

# Protectionist Property Taxes

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*ABSTRACT: National restrictions on trade and immigration are the most salient illustrations of the current protectionist moment, but cities have played their part too, taxing foreign investors in local real estate and imposing second or vacant home taxes that indirectly burden foreign investment. We call these taxes “protectionist property taxes.” Although these taxes are new, they draw from an old well of suspicion about foreign ownership. We provide economic and historical context for the recent wave of protectionist property taxes and evaluate their legality under U.S. law. We conclude that taxes on second or vacant homes would likely survive constitutional challenge but facially protectionist property taxes generally would not. We then assess the policy merits of these taxes using an economic framework that highlights how law affects housing risk. We show that foreign real estate investment can reduce the riskiness of local housing markets so that even if a city can get away with enacting a protectionist property tax, it is not typically a good idea. Government spending can better achieve policy goals such as affordable housing and neighborhood stability without running afoul of constitutional prohibitions.*

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## I. INTRODUCTION

The United States is in the midst of a return to economic protectionism that is unprecedented in the postwar era,<sup>1</sup> which has observers wondering if the United States has abandoned free trade for a return to eighteenth century mercantilism. And the United States is not alone. The last several years have witnessed high-profile international retreats from global markets in goods, labor, and capital.<sup>2</sup> The United States withdrew from the Trans-Pacific

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1. This return to trade protectionism alone cost U.S. consumers roughly \$51 billion. Pablo D. Fajgelbaum, Pinelopi K. Goldberg, Patrick J. Kennedy & Amit K. Khandelwal, *The Return to Protectionism*, 135 Q.J. ECON. 1, 52 (2020).

2. See, e.g., Daniel Griswold, *Assessing President Trump's Trade Priorities*, 39 CATO J. 199, 199 (2019) ("President Trump's trade agenda has challenged more than seven decades of bipartisan policy commitment to seeking lower trade barriers at home and abroad through negotiated agreements."). Although integrated global markets are often associated with political conservatism, this need not be the case. See KIMBERLY CLAUSING, OPEN: THE PROGRESSIVE CASE FOR FREE TRADE, IMMIGRATION, AND GLOBAL CAPITAL 3 (2019).

Partnership Agreement,<sup>3</sup> imposed tariffs on Chinese exports,<sup>4</sup> and imposed tariffs on steel from the European Union, Canada, and Mexico.<sup>5</sup> Many countries adopted more restrictive immigration policies, including Australia,<sup>6</sup> the European Union,<sup>7</sup> and the United States.<sup>8</sup> National restrictions on foreign capital have not, for the most part, followed this trend towards protectionism.<sup>9</sup> Still, just below the surface, a number of cosmopolitan “superstar cities,” including London, Hong Kong, Paris, Toronto, and Vancouver, have imposed taxes on foreign owners of local real estate or have adopted vacant-home taxes that indirectly burden foreign investment.<sup>10</sup> As these “protectionist property taxes” have spread internationally, cities in the United States have discussed following suit.<sup>11</sup>

The spread of protectionist property taxes is noteworthy for two reasons. First, protectionist measures are typically imposed nationally, not at the municipal level. The adoption of local protectionist property taxes in countries like Canada and the United Kingdom raises the legal question of whether U.S. cities could do the same and the prudential question of whether they should. Second, foreign ownership limits themselves are somewhat unusual. We do not generally observe restrictions on foreign ownership of

3. See Peter Baker, *Upending Trade Policies, Trump Scraps Asia Pact*, N.Y. TIMES (Jan. 24, 2017), <https://www.nytimes.com/images/2017/01/24/nytf/nytf/scannat.pdf> [<https://perma.cc/C3BF-YNQU>].

4. See, e.g., Alan Rappeport & Keith Bradsher, *Trump Says He Will Raise Existing Tariffs on Chinese Goods to 30%*, N.Y. TIMES (Dec. 31, 2020, 9:20 AM), <https://www.nytimes.com/2019/08/23/business/china-tariffs-trump.html> [<https://perma.cc/4CHF-EZ7M>].

5. Some of these tariffs were subsequently lifted. See, e.g., Ana Swanson, *Trump Lifts Metal Tariffs and Delays Auto Levies, Limiting Global Trade Fight*, N.Y. TIMES (May 17, 2019), <https://www.nytimes.com/2019/05/17/us/politics/china-auto-tariffs-donald-trump.html> [<https://perma.cc/5PJB-39YT>].

6. See, e.g., Damien Cave & Isabella Kwai, *Why Has Australia Fallen Out of Love with Immigration?*, N.Y. TIMES (Apr. 22, 2019), <https://www.nytimes.com/2019/04/22/world/australia/immigration.html> [<https://perma.cc/DL9L-PVR2>].

7. See, e.g., Matina Stevis-Gridneff, *Europe Keeps Asylum Seekers at a Distance, This Time in Rwanda*, N.Y. TIMES (Sept. 18, 2020), <https://www.nytimes.com/2019/09/08/world/europe/migrants-africa-rwanda.html> [<https://perma.cc/74EV-SSTH>].

8. See, e.g., Adam Liptak, *Supreme Court Says Trump Can Bar Asylum Seekers While Legal Fight Continues*, N.Y. TIMES (Sept. 11, 2019), <https://www.nytimes.com/2019/09/11/us/politics/supreme-court-trump-asylum.html> [<https://perma.cc/6SSZ-DYCU>].

9. See ORG. FOR ECON. COOP. & DEV. [OECD], FOREIGN DIRECT INVESTMENT REGULATORY RESTRICTIVENESS INDEX (2018), <https://goingdigital.oecd.org/en/indicator/74> [<https://perma.cc/5ZQH-8QYR>]. However, in 2018, the United States did enact the Foreign Investment Risk Review Modernization Act, adding limitations on foreign investment, including investment in real estate. See Foreign Investment Risk Review Modernization Act of 2018, Pub. L. No. 115-232, 132 Stat. 2174 (codified at 50 U.S.C. § 4565).

10. See *infra* text accompanying notes 88–95, 107–16.

11. See *infra* text accompanying notes 54–59.

personal property, such as stock in business corporations.<sup>12</sup> But real estate has unique features that make it a natural focus of local protectionist efforts. Land is special. It has deep, almost mystical, properties in many cultures, connecting families and peoples across time. Poets muse, “[t]he soil is the great connector of lives, the source and destination of all,”<sup>13</sup> and “[w]e come and go, but the land is always here. And the people who love it and understand it are the people who own it—for a little while.”<sup>14</sup> Poetry aside, real estate also has special (if less romantic) economic features that explain the politics of local real estate protectionism.

In this Article we answer both the “could” and the “should” questions about protectionist property taxes. In doing so, we distinguish between local laws that target or impact residents of other countries (“foreign” investors) and laws that target or impact all nonresidents of the municipality (“outsiders”), including residents of other states.<sup>15</sup>

In the United States, state and local lawmaking is constrained by the federal Constitution, which both enforces anti-protectionist norms among the states and assigns to Congress the plenary power to regulate foreign commerce.<sup>16</sup> Protectionist property taxes likely affect foreign and domestic commerce, and, for that reason alone, they are subject to constitutional challenge. But the Constitution also protects fundamental individual rights,<sup>17</sup> and it polices the unequal treatment of different classes of persons.<sup>18</sup> Thus, protectionist property taxes may constitute discrimination that offends the Privilege and Immunities Clause of Article IV and the Equal Protection Clause of the Fourteenth Amendment to the Constitution.

We conclude that facially neutral taxes on property use, such as taxes on second homes and vacant properties,<sup>19</sup> are likely to survive constitutional

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12. Indeed, anti-takeover statutes that target foreign owners of local businesses have been held to be unconstitutional. *See, e.g.,* *Campeau Corp. v. Federated Dep’t Stores*, 679 F. Supp. 735, 739 (S.D. Ohio 1988).

13. WENDELL BERRY, *THE UNSETTLING OF AMERICA: CULTURE & AGRICULTURE* 90 (First Counterpoint ed. 2015) (1977).

14. WILLA SIBERT CATHER, *O PIONEERS!* 308 (1913).

15. For a discussion of ways that foreigners of various kinds may be subject to, and indeed targeted for, differential taxation, see generally Henry Ordower, *Taxing Others in the Age of Trump: Foreigners (and the Politically Weak) as Tax Subjects*, 62 *ST. LOUIS U. L.J.* 157 (2017).

16. U.S. CONST. art. I, § 8, cl. 3.

17. U.S. CONST. amend. XIV, § 1.

18. *Id.*

19. These are typically properties left unused more than six months a year. *See, e.g., Exemptions for Individuals for the Speculation and Vacancy Tax*, BRIT. COLUM., <https://www2.gov.bc.ca/gov/content/taxes/speculation-vacancy-tax/exemptions-speculation-and-vacancy-tax/individuals> [<https://perma.cc/3X8J-RRPF>] (“If a renter or non-arm’s length tenant occupies an owner’s home for at least six months in the calendar year, the owner may be exempt from the tax.”); *Empty Homes Tax*, CITY OF VANCOUVER, <https://vancouver.ca/home-property-development/empty-homes-tax.aspx> [<https://perma.cc/EG88-FZ7W>] (“Most homes will not be subject to the tax, as it does not apply to principal residences or homes rented for at least six months of the year . . .”).

scrutiny because they have only a disparate impact on outsiders. However, facially discriminatory property taxes are almost certainly unconstitutional. Although unlikely to succeed on the merits, discriminatory property taxes may be able survive, for a time, because federal courts do not generally have jurisdiction to enjoin local taxes, and state courts may be more favorable to the arguments of local governments.<sup>20</sup> However, a delayed reckoning can result in massive damages if a court eventually finds a protectionist property tax unconstitutional.<sup>21</sup>

Even if protectionist property taxes survive constitutional scrutiny, that doesn't mean that cities should enact them. Familiar arguments against economic protectionism apply to protectionist property taxes. We also evaluate the wisdom of these taxes using an economic framework that conceives of the local government as a manager of the risks—including housing price risks—faced by its constituents. We argue that outsiders' demand for local real estate will generally reduce the housing risk of local homeowners unless the risks faced by the outsiders in their home markets are both large and very similar to the risks in the local market.<sup>22</sup> In fact, the more "foreign" the investors are, the better the result for local homeowners, as this foreign-ness enhances the benefits of what financial economists call "diversification."<sup>23</sup> Our risk-management framework for evaluating local government law and policy accommodates the conventional wisdom about the benefits of open markets but also rigorously grounds objections about their disruptive effects.

There are two important caveats to our argument. First, advocates for protectionist property taxes sometimes argue that second homes or vacant homes impose costs on their surrounding neighborhoods.<sup>24</sup> This argument becomes more persuasive when these homes rise as a share of the total market. Coincidentally, a substantial market share also reduces the risk-reduction benefits of diversification.<sup>25</sup> As a result, the case for protectionist

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20. See *infra* notes 196–208 and accompanying text.

21. See, e.g., *Harper v. Va. Dep't of Tax'n*, 509 U.S. 86, 101 (1993) (requiring Virginia "to provide meaningful backward-looking relief to rectify" a discriminatory tax (quoting *McKesson Corp. v. Div. of Alcoholic Beverages & Tobacco, Dep't of Bus. Regul. of Fla.*, 496 U.S. 18, 31 (1990))).

22. In a contemporaneous paper, several economists make a similar argument about the benefits of international trade. See generally Francesco Caselli, Miklós Koren, Milan Lisicky & Silvana Teneyro, *Diversification Through Trade*, 135 Q.J. ECON. 449 (2020) (challenging the conventional wisdom that international trade leads to income volatility).

23. See *infra* Section IV.A.2.ii.

24. See generally Christian A.L. Hilber & Olivier Schöni, *The Economic Impacts of Constraining Second Home Investments* (Ctr. for Econ. Performance, Discussion Paper No. 1556, 2018), [http://eprints.lse.ac.uk/91677/1/Hilber\\_The-economic-impacts-of-constraining\\_Author.pdf](http://eprints.lse.ac.uk/91677/1/Hilber_The-economic-impacts-of-constraining_Author.pdf) [<https://perma.cc/Y56G-SS4X>] (noting that advocates often argue that second homes harm neighbors by either increasing or decreasing housing density).

25. See *infra* note 251–55 and accompanying text.

property taxes becomes stronger when outsiders dominate local land ownership. Second, the rush to adopt protectionist property taxes is partially motivated by rapid escalations of housing prices that raise legitimate concerns about affordability. We argue that government spending is a better instrument for dealing with housing affordability issues than protectionism.

Part II describes the recent trend of cities adopting protectionist property taxes. We place this trend in its economic and political context, noting how it is rooted in a long history of suspicion surrounding foreign ownership of land but also noting the ways that contemporary anti-foreign sentiments are different than those that came before. Specifically, we highlight the popularity of anti-foreigner limitations in urban real estate markets and a growing number of proxy restrictions, such as taxes on vacant properties and second homes. Part III evaluates the legality of protectionist property taxes. Part IV takes up the question of which, and under what circumstances, protectionist property taxes are sensible policy.

## II. DEVELOPMENTS IN PROTECTIONIST PROPERTY TAXATION

We begin by providing the political and economic context for the emergence of protectionist property taxes. We distinguish between protectionist taxes that facially discriminate against outside ownership of local real estate and those that only do so indirectly, and we discuss each in turn.

### A. ECONOMIC AND POLITICAL CONTEXT

Figure 1 shows the value of U.S. residential property acquisitions made by resident and nonresident aliens over time. Foreign investment in U.S. residential real estate increased in fits and starts from 2011 to 2017, but has declined sharply in the last three years. In the year ending in March of 2020, foreign buyers purchased 154,000 residential properties in the United States at an average price of \$480,870.<sup>26</sup> Non-resident aliens acquired a total of \$33 billion in U.S. residential real estate, a 56 percent decline from 2017.<sup>27</sup>

Foreign purchasers buy U.S. real estate as vacation homes, as status symbols,<sup>28</sup> and as financial investments that they believe will appreciate over

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26. NAT'L ASS'N OF REALTORS, INTERNATIONAL TRANSACTIONS IN U.S. RESIDENTIAL REAL ESTATE 12–14 (2020) [hereinafter NAR REPORT], <https://cdn.nar.realtor/sites/default/files/documents/2020-international-transactions-in-us-residential-real-estate-08-06-2020.pdf> [<https://perma.cc/2PR8-BXTC>].

27. See *id.* at 12.

28. See, e.g., Sara Ursic, Roko Mišetic & Anka Mišetic, *How to Preserve Landscape Quality—Second Home Paradox*, 37 *PROCEDIA ENV'T SCIS.* 101, 103 (2017); Stefanos Chen, *Another Real Estate Record. Go Figure.*, N.Y. TIMES (Feb. 1, 2019), <https://www.nytimes.com/2019/02/01/realestate/another-real-estate-record-go-figure.html> [<https://perma.cc/73XR-U7N4>]; Katherine Clarke, *A Russian Billionaire's \$1.3 Billion Bet on New York's Iconic Crown Building*, WALL ST. J. (June 13, 2019, 11:35 AM), <https://www.wsj.com/articles/a-russian-billionaires-1-3-billion-bet-on-new-yorks-iconic-crown-building-11560440111> [<https://perma.cc/V8SA-S5R3>]; Esther Fung, *Chinese Dumped \$1 Billion of U.S. Real Estate in Third Quarter, Extending Recent Retreat*, WALL ST. J.

time or will serve as a hedge against instability and risk in their own country of residence. Purchasers located in jurisdictions where there is political risk of expropriation may also purchase real estate as a way of hiding assets from their government.<sup>29</sup> Thus, demand for U.S. real estate is, at least in part, contingent on the political and economic circumstances in foreign countries.

Much of the recent decline in foreign real estate investment is due to factors affecting Chinese investors, who are responsible for the lion's share of new foreign investment in U.S. residential real estate.<sup>30</sup> Industry observers attribute this decline to the appreciation of the U.S. dollar vis-à-vis the Chinese yuan, Chinese capital controls, limitations on the U.S. housing supply, and slowing economic growth abroad.<sup>31</sup> The last two years vividly illustrate how macroeconomic factors and policy decisions made far away—in Beijing, in particular—can have a direct effect on demand for real estate in the United States.

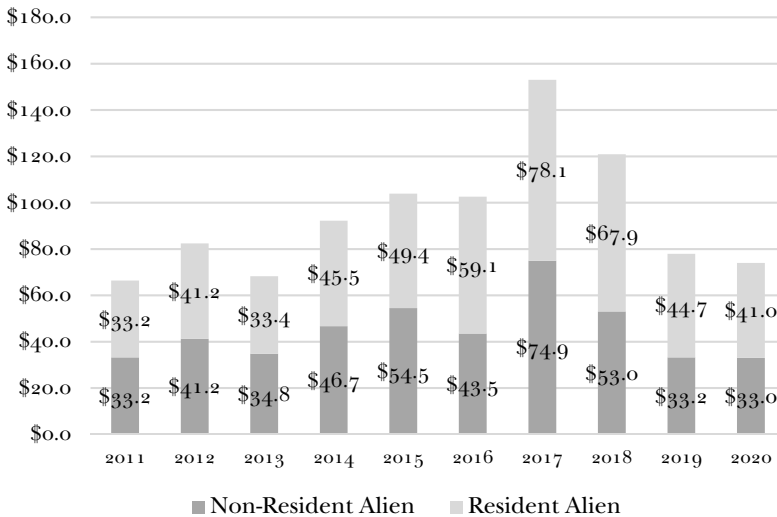
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(Dec. 4, 2018, 7:00 AM), <https://www.wsj.com/articles/chinese-dumped-1-billion-of-u-s-real-estate-in-third-quarter-extending-recent-retreat-1543924802> [<https://perma.cc/T8NT-PWCY>] (discussing purchase prices of trophy properties); Tim Roy, *Reasons to Buy a Vacation Property*, TURNOVERBNB (June 24, 2017), <https://turnoverbnb.com/reasons-to-buy-vacation-property> [<https://perma.cc/8ZZN-DVWF>].

29. See, e.g., Rob Taylor & Wei Gu, *Market Turmoil Seen Spurring China Property Purchases Overseas*, WALL ST. J. (Aug. 27, 2015, 6:10 AM), <https://www.wsj.com/articles/australia-worried-about-rise-in-chinese-property-buying-1440654099> [<https://perma.cc/2G4G-ANQ2>]; Wolf Richter, *Why Are Investors in China so Eager to Buy US Homes?*, WOLF ST. (Mar. 13, 2018), <https://wolfstreet.com/2018/03/13/why-are-investors-in-china-so-eager-to-buy-us-homes> [<https://perma.cc/E8RP-7FKS>]; Diana Olick, *Chinese Buyers Expand Their Reach in the US Housing Market as the Middle Class Gets in on the Act*, CNBC (Jan. 8, 2019, 5:08 PM), <https://www.cnbc.com/2019/01/08/chinese-middle-class-buying-up-american-residential-real-estate.html> [<https://perma.cc/VDW2-4ELZ>]; Abby Schultz, *Chinese U.S. Real Estate Demand Tip of the Iceberg*, BARRON'S (May 20, 2016), <https://www.barrons.com/articles/chinese-u-s-real-estate-demand-tip-of-the-iceberg-1463706667> [<https://perma.cc/34VU-XMPR>].

30. See Brittany De Lea, *The Hottest US States for Foreign Real Estate Investors*, FOX BUS. (July 17, 2019), <https://www.foxbusiness.com/economy/us-real-estate-foreign-investment> [<https://perma.cc/HA3U-4F29>] (explaining that Chinese buyers accounted for \$13.4 billion in U.S. residential real property purchases between April 2018 and March 2019 and that Canadian buyers were second with \$8 billion). Investors from Canada, India, Colombia, and Mexico also make large investments in U.S. residential real estate. NAR REPORT, *supra* note 26, at 13.

31. *Id.* at 12.

Figure 1. Foreign Investment in U.S. Residential Real Estate (USD \$Bil)<sup>32</sup>

While national media attention is focused on Russian oligarchs and trophy properties in New York City,<sup>33</sup> the most attractive U.S. states for foreign residential real estate investors are Florida, California, Texas and Arizona.<sup>34</sup> Florida is an especially popular market for Canadian purchasers; California is most attractive to Chinese investors; and Texas draws significant investment from Latin America, the Caribbean and Mexico.<sup>35</sup> The data also contradict the notion that foreign investors focus on apartments in urban areas. In the last year, “[f]orty-eight percent of foreign buyers purchased in a suburban area” while 74 percent “purchased a detached single-family home or townhome.”<sup>36</sup> Foreign purchasers also tend to buy more valuable properties than the typical American household, with “[e]ight percent of foreign buyers purchased properties worth more than \$1 million . . . compared to about 3% among all existing-home buyers.”<sup>37</sup>

As foreign investment in residential real estate has increased, so has the number of second homes. Between 1990 and 2005, the number of second homes in the United States increased by about 20 percent, totaling 6.8 million

32. This table is taken from the National Association of Realtors Report. *Id.*

33. See, e.g., Vivian Marino, *Russian Oligarch Transfers \$92.3 Million in Manhattan Property*, N.Y. TIMES (Oct. 5, 2018), <https://www.nytimes.com/2018/10/05/realestate/russian-oligarch-transfers-92-3-million-in-manhattan-property.html> [<https://perma.cc/3RGC-943H>]; Clarke, *supra* note 28.

34. De Lea, *supra* note 30.

35. NAR REPORT, *supra* note 26, at 17.

36. *Id.* at 4, 23.

37. *Id.* at 19.



homes,<sup>38</sup> or roughly five percent of all housing units.<sup>39</sup> Other countries have seen similar increases. Canada had a 22 percent increase in second-home ownership over this same period, and the number of second homes in the United Kingdom more than doubled between 1995 and 2013.<sup>40</sup> In France, second homes now account for almost ten percent of the total housing stock.<sup>41</sup>

Some of the increase in real estate investment over time is simply attributable to the continued globalization of markets, but recent events have made real estate a particularly attractive home for foreign capital. Throughout the Great Recession, a glut of global savings drove up prices and drove down the returns on investments across the board,<sup>42</sup> leading to a “search for yield” that sent investors looking for greater investment returns wherever they could be found.<sup>43</sup> Some of this savings was invested in real estate and drove up land prices.<sup>44</sup> For example, home prices in New York increased by roughly 25 percent from May 2012 to May 2019,<sup>45</sup> and home prices in Seattle increased by about 85 percent over this same period.<sup>46</sup> Although this price increase is good news for existing homeowners, it has generated concerns about housing affordability for new purchasers and renters.

Figure 2 shows Zillow’s median housing price indices for the most populous counties in the four most attractive states for foreign residential real estate investment: Dallas County (Texas), Los Angeles County (California), Maricopa County (Arizona), and Miami–Dade County (Florida). Home prices in all four counties increased steadily until the housing market collapse associated with the Great Recession and have rapidly recovered since then.

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38. See Hilber & Schöni, *supra* note 24, at 1.

39. The total number of housing units in the United States in 2005 was about 125 million. *Housing Inventory Estimate: Total Housing Units for the United States*, FRED ECON. DATA, <https://fred.stlouisfed.org/series/ETOTALUSQ176N> [<https://perma.cc/7Y7B-WBRE>] (last updated Oct. 27, 2020).

40. See Hilber & Schöni, *supra* note 24, at 1.

41. *Id.* (citing a French National Institute of Statistics and Economics Studies estimate that second homes account for 9.3 percent of total housing stock).

42. See Ira Iosebashvili, *Investors Scramble for Yield as Growth Outlook Darkens*, WALL ST. J. (Sept. 30, 2019, 9:00 AM), <https://www.wsj.com/articles/investors-scramble-for-yield-as-growth-outlook-darkens-11569848400> [<https://perma.cc/YGE7-HYEN>].

43. Ben Eisen & Telis Demos, *Banks Warm to Mortgage Bonds that Burned Them in 2008*, WALL ST. J. (Sept. 16, 2019, 5:30 AM), <https://www.wsj.com/articles/banks-warm-to-mortgage-bonds-that-burned-them-in-2008-11568626202> [<https://perma.cc/9X9C-Z3CC>].

44. Laura Kusisto, *Foreign Buyers Pump up U.S. Home Prices*, WALL ST. J. (July 18, 2017, 7:19 PM), <https://www.wsj.com/articles/big-jump-in-foreign-buying-adds-to-home-price-pressures-1500397264> [<https://perma.cc/5TEC-MTUT>].

45. *S&P/Case-Shiller NY-New York Home Price Index*, FRED ECON. DATA, <https://fred.stlouisfed.org/series/NYXRSA> [<https://perma.cc/ZN73-4J7C>] (last updated Dec. 29, 2020).

46. *S&P/Case-Shiller WA-Seattle Home Price Index*, FRED ECON. DATA, <https://fred.stlouisfed.org/series/SEXRNSA> [<https://perma.cc/V9CZ-FC3G>] (last updated Dec. 29, 2020).

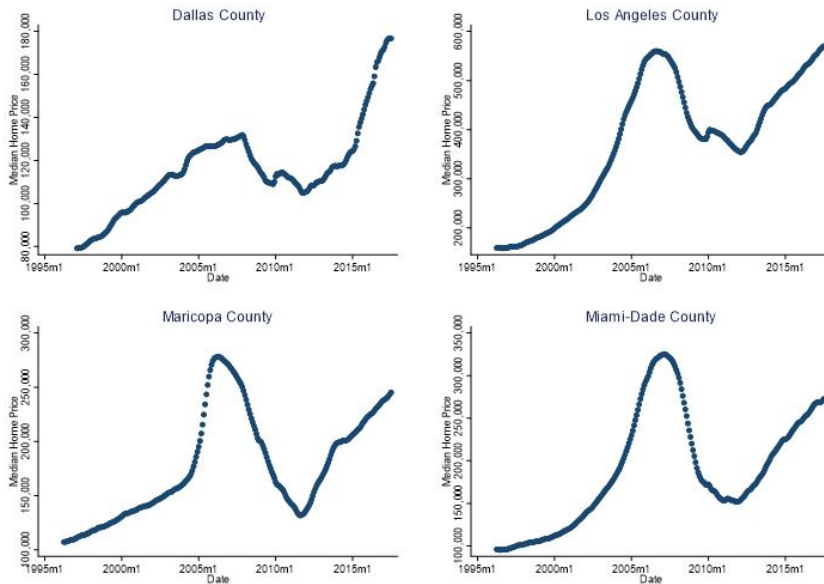
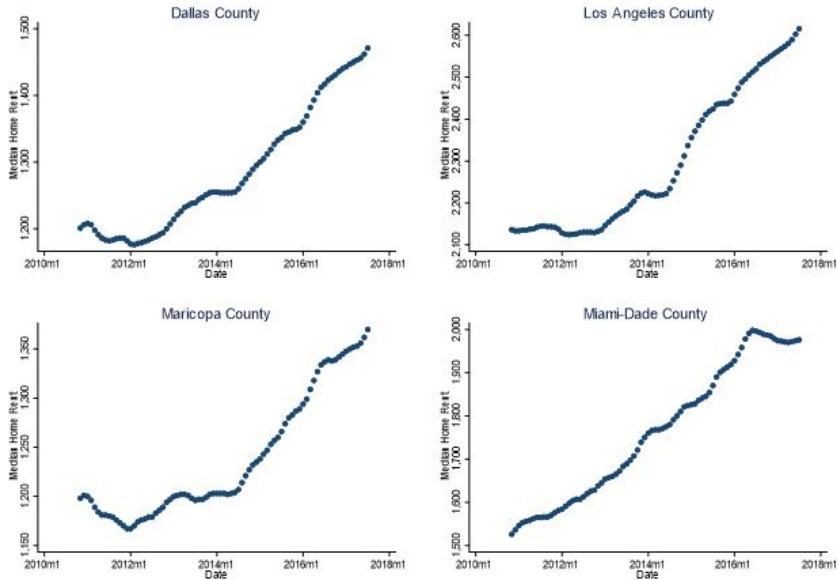
Figure 2. Median Housing Prices by County<sup>47</sup>

Figure 3 shows the Zillow median rent index for the same four counties in the period since April 2011. The data do not cover the Great Recession, but they illustrate steadily rising rental prices with no sign of abatement, except perhaps in Miami-Dade County where rents in the last several months have leveled off.

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47. These figures were generated by the authors from publicly available data provided by Zillow at <https://www.zillow.com/research/data>.

Figure 3. Median Rent by County<sup>48</sup>

Renters and would-be homeowners have responded to this affordability crisis by agitating for laws that reduce housing costs by keeping outside homebuyers out of the market. But real estate protectionism has appeal even when home prices are stable. Real estate is the sixth most protected industry in the OECD, as measured by regulatory restrictiveness.<sup>49</sup> Unlike other industries subject to stringent protectionism such as media,<sup>50</sup> electricity generation and distribution, air, maritime, transportation, and telecommunications, there is not even a *prima facie* national security justification for residential real estate protectionism. What mischief can foreign actors do with their ownership of residential real estate, particularly given regulations on land use? Foreign ownership of real estate can raise national security issues if the real estate is near to sensitive facilities such as military installations, large airports, or ports, but federal law already regulates

48. These figures were generated by the authors from publicly available data provided by Zillow at <https://www.zillow.com/research/data>.

49. *OECD FDI Regulatory Restrictiveness Index*, OECD.STAT, <https://stats.oecd.org/Index.aspx?datasetcode=FDIINDEX> [<https://perma.cc/Y48U-S8YM>].

50. See 47 U.S.C. § 310 (2018) (restricting grants of radio licenses to foreign governments, foreign corporations, or aliens and their representatives). For a discussion of the United States' restrictions on foreign ownership of electronic media, see generally Adeno Addis, *Who's Afraid of Foreigners? The Restrictions on Alien Ownership of Electronic Media*, 22 IMMIGR. & NAT'Y L. REV. 387 (2001).

such ownership.<sup>51</sup> Moreover, real estate does not generate economies of scale, and it is not compatible with “infant industry” arguments, the two most familiar justifications for protectionism.

But the economics of real estate can explain the protectionist instinct. The total supply of real estate is fixed, at least in the short term.<sup>52</sup> Zoning restrictions limit density and building heights. Loosening these regulatory restrictions and engaging in new construction take time. As a result, foreign real estate demand tends to drive up housing prices rather than increase the supply of housing. Moreover, everyone has exposure to the real estate market. Homeowners have a long position in real estate (benefitting when prices go up) that typically makes up a substantial share of their wealth.<sup>53</sup> Renters have a short position in local real estate (benefitting when prices fall), which makes them interested parties as well. By contrast, the effects of protectionism for most other industries are more limited, affecting the interests of a narrower slice of consumers and workers.

Whatever the reason, discriminating against foreign real estate buyers is in fashion. A direct tax on foreign buyers was proposed in the recent mayoral race in Seattle,<sup>54</sup> and urban planners have advocated for such a tax in major media outlets.<sup>55</sup> Such taxes would not be out of step with other countries that have begun to discourage foreign real estate investment, including Australia, New Zealand, Singapore, Switzerland, and the United Kingdom.<sup>56</sup> U.S. cities and states have also begun to adopt measures, such as taxes on second homes and vacant units, that are likely to hit outsiders particularly hard.

For example, New York lawmakers persist in their attempts to implement a “pied-à-terre” tax for New York City.<sup>57</sup> In November 2018, voters in Oakland,

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51. See 50 U.S.C. § 4565(a)(4)(B)(ii); Provisions Pertaining to Certain Transactions by Foreign Persons Involving Real Estate in the United States, 85 Fed. Reg. 12,3158, 12,3166 (Jan. 17, 2020) (to be codified at 31 C.F.R. pt. 802).

52. See N. GREGORY MANKIW, PRINCIPLES OF ECONOMICS 115 (8th ed. 2018) (describing the fixed supply of rental properties in the short run).

53. See *infra* note 264 and accompanying text.

54. Daniel Beekman, Jim Brunner & Mike Rosenberg, *Proposed Seattle Taxes Targeting Foreign Buyers, Investment Properties Take Fire*, SEATTLE TIMES (Aug. 24, 2017, 10:16 AM), <https://www.seattletimes.com/seattle-news/politics/proposed-seattle-taxes-targeting-foreign-buyers-investment-properties-take-fire> [<https://perma.cc/B79W-UYFW>].

55. James Surowiecki, *Real Estate Goes Global*, NEW YORKER (May 19, 2014), <https://www.newyorker.com/magazine/2014/05/26/real-estate-goes-global> [<https://perma.cc/GUL7-7DSL>].

56. Tamsin McMahon, *How Other Countries Have Tried to Deter Foreign Real Estate Investors*, GLOBE & MAIL (July 27, 2016), <https://www.theglobeandmail.com/report-on-business/how-other-countries-have-tried-to-deter-foreign-real-estate-investors/article31128696> [<https://perma.cc/T9XD-X7ZG>].

57. Erin Hudson, *Pied-à-Terre Tax to Make a Return in Albany, Lawmakers Say*, REAL DEAL (Sept. 11, 2019, 6:57 PM), <https://therealdeal.com/2019/09/11/pied-a-terre-tax-to-make-a-return-albany-lawmakers-say> [<https://perma.cc/WKW3-3FZC>].

California, approved a new tax on unoccupied condominiums.<sup>58</sup> Los Angeles is considering adopting a vacancy tax in 2022, encouraged by the apparent success of Vancouver, Canada, in using a vacancy tax to slow rent inflation.<sup>59</sup>

The enthusiasm around local initiatives to restrict or influence foreign ownership and uses of residential property is part of a broader discussion about the relative values of localism and the disintegrating effects of global markets on economic and cultural stability.<sup>60</sup> Members from both the political left and right challenge an earlier consensus about the benefits flowing from the free migration of people, goods, services, and capital across national borders.<sup>61</sup> Some of these challenges derive from non-economic concerns about social policy and cultural anxiety,<sup>62</sup> but other challenges directly contest

58. Larry Buhl, *Can Vacancy Taxes Bring Down Housing Prices?*, AM. PROSPECT (July 24, 2019), <https://prospect.org/economy/can-vacancy-taxes-bring-housing-prices> [https://perma.cc/3zYN-L3ZT].

59. *Id.*

60. See generally DAVID HELD & ANTHONY MCGREW, *GLOBALIZATION/ANTI-GLOBALIZATION: BEYOND THE GREAT DIVIDE* (2d ed. 2007) (discussing trends in globalization and whether globalization is still important in the modern age); *GLOBALIZATION: UNIVERSAL TRENDS, REGIONAL IMPLICATIONS* (Howard J. Wiarda ed., 2007) (including scholarship by various experts in politics with a focus on the topic of globalization and the controversy attached to it); MANFRED B. STEGER, *GLOBALISMS: THE GREAT IDEOLOGICAL STRUGGLE OF THE TWENTY-FIRST CENTURY* (3d ed. 2009) (focusing specifically on “market globalism”); LUI HEBRON & JOHN F. STACK JR., *GLOBALIZATION: DEBUNKING THE MYTHS* (3d ed. 2017) (discussing how perception of globalization varies by factors such as geographic location and culture); Leif van Neuss, *Globalization and Deindustrialization in Advanced Countries*, 45 *STRUCTURAL CHANGE & ECON. DYNAMICS* 49 (2018) (discussing research on deindustrialization and how it is tied to factors that are also connected to globalization); Michael Barrow & Mike Hall, *The Impact of a Large Multinational Organization on a Small Local Economy*, 29 *REG’L STUD.* 635 (1995) (discussing a study done on American Express, a large international company, and its impact on a “small local economy”).

61. Cf. *Withdrawal of the United States from the Trans-Pacific Partnership Negotiations and Agreement: Memorandum for the United States Trade Representative*, 82 *Fed. Reg.* 8497, 8497 (Jan. 23, 2017) (stating factors that resulted in the United States withdrawing from Trans-Pacific Partnership negotiations). Senators Warren and Sanders also opposed the TPP. See Annie Linskey, *Warren Announces Plan to Negotiate Trade Deals More Openly*, WASH. POST (July 29, 2019, 11:00 AM), [https://www.washingtonpost.com/politics/warren-announces-plan-to-negotiate-trade-deals-more-openly/2019/07/29/1b77d564-b19b-11e9-951e-de024209545d\\_story.html](https://www.washingtonpost.com/politics/warren-announces-plan-to-negotiate-trade-deals-more-openly/2019/07/29/1b77d564-b19b-11e9-951e-de024209545d_story.html) [https://perma.cc/2B54-A75N]; Press Release, Elizabeth Warren, Senator Warren Urges Congress to Reject TPP Agreement (Feb. 2, 2016), <https://www.warren.senate.gov/newsroom/press-releases/senator-warren-urges-congress-to-reject-tpp-agreement> [https://perma.cc/47SZ-AqJW]; Arnie Seipel, *Sanders Centers Platform Fight on Trans-Pacific Trade Deal*, NPR (July 3, 2016, 12:50 PM), <https://www.npr.org/2016/07/03/484574128/sanders-centers-platform-fight-on-trans-pacific-trade-deal> [https://perma.cc/779H-SYB3].

62. See Leonard M. Niehoff & Deeva Shah, *The Resilience of Noxious Doctrine: The 2016 Election, the Marketplace of Ideas, and the Obstinance of Bias*, 22 *MICH. J. RACE & L.* 243, 260–65 (2017); Magdalena Saldaña, Lourdes M. Cueva Chacón & Víctor García-Perdomo, *When Gaps Become HUUUGE: Donald Trump and Beliefs About Immigration*, 21 *MASS COMM’N & SOC’Y* 785, 789–91 (2018); Tyler T. Reny, Loren Collingwood & Ali A. Valenzuela, *Vote Switching in the 2016 Election: How Racial and Immigration Attitudes, Not Economics, Explain Shifts in White Voting*, 83 *PUB. OP. Q.* 91, 91, 94, 103–05 (2019).

the purported economic benefits of market liberalism. Open capital markets will tend to increase foreign investment in local real estate and subject locals to the effects of economic and political events in other countries. Some view this as a negative effect of globalization. As we show in Part IV, however, there are good reasons to believe that foreign investment will actually reduce volatility in local real estate markets.

Nevertheless, the current political moment seems to reflect a recalibrating of the trade-off between risk, growth, efficiency, and local control. The promises of globally integrated markets have been found wanting for influential political constituencies, who believe that free markets destabilize the local values and traditional ways of life that they regard as necessary to living a good life and to giving it meaning.<sup>63</sup> As a political matter, the appeal of free markets or the notion that improvements in material living standards will be at the center of policy discussions about the openness of the economy can no longer be taken for granted.

This contemporary resurgence of localism and suspicion of free markets may turn out to have constitutional consequences. The purpose of vesting Congress with plenary authority over interstate and foreign commerce is to prevent economic isolationism by the states and the kind of tit-for-tat trade wars that might otherwise arise.<sup>64</sup> Dormant Commerce Clause jurisprudence extends this authority beyond the areas where Congress has already legislated to prohibit protectionist state legislation even if that legislation might also protect legitimate state interests.<sup>65</sup> At the same time, influential legal scholars

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63. See PATRICK J. DENEEN, *WHY LIBERALISM FAILED* 7–8 (2018); Maurice Obstfeld, *The Global Capital Market: Benefactor or Menace?*, 12 J. ECON. PERSPS. 9, 19–21 (1998); Nikil Saval, *Globalisation: The Rise and Fall of an Idea that Swept the World*, GUARDIAN (July 14, 2017, 12:28 AM), <https://www.theguardian.com/world/2017/jul/14/globalisation-the-rise-and-fall-of-an-idea-that-swept-the-world> [<https://perma.cc/Q5W4-AH84>]; Pranab Bardhan, *Does Globalization Help or Hurt the World's Poor?: Overview/Globalization and Poverty*, SCI. AM. (Mar. 26, 2006), <https://www.scientificamerican.com/article/does-globalization-help-o-2006-04> [<https://perma.cc/U4XU-JW2A>]; David Brooks, *The Remoralization of the Market*, N.Y. TIMES (Jan. 10, 2019), <https://www.nytimes.com/2019/01/10/opinion/market-morality.html> [<https://perma.cc/RD59-JW8Q>]; David Brooks, *A New Center Being Born*, N.Y. TIMES (Dec. 20, 2018), <https://www.nytimes.com/2018/12/20/opinion/centrism-moderate-capitalism-welfare.html> [<https://perma.cc/FQ7U-FG7U>] (examining debates on the role of globalization in society).

64. See, e.g., 1 JOSEPH STORY, COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES § 259 (1833).

65. Earl M. Maltz, *How Much Regulation is Too Much—An Examination of Commerce Clause Jurisprudence*, 50 GEO. WASH. L. REV. 47, 49–58 (1981); Donald H. Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 MICH. L. REV. 1091, 1094 (1986). Justices Thomas and Gorsuch reject the theory of the dormant Commerce Clause. See, e.g., *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 610 (1997) (Thomas, J., dissenting) (“The negative Commerce Clause has no basis in the text of the Constitution, makes little sense, and has proved virtually unworkable in application.”); *Direct Mktg. Ass’n v. Brohl*, 814 F.3d 1129, 1148–49 (10th Cir. 2016) (Gorsuch, J., concurring) (discussing the dormant Commerce Clause, now-Justice Gorsuch follows Supreme Court precedent but refers to the dormant Commerce Clause as “artificial” and “formalistic”).

and judges contest the reach of the dormant Commerce Clause, or even regard it as illegitimate.<sup>66</sup> Congress' right to regulate interstate commerce has always been in tension with the states' powers to regulate intrastate activities that happen also to affect interstate commerce. The balance struck between these two sets of interests is an uneasy one, and, with localism ascendant, a court considering the issue of restrictions on foreign real estate ownership may come to a different conclusion now than might be anticipated based on earlier case law.

In this Article, we focus on taxes that inhibit investment by outsiders in local residential real estate. These are "protectionist property taxes." There are economic, political, and cultural pressures that make such taxes attractive. Some of these pressures likely reflect the high-water mark of a backlash against the neoliberal consensus that has been building for years.<sup>67</sup> And yet, focusing exclusively on this trend would neglect the deep wellsprings from which these ideas draw. The United States has a long history of limiting land ownership by foreigners, and it is not alone. In the remainder of this Part we describe some of this history, both to provide context for current anti-foreign sentiment and also to preview some of the legal issues that may arise should a city adopt a protectionist property tax.

### B. OWNERSHIP AND TRANSFER RESTRICTIONS

Direct restrictions on foreign ownership of U.S. real estate—particularly foreign ownership of U.S. agricultural land—have deep roots. Six states still limit foreign ownership of agricultural land, Missouri is considering a complete ban,<sup>68</sup> and Senator Elizabeth Warren has indicated support for a

66. See, e.g., Martin H. Redish & Shane V. Nugent, *The Dormant Commerce Clause and the Constitutional Balance of Federalism*, 1987 DUKE L.J. 569, 599; Julian N. Eule, *Laying the Dormant Commerce Clause to Rest*, 91 YALE L.J. 425, 435–37 (1982); Paul E. McGreal, *The Flawed Economics of the Dormant Commerce Clause*, 39 WM. & MARY L. REV. 1191, 1193–95 (1998).

67. See generally DAVID HARVEY, *A BRIEF HISTORY OF NEOLIBERALISM* (2005) (exploring backlash against neoliberal consensus); NAOMI KLEIN, *THE SHOCK DOCTRINE: THE RISE OF DISASTER CAPITALISM* (2007) (same).

68. These states are Hawaii, Iowa, Minnesota, Mississippi, North Dakota and Oklahoma. See HAW. REV. STAT. § 171-68 (2011) (requiring a person to be a resident of the state for three years before being eligible to purchase public land for farming); IOWA CODE § 9I.3 (2013) ("[A] nonresident alien . . . shall not purchase or otherwise acquire agricultural land in this state."); MINN. STAT. § 500.221 (2018) ("Except as hereinafter provided, no natural person shall acquire directly or indirectly any interest in agricultural land unless the person is a citizen of the United States or a permanent resident alien of the United States."); MISS. CODE ANN. § 89-1-23 (2019) ("Except as otherwise provided in this section, nonresident aliens shall not hereafter acquire or hold land . . ."); N.D. CENT. CODE ANN. § 47-10.1-02 (West 2014) (stating "[a]n individual who is not a citizen of the United States, a citizen of Canada, or a permanent resident alien of the United States may not acquire directly or indirectly any interest in agricultural land," with certain exceptions); OKLA. CONST. art. XXII, § 1 ("No alien or person who is not a citizen of the United States, shall acquire title to or own land in this state, and the Legislature shall enact laws whereby all persons not citizens of the United States, and their heirs, who may hereafter acquire real estate in this state by devise, descent, or otherwise, shall dispose of the same within five years . . ."); see

federal limit.<sup>69</sup> Restrictions on foreign real estate ownership have a long and sometimes dishonorable pedigree. The taint of xenophobia and racism attaches to much of this history, just as it does to the history of anti-immigrant and anti-trade restrictions generally.<sup>70</sup>

Restrictions on alien land ownership date to the colonial era.<sup>71</sup> In the years before and after American independence, the common law prohibited aliens from owning real property.<sup>72</sup> During the early decades of the nineteenth century, many states overruled this common-law prohibition by statute or in the state constitution, in part to attract new settlers to the west.<sup>73</sup> Yet, at the same time that states were liberalizing their laws on foreign real

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also H.B. 652, 773 & 948, 100th Gen. Assemb., 1st Reg. Sess. (Mo. 2019) (referring a number of bills regarding the foreign ownership of agriculture land to committee; there has been no further action).

69. Jonathan Hettinger, *Efforts to Restrict Foreign Ownership of US Farmland Grow*, AP NEWS (June 9, 2019), <https://www.apnews.com/e541895e692545ee80dofc609cf40011> [<https://perma.cc/H5AV-EHZD>]. Real estate is already singled out for special treatment under federal law. For example, foreigners acquiring at least a ten percent interest in U.S. agricultural land must disclose that ownership with the U.S. Department of Agriculture. Foreign owners of U.S. real property are taxed less favorably than foreign owners of other forms of U.S. property. Foreign persons who own a “United States real property interest” (which generally includes both U.S. real property and equity interests in a corporation that primarily holds U.S. real property) are taxed on gains from the disposition of that property at the regular rates applicable to U.S. taxpayers. I.R.C. § 897 (2018). Moreover, 15 percent of the sales price from the disposition of a U.S. real property interest must generally be withheld by the purchaser and remitted to the U.S. Treasury. I.R.C. § 1445. By contrast, gains from the sale of personal property by foreign persons are generally not taxed by the United States, unless those gains are effectively connected to a U.S. trade or business. See I.R.C. § 864(c).

70. See generally DANA FRANK, *BUY AMERICAN: THE UNTOLD STORY OF ECONOMIC NATIONALISM* (1999) (documenting the history of economic nationalism in the United States).

71. See Polly J. Price, *Alien Land Restrictions in the American Common Law: Exploring the Relative Autonomy Paradigm*, 43 AM. J. LEGAL HIST. 152, 157–59 (1999); Allison Brownell Tirres, *Property Outliers: Non-Citizens, Property Rights and State Power*, 27 GEO. IMMIGR. L.J. 77, 98 n.117 (2012). The details of these state-level restrictions vary widely across the country and have been subject to significant revision over time. Tirres, *supra*, at 97 (“A survey of modern alien land laws reveals striking differences that defy easy categorization. Almost no two laws are alike.” (footnote omitted)). Several academics have attempted to categorize these laws. See, e.g., James R. Mason, Jr., “PSSST, Hey Buddy, Wanna Buy a Country?” *An Economic and Political Policy Analysis of Federal and State Laws Governing Foreign Ownership of United States Real Estate*, 27 VAND. J. TRANSNAT’L L. 453, 456, 459–62 (1994); Fred L. Morrison, *Limitations on Alien Investment in American Real Estate*, 60 MINN. L. REV. 621, 631 (1976); Mark Shapiro, *The Dormant Commerce Clause: A Limit on Alien Land Laws*, 20 BROOK. J. INT’L L. 217, 223 (1993). Minnesota’s alien land laws have changed 35 times in the 161 years since she gained statehood. See SAM RANKIN, MINN. HOUSE OF REPRESENTATIVES RSCH. DEP’T, *ALIEN FARMERS IN MINNESOTA: 1851-2004*, at 1 (2004).

72. Charles H. Sullivan, *Alien Land Laws: A Re-evaluation*, 36 TEMP. L.Q. 15, 16 (1962); Ronald L. Bell & Jonathan D. Savage, *Our Land Is Your Land: Ineffective State Restriction of Alien Land Ownership and the Need for Federal Legislation*, 13 J. MARSHALL L. REV. 679, 684 (1980).

73. Sullivan, *supra* note 72, at 29.



estate ownership, the federal government was imposing restrictions of its own. For example, only U.S. citizens could claim land under the Homestead Acts.<sup>74</sup>

Western states changed their posture in the latter part of the nineteenth century and early part of the twentieth century by enacting a series of bans on alien land ownership. Federal action complemented the state bans: The Territorial Land Act of 1887 banned alien ownership of land in the territories.<sup>75</sup> This retreat to greater protectionism had racist anti-Asian underpinnings,<sup>76</sup> and also reflected concerns about a new colonialism from wealthy Europeans buying U.S. real estate.<sup>77</sup> By 1950, many of these laws had either been rendered invalid by the Supreme Court on account of their racial aspects<sup>78</sup> or undermined by changes made by the Immigration and Nationality Act of 1952,<sup>79</sup> which eliminated the referents in the discriminatory state laws.<sup>80</sup>

The next stage in the evolution of alien land ownership restrictions occurred in the 1970s in the Midwest,<sup>81</sup> where states adopted statutory limits

74. Homestead Act of 1862, Pub. L. No. 37-64, 12 Stat. 392, 392 (1862) (repealed 1976) (“[A] citizen of the United States, or who shall have filed his declaration of intention to become such, as required by the naturalization laws of the United States . . .”).

75. 48 U.S.C. § 1501 (2018).

76. The so-called “Yellow Peril” was a perceived threat to Western Civilization by the spread of Eastern Asian culture or migration of East Asian peoples. It was a popular sentiment among many Americans, particularly on the Pacific Coast, in the late nineteenth century through World War II. It led to many laws designed to ban property ownership by Chinese and Japanese immigrants and their descendants. *See, e.g.*, OR. CONST. art. XV, § 8 (1857) (“No Chinaman . . . shall ever hold any real estate . . .”) (repealed 1946), <https://sos.oregon.gov/archives/exhibits/constitution/Documents/transcribed-1857-oregon-constitution.pdf> [<https://perma.cc/CT3X-SRN7>]. Such laws are unconstitutional and became ineffective around 1950. *See discussion infra* notes 78–79. *See generally* Dudley O. McGovney, *The Anti-Japanese Land Laws of California and Ten Other States*, 35 CALIF. L. REV. 7 (1947) (exploring how the laws of nine U.S. states “put[] every alien in the world either completely or substantially on an equality with a citizen with respect to acquiring and holding real property within their borders, except aliens who are *racially* ineligible to naturalization under the laws of the United States”).

77. This sentiment was particularly strong in the Midwest. *See* Tirres, *supra* note 71, at 94–96; Bell & Savage, *supra* note 72, at 686 n.37.

78. Shapiro, *supra* note 71, at 221 (observing that the Supreme Court has never struck down alien land laws as facially unconstitutional, but indicated they are suspect to equal protection challenge in dicta in two cases); *see* *Oyama v. California*, 332 U.S. 633, 647–50 (1948) (Black, J., concurring) (going further than the narrow majority opinion which held that the application of the California Alien Land Laws of 1913 & 1920 to an American citizen born of a Japanese immigrant violated equal protection); *id.* at 650 (Murphy, J., concurring); *Takahashi v. Fish & Game Comm’n*, 334 U.S. 410, 425 (1948) (Murphy, J., concurring); *see also* Bell & Savage, *supra* note 72, at 701–02 (discussing the holdings of *Oyama* and *Takahashi*).

79. *See* Immigration and Nationality Act of 1952, 82 Pub. L. No. 414-477, § 212, 66 Stat. 163, 182–88 (1952) (eliminating Asians as a class of “aliens ineligible” for admission under the U.S. Immigration Code).

80. *See* Bell & Savage, *supra* note 72, at 688; Shapiro, *supra* note 71, at 222; Sullivan, *supra* note 72, at 15.

81. *See* David Cole, *Are Foreign Nationals Entitled to the Same Constitutional Rights as Citizens?*, 25 T. JEFFERSON L. REV. 367, 369 n.8 (2003) (citing cases where the Supreme Court has upheld

on the amount of land that aliens could acquire. Purporting to be motivated by concerns about national security and protecting the food chain, these laws focused on agricultural land and sometimes exempted lands in cities or towns.<sup>82</sup> These state restrictions were roughly contemporaneous with the federal Agricultural Foreign Investment Disclosure Act of 1978<sup>83</sup> and Foreign Investment in Real Property Tax Act of 1980,<sup>84</sup> federal laws motivated by concerns about land prices<sup>85</sup> and perceived inequities in the tax treatment of foreign real estate investors.<sup>86</sup> There is no single reason for the proliferation of ownership restrictions in the 1970s. Principled justifications sounding in national security and tax policy coexisted with less savory motives, such as xenophobia and wanting to insulate local interests from foreign competition.<sup>87</sup>

The recent wave of foreign laws targeting outside ownership is something new, largely because of its focus on urban real estate and concerns about affordable housing. For example, in 2018, New Zealand passed legislation prohibiting nonresidents from buying homes.<sup>88</sup> At the time of enactment, the associate finance minister David Parker said that it was the “birthright” of New

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laws preventing foreign nationals from owning land). *See generally* Leslie J. Levinson, Note, *Foreign Investment in United States Real Estate: Federal and State Regulation*, 12 CASE W. RES. J. INT'L L. 231 (1980) (discussing federal and state laws which attempt to place control on aliens' acquisition of domestic real estate).

82. *See* Levinson, *supra* note 81, at 241–42 (describing states that have a non-agricultural use exemption in their statutes); *cf.* Grant Wilson, Note, *Reforming Alien Agricultural Landownership Restrictions in Corporate Farming Law States: A Constitutional and Policy View from Iowa*, 17 DRAKE J. AGRIC. L. 709, 721–24 (2012) (discussing the history of alien landownership restrictions in the 1970s).

83. Agricultural Foreign Investment Disclosure Act of 1978, Pub. L. No. 95-460, § 2, 92 Stat. 1263, 1263–65 (1978).

84. Foreign Investment in Real Property Tax Act of 1980, Pub. L. No. 96-499, §§ 1121–1125, 94 Stat. 2599, 2682–91 (1980).

85. *See* Willard B. Taylor, *Suppose FIRPTA Was Repealed*, 14 FLA. TAX REV. 1, 10 (2013); *Tax Sought on Foreign Farm Deals*, N.Y. TIMES (Aug. 20, 1979), <https://www.nytimes.com/1979/08/20/archives/tax-sought-on-foreign-farm-deals-a-matter-of-equity.html> [<https://perma.cc/2CQE-BZDY>]; Michael Goodwin, *Everybody's Getting in On Foreign Investor Action*, N.Y. TIMES (July 2, 1978), <https://www.nytimes.com/1978/07/02/archives/everybodys-getting-in-on-foreign-investor-action-everybody-is.html> [<https://perma.cc/2KX5-Y8RM>]; Robert Lindsey, *Foreign Investors Rush to Acquire U.S. Property as Haven for Funds*, N.Y. TIMES (May 14, 1978), <https://www.nytimes.com/1978/05/14/archives/foreign-investors-rush-to-acquire-us-property-as-haven-for-funds.html> [<https://perma.cc/SK9M-X6ZH>].

86. David J. Herzig, *Elective Taxation on Inbound Real Estate Investment*, 2016 U. ILL. L. REV. 1025, 1028; *see also* Richard L. Kaplan, *Creeping Xenophobia and the Taxation of Foreign-Owned Real Estate*, 71 GEO. L.J. 1091, 1123 (1983) (describing the effect that foreign investors have on real estate in the United States).

87. *See generally* Kaplan, *supra* note 86 (analyzing the justifications for FIRPTA and its application to foreign investors); Herzig, *supra* note 86 (examining FIRPTA's history and influence on foreign real estate investment).

88. Overseas Investment Amendment Act 2018 (N.Z.); *New Zealand Bans Most Foreigners from Buying Homes*, CNBC (Aug. 16, 2018, 10:42 AM), <https://www.cnbc.com/2018/08/16/new-zealand-bans-most-foreigners-from-buying-homes.html> [<https://perma.cc/3AVS-V5HE>].

Zealanders to purchase homes.<sup>89</sup> Two months after New Zealand enacted its legislation, the British government announced plans to increase its stamp duty (transfer tax) on foreign buyers of real estate.<sup>90</sup> Prime Minister Teresa May said, “[i]t cannot be right that it is as easy for individuals who don’t live in the UK, as well as foreign-based companies, to buy homes as hard-working British residents.”<sup>91</sup>

In 2012, Hong Kong increased its stamp duty on foreign buyers to 15 percent and restricted where nonresidents could buy homes.<sup>92</sup> In 2016, Vancouver imposed a 20 percent tax on foreign buyers.<sup>93</sup> In 2017, Toronto followed Vancouver’s lead and adopted a 15 percent tax on foreign buyers.<sup>94</sup> These cities have also adopted measures that target proxies (such as housing vacancy) for foreign ownership. Canada’s Prime Minister Justin Trudeau has proposed a national vacancy tax of one percent of the assessed value of the property that would apply only to “non-resident, non-Canadians.”<sup>95</sup> Of course, foreign ownership would have little effect on housing affordability if foreign buyers rented their properties to residents, but many owners leave their properties vacant. The British press has reported that 279,000 privately owned homes in England are left empty.<sup>96</sup> Taxing foreign owners may reduce

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89. Antonia Noori Farzan, *Faced with an Affordability Crisis, New Zealand Bans Foreigners from Buying Homes*, WASH. POST (Aug. 16, 2018, 6:09 AM), <https://www.washingtonpost.com/news/morning-mix/wp/2018/08/16/faced-with-an-affordability-crisis-new-zealand-bans-foreigners-from-buying-homes> [https://perma.cc/WX76-R8GL].

90. Michael Savage, *May Acts to Tackle Housing Crisis by Imposing Levy on Foreign Buyers*, GUARDIAN (Sept. 29, 2018, 5:30 PM), <https://www.theguardian.com/politics/2018/sep/29/theresa-may-slaps-new-property-tax-on-foreign-buyers> [https://perma.cc/QJ7V-P6YK].

91. David Reid, *Tax on Foreign Buyers Sends UK Real Estate Stocks Tumbling*, CNBC (Oct. 1, 2018, 6:41 AM), <https://www.cnbc.com/2018/10/01/foreign-house-buyer-tax-sends-uk-real-estate-stocks-tumbling.html> [https://perma.cc/8S46-QQLG].

92. Stamp Duty (Amendment) (No. 2) Ordinance, No. 14, (2014) 117 O.H.K., § 29; Tony Cheung, *Higher Stamp Duties Approved by Legco 16 Months After Being Imposed*, S. CHINA MORNING POST (Feb. 23, 2014, 2:40 PM), <https://www.scmp.com/news/hong-kong/article/1433559/higher-stamp-duties-approved-legco-16-months-after-being-imposed> [https://perma.cc/QT8G-B54A].

93. Jon Talton, *Vancouver, B.C., Tries Again to Thwart Foreign Real-Estate Speculators*, SEATTLE TIMES (June 12, 2018, 9:50 AM), <https://www.seattletimes.com/business/real-estate/vancouver-b-c-tries-again-to-thwart-foreign-real-estate-speculators> [https://perma.cc/DC5U-7UKX].

94. Mike Crawley, *New Stats Show Fewer Foreign Residents Buying GTA Homes*, CBC NEWS (May 15, 2019, 4:00 AM), <https://www.cbc.ca/news/canada/toronto/ontario-foreign-buyers-tax-real-estate-1.5135338> [https://perma.cc/WT6M-8UHJ].

95. Geoff Zochodne, *Foreign Buyer Vacancy Tax Unlikely to Derail Housing Rebound, Real Estate Market Watchers Say*, FIN. POST (Sept. 13, 2019), <https://business.financialpost.com/news/economy/foreign-buyer-vacancy-tax-unlikely-to-derail-housing-rebound-real-estate-market-watchers-say> [https://perma.cc/PC99-3GH4].

96. Reid, *supra* note 91.

the number of properties left vacant if foreign owners are less likely to lease their properties.<sup>97</sup>

In the summer of 2017, Seattle city leaders discussed taxing both foreign buyers and vacant homes, but the proposals stalled. The City Attorney's Office judged the taxes to be illegal,<sup>98</sup> and also expressed concern that the taxes would engender anti-Asian animus and were uncomfortably similar to xenophobic nineteenth-century restrictions on land ownership by Asian immigrants.<sup>99</sup> The local property assessor also denied a request by a Seattle city council member to look through shell companies to their beneficial owners, asserting that he "would not support any policy response that could lead to racial bias or anything that smacks of the Chinese Exclusion laws from two centuries ago."<sup>100</sup>

Even real estate taxes that do not facially discriminate against foreigners may discourage them from investing in local real estate. Consider real estate transfer taxes, which are calculated as a fixed percentage of a property's value. Unless the transfer tax is adjusted for the duration of ownership, the tax will deter investors who want the flexibility to sell the property after a short period of ownership.<sup>101</sup> The present value of a tax paid after five years of ownership is much greater than the same tax paid after 30 years of ownership. If foreign investors are more likely to have shorter investment horizons than other home purchasers, a transfer tax will be especially burdensome to them.

### C. SECOND HOME AND VACANCY TAXES

Although most taxes on second homes and vacant properties do not facially discriminate against outsiders,<sup>102</sup> they are likely to have a disparate

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97. Britain already has a tax on second homes. HM Revenue & Customs, *Higher Rates of Stamp Duty Land Tax*, GOV.UK, <https://www.gov.uk/guidance/stamp-duty-land-tax-buying-an-additional-residential-property> (last updated Aug. 27, 2020).

98. Beekman et al., *supra* note 54.

99. *Id.*

100. *Id.*

101. Lock-in is an especially big problem for buyers and sellers who are liquidity constrained, and even many middle-income households are liquidity constrained. Andrew T. Hayashi, *The Quiet Costs of Taxation: Cash Taxes and Noncash Bases*, 71 TAX L. REV. 781, 783–86 (2018); Greg Kaplan, Giovanni L. Violante & Justin Weidner, *The Wealthy Hand-to-Mouth*, 2014 BROOKINGS PAPERS ON ECON. ACTIVITY 77, 131–32. There is also evidence that transfer taxes reduce property values. See, e.g., Ben Dachis, Gilles Duranton & Matthew A. Turner, *The Effects of Land Transfer Taxes on Real Estate Markets: Evidence from a Natural Experiment in Toronto*, 12 J. ECON. GEOGRAPHY 327, 347–52 (2012). See generally Wojciech Kopczuk & David Munroe, *Mansion Tax: The Effect of Transfer Taxes on the Residential Real Estate Market*, 7 AM. ECON. J.: ECON. POL'Y 214 (2015) (presenting research about the effects of housing transaction taxes in New York and New Jersey on the real estate market).

102. The Prime Minister of Canada has proposed a vacancy tax that would explicitly discriminate against foreigners. Zochodne, *supra* note 95.

impact on them.<sup>103</sup> Some people do purchase second homes in the city of their residence, but this man-bites-dog practice is sufficiently rare to warrant human-interest newspaper stories.<sup>104</sup> The overwhelming majority of second-home buyers reside overseas or at least in other parts of the state or country. Outside owners are more likely to leave their properties vacant than local owners, either because they use the property as a vacation home and do not want to take tenants, or because the costs of monitoring the management of the property from a distance make it less attractive to rent the property. Foreign owners may also prefer not to rent their properties because doing so increases the risk that they would be subject to U.S. federal income tax filing requirements or other disclosure rules.<sup>105</sup> Some advocates of second home and vacancy taxes are clearly motivated by a desire to restrict foreign ownership. For example, the state senator who sponsored New York's failed tax on second homes said that "I like to call it an oligarch tax because there are foreign owners currently purchasing property in New York City—tens of millions of dollars—not contributing to city services."<sup>106</sup>

In 2012, Switzerland effectively prohibited the construction of second homes in certain regions.<sup>107</sup> In 2014, France enacted a law that allowed municipalities to introduce a property tax of up to 20 percent on second homes,<sup>108</sup> and in 2017 Paris exercised the authority granted to it under this law to triple the surcharge to 60 percent.<sup>109</sup> In 2016, the United Kingdom adopted a three percent transfer tax on second-home purchases,<sup>110</sup> and some tourist destinations within the U.K. adopted complete bans on second homes.<sup>111</sup> The concerns motivating these restrictions on second homes are

103. Moreover, virtually every state provides for a partial tax exemption or tax credit for owner-occupants. *Residential Property Tax Relief Programs*, LINCOLN INST. LAND POL'Y, <https://www.lincolninst.edu/research-data/data-toolkits/significant-features-property-tax/access-property-tax-database/residential-property-tax-relief-programs> [<https://perma.cc/4U7N-gY6M>].

104. See Candace Taylor, *The Ultimate Staycation? A Second Home in the Same City*, WALL ST. J. (June 2, 2016, 9:57 AM), <https://www.wsj.com/articles/the-ultimate-staycation-a-second-home-in-the-same-city-1464875847> [<https://perma.cc/XP9B-FFVC>].

105. Non-resident aliens must file an income tax return if they operate a trade or business in the United States. Whether the nonresident's rental activities rise to the level of being a trade or business is a facts and circumstances determination. See I.R.C. § 864 (2018).

106. Brittany De Lea, *New York 'Oligarch Tax' Aimed at Wealthy Buyer's Second Homes*, FOX BUS. (Feb. 26, 2019), <https://www.foxbusiness.com/economy/new-york-oligarch-tax-aimed-at-wealthy-buyers-second-homes> [<https://perma.cc/KSU2-YHNG>].

107. See Hilber & Schöni, *supra* note 24, at 1.

108. *Id.* at 2.

109. Feargus O'Sullivan, *Paris Is Tripling Its Tax on Second Homes*, BLOOMBERG: CITYLAB (Jan. 26, 2017, 10:47 AM), <https://www.citylab.com/equity/2017/01/paris-france-property-taxes-vacation-homes/514496> [<https://perma.cc/PB6N-VHKW>].

110. Finance Act 2016, c. 24, § 128, sch. 4ZA (UK), <https://www.legislation.gov.uk/ukpga/2016/24/section/128> [<https://perma.cc/J7D5-PPZX>].

111. See Hilber & Schöni, *supra* note 24, at 6–7; Elliott Kime, *Has St. Ives' Second Home Ban Backfired?*, FIN. TIMES (Sept. 13, 2019, 10:00 AM), <https://www.ft.com/content/6abb85e8-c349-11e9-ac6e-a26d1d0455f4> [<https://perma.cc/PFH4-GSMM>].

the same as those driving taxes on foreign ownership: a desire to preserve affordable housing by insulating the local housing market from demand by outsiders.<sup>112</sup> Second-home taxes are also protectionist property taxes.

Vacancy has historically been a concern in economically depressed areas, where it is associated with poor property maintenance,<sup>113</sup> declining property values,<sup>114</sup> crime,<sup>115</sup> and blight. More recently, vacant property taxes and regulations have been considered in places with booming real estate markets, such as Oakland, San Francisco and Los Angeles.<sup>116</sup> In these places, vacancy taxes are an inducement to rent the properties to locals, but for buyers—perhaps disproportionately outsiders—who don’t want to rent, the taxes may discourage them from buying at all. For this reason, vacancy taxes are protectionist property taxes too.

### III. THE LEGALITY OF PROTECTIONIST PROPERTY TAXES

In this Part, we discuss the legality of local protectionist property taxes that treat outsiders worse than they treat local property owners.<sup>117</sup> As a threshold matter, any local tax must be within the scope of the local government’s authority and not violate state constitutional limitations. Cities

112. Aamna Mohdin, *To Solve the World’s Affordable Housing Crisis, Should Second Homes Be Banned?*, QUARTZ (May 24, 2016), <https://qz.com/690180/to-solve-the-worlds-affordable-housing-crisis-should-second-homes-be-banned> [<https://perma.cc/S9QP-S7RM>].

113. Lauren Lambie-Hanson, *When Does Delinquency Result in Neglect? Mortgage Distress and Property Maintenance*, 90 J. URB. ECON. 1, 11 (2015).

114. There is evidence that foreclosures have spillover effects on nearby property values. *See, e.g.*, Dan Immergluck & Geoff Smith, *The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values*, 17 HOUS. POL’Y DEBATE 57, 70, 73 (2006); Jenny Schuetz, Vicki Been & Ingrid Gould Ellen, *Neighborhood Effects of Concentrated Mortgage Foreclosures*, 17 J. HOUS. ECON. 306, 307–08 (2008).

115. *See, e.g.*, Lin Cui & Randall Walsh, *Foreclosure, Vacancy and Crime*, 87 J. URB. ECON. 72, 79–81 (2015) (finding in analysis of data from Pittsburgh, Pennsylvania that vacancies after foreclosure increased crime in those neighborhoods); Ingrid Gould Ellen, Johanna Lacoe & Claudia Ayanna Sharygin, *Do Foreclosures Cause Crime?*, 74 J. URB. ECON. 59, 65 (2013) (finding in New York City data, a correlation between foreclosures and more crime, especially violent crime, noting weaker correlation to property crime since “foreclosed properties . . . sit[ting] vacant . . . may be less attractive targets for theft”); William Spelman, *Abandoned Buildings: Magnets for Crime?*, 21 J. CRIM. JUST. 481, 488–89 (1993) (finding indications of crimes including drug use and prostitution in 83 percent of unsecured abandoned buildings in an Austin, Texas neighborhood). *But see* David S. Kirk & Derek S. Hyra, *Home Foreclosures and Community Crime: Causal or Spurious Association?*, 93 SOC. SCI. Q. 648, 663–65 (2012) (finding evidence which calls into question the link between foreclosures and crime rates).

116. *See supra* text accompanying notes 58–59.

117. Scholars have argued that Congress has power under the Commerce Clause, foreign affairs and treaty power to regulate the ownership by aliens of real property in the United States, and that these powers could pre-empt conflicting state laws. Bell & Savage, *supra* note 72, at 708; Sullivan, *supra* note 72, at 44; *see* Anthony J. Colangelo, *The Foreign Commerce Clause*, 96 VA. L. REV. 949, 962 (2010). The Court has ruled that Congress may regulate land ownership by aliens. Bell & Savage, *supra* note 72, at 706; *see also* N. Am. Co. v. SEC, 327 U.S. 686, 707–08 (1946) (holding the SEC had power to regulate a foreign company’s American landholdings).

are creatures of the states.<sup>118</sup> Most states apply Dillon's Rule,<sup>119</sup> meaning local governments enjoy only those powers expressly granted to them by state statute, home-rule charter, or the state constitution, as well as any powers implied by those powers or necessary for the exercise of those powers. In home-rule states, Dillon's Rule applies only to matters of statewide concern, and local governments enjoy plenary power over purely local matters. Many state constitutions have equal protection and "uniformity" clauses that limit localities' freedom to set property tax rates.<sup>120</sup> For example, the Washington Supreme Court has held that all real estate in a jurisdiction must be taxed at the same rate, unless that property is specifically exempt.<sup>121</sup> This uniformity requirement would bar a protectionist property tax, and so Seattle would need a change in state law to allow it to tax foreign owners.

Even if a municipality can pass a protectionist property tax under state law, there are federal constitutional questions to contend with. As we explain below, vacant and second-home taxes would likely survive constitutional scrutiny because they merely have a disparate impact on outsiders. However, taxes that explicitly target outsiders are likely unconstitutional, and this is almost certainly true if they target residents of other states. As a practical matter, municipalities may (at least for a time) be able to treat outsiders unfavorably because federal courts' jurisdiction to enjoin local taxes is limited, and state courts have been more tolerant of discriminatory local taxes. However, postponing a reckoning imposes risks for cities that adopt protectionist property taxes, and an eventual loss may result in enormous damages.<sup>122</sup>

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118. See, e.g., *City of Trenton v. New Jersey*, 262 U.S. 182, 187 (1923) ("In the absence of state constitutional provisions safeguarding it to them, municipalities have no inherent right of self-government which is beyond the legislative control of the state. A municipality is merely a department of the state, and the state may withhold, grant or withdraw powers and privileges as it sees fit. However great or small its sphere of action, it remains the creature of the state exercising and holding powers and privileges subject to the sovereign will." (footnote omitted)); see also OSBORNE M. REYNOLDS, JR., *LOCAL GOVERNMENT LAW* 150–51 (5th ed. 2019) ("All cities—whether or not having home-rule—do have one thing in common: They are creatures of the law established for special purposes, and their powers must be granted by law: in the case of home-rule governments, by the home-rule charter or by state statutes and constitutional provisions; in the case of non-home-rule entities, by state statutes or constitutional provisions alone." (emphasis added)).

119. See REYNOLDS, *supra* note 118, at 151–52.

120. See, e.g., *Culliton v. Chase*, 25 P.2d 81, 91 (Wash. 1933) (overturning the state income tax law for violating constitutional requirement for uniform taxes).

121. *Id.*

122. See *infra* text accompanying note 199. It is left to state courts to determine appropriate retrospective relief in the case of state taxes that have been determined unconstitutional, so long as such relief is consistent with due process under the Fourteenth Amendment. *Harper v. Va. Dep't of Tax'n*, 509 U.S. 86, 100–02 (1993). If that relief is a refund of taxes paid over a period of years, the amount could be very large.

A. *FACIALLY PROTECTIONIST PROPERTY TAXES*

Consider a local property tax of one percent of the property's value, payable only if the owner is a nonresident. There are several potential federal constitutional challenges to such a tax. The tax may violate the Privileges and Immunities Clause of Article IV, Section 2; it may be struck down under the Commerce Clause of Article 1, Section 8; or it may run afoul of the federal guarantee of equal protection under the Fourteenth Amendment.

1. The Comity Clause

The Privileges and Immunities Clause of Article IV (the "Comity Clause") requires that "[t]he Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States."<sup>123</sup> The Supreme Court has interpreted the term "citizens" to include non-citizen residents, so the Comity Clause protects all residents of the United States.<sup>124</sup>

The first question is whether the entitlement to be free of discriminatory real estate taxation is among the privileges and immunities covered by the Comity Clause. In *Corfield v. Coryell*, the first case interpreting the Comity Clause, Justice Washington wrote that the privileges include the right "to take, hold and dispose of property, either real or personal; and an exemption from higher taxes or impositions than are paid by the other citizens of the state."<sup>125</sup> Property taxes that discriminate against municipal outsiders burden these rights and so they represent at least a prima facie violation of the Comity Clause. The fact that a municipal law treats all municipal outsiders unfavorably (including those who reside in the same state) does not immunize the law from Comity Clause challenge.<sup>126</sup>

But a prima facie violation is not enough. Protectionist property taxes that offend the Comity Clause may be upheld if there is a substantial reason for discriminating against outsiders. States have considerable leeway to determine the nature of local problems and to tailor solutions to those problems.<sup>127</sup> If outsiders "constitute a peculiar source of the evil at which the statute is aimed," then even a law that discriminates against them may be upheld.<sup>128</sup>

123. U.S. CONST. art. IV, § 2, cl. 1.

124. See *United Bldg. & Constr. Trades Council of Camden Cnty. v. Mayor of Camden*, 465 U.S. 208, 216 (1984); *Hicklin v. Orbeck*, 437 U.S. 518, 523-24 (1978); *Austin v. New Hampshire*, 420 U.S. 656, 662 (1975); *Toomer v. Witsell*, 334 U.S. 385, 395 (1948).

125. *Corfield v. Coryell*, 6 F. Cas. 546, 552 (C.C.E.D. Pa. 1823) (No. 3230); see also *Ward v. Maryland*, 79 U.S. (12 Wall.) 418, 430 (1871) (finding privileges and immunities over "being subjected to any higher tax or excise than that exacted by law of . . . permanent residents"). For a discussion of the history of the Comity Clause, see generally David R. Upham, Note, *Corfield v. Coryell and the Privileges and Immunities of American Citizenship*, 83 TEX. L. REV. 1483 (2005).

126. *United Bldg.*, 465 U.S. at 217-18.

127. See *Toomer*, 334 U.S. at 395-96.

128. *Id.* at 396-98 ("[T]he privileges and immunities clause is not an absolute.").



It is hard to find a local problem for which outsiders are particularly responsible. Housing affordability is a legitimate local government interest, but home prices are not more sensitive to demand from outsiders than demand from residents. Nondiscriminatory policies will be at least as effective at holding down property values as discriminatory property taxes. Loosening zoning restrictions could increase local housing supply, and vacancy taxes could induce more property owners—including both outsiders and local owners—to rent their properties.

One justification for targeting outside property owners is that they benefit from local public goods, such as fire and police protection of their properties, but do not pay their fair share for those benefits. For example, depending on the municipality, residents may pay income or sales taxes that nonresidents do not. A municipality may argue that a tax on outsiders ensures that residents and nonresidents bear roughly the same overall tax burden for the services they enjoy.

In *Marilley v. Bonham*, the Ninth Circuit, sitting en banc, upheld a fee for nonresident commercial fishers imposed by the state of California.<sup>129</sup> The Court held that the state may “charge non-residents a differential which would merely compensate the State for . . . any conservation expenditures from taxes which only residents pay.”<sup>130</sup> It is unclear how close the connection must be between the size of the discriminatory fee/tax and the additional amounts that only residents pay. The Comity Clause requires “substantial equality”<sup>131</sup> or “rough parity.”<sup>132</sup> Perfect equality of treatment is not required.<sup>133</sup> We think it is unlikely that even rough equality would exist between the burdens on outsiders from a protectionist property tax and the burdens borne by local owners, but it will depend on the facts of the particular case.

But even if a Comity Clause challenge to a broad protectionist property tax would succeed, a municipality may be able to tailor a narrower tax to survive. The Comity Clause does not apply to corporations or persons who are

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129. *Marilley v. Bonham*, 844 F.3d 841, 844 (9th Cir. 2016) (en banc); see also *Carlson v. State*, 798 P.2d 1269, 1274–78 (Alaska 1990) (stating that a discriminatory license fee charged to nonresident commercial fishermen should be upheld if the fee bore a close enough relationship to the burden borne by residents for maintaining fisheries through general state revenues). In *Travellers’ Insurance Co. v. Connecticut*, 185 U.S. 364 (1902), the state of Connecticut taxed nonresident shareholders of local companies based on the full value of their stock in those companies, whereas it taxed resident shareholders on the value of their stock holdings less the allocable share of real estate owned by the company and on which it had paid local property taxes. The Court upheld the tax after taking into account the fact that resident shareholders paid local property taxes themselves, in an amount that was at least equal to the additional tax borne by nonresidents. *Id.* at 368–71.

130. *Marilley*, 844 F.3d at 850 (quoting *Toomer*, 334 U.S. at 399).

131. *Austin v. New Hampshire*, 420 U.S. 656, 665 (1975).

132. *Lunding v. N.Y. Tax Appeals Tribunal*, 522 U.S. 287, 319 (1998) (Ginsburg, J., dissenting).

133. See *State v. Carlson*, 191 P.3d 137, 147 (Alaska 2008), overruled in part by *Burton v. Fountainhead Dev., Inc.*, 393 P.3d 387 (Alaska 2017).

not citizens or residents of the United States.<sup>134</sup> A tax on nonresident corporate owners and all persons who are not U.S. residents or citizens might reach most of the outsiders that a broad protectionist property tax would. As we argue in the next Section, however, such a tax would likely violate the Commerce Clause or be pre-empted by federal law.

## 2. The Commerce Clause

The Constitution provides that “[t]he Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.”<sup>135</sup> Federal legislation regulating interstate or foreign commerce preempts any contradictory state law,<sup>136</sup> but the issue for local real estate taxes arises not only because of the possibility of federal preemption but also because of the Court’s dormant Commerce Clause jurisprudence, under which state legislation that discriminates against or unduly burdens interstate or foreign commerce is unconstitutional. Foreign Commerce Clause analysis merely adds two additional considerations to interstate Commerce Clause analysis, so we begin with interstate commerce.

### *i. Interstate Commerce*

A core value undergirding the dormant Commerce Clause is, and has always been, discouraging economic protectionism.<sup>137</sup> State laws that discriminate against interstate commerce, such as by discriminating against out-of-state goods or economic actors, are unconstitutional unless they are justified or have congressional approval.<sup>138</sup> A tax on real estate ownership by outsiders will violate the dormant Commerce Clause if three conditions are

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134. See *W. Turf Ass’n v. Greenberg*, 204 U.S. 359, 363 (1907).

135. U.S. CONST. art. I, § 8, cl. 3.

136. U.S. CONST. art. VI, cl. 2.

137. *Dep’t of Revenue of Ky. v. Davis*, 553 U.S. 328, 337–38 (2008) (“The modern law of what has come to be called the dormant Commerce Clause is driven by concern about ‘economic protectionism . . . .’”); see also *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 273–74 (1988) (“[S]tate statutes that clearly discriminate against interstate commerce are routinely struck down unless the discrimination is demonstrably justified by a valid factor unrelated to economic protectionism.” (citations omitted)); *Hughes v. Oklahoma*, 441 U.S. 322, 325–26 (1979) (“The few simple words of the Commerce Clause . . . reflected a central concern of the Framers that was an immediate reason for calling the Constitutional Convention: the conviction that in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation.”); *W. Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 192–93 (1994) (“This ‘negative’ aspect of the Commerce Clause prohibits economic protectionism . . . .” (quoting *New Energy Co. of Ind.*, 486 U.S. at 273–74)). See generally Michael S. Knoll & Ruth Mason, *The Economic Foundation of the Dormant Commerce Clause*, 103 VA. L. REV. 309 (2017) (distinguishing between taxes that merely discourage interstate commerce and taxes that discriminate against interstate commerce, and arguing that only the latter violate the dormant Commerce Clause).

138. See *Tenn. Wine & Spirits Retailers Ass’n v. Thomas*, 139 S. Ct. 2449, 2462 (2019); *Comptroller of Treasury of Md. v. Wynne*, 135 S. Ct. 1787, 1794 (2015).

met. First, the tax affects interstate commerce. Second, the tax fails the four-part test outlined in *Complete Auto Transit, Inc. v. Brady*.<sup>139</sup> Third, the tax does not advance a legitimate local purpose that cannot be achieved by a less-discriminatory tax.<sup>140</sup>

We begin our Commerce Clause analysis with the threshold question of whether a property tax based on the owner's residence affects interstate commerce. The threshold for whether a law affects interstate commerce is low.<sup>141</sup> Even entirely local commercial activities which, in the aggregate, affect the national economy are within Congress' power to regulate interstate commerce.<sup>142</sup> The negative implication of this is that if a protectionist property tax has a substantial effect on interstate commerce then it may be unconstitutional if it discriminates against interstate commerce, even if the real estate itself cannot cross state boundaries.<sup>143</sup>

There are two categories of activities affected by real estate taxes that could potentially be "commerce" within the meaning of the Commerce Clause: the services enabled by real estate investment and the buying and selling of the real estate itself. Local real estate taxes increase the cost of acquiring or owning real property. The first effect of this increased cost is to encourage investors to divest from the taxed real estate and switch to other investments, such as stocks and securities. The second effect, which follows from the first effect, is a reduction in the supply of the services that real estate is used to provide. Increasing real estate taxes will reduce the amount of rental housing, the number of amusement parks, and the number of vacation properties. Increasing real estate taxes will also reduce the demand for services used in real estate transactions, such as mortgage financing, property insurance, and construction.

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139. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

140. *Or. Waste Sys., Inc. v. Dep't of Env't Quality of Or.*, 511 U.S. 93, 101 (1994). This is an extremely difficult burden, "so heavy that 'facial discrimination by itself may be a fatal defect.'" *Id.* (quoting *Hughes*, 441 U.S. at 337).

141. *See, e.g., Wickard v. Filburn*, 317 U.S. 111, 124-25 (1942); *Gonzales v. Raich*, 545 U.S. 1, 16-18 (2005).

142. *See United States v. Morrison*, 529 U.S. 598, 610 (2000) (citing *United States v. Lopez*, 514 U.S. 549, 560 (1995)); *United States v. Darby*, 312 U.S. 100, 122-23 (1941); *Wickard*, 317 U.S. at 128-29.

143. *See Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 615 (1981) ("The Court has, however, long since rejected any suggestion that a state tax or regulation affecting interstate commerce is immune from Commerce Clause scrutiny because it attaches only to a 'local' or intrastate activity."). For example, land use regulations can be subject to Commerce Clause scrutiny. *See, e.g., Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 281 (1995) (holding that a contract for the sale of residential property involving treatment for termites satisfied the interstate commerce requirement of the Federal Arbitration Act). At the same time, Professor Schragger has observed that the Court is generally permissive when local governments use land use regulations for protectionist purposes. Richard C. Schragger, *Cities, Economic Development, and the Free Trade Constitution*, 94 VA. L. REV. 1091, 1108 (2008).

In *McLain v. Real Estate Board of New Orleans, Inc.*, the Court held that collusive local real estate brokerage activities could affect national markets for mortgage financing and homeowners' insurance, satisfying the jurisdictional requirement for the federal Sherman Act.<sup>144</sup> The Court held that "whatever stimulates or retards the volume of residential sales, or has an impact on the purchase price, affects the demand for financing and title insurance, those two commercial activities that on this record are shown to have occurred in interstate commerce."<sup>145</sup> This is a breathtakingly broad statement of Congress' power over real estate, and if a protectionist property tax were evaluated under this standard, it would clearly be viewed as affecting interstate commerce. Real estate taxes affect the price and volume of real estate sales, so they affect commercial services that are used to transact in real estate.

It is also clear that the services provided with real estate can be commerce. In *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, the Court evaluated a property tax exemption that was available to nonprofit organizations only if they primarily served state residents.<sup>146</sup> Citing *Heart of Atlanta Motel, Inc. v. United States*,<sup>147</sup> the Court had little trouble concluding that a religious summer camp that drew out-of-state campers was engaged in interstate commerce, much like hotels that solicit customers from outside the state.<sup>148</sup> Property taxes make summer camps and hotels less profitable, and to the extent that these businesses draw out-of-state customers, then protectionist property taxes affect interstate commerce in this way as well.

But not all real estate is used in commerce. What about outsiders who acquire real estate for personal use? Identifying the commerce enabled by property ownership in this case is more elusive. Is a property owner who uses the property as a vacation home engaged in commerce? Commerce includes much more than just the buying and selling of goods.<sup>149</sup> Still, it has not been extended to cover the provision of housing services to oneself.<sup>150</sup>

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144. *McLain v. Real Est. Bd. of New Orleans, Inc.*, 444 U.S. 232, 246-47 (1980).

145. *Id.* at 246.

146. *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 573 (1997) ("[The camp] is unquestionably engaged in commerce . . . as a provider of goods and services. It markets those services, together with an opportunity to enjoy the natural beauty of an inland lake in Maine, to campers who are attracted to its facility from all parts of the Nation.")

147. *Heart of Atlanta Motel, Inc. v. United States*, 379 U.S. 241, 260-61 (1964).

148. *Camps Newfound*, 520 U.S. at 573-74.

149. Justice Marshall rejected such a narrow definition of commerce, noting that, "[c]ommerce, undoubtedly, is traffic, but it is something more: it is intercourse. It describes the commercial intercourse between nations, and parts of nations, in all its branches." *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1, 189-90 (1824). The term now covers, for example, the writing of casualty insurance policies, previously held in the post-Civil War era to not be commerce. *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533, 539 (1944).

150. See *Jones v. United States*, 529 U.S. 848, 859 (2000) (finding that owner-occupied residence not used for a commercial purpose did not qualify as property "used in" commerce or a commerce-affecting activity).

Although not free from doubt, we think that a real estate tax on outsiders is likely to be viewed as affecting interstate commerce, but that the case is much clearer as applied to outsider landlords than to outsiders who are second-home owners and who do not use the property for commercial activities. The problem for opponents of protectionist property taxes is—as we discuss below—that facially protectionist property taxes do not discriminate against the interstate services enabled by real estate; they discriminate against interstate chains of ownership.

But isn't buying real estate itself clearly "commerce"?<sup>151</sup> We think it is uncertain how courts would rule on this question. A protectionist property tax will tend to encourage outsiders to sell vacation homes in the taxing jurisdiction and buy homes in other jurisdictions. Federal circuit courts have upheld federal fair housing laws by finding that there was a rational basis for believing "that the sale and rental of residential housing . . . concerns more than one state and 'has a real and substantial relation to the national interest.'"<sup>152</sup> And yet, federal district courts have resisted the application of the Federal Arbitration Act by holding that mere sales of residential property between in-state and out-of-state residents do not involve interstate commerce.<sup>153</sup> The law is not clear about whether property ownership, itself, constitutes commerce.

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151. Some argue that it is, since it affects the flow of foreign currency into the country, banking, and use of brokers. See Shapiro, *supra* note 71, at 245. But a New York appeals court held that it was not. *Tamagni v. Tax Appeals Tribunal*, 695 N.E.2d 1125, 1132–33 (N.Y. 1998). For a discussion of this case, arguing it was wrongly decided, see Michael S. Knoll & Ruth Mason, *New York's Unconstitutional Tax Residence Rule*, 85 ST. TAX NOTES 707, 712–15 (2017).

152. *Morgan v. Sec'y of Hous. & Urb. Dev.*, 985 F.2d 1451, 1455 (10th Cir. 1993) (quoting *Heart of Atlanta*, 379 U.S. at 255); see also *Groome Res. Ltd. v. Parish of Jefferson*, 234 F.3d 192, 205 (5th Cir. 2000) (upholding the validity of federal fair housing laws); *Oxford House-C v. City of St. Louis*, 77 F.3d 249, 251 (8th Cir. 1996) (same); *Seniors Civ. Liberties Ass'n v. Kemp*, 965 F.2d 1030, 1034 (11th Cir. 1992) (same).

153. See, e.g., *Bradley v. Brentwood Homes, Inc.*, 730 S.E.2d 312, 318 (S.C. 2012) ("Because the essential character of the Agreement was strictly for the purchase of a completed residential dwelling and not the construction, we find the FAA does not apply as these types of transactions have historically been deemed to involve intrastate commerce."); *Garrison v. Palmas del Mar Homeowners Ass'n*, 538 F. Supp. 2d 468, 473 (D.P.R. 2008) ("The FAA generally does not apply to residential real estate transactions that have no substantial or direct connection to interstate commerce, regardless of whether said transactions involve out-of-state purchasers."); *Saneii v. Robards*, 289 F. Supp. 2d 855, 858 (W.D. Ky. 2003) ("Notwithstanding its congenial effects on interstate commerce, the sale of residential real estate is inherently intrastate. Contracts strictly for the sale of residential real estate focus entirely on a commodity—the land—which is firmly planted in one particular state. The citizenship of immediate parties (the buyer and the seller) or their movements to or from that state are incidental to the real estate transaction."); *SI V, LLC v. FMC Corp.*, 223 F. Supp. 2d 1059, 1062 (N.D. Cal. 2002) (finding that a real estate sale by an in-state buyer from an out-of-state seller did not involve interstate commerce); *Cecala v. Moore*, 982 F. Supp. 609, 612 (N.D. Ill. 1997) (holding that the absence of additional transactions attendant to the sale of real estate indicates no interstate commerce). Many state courts have resisted application of the dormant Commerce Clause. See JEROME R. HELLERSTEIN, WALTER HELLERSTEIN & JOHN A. SWAIN, *STATE TAXATION* ¶ 4.06[1] n.83 (Thomson Reuters 3d ed. 2020).

Moreover, in the wake of the Court's decision in *National Federation of Independent Businesses v. Sebelius*,<sup>154</sup> a court may distinguish between a property tax imposed periodically on a property's value and a transfer tax. Whereas a real estate transfer tax is a tax on activity (a sale), an annual property tax is not.<sup>155</sup> One engages in commerce; it is something one *does*. A tax on people who own property is not triggered by doing anything at all. Although a tax on property ownership is likely to affect the decision to buy real estate to begin with, the Court in *NFIB* rejected the view that Congress could regulate inactivity just because that inactivity affected interstate commerce or affected the terms on which individuals might subsequently engage (or had previously engaged) in commerce.<sup>156</sup> The Court's language in *NFIB* gives us pause that it would view an annual protectionist property tax (as compared with a real estate transfer tax) as reaching commercial activity.<sup>157</sup>

If real estate ownership is itself commerce, then we think it is clear that a protectionist property tax will not survive Commerce Clause challenge. The reason is that a protectionist property tax essentially operates as an export tariff on real property or an import tariff on capital invested in real estate,<sup>158</sup> and the "state tariff[ is] the quintessential evil targeted by the dormant Commerce Clause."<sup>159</sup> Doctrinally, a protectionist property tax will fail if it cannot satisfy the test articulated by the Court in *Complete Auto Transit, Inc. v. Brady*.<sup>160</sup> Although *Complete Auto* provides a four-part test, we focus on the third factor because the other criteria are likely to be easily satisfied.<sup>161</sup>

154. *Nat'l Fed'n of Indep. Bus. v. Sebelius*, 567 U.S. 519, 530 (2012).

155. Yet at the same time, the Court has recognized a certain equivalence between a tax on the transfer of property and a tax on the property itself. *Dep't of Revenue of Wash. v. Ass'n of Wash. Stevedoring Cos.*, 435 U.S. 734, 756 n.21 (1978) (explaining that "the Court had always considered a tax on the sale of goods to be a tax on the goods themselves").

156. *Sebelius*, 567 U.S. at 556–57.

157. See Knoll & Mason, *supra* note 151, at 712–13 (stating that "New York's statutory tax residence rule affects interstate commerce" by discouraging establishing residency in New York and investing in intangible assets, thereby "discourag[ing the] participation in the national capital markets").

158. Ruth Mason & Michael S. Knoll, *What Is Tax Discrimination?*, 121 YALE L.J. 1014, 1107–14 (2012) (arguing that the dormant Commerce Clause forbids taxes that function equivalently to tariffs). Such a tariff distorts the pattern of ownership of local real estate. The tax literature refers to this as a violation of "capital ownership neutrality" or "competitive neutrality." See James R. Hines Jr., *Reconsidering the Taxation of Foreign Income*, 62 TAX L. REV. 269, 275–77 (2009); Mason & Knoll, *supra*, at 1021.

159. *Comptroller of Treasury of Md. v. Wynne*, 135 S. Ct. 1787, 1792 (2015).

160. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

161. The other three factors are that "the tax [(1)] is applied to an activity with a substantial nexus with the taxing State, [(2)] is fairly apportioned, . . . and [(3)] is fairly related to the services provided by the State." *Id.* If ownership is an activity, then it is hard to imagine an activity with a closer nexus to a state than the ownership of real property in that state. The requirement that the tax be fairly apportioned and fairly related to the services provided by the state should be satisfied by the fact that property taxes are used to fund police, fire, and other services provided by the locality. Courts sometimes use the internal consistency test described *infra* to

To pass the *Complete Auto* test, a tax must not unjustifiably discriminate against interstate commerce.<sup>162</sup> A tax discriminates against interstate commerce if it facially discriminates against interstate commerce, if it imposes a higher tax on interstate commerce than intrastate commerce, or if it has a disparate impact on interstate commerce that was motivated by a protectionist purpose. If real estate ownership is itself commerce, then a facially protectionist property tax discriminates against interstate commerce. Laws that facially discriminate against interstate commerce “are ‘virtually *per se* invalid.’”<sup>163</sup> On the other hand, if it is only the services ancillary to ownership that are commerce, then protectionist property taxes are nondiscriminatory. Protectionist property taxes that discriminate based on the owner’s residence do not facially, or in effect (by imposing a higher tax), discriminate against interstate rental, insurance, or mortgage markets. However, even a tax that does not discriminate against interstate commerce, facially or effectively, may be struck down if it is intended to impose a burden on out-of-state actors for the purpose of protecting local competitors.<sup>164</sup> Direct evidence of protectionist intentions is typically also fatal.<sup>165</sup> In *Bacchus Imports, Ltd. v. Dias*, the Court held that compelling evidence of a protectionist purpose was sufficient to strike down a tax on alcoholic beverages and preclude a balancing of local interests and discriminatory effect.<sup>166</sup> The openly protectionist political rhetoric used by advocates of protectionist property taxes is yet another reason why a court may find that these taxes are unconstitutional.

A discriminatory tax that fails *Complete Auto* can only be redeemed if “it advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives.”<sup>167</sup> However, the standard for redeeming a discriminatory tax is high.<sup>168</sup> Since protectionism is not a legitimate purpose, municipalities would have to provide other, permissible, justifications for the tax. Moreover, they would need to show that the protectionist property tax fared better than alternative policies, such as

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operationalize the fair apportionment prong of the *Complete Auto* test. See Knoll & Mason, *supra* note 137, at 311–12.

162. See, e.g., *Bos. Stock Exch. v. State Tax Comm’n*, 429 U.S. 318, 329 (1977) (explaining that “[n]o State, consistent with the Commerce Clause, may ‘impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business’” (quoting *Nw. States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959))).

163. *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 575 (1997) (quoting *Fulton Corp. v. Faulkner*, 516 U.S. 325, 331 (1996)).

164. See Knoll & Mason, *supra* note 137, at 354; Regan, *supra* note 65, at 1093.

165. See HELLERSTEIN ET AL., *supra* note 153, ¶ 4.14.

166. *Bacchus Imps., Ltd. v. Dias*, 468 U.S. 263, 270 (1984).

167. *Or. Waste Sys., Inc. v. Dep’t of Env’t Quality of Or.*, 511 U.S. 93, 101 (1994) (quoting *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 278 (1988)); see also *Maine v. Taylor*, 477 U.S. 131, 138 (1986) (explaining that states can regulate matters of local concern despite its effect on interstate commerce).

168. See *New Energy Co. of Ind.*, 486 U.S. at 277.

housing vouchers, inclusionary zoning and rent control that could achieve goals such as affordable housing without discriminating against interstate commerce.

ii. *Foreign Commerce*

Discrimination against foreign commerce is no less a constitutional problem than discrimination against interstate commerce,<sup>169</sup> and in fact the state and local taxation of foreign commerce is subject to even greater scrutiny.<sup>170</sup> The heightened scrutiny that courts apply to state laws burdening foreign commerce derives from the need for the country to speak with “one voice” in international affairs and to avoid the risk of multiple taxation by both U.S. and foreign governments.<sup>171</sup> The risk of multiple taxation is low. Real estate is generally only taxable within the international tax system by the jurisdiction in which the property is located.

Whereas discriminatory taxes affecting interstate commerce can only be excused by explicit congressional permission, for taxes that do not discriminate against interstate commerce, “Congress may more passively indicate that certain state practices do *not* ‘impair federal uniformity in an area where federal uniformity is essential.’”<sup>172</sup> This raises the question of whether there is any federal action in the field of international investment or taxation that could be viewed as either pre-empting local property taxation of

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169. *S. Cent. Bell Tel. Co. v. Alabama*, 526 U.S. 160, 169 (1999) (asserting discrimination in favor of domestic over foreign entities constitutes a per se violation of the Commerce Clause). The question of whether the internal consistency test applies in the dormant foreign Commerce Clause context may come before the Court. See Michael S. Knoll & Ruth Mason, *Why the Supreme Court Should Grant Certiorari in Steiner v. Utah*, TAX NOTES (Feb. 3, 2020), <https://www.taxnotes.com/tax-notes-state/litigation-and-appeals/why-supreme-court-should-grant-certiorari-steinier-v-utah/2020/02/03/2c2jy> [<https://perma.cc/PMT3-RG7W>] (arguing that the Court should grant certiorari in an upcoming dormant Commerce Clause case and that the internal consistency test applies in the foreign commerce context).

170. A state may not favor domestic commerce over foreign commerce. See *Barclays Bank PLC v. Franchise Tax Bd. of Cal.*, 512 U.S. 298, 332 (1994) (Scalia, J., concurring) (“I will enforce a self-executing, ‘negative’ Commerce Clause . . . against a state law that facially discriminates against interstate [or foreign] commerce . . .” (alteration in original) (quoting *Intl Containers Int’l Corp. v. Huddleston*, 507 U.S. 60, 78–79 (1993))); *Kraft Gen. Foods, Inc. v. Iowa Dep’t of Revenue & Fin.*, 505 U.S. 71, 79 (1992) (“[A] State’s preference for domestic commerce over foreign commerce is inconsistent with the Commerce Clause even if the State’s own economy is not a direct beneficiary of the discrimination.”).

171. These are the two so-called “Japan Line” factors. See Michael S. Knoll & Ruth Mason, *The Dormant Foreign Commerce Clause After Wynne*, 39 VA. TAX REV. 357, 361 (2020) (discussing the role of the dormant Commerce Clause when applied to taxes on foreign states using the two Japan Line factors). In *Barclays Bank PLC*, the Court applied the two factors to a state franchise tax. *Barclays Bank PLC*, 512 U.S. at 310–31. But see *Wardair Can. Inc. v. Fla. Dep’t of Revenue*, 477 U.S. 1, 13 (1986) (indicating that the Foreign Commerce Clause may not require the government to speak with one voice); *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 193 (1983) (retreating from an expansive view of Foreign Commerce Clause).

172. *Barclays Bank PLC*, 512 U.S. at 323 (quoting *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 448 (1979)).



non-U.S. owners or tacitly permitting it. The United States has federal income tax treaties with 50 countries that contain nondiscrimination provisions. In some treaties these nondiscrimination rules may conflict with a facially discriminatory property tax and in other treaties they do not.<sup>173</sup>

Also relevant are bilateral Friendship, Commerce and Navigation (“FCN”) treaties that the United States has with a number of countries.<sup>174</sup> These treaties often explicitly allow foreign nationals of the counterparty state to acquire some rights in U.S. real property.<sup>175</sup> Some read these treaties as implicit federal recognition of “the general permissibility of state restrictions on alien land ownership,”<sup>176</sup> but others do not read them so broadly.

Even if one could find tacit permission in income tax and FCN treaties for discriminatory state taxes, such as would allow a municipality to overcome the “one voice” requirement, the tax would still fail the *Complete Auto* test. If a state statute discriminates against foreign commerce without justification, then it is invalid in the absence of *explicit* congressional consent. Thus, the relevant provisions of FCN and income tax treaties act more as another hurdle for protectionist property taxes, not a stamp of approval. Even if courts found property taxes based on residency to be nondiscriminatory within the meaning of the dormant Commerce Clause, they still could be preempted by treaties. Thus, a question remains whether the language of a particular FCN treaty preempts discriminatory state or local property taxation of foreigners. The answer to the preemption question must depend on the particular facts of the treaty and the tax.<sup>177</sup>

In the final analysis, we think it likely that a protectionist property tax that facially discriminates against outsiders would be found unconstitutional

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173. For an example of the latter, see Income Tax Convention, China-U.S., art. 23, Apr. 30, 1984. Although the nondiscrimination rules contained in article 23 cover “any taxation or any requirement connected therewith,” *id.*, the Treasury Department’s technical explanation to article 23 states that “[t]his article prohibits discriminatory application of the taxes covered by the Agreement,” and state property taxes are not within the covered taxes. U.S. DEP’T OF TREASURY, TREASURY DEPARTMENT TECHNICAL EXPLANATION OF THE AGREEMENT BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE PEOPLE’S REPUBLIC OF CHINA FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF TAX EVASION WITH RESPECT TO TAXES ON INCOME art. 23 (1987). The current version of the U.S. Model Treaty includes all taxes (not only federal income taxes) in the nondiscrimination rules. U.S. MODEL INCOME TAX CONVENTION art. 24 (U.S. DEP’T OF TREASURY 2016).

174. See, e.g., Friendship, Commerce and Navigation Treaty, Neth.-U.S., art. IX, ¶ 1, Mar. 27, 1956, 8 U.S.T. 2043.

175. See *id.* These treaties may also include provisions that allow the United States to limit the further acquisition of rights in real property. *Id.* art. VI, ¶ 2.

176. Morrison, *supra* note 71, at 660.

177. One might argue that other federal laws preempt protectionist property taxes. However, these laws only compel information disclosure about foreign ownership. See 7 U.S.C. §§ 3501–3508 (2018) (requiring reporting of certain transfers of agricultural land); see also 22 U.S.C. §§ 3101–3108 (requiring reporting of acquisitions of at least ten percent of a business enterprise, including real estate); cf. Levinson, *supra* note 81, at 235 (explaining how the laws connect to foreign investment).

under the Commerce Clause because it erects protectionist barriers in interstate or foreign commerce. Moreover, such taxes may be invalid as applied to residents of states that are party to a treaty with the United States.

Our conclusion that facially protectionist property taxes likely violate the Commerce Clause is not free from doubt. Scholars note that real property law “has remained the jealously guarded domain of the states . . . relatively immune to movements toward uniformity,”<sup>178</sup> concluding even that control over alien land ownership is an inherent state power.<sup>179</sup> One can mount an originalist argument that we are wrong. As noted in Part II, restrictions on alien ownership were a settled feature of common (and therefore state) law at the time of the founding.<sup>180</sup> Professor Tirres argues that in 1790 Congress rejected a proposal to allow aliens to obtain property because members thought the matter was one for states to decide.<sup>181</sup> In the next Section we discuss early twentieth century cases in which the Supreme Court rejected equal protection challenges to restrictions on foreign ownership; to the best of our knowledge, the movants never bothered to raise a dormant Commerce Clause challenge.<sup>182</sup>

Our main response to this critique is that the law abandoned an originalist understanding of the Commerce Clause long ago. While the framers may not have envisioned the use of this clause to limit the states’ ability to enact local land ownership restrictions, they also would not have envisioned its use to justify the current federal regulatory state, but contemporary Commerce Clause jurisprudence accommodates much greater federal power.<sup>183</sup> Expanding the Commerce Clause expands federal power,

178. Morrison, *supra* note 71, at 622.

179. See James A. Frechter, *Alien Landownership in the United States: A Matter of State Control*, 14 BROOK. J. INT’L L. 147, 185 (1988). But see generally Shapiro, *supra* note 71 (examining alien land laws and their connection to the dormant Commerce Clause). For further analysis of the legislative history of alien land laws, see generally James Alan Huizinga, Note, *Alien Land Laws: Constitutional Limitations on State Power to Regulate*, 32 HASTINGS L.J. 251 (1980).

180. See *supra* notes 71–72 and accompanying text; see also WILLIAM MACLAY, SKETCHES OF DEBATE IN THE FIRST SENATE OF THE UNITED STATES, IN 1789-90-91, at 179 (George W. Harris ed., 1880) (“It, therefore, strictly speaking, rested with the respective States whether they would repeal the common law, with respect to aliens . . .”). Moreover, many such alien land laws remain. William B. Fisch, *State Regulation of Alien Land Ownership*, 43 MO. L. REV. 407, 428 (1978) (“The United States Supreme Court’s long tolerance of many forms of alien land law . . . must leave considerable doubt that the Court would invalidate these statutes.”).

181. See Allison Brownell Tirres, *Ownership Without Citizenship: The Creation of Noncitizen Property Rights*, 19 MICH. J. RACE & L. 1, 9–10 (2013).

182. See *infra* note 186 and accompanying text.

183. See, e.g., Richard A. Epstein, *The Proper Scope of the Commerce Power*, 73 VA. L. REV. 1387, 1388 (1987) (“I think that the expansive construction of the clause accepted by the New Deal Supreme Court is wrong, and clearly so, and that a host of other interpretations are more consistent with both the text and the structure of our constitutional government.”); see also Robert J. Pushaw, Jr. & Grant S. Nelson, *A Critique of the Narrow Interpretation of the Commerce Clause*, 96 NW. U. L. REV. 695, 696–97 (2002) (describing various scholars’ views on restrictive versus expansive original meaning of the Commerce Clause).

but it can also limit state power by expanding the scope of the dormant Commerce Clause.<sup>184</sup> There is also an argument that protectionist property taxes violate the Commerce Clause even under an originalist interpretation because the facts of commerce and local government have changed since the founding era. The market for real estate is more integrated across state and national boundaries than it was in the nineteenth century, and local interests have changed too. There is a less urgent need for states to attract settlers, and it is easier for states and municipalities to collect taxes from nonresidents. Thus, there is more of an interstate and even international market for real estate, and discrimination may no longer serve a legitimate local purpose that cannot be achieved by a less-discriminatory tax. This accommodates the possibility that founding era restrictions on foreign ownership were constitutional at the time, but would not be now.

### 3. Equal Protection

Resident aliens are a protected class under the Equal Protection Clause of the Fourteenth Amendment, and property taxes that discriminate against them are almost surely unconstitutional.<sup>185</sup> By contrast, nonresident aliens are not a protected class, and the Supreme Court has rejected equal protection and due process challenges to nonresident alien land ownership

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184. See *City of Philadelphia v. New Jersey*, 437 U.S. 617, 622–23 (1978) (rejecting state court view of two definitions of “commerce,” one to support federal regulation and another to strike down or restrict state legislation); *Lewis v. BT Inv. Managers, Inc.*, 447 U.S. 27, 39 (1980) (“[T]he same interstate attributes that establish Congress’ power to regulate commerce also support constitutional limitations on the powers of the States.”).

185. Cf. U.S. CONST. amend. XIV, § 1. Although many alienage cases predate the contemporary “tiers of scrutiny” approach to equal protection analysis, alienage is generally regarded as a suspect classification that triggers strict scrutiny. *Graham v. Richardson*, 403 U.S. 365, 371–72 (1971). For a tax to survive strict scrutiny, it must be narrowly tailored to further a compelling government interest. Even if suppressing housing price growth were a compelling government interest, discriminating against aliens is not a narrowly tailored remedy. Aliens’ dollars have the same effect on housing prices as a citizen’s dollars. There is some question about whether nonresident aliens are protected by the Fourteenth Amendment, which obligates states to provide equal protection to “any person within its jurisdiction.” Although the Supreme Court has not addressed real estate taxes based on alienage, it has upheld prohibitions on real estate ownership for certain categories of aliens. See *Terrace v. Thompson*, 263 U.S. 197, 217 (1923) (law prohibiting land ownership by aliens who had not declared their intent to become citizens did not violate the equal protection or due process protections of the Constitution, and holding that “each State, in the absence of any treaty provision to the contrary, has power to deny to aliens the right to own land within its borders”); *Porterfield v. Webb*, 263 U.S. 225, 233 (1923) (upholding laws proscribing anyone ineligible for citizenship from holding land). These cases date from a period of racism towards Asian Americans and the laws were subsequently repealed or struck down by state courts on account of their racist character. See, e.g., *Sei Fujii v. State*, 242 P.2d 617, 630 (Cal. 1952) (in banc). The Supreme Court has never overturned precedents holding that states have a right to ban aliens from owning property, and certain states still limit land ownership by resident and nonresident aliens. See sources cited *supra* note 68. For a discussion of limits on alien ownership of agricultural land, see Wilson, *supra* note 82, at 725–29.

restrictions.<sup>186</sup> Since nonresident aliens are not a protected class, a protectionist property tax that discriminated against them would only need to satisfy rational basis review, requiring that the law be rationally related to a legitimate government purpose. This test is easy to meet. For example, the owner's residence may affect the difficulty of collecting on delinquent property tax bills. In that case, the additional tax owed by nonresidents may be justified as part of the cost borne by the state for the higher rates of non-collection.

The only caveat to our conclusion about the weakness of an equal protection challenge is that evidence of animus against foreigners by the local government could cause a discriminatory tax to fail even rational basis review. The presence of animus demands a more "searching form of rational basis review."<sup>187</sup> Animus cannot constitute a legitimate government purpose,<sup>188</sup> and it will cause the Court to scrutinize the stated purposes of the law more carefully. Given the historical association of xenophobia with laws against foreign ownership and the amount of real estate investment being made by Chinese nationals, it is unsurprising that some are suspicious about the presence of ethnic animus behind the adoption of protectionist property taxes.<sup>189</sup>

#### B. SECOND HOME AND VACANCY TAXES

In this Section we consider the constitutionality of imposing a facially neutral tax on either vacant properties or second homes. These taxes are not facially discriminatory, because they do not tax owners based on their residence. Moreover, they do not have a discriminatory effect on interstate commerce. Under the "internal consistency" test adopted by the Court in *Comptroller of the Treasury of Maryland v. Wynne*,<sup>190</sup> a tax has a discriminatory effect when interstate commerce (whether that commerce is real estate investment itself, or the commerce enabled by real estate ownership) would bear a heavier burden than intrastate commerce if all 50 states adopted such a tax. This would not be the case for a vacancy or second-home tax.

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186. *Terrace*, 263 U.S. at 217 ("[E]ach State, in the absence of any treaty provision to the contrary, has power to deny to aliens the right to own land within its borders."); *Porterfield*, 263 U.S. at 233 (upholding the California Alien Land Laws of 1913 and 1920 as not violating the Equal Protection Clause); see Bell & Savage, *supra* note 72, at 699–704; Tirres, *supra* note 71, at 101–09.

187. *Lawrence v. Texas*, 539 U.S. 558, 580 (2003) (O'Connor, J., concurring).

188. See *U.S. Dep't of Agric. v. Moreno*, 413 U.S. 528, 534–35 (1973).

189. Beekman et al., *supra* note 54 (a spokesperson for a mayoral candidate in Seattle stated that "[c]hanging the name to 'non-resident' does not change the fact that this started as anti-Chinese buyer tax. Seattle has a dark history of discrimination against people of Asian descent, such as the Chinese Exclusion laws and the mass internment of Japanese. We cannot go there—particularly in the age of (President Donald) Trump.").

190. *Comptroller of Treasury of Md. v. Wynne*, 135 S. Ct. 1787, 1792–93 (2015). A tax that fails the internal consistency test is protectionist. Knoll & Mason, *supra* note 171, at 361.

The fact that vacancy taxes and second-home taxes do not facially or effectively discriminate does not immunize them from Commerce Clause challenges.<sup>191</sup> These taxes may, as a practical matter, be paid primarily by outsiders. The scope of the dormant Commerce Clause covers discrimination against interstate commerce “whether forthright or ingenious,”<sup>192</sup> and it is the task of the court “to determine whether the statute under attack . . . will in its practical operation work discrimination against interstate commerce.”<sup>193</sup> Merely having a disparate impact on outsiders is insufficient, on its own, to cause a law to fail a Commerce Clause challenge.<sup>194</sup> But evidence of anti-outsider animus or the intent to unconstitutionally discriminate by proxy may be sufficient.

Under equal protection analysis, discrimination based on property use and vacancy status does not employ a suspect classification and therefore these laws would only be subject to rational basis review. It is not at all difficult to imagine legitimate government purposes for vacancy and second-homes taxes. These taxes provide owners with an incentive to rent the property, thereby making more housing stock available to reduce pressure on rents. Vacancy taxes discourage blight in abandoned neighborhoods and encourage population density. The implicitly favorable tax treatment for principal residences that comes from taxing second homes may be justified by the positive externalities of owner-occupants, as an expression of the idea that people tend to be better citizens and more invested members of the communities in which they live. Taxpayers who have challenged favorable property tax treatment for primary residences—what are known as “homestead exemptions”—have consistently failed because the exemptions bear a rational relationship to a legitimate government purpose and because the exemption is based on the use of the property and not the identity of the owner.<sup>195</sup>

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191. The leading treatise author on the topic, Prof. Walter Hellerstein, argues that “[t]he Court has . . . made it clear that the Commerce Clause bars taxes effectively discriminating against interstate commerce no less than taxes that do so by their terms.” HELLERSTEIN ET AL., *supra* note 153, ¶ 4.14.

192. *Best & Co. v. Maxwell*, 311 U.S. 454, 455 (1940).

193. *Id.* at 455–56; *see Bacchus Imps., Ltd. v. Dias*, 468 U.S. 263, 270 (1984).

194. *See Saban Rent-a-Car LLC v. Ariz. Dep’t of Revenue*, 434 P.3d 1168, 1173–74 (Ariz.), *cert. denied*, 140 S. Ct. 195 (2019); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 618–19 (1981) (holding that an excise tax on coal extracted from an in-state mine is not discriminatory merely because most of the coal is purchased by out-of-state residents). A discriminatory law that burdens interstate commerce is not saved merely because it also burdens intrastate commerce, *see Dean Milk Co. v. City of Madison*, 340 U.S. 349, 354–56 (1951); *In re CIG Field Servs. Co.*, 112 P.3d 138, 150 (Kan. 2005), where some in-state harm does not outweigh effect on out-of-state harm. In *Reinish v. Clark*, 765 So. 2d 197, 215 (Fla. Dist. Ct. App. 2000), the court held that a homestead exemption was constitutional because the higher tax on second homes applied to second homeowners regardless of their state of residence.

195. *See, e.g., Fla. Dep’t of Revenue v. DIRECTV, Inc.*, 215 So. 3d 46, 55 (Fla. 2017); *Markham v. Comstock*, 708 N.Y.S.2d 674, 675 (App. Div. 2000). An instructive comparison is

*C. LACK OF FEDERAL COURT JURISDICTION*

Part of the appeal to local governments of taxes that discriminate against outsiders is political. These taxes appear to burden outsiders to the political community who cannot vote or mobilize effectively to advocate for their interests. We say “appear to burden” because, as we discuss below, the actual economic burden of these taxes, as with tariffs generally, is often not borne by outsiders. Nevertheless, the illusion of being able to “export” the tax burden is a seductive one. Since political solutions are often unavailing, outsiders must look to the courts for relief. However, there are significant procedural limitations to accessing federal courts for litigating outsiders’ constitutional claims. Moreover, there is reason to think that state courts may be less sympathetic fora for claims of tax discrimination. As a result, we believe it is likely that local governments may be able to maintain protectionist property taxes, notwithstanding the strong constitutional case against them.

The Tax Injunction Act of 1937 provides that U.S. federal district courts may “not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such state.”<sup>196</sup> The law is not a bar to federal jurisdiction in all local tax cases. It may permit suits where state courts cannot provide a “plain, speedy and efficient remedy”<sup>197</sup> and suits for monetary relief.<sup>198</sup> If it takes years

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“acquisition value taxation.” In California, the assessed value of real estate is based on the price at which it was acquired. As a result, selling property in an arm’s length sale will generally increase its assessed value, and therefore its property tax bill. Professor LaFrance has analyzed this regime in depth, suggesting that the flow of capital across borders is an aspect of interstate commerce. Mary LaFrance, *Constitutional Implications of Acquisition-Value Real Property Taxation: Assessing the Burdens on Travel and Commerce*, 1994 UTAH L. REV. 1027, 1098. California’s method of taxation survived equal protection challenge in *Nordlinger v. Hahn*, 505 U.S. 1 (1992). *But see* *Allegheny Pittsburgh Coal Co. v. Cnty. Comm’n of Webster Cnty.*, 488 U.S. 336, 346 (1989) (finding a similar tax scheme implemented by discretion of individual property assessor was unconstitutional).

196. 28 U.S.C. § 1341 (2018). The term “tax” has been given a broad definition. *See* *Henderson v. Stalder*, 407 F.3d 351, 356 (5th Cir. 2005). For a critical discussion, see generally Brianne J. Gorod, Comment, *Limiting the Federal Forum: The Dangers of an Expansive Interpretation of the Tax Injunction Act*, 115 YALE L.J. 727 (2005). Although state court decisions may be appealed to the Supreme Court, there is no assurance of being granted certiorari.

197. 28 U.S.C. § 1341. For analysis of the scope of the TIA, see generally Robert F. Williams, *The Tax Injunction Act and Judicial Restraint: Property Tax Litigation in Federal Courts*, 12 RUTGERS L.J. 653 (1981); and Peter D. Enrich, *Federal Courts and State Taxes: Some Jurisdictional Issues, with Special Attention to the Tax Injunction Act*, 65 TAX LAW. 731 (2012). The “plain, speedy and efficient” language has been interpreted by the Court to cover only procedural matters. *Rosewell v. LaSalle Nat’l Bank*, 450 U.S. 503, 512–24 (1981).

198. *See* *Fulton Mkt. Cold Storage Co. v. Cullerton*, 582 F.2d 1071, 1078–80 (7th Cir. 1978), *abrogated by* *Real Est. Ass’n v. McNary*, 454 U.S. 100 (1981). For a discussion of the availability of monetary relief, see generally Frederick C. Lowinger, *The Tax Injunction Act and Suits for Monetary Relief*, 46 U. CHI. L. REV. 736 (1979), covering the history of the Tax Injunction Act and the various forms of relief it provides.

for a dispute to reach a federal court, a municipality's liability could be enormous.<sup>199</sup>

Does it make a difference to a litigant if a constitutional challenge to a discriminatory local tax is adjudicated in state or federal court? The traditional view is that the founders created federal diversity jurisdiction because they feared that state courts would be hostile to out of state interests,<sup>200</sup> but scholars disagree about whether state courts are as vigorous defenders as federal courts of rights under the U.S. Constitution in general.<sup>201</sup> In the case of protectionist property taxes, we have recent evidence of state courts' congenial treatment, although we cannot say that a federal court would decide these cases differently.

Many states and municipalities impose real estate transfer taxes. In Illinois, more than 40 municipalities provide an exemption or refund of the tax either because the purchaser of the property is a town resident or because the seller of the property acquires another property in the town shortly afterwards.

In *Rajterowski v. City of Sycamore*,<sup>202</sup> an Illinois appellate court considered an exemption of the first kind. The plaintiffs, who had moved to Sycamore from another city and were therefore not exempt from the transfer tax, raised two federal claims: that the tax violates their rights to travel and purchase property under Article IV and that the tax violated their right to equal protection under the Fourteenth Amendment.<sup>203</sup> The court dismissed the first claim for the plaintiff's failure to plead facts with enough specificity to demonstrate that there was no reasonable relationship between tax discrimination against outsiders and the problem of school underfunding, which the tax was intended to ameliorate.<sup>204</sup> After determining that the tax discrimination was only subject to rational basis review, the court easily concluded that the tax did not violate the Fourteenth Amendment.<sup>205</sup> The plaintiff did not raise a Commerce Clause challenge and we do not know how the court would have ruled on the privileges and immunities question if the pleadings had been more detailed. We think it is clear that this tax violates both the dormant Commerce Clause and Article IV.

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199. See, e.g., *Harper v. Va. Dep't of Tax'n*, 509 U.S. 86, 101 (1993) (requiring Virginia to provide "meaningful backward-looking relief to rectify" a discriminatory tax).

200. See ERWIN CHEMERINSKY, *FEDERAL JURISDICTION* § 5.3.2 (Wolters Kluwer 7th ed. 2016) (noting "[t]he traditional theory is that diversity jurisdiction was intended to protect out-of-state residents from the bias that they might experience, or at least fear that they might face, in state courts").

201. See Burt Neuborne, *Toward Procedural Parity in Constitutional Litigation*, 22 WM. & MARY L. REV. 725, 725 (1981) ("The debate over the relative efficacy of state and federal courts as constitutional enforcement forums may have reached an impasse.").

202. *Rajterowski v. City of Sycamore*, 940 N.E.2d 682, 691-97 (Ill. App. Ct. 2010).

203. *Id.* at 687.

204. *Id.* at 691.

205. *Id.* at 695-97.

*Stahl v. Village of Hoffman Estates*<sup>206</sup> involved a property tax exemption that was available to a property seller if she purchased another property in the city within a specified time period. In *Stahl*, the Illinois appellate court held that the exemption, which encourages reinvestment in local estate rather than in out-of-jurisdiction real estate, did not violate the dormant Commerce Clause because real estate sellers are not engaged in interstate commerce.<sup>207</sup> We argue above that investment is a form of commerce. The transfer tax in *Stahl* is not protectionist in the traditional sense of keeping foreign investment and commerce out; it is designed to keep local commerce in. Professors Knoll and Mason call such a tax “retentionist,” and it is no less violative of the dormant Commerce Clause than a protectionist tax.<sup>208</sup>

#### IV. THE WISDOM OF MUNICIPAL PROTECTIONIST PROPERTY TAXES

In this Part we address two policy questions about protectionist property taxes. First, are these taxes prudent? Second, should federal and state governments allow voters of a municipality to decide that they are?

Concerning the first question, we argue that protectionist property taxes are best understood as protectionist policies similar to export restrictions imposed on raw materials or food.<sup>209</sup> Like other protectionists, proponents of protectionist property taxes advance distributional justifications, such as ensuring that housing remains affordable for the poor.<sup>210</sup> We argue that income transfers can better achieve this goal. Another possible justification sounds in economic efficiency. Proponents of protectionist property taxes argue that foreign ownership can create negative externalities by increasing or decreasing density.<sup>211</sup> The plausibility of this argument depends on several factors, including a municipality’s freedom to use other tools to adjust the density and the share of housing owned by outsiders. Absent such externalities, standard economic analysis suggests that the losses suffered by the losers from these taxes are greater than the gains enjoyed by the winners.

Since the prudence of protectionist property taxes is context-specific, it is intuitive that municipalities should be free to decide for themselves whether to adopt these taxes. However, cities may not fully account for the costs of these taxes to the extent that the costs fall on outsiders who lack a political voice. Indeed, this ability to externalize costs is one of the stated justifications

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206. *Stahl v. Vill. of Hoffman Ests.*, 694 N.E.2d 1102, 1104 (Ill. App. Ct. 1998).

207. *See id.* at 1105–07. The court also rejected the plaintiff’s federal privileges and immunities and right to claims, and their due process, equal protection, and right to uniformity claims under the Illinois Constitution. *See id.* at 1108. *See generally* Ball v. Vill. of Streamwood, 665 N.E.2d 311 (Ill. App. Ct. 1996) (rejecting similar constitutional arguments to an identical transfer tax ordinance).

208. *See* Knoll & Mason, *supra* note 171, at 369.

209. *See infra* notes 215–20 and accompanying text.

210. *See infra* Section IV.A.3.

211. *See infra* notes 227–29 and accompanying text.



for protectionist property taxes.<sup>212</sup> As a result, there are plausible arguments for reserving the right to adopt these protectionist measures for the federal or state governments.<sup>213</sup>

#### A. ARE PROTECTIONIST PROPERTY TAXES PRUDENT?

Protectionist property taxes help preserve real estate for local residents.<sup>214</sup> In this way, they are economically similar to legal prohibitions or tariffs on the export of raw materials or food, adopted so that more is available for local businesses and consumers. In Section IV.A.1, we argue that protectionist property taxes are likely inefficient and reduce the welfare of local residents. However, we acknowledge that there are efficiency-based reasons for protectionist property taxes that are plausible in some circumstances, particularly when outside ownership becomes a significant share of the local real estate market. In Section IV.A.2 we turn our attention to the effect of protectionist property taxes on the housing risk to which local residents are exposed. Once again, outside ownership becomes less attractive when it predominates. Finally, in Section IV.A.3 we consider distributional arguments for protectionist property taxes, focusing on housing affordability for lower-income residents. We conclude that these laws are poor policy instruments. Indeed, these laws may leave low-income residents worse off while conferring benefits upon wealthy home buyers. We argue that housing vouchers or income transfers are a much better way to provide housing to the poor.

##### 1. Conventional Tax Policy Considerations

Tax policy balances equity and efficiency.<sup>215</sup> Standard economic theory suggests that taxes designed to protect local market actors are inefficient.<sup>216</sup>

<sup>212</sup>. See *infra* notes 227–29 and accompanying text.

<sup>213</sup>. See *infra* Section IV.B.

<sup>214</sup>. See, e.g., JONAS J.N. SHAEDE, FISCAL POL'Y INST., THE PIED-À-TERRE TAX: AN INTERNATIONAL REVIEW AND EVALUATION FOR NEW YORK 1 (2019), <http://fiscalpolicy.org/wp-content/uploads/2019/03/Pied-a-Terre-FPI.pdf> [<https://perma.cc/S5G6-THNE>] (arguing that second-home taxes are “a way to re-orient the local real estate market around housing for full-time residents”).

<sup>215</sup>. See, e.g., Joseph E. Stiglitz, *Pareto Efficient and Optimal Taxation and the New New Welfare Economics*, in 2 HANDBOOK OF PUBLIC ECONOMICS 991 (Alan J. Auerbach & Martin Feldstein eds., 1987) (reviewing the relevant literature on taxation). In addition to these familiar goals, taxes can also help stabilize an economy during an economic downturn. See Andrew T. Hayashi, *Countercyclical Property Taxes* 3–4 (Univ. Va. Sch. L., L. & Econ. Research Paper No. 2020-04, 2020), [https://papers.ssrn.com/sol3/papers.cfmabstract\\_id=3553859](https://papers.ssrn.com/sol3/papers.cfmabstract_id=3553859) [<https://perma.cc/X3B6-R9MS>].

<sup>216</sup>. For an economic analysis of food export restrictions, see generally Ramesh Sharma, *Food Export Restrictions: Review of the 2007–2010 Experience and Considerations for Disciplining Restrictive Measures* (FAO Commodity & Trade Pol'y Rsch., Working Paper No. 32, 2011), [http://www.fao.org/fileadmin/templates/est/PUBLICATIONS/Comm\\_Working\\_Papers/EST-WP32.pdf](http://www.fao.org/fileadmin/templates/est/PUBLICATIONS/Comm_Working_Papers/EST-WP32.pdf) [<https://perma.cc/Y6GP-75D5>].

Consider a simple protectionist tax—a tax on the export of a corn. Assume that this tax is adopted by a very small corn exporter such as India, which accounts for less than one percent of world corn exports.<sup>217</sup> Since India is such a small player in the corn market, any reduction in India’s exports will not affect the global price of corn. An economist would say that India has no “market power” in corn.<sup>218</sup> The tax should either cause India to cease exporting corn altogether or cause the price of corn in India to fall by the amount of the tax; if corn is trading at \$3.80 per bushel on the global market and the tax on corn is \$1.00, the price of corn in India should be \$2.80. If the local price were less than \$2.80, Indian farmers would export corn for \$3.80 and pay the \$1 tax, and the lack of corn available to local consumers will cause the local price to rise. If the Indian price were more than \$2.80, local farmers would export less and supply more corn to the local market until the price falls.

The drop in the local price of corn will hurt local farmers but benefit local buyers such as local cereal producers. However, farmers will lose more than the sum of the government’s revenue and the cereal producers gain. Why? Because if farmers are no longer receiving \$3.80 per bushel, they will produce less corn. This is inefficient because the social value of this lost corn, \$3.80, exceeds their cost of production. Moreover, the tax shifts some corn sales from the export market to domestic cereal producers. These sales are inefficient because the domestic cereal producers who began buying corn only after the fall in price value the corn at less than \$3.80—the amount that the farmers would receive if they could export the corn freely.

The analysis is more complicated if the export tax is adopted by a major corn exporter such as the United States, which accounts for more than 30 percent of world corn exports.<sup>219</sup> Just as a monopolist increases the price of

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217. See *Corn (HS 1005)*, OBSERVATORY ECON. COMPLEXITY (2018), <https://oec.world/en/profile/hs92/21005/Exporters> [<https://perma.cc/NAF6-8KXX>] (showing India exported 0.75 percent—\$256 million out of \$34.4 billion—of the global value of corn exports); see also SANTOSH K. SINGH, U.S. DEP’T OF AGRIC., GAIN REPORT NO. IN8027, INDIA: GRAIN AND FEED ANNUAL 2018, at 31 (2018), [https://apps.fas.usda.gov/newgainapi/api/report/downloadreportbyfilename?filename=Grain%20and%20Feed%20Annual\\_New%20Delhi\\_India\\_3-16-2018.pdf](https://apps.fas.usda.gov/newgainapi/api/report/downloadreportbyfilename?filename=Grain%20and%20Feed%20Annual_New%20Delhi_India_3-16-2018.pdf) [<https://perma.cc/8BXU-8FFC>] (“Indian corn is uncompetitive in the international market due to relatively weak international prices. Due to expected tight domestic supplies, Post forecasts MY 2018/19 corn exports lower at 300,000 MT, mostly to neighboring Nepal and some seed exports.”).

218. See MANKIW, *supra* note 52, at 12 (describing market power as “the ability of a single person or firm (or a small group) to unduly influence market prices”).

219. *Corn (HS 1005)*, *supra* note 217 (showing the United States exported 38.1 percent—\$13.1 billion—of the global value of corn exports in 2018); see also *Argentina, Brazil, and Ukraine Are Capturing the Growth in Global Corn Trade*, U.S. DEP’T OF AGRIC.: ECON. RSCH. SERV., <https://www.ers.usda.gov/data-products/chart-gallery/gallery/chart-detail/?chartId=92431> [<https://perma.cc/KN9H-VDJH>] (last updated Mar. 7, 2019) (showing that “[t]he United States is the world’s largest exporter of corn . . . In 2018, U.S. exports were nearly three times that of any of the closest U.S. competitors”).

its product by restricting output, the United States may be able to increase the global price of corn by reducing exports. Thus, a corn export tax could theoretically benefit the United States by improving the terms of its trade in goods with the world.<sup>220</sup> However, this benefit to the United States is precisely offset by the loss suffered by foreign buyers who must pay more for corn. The efficiency costs discussed above remain; farmers fail to grow corn that is valued more highly than the cost of production, and some domestic buyers purchase corn even though global buyers value it more highly. As a result, the export tax would still reduce global welfare. Moreover, any local gains enjoyed by the United States may be offset by losses if foreign jurisdictions adopt retaliatory measures.

At a basic level, the efficiency analysis of protectionist property taxes is similar to that of export taxes. Again, we begin by assuming the municipality has no market power so that the tax has little effect on the total price (sales price plus tax) that outsiders are willing to pay for local real estate. This would be true if outsiders are largely indifferent between a number of geographic locations for their real estate investments, and their demand for real estate in any particular city is very sensitive to an increase in taxes. Whereas residents choose a place to live on the basis of amenities such as schools, parks, and proximity to employment and family, investors may not have any such attachment to a particular place in deciding where to locate their capital. Real estate demand that is very sensitive to taxes in this way is known as “elastic” in the economics literature.<sup>221</sup>

If investor demand is very elastic, a protectionist property tax will have little or no effect on the welfare of outsiders. Even if outside investors pay this tax as a formal matter, they will bear none of its costs (its “incidence”) because they will only buy if the price of local real estate falls enough to compensate them for the tax. The true cost of the tax is therefore largely borne by existing owners of local real estate (some of whom, admittedly, may be outsiders) and

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220. Scholars and politicians have offered efficiency justifications for import and export restrictions. For example, an export restriction on corn may allow a local and infant cereal industry to develop and compete on the global stage. Important trade agreements have recognized an infant industry exception. *See, e.g., Note, Free Trade and Preferential Tariffs: The Evolution of International Trade Regulation in GATT and UNCTAD*, 81 HARV. L. REV. 1806, 1808 (1968).

221. *See, e.g., MANKIW, supra note 52, at 90* (defining elasticity as “a measure of the responsiveness of quantity demanded or quantity supplied to a change in one of its determinants”). One economist estimated this elasticity for New York City and found that second home buyers have “moderate sensitivity to taxation,” but also noted that this “sensitivity increase[es] in market value, consistent with non-resident buyers in the higher end of the market being more investment oriented.” Michael Suher, *Is Anybody Home? The Impact and Taxation of Non-Resident Buyers* 3 (Feb. 2016) (unpublished manuscript), [https://en-coller.m.tau.ac.il/sites/nihul.tau.ac.il/files/media\\_server/Recanati/management/elrov/Conf\\_Housing/Suher-TAU%20paper%20\(1\).pdf](https://en-coller.m.tau.ac.il/sites/nihul.tau.ac.il/files/media_server/Recanati/management/elrov/Conf_Housing/Suher-TAU%20paper%20(1).pdf) [<https://perma.cc/85MC-BL7D>].

those in the construction industry, because the fall in price should lead to less home building.<sup>222</sup>

Local buyers, who do not have to pay the export tax, will benefit from the price drop. However, the buyers' gain will be less than the owners' and builders' losses both because the price drop should reduce the supply of housing and because the local buyers who purchase a home only after the price drop value the home at an amount that is less than the amount the outside buyers would have paid to the owner. As a result, the protectionist property tax is inefficient and, unless outsiders already own much of the local real estate and bear a large share of the cost for that reason, the tax reduces the welfare of local residents as well.

Now assume that the jurisdiction does have market power. Just as product differentiation can give some brands market power in consumer goods (e.g., some consumers are willing to pay a premium for their preferred brand of soft drink),<sup>223</sup> a jurisdiction may have market power if its real estate has unique attributes that cannot be found elsewhere. Some buyers may have a special interest in a particular city either because the city has amenities that they desire for their vacation home or because the city has a sufficiently liquid market in high-value homes so that buyers can easily sell their properties at a future date and exit their investments.

If a city does have market power, outsiders will bear some of the cost of a protectionist property tax because the tax will increase the total price that outside investors pay. If the price increases by enough, the tax can make city residents better off through the same terms of trade effect described in the case of U.S. exports of corn. As in that case, this terms-of-trade gain enjoyed by locals comes at the expense of outside buyers, and the added efficiency costs ensure that global welfare falls. Of course, the political leaders of the municipality may care only about the welfare of local residents and not global welfare.

Some advocates argue that discouraging outside ownership, or at least discouraging second-homes, can improve a city's finances by attracting high-income residents who will pay income taxes.<sup>224</sup> We note that the gains the jurisdiction receives from high-income immigrants will be at least partially offset by losses from the jurisdictions that lose these high-earners, and so

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222. See *infra* notes 277–80 and accompanying text.

223. This market structure is called monopolistic competition. See, e.g., MANKIW, *supra* note 52, at 322–23 (describing monopolistic competition with differentiated products as a market structure in which a “firm chooses its quantity and price just as a monopoly does”).

224. See, e.g., Jeffery C. Mays & Jesse McKinley, *Lawmakers Support ‘Pied-à-Terre’ Tax on Multimillion-Dollar Second Homes*, N.Y. TIMES (Mar. 11, 2019), <https://www.nytimes.com/2019/03/11/nyregion/mta-subways-pied-a-terre-tax.html> [<https://perma.cc/S5UG-K7D9>] (“If they chose to sell, then the property has the chance of being purchased by a full-time city resident, who would then be subject to income and sales tax.”).

this is not a strong argument for increasing global welfare.<sup>225</sup> Even if the municipality only cares about the welfare of local residents, we still do not find this argument convincing. The argument assumes that the homes of the missing second-home buyers will be filled by high-income immigrants. To be sure, foreign investment tends to be concentrated in higher value housing.<sup>226</sup> However, the absence of outside buyers may simply mean that their luxury homes will be purchased by high-income locals who already pay income taxes to the city or that fewer luxury homes are built. Of course, these local buyers of luxury homes may sell their old homes to high-income immigrants, but this is just one of many possibilities. For example, locals may simply consume more housing, such as by living alone rather than with a roommate. Finally, we note that outside owners pay property taxes but do not utilize costly government services such as public schooling, so their net impact on local government finances is ambiguous.

A more plausible efficiency justification for protectionist property taxes is a version of the standard externality argument. Supporters of protectionist property taxes claim that second-home buyers harm their neighbors (imposing an “externality”) by changing the neighborhood’s density.<sup>227</sup> In rural vacation areas, the suggested harm is from too much density; too many houses spoil the mountain views and too many hikers clog the trails.<sup>228</sup> In cities, the suggested harm is from too little density; there are not enough people to support local restaurants, and city-dwellers may prefer livelier neighborhoods to ghostly streets where foreign investors park their “blocks of

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225. The game may not be entirely zero-sum if the move increases the earnings capacity of these individuals.

226. See NAR REPORT, *supra* note 26, at 19; see *supra* text accompanying note 26.

227. See, e.g., Christian Hilber, *Second Home Investments*, CENTREPIECE, Autumn 2018, at 25, 25 (“The backlash has at least in part been driven by legitimate concerns, such as . . . destruction of areas of natural beauty or creation of ghost towns during large parts of the year.”); Jack Favilukis & Stijn Van Nieuwerburgh, *Out-of-Town Home Buyers and City Welfare* 1 (July 17, 2020) (unpublished manuscript), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2922230](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2922230) [<https://perma.cc/BF64-845R>] (using a model to demonstrate how out-of-town home purchases can decrease residents’ welfare in terms of housing affordability and aggregate employment). In the aftermath of the foreclosure crisis, scholars pointed to blight or other externalities caused by vacant homes. See, e.g., David P. Weber, *Taxing Zombies: Killing Zombie Mortgages with Differential Property Taxes*, 2017 U. ILL. L. REV. 1135, 1136–37.

228. See Hilber, *supra* note 227, at 25–26; Katharine Q. Seelye, *Welcome to Provincetown. Winter Population: Dwindling*, N.Y. TIMES (Dec. 20, 2015), <https://www.nytimes.com/2015/12/21/us/welcome-to-provincetown-winter-population-dwindling.html> [<https://perma.cc/D4T2-39AK>] (describing tax decreases for year-round residents and increases for second-home owners to address seasonal fluctuation in population, and infrastructure challenges related to the fluctuation); Nosheen Iqbal, *Are Holiday Homes Ruining the British Seaside?*, GUARDIAN (Aug. 19, 2018, 4:00 AM), <https://www.theguardian.com/money/2018/aug/19/are-holiday-homes-ruining-uk-seaside> [<https://perma.cc/7A8K-VX9L>] (describing problems caused by number of holiday homes in British towns like St. Ives, including home prices too expensive for year-round residents, inadequate infrastructure for holiday crowds and “ghost towns” during the off-season).

bullion in the sky.”<sup>229</sup> Just as a tax on harmful pollutants can cause the emitter to account for the social costs created by her activities, so a tax on outside owners might cause outside investors to reduce their demand for real estate to account for these density costs.

This concern cannot be dismissed out of hand. A large amount of economics literature suggests that urban density can substantially increase labor productivity,<sup>230</sup> and there is evidence that vacant homes can increase crime and other problems.<sup>231</sup> That said, once a city becomes very dense, the loss from reducing density by a small amount may be relatively small,<sup>232</sup> and so it is unlikely that a small amount of outside ownership would impose significant costs. Even if local population density is not quite optimal, cities have other, more direct, means of targeting the problem. They can, for example, ease zoning restrictions to allow for more housing to be built.

## 2. Risk Management

Although equity and efficiency in the allocation of housing are important values, focusing only on these values provides a static and partial view of the costs of keeping outside investors out of the local housing market. People also care about stability. Life is full of risks, with technological change, natural disasters, economic booms and recessions all creating uncertainty and disrupting people’s life plans. Even short-lived fluctuations in housing markets can have significant effects on households, who may be compelled by

229. Kashmiri Gander, *London Mayor Boris Johnson Warns UK Should Not ‘Slam the Door’ on Super-Rich Foreigners*, INDEPENDENT (Jan. 17, 2014, 1:06 PM), <https://www.independent.co.uk/news/uk/politics/london-mayor-boris-johnson-warns-uk-should-not-slam-the-door-on-super-rich-foreigners-9067107.html> [https://perma.cc/D34T-JHTJ]; see, e.g., Julie Satow, *Pied-à-Neighborhood*, N.Y. TIMES (Oct. 24, 2014), <https://www.nytimes.com/2014/10/26/realestate/pieds-terre-owners-dominate-some-new-york-buildings.html> [https://perma.cc/T2L7-TTPD] (describing vacancy in Midtown Manhattan apartments, co-ops, and condos and a proposed tax targeted at non-New York residents).

230. See, e.g., Jaison R. Abel, Ishita Dey & Todd M. Gabe, *Productivity and the Density of Human Capital*, 52 J. REG’L SCI. 562, 565 (2012) (finding “a doubling of density increases productivity by an average of 2–4 percent” in a study of 363 U.S. metropolitan areas); Patricia C. Melo, Daniel J. Graham, David Levinson & Sarah Aarabi, *Agglomeration, Accessibility and Productivity: Evidence for Large Metropolitan Areas in the US*, 54 URB. STUD. 179, 189–91 (2017) (finding that employment density and travel time to jobs contribute to productivity in a study of major U.S. metropolitan areas); Shlomo Angel & Alejandro M. Blei, *The Productivity of American Cities: How Densification, Relocation, and Greater Mobility Sustain the Productive Advantage of Larger U.S. Metropolitan Labor Markets*, 51 CITIES 36, 48–49 (2016) (demonstrating importance of “tolerable commute range” to cities’ productivity). For a review of density’s benefits and costs, see generally Gilles Duranton & Diego Puga, *The Economics of Urban Density*, J. ECON. PERSPS., Summer 2020, at 3. While they do not explicitly advocate for protectionist property taxes, Duranton and Puga note that outsider ownership can “push toward suboptimally low levels of density” because “[w]hen the land is not owned by local residents, a fraction of the net benefits from density are transferred away as rents to absentee landowners who benefit from agglomeration without contributing to it.” *Id.* at 20.

231. See *supra* notes 113–15 and accompanying text.

232. This is just the standard economic assumption that the marginal benefit from a good generally declines as the amount of consumption increases.

life circumstances to buy or sell real estate when the market is unfavorable. Older households may need to sell their home to fund their retirement, and younger households may need to purchase or rent a bigger home to accommodate a growing family. Households may also have little ability to control when they move into or out of a city because of employment changes.

A core function of government is the efficient and equitable allocation of these risks among its citizens, and decisions about how open the economy is to trade, migration, and investment bear directly on that core function. An open economy is exposed to the risks of other economies. Natural or manmade disruptions to those outside economies will affect the migratory preferences of their residents and their demand for goods and services that are exported from the local market. As a result, the price of locally produced goods and services does not depend only on local demand.<sup>233</sup> Counterintuitively, exposure to the risks of outside economies can actually reduce the riskiness of economic life for locals, through the magic of diversification.<sup>234</sup> The net benefits to locals of diversification through open markets depends on locals' ability to diversify their own economic risks through private investment markets. Since the ability to access these markets varies widely among individuals, the diversification benefits of open economies will also differ among its citizens. Thus, distributional considerations need to be at the center of discussions about protectionist property taxes.

A home purchase is the largest single investment that most Americans will ever make,<sup>235</sup> and, as demonstrated by the housing market collapse preceding the Great Recession, it is an investment that exposes the buyer to significant risk.<sup>236</sup> Since the riskiness of a home's market value depends on

233. As a *Washington Post* journalist put it, "real estate markets are becoming disconnected from the economic reality of people who already live in these cities." Emily Badger, *Foreign Investors Are Making Housing More Expensive. Should We Tax Them for It?*, WASH. POST (May 20, 2014, 2:00 PM), <https://www.washingtonpost.com/news/wonk/wp/2014/05/20/foreign-home-buyers-are-making-housing-more-expensive-should-cities-tax-them-for-it> [<https://perma.cc/MT7Q-4JSg>]. Indeed, this is precisely how diversification works.

234. For an explanation of how diversification reduces risk, see *infra* Section IV.A.2.ii.

235. Graham T.T. Molitor, *Trends and Drivers in the Information Economy: Strategic Options for the Insurance and Banking Industry*, 2 *FORESIGHT* 55, 57 (2000); see also BD. OF GOVERNORS FED. RSRV. SYS., FINANCIAL ACCOUNTS OF THE UNITED STATES: FLOW OF FUNDS, BALANCE SHEETS, AND INTEGRATED MACROECONOMIC ACCOUNTS, FIRST QUARTER 2020, at 144 tbl.B.101.h (2020) (showing balance sheet of households, in particular that \$29,929.9 billion of households' \$35,682.4 billion total nonfinancial assets are real estate, and that \$10,600.1 billion of their \$15,577.6 billion liabilities are home mortgages).

236. See FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT 402 (2011) (noting that "[s]ince the housing bubble burst, about four million families have lost their homes to foreclosure and another four and a half million have slipped into the foreclosure process or are seriously behind on their mortgage payments" (footnotes omitted)); see also Michele Lerner, *10 Years Later: How the Housing Market has Changed Since the Crash*, WASH. POST (Oct. 4, 2018), <https://www.washingtonpost.com/news/business/wp/2018/10/04/feature/10-years-later-how-the-housing-market-has-changed-since-the-crash> [<https://perma.cc/52UL-3KRJ>] (noting ten

demand for that home, we turn now to the effects of opening the market for that home to foreign purchasers.

There are two ways that outsiders' demand for local housing can affect the riskiness of local housing. The first way is by correcting temporary mispricing of local real estate. If outsiders are careful observers of the market and profit by exploiting fluctuations in property values, they act as arbitrageurs and their investment and divestment can mitigate volatility in housing prices. But this picture turns out to be complicated by evidence that outside investors may be more likely to create mispricing through the creation of bubbles than they are to mitigate them as arbitrageurs. The second way that outside investors affect local housing risk is through diversification. Outside investors make holding local real estate less risky by introducing new and uncorrelated risks to the demand for that real estate.

*i. Are Foreigners Arbitrageurs or Naïve Investors?*

To see the potential of arbitrageurs to moderate price swings, consider the stock market. Firms issue new stock episodically, but the number of a firm's outstanding shares is fixed in the short run. Financial economists argue that very large orders to buy or sell shares are unlikely to affect the price of a firm's stock as long as market participants do not believe that the trader has inside information about the firm.<sup>237</sup> Informed investors (arbitrageurs) stand ready to buy shares when the price falls too low or sell shares if the price rises too high. As a result, share prices should always reflect the present value of the future cash flows of the firm.

Outside investors may have played this role in the London housing market during the recent financial crisis. The meltdown caused "chaos in the UK property market," but not in London,<sup>238</sup> despite the fact that London is a major financial center and one might have thought that it would have suffered the most. The resilience of the London property market is attributed in part to outside investors who rushed into the market in response to the fall in prices.<sup>239</sup> These initial outside investors were playing the part of arbitrageurs, preventing prices from falling too sharply. But the prices did not merely remain stable; they rose substantially as foreign investors came to view London as a convenient place to park their money—as a place to store "blocks of

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million people lost homes to foreclosure and homeowners lost \$16 trillion of their net worth in the recession that started in 2008).

237. See, e.g., RICHARD A. BREALEY, STEWART C. MYERS & FRANKLIN ALLEN, *PRINCIPLES OF CORPORATE FINANCE* 356 (13th ed. 2020).

238. Caitlin Morrison, *How the Global Financial Crisis Hit the UK Housing Market*, INDEPENDENT (Sept. 14, 2018, 4:40 PM), <https://www.independent.co.uk/news/business/analysis-and-features/global-financial-crisis-lehman-brothers-property-house-prices-uk-housing-market-a8538176.html> [<https://perma.cc/W6W5-35SS>].

239. *Id.*



bullion in the sky.”<sup>240</sup> Although locals might have been capable of performing the same arbitrage function, local investors may lack access to sufficient capital and may have little interest in placing such large bets on local real estate.<sup>241</sup>

This rosy, and largely theoretical, picture of the role of outside investors as arbitrageurs faces significant practical limitations. Would-be arbitrageurs face much higher transactions costs trading in the residential housing market than in markets for stock and securities.<sup>242</sup> For example, arbitrageurs who think that stock prices are too high can bet against the stock by selling stock that they borrow from a broker and promising to replace this borrowed stock in the future with the same stock.<sup>243</sup> It is obviously much more difficult to short the housing market because real estate is not fungible.

Although it is possible for outside investment to play a stabilizing role when local real estate prices become decoupled from the economic fundamentals of the market, it is also true that this investment can fuel speculative bubbles, introducing volatility as investors purchase real estate solely because they anticipate being able to sell the property in short order to another buyer, who in turn buys the property expecting to sell it to another buyer, before real estate prices correct downward.<sup>244</sup> On this view, not only do outside investors drive an increase in home prices, which they did in the U.K. and Swiss housing booms that preceded the Great Recession,<sup>245</sup> but they also cause real estate prices to separate from economic fundamentals.

240. See, e.g., Gander, *supra* note 229.

241. One reason for foreign investors' attraction to this investment is that it provides greater diversification for their portfolios. See *infra* Section IV.A.2.ii.

242. Arbitrage can even be difficult in the stock market. See, e.g., BREALEY ET AL., *supra* note 237, at 351–53.

243. *Id.*

244. There is no agreed upon definition of a bubble. One proffered definition is that it is when the realized return over some time interval is more than two standard deviations above its expected return. See generally Jeremy J. Siegel, *What is an Asset Price Bubble? An Operational Definition*, 9 EUR. FIN. MGMT. 11 (2003) (reviewing and analyzing current definitions of bubbles and “propos[ing] an operational definition of a bubble as any time the *realised* asset return over given future period is more than two standard deviations from its *expected* return”).

245. See ANDREW HAUGHWOUT, DONGHOON LEE, JOSEPH TRACY & WILBERT VAN DER KLAUW, FED. RESRV. BANK N.Y., STAFF REP. NO. 514, REAL ESTATE INVESTORS, THE LEVERAGE CYCLE, AND THE HOUSING MARKET CRISIS 12–17 (2011), [https://www.newyorkfed.org/medialibrary/media/research/staff\\_reports/sr514.pdf](https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr514.pdf) [<https://perma.cc/Q4ZG-KH88>]; Filipa Sá, *The Effect of Foreign Investors on Local Housing Markets: Evidence from the UK* 11 (Ctr. for Macroeconomics, Discussion Paper No. 1639, 2016), <http://www.centreformacroeconomics.ac.uk/Discussion-Papers/2016/CFM2016-39-Paper.pdf> [<https://perma.cc/X4R3-9K58>] (finding positive price effects on U.K. house prices and home ownership rates, using data on properties owned by overseas companies); Hilber & Schöni, *supra* note 24, at 5 (noting that non-resident real estate investors can increase local house prices and fuel market instability).

And there is evidence that second-home buyers do in fact behave as misinformed speculators and magnify housing bubbles.<sup>246</sup> Thus, discouraging second home buyers may lead to more stable home prices, an argument that has found traction not only in the United States, which has a long history of booms and busts in the real estate market,<sup>247</sup> but also other countries that share similar experiences. For example, foreign investment in Vietnam's real estate market may have contributed to the formation of a bubble and to macroeconomic instability.<sup>248</sup> There is also evidence of outside investment driving price volatility in London and Singapore.<sup>249</sup>

Foreign investors can also expose local residents to downside housing price risk. If a large share of a city's real estate is owned by investors from a particular country, that city's real estate prices could fall substantially if these outside investors are forced to sell their real estate to generate liquidity in response to an economic shock in their home country. For example, journalists have recently speculated that Brexit could sharply depress London real estate prices if foreign investors choose to divest en masse.<sup>250</sup>

### ii. *Outside Buyers and Diversification*

Even setting aside possible roles as arbitrageurs, the presence of outside buyers can stabilize housing demand.<sup>251</sup> This is obviously true if the demand

246. See Patrick Bayer, Christopher Geissler, Kyle Mangum & James W. Roberts, *Speculators and Middlemen: The Strategy and Performance of Investors in the Housing Market* 31–36 (Nat'l Bureau of Econ. Resch., Working Paper No. 16784, 2011), <https://www.nber.org/papers/w16784> [<https://perma.cc/RSM5-SMRR>]; Dragana Cvijanovic & Christophe Spaenjers, *Real Estate as a Luxury Good: Non-Resident Demand and Property Prices in Paris* 12–13 (Aug. 28, 2015) (unpublished manuscript), <https://pdfs.semanticscholar.org/7b66/a26f35d3d96f38ea4824400340ef3a6b862a.pdf> [<https://perma.cc/9ZHR-B2NP>] (finding that non-resident buyers realize lower capital gains and have a positive effect on price levels); see also Alex Chinco & Christopher Mayer, *Misinformed Speculators and Mispricing in the Housing Market*, 29 REV. FIN. STUD. 486, 509–15 (2016) (finding that out-of-town second-home buyers behave like misinformed speculators and obtain lower returns than local buyers).

247. See Edward L. Glaeser, *A Nation of Gamblers: Real Estate Speculation and American History*, AM. ECON. REV.: PAPERS & PROC., May 2013, at 1, 1–2.

248. See generally Thanh Nga Nguyen, *Foreign Direct Investment in Real Estate Projects and Macroeconomic Instability*, 28 ASEAN ECON. BULL. 74 (2011) (arguing foreign domestic investment into Vietnam's real estate market and construction sector is a significant contributor to macroeconomic instability).

249. Cristian Badariza & Tarun Ramadorai, *Home Away from Home? Foreign Demand and London House Prices*, 130 J. FIN. ECON. 532, 533 (2018) (“Real estate prices around the world have been particularly volatile over the past few decades, exhibiting dramatic booms and occasional busts. A widely held view is that foreign capital is at least partly responsible for these gyrations in prices, especially in global cities such as London, New York, and Singapore . . .”).

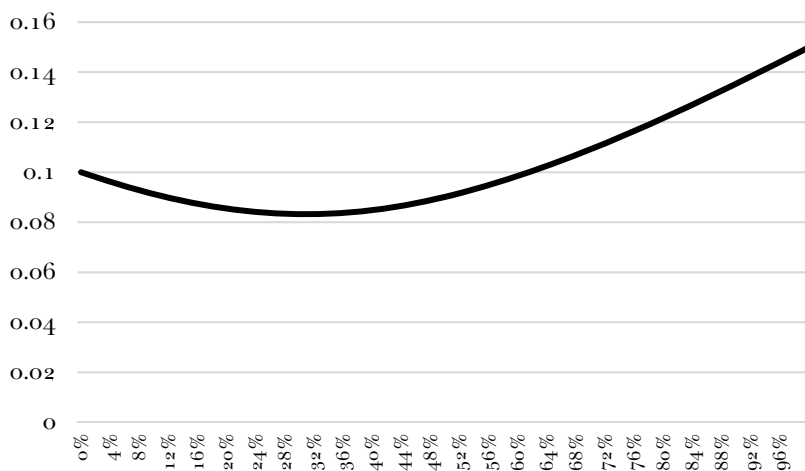
250. Morrison, *supra* note 238.

251. This is in sharp contrast to the argument of Favilukis and Van Nieuwerburgh that foreign investors reduce welfare by introducing aggregate risk. See Favilukis & Van Nieuwerburgh, *supra* note 227, at 16, 45. Critically, however, shocks to aggregate demand “are the only source of aggregate risk in [their] model,” and thus their model excludes the possibility of diversification. See *id.* at 16.

of outside buyers for local real estate is inherently more stable than the demand of local buyers, but the presence of outside buyers can stabilize aggregate housing demand even if foreign demand is inherently *less stable*. To see this, consider a very simple numerical example. Assume that a coin flip will determine whether the housing demand of local buyers increases or decreases by ten percent, and a second coin flip determines whether the local housing demand of outside buyers increases or decreases by 15 percent. That is, outside demand is 50 percent riskier than local demand. However, since the two coin flips are independent of each other, local and outside demand are uncorrelated.

Figure 4 shows how the riskiness of aggregate housing demand changes with the share of housing demand initially attributable to outsiders (before the coin flips).<sup>252</sup> Because we assumed that outside demand is half again riskier than local demand, a market that is wholly comprised of outside buyers is half again riskier than a market wholly dominated by local buyers. Importantly, however, increasing the share of outside buyers actually reduces the riskiness of local real estate as long as outside buyers do not account for too much (here about 30 percent) of the market. When outside buyers account for 30 percent of the market, they reduce the risk of aggregate housing demand by about 17 percent. The reason for this fall in risk is diversification.

Figure 4. Risk of Aggregate Housing Demand



252. Risk is measured by its standard deviation. Financial economists frequently measure risk by the standard deviation or the square of this measure, the variance. See, e.g., BREALEY ET AL., *supra* note 237, at 174 (describing risk as the spread of possible outcomes and noting that “[t]he standard statistical measures of spread are variance and standard deviation” (emphasis omitted)).

Diversification is a fundamental principle of modern finance.<sup>253</sup> Portfolios with many investments have more predictable returns than portfolios with few. An abstract example will help illustrate the point. Betting a large sum of money on a single coin toss is very risky as you will lose your money half the time. However, if you spread your bets over 100 coin tosses, you can be confident that you will win about half of your bets and thus are likely to break even. In fact, there is a 96 percent chance that you will win between 40 and 60 percent of your bets.<sup>254</sup> If you spread your bets over 1,000 coin flips, you are almost certain to have neither won nor lost very much in the aggregate. There is an almost 99 percent chance that you will have won between 46 and 54 percent of your bets.<sup>255</sup> The two preceding examples assumed risks that were completely independent of one another, but this is not necessary for diversification to reduce risk; it is enough that the risks are not perfectly aligned. We discuss this point in more detail in the Appendix.

These benefits of diversification are well understood and are in fact one of the reasons why U.S. real estate is an attractive investment for foreigners. However, our point is quite different. When foreign investors purchase U.S. real estate to diversify their portfolios, they simultaneously bring the benefits of diversification to local homeowners by reducing the risk of a collapse in housing demand when the homeowners want to sell. San Marino, California, provides an especially vivid example of this phenomenon. The popularity of this wealthy enclave for foreign (specifically, Chinese) investors meant that it was the only part of the greater Los Angeles area that did not experience a housing price slump during the Great Recession.<sup>256</sup> In 2005, “[t]he share of absentee [home]buyers . . . in San Marino” was about 17 percent, and by 2011 it remained ten percent.<sup>257</sup> But there was a downside to having such a significant share of foreign owners. San Marino was negatively affected by the imposition of capital controls in China discussed in Part II.<sup>258</sup>

Local homeowners would not need the benefits of this diversification if they diversified their other asset holdings. But real individuals are not fully diversified. Many Americans have little wealth beyond their human capital,<sup>259</sup>

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253. See *id.* at 176–90.

254. These figures can be calculated using the binomial distribution or Excel’s “BINOM.DST” function.

255. These figures can be calculated using the binomial distribution or Excel’s “BINOM.DST” function.

256. Lauren Beale, *Housing Crisis Hasn’t Touched San Marino*, L.A. TIMES (Jan. 31, 2011, 12:00 AM), <https://www.latimes.com/business/la-xpm-2011-jan-31-la-fi-san-marino-housing-20110131-story.html>.

257. *Id.*

258. David Pierson, *Mega-Mansions in this L.A. Suburb Used to Sell to Chinese Buyers in Days. Now They’re Sitting Empty for Months*, L.A. TIMES (Feb. 23, 2017, 3:00 AM), <https://www.latimes.com/business/la-fi-san-gabriel-housing-20170223-story.html>.

259. See, e.g., João F. Cocco, *Portfolio Choice in the Presence of Housing*, 18 REV. FIN. STUD. 535, 561 (2005) (finding that human capital comprised more than 86 percent of the total assets of

a term that economists use to describe an individual's future earning capacity. Like most other investments, human capital is inherently risky. Sickness or disability can deprive a worker of her earnings potential. Technology may render the individual's education or skills less valuable than they once were. The worker's firm may fail, destroying any skills that were specific to that firm. Workers receive some protection against these risks through social insurance programs, informal insurance through family and social networks, and the right to file for bankruptcy.<sup>260</sup> However, this protection can be quite limited.

Similarly, the diversification benefits of outside ownership are greatest for local economies that are dependent on a single industry. For example, Houston, Midland–Odessa, and Calgary are heavily reliant on natural resource extraction,<sup>261</sup> and housing prices in these cities are sensitive to fluctuations in the price of oil and natural gas.<sup>262</sup> By contrast, the diversification benefits are smaller in cities with well-diversified economies, such as San Diego.<sup>263</sup>

Some homeowners own assets such as stocks and bonds, but their homes themselves are typically their most valuable asset.<sup>264</sup> By concentrating financial capital in a single, geographically-situated asset, these individuals enjoy only modestly more diversification benefits than non-homeowners. Real estate is not a riskless investment.<sup>265</sup> Home prices rise and fall. Sometimes these swings are due to macroeconomic factors such as the Great Recession that affect

households under age 35 and even comprised more than 61 percent of total assets of households age 65 and over).

260. For a discussion of bankruptcy as a form of insurance, see Richard M. Hynes, *Non-Procrustean Bankruptcy*, 2004 U. ILL. L. REV. 301, 328–31.

261. ROBERT W. GILMER, TIMOTHY K. HOPPER & SCOTT SCHWARTZBERG, FED. RESRV. BANK DALL., IS THERE LIFE AFTER OIL IN MIDLAND AND ODESSA? 1 (2003), [https://www.dallasfed.org/~media/documents/research/houston/2003/hbo3o6.pdf](https://www.dallasfed.org/~/media/documents/research/houston/2003/hbo3o6.pdf) [<https://perma.cc/G2AE-C986>] (“Because these two cities are located in the heart of the Permian Basin, oil has been their most important economic force for 80 years, and—like Houston during this same period—Midland and Odessa have repeatedly ridden the boom and bust cycles of the oil and natural gas industry.”).

262. See Laura Kusisto & Rita Trichur, *Calgary Home Market Struggles with Oil Bust*, WALL ST. J. (Apr. 5, 2016, 4:53 PM), <https://www.wsj.com/articles/calgary-home-market-struggles-with-oil-bust-1459876561> [<https://perma.cc/9VZM-8KM9>] (comparing Calgary's more widespread home sale decreases to Houston's decrease in sales of higher-priced homes and noting the 1980s oil price drop's greater impact on both cities' economies).

263. For an estimate of the diversification of the employment bases of several major American cities, see SCOTT M. STRINGER, OFF. N.Y.C. COMPTROLLER, NEW YORK CITY'S ECONOMY HAS BECOME MORE DIVERSIFIED: SO WHAT? 9 (2017), [https://comptroller.nyc.gov/wp-content/uploads/documents/NYC\\_Economy\\_Diversified.pdf](https://comptroller.nyc.gov/wp-content/uploads/documents/NYC_Economy_Diversified.pdf) [<https://perma.cc/NMT4-JRN2>]. Note that size alone is insufficient to ensure diversification. For example, New York City planners worry about its excessive reliance on the securities industry and the vulnerability of the city to economic downturns. *Id.* at 4.

264. See Cocco, *supra* note 259, at 561 (reporting that real estate accounted for more than 73 percent of financial assets for households under age 35 and nearly 60 percent of financial assets for households age 65 and older).

265. See, e.g., Glaeser, *supra* note 247, at 3.

virtually all investments, but there are other risks that are unique to local residential real estate. For example, a home's price may fall because of conditions specific to the home (e.g., termites damage the structure) or conditions specific to the neighborhood or city (e.g., a local plant closure, municipal mismanagement, or natural disasters) or conditions specific to residential housing in general (e.g., repeal of favorable tax treatment such as the mortgage interest deduction or the exclusion of gains from the sale of a principal residence).<sup>266</sup> In some cases, the same risks that may destroy a worker's human capital (e.g., a plant closure) can also destroy the value of her home. This is important, because the diversification benefit from homeownership depends on how different the risks to the home's value are from the risks facing the owner's other assets.<sup>267</sup>

Finally, we note that a reduction in housing demand risk may not be good for all residents. Consider again cities such as Houston, Midland–Odessa, and Calgary that depend on the natural resource industry. A decline in this industry will almost certainly reduce the employment prospects of residents of this city as well as housing prices. For homeowners this is two pieces of bad news, but for renters the drop in housing prices may help cushion the blow of the fall in their wages. Risk must be evaluated in terms of an investor's portfolio, and renters effectively have short positions in real estate, benefitting from a decline in property values.<sup>268</sup> This position may be negatively correlated with their human capital because the same economic shocks that reduce their wages may reduce housing prices. To the extent that foreign investment stabilizes prices, it eliminates this effective wage insurance.

### 3. Distributional Considerations

Protectionist policies are usually justified with distributional arguments. For example, proponents of corn export restrictions may argue that the

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266. See I.R.C. §§ 121, 163 (2018). Professor Fennell “distinguish[es] between onsite and offsite [factors that] influence[] . . . home values.” Lee Anne Fennell, *Homeownership 2.0*, 102 NW. U. L. REV. 1047, 1073 (2008). Offsite factors are those that are largely outside the homeowner's control, such as demand for local housing from abroad. Fennell argues that homeownership should disentangle onsite from offsite factors in defining “Homeownership 2.0.” *Id.*

267. Thus, a portfolio of investments that is concentrated should be much less valuable than a fully diversified portfolio. See, e.g., Richard M. Hynes, *Unique Risk and Bankruptcy Valuation*, 168 U. PA. L. REV. ONLINE 49, 55–56 (2019). For articles discussing optimal portfolio choice in the presence of housing, see generally Cocco, *supra* note 259; and Rui Yao & Harold H. Zhang, *Optimal Consumption and Portfolio Choices with Risky Housing and Borrowing Constraints*, 18 REV. FIN. STUD. 197 (2005).

268. Professors Fennell and Roin describe some of the problems arising from residents who have either too small or too large a stake in the local housing market, and they suggest that there are benefits from more diverse forms of stakeholding that allow residents to avoid these extremes. See generally Lee Anne Fennell & Julie A. Roin, *Controlling Residential Stakes*, 77 U. CHI. L. REV. 143 (2010).

restrictions will ensure that the poor can afford food.<sup>269</sup> Advocates of protectionist property taxes argue that the resulting price reduction will make housing more affordable for the poor. In both cases, we think that income transfers would likely provide more targeted relief to low-income residents.

At first glance, taxes on outside ownership, second homes, and vacancies would seem to score well on grounds of equity. Indeed, proponents sometimes label these taxes “oligarch taxes” because they can be structured so that they are paid by foreign buyers.<sup>270</sup> While this may overstate matters, outside purchasers of real estate are likely to be wealthier than most residents of the typical city or county, if only because the ability to buy a second home requires more investment capital and access to credit than the average homeowner has. Similarly, a property owner that leaves the property vacant foregoes the rental income that she would otherwise obtain from leasing the property in exchange for the flexibility of using the property at her convenience, to purchase greater anonymity, or merely to avoid the hassle of dealing with tenants.

However, a fundamental lesson of tax scholarship is that what determines who bears the cost of a tax is not who writes the check but rather the elasticities of supply and demand.<sup>271</sup> As noted above, outside demand for real estate may be relatively elastic (price sensitive), and this elasticity likely increases as one focuses on more valuable property.<sup>272</sup> If this is the case, then outsiders will not bear the burden of a protectionist tax either because they will stop buying local real estate or the price will fall to compensate them for having to pay the tax.<sup>273</sup> As a result, the burden of the tax will instead fall on current owners of local real estate, property developers, and those in the construction industry.<sup>274</sup>

Thus, evaluating the distributional effects of protectionist property taxes depends crucially on whether outside investment affects local housing prices and, if so, whether the effects are concentrated on more or less valuable homes. If outside investment increases the price of only the most expensive properties, then the burden of a protectionist property tax is unlikely to fall on low-income households. But if this is true, it also undermines the argument that the taxes improve housing affordability for low-income households.

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269. See, e.g., Tom G. Hall, *Wilson and the Food Crisis: Agricultural Price Control During World War I*, 47 *AGRIC. HIST.* 25, 28–30 (1973) (describing lobbying efforts for a food embargo during World War I to ensure an adequate domestic supply and keep domestic prices low).

270. See, e.g., De Lea, *supra* note 106 (characterizing a second-home tax as a tax on “oligarchs”).

271. See MANKIWI, *supra* note 52, at 154 (“[T]he elasticities of supply and demand determine how the tax burden is distributed between producers and consumers.”).

272. See generally Suher, *supra* note 221 (“[T]his sensitivity to taxation is higher for higher price properties.”).

273. See *supra* notes 221–23 and accompanying text.

274. See *infra* notes 277–79 and accompanying text.

Evidence from Paris and New York City suggest that foreign investment increases the price of local real estate primarily in the most desirable parts of the city.<sup>275</sup> Thus, the primary beneficiaries of taxes on outside owners may be higher-income home buyers who can afford the homes that would have otherwise been purchased by second-home buyers.

Protectionist property taxes may be poorly targeted at helping the poor. But the empirical literature does not suggest that all the effects of outside investment are localized to particular neighborhoods or market segments, and one can imagine several possibilities for how events will unfold if outside investors are driven out of the real estate market. The access-to-housing argument for protectionist property taxes assumes that fewer outside buyers will result in a chain of property sales that ultimately makes more housing available to lower or middle-income residents. The greater density argument assumes that this chain of sales ultimately results in more housing for new immigrants to the city or to households who would have otherwise emigrated. The greater income tax argument assumes that the chain of sales results in more high-income immigrants to the city and not lower-income residents who would pay little in tax and utilize more government services than outside investors and second-home buyers. Each of these stories is plausible, though they are obviously inconsistent with one another.<sup>276</sup>

In fact, protectionist property taxes may actually transfer wealth from poor residents to rich residents. In a recent paper, Professors Hilber and Schöni argue that working class residents may be hurt by a foreign owner or second-home tax if the market for second homes is sufficiently different from the market for residential homes.<sup>277</sup> They offer an example of a Swiss mountain town in which second-home buyers prefer mountain homes with spectacular views while residents prefer homes located near schools and grocery stores.<sup>278</sup> A collapse in the price of mountain homes does not help local residents because they are buying very different homes. The reduced demand for real estate may also reduce new construction in the jurisdiction,

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275. See Cvijanovic & Spaenjers, *supra* note 246, at 8–10; Suher, *supra* note 221, at 1, 18–19, 27. In their study of London real estate, Professors Badarinza and Ramadorai find that fluctuations in foreign demand for real estate accounts for 7.9 percent of the variation of London house prices. Badarinza & Ramadorai, *supra* note 249, at 534.

276. Vacant and second-home taxes may have an additional redistributive effect by shifting bargaining power to prospective lessees. Vacancy taxes raise the cost to the landlord of denying a lease application or evicting a tenant. See Sébastien Ménard, *Should We Tax Vacant Dwellings? A Search Equilibrium Model Applied to the Rental Housing Market*, 117 *ECON. LETTERS* 88, 89–90 (2012); Mariona Segú, *Taxing Vacant Dwellings: Can Fiscal Policy Reduce Vacancy?* 4 (Munich Personal RePEc Archive, Working Paper No. 89686, 2018), [https://mpira.uni-muenchen.de/89686/1/MPRA\\_paper\\_89686.pdf](https://mpira.uni-muenchen.de/89686/1/MPRA_paper_89686.pdf) [<https://perma.cc/LHC2-2TZB>].

277. See generally Hilber & Schöni, *supra* note 24 (describing the ways a ban on new second home builds negatively impacts local economies). In contrast to our work, Hilber and Schöni do not consider the effect that foreign investment can have on the risk profile of local residents.

278. *Id.* at 8.



which may harm lower and middle-income households by reducing demand for their labor and thus lowering wages and employment among construction workers, contractors, and real estate professionals.<sup>279</sup> Thus, restrictions on foreign ownership or second homes may be both inefficient because they discourage the purchase of homes and inequitable because a significant portion of the cost of these policies is borne by lower and middle-income households.

Whether the concerns noted by Hilber and Schöni apply to the imposition of a second-home tax in any particular jurisdiction depend on local land use regulations and the separation between the various housing markets. Their story focuses on a context with sharply dichotomous housing markets, but the various submarkets in a city may be more interconnected.<sup>280</sup> This is especially true if outside buyers are targeting a wide range of homes in a city instead of just a small number of high-end properties. If a city's zoning restrictions already constrain new construction, the additional effects of second home and foreign owner taxes on real estate would be attenuated. Still, given that outside buyers tend to target higher end housing and that construction serves as a major source of employment, their concern should be taken seriously.

#### B. SHOULD MUNICIPALITIES BE FREE TO DECIDE?

In Section IV.A, we argued that protectionist property taxes are likely inefficient, a poor policy for achieving housing affordability, and may increase the riskiness of homeownership. However, we also noted that when outsiders acquire a very large share of local real estate, then one can credibly argue that outside ownership imposes negative externalities and that the diversification benefits of further foreign ownership become minimal. In other words, the desirability of protectionist property taxes is likely to be context specific. We conclude by highlighting a couple considerations for whether municipalities are the right level of government for setting protectionist property taxes.<sup>281</sup>

Policy choices that are context specific seem ideal for decentralized decision-making. Municipalities have much better information about the context in which they operate than the federal or even state government, and so legal rules that depend on local economic and cultural conditions for their

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279. *Id.* at 28. Switzerland's banned construction of new second homes in certain touristic areas lowered price growth on primary homes and increased price growth of second homes and increased the growth in local unemployment rates. *Id.*

280. Housing markets are likely to be more homogeneous within a city than across cities, or even across a metropolitan area. When potential homebuyers are "broad searchers" who view homes across several different areas as substitutes, housing shocks (such as new construction) to submarkets within the scope of their search tend to be dispersed. Monika Piazzesi, Martin Schneider & Johannes Stroebel, *Segmented Housing Search*, 110 AM. ECON. REV. 720, 723-24 (2020).

281. For a fuller discussion of these issues, see Schragger, *supra* note 143, at 1143-59.

efficacy should be left to local governments.<sup>282</sup> Or so the argument goes. But just as we worry that individuals will not make decisions in the social interest when their actions impose significant costs on their neighbors, we might also worry that local governments will not take accounts of the costs of their decisions on individuals who cannot participate in the municipality's political process.<sup>283</sup> Thus, if a city enjoys substantial market power, outsiders who lack local political representation may bear much of the cost of protectionist property taxes, leading to taxes that are inefficiently high.<sup>284</sup>

This is not to say that municipalities should never be allowed to take actions that affect those who live outside their boundaries. Outsiders themselves may take actions that impose more costs than benefits on the jurisdiction. This is the standard argument for so-called "commuter taxes." Commuters use city resources like streets and so should pay for the services.<sup>285</sup> Similarly, outside owners utilize city services like police forces and fire departments that protect their property and so should pay for them. The obvious problem with this argument is that outsiders do pay for these services through property taxes.<sup>286</sup> One therefore needs to explain why the property taxes are insufficient to cover these costs.

A second reason for sometimes allowing cities to exploit their market power is that it gives them an incentive to make good decisions that make their real estate attractive to outside investors. Just as society accepts the inefficiencies generated by patents and copyrights to provide inventors with

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282. See, e.g., Clayton P. Gillette, *Who Should Authorize a Commuter Tax?*, 77 U. CHI. L. REV. 223, 223 (2010) (arguing "that state representatives have fewer incentives to consider the benefits, as well as the costs of . . . a commuter tax").

283. See *id.* at 234 (summarizing arguments against allowing cities to impose taxes on non-residents as "[l]eft to their own devices, officials of central cities might be thought systematically biased in favor of the tax because it provides them with revenues for which their constituents do not bear the burden").

284. Wildasin and Wilson present an argument that is similar to our own in that cities that are not constrained in their policy making adopt inefficiently high taxes that prevent citizens from enjoying the benefits of diversification. See David E. Wildasin & John Douglas Wilson, *Risky Local Tax Bases: Risk-Pooling vs. Rent-Capture*, 69 J. PUB. ECON. 229, 244 (1998) ("[D]ecentralized taxation can lead to inefficient allocation of risk."). Notably, this occurs in their model even though locals and foreigners pay the same property taxes. See *id.* at 230.

285. See Gillette, *supra* note 282, at 227-33 (summarizing the argument). However, both the federal and state governments have limited the authority of cities to impose commuter taxes. See, e.g., Herbert Kaylor, *The Experience of Several Cities in Implementing a Commuter Tax*, TAX NOTES (July 12, 2004), <https://www.taxnotes.com/tax-notes-today-state/individual-income-taxation/experience-several-cities-implementing-commuter-tax/2004/07/12/4ko2?highlight=%22The%20Experience%20of%20Several%20Cities%20in%20Implementing%20a%20Commuter%20Tax%22> [https://perma.cc/W45C-QPWZ].

286. Similarly, commuters do pay some taxes and provide benefits to the city. Gillette, *supra* note 282, at 229 (noting that commuters may provide benefits that exceed the costs they impose and that "[t]he evidence on the competing empirical claims, however, is highly contestable"). Notwithstanding these arguments, Gillette argues that the city may still be the best level of government to decide on the advisability of a tax because competition will discipline its behavior. *Id.* at 235-39.

the incentive to create,<sup>287</sup> perhaps cities should be allowed to tax outside buyers as an incentive to create the type of markets where those outsiders would want to invest.

In summary, the desirability of state or federal laws that restrict the ability of a municipality to enact protectionist property taxes depends on which externality is bigger. If one believes that cities are merely charging for a cost that nonresidents are imposing on the city, higher levels of government should not intervene. However, these governments should not allow a city to use these discriminatory taxes as a way to shift some of the city's fiscal burden to those who cannot vote in city elections.

## V. CONCLUSION

Cities around the world are adopting taxes to discourage foreign investment in local real estate and preserve property for residents. We analyze whether local governments in the United States could adopt similar taxes as a way of increasing the availability of affordable housing and insulating residents from the vicissitudes of foreign markets and the volatility of foreign investment.

We conclude that protectionist property taxes are likely unconstitutional and are almost certainly bad policy as there are better ways to achieve desirable goals, such as ensuring the availability of affordable housing. Vacant property and second-home taxes are much more likely to survive constitutional challenge, and they may be prudent policies when second-home buyers impose more costs than benefits upon a municipality. However, municipalities may be tempted to enact such taxes as they offer the hope of externalizing the tax burden onto unrepresented outsiders, so there may be a role for state or federal regulation to limit local adoption of protectionist property taxes.

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287. See *Graham v. John Deere Co. of Kan. City*, 383 U.S. 1, 11 (1966) (explaining patent law provides incentives for “those inventions which would not be disclosed or devised but for the inducement of a patent”); Michael Abramowicz & John F. Duffy, *The Inducement Standard of Patentability*, 120 YALE L.J. 1590, 1596 (2011) (arguing that the inducement standard is the correct standard for awarding patents).

## APPENDIX: DIVERSIFICATION

In this Appendix we present a slightly more formal model that demonstrates how foreign or other outside investment can reduce demand risk for local real estate owners. Assume that a city has a fixed supply of housing units,  $S$ . The local demand for housing is given by  $L - P$ , and the foreign demand for housing is given by  $M(F - P)$ .  $P$  is the price of a housing unit,  $M$  represents the relative importance of foreign investment in the real estate market, and  $L$  and  $F$  are variables that incorporate shocks to local or foreign demand. For example,  $L$  may be low because a local firm closes a plant and lays off workers, and  $F$  may be high because a booming foreign economy causes foreign investors to use their new wealth to buy housing in the local market. Alternatively,  $L$  may be high because the mayor launches a successful redevelopment plan that attracts new residents, and  $F$  may be low because a foreign government restricts the ability of its citizens to send money abroad. Assume that  $L$  and  $F$  are always sufficiently large that neither foreign nor local demand are ever negative.<sup>288</sup>

If the city allows foreign investment in real estate, the equilibrium price must equalize supply and demand,  $S = L - P + M(F - P)$ . The price that does this is given by:  $P = \frac{L+MF}{(1+M)} - \frac{S}{(1+M)}$ . If the city banned foreign investment in real estate,  $M$  would fall to zero, and, because the supply of housing is assumed to be fixed, the price of housing would fall to  $P = L - S$ .<sup>289</sup> This result captures much of the intuition that banning foreign investment can reduce aggregate demand and thus reduce housing prices, at least if the supply of housing is fixed. However, our focus here is on housing price risk.

Assume that the local housing demand variable,  $L$ , has a standard deviation of  $\sigma_L$ , the foreign housing demand variable has a standard deviation of  $\sigma_F$ , and that both are distributed normally. Because the supply of housing is constant, the variance of the price of housing is determined solely by the variance in the demand for housing. When foreign investment is prohibited, this variance is simply the variance of  $L$ , or  $\sigma_L^2$ . Similarly, the variance of the price of housing when foreign investment is permitted is determined by the variance of  $\frac{L+MF}{(1+M)}$ , which depends on both  $\sigma_L$  and  $\sigma_F$  but also on whether the two shocks are closely related. This concept is captured by the correlation

288. This requires that  $F \geq L - S$  and  $L \geq F - \frac{S}{M}$ .

289. Note that this is a reduction in price because the foreign demand for housing can't be less than zero;  $F \geq L - S$ .

coefficient,  $\rho_{LF}$ , which can vary between -1 and 1.<sup>290</sup> The variance of  $\frac{L+MF}{(1+M)}$  is given by:

$$\left(\frac{1}{1+M}\right)^2 \sigma_L^2 + \left(\frac{M}{1+M}\right)^2 \sigma_F^2 + 2\left(\frac{1}{1+M}\right)\left(\frac{M}{1+M}\right)\rho_{LF}\sigma_L\sigma_F$$

Banning foreign investment reduces local housing price risk if:

$$\left(\frac{1}{1+M}\right)^2 \sigma_L^2 + \left(\frac{M}{1+M}\right)^2 \sigma_F^2 + 2\left(\frac{1}{1+M}\right)\left(\frac{M}{1+M}\right)\rho_{LF}\sigma_L\sigma_F > \sigma_L^2$$

This is true when:

$$M(\sigma_F^2 - \sigma_L^2) + 2(\sigma_L(\rho_{LF}\sigma_F - \sigma_L)) > 0$$

When will this inequality hold? Foreign investment can only increase local housing price risk if  $\sigma_F > \sigma_L$ , which is to say that foreign demand is inherently riskier than local demand. This is certainly plausible. Local housing demand may have low risk if, for example, a city's industrial base is well-diversified so that aggregate employment is not vulnerable to a downturn in any one sector. Foreign demand may have high risk if it comes primarily from a small set of countries or is vulnerable to political risks such as the threat of Brexit. But it is not enough that  $\sigma_F > \sigma_L$ . When foreign demand has a small effect on aggregate demand ( $M$  is small) the first term becomes unimportant in the inequality. The second term is positive only if foreign demand is both riskier than local demand *and* is highly correlated with local demand. A few quick lessons emerge from this simple inequality. First, for the foreign investment to increase risk it must comprise a very large share of the local market. Second, the risk of foreign investment fleeing local real estate must be highly correlated with the other risks of the local market. When these are not true, foreign investment will make local real estate less risky through the power of diversification.

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290. If you bet on two separate coin flips, your investments would be independent and have a correlation of zero. If you bought two shares of the same stock, the returns on your two investments would be perfectly correlated and have a correlation coefficient of 1. If you bought a share of a stock and shorted a share of the same stock, your two investments would be perfectly negatively correlated and have a coefficient of -1.