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Summary

This Chapter merely sets out an indicative framework of options for imposing LVT in some form or another. These options are certainly not presented as exhaustive, and further investigation will no doubt reveal more, but they do indicate the likely range of choices from which we have to build a rationale for recommendations. What does emerge thus far, in the context of proposals for Britain, is the case for gradualism in the sense that any acceptance of new and changed land taxation by politicians and the general public alike will have to be weaned by stealthy progression rather than by challenging confrontation.

Chapter 7: Towards an Acceptable LVT Solution for Britain?

Introductory Rationale

In reviewing the land taxation practices around the world we are inclined to accept Andelson's view (1997:3) that implementation of LVT has really been extremely modest and 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. We look at the extremes, as suggested by Prest (1981:170).

Deep End, the Georgist Approach

We first consider an interpretation of the deepest (Georgist) end, which involves the assessment of all land at its valuation for highest and best use (as interpreted by the market including "hope" value in advance of any planning confirmation) and taxing the owner at approaching 100% of the full economic rental value. This would be tantamount to Government sequestration of the value of the land. Several 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, 1997:3)

"Indeed, to raise the land tax too sharply (to say nothing of suddenly collecting the entire land rent for the public sector) would create a financial crisis, because the rental income cannot be paid both to the government and the creditors." (Andelson, 1997:32)

"...if 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 the point of “*owning*” land other than for occupation? An owner in occupation would pay a full economic rent by way of taxation to some level of Government. There would be no real investment market as such in land—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 is no positive cash flow only a tax liability. Only a prospective occupier could be interested in such a scenario of land tax payments and then only as quasi-rent which would be paid to the Government not to the erstwhile freehold owner. The end product would virtually be that while the Government has not nationalised the land but it has nationalised the rent in the land without payment of compensation. This leaves the owner-occupiers to be allowed to exercise occupational opportunities of investing in improvements and carrying on businesses on the land, or just exercising habitational rights in return for 100% taxes on the land’s full economic rent.

What does all this mean?

Landowners would have their interests “*liquidated*” by taxation and even owner-occupiers, paying land value tax in lieu of rent, would feel the financial pinch if their occupational activities were anything less than the highest and best use value that the market might assume. And this in itself assumes that there is still a market to be interpreted to find such values—a very doubtful premise on which to balance a land value taxation system.

Such a process is really the nationalisation of rental value and the right to receive it, as compared with the extant system of nationalisation of development rights and holding them, in almost escrow-like fashion, until the time comes for obtaining planning permission with no compensation for refusal and no betterment levy for approval except for buying into “*planning gain*.”

Away from that Deepest End

In contemplating anything less than the full Georgist solution there is a whole range of options but these rely on acceptance or rejection of certain starting principles:

(1) Full economic rental values (including hope values) may form the basis of the land assessment but the rate applied could be less than 100% so ensuring that some semblance of ownership of rental value rights maintain within a surviving land market.

(2) As for (1) but only allocating values to highest and best uses that are plan-led i.e. having Development Plan expectations of approval. This was the amended basis adopted by Wilks (1974) in his second Whitstable survey in Kent (see **Appendix A** for further details).

(3) Instead of abandoning taxation on improvements on land another solution would be to value the land and the buildings etc. separately and to allocate differential rates of tax to each, e.g. the Pennsylvania “two-rate” system as reviewed by Hartzok (1997).

(4) The above approaches in (1), (2) and (3) assume that the owner of the land would bear the tax burden and that virtually all land would be so taxed. But in order to deal with political and other oppositions some exemptions from such an all-embracing tax could be incorporated to ensure acceptability e.g. some agricultural interests, ownerships having charitable and cultural significance and possibly residential property (which would have considerable political influence). Furthermore, selective taxation principles might even be extended ultimately to encourage land policy aspirations.

(5) All the above involve the proposition that the tax relates to the full current value of the site (taking into account the cited provisos). But there is another basis, designed to meet objectors who claim unfairness, in that the tax should be raised incrementally, i.e. the tax would only apply to excess values beyond a valuation base date. This was a principle recommended by Uthwatt, but it is important to recall that his Committee were only considering taxing incremental existing use values of land not highest and best values. But even adopting the highest and best use scenario this has the political attraction in that existing owners would retain the land value that they already own despite their future prospect of being taxed on incremental gains.

(6) Which brings us to one of the shallowest options of all, in that a system of land taxation could be based on current existing use. That would eschew some of the fundamental arguments for LVT e.g. that it should encourage development and should penalise land hoarding. Such a restrictive course could also be incorporated within some of the previous options right down to the incremental basis on existing use values favoured by Uthwatt.

Let us first refer briefly to some of the technical and other objections to introducing LVT even at the shallow end (which are responded to later in this Chapter);

- Valuation difficulties and revaluation costs
- Upheavals and costs of aborting existing local revenue tax systems
- Tracing owners and apportioning their tax liability throughout the hierarchy of possible legal interests that may subsist within an individual land holding.

“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)

“Moreover, even 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 more to Solon than to Draco is worth considering in an effort to disentangle such difficulties in tracing owners and allocating the tax burden amongst hierarchical land interests. **(See Appendix B)**

Synthesis: The Deep or Shallow End

So how can we put all these different strands together to form a considered view on the end product of this Report? In this we have to remember our terms of reference are to make:

“...recommendations for specific proposals for introducing legislation and practice for Britain which would be compatible with the town and country planning system, and in a way that could be compatible to the new Labour Government.”

What sort of LVT system could possibly play within such constraints and what is the right sort of land value tax to deal reasonably with the following situations which seem to be emerging as the reasonable objectives?

- Garnering Government revenues in a fairer and more comprehensive way.
- Supporting plan led land policy viz. encouraging the right development at the right time in the right place and conversely, discouraging the wrong development.

It is pertinent to our consideration of an acceptable LVT system that this New Labour Government has already demonstrated a disinclination to rock the financial boat. As far as Local Government revenues are concerned it has decided not to amend the Council Tax banding basis, which is still manifestly regressive, and has put off any prospect of a revaluation for this particular tax on the grounds of expense whereas it has decided to go ahead with a revaluation of non-domestic properties for business rates for the year 2000. However the existing basic principle that the UBR (Uniform Business Rate) is set nationally, and not locally, is likely to be retained, despite contrary pre-election rhetoric on the subject, as confirmed by DETR (1988) in the following terms:

“...a national non-domestic rate, set annually, with revenue from the national non-domestic rate pooled and redistributed to authorities, much as now.”

Taking this caution into account and realising that any new scheme would be unlikely to emerge until after the next General Election and positing the retention of a Labour Administration in about the year 2002—the shallowest end seems the best place to fish for possible LVT solutions!

In this vein it is relevant to recap what we are aiming to do:

- (i) Fairer system (equity rules!)

- (ii) Slowly, slowly—gradualism and experimentation (per Prest, 1981:188)
- (iii) Don't rock the boat or make too many waves for the Government
- (iv) Pick up the land profiteers

As far as (iv) is concerned Prest (1981:178-9) argues that it is possible for an LVT (or a Site Value Rate) system to run alongside a generic development gains tax system (see final section of this Chapter). As regards the latter he suggests (1981:176-7) that there is really no point in going beyond a special form of Capital Gains Tax (CGT) targeting land deals, perhaps with:

- a higher rate
- no roll-overs
- 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)

But apart from such special tax hits on the potential profit-takers from land deals (see Chapter 3) there is the question of annual taxation of land, basically for garnering revenues, to evaluate in terms of a system that might favour and acceptance in Government and wider circles.

A Simple Solution?

Remembering that complexities and running costs of previous attempts at various forms of land taxation in Britain have largely contributed to their failure as fiscal or equitable devices, the keynote of any recommended system must be comparative simplicity for it to have any chance of success (or even to see the light of day)! Furthermore the doctrine of “gradualism” through transitional stages seems a common sense approach, geared to acceptability, rather than a dramatic over-night replacement of existing property taxation procedures.

It is within this context that the following scheme is now put forward:

- Revaluation of non-domestic properties for rating takes place in year 2000.
- The Government's Inland Revenue Valuation Agency should undertake splitting the new rating assessments between annual land value and annual improvement value (i.e. relating to the buildings element etc.)—both would be derived from existing uses on the principle of *rebus sic stantibus* (ECCB [Uthwatt] 1942:139). Even if there is a logistical difficulty in making these apportionments by the date of the revaluation then they could follow in due course within a year or so without too much prejudice and thus fit in with an incoming Government's mandate perhaps in the year 2002.

- Thus the annual land value would become the basis of the “*owner’s land tax*” (a form of site value rating) and the improvement value would become the “*occupiers rate*.” Differential taxation rates could be applied depending on Central and Local Governmental policies (following the Pennsylvanian examples of “*two rates*” in the USA). On this Hartzok (1997:205-206) reports that the State of Pennsylvania has been experimenting with a new approach to property tax reform which has already begun to attract attention in New York, Maryland, and other States. Hartzok’s comments on this process are as follows:
 - *The property tax is actually two types of taxes, one upon building values, and the other upon at land values. This distinction is an important one, as these two types of taxes have significantly different impacts on incentive motives and development results.*
 - *Pennsylvania’s pioneering approach to property tax reform recognises this important distinction between land and building values through what is now known as the split-rate or two-tier property tax. The tax is decreased on buildings, thereby giving property owners and the incentive to build and to maintain and improve their properties, and the levy on land values is increased, thus discouraging land speculation and encouraging infill development. This shifting of the tax burden promotes a more efficient use of urban infrastructure (such as roads and sewers), decreases the pressure towards urban sprawl, and assures a broader spread of the benefits of development to the community as a whole.*

However it is worth re-iterating the need for “*gradualism*” in the process which is emphasised by Hartzok (1997:212) in reviewing the Pennsylvanian “*two-rate*” system:

- *“There is a lesson here in the ‘art of tax improvement.’ It is necessary to move to the two-rate system while maintaining a revenue neutral tax base, at least initially. Another key is to move gradually. One generally accepted guideline is to shift no more than 20% of the taxes off buildings and onto land each year for a period of five years, or 10% each year for a period of ten years, in order to fully shift all taxes off buildings and onto land value.*
- *Such a gradual transition, combined with community education, allows the citizenry to make the adjustments required, particularly to orient away from expectations of speculative gain in real estate land price escalation and towards investment in the development of affordable housing and business activities. Obviously, as buildings are taxed less their value might rise, while the value of the more heavily taxed land should fall. Whilst more research of these types of effects is needed it would appear from the longer continuation of this tax policy in areas that have tried it that it meets with voter approval.”*

The combined tax liability would be met in the first instance by the “*rating occupier*” but the owner’s land tax could be deducted from the rent that the occupier pays to the immediate landlord. This would allow the owner’s tax burden to be passed upward and

apportioned through a hierarchical chain of successive owners' interests (see further explanations and examples below and in **Appendix B**).

Proposed Rules for the Apportionment of Land Taxes

Owner's land tax is set at x% on the assessed annual site value.

All tenants and leaseholders can deduct the following from the rent that they pay to their immediate landlord:

- x% of the assessed annual site value, OR
- x% of the rent that they pay to their landlord.

whichever is the **LESS**

This procedure would pass the burden of land tax upwards through the hierarchy of legal interests from the occupying tenant to the ultimate freeholder—apportioning that burden on the way. This is analogous to the procedure of apportioning income tax liability from imputed Schedule A (Income Tax) assessments. Furthermore it was also a feature of the LCC Site Rating Bill of 1938 and was recommended in the Minority Report of the Simes Committee (1952: 88), as referred to by Lichfield and Connellan (1997: 15). The effectiveness and equity of such procedure is demonstrated in the examples in **Appendix B**.

Progressions (Towards a More Comprehensive Form of LVT)

The above procedures commence with and are related to the shallowest type of dual rate taxing of land and buildings, being separately targeted on existing uses, or as (Uthwatt, 1942:139) 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.”

But at some time consideration would also have to be given to properties outside the present rating system e.g. agricultural holdings particularly on the urban fringes, vacant sites and derelict property—this is apart from any increased CGT obligations previously mooted. This is a political decision but if it is 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 direct alongside the dual rate system described above. For the required details of such a valuation exercise in Britain we can really do no better than to return to Wilks (1974) and the bases he adopted in his experiments at Whitstable in Kent, See **Appendix A**.

However this would be a bold political initiative which might prove too insensitive to public and particularly to electorate opinion. A more cautious approach would be to introduce LVT on these unrated properties on an incremental basis following Uthwatt precepts but geared to highest and best use values rather than existing use values. This would mean taking a base date (say the year 2000 as with the next rating revaluation) and taxing property owners on the yearly increments in their land value at an assessed percentage tax. For a description see **Appendix C**.

But moving on down the line of progressions towards a more comprehensive form of LVT, at some later time it would be possible to re-assess the annual land element and change the valuation basis of the owner's land tax from existing use to highest and best use but 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 but a short technical step towards dropping the occupier's assessment altogether and taxing the owner solely on the land's highest and best use value. Both of these adjustments between valuation and tax bases could be "*cushioned*" by transitional steps over a period of time if thought politically and socially appropriate.

But the actual method of collecting the owner's progressing tax liability could follow the same procedure outlined above i.e. that during the operation of the dual system the identified rateable occupier could initially pay the owner's tax and then deduct it from the rent payable to the immediate landlord and so on upwards through any chain of ownership interests. However, by the time when the occupier's assessment might eventually be superseded, the immediate (and lowest order) owner should have become readily identifiable and the owner's tax demand could be re-directed accordingly.

Council Tax

All the above considerations apply to business rates on non-domestic properties. As far as homeowners are concerned, who now contribute to local government revenues on the basis of the Council Tax, it seems almost axiomatic that in the current political climate that they should be excluded from any like form of land taxation as indeed such exemption might well be a popular political decision. However it is pertinent to examine how could the same LVT considerations be incorporated into the Council Tax system, which system now seems set to run without a revaluation in the foreseeable future? In particular, if allocation into value bands, rather than individual property valuations, is the norm how could apportionments between land value and building etc. value be made?

To find a ready solution in the face of such constraints needs a relatively broad-brush approach to the valuation process in that apportionments to land value could probably only be made within the existing value bands on across-the-board percentage bases. In other words, within a particular rating area certain percentages would be prescribed for the various value bands to represent an approximation of the constituent land value element paving the way to a dual tax rate system, analogous to the non-domestic system previously described.

As to progressions towards a more comprehensive form of LVT, with some forward thinking from tax administrators and assessors, the same trail could be followed as regards the collection and apportionment of hierarchical landowners' tax liabilities and also as regards the possibility of ultimate development towards a single tax on domestic landowners based on the highest and best use of their land. But again the speed and extent of such progressions would have to be measured against political and social expediency as does the basic issue of whether it is sound policy to disturb the existing Council Tax arrangements at all.

Commentary on the Proposed Scheme

The aim is to get some modest form of LVT started and to provide the opportunities to let the system progress still further as time passes, providing that political will and public opinion goes with it.

However there may be a dichotomy in the design of the Scheme whether we go slowly by apportioning existing use land values derived from rating assessments and/or by incorporating incremental land values on the highest and best use basis. This point is discussed in more detail below.

The proposal is that the first introduction of an owner's LVT happens in about the year 2002 by splitting the latest non-domestic rating assessments between 'site value' and 'improvements' (buildings etc.).

But no doubt certain technical problems will be raised by rating practitioners. For example, how far are the processes of splitting the assessment prejudiced by the original methods of valuation e.g. comparative, profits, contractors (cost), or statutory formulae? In this connection the RICS (1995) gives some advice in Guidance Note 5 on the apportionment of a valuation between land and buildings:

GN 5.3.4 Where the property has been acquired and is carried in the balance sheet... it is necessary for the Valuer to ascertain the value applicable to the buildings and the value of the land by an apportionment of the cost or the valuation as between buildings and land. The building will be the 'depreciable amount' and the land element will be the 'residual amount.'

GH 5 then goes on to describe two methods of carrying out the apportionment process. This process has been previously commented upon by Connellan et al (1991:161-167) and the relevant parts of this commentary are reproduced in **Appendix D**.

Although the above guidance to valuers is directed primarily towards apportionments of capital values for accounting purposes it is not a quantum leap for rating practitioners to adapt such recommended methods to apportioning annual values in like fashion. Doubtless some broad brush strokes would have to be incorporated into the processes of apportioning large scale undertakings currently assessed by the profits method or by

statutory formulae. However by using some ingenuity, which has never been in short supply within the rating valuation profession, the outcome certainly need not be one of insurmountable difficulties.

But it is interesting and relevant to this proposal that Uthwatt proposed virtually the same procedure of apportioning the annual values of land and buildings as part and parcel of the rating assessment process without any qualms as to its practicability (ECCB [Uthwatt] 1942:137)

Alternative Initial Approach

It was our original approach that non-rated land should be taxed at an appropriate percentage rate on a full LVT value based on highest and best use. But this might well be challenged as discriminatory as other (rated) owners are to be taxed on the basis of land value related to existing use. A possible alleviation for consideration is that these unrated owners should initially be taxed on an incremental basis (ECCB [Uthwatt] 1942) but related to highest and best use, remembering that this is only a partial tax hit on development rights which are actually now in the ownership of the Crown as emphasised by Lichfield and Connellan (1997: 41) as follows:

“However this has now an additional importance beyond the solution to the compensation problem when land value is mooted as a new taxation base. Any objections from land owners, for example, to an incremental betterment tax, as envisaged in the Uthwatt Report (1942: 135-154), on the development rights which they do not own but nevertheless can enjoy, would hardly make a credible case at the Court of Equity.”

Transitional Stages

The process of development will, of course, bring non-rated land into the net of apportioned rating assessments and the land value thus determined will reflect the development rights thus far exercised by the owner. This development and rating process will subsume any prior incremental taxation (or fuller taxation) of such previously unrated land.

But there are wider transitional concepts to consider, namely any movements beyond existing use value on rated land and possible incremental value on highest and best use on unrated land. An ultimate goal of an overall standard of full highest and best use value on all of this rated and unrated land as a basis for a consolidated LVT programme (at appropriate tax rate percentages) might be on a future Government agenda depending, of course, on political will and public acquiescence. Such an advance would provide an opportunity of eliminating any existing occupiers' rates based on buildings and improvements and replacing them within the owner's extended liability for land tax based on highest and best use principles which Wilks (1974, 1975) argued as eminently feasible.

The effect of any transitional arrangements 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) these 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 the tenets of “*value capture*” through LVT itself, planning gains, impact fees, greenfield taxes and the like will tend in time to work through the capitalisation process to produce ripples in the land market in what Prest (1981:37) refers to as “*a sort of Chinese puzzle argument.*”

Possible Criticisms of Scheme

- Technical difficulties over apportionments of rating assessments between land and buildings. But as previously indicated the feasibility of the exercise has already been endorsed by Uthwatt and the practice is widespread in the “two rate” system adopted in the State of Pennsylvania.
- “*Scratching the surface*” by only going for existing use land values. But it is at least a start 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) as between owners and occupiers and also as between different types of land uses.
- The scheme is just another form of rating (local property tax). But it lessens the load on the occupier by transferring some of the tax burden to the owner. Furthermore it opens up the possibility of progression towards a more universal form of LVT affecting owners of land now currently rated and unrated.
- The system only hits ratepayers. But there are proposals which encompass unrated land possibly by firstly introducing incremental LVT which may 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*” which 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’—but 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 so that all land falls to valued on a highest and best use basis then this will resolve any differential problems, either between the classifications of rated and unrated properties or even within those classifications themselves.
- There is nothing in the scheme for owners—but whilst admitting that a land tax burden is to be placed on those arguably best able to bear it, there might be some solace for those taxpayers who have long been claiming unfairness in the lack of tax write-offs for building etc. depreciation. If property owners are clearly to be taxed on “*the indestructibility of the soil*” in that a separation is made in taxation terms of real

estate i.e. from the parts that are destructible, will not this lend weight to those claims from those same owners for an introduction of income and/or corporation tax deductions for depreciation of buildings and other improvements to land that have limited lives (perhaps on the US pattern)?

Conclusion on Possibilities

What seems to be emerging is a combination of an enhanced CGT and an annual betterment levy and it is worth considering whether they are mutually exclusive or whether they can be imposed side by side. Prest (1971:178-179) unsurprisingly has some interesting and relevant views on the subject:

“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 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. 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. Most people accept the combination of DLT and the present local rating system (and for that matter are combination of income tax on rents and local rates) without too many qualms.

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. And, in any case, as we have explained at various times, it is simply not the case that the two tax bases are identical.

What is perfectly true is that if both taxes existed simultaneously there would be a number of interaction is between them. Thus SVR might be expected to reduce the land values through the capitalisation 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

Those who think that any idea of combining these two sorts of taxes together is a wicked modern invention might be referred to other times and other countries... So we may say that neither 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."

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