CHAPTER TEN

Towards Acceptable LVT Systems for Britain

In the previous chapter we examined criteria for choosing options for the introduction of LVT into Britain. We now examine prospects for acceptable LVT systems for the U.K.

Background

In reviewing land valuation practices around the world, we are inclined to accept Andelson's view (2000, xxxiv) that implementation of LVT has in reality been extremely modest and that its impact has often been blunted by countervailing policies. So, what lessons emerge from such reviews that can be applied to present circumstances in Britain? One thing is clear: there is a considerable range of options. To start our examination, we look at the extremes, as suggested by Prest (1981, 170).

The "Deep End": The Georgist Approach

The deepest (Georgist) end involves assessing the value of all land at its highest and best use (as interpreted by the market, including hope value in advance of any planning confirmation) and taxing the owner at 100 percent of the full economic rental value. This would be tantamount to government sequestration of the value of the land. Some commentators have made this point in various ways and contexts:

> Were a site's rent to be socially appropriated in full for the foreseeable future, its capital or selling value would be extinguished. (Andelson 2000, xxii)

> [I]f a land tax is levied at a rate equal to 100% of the net income accruing (including capital gains) there would be no inducement whatever to hold land as an asset either for the sake of any current income or for capital appreciation reasons. In these circumstances, speculative land holding would be pointless. (Prest 1981, 38–39)

So what would be the point of owning land, other than for occupation? An owner in occupation would pay a quasi-rent, by way of taxation, to some level of government. There would be no real investment market as such in land itself; no freeholder could lease the land at a rent, as this would all be swallowed up by land tax. Nor could the freeholder sell his interest as an investment, because there would be no positive cash flow, and it would only be a tax liability. Admittedly, a prospective occupier could be interested in such a scenario of land tax payments, but then only as a quasi-rent, which would be paid to the government, not to the erstwhile freehold owner. The end result would be that, while the government would not have nationalised the land, it would have nationalised the rent in the land without payment of compensation. This would leave owner-occupiers the freedom to invest in improvements and carry on business on the land or simply live there, in return for 100 percent taxes on the land's rental value.

This means that landowners' interests would be liquidated by taxation, and even owner-occupiers, paying LVT in lieu of rent, would feel the financial pinch if their use of the land were anything less than the highest and best use value assigned by the market. However, this assumes that there would still be a market from which to extract such values—a doubtful premise on which to base an LVT system.

Since the process would really be the nationalisation of rental value and the right to receive it, this has to be compared with the extant British system of nationalising development rights and holding them, in escrow-like fashion, until the time comes for obtaining planning permission, with no compensation for refusal of permission and no betterment levy for approval except for buying into the extant planning gain or planning obligation (see Chapter 8).

Away from the Deepest End

Short of the full Georgist solution, a whole range of possibilities for LVT exists:

1. Land is assessed based on full economic rental values (including hope values), but the rate applied is less than 100 percent, ensuring that some semblance of ownership of rental value rights is maintained and that the land market survives.

2. Under the same conditions as (1), values are allocated only to highest and best uses that are plan-led, i.e., in line with development plan expectations. This was the amended basis adopted by Wilks (1974) in his second Whitstable survey in Kent (see Annexe 3 to this chapter for further details).

3. Land is valued separately from buildings and other improvements, and different rates of tax are allocated to each. This is at the heart of the Pennsylvania two-rate system as reviewed by Hartzok (1997).
4. In order to deal with political opposition, instead of taxing all land and all landowners the same way across the board, there could be certain exemptions from such an all-embracing tax, e.g., agricultural interests, ownerships having charitable and cultural significance, or residential property (which would have considerable political influence). Selective taxation could even be a way to encourage land policy aspirations.
5. Instead of basing the tax on the full current value of the site, the tax could be raised incrementally: it would only apply to excess values beyond a valuation base date. This principle was recommended by Uthwatt (1942), but it is important to recall that his committee was only considering taxing incremental existing-use values of land and not highest and best values. But even if land were taxed based on highest and best use, this option still might be politically attractive, because existing owners would retain the land value that they already owned, regardless of any future taxes on incremental gains.
6. Land taxation could be based on current existing use, which would eschew some of the fundamental arguments for LVT in encouraging development and penalising land hoarding.

Each of these options would affect the land market differently. The deepest end would result in the drastic outcomes outlined by Andelson and Prest. A smaller market impact would result from the less-extreme options. Prest (1981, 37–39) illustrates this phenomenon with a series of examples showing the effects of differing rates of LVT on a capital value base. As land taxation rates increase, capital values decrease, and when the rate reaches 100 percent, there is no inducement to hold land itself as an investment asset, although there could be some incentive for investing in buildings and other improvements on the land.

Some Obstacles to Introducing LVT

There are, of course, arguable obstacles to introducing LVT, even at the shallow end. Valuation of land could be difficult, and revaluation might be expensive; aborting existing local revenue tax systems could be costly and disruptive; and tracing landowners and apportioning their tax liability throughout the hierarchy of possible legal interests that may subsist within an individual land holding could be extremely difficult, as has been pointed out:

> The serious question, and the one which has been the subject of most controversy, is the division of the site value rate between the owners of interests superior to that of the occupier. (Turvey 1957, 79)

> [E]ven if one can disentangle the total value of a site by some means, the apportionment of tax liability between a freeholder and a lessee may be a source of further difficulty, unless one imposes the whole of the tax at one level and allows the different interests to sort it out between them. But that has been held to be a Draconian situation. (Prest 1981, 42)

However, a remedy that would appeal less to Draco, and perhaps more to Solon, is worth considering in an effort to disentangle such difficulties in tracing owners and allocating the tax burden among hierarchical land interests (see Annexe 4 to this chapter).

The Deep or Shallow End?

Putting all of these different strands together, what sort of LVT legislation and practice would be compatible with Britain's town and country planning system? LVT should accomplish the following objectives:

- garner government revenues in a fairer and more comprehensive way;
- capture development value for the benefit of the community; and
- support plan-led land policy (encouraging the right development at the right time in the right place and discouraging wrong development).

The present Labour government, following the previous Labour administration, has demonstrated a disinclination to overtly rock the financial boat. As far as local government revenues are concerned, the administration has shown reluctance to amend the council tax banding basis, which is still manifestly regressive, and it has put off any prospect of a revaluation for this particular tax until 2007 (see Chapter 4). Although government went ahead with a revaluation of nondomestic properties for business rates for the year 2000, and it will again in 2005, the existing basic principle that the uniform business rate (UBR) is set nationally, not locally, is likely to be retained, as confirmed by DETR (1988b). Taking a cautionary stance into account, and realising that any steps towards a new property tax scheme would be unlikely to emerge until further into the current Labour government's term of office (and perhaps even beyond), the shallowest end seems the best place to fish for possible LVT solutions.

In this vein, it is relevant to recap what such a solution should do:

- make the system fairer (equity rules!);
- move forward slowly, gradually and experimentally;
- not rock the boat or make too many waves for the government; and
- identify and tax land profits.

Prest argues that it is possible for an LVT (or site value rating) system to run alongside a generic development gains tax system. Regarding the latter, he suggests that there is no point in going beyond a special form of capital gains tax (CGT) targeting land deals, perhaps with:

- a higher-than-normal rate of CGT;
- no rollovers (i.e., postponing the tax liability from an initial disposal and repurchase until a subsequent disposal takes place); and
- increased taxation opportunities, perhaps on points of accrual, and not restricted to acts of disposal (but this would involve periodic valuation processes, which could prove cumbersome and expensive). (Prest 1981, 176–177)

Apart from such special tax hits on the potential profit takers from land deals (see Chapter 12), there is the question of whether to tax land annually in order to garner government revenues. We evaluate this question in terms of a system that might favour this type of tax and in terms of the general acceptance of such taxation in government and in wider circles.

Over time, with regular and periodic revaluations, such an annual tax will gradually gear itself to the accumulating value of land from whatever cause. So, we now examine what is essentially an SVR system for Britain: an annual tax to replace extant rates (property taxes).

A Simple Solution?

Complexities and implementation costs of previous LVT attempts in Britain have largely contributed to their failure, therefore, any recommended system must be comparatively simple for it to have any chance of success (Connellan 1998). Gradualism, or changing taxation procedures in stages, seems to make more sense and to be more likely to be accepted than any dramatic overnight replacement of existing property taxation procedures.

Within this context, we put forward the following scheme:

- The trigger events would be the revaluations of nondomestic properties for rating, which take place quinquennially in 2005 and 2010.
- The government's Inland Revenue Valuation Agency would make an apportionment of the assessments of total property annual value between its components of land (site) value and the value attributable to buildings, etc. Initially, both values would be derived from existing uses, on the principle of *rebus sic stantibus* (see Chapter 4 and Uthwatt 1942, 139).
- The annual land value would thus become the basis of the owner's land tax (a form of site value rating), and the annual value for buildings, etc., would become the basis of the occupier's rate. Differing taxation rates

could be applied according to the policies of central and local governments, following Pennsylvania's two rates approach.

- The combined tax liability would be met in the first instance by the "rating occupier" (the tenant), but the amount of the owner's land tax could be deducted from the rent that the occupier paid to the immediate landlord. Thereafter, the owner's tax burden could be passed upward and apportioned throughout a hierarchical chain of successive owners' interests (see further discussion in Annexe 4; see also Annexe 6 and Appendix B on the practicalities of introducing SVR as an annual tax to eventually replace the extant rates system).

Towards a More Comprehensive Form of LVT

The above proposals reflect the dual-rate taxing of land and buildings, being separately targeted on existing uses or, as Uthwatt puts it, "the annual value of the site as then actually and physically developed and as if it were permanently restricted against any other form of development" (1942, 139). But consideration would also have to be given to properties outside the present rating system, for example, agricultural holdings (particularly on the urban fringes), vacant sites and derelict property (see Chapter 4 for details of rating exemptions). This political decision would be fairly bold, but if it were decided to extend the taxation net and to embrace the long-argued merits of LVT in influencing land policy, it would be possible to assess such land on the basis of highest and best use on plan-led principles and to tax the owners directly alongside the dual-rate system described above. For the details that would be required for such a valuation exercise in Britain, we can return to Wilks (1974) and the bases he adopted in his experiments at Whitstable in Kent (see Annexe 3).

But moving towards a more comprehensive form of LVT, at some later time it would be possible to reassess the annual land element from the dual-rate assessment and thereafter base the owner's land tax not on the land's existing use but on its highest and best use (as defined by plan-led principles), while still retaining the occupier's assessment on existing buildings and improvements. The dual-rate system might run for a while on this basis, but it would then be just a short technical step to drop the occupier's assessment altogether and tax the owner solely on the land's highest and best use value. Both of these adjustments of valuation and tax bases could be cushioned by transitional steps over a period of time, if politically and socially appropriate.

But the actual method of collecting the owner's progressing tax liability could be that the identified rateable occupier initially could pay the owner's tax and then deduct it from the rent they paid to the immediate (lowest-order) landlord, and so on upwards through any chain of ownership interests (see Annexe 4). However, by the time the occupier's assessment was superseded, the immediate

owner would have become readily identifiable, and the owner's tax demand could be redirected accordingly.

Council Tax

Might LVT also be applied to domestic properties? Because house owners now contribute to local government revenues via the council tax, the present Labour government may well be reluctant to move towards LVT on domestic properties, which would be a drastic change. However, it is still pertinent for the future to examine how LVT considerations could be incorporated into the council tax system. In particular, if allocation into value bands, rather than discrete property valuations, is the norm, how could apportionments between the value of land and the value of buildings and other improvements be made?

In the face of such constraints, any solution would need to take a relatively broad-brush approach to the valuation process. Apportionments to land value could probably only be made within the existing value bands on across-the-board percentage bases: within a particular rating area, certain percentages could be prescribed for the various value bands. This would approximate the constituent land value element and pave the way to a dual-rate tax system, analogous to the nondomestic system previously described.

With some forward thinking from tax administrators and assessors, the same trail towards LVT could be followed with respect to collecting and apportioning tax liabilities throughout a hierarchy of landowners. Similarly possible is an eventual shift towards a single land tax based on highest and best use for domestic properties, within the constraints of the extant planning system. However, as with the proposals for nondomestic properties, the speed and extent of such progressions would have to be measured against political and social expediency.

Agricultural Land

Agricultural land and buildings have long been exempt from rating liability in Britain (General Rate Act of 1967 and Rating Act of 1971). If such liability were to be reintroduced, LVT could arguably be the simplest way forward: most assessments could be levied on agricultural value as utilised. However, with properties such as urban fringe land, where the approved development plan reflects development expectations, the assessment would be based on the land's highest and best use, which in this case would be its plan-led use, rather than on its current agricultural use.

Although such assessment procedures would follow Georgist precepts of equity and fairness, the current hardships claimed for the agricultural industry would again mean that political and social expediency would significantly affect the timing of introducing such measures.

Commentary on the Proposed Scheme

According to the proposal, an owner's LVT would be introduced after a quinquennial revaluation by splitting the latest nondomestic rating assessments between site value and improvements (buildings, etc.). Royal Institution of Chartered Surveyors (1995)[1] gives some advice in Guidance Note 5 (GN 5) on the process of apportioning, which has been previously commented upon by Britton et al. (1991, 161–67), and the relevant parts of this commentary are reproduced in Annexe 5a (www.lincolninst.edu).

Although the above guidance to valuers is directed towards apportionments of capital values for accounting purposes, it is not a quantum leap for rating practitioners to also adapt such recommended methods to apportioning annual values. Of course some changes would have to be made in the processes of apportioning large-scale undertakings currently assessed by the profits method or by statutory formulas. However, with some ingenuity, which has never been in short supply in the rating valuation profession, the outcome certainly need not be one of insurmountable difficulties (Connellan et al. 1998).[2]

Alternative Initial Approaches

Lichfield and Connellan (2000a) proposed that nonrated land should be taxed at an appropriate percentage rate on a full LVT value based on highest and best use, in accordance with the development plan. This might well now be challengeable as discriminatory, however, as other (rated) owners are initially to be taxed on the basis of land value related to existing use. A possible remedy would be to tax these unrated owners initially on a matching existing use basis or, alternatively, on an incremental basis (Uthwatt 1942), following Uthwatt precepts but geared to highest and best use values rather than existing use values. This would mean establishing a base date (for example, the next rating revaluation in 2005) and taxing property owners thereafter on the yearly increments in their land value at an assessed percentage tax (see Annexe 5), but related to highest and best use in accordance with development plan proposals.

However, it would only be a partial tax hit on development rights, which are now actually in the ownership of the Crown.

Transitional Stages

The process of developing land will, of course, bring nonrated land into the net of apportioned rating assessments, and the land value thus determined will reflect the degree to which the owner chose to develop (or not develop) the land

1. This manual is currently under revision, but similar advice is being retained.

2. It is interesting and relevant to note that Uthwatt proposed virtually the same procedure of apportioning the annual values of land and buildings as part of the rating assessment process without any concern over its practicability (Uthwatt 1942, 137).

up until the time of the assessment. This development and rating process will subsume any prior incremental taxation (or fuller taxation) of such previously unrated land.

Eventually, the tax system might move beyond being based on existing use value on rated land and possible incremental value on highest and best use on unrated land. The ultimate goal of a consolidated LVT program based on highest and best use value of all rated and unrated land (at appropriate tax rate percentages) might be on a future government agenda. The effect of any transitions between different valuation and taxation bases on land can be cushioned over time by slowly merging those bases. But as they gradually become capitalised into land market prices (and a downward pressure could be anticipated in real terms), they will in turn tend to affect other fiscal measures that are geared to the land market (e.g., CGT, inheritance tax, income tax, etc.). In addition, it should be remembered that all of the tenets of value capture through LVT itself (planning gains, impact fees, greenfield taxes and the like) over time will tend to work through the capitalisation process to produce ripples in the land market, in what Prest refers to as "a sort of Chinese puzzle argument" (1981, 37).

Responses to Possible Criticisms

- ***Apportioning rating assessments between land and buildings could be technically difficult.*** Uthwatt has already endorsed the feasibility of the exercise, and the practice is in place in the dual-rate system adopted in Pennsylvania (see also Annexe 5a for technical considerations).
- ***Targeting only existing use land values could be seen as merely "scratching the surface."*** It is a reasonable starting point and it establishes the principle of an owner's assessment and tax liability on land value. It also provides scope for differential taxation (via different percentage rates) between owners and occupiers and between different types of land use.
- ***The scheme is just another form of rating (local property tax).*** Initially it lessens the load on the occupier, depending on the lease structure, by transferring some of the tax burden to the owner. It also opens up the possibility of progressing towards a more universal form of LVT, which would affect owners of land currently rated and unrated.
- ***The system initially only reaches ratepayers.*** Certain proposals encompass unrated land, which could eventually lead to the full valuation assessment of land at highest and best use (levied at appropriate percentage rates).
- ***Within the ambit of existing rating valuations, there are "grey areas" that will only achieve minimum assessment for what may be temporary existing uses, e.g., reserve land held for future expansion within an industrial complex or within a statutory formula assessment.*** Rating assessments are

derived from hypothetical tenancies on a year-to-year basis and are therefore unlikely to reflect underlying and unrealised development values. However, if the proposed transition is eventually made, and all land is valued on a highest and best use basis, any differential problems, either between the classifications of rated and unrated properties or within those classifications themselves, will be resolved.

- ***There is nothing in the scheme for owners.*** The intention of LVT is to place the burden on those arguably best able to bear it. But there might be some solace for those taxpayers in Britain who have long been claiming unfairness in the lack of tax write-offs for depreciation of buildings and other improvements. If property owners are clearly taxed on "the indestructibility of the soil," and, in taxation terms, the indestructible part of real estate is considered separately from the parts that are destructible, will not this lend weight to the claims from those same owners for an extension of income and/or corporation tax allowances for depreciation of buildings and other improvements (perhaps on the U.S. pattern)?

Summary

What seems to be emerging from the above, as far as acceptable LVT systems for Britain are concerned, is the possibility of combining an annual impost on land values with a capital levy, perhaps by means of an enhanced capital gains tax. But, we must remember the fundamental differences between two types of LVT: SVR as an annual ongoing tax, and development value capture taxes. Are they mutually exclusive, or can they be imposed side by side? Prest has some interesting and relevant views in support of running the two types of land value taxes:

> Objections of principle are sometimes raised on the grounds that it would be inequitable to have a tax system which includes both taxation of the stock of capital and taxation of the increments in the stock. This point is misconceived. First of all, it is generally accepted today that capital gains are a form of income and that some kind of annual tax should therefore be applied to them as well as to other forms of income. The taxation of wealth separately from and in addition to income is a matter for considerable discussion depending on whether one thinks there is a case for differential taxation on investment income. . . . However, even if one were not convinced of the separateness of wealth taxation and capital gains taxation at the national level, the proposal in question is the combination of the local site value rating with a central DLT (Development Land Tax). If it is considered desirable to have a local source of local finance and some sort of tax on realty as the best way of giving effect to that principle, then it is perfectly reasonable to have the two taxes simultaneously.
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> What seems to be behind the incompatibility arguments is the proposition that gains on development amount to a large fraction of land capital values and

> so that two taxes would have a very similar base. Even if this proposition were true, it would be incorrect to deduce that one cannot have both kinds of tax operated simultaneously, especially when one is at local and the other at central level.
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> What is perfectly true is that if both taxes existed simultaneously there would be a number of interactions between them. Thus SVR (Site Value Rating) might be expected to reduce the land values through the capitalization process. . . . More generally, if the combined burden of local SVR and national DLT, or any other tax on land gains, were thought to be too great an imposition on allocation or distributional grounds, there would be plenty of scope for some sort of crediting arrangements of local SVR against national taxes, as with property taxation in different parts of North America today. . . . [N]either arguments or general principle nor historical precedent lead to the conclusion that it is impossible to have a combination of the two main types of tax if it is so desired. (1981, 178–179)

As with many other issues, perhaps we should leave Prest with the last words on that particular subject.