjusted gross income reported for individuals filing Vermont income tax returns. (Such income does not disclose wealth. A taxpayer may own substantial wealth without receiving significant income, or have substantially adjusted income that deflates reportable income.) With these concerns in mind, we did find that people in all classes of income, including those making less than $4,000 per year, realized gain on short-term land sales. The state collected an average tax ranging from $150 to $425 per taxable transaction from all income levels. Taxpayers reporting less than $10,000 in adjusted gross income paid about $100 less in land gains taxes than high income taxpayers.

Table 3 puts these income categories in better perspective. The clear bar graph indicates the percentage of Vermont personal income taxpayers in each income group, and the cross-hatched bars show the percentage of land gains taxes they paid. We can conclude from a comparison of the two bar heights that all income groups buy and sell land, earn profits in the land market, and pay the land gains tax. Only the sellers in the $25,000-50,000 income class paid proportionately more tax than their incidence in the taxpaying population.

One surprising statistical finding that provides greater insight into who bears the land gains tax burden is the comparison of taxable income with the amount of land gains tax paid for each bracket of profitability. The following tables reveal the surprising fact that Vermont residents with annual incomes of less than $4,000 profitably invested in real estate. Note, however, the significant amount of tax raised from taxpayers in the sample for whom personal income tax data were not available because they paid no individual Vermont income tax, presumably because of non-residency or status as a business.

TABLE 2

AVERAGE LAND GAINS TAX PAID PER TAXABLE TRANSACTION BY ADJUSTED GROSS SELLER INCOME*
1973-1976
(SOURCE: RANDOM SAMPLE OF 1,000 LAND GAINS TAX RETURNS)

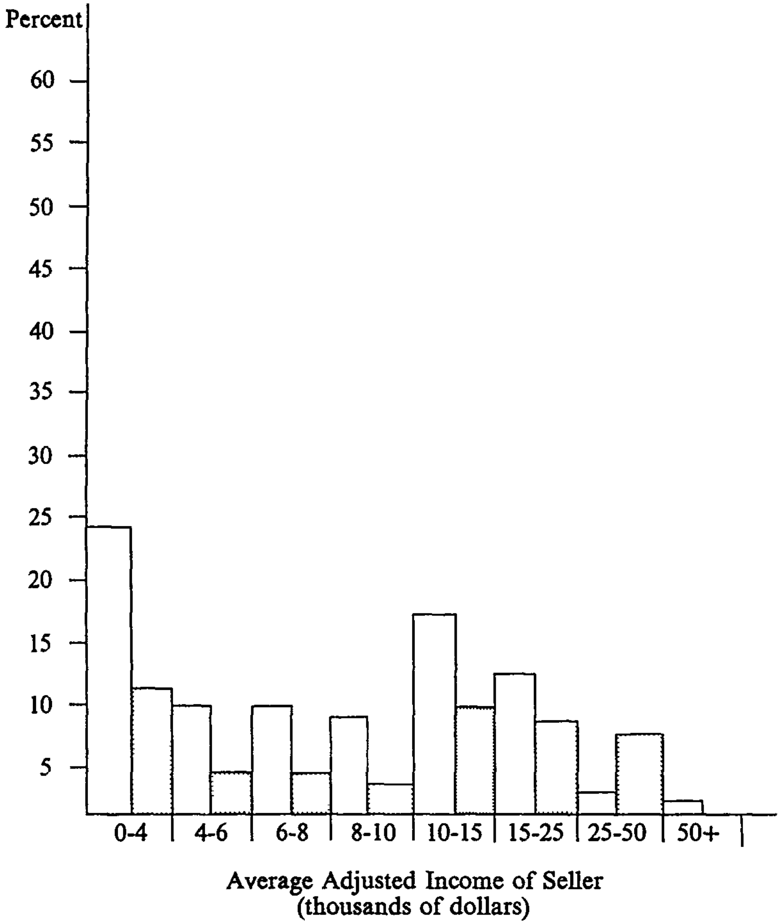


* Report from individuals filing Vermont income tax returns only; no data on partnerships or corporations.

TABLE 3

COMPARISON OF PERCENT OF LAND GAINS TAX PAID AND PERCENT OF VERMONT PERSONAL INCOME TAX RETURNS FILED BY INCOME

(SOURCE: RANDOM SAMPLE OF LAND GAINS TAX RETURNS)



☐ Percent of 1975 Vermont Personal Income Tax Returns filed

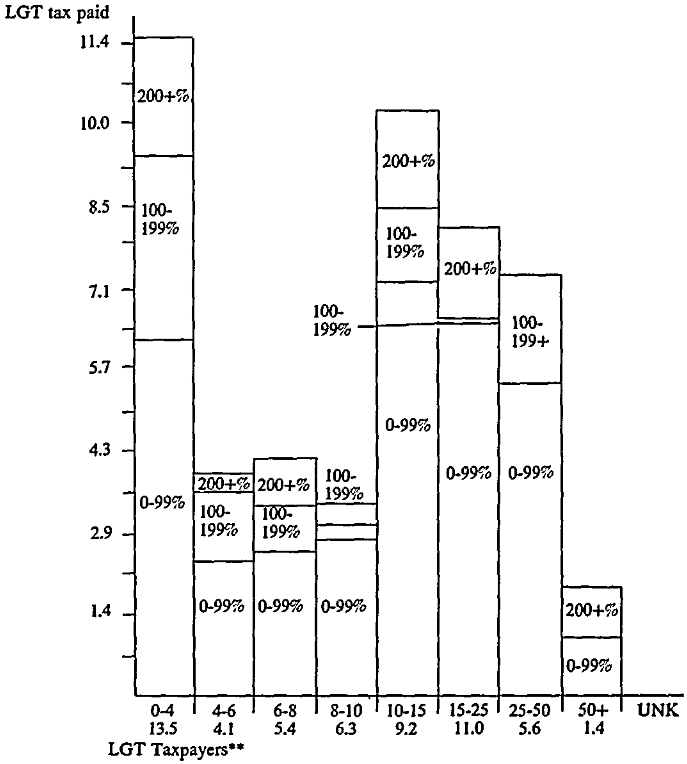
☐ Percent of 1973-1976 LGT paid

Income classes for LGT and VT Personal Income tax payment are not strictly comparable because Vermont Income tax data are not presented by income for nonresident taxpayers.

TABLE 4

PERCENT OF LAND GAINS TAX PAID BY SELLER INCOME IN EACH LAND GAINS TAX CATEGORY OF LAND GAINS AS A % OF COST

(Source: random sample of 1,000 Vermont land gains tax returns)



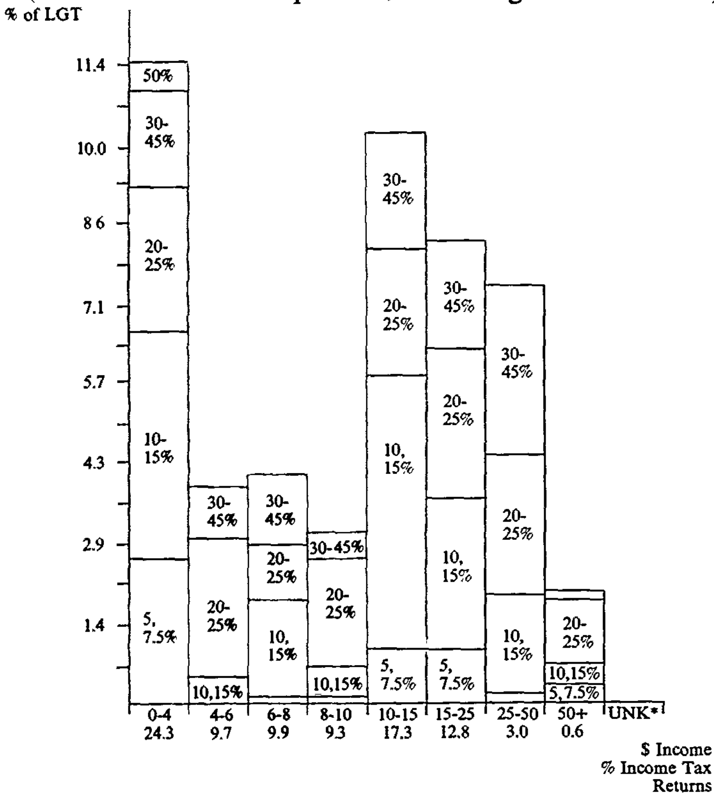
[1] Average Adjusted Gross Income of Seller (thousands of dollars)
[2] see tax paid by sellers with income unknown below
* Tax paid by sellers with income unknown: (43.5% of Land Gains Taxpayers sample)

0 - 99%:	31.2	
100-199%:	16.2	% of LGT paid
200+%:	2.4	
	49.8	

TABLE 5

DISTRIBUTION OF LAND GAINS TAX PAID BY SELLERS INCOME AND TAX RATE AS A PERCENTAGE OF GAIN ON LAND 1973-1976

(Source: random sample of 1,000 land gains tax returns)



Average Adjusted Gross Income of Seller
(thousands of dollars) & % of 1975 Vt. Income Tax Returns

* Percent of LGT tax returns paid by sellers with income unknown:

5, 7 5%	6.3%	30-40%:	12.4%
10, 15%	19 4%	50%:	-0-%
20-25%	11.2%	60%:	0.5%

NOTE. Income classes for LGT and Vt. Personal Income tax payments are not strictly comparable because Vermont Income tax data are not presented by income for non-residents.

In trying to examine the question of who pays the tax, we only looked at the party who had the *legal* obligation to pay the tax—the seller. By placing the legal incidence of the tax on the seller, the Vermont legislature sought to regulate that seller's behavior in the land market. The actual *economic* incidence of the tax, however, does not necessarily have to coincide with the legal incidence. A seller may try to minimize the impact of the tax by shifting the economic burden to the purchaser by including the tax in the sale price. It can be argued however, that the seller cannot successfully escape the tax burden because if he inflates the price of the land, it may not sell. If the land does not sell, the seller should reduce his price, thus absorbing the burden of the tax. This study does not attempt to decide this issue of whether the seller or buyer shoulders the tax.

C. *Regulatory Impact*

The second primary goal of the tax was to deter speculators from entering the Vermont land market. The research suggested two consequences of achieving this goal: controlling subdivision and controlling land prices. This section discusses the findings on whether the tax achieved these expectancies.

1. Has the Land Gains Tax Deterred Speculators and Subdividers From Entering the Vermont Land Market?[77]

The answer to this question was largely drawn from the survey data. The methodology has been described above, but involved using the answers of two sets of respondents—certain large parcel purchasers and subdividers—to determine how the characteristics of buyers have changed over time and how they responded to the land gains tax. We determined from the survey that the land gains tax at least partially influenced the purchase, sale, and development decisions of certain investors, as well as subdividers, to withdraw from the land market. We base our conclusion on a variety of data, including evi-

77. Recall from our background discussion that Vermont's regulatory purpose for enacting the land gains tax was to deter speculation. We noted that one possible consequence of the tax achieving this goal was to control land subdivision. In the following survey of the law's regulatory impact, we asked the same questions of all purchasers regardless of their reasons for buying or their subsequent land use decisions. Speculation and subdivision are distinguishable types of land behavior, and the survey analyzes the answers of these purchasers separately. When such subdividers appear in tables they are separately set out. All other references are to purchasers of parcels of 100 acres in size or more.

dence showing: (1) an increase in the number of purchasers who brought 100 acre parcels of land to live on and to farm; (2) a decrease in the number of purchasers who bought such land as an investment; and (3) that such investors (as well as subdividers) were more familiar with the terms and implications of the tax than were those who purchased for other purposes. Moreover, such investors and subdividers, more than any other purchasers, said the tax influenced their decisions.[78]

What follows is a more detailed analysis of these general findings. First, our findings on the identity of large parcel purchasers added to the evidence that some investors withdrew from the Vermont land market following passage of the tax. For example, the number of lawyers, brokers, and developers in the population that purchased parcels of at least 100 acres after 1968 significantly declined after 1973. The number of farmers buying land increased substantially

TABLE 6

MAIN OCCUPATION OF OWNERS OF 100-ACRE PARCELS BY DATE OF ACQUISITION

	Date of Acquisition		
Occupation	1968-1970	1971-April 1973	May 1973-1978
Lawyers	6%	7%	2%
Other professionals	26	31	19
Realtors, brokers, developers, builders	13	4	4
Farmers	21	30	45
Other businessmen	12	12	13
Others	22	16	17
Total	100%	100%	100%
N =	151	136	163

* The percentage figures in this and subsequent tables are based on weighted distributions that adjust for the differential probability of selection of particular owners and particular parcels of land. The N's given, however, are the number of interviews on which percentages are based.
The careful readers will also note that the N's provided throughout the report are not exact. For some percentage distributions, there were missing data because uncodable answers were given. Generally, percentages given are based only on the number of persons giving codable answers. This number varies slightly from answer to answer. The weighted computer output did not provide the exact unweighted numbers. The numbers given certainly provide the information needed to assess the reliability of the percentages. However, they are approximations.

78. *See* table 22 *infra*.

during this period, though these trends occurred gradually during the years studied.

One would expect that if fewer investors entered the Vermont land market, a corresponding decrease would follow in the number of purchasers who at least derive part of their income from real estate development. The survey confirmed this expectation in two separate findings. First, fewer buyers of major parcels of Vermont land said they earn income on real estate. Second, the number of purchasers of Vermont land who also owned major parcels outside Vermont decreased after 1973.

TABLE 7

PERCENTAGE OF OWNER'S INCOME FROM REAL ESTATE INVESTMENTS BY DATE OF ACQUISITION

	Date of Acquisition		
Percent of Income From Real Estate	1968-1970	1971-April 1973	May 1973-1978
No income from real estate	57%	55%	69%
1-10%	24	28	17
11% or more	19	17	14
Total	100%	100%	100%
N =	141	136	163

TABLE 8

NUMBER OF PARCELS OF ANY SIZE OWNED OUTSIDE VERMONT IN PAST TEN YEARS BY DATE OF ACQUISITION (of Selected Parcel)

	Date of Acquisition		
Number of Parcels	1968-1970	1971-April 1973	May 1973-1978
No parcels	46%	51%	63%
One parcel	20	16	17
Two or more parcels	34	33	20
Total	100%	100%	100%
N =	141	136	163

Note that thirty-four percent of the Vermont land purchasers before 1970 owned two or more parcels in other states, compared to twenty percent after 1973. In the same period, we found no signifi-

TABLE 9

NUMBER OF OTHER 100-ACRE PARCELS OWNED IN VERMONT IN PAST TEN YEARS BY DATE OF ACQUISITION (of Selected Parcel)

Number of Other 100-Acre Parcels Owned	Date of Acquisition 1968-1970	1971-April 1973	May 1973-1978
None	65%	65%	63%
One	12	16	21
Two or more	23	20	16
Total	100%	100%	100%
N =	141	136	163

cant change in the number of persons owning more than one parcel in Vermont as opposed to other states, leading to a conclusion that some purchasers who bought multiple parcels in other states left Vermont after 1973.

We did find some interesting patterns when comparing investor plans for their land at the time of purchase and their subsequent land use decisions. The most important change occurred in planned holding or selling patterns. We saw earlier in our sample of all purchasers of large parcels no particular trend. But when we isolate investors in this sample,—i.e. those who said their reason for purchase was investment—those investors who bought after 1973 (when the land gains tax took effect) were much more likely to plan to hold the property indefinitely than previously. The land gains tax hits hardest those who hold their property for short times before selling it.

We have surveyed large parcel purchasers in the Vermont land market, and found that those who bought for investment rather than for use made fewer purchases after enactment of the land gains tax. We also found that those who invested after 1973 more frequently planned to hold their property, rather than sell quickly. We also analyzed large parcel purchaser motives for buying, and found an increase in the proportion of purchases for residential purposes after Vermont passed the land gains tax. The survey examined whether the purchaser ever lived on the land and if so, whether the land was a primary residence or a secondary, seasonal property. The most dramatic change in the buying/living pattern occurred on seasonal

TABLE 10

SELECTED PLANS OF INVESTORS* IN 100-ACRE PARCELS BY DATE OF ACQUISITION

	Date of Acquisition		
Planned to Sub-divide	1963-1970	1971-April 1973	May 1973-1978
Yes	31%	18%	34%
No	69	82	66
Total	100%	100%	100%
Sale Plans			
Planned to resell	66	65	43
Planned to hold indefinitely	34	35	57
Total	100%	100%	100%
Planned to Build Houses			
Yes	16	22	26
No	84	78	74
Total	100%	100%	100%
N =	59	44	41

* Said main purpose of acquiring land was investment.

homesites. Considerably fewer purchasers lived on their property part-time in the early 1970's.[79]

Given the increased number of land purchases for primary residential use, we expected that recent buyers would more likely live in Vermont during the later period studied than did purchasers in earlier times. The survey findings support our expectation, and also show that fewer non-residents purchased property in Vermont after 1973.

The findings that more people bought land for their own purposes are consistent with the evidence of investors dropping out of the market after 1973. The result was surprising, however, when we isolated one of these private use purposes—farming. We found a dramatic

79. We also gained insight into residential buying patterns by studying income producing property. The survey revealed a consistent pattern of rental income from

increase in purchases for farm use that exceeded the decline of investor competition for land. After 1973, almost half of the owners of 100-acre parcels were farmers, compared to only about one-third previously. In the same table that revealed a decline in rental income from property, we also found a dramatic increase in the purchase rate

TABLE 11

YEAR-ROUND VERMONT LIVING STATUS OF OWNERS BY DATE OF ACQUISITION OF PARCELS OF MORE THAN 100 ACRES

	Date of Acquisition		
Year-Round Vermont Living Status	1968-1970	1971-April 1973	May 1973-1978
Currently living in Vermont year round	58%	69%	82%
Previously lived in Vermont year round, currently lives out of state	10	9	3
Never lived in Vermont year round	31	22	15
Total	100%	100%	100%
N =	141	136	163

of working farms. Buyers operated almost half of these parcels as working farms compared to only about one-third previously. Thus, parcels purchased after 1973 were much more likely to produce farm

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parcels purchased before 1971. Rental income is a frequent concomitant of seasonal property ownership. The finding confirms the existence of a trend away from secondary homesite purchases.

Table 13

Sources of Income for Sample of Purchasers of 100-Plus Acre Parcels Selected Parcel by Date of Parcel Acquisition

	Date of Acquisition		
Sources of Income	1968-1970	1971 April 1973	May 1973-1978
No income	40%	42%	36%
Rents	12	5	6
Farming	33	37	48
Timber	9	12	7
Farming and other types	6	4	3
Total	100%	100%	100%
N =	141	136	163

income than parcels bought before 1973. The following table demonstrates another commitment to farming: after 1973, these new purchasers were more likely to maintain their land as farms than before.

TABLE 12

PERCENTAGE OF 100-ACRE WORKING FARMS THAT CONTINUED TO BE FARMED BY DATE OF ACQUISITION

	Date of Acquisition		
Whether or Not Farmed After Acquisition	1968-1970	1971-April 1973	May 1973-1978
Yes	62%	66%	79%
No	38	34	21
Total	100%	100%	100%
N =	54	55	84

We hesitate to speculate on the role of the land gains tax in stimulating farming. Certainly if the tax deterred investors, more land became available for people who otherwise could not locate property to farm. In addition, if investors derive more income from their land purchases than do people who buy to farm, it is not surprising that more persons with incomes under $10,000 entered the land market after 1973.

We must keep one point in mind when analyzing the impact of the land gains tax on increased purchases of land for farm use. The land gains tax ordinarily will not deter people who buy property for their own use because these purchasers presumably will hold the land for a longer time. Thus, the tax may not have deterred farmers from demanding large parcels. If the tax deterred investors, however, it may have removed some purchasers who competed with farmers for agricultural land. Other cultural or value factors, however, may also have influenced the market for Vermont farms.

Parcel division or addition is another type of environmentally significant land use decision. We analyzed what owners did to the size of their parcels after purchasing them. They could alter the lot two ways: they could create small parcels of land by filing a subdivision plan, or they could enlarge their holding by purchasing adjacent property. The following tables reveal that the number of subdivision plans that large parcel purchasers said they filed over the periods studied did not change. We caution that the filing rate must be dramatically larger to be statistically significant. In contrast, the rate of acquisition of adjacent properties noticeably increased.

TABLE 14

WHETHER OR NOT SUB-DIVISIONS PLAN FILED FOR 100-ACRE PARCEL BY DATE OF ACQUISITION

	Date of Acquisition		
Parcel Purchaser Said Sub-division Plan Filed	1968-1970	1971-April 1973	May 1973-1978
Yes	8%	10%	9%
No	92	90	91
Total	100%	100%	100%
N =	141	136	163

TABLE 15

WHETHER OR NOT PROPERTY ADJACENT TO 100-ACRE PARCEL ACQUIRED BY DATE OF ACQUISITION

	Date of Acquisition		
Acquired Additional Adjacent Property	1968-1970	1971-April 1973	May 1973-1978
Yes	9%	9%	19%
No	91	91	81
Total	100%	100%	100%
N =	141	136	163

A question that is separate from changes in lot size is how owners may have developed their property. The fact that recently purchased properties were already developed at the time of transfer made it difficult to analyze the extent of new development. One possible indication of development is if the owner built two or more houses on the land. The rates of such development were so low in our survey that we could not identify a statistically reliable trend.

To summarize, we now have evidence that after 1973, some investors withdrew from the Vermont land market, while Vermont residents increased their holdings.[80] These findings suggest that speculation in the Vermont land market decreased after Vermont enacted the land gains tax. The important question is whether the land

80. *See* table 11 *supra*.

gains tax *caused* these changes. We conclude that the tax played some role in stimulating a withdrawal of certain investors.

In our interviews with purchasers, we asked several questions to learn why they made their land acquisitions and use decisions. These inquiries assisted us as we tried to isolate the land gains tax as a factor in the plans of purchasers. Clearly, the land gains tax most affected the buying decisions of investors and subdividers.[81] The evidence also suggest that the major impact of the tax on affected investors was causing them to stop buying Vermont land.[82] A variety of survey questions demonstrate the salience of the land gains tax on their decisions.

To begin our study of the effect of the tax on investment decisions, we investigated the respondent's knowledge of the law. To measure their understanding, we asked four questions about the tax:

1) What is the minimum tax rate?

2) Whether the tax applied to gains realized on buildings and land or applied only to gains realized on the land itself?

3) What is the period of time after the date of purchase for which the land gains tax is still in effect?

4) Whether the buyer's plans for use of the land affects the land gains tax to be paid by the seller?

First, we asked the respondents if they were generally familiar with the terms of the land gains tax. Almost one-fifth of the total sample of 100-plus acre parcel purchasers knew nothing about its terms. Significantly, the two primary targets of the law—investors and subdi-

TABLE 16

REPORTED FAMILIARITY WITH TERMS OF LAND GAINS TAX BY DATE OF ACQUISITION

Familiarity with Terms of Land Gains Tax	Date of Acquisition 1968-1970	1971-April 1972	May 1973-1978
Yes	75%	83%	81%
No	25	17	19
Total	100%	100%	100%
N =	141	136	163

81. *See* table 22 *infra*.

82. *See* table 25 *infra*.

viders—claimed that they knew more about the tax then did residential buyers.

TABLE 17

REPORTED FAMILIARITY WITH TERMS OF LAND GAINS TAX BY PLANS FOR 100-ACRE PARCELS; AND FOR SUBDIVIDERS

	For Sample of Purchasers of 100-Acre Parcels by Plans for Such Parcels			For Subdivider Sample
Familiarity with Terms of Land Gains Tax	Investment	Year-Round or Seasonal Living	To Use But Not To Live On	
Yes	90%	74%	81%	86%
No	10	26	19	14
Total	100%	100%	100%	100%
N	145	203	67	149

After isolating the respondents who said they knew about the law, we asked specific questions about the tax. This sample of purchasers was most familiar with the six-year holding period for tax liability, and the provision that allocates taxable gain to land while exempting gain realized on structures built on the property. Less than half of the sample, however, correctly answered these questions. Few respondents understood that the buyer's plans for the land can affect the seller's tax liability. We also noted that respondents who had

TABLE 18

PERCENTAGE OF THOSE REPORTING FAMILIARITY WITH THE LAND GAINS TAX GIVING CORRECT ANSWERS REGARDING TERMS OF LAND GAINS TAX BY SAMPLE TYPE

	Sample Type	
Item	100-Acre Purchasers (1968-1977)	Subdividers (1970-1977)
Maximum Land Gains Tax Rate (60 percent)	16%	32%
Land or Building Gains Taxed? (Land only)	35	64
Holding Period Until No Tax (6 years)	40	61
Buyers Plans Affect Gains Tax (If Principal Residence, No Tax)	7	31
N	441	149

filed for a subdivision permit were considerably more familiar with relevant tax terms than were the cross-section of purchasers.

We sought to further refine our analysis of respondent's knowledge by indexing the number of correct answers. Less than ten percent of the total sample gave four correct answers, and more than forty percent either answered all questions incorrectly or lacked any knowledge of the tax.

TABLE 19

NUMBER OF CORRECT ANSWERS ABOUT LAND GAINS TAX BY PLANS FOR 100-ACRE PARCELS; AND FOR SUBDIVIDERS

	For Sample of Purchasers of 100-Acre Parcels by Plans for such Parcels			For Subdivider Sample
Number of Correct Answers About Land Gains Tax	Investment	Year Round or Seasonal Living	To Use But Not Live On	
None (or not familiar with tax)	27%	59%	38%	25%
One to three	59	40	61	58
Four	13	1	1	17
Total	100%	100%	100%	100%
N	145	203	67	149

When we add the forty percent who answered all questions incorrectly to the twenty percent in the total sample who knew nothing about the tax, we find that sixty percent of major land purchasers gave no correct answers. This is not surprising because many farmers and homebuyers in the sample do not need to consider the tax in their plans. The table does show that investors and subdividers, whose behavior the tax seeks to regulate, knew more about the law than the sample in general. We conclude from this survey of purchaser familiarity with the law that those whom the tax influenced were more likely to adjust their land holding periods. They were less inclined to change the planned use of their property to minimize the impact of the land gains tax on their investments.

We then sought to understand whether the land gains tax actually had an effect, and if so, how much of an effect, on purchase decisions. The tax is one of many considerations for a potential buyer, and we developed two methodologies to gauge specifically the salience of the law. First, we asked respondents open-ended questions about factors they considered in their purchase plans. Second, we asked them direct questions on their perception of the importance of the land gains tax. We were not surprised that these two approaches yielded different results of the significance of any one factor.

In the initial part of the survey, which examined respondents' plans and actual uses of specific parcels selected for survey, only investors and subdividers said the land gains tax was a consideration in changing their decisions. It was only a minor factor, too.

TABLE 20

WHETHER OR NOT LAND GAINS TAX MENTIONED AS A REASON FOR CHANGE IN PLANS FOR SELECTED PARCEL BY PLANS FOR 100-ACRE PARCEL; AND FOR SUBDIVIDERS

	For Sample of Purchasers of 100-Acre Parcels by Plans for such Parcels			For Subdivider Sample
Land Gains Tax Mentioned as Reason for Changed Plans	Investment	Year Round or Seasonal Living	To Use But Not Live On	
Yes	6	*	*	3
**No	94	100	100	97
Total	100%	100%	100%	100%
N	145	203	67	149

TABLE 21

WHETHER OR NOT LAND GAINS TAX MENTIONED AS A REASON FOR A CHANGE IN PLANS FOR SELECTED PARCEL BY DATE OF ACQUISITION

	100-Plus Acre Purchasers by Date of Acquisition		
Land Gains Tax Mentioned As Reason for Changed Plans	1968	1971	1973
Yes	*	5	1
No	100	95	99
Total	100%	100%	100%
N	141	136	163

* Less than half of 1 percent.

Note that only purchasers in the second period bought land before Vermont passed the land gains tax, but still had a short enough holding period to be influenced by the tax. Thus, the patterns of spontaneous open responses about the salience of the land gains tax were not surprising. The impact of the tax on the plans of all purchasers between 1968 and 1978 was, however, minimal.

Then we asked direct questions about the impact of the land gains tax on decisions. Approximately twenty percent of the respondents said the land gains tax affected their plans for the particular parcel

TABLE 22

REPORTED INFLUENCE OF VERMONT LAND GAINS TAX ON PLANS FOR BUYING SELLING OR DEVELOPING SELECTED PARCEL BY PLANNED USE OF LAND; AND FOR SUBDIVIDERS

	For Sample of Purchasers of 100-Acre Parcels by Plans for such Parcels			For Subdivider Sample
Plans for Parcel Influenced by Tax	Investment	Year Round or Seasonal Living	To Use But Not Live On	
Yes	27%	7%	9%	20%
No	73	93	91	80
Total	100%	100%	100%	100%
N	145	203	67	149

* Includes those who said they were not at all familiar with tax.

selected for the survey, and almost thirty percent said the tax affected their plans for buying, selling or developing other Vermont property.

The key finding was that those whom the Vermont legislature wanted to regulate through the land gains tax most often said the tax affected their plans. Similarly, a significant percentage of subdividers and investors said the tax affected their plans for other parcels in Vermont.

The responses by the date of purchase are also useful. We note that almost ninety percent of the land purchasers prior to 1970 still own Vermont land; nearly eighty percent of the land buyers since 1973 have also owned other Vermont parcels. Thus, the groups overlap. Those who owned multiple major parcels of land were, to an extent, classified by chance on which parcel we selected to study. In the first part of our analysis above, however, we saw that the character of purchasers of 100-plus acre parcels appeared to have changed since 1973. Although the differences are modest, recent purchasers appear less likely to say the land gains tax affected their plans for other parcels of Vermont land than were purchasers of land at an earlier period.

TABLE 23

REPORTED INFLUENCE OF LAND GAINS TAX ON PLANS FOR BUYING, SELLING OR DEVELOPING OTHER LAND IN VERMONT BY PLANNED USE OF LAND; AND FOR SUBDIVIDERS

	For Sample of Purchasers of 100-Acre Parcels by Plans for such Parcels			For Subdivider Sample
Influence of Tax on Plans for Other Parcels Reported	Investment	Year Round or Seasonal Living	To Use But Not Live On	
Yes	39%	13%	18%	33%
No*	61	87	82	67
Total	100%	100%	100%	100%
N	145	203	67	149

* Includes those who said they were not at all familiar with terms of tax.

It is difficult to use social science measurement to produce absolute measures. Thus, it may be impossible to precisely determine the salience of the land gains tax in land decisions. The tax was rarely a major factor in significant changes in plans for parcels already purchased, but a substantial minority of major purchasers and subdi-

TABLE 24

REPORTED INFLUENCE OF LAND GAINS TAX ON PLANS OF 100-PLUS ACRE PURCHASERS FOR BUYING, SELLING OR DEVELOPING OTHER LAND IN VERMONT BY DATE OF ACQUISITION

	Date of Acquisition		
Influence of Tax Reported	1968-1970	1970-April 1973	May 1973-1978
Yes	26%	23%	15%
No	74	77	77
Total	100%	100%	100%
N	141	136	163

viders said that it influenced their decisions for future land purchases. Perhaps most important, a very clear pattern emerged of purchasers who were most likely to perceive an impact of the land gains tax. Those who purchased to invest and subdivide were significantly more likely to report an impact of the tax than purchasers for personal use. This pattern is important for two reasons. First, the Vermont legislature intended the tax to discourage land speculation without seriously hurting those who wanted to buy land for their own purposes and to live on. Generally speaking, Vermont appears to have achieved this goal. Second, those purchasing land for investment purposes, particularly non-residents, may have been less active in the land market in Vermont since 1973. The admission of Vermont investors that the land gains tax was relatively important in their plans is consistent with the hypothesis that the land gains tax played a role in this correlation.

Having determined that the land gains tax did affect land buying decisions, our crucial question is what kind of effect did it have? Did it deter the speculation and subdivision that Vermont believed was harming its land? When questioned about the influence of the tax on their plans for other parcels in Vermont, most respondents said that because of the law, they decided not to buy land they would have otherwise purchased. A significant percentage also said the law caused them to hold the property longer. Once again, the two groups

TABLE 25

THE WAY LAND GAINS TAX SAID TO HAVE AFFECTED PLANS FOR BUYING, SELLING OR DEVELOPING OTHER VERMONT LAND BY PLANNED USE OF LAND; AND FOR SUBDIVIDERS

	For Sample of Purchasers of 100-Acre Parcels by Plans for such Parcels			For Subdivider Sample
Affect of Land Gains Tax	Investment	Year Round or Seasonal Living	To Use But Not Live On	
Held Longer	8%	4%	8%	5%
Increased Price	1	*	*	1
Did not buy	15	3	6	13
Other	4	3	*	5
Not Ascertained	14	4	5	10
No Effect	58	86	81	66
Total	100%	100%	100%	100%
N	145	203	67	149

that the land gains tax most affected—investors and subdividers—most often refrained from buying.

Finally, we asked respondents who owned land for at least five years prior to the interview if they had changed the size of their holdings. While the responses generally were evenly split, they differed markedly depending on the planned use of the property. Investors and subdividers were likely to own substantially less land than before. Those who purchased for their own use increased their holdings as often as they decreased them.

TABLE 26

AMOUNT OF VERMONT OWNED NOW AND FIVE YEARS AGO COMPARED BY OWNERS OF ANY VERMONT LAND FIVE YEARS AGO BY PLANNED USE OF LAND; AND FOR SUBDIVIDERS

	Plans for 100-Acre Parcels			
Vermont Land Owned Now and Five Years Ago Compared	Investment	Year Round or Seasonal Living	To Use But Not Live On	Subdividers
More Now	26%	30%	30%	24%
Same	31	48	36	23
More Five Years Ago	44	22	35	53
Total	100%	100%	100%	100%
N	119	181	50	122

Respondents offered a variety of reasons for reducing their holdings. The land gains tax and land regulations were one answer, but no particular reason stood out. We may, however, conclude that subdividers and investment-oriented land purchasers have decreased their investment in Vermont land more so than have other kinds of purchasers.

Conclusion of Survey Analysis

Our most important task in this conclusion is to use the above survey data to put the land gains tax in perspective. We may state with confidence two general conclusions. First, the land gains tax has only minimally influenced purchasers of large parcels of Vermont land in the past ten years in what they did with the parcel they bought, though it may have caused them to hold it longer in some cases. The majority of these people were unfamiliar with the details of the tax and how it works. Second, while we do not overstate the salience of the tax in land market behavior, the data does reveal that the tax was a factor in some purchase decisions. We have identified significant changes in the characteristics of land buyers, the kind of land they purchased, and the reasons they had for buying in Vermont since 1973. These changes confirm that some major investors in Vermont land have left the market. A small but significant minority of investors conceded that they stopped buying other Vermont property because of the land gains tax.

Space considerations required omitting much evidence in the full report that leads us to hesitate to draw here a specific conclusion about the importance of the land gains tax compared to other factors that might enter into one's land market decision. We find it difficult, however, to conclude from the data other than that the land gains tax played a part in recent changes in the Vermont land market. It has discouraged some subset of would-be investors from investing in Vermont land.

2. Has the Land Gains Tax Affected Prices in the Vermont Land Market?

The second perceived regulatory consequence of decreased land speculation is a lessening of the rapid escalation of land prices. The research did demonstrate that the gains tax has deterred speculation in the Vermont land market, but was unable to isolate the resulting effect on prices. Our descriptive analysis revealed only that the land gains tax has played some part in stabilizing the market for Vermont land during a recession. Open land prices, however, even within a single community, varied to the extent that further, manageable analysis of land prices proved unreliable and misleading. Although we could not draw reliable conclusions on the impact of the gains tax on land prices, we believe it beneficial to explain our research methodology. By describing what we did, and considered doing, we hope to assist future researchers in this area and help them to avoid some of the problems inherent in this type of study.

The strength of our study lies in its integration of several research methodologies. These included interviews with key Vermont market observers, surveys of land market participants, and statistical comparisons of open land prices in pairs of towns in Vermont and New Hampshire. This integrated approach alerted us to problems we otherwise would have ignored in a simple statistical analysis of land price data.

We began with the basic research assumption that we could isolate the effect of the land gains tax on Vermont land prices by (1) modeling price determinants common to all land markets, and (2) controlling for variables unique to the Vermont land market. We then proceeded with two alternative approaches. First, we compared open land sales in 10 key Vermont towns before and after enactment of the tax. Second, we compared sales of that Vermont land with transactions in comparable towns in New Hampshire. In the first approach, we hoped to conclude whether the land gains tax accounted for any changes in prices not otherwise explained by existing or other new price factors in the market. In the second procedure, by studying comparable land on the Vermont-New Hampshire border subject to the same regional and national influences, use regulations, and local levies except for the land gains tax, we hoped similarly to conclude whether the gains tax accounted for price differences. We would have been even more certain of our findings if both the time series and interstate analysis showed the same impacts. Unfortunately, our inability to accurately model the Vermont land market to our satisfaction meant that we could not isolate the effect of the land gains tax on price in either case. Simply stated, the price per acre of equal-sized open land parcels in our comparable Vermont and New Hampshire towns varied so greatly that it masked any general price trends, much less price differences, attributable to the land gains tax.

We conclude from these price variations that Vermont does not have a land market characterized by informed buyers and sellers with similar values and expectations. Traditional economic theory cannot accurately account for the basic workings in such a market. Lacking such knowledge, even the most sophisticated statistical analysis would be misleading and its results unfounded.

V. CONSTITUTIONAL ISSUES INVOLVED IN THE ENACTMENT OF A FEDERAL OR STATE LAND GAINS TAX

Introduction

Federal and state governments do not have unlimited power to tax. The federal government has powers only to the extent provided either explicitly or by implication in the Constitution. Other constitutional provisions may also limit Congress in its specific exercise of the taxing power. By contrast, state governments have plenary power to tax but are subject to federal or state constitutional limits. This portion of the article examines how these issues concerning the limits on the taxing power might influence the enactment of a land gains tax at the national or state level. Specifically, the first section analyzes whether the federal government has the power to enact a national land gains tax, either as a tax or as a regulatory measure. Since federal and state tax law overlap somewhat, this discussion of federal law provides some background for a similar analysis of state constitutional law. The second section examines the constitutional limits on legislative power such as protections against unfair burdens, arbitrary classifications, and undue burdens on non-residents or interstate commerce. The last section analyzes the extent to which provisions of individual state constitutions may limit the enactment of a state land gains tax involving graduated rates dependent upon profit, holding period, and type of property sold.

A. *The Scope of Federal Power to Tax the Short-Term Sale or Exchange of Land*

Congressional power to tax is not unlimited. The Supreme Court historically has interpreted the Constitution as recognizing two types of taxes: "direct" and "indirect".[83] Until the passage of the sixteenth amendment, the Supreme Court required apportionment of direct federal taxes among the states by population and uniformity of indirect taxes throughout the country.[84] The sixteenth amendment exempted "income" taxes from the apportionment requirement on "direct" taxes.[85]

These limitations pose the following problems for a legislature contemplating the enactment of a national land gains tax: what type of tax would it be and what constitutional requirement must the tax meet?

1. Direct Taxes and Income Taxes

The political difficulty of apportioning a direct tax based on popu-

83. *See* Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429, 557 (1895), *citing* The License Tax Cases 72 U.S. (5 Wall.) 462, 471 (1866).

84. *See, e.g.*, Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429 (1895).

85. The amendment reads: "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration." U.S. CONST. amend. XVI.

lation has encouraged Congress to fashion "indirect" taxes. Until 1895, the Supreme Court generally upheld federal taxing measures[86] because it narrowly defined direct taxes as "confined to taxes levied directly on real estate because of its ownership."[87] Then in *Pollock v. Farmers' Loan & Trust Co.*,[88] the Supreme Court departed from this doctrine by holding that a tax on income from property was the equivalent of a tax on the property itself. Accordingly, the Court invalidated a non-apportioned tax on income derived from real and other property on the grounds that the tax was "direct."[89] Standing alone, *Pollock* raises the possibility that the Supreme Court might construe a national land gains tax as a direct tax, requiring apportionment, because it taxes the gain a land owner derives from the sale of real property.

Post-*Pollock* developments, however, make such a construction highly unlikely. First, the sixteenth amendment nullified the holding in *Pollock* in 1913. To avoid problems of characterizing income by source as a means of determining whether it is "direct" or "indirect", the sixteenth amendment validates a tax on income "from whatever source derived."[90] Second, even before the ratification of the sixteenth amendment, the Supreme Court had begun to back away from categorizing federal taxes as direct.[91] Finally, one might not categorize a national land gains tax as a tax on income, but as a levy on the sale or exchange of land, with gain derived constituting a measure rather than the subject of a tax. Under this approach, Congress would impose a national land gains tax on an incident of land owner-

86. *See, e.g.*, Springer v. United States, 102 U.S. 586 (1880) (tax on certain income); Scholey v. Rew, 90 U.S. (23 Wall.) 331 (1874) (succession of property); Veazie Bank v. Fenno, 75 U.S. (8 Wall.) 533 (1869) (state bank notes); Pacific Ins. Co. v. Soule, 74 U.S. (7 Wall.) 433 (1868) (insurance company business); and Hylton v. United States, 3 U.S. (3 Dall.) 171 (1796) (carriages).

87. Brushaber v. Union Pac. R.R. Co., 240 U.S. 1, 19 (1915).

88. 157 U.S. 429 (1895).

89. *Id.* at 583.

90. U.S. CONST. amend. XVI.

91. *See, e.g.*, Bromley v. McCaughn, 280 U.S. 124 (1929) (federal gift tax); New York Trust Co. v. Eisner, 256 U.S. 345 (1921) (tax on transfer of net estate of decedents); Flint v. Stone Tracy Co., 220 U.S. 107 (1911) (excise tax on business done in corporate form); Spreckels Sugar Refining Co. v. McClain, 192 U.S. 397 (1904) (tax on business of refining sugar measured by gross annual receipts); and Knowlton v. Moore, 178 U.S. 41 (1900) (inheritance tax). The Court contined to attack the origin test as late as 1939. *See* Graves v. New York *ex rel.* O'Keefe, 306 U.S. 466 (1939) (upholding power of state to tax income of instrumentality of the United States).

ship rather than on property.[92] Consequently, it seems highly unlikely that a national land gains tax would constitute a "direct" tax requiring Congress to satisfy the constitutional mandate of apportionment. If the Supreme Court were to interpret the tax as direct, it would probably construe it as an income tax, exempt from the apportionment requirement as provided in the sixteenth amendment.

2. Indirect Taxation and Uniformity

If a national land gains tax would not qualify as a direct tax, it would constitute an indirect tax subject to the constitutional mandate of uniformity. Taxable land sales are unlikely to be equally distributed throughout the country. Nevertheless, Supreme Court decisions construing other tax measures suggest that a national land gains tax would probably still meet the uniformity requirement. The Court has historically upheld excise taxes, a species of indirect taxation, that Congress has not necessarily applied on a uniform geographic basis.[93] For example, the Court's treatment of uniformity saved a corporate tax that was an excise on the privilege of doing business. While states do not have uniform requirements for incorporation, the Court reasoned that the Constitution "does not require the equal application of the tax to all persons or corporations who may come within its operation . . . ."[94] Thus, inequality of application owing to different local conditions did not invalidate the excise. Thus, a national land gains tax would probably meet the uniformity requirements of an "indirect" tax.

3. Will a Regulatory Objective in a National Land Gains Tax Put it Beyond the Reach of the Taxing Power?

The Supreme Court's expansive interpretation of the Commerce

92. The Supreme Court articulated this theory when it upheld the federal gift tax in Bromley v. McCaughn, 280 U.S. 124 (1929) (tax imposed upon particular use of property, incidental to ownership, is an excise that need not be apportioned).

93. For example, in Knowlton v. Moore, 178 U.S. 41 (1900), the Court rejected a challenge to the federal inheritance tax. The tax rate varied based on the legatee's relationship to the deceased, and the amount of the legacy. Opponents also argued that the tax was not geographically uniform because testamentary and intestacy laws differed among states. But the Court said, "[w]hat the Constitution commands is the imposition of the tax by the rule of geographical uniformity, not that in order to levy such a tax objects must be selected which exist uniformly in the several States." *Id.* at 108.

94. Flint v. Stone Tracy Co., 220 U.S. 107, 158 (1911).

power has largely rendered this a moot question at the federal level. Nevertheless, similar problems might arise at the local level; for example, a local government might have a limited taxation power but no power to regulate certain conduct either because of affirmative preemption or lack of specific enabling authority from the state. Consequently, it is worth looking briefly at the federal experience.

Some older federal cases found certain taxes beyond the scope of the taxing power because the behavior modification was not inherent in the design of the tax, but instead arose because the tax was an enforcement mechanism for specific standards external to the tax. In such instances the older cases were likely to find the tax a penalty requiring independent regulatory authorization. For example, in *Bailey v. Drexel Furniture Company*,[95] the Supreme Court struck down an excise tax whose obligation arose out of an employer's knowing non-compliance with federal regulations regarding the use of child labor because four years earlier the Court had decided that Congress lacked the power to regulate such use of child labor. While this case does not currently represent federal law, its distinction between a regulatory tax and a tax regulation is instructive:

> Does this law impose a tax with only that incidental restraint and regulation which a tax must inevitably involve? Or does it regulate by the use of the so-called tax as a penalty? . . . Taxes are occasionally imposed on the discretion of the legislature on proper subjects with the primary motive of obtaining revenue from them and with the incidental motive of discouraging them by making their continuance onerous. They do not lose their character as taxes because of the incidental motive. But there comes a time in the extension of the penalizing feature of the so-called tax when it loses its character as such and becomes a mere penalty with the characteristics of regulation and punishment.[96]

For similar reasons, the Court invalidated other taxes depending upon non-compliance with federal regulations.[97]

The Supreme Court later retreated from its narrow reading of the

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95. 259 U.S. 20 (1922).

96. *Id.* at 36, 38.

97. Carter v. Carter Coal Co., 298 U.S. 238 (1936) (struck down tax imposed by Congress that provided a 90% credit to producers obeying price-fixing and labor provisions of the act); United States v. Constantine, 296 U.S. 287 (1935) (invalidated federal tax on liquor dealers not operating in compliance with state law); and Hill v. Wallace, 259 U.S. 44 (1922) (invalidated tax for non-compliance with federal regulations on the operation of grain boards of trade).

taxing power.[98] In 1950, the Court said that the regulatory aim might even be dominant rather than secondary to the revenue raising purpose:

> It is beyond serious question that a tax does not cease to be valid merely because it regulates, discourages, or even definitely deters the activities taxed. . . . The principle applies even though the revenue obtained is obviously negligible . . . or the revenue purpose of the tax may be secondary . . . [n]or does the tax statute necessarily fall because it touches on activities which Congress might not otherwise regulate. As was pointed out in *Magnano Co. v. Hamilton*, 292 U.S. 40, 47 (1934) [upholding a severe state tax on butter substitutes]: 'From the beginning of our government, the courts have sustained taxes although imposed with the collateral intent of effecting ulterior ends which, considered apart, were beyond the constitutional power of the lawmakers to realize by the legislation directly addressed to their accomplishment.'[99]

Although it is not decisive as to the federal issues, the Vermont Supreme Court echoed this sentiment when it upheld the Vermont land gains tax. It declared that the legislature had the authority to achieve particular social and economic objectives by imposing a tax in a particular manner, even if the objective might be deemed beyond the legislature's other powers.[100]

The converse issue of whether a tax is a regulation in disguise is whether a regulation with tax characteristics is a valid regulation. Here the Supreme Court decisions give Congress broad discretion as to how it achieves a regulatory objective.[101] Consequently, even if

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98. *See* United States v. Kahriger, 345 U.S. 22 (1953) (upholding federal tax on persons engaged in accepting wagers); and Sonzinsky v. United States, 300 U.S. 506 (1937) (upholding license tax on firearms dealers).

99. United States v. Sanchez, 340 U.S. 42, 44-45 (1950).

100. Andrews v. Lathrop, 132 Vt. 256, 261, 315 A.2d 860, 863 (1974).

101. In Sunshine Anthracite Coal Co. v. Adkins, 310 U.S. 381 (1940), the Court upheld a price-fixing arrangement designed to stabilize the coal industry and eliminate unfair competition. The scheme included a 19½% sales tax on bituminous coal that non-participating producers sold. The Court said:

> Clearly this tax is not designed merely for revenue purposes. In purpose and effect it is primarily a sanction to enforce regulatory provisions of the Act. But that does not mean that the statute is invalid and that the tax unenforceable. Congress may impose penalties in aid of the exercise of any of its enumerated powers. The power of taxation, granted to Congress by the Constitution, may be utilized as a sanction for the exercise of another power which is granted it . . . .
> It is so utilized here.

Id. at 393.

the Supreme Court were to construe a national land gains tax as a tax-like regulation rather than a regulatory tax, it would be valid so long as Congress can constitutionally regulate the sale or exchange of land. Under the Commerce Clause,[102] Congress has the power to regulate almost any intrastate activity having an effect on interstate commerce, even if the activity is only relevant in its cumulative impact together with other activity.[103] It therefore appears that congressional power under the Commerce Clause to enact a national land gains tax would only require judicial determinations that such a tax was a reasonable means to effect the regulatory end, and that Congress could rationally find that the conduct deterred would affect interstate commerce.[104]

B. *Limits on Federal and State Power*

In addition to the requirement that a national land gains tax fall within the scope of congressional power, it also must not violate any limitation contained in the Bill of Rights or subsequent constitutional amendments. States considering a land gains tax must also consider the same limitations. Generally, these provisions protect citizens from federal or state government actions that impose unfair burdens, create arbitrary distinctions, or unduly limit access to the benefits flowing from a unified national political and economic system.

1. Unfair Burdens

The fifth amendment[105] and the Due Process Clause of the fourteenth amendment[106] protect citizens against undue burdens in the

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102. U.S. CONST. art. I, § 8, cl. 3.

103. *See*, Perez v. United States, 402 U.S. 146 (1971) (upholding conviction for illegal loan sharking, despite activity taking place in state, and lack of evidence that defendant was connected to organized crime or had ever used instrumentalities of commerce in interstate extortion); Katzenbach v. McClung, 379 U.S. 294 (1964) (upholding application of Civil Rights Act against small restaurant despite only link to interstate commerce being acquisition of meat); and Wickard v. Filburn, 317 U.S. 111 (1942) (upholding federal statute regulating wheat grown for home consumption because it affected supply available for interstate commerce and demand for the product). *See also* South Terminal Corp. v. EPA, 504 F.2d 646 (1st Cir. 1974) (upholding federal authority to control automobile pollution through rules resembling local zoning ordinances).

104. *See* Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 241 (1964).

105. U.S. CONST. amend. V.

106. *Id.* amend XIV.

form of a "taking" of private property without just compensation by federal or state governments. The Supreme Court has suggested that "rare and special instances" may exist where a taxing statute is "so arbitrary as to compel the conclusion that it does not involve an exertion of the taxing power, but constitutes, in substance and effect, the direct exertion of a different and forbidden power, as, for example, the confiscation of property."[107] The Court, however, has never relied upon this theory to invalidate a tax.

The Vermont land gains tax maximum rate of sixty percent probably does not constitute an unfair burden. While the Vermont tax rate is high, it is not unprecedented. Until the taxable year beginning after December 31, 1981, the federal short-term capital gain rate was seventy percent.[108] The housing speculation tax enacted in Washington, D.C. contains rates as high as ninety-seven percent.[109] Furthermore, a landowner can avoid or minimize the tax altogether by waiting through the holding period. Even if a landowner pays the full sixty percent, he still realizes a portion of the gain. Consequently, it seems unlikely that even the application of the sixty percent rate would constitute forbidden "confiscation."[110]

2. Protection Against Arbitrary Distinctions

The Constitution does not have explicit language analogous to the fourteenth amendment restriction on state denial of equal protection of the laws. Nevertheless, the Supreme Court has applied equal protection concepts to federal laws through the Due Process clause of the

107. A. Magnano Co. v. Hamilton, 292 U.S. 40, 44 (1934) (sustaining state excise tax of 15¢ per pound on all butter substitutes sold within the state, despite tax being so excessive that it destroyed a particular business). In City of Pittsburgh v. Alco Parking Corp., 417 U.S. 369 (1974), the Court examined a 20% gross receipts tax on the city's private parking garages. These facilities also competed with a public parking authority that charged lower rates. The Court declined to hold that government competition was sufficient to invalidate the tax as an unconstitutional "taking" of property, nor did it further define a "rare and special instance."

108. I.R.C. § 1(a) (West Supp. 1980). Congress subsequently lowered the maximum rate to 50%. *Id., as amended by* Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 59 Stat. 172.

109. D.C. CODE ANN. § 47-3305 (Supp. 1980).

110. As a result of the Vermont Supreme Court's interpretation of the land gains tax rate schedule, even the 60% rate is now applicable only on a portion of the taxable gain. See note 37 *supra*. For a further discussion of the "taking" issue, see Baker, *Controlling Land Uses and Prices by Using Special Gain Taxation to Intervene in the Land Market: The Vermont Experiment*, 4 ENVT'L AFF. 427 (1975).

fifth amendment.[111] Thus, the following discussion treats both the federal and state governments as similarly limited by equal protection concepts.

Equal protection under both federal and state laws requires protection against arbitrary exercises of legislative power. Since most laws involve some kind of classification (as does the land gains tax), courts must determine which classifications are permissible and which are unconstitutional. The scope of judicial review of the constitutionality of the classification depends upon the nature of the classification itself. In general, a classification that impinges upon a "fundamental right" or involves a "suspect class" will trigger a stringent requirement that the classification be linked to a "compelling state interest". As a practical matter few laws can survive this test. Other classifications are valid if they rationally relate to a legitimate state interest.

A land gains tax would probably withstand equal protection challenges. It is difficult to argue that its regulatory classifications would impinge upon a "fundamental right" or involve a suspect class.[112] Consequently the tax would only have to meet the more relaxed standard of judicial review—whether the classification involved is rationally related to a legitimate state interest.[113] Moreover, if courts classify a land gains tax as a tax rather than a regulatory measure, the tax might face an even less strict standard of review.[114] While not dispositive of other jurisdictions, the Vermont Supreme Court rejected an equal protection challenge to the tax by holding that the classification based upon holding period bore a rational relationship

111. *See* Bolling v. Sharpe, 347 U.S. 497 (1954). *See also* Buckley v. Valeo, 424 U.S. 1 (1976). The Supreme Court has not examined a federal tax law on the basis of equal protection rationale, but for the opinion of one federal court of appeals, see Moritz v. Commissioner, 469 F.2d 466 (10th Cir. 1972), *cert. denied*, 412 U.S. 906 (1973) (invalidating statutory denial to single man of deduction for dependent care expenses available to others because the classification was based on sex and lacked a fair and substantial relation to the object of the legislation).

112. The Supreme Court has not held that access to adequate housing is such a right. Lindsey v. Normet, 405 U.S. 56 (1972).

113. *See* City of New Orleans v. Dukes, 427 U.S. 297 (1976) (city ordinance adversely affecting vendors in an historic district, who had sold for less than eight years, is valid under the rational relation test).

114. The Supreme Court usually gives considerable deference to state tax classifications. *See, e.g.*, Kahn v. Shevin, 416 U.S. 351 (1974) (upholding state statute permitting $500 annual exemption from property tax for widows, but not widowers); and Lehhausen v. Lakeshore Auto Parts Co., 410 U.S. 356 (1973) *rehearing denied*, 411 U.S. 910 (1973) (upholding state constitutional provision subjecting corporations and similar entities but not individuals to personal property tax).

to one of the purposes of the tax—the deterrence of speculation.[115]

3. Limits Arising from a Unified National and Political Economic System

A state land gains tax must meet federal constitutional limitations on state power growing out of the nature of a federal system. Specifically, a state may not unfairly discriminate against individuals who are not citizens of the state or against activities constituting interstate commerce. The two areas are fundamentally related, but can be functionally divided according to whether the party adversely affected is an individual or an enterprise.

a. *Protection for Individuals: the Privileges and Immunities of Citizenship, Including the Right to Travel*

The fourteenth amendment[116] protects citizens of the United States from state abridgement of the privileges and immunities of their national citizenship. This clause has provided a basis for judicial invalidation of laws that seemed aimed at non-residents without substantial justification for the distinction. A state land gains tax should withstand a constitutional challenge based upon the privilege and immunities clause.

Land speculation in Vermont is an activity undertaken by both residents and non-residents of Vermont. Consequently, a tax on land speculation *per se*, such as the Vermont land gains tax, draws no distinction between individuals who live in Vermont and those who do not. The one provision of the statute that might be subject to question is the primary homesite exemption.[117]

As a threshold matter, it is not certain this provision would trigger a privileges and immunities analysis. The distinction relates to the use of the land, rather than the citizenship of the seller or buyer.

115. The court rejected the claim of landowners that the tax violated equal protection guarantees because it arbitrarily taxes land held less than six years. Andrews v. Lathrop, 132 Vt. 256, 260, 315 A.2d 860, 864 (1974). The court quoted Justice Holmes' dissent in Louisville Gas and Elec. Co. v. Coleman, 277 U.S. 32 (1928), when he stated "the decision of the legislature must be accepted unless we can say that it is very wide of any reasonable mark." *Id.* at 41 (Holmes, J., dissenting). *Andrews* did not address the tax exemption on gain allocable to structures or small primary residential lots. These classifications, however, also are arguably constitutional because they are rationally related to the purpose of deterring land speculation.

116. U.S. CONST. amend. XIV.

117. VT. STAT. ANN. tit. 32, § 10002(b) (1973).

Some citizens of Vermont may be unable to take advantage of the exemption because the land they are selling is not the site of their primary residence. Moreover, some citizens of other states may be able to sell primary residential homesites to Vermont citizens, thus taking advantage of the exemption.

Nonetheless, the scope of the primary residential homesite exemption has evolved to almost completely remove the burden of the tax from existing or prospective citizens whose only land transaction is likely to be their apparent or anticipated home. A court might therefore hold this exemption to be the equivalent of a distinction based on citizenship. But if the exemption did trigger a privileges and immunities scrutiny, it would probably still be valid. First, the burden upon non-residents is slight. The tax only affects short-term sales of land;[118] all other sales, and gain allocable to structures, are exempt.[119] Second, this burden is probably offset by a sufficient state

118. In contrast, the Supreme Court has invalidated a New Hampshire commuter tax that discriminated against non-residents. A non-resident paid a $250 tax, while residents earning the same income paid only $10. Austin v. New Hampshire, 420 U.S. 656 (1975).

Three years later, the Court upheld a system of hunting license fees that resulted in a non-resident paying more than seven times the fee that a resident paid. The court said residency distinctions are not necessarily unconstitutional. Prohibited distinctions "hinder the formation, the purpose, or the development of a single union of (individual) states. Only with respect to those 'privileges' and 'immunities' bearing upon the vitality of the Nation as a single entity must the State treat all citizens, resident and non-resident, equally." Baldwin v. Fish and Game Comm'n, 436 U.S. 371 (1978). *See also* Hicklin v. Orbeck, 437 U.S. 518 (1978) (invalidating Alaskan law giving hiring preference to qualified Alaskan residents over equally qualified, non-residents for jobs on the Alaska pipeline). It is difficult to reconcile these decisions, except to argue that access to elk is a less important "privilege" than access to employment. *See generally*, L. TRIBE, AMERICAN CONSTITUTIONAL LAW (1979).

Courts will also consider the reason for the law, as well as the type of interest it affects. Non-residents are also subject to discrimination if they constitute a "particular source of the evil by which the statute is aimed." Toomer v. Witsell, 334 U.S. 385, 398 (1948) (striking down a Louisiana statute distinguishing between residents and non-residents for fishing licenses). There must, however, still be a "reasonable relationship between the danger represented by non-citizens, as a class, and the severe discrimination practiced upon them" *Id.*, at 399.

119. Significantly, the Court in Baldwin v. Fish and Game Comm'n, 436 U.S. 371, 383 (1978), cited Blake v. McClung, 172 U.S. 239 (1898), to hold that the privileges and immunities clause prevents states from imposing unreasonable burdens on aliens" in the ownership and *disposition* of property held in the State. (Emphasis supplied). *Blake* invalidated a Tennessee statute giving resident creditors of a bankrupt Tennessee corporation preference over non-resident creditors. Vermont's land gains on non-residents is a lighter burden than was the situation in *Blake*.

interest in the passage of the law.[120]

Another possible argument is that the primary residential homesite exemption violates a constitutionally protected "right to travel" because a buyer must establish a primary residence in order to receive the benefit of the land gains tax exemption upon resale within the taxable six year period.[121] In addition, the land gains tax is easily distinguishable from these cases, which involved indigents. By contrast, the tax falls on individuals who are wealthy enough to own land. Also, by inducing Vermont purchasers to reside primarily in Vermont rather than to live elsewhere, the land gains tax is hardly a vehicle for Vermont to close its borders to undesired immigration. In addition, recent cases indicate a reluctance to overturn a statute on "right to travel" grounds.[122]

b. *Protection for Interstate Commerce*

While not an automatic conclusion, it appears safe to assume that a land gains tax could be subject to judicial scrutiny under a commerce clause analysis. The United States Supreme Court has articulated two tests depending upon whether the particular law is a regulation or a tax. Since the land gains tax has mixed characteristics[123], both tests will be examined.

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120. As the Vermont Supreme Court noted in upholding the land gains tax:

> [W]e may take judicial notice of an increasing concern within the State over the use and development of land as a natural resource, a concern to which the legislature has responded in other instances with appropriate legislation [Act 250] . . . . Speculation falls within the ambit of such concern as a land use; indeed it has a bearing on many other uses to which the land might be put.

Andrews v. Lathrop, 132 Vt. 256, 261-62, 315 A.2d 860, 863 (1974).

121. The Supreme Court addressed this argument in Shapiro v. Thompson, 394 U.S. 618 (1969). *Shapiro* invalidated a residency requirement for state welfare eligibility.

122. *See* McCarthy v. Philadelphia Civil Serv. Comm'n, 424 U.S. 645 (1976) (upholding residency requirements for municipal employment); Sosna v. Iowa, 419 U.S. 393 (1975) (divorce). *See also* Steel Hill Dev. Co., Inc. v. Town of Sanborton, 469 F.2d 956 (1st Cir. 1972) (upholding large lot zoning ordinance against challenge as exclusionary, in part on grounds that second home ownership was entitled to a lower order of judicial protection than primary home ownership).

123. The Vermont Supreme Court has held the tax has two purposes: deterring land speculation, and raising revenue. Andrews v. Lathrop, 132 Vt. 256, 315 A.2d 860 (1974).

1.) Regulation

For regulatory action, the Court focuses on the legitimacy of the local purpose and the degree of burden imposed on commerce.[124] In analyzing a regulatory state law, a threshold question is whether it would be viewed as "basically a protectionist measure, or whether it can fairly be viewed as a law directed to legitimate local concerns, with effects upon interstate commerce that are only incidental."[125] Restrictions upon either the flow of commerce into or out of a state are vulnerable if a state:

> . . . has overtly moved to slow or freeze the flow of commerce for protectionist reasons. It does not matter that the State has shut the article of commerce inside the State in one case and outside the State in the other. What is crucial is the attempt by one State to isolate itself from a problem common to many by erecting a barrier against the movement of interstate trade.[126]

Is a land gains tax subject to a challenge as protectionist? The Vermont Supreme Court found that the regulatory purpose of the land gains tax was the deterrence of land speculation and its assumed undesirable land use consequences.[127] A land gains tax may discourage out-of-state investors, but it also discourages local ones and does not seem aimed at protecting a favored local real estate industry.[128]

124. *See generally* Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970) (forbidding state from requiring local company to package its goods within the state).

125. City of Philadelphia v. New Jersey, 437 U.S. 617, 624 (1978). The Court overturned New Jersey's ban on importation of waste originating outside its territorial limits. The Court said the prohibition was an exclusionary, protectionist measure, because it imposed on those outside the state the entire burden of slowing the flow of refuse into New Jersey's remaining landfill sites. The Court also noted opposite situations—where the commerce clause barred states from giving their own inhabitants a preferred right of access to natural resources over non-residents. *See also* Pennsylvania v. West Virginia, 262 U.S. 553 (1923) (invalidating law granting preference to local consumers of natural gas produced within the state); and West v. Kansas Natural Gas Co., 221 U.S. 229 (1911) (invalidating state statute designed to prohibit transportation of gas produced in Oklahoma beyond the state).

But the Court recently upheld a coal severance tax despite arguments that it unduly burdened interstate commerce. *See* Commonwealth Edison Co. v. Montana, 101 S. Ct. 2946 (1981). Apparently such a tax on exploitation of natural resources does not cross the protectionist threshold, but is a valid means of preserving the environment. A land gains tax, viewed as a conservation rather than a protectionist measure, would likely survive commerce clause scrutiny.

126. City of Philadelphia v. New Jersey, 437 U.S. 617, 628 (1978).

127. Andrews v. Lathrop, 132 Vt. 256, 315 A.2d 860 (1974).

128. *Cf.* Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511 (1935) (invalidated state's refusal to license milk dealer who obtained milk out-of-state at a price fixed below

Moreover, the Court will also examine the burden imposed on commerce, striking down those burdens that seem unduly excessive in relation to the local benefit.[129] With the Vermont land gains tax, however, the ability of land owners to wait out the tax holding period mitigates the burden. Furthermore, the Vermont land gains tax, while imposing a burden on some interstate commerce, also imposes a similar burden on local commerce in land. Thus the burden on interstate commerce appears too slight to produce a viable challenge on a regulatory test.

2.) Revenue Measures and Interstate Commerce

In contrast to judicial inquiry of regulatory action, the land gains tax undergoes scrutiny as a revenue raising device by analysis of its effect. Specifically, the Supreme Court has recently suggested testing a statute by whether "the activity is not sufficiently connected to the State to justify a tax, or that the tax is not fairly related to the benefits provided the taxpayer, or that the tax discriminates against interstate commerce, or that the tax is not fairly apportioned."[130]

Even if the activity is wholly interstate, however, direct taxation of interstate commerce is permissible so long as the "forbidden effects" do not appear.[131]

Clearly a land gains tax relating only to the sale or exchange of land within that state is "sufficiently connected to the State to justify a tax."[132] Moreover, the land gains tax would be fairly related to the benefits provided the taxpayer.[133] Since real property is an asset for which a state provides particularly local benefits and protection, a tax on its transfer should not be vulnerable.

States must apportion their taxation so that they only tax that por-

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that for instate dealers; Court held state was trying to protect local suppliers from foreign competition).

129. *See* Huron Portland Cement Co. v. City of Detroit, 362 U.S. 440 (1960) (upholding legitimate state environmental control laws on ship smoke pollution); Proctor & Gamble Co. v. City of Chicago, 509 F.2d 69 (7th Cir. 1975), *cert. denied*, 421 U.S. 978 (1975) (city ordinance banning sale of phosphate detergents does not interfere with interstate commerce).

130. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 287 (1977).

131. Dep't of Revenue of Wash. v. Ass'n of Wash. Stevedoring Cos., 435 U.S. 734 (1978).

132. Complete Auto Transit v. Brady, 430 U.S. 274, 287 (1977).

133. Standard Pressed Steel Co. v. Dep't of Revenue of Wash., 419 U.S. 560, 562 (1975), *citing* Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1960).

tion of interstate commerce that is fairly related to the taxing jurisdiction. The rationale behind this apportionment requirement is to avoid the risk of multiple taxation that could produce a burden on interstate commerce that is not imposed upon local commerce.[134] In contrast to the usual taxes challenged under an apportionment test, a land gains tax would subject the seller at most to two taxes—one by Vermont where the land sale occurred and the other by the state of the seller's domicile under an income tax theory. Since Vermont also imposes an income tax on its citizens, residents and non-residents are treated with relative equality.

Occasionally, the Court has struck down measures whose wording is not explicitly discriminatory on the grounds that the measure in fact taxes interstate activity without imposing a similar burden on local enterprise.[135] In those cases, the court's primary concern is the effect such a tax has on the non-resident enterprise since the only means for the non-local activity to conduct its business is to pay the required fee, while residents conducting similar enterprises have other means of carrying on their business. The land gains tax, however, is a different revenue measure. Local sellers of Vermont land have no easy alternative to sale not available to non-residents. Their only advantage is the principal residential homesite exemption which is also unavailable to many Vermont residents who own vacation homesites or large parcels of Vermont land not used as a residence at all. Thus, while not automatically exempt from scrutiny, the burdens the land gains tax imposes on interstate commerce do not seem sufficient to raise the prospect of a successful constitutional challenge.

C. *State Constitutional Limits on the Taxing Power*

State governments, unlike the federal government, have plenary powers to tax. Almost all state constitutions, however, contain a provision requiring selected taxes to be "uniform" or "proportional".[136] These uniformity provisions pose a problem for jurisdictions consid-

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134. *See generally* Western Live Stock v. Bureau of Revenue, 303 U.S. 250 (1938).

135. *See, e.g.*, Nippert v. City of Richmond, 327 U.S. 416 (1946) (striking a tax on business solicitation); Robbins v. Shelby Co. Taxing Dist., 120 U.S. 489 (1887) (invalidating a licensing fee on agents soliciting business for non-resident enterprises).

136. For an analysis of these constitutional provisions, *see* W. NEWHOUSE, CONSTITUTIONAL UNIFORMITY AND EQUALITY IN STATE TAXATION (1959). *See also* M. BERNARD, CONSTITUTIONS, TAXATION, AND LAND POLICY (1979).

ering a land gains tax because a gains tax (1) applies to gain from land alone; (2) is progressively more severe as profits increase; and (3) has a tax rate that varies according to the length of the holding term. The issues for analysis are twofold: (1) is the land gains tax likely to be classified as one that must meet the equality and uniformity provisions and (2) if so, can it still pass constitutional muster? Rather than analyzing the taxing provisions of fifty states in detail, this section merely attempts to highlight how states might resolve these questions.

Most states permit graduated income taxes.[137] Since a land gains tax shares many of the uniformity problems of a graduated income tax, it is almost certain that these states would permit a land gains tax.

The validity of a state land gains tax becomes less certain among those states that do not permit graduated income taxes.[138] The survival of a land gains tax in these state requires that the tax be classified as an excise tax, and that the state allow excise taxes to have graduated rates.[139] Massachusetts may serve as a test case for the

137. Without judging whether a particular state would classify a land gains tax as an income tax, our analysis discloses that 36 states levy graduated income taxes:

Alabama	Alaska	Arizona
Arkansas	California	Colorado
Delaware	Georgia	Hawaii
Idaho	Iowa	Kansas
Kentucky	Louisiana	Maryland
Minnesota	Mississippi	Missouri
Montana	Nebraska	New Jersey
New Mexico	New York	North Carolina
North Dakota	Ohio	Oregon
Rhode Island	South Carolina	Utah
Vermont	Virginia	West Virginia
Wisconsin		

Three states would probably permit graduated income tax, even though they have not acted. They are Connecticut, Indiana, and South Dakota. Three states may permit graduated income taxes. They are Nevada, Texas and Wyoming.

138. Seven states appear not to permit graduated income taxes at all. They are Florida, Illinois, Massachusetts, Michigan, New Hampshire, Tennessee, and Washington.

139. Many states permit reasonable graduation of rate when an excise tax is involved. For example, in holding that a graduated excise tax on oil was valid, the United State Supreme Court said "[t]he State is not limited to *ad valorem* taxation. It may impose specific taxes upon different trades and professions and may vary the rate of excise upon various products." Ohio Oil Co. v. Conway, 281 U.S. 146, 159 (1930).

type of problems faced in these states.

In order for a land gains tax to survive uniformity challenges in Massachusetts, it has to fall outside both the property tax and the income tax classifications[140] into the third remaining classification: excise taxation. While a land gains tax may have constituted a property tax at one time in Massachusetts,[141] recent Massachusetts cases suggest that the tax currently falls outside a property tax classification.[142] Massachusetts law is extremely unclear on whether a tax on the gain derived from real estate could constitute income.[143] Opponents of the income classification would argue that gain derived from real estate can be used as the *measure* of an excise tax, rather than as the *subject* of an income tax. Under this theory, a land gains tax is imposed upon the exercise of the right of property transfer, rather than on gain derived.[144] If so, then the tax only has to be "reason-

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While state constitutional provisions may vary, in general the only restriction on state graduated excise taxes is that they not be arbitrary or unreasonable. *Id.*

140. Article 44 of the Massachusetts Constitution requires that an income tax be levied at uniform rates throughout the Commonwealth. MASS. CONST. art. 44. Thus, Massachusetts taxes earned income at one rate and unearned income at another rate. Both rates, however, are uniform for that class of income and are not dependent, as in federal income tax law, on the total amounts received.

141. *See* State Tax Comm'n v. Fine, 356 Mass. 51, 247 N.E.2d 701 (1969) (dividends paid to a Massachusetts beneficiary by a foreign trust on foreign land were not taxable in Massachusetts under the then state income tax). In *Fine*, the court focused on the origin rather than the destination of the income involved and explained that the income at issue was a property tax in the sense that it was a tax on the underlying estate.

142. *See* Ingraham v. State Tax Comm'n, 368 Mass. 242, 331 N.E.2d 795 (1975). In *Ingraham*, the Massachusetts Supreme Judicial Court apparently abandoned the origin test and focused instead on the destination of the income. The court explicitly declined, however, to determine whether a tax on income remained a property tax as well as an income tax, or whether the tax was an excise tax for state purposes. *Id.* at 248, 331 N.E.2d at 798.

143. The actual language of Article 44 of the Amendments to the Massachusetts Constitution distinguishes an income tax from an excise tax. Nevertheless, the language may have been based on the possibly discredited perception that an income tax was a form of property tax. *See* notes 88-92 and accompanying text *supra*.

144. *See, e.g.*, Bromley v. McCaughn, 280 U.S. 124, 136-37 (1929) (an excise tax is "laid only upon the exercise of a single one of those powers incident to ownership"); Atlantic Lumber Co. v. Commissioner of Corps. and Taxation, 292 Mass. 51, 197 N.E. 525 (1935), *aff'd*, 298 U.S. 553 (1936) (tax on privilege of business activity measured in part by net income upheld as valid excise tax); Minot v. Winthrop, 162 Mass. 113, 38 N.E. 512 (1894) (deathtime succession tax upheld as valid excise tax even though measured on the basis of amount of property).

able" without the requirements of proportionality or the prescription against being graduated.

Similar analysis must be taken in other jurisdictions based on their particular constitutional provisions. Aside from states that appear to allow graduated income taxes (and thus a land gains tax), the following states appear to have relatively liberal rules on excise taxes: Florida, Illinois, Tennesee, Texas, Wyoming, and Washington (though in Washington a land gains tax might be classified as a property tax). Michigan, Nevada, and New Hampshire impose restrictions on their excise taxes. Pennsylvania does not appear to allow a graduated tax of any kind.

CONCLUSION

The Vermont land gains tax is remarkable because it is the first domestic attempt to use a tax disincentive in the land market to control land use and price. Except for the problem of allocating gain between buildings and land, the tax has benefits. It only applies to realized gain, and it is relatively easy to compute. Moreover, the statute does not tax gain derived from long-term sales or loss transactions.

The land gains tax, however, has many of the drawbacks of taxes in general. It preserves environmental quality only to the extent that it discourages particularly undesirable purchasers from investing in Vermont land. The Vermont development community consistently argued that the tax unnecessarily burdened the land market in view of the state's existing successful land use regulations. Supporters countered that the tax would supplement those regulations by controlling second homesite and other development.

Jurisdictions lacking Vermont's direct land use regulation may look to a land gains tax as a comprehensive deterrent to uncontrolled land speculation. Those states should carefully consider whether a tax alone is the most appropriate means to achieve the desired end. The tax has no environmental favorites. Conversely, a state with regulatory controls similar to Vermont's might consider tying a land gains tax exemption directly to compliance with its land use controls.

We could not conclusively answer some questions that would provide observers of the land gains tax with more insight into the law. In particular, we could not determine the effect of the land gains tax on land prices. In fact, the intense field survey persuades us that econometric analysis of land prices is useful only if accompanied by thorough background investigations of the local market environment and its participants. We do feel, however, that we have significantly extended the methodology for determining the law's impact beyond an analysis of personal interviews with key local officials. For example, we have demonstrated the utility of a sophisticated survey that reveals to concerned legislators the impact of the tax on land market participants. The survey also produced unexpected results, such as the apparent link of the land gains tax to the increase in the proportion of land purchasers after 1973 who used their new property as working farms.

Thus, we focused on the land gains tax in a general study of economic disincentives as an environmental control. We hope, however, that this study will also provide insights into methodologies for determining the impact of law.