● Margaret Thatcher

What the reformers want to change

By HENRY LAW

BRITAIN'S property tax (the rates) would probably take first prize for being the most unpopular of all taxes. They raise about £20 billion a year. This covers about half the expenditure of local authorities, the remainder being paid by central government.

There is a vocal demand for change. Public debate is dominated by the image of the poor old widow living in the same house that she has occupied since she got married, and who has to pay the same amount in rates as her neighbours, a middle-aged couple with five strapping sons, all of them earning good wages.

On the commercial front, we hear of businesses being forced to close or move away by the insatiable demands of spendthrift Labour-controlled councils, who have been elected without businessmen having had any say in the matter. Business rates are held up as a classic case of "taxation without representation".

Reforms have been suggested. Prime Minister Thatcher (above), favours a "Residents' Tax", although opinion in the Conservative Party remains divided. The Labour Party proposes to supplement the existing system with a Local Income Tax (LIT). The Liberals, having abandoned their long-standing commitment to site-value rating, have also come out in favour of LIT, but as a total replacement for domestic rates; this solution is supported by their partners in the Alliance, the SDP.

RATES are an annual levy on an assessed valuation, set each year by the local authority, as an amount per pound of the valuation. Where there are two tiers of local authority, such as district councils and county councils, the lower tier authority, usually the borough, is responsible for collecting the rate.

The higher authority collects its revenue from the borough as a fixed "precept", which covers the cost of services not provided by the borough (fire service and the police).

Rates are also levied by water authorities, again based on rateable values, although there is a growing tendency for commercial consumers to pay directly for water delivered by a metered supply.

The schedules of valuations are prepared by a staff of valuation officers attached to the Inland Revenue. Valuations are meant to be the current rental values of the properties, taking land and buildings together as a unit, and values are supposed to be revised regularly. This has not happened in recent years, because governments have succumbed to the temptation of deferring the valuations. In England and Wales, there has been no valuation since 1973. One was conducted in Scotland in 1985.

Because the valuation is a composite of both land and buildings, the rateable value of a vacant site or derelict property is nil, since it is not capable of "beneficial occupation" – no-one could use it. Agricultural land and buildings (apart from farmhouses) are totally exempt.

Rates used to be payable only on occupied premises. Changes were made in the early 1970s because of widespread public concern over empty office blocks. Local authorities were given powers to levy a proportion of the total rates on empty premises. This led to an epidemic of "de-roofing" of empty factories as a means of avoiding the rates. The government changed the rules so that vacant industrial premises were once again relieved of rates.

An important exception to the rating system occurs in Britain's experimental Enterprise Zones, which enjoy a package of concessions, including freedom from planning controls and a 10-year "rates holiday".

Administratively, rates work well. The system is flexible, being suitable for all tiers of local authority. Councils are able to make their budgets in confidence, as the amount from rates can be calculated in advance.

There is no opportunity for avoidance or evasion, although the rate rebate system, for those on low incomes, is vulnerable to false claims. Collection costs are very low, being about 1.5% of the yield, which makes local rates among the most efficient of all taxes.

The injustices

DESPITE the merits of the rating system, there is a widespread feeling that there is a fundamental injustice about this method of raising local revenue.

● *Rates are unfair because a single person living in a house pays the same as a family with several wage-earners*

The unstated assumption is that rates are different from other household expenses. If wage-earning sons, daughters, lodgers and tenants choose to share a house, then their contribution to the household expenses includes a share of the rates, just as it includes the cost of other services such as lighting and heating.

Most of the services paid for by the rates cost exactly the same to provide, irrespective of the number of people living in the house; there is no more justification for charging rates in proportion to the number of residents in a household than there would be for charging car tax according to the numbers of passengers carried.

The cost of education and refuse collection depend directly on the number of people using them, but the logical answer would be to charge directly for such services rather than abolish the rating system.

● *Rates are not related to ability to pay*

This has some validity, but less than is often supposed. The 1981 Green Paper on Rates noted that for 50% of households, rates amounted to between 2% and 3% of household income; only in the case of 20% of households was the rates bill outside the range 1.5%-4% of income.

The underlying relationship between rates and household income is only to be expected. Better-off households occupy houses which are more expensive, and whose rateable values are consequently higher.

● *Rates lead to lack of accountability*

Rates are often likened to the taxes that prompted the citizens of Boston to cry "no taxation without representation!" as they hurled the tea chests into the harbour. It was a protest against having to pay taxes to a government 3,000 miles away and then being allowed precious little say in the inept decisions that it was making.

The Boston Tea Party makes a stirring tale,

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Plucked out of the blue

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but the notion that a direct connection should exist between voting and taxpaying does not bear close examination.

The whole concept of accountability rests on a dubious premise. Using the same line of reasoning, it could be argued that there should be special votes for car drivers, cigarette smokers or whisky drinkers.

Taking the idea to its logical conclusion, it would follow that voting ought to be weighted according to the tax that people paid.

There is another fallacy, too, behind the idea of accountability; it rests on the assumption that some taxes are more effective than others in encouraging electors to be vigilant about the way that government spends public money. This is to ignore many of the reasons why public bodies do not spend wisely. The major problem must surely be the quality of the politicians (of all colours) whom we elect.

- *Rateable values are hypothetical or out of date*

Valuations are frequently criticised as being figures "plucked out of the blue". Re-valuations can certainly cause serious problems for some ratepayers, if a long time has elapsed since the last valuation. This is not a fault in the system, but a reason for regular and realistic re-valuations.

In the domestic sector, there is insufficient evidence of domestic rental values, because government legislation has abolished the free-market in rented residential property.

There is, however, nothing hypothetical about annual rental values. They are the primary measure of the value of real estate. Selling prices are derived from annual values, and not the other way round; the selling price is the capitalisation of the rent at current rates of interest, with a speculative element added on to allow for the expectation of increases in value in the future.

- *Rates discourage improvements*

This objective receives least attention, yet it has more substance than any of the others. Anyone who improves his house by building a garage or converting it into flats is penalised by having to pay more rates. This is a discouragement, but the consequences of the same thing in the commercial sector are far more damaging; rates penalise enterprise.

This is particularly harmful to industry, because installed plant is rated. Industries like steel and chemicals manufacturing are badly affected because the value of the plant accounts for a high proportion of the total valuation.

- *Rates harm the economy*

Rates are essentially a tax on rent, and are, in part, a tax on the rent of land. Economic theory demonstrates that taxes on the rent of land are ultimately passed backwards onto property owners. This is amply borne out by practical observation.

Under the present rating system, it is often to the owners' advantage to allow vacant land and unoccupied premises to stand idle and derelict. Rates are thus a disincentive to occupation, development and improvement.

One of the surprising facts about rates is that there appears to be little or no correlation between industrial location and rates or increases in rates. This was the conclusion drawn from an exhaustive survey conducted by the Department of Land Economics at Cambridge University, and it discredits the commonly-held view that businesses are being destroyed by punitive rates. The research team suggested that their observations could be explained by the process mentioned above, whereby commercial rates are passed backwards onto landlords.

THE REASON why rates have been singled out for popular attack in recent years is surely because, for most people, they are the only tax which is paid directly.

There is also a widespread feeling that the money is not well spent, perhaps because local government waste is more visible than central government waste, yet the method of taxation itself is held to be the problem.

OBJECTIONS? VITAL CLEAR

LAND-VALUE rating would work in exactly the same way as the present system, but the valuation would be the annual rental value of the land alone. Buildings and improvements would be de-rated.

Vacant and agricultural land would be subject to the rate, and the valuation would be on the assumption that it was at its maximum likely permitted use.

This method has a number of advantages.

- Land is permanent and holds the core of the value.
- There is no possibility for avoidance or evasion. It is suitable for all tiers of local authority. Land value registers are easier to compile than the present valuation lists, because there is no need to take account of buildings and improvements.
- The yield is predictable, and keeps pace with inflation, because land values rise faster than the rate of inflation.
- LVR would recoup increases in land value due to public investment in improvements such as motorways and subsidised transport, as well as serving as a clawback mechanism to recover increases in value resulting from special arrangements and subsidies, such as the Common Agricultural Policy and the Enterprise Zones.

THE RATE would be a fair tax because the value of land is the market value of the location; it is what people are willing to pay for the benefits which are available there, in the way of amenities and productive advantages, both natural and man-made.

Thus, a rate based on land values is related both to ability to pay and benefits received. The burden on both householders and commerce would be reduced, as the tax base would be widened; vacant and agricultural land would be brought into the rating system, and under-used land would be rated at its true value.

There are numerous objections to LVR.

1. ***The poor widow would pay as much as her wage-earning neighbours***

The solution lies in designing the system of welfare benefits to ensure that pensions and the social security system are adequate. Alternatively, any hardship could be alleviated by deferring collection until after her death, when the rate would become a charge on her estate.

2. ***If land values rose in certain areas, rates would rise with them, and long standing residents would be forced to move***

This tendency exists already, and is not altogether undesirable: widget makers have long since moved out of the City to places like Harlow, which are adequate for their needs, leaving the City to the kind of business which cannot be carried on anywhere else.

When the land market is functioning freely, it ensures that a valuable resource is allocated efficiently. A site goes, in theory, to the user who can make best use of it; individual enterprises locate themselves in the cheapest position which is suitable for their needs. In this process, existing tenants are often squeezed out by rising rents, as land uses in the vicinity become more intensive or specialised.

Squeezing-out also affects owner-occupiers today, without land-value rating; they cash-in and go to live somewhere else. For them, the increase in value comes as a windfall. With land-value rating, some of the increase in value would be recovered by the community instead of ending up in the pockets of individuals who just happen to have been lucky.

Changes in patterns of land use are a natural process. The introduction of land-value rating would certainly tend to discourage "fossilisation". If, however, we wished to resist change, for social reasons, for example, a rebate scheme could be devised.

3. ***The rate would lead to over-development and loss of amenities***

The spectre raised here is the prospect of an epidemic of office blocks in back-gardens. This fear is unfounded; the introduction of LVR would in no way conflict with the present planning legislation. The existing system of development control could continue in its present form. Planning restrictions would be reflected in the valuation, and therefore the rate payable, which would be reduced accordingly.

Even in the absence of planning control, land-value rating would not lead to this kind of over-development; developers may build speculatively, but only where an underlying demand already exists.

4. ***LVR would penalise the suburban householder with a large garden***

Not so; a large suburban garden does not

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ATTEMPTS to reintroduce agricultural rates have been torpedoed by the false argument that food prices would rise. Food prices are determined by supply and demand, modified by EEC food policies which add £7 a week to the food bill of the average UK household. Food prices would no more be affected by rates than they are by rents. High rents are a consequence of high food prices, not a cause; agricultural rates would be a *subtraction* from the rent.

Making real sense down on the farms . . .

FARM LAND and farm buildings (but not farmhouses) were exempted from rates in 1929. The benefits did not go to the farmers. The cut in rates was, within a season, absorbed by the landowners, who charged higher rents.

This is precisely the same as the experience when businesses in Britain's Enterprise Zones were exempted from rates in 1980.

There is no justification for the privileged position of owners of agricultural land. All other businesses and industries pay local authorities for the services provided. Why should agriculture be treated any differently? The burden is simply shifted onto other sections of the community.

Reintroduction of agricultural rates on their present basis would, however, have a harmful effect on agriculture. Dairy farmers would suffer because they have more buildings than arable farmers. Other sectors of agriculture would also be harmed, in particular, specialists such as horticulturalists with greenhouses, fruit growers and fish farmers.

Rates would discourage works like land drainage and, in upland areas, the burden of rates could put some farmers out of business altogether, leading to abandonment. "De-roofing" is another likely consequence, with historic buildings being destroyed.

These objections would not apply if valuation was based on the value of land in its unimproved state. Agricultural land-value rating would not discriminate against farming activities which required buildings. Farmers on marginal land would pay little or no rates at all; indeed, because farmhouses would be exempted, upland farmers could well end up paying less than they do now.

Since most of the benefits of the Common Agricultural Policy ended up in enhancing agricultural land values, a land-value rating system would operate as a clawback mechanism.

Conversely, if the CAP is dismantled, land values would drop. This would be reflected in the reduced valuations, and hence lower rates.

Agricultural land-value rating would also help to resolve a long-standing problem – the young farmer attempting to get established. For the 10 years up to 1983, farmland was a popular investment and hedge against inflation. As a result, unrealistically high land prices kept out new entrants. Unless they have been fortunate enough to inherit a family holding, graduates of agricultural colleges have had to content themselves with working as paid farm managers.

Although recent changes to the CAP have led to a fall in farmland prices, they are still high in relation to the earning capacity of the land. The introduction of rating for farmland would remove some of the speculative froth from values, which would fall to levels which were more in line with earning capacity.

ANSWERS THAT PUT CASE FOR LVT

have a particularly high value unless it also has development potential and a favourable planning policy. This occurs only where pressures already exist for redevelopment at a higher density.

5. ***Planners could raise land values artificially by re-zoning***

The idea that planning consent increases the value of land is an illusion. The consent releases a latent value which already exists. The sheep would not be disturbed if the planning authority gave permission to build a hypermarket on the top of Ben Nevis.

LVR would, however, capture the increase in land value released by planning consent, and in doing so, it would remedy a long-standing deficiency in the planning system.

6. ***It is unjust to levy a tax according to potential value***

Anyone who holds land vacant is doing so out of choice. If the land is capable of being developed, the owner is depriving others of its use; an owner always has the option of disposing of the land. One of the aims of land-value rating is not to penalise development, which is possible only if land is treated the same, for tax purposes, regardless of whether it is developed or not.

7. ***A land-value rate could not raise sufficient revenue***

There is little evidence either to support or refute this statement. So far as British conditions are concerned, the only substantial body of information comes from the land value surveys conducted in Whitstable in 1963 and 1973. The later survey indicated that the total value of all the land was about 20% higher than the rateable values, as assessed the previous year, and thus a poundage would have raised the same revenue as the present rating system.

The evidence is not, of course, sufficient to refute the objection conclusively, but it suggests that LVR should not be dismissed on the grounds that it could not raise sufficient revenue.

8. ***The rate would be passed on in higher rents. Widespread prices increases would follow***

A rate based on land values would be a direct tax on rental value. It does not fall on the user and cannot be transferred from the landlord to the tenant. This is because the value of a piece of land is, by definition, the maximum that anyone will pay in order to use it. If a tax is levied on that rent, it does not make anyone willing to pay more, nor does it enable the owner to demand more; the tax is a subtraction from the rent.

To suggest that landowners could pass the tax onto tenants is to imply that the owners do not already get as much as they can for their land, and that they could put up the rent whenever they wanted to.

In practice, the introduction of LVR would mean that landlords would have to set their rents keenly. Since the land-value rate would have to be paid, regardless of whether the land was in productive use or not, owners would be anxious to attract tenants. Rents generally would tend to drop because unused land would be competing for occupiers.

The other reason why a land-value rate could not be passed on in higher prices is this: land value has no effect on the prices of the goods produced or sold on the land; all the branches of a chain store charge the same for their goods. Shopkeepers on expensive sites can not and do not charge higher prices merely because they pay higher ground rents. A higher rent can be obtained for the better location because it is easier to sell goods there and the total volume of trade is greater.

LAND-VALUE rating could have a number of beneficial effects. It would eliminate the penalty on improvements, and encourage owners of vacant property to bring it into productive use.

Rents and land prices would fall to competitive levels as vacant land would have to be developed in order to yield the rent with which to pay the rate. This would stimulate the economy by encouraging the efficient use of a limited resource.

Land-value rating retains all of the advantages of the present system, which it would closely resemble, but eliminates some of the drawbacks and expands the tax base. As a practical alternative which is used in a number of other countries, it merits further attention.

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An INCIDENTAL side-effect of agricultural land-value rating would be the benefit to wildlife. Designated areas, such as sites of scientific interest or archaeological importance, restrict operations and tend to depress land values. This is why farmers object to them. If farm rates were based on land values, the system would automatically compensate for the disadvantages of having to provide homes for rare butterflies.

How LVR would work in practice

WITH LAND-value rating, the relevant value is that of the bare site, assuming that it is at its maximum permitted use. This presents problems in built up areas, where undeveloped sites change hands only rarely. It is then necessary to extract the value of the land from the total value of the property. There are two basic ways of doing this.

The "residual method" relies on the assumption that the value of the land is the total value of the property, less the cost of constructing the building. It is not quite as easy as this in practice, because, as many owners of old buildings know, the value for fire insurance purposes is often more than the total value of the property.

The second method is to establish a set of values per square metre, mathematically weighted to reflect the fact that, in towns, frontage is more valuable than depth.

The two methods can produce realistic and consistent results, if taken in conjunction with each other.

Land-value rating in practice has proved simple and straightforward, as was found when the Rating and Valuation Association conducted pilot land-value surveys in Whitstable in 1963. This is because a row of houses standing on identical plots all have the same assessment; once the value has been determined for one property, it will be the same for all. This is in contrast to the present system, where improvements such as extensions, garages and conversions have to be taken into account.

Valuations would be prepared exactly as now, by teams of valuers. Alternatively, the work could be done by private surveyors, interpolating their own valuations from a series of bench-mark values determined by the official valuers.

With a bench-mark system, it could even be possible for owners to compile valuation lists by self-assessment, with provision for refunds in cases of overpayment.

Collection of the land-value rate could be organised in one of two ways. Payment could be made the responsibility of either the **occupier,** as at present, or of the **freeholder.**

In either case, the burden of the rate is borne by whoever effectively enjoys the true rental value of the land. Usually, this is the freeholder, but not always. Where tenants hold leases on rents agreed long ago, a proportion of the current rental value is, in reality, enjoyed by the tenant. In such cases, the burden of the rate would have to be apportioned between landlord and tenant.

For the tenant occupier who pays the rate, the rent that the owner can obtain will be proportionately less. In this way, the burden of the rate will automatically be the free-holder's.

MAKING THE SWITCH

THE DETAILS of the transition from the present rating system to LVR would need to be worked out. This plan is suggested as a basis for further discussion.

STAGE 1 (year 1)

A Domestic Rates

The yield from existing rates to be raised by local land value rate; domestic rates to be fixed by local authority.

B Commercial Rates

The yield from commercial rates to be raised from uniform national land value tax, and revenue assigned to local authorities.

Vacant land to be subject to same rate as other land in business use, with additional revenue raised from this source to be assigned to local authorities, with corresponding cuts in other taxes.

Agricultural land to be subject to business rate, with introduction phased over five years.

STAGE 2 (years 2-5)

The rate support grant to be phased out and replaced by a national land value rate equalisation scheme, to transfer resources from areas where land values were high to those where values were low.

For this purpose, a uniform national land value rate precept would be levied. This would enable other taxes to be reduced by £20 billion a year, equivalent to reducing income tax to 10p in the £. National rates would be collected by local authorities as a precept, just as county rates are collected now. Details:

A Domestic Rates

The site value rate set by local authorities to continue as in year 1. In addition, a new site value tax to be levied at a uniform rate throughout the country, to be used in the national equalisation scheme suggested above.

B Commercial Rates

The national business rate to continue as in year 1. In addition, commercial land would also be subject to the equalisation precept, levied at the same rate as the residential equalisation precept. There would be substantial cuts in other taxes.

MAJOR BUSINESS ADVANTAGES. . .

SOME OF the implications of land-value rating on business have already been discussed. The principal advantages are:

- **Because the rate would have to be paid regardless of whether premises were derelict, vacant or in use, landlords would be encouraged to price land and buildings into use. This would increase competition between landlords and therefore lower rents.**

- **Because buildings, plant and improvements would not be taken into account in the valuation, they would be effectively de-rated.**