8 *Alan R. Prest*

United Kingdom Land Taxation in Perspective

There are two main ways in which land is taxed in the United Kingdom, as well as a number of subsidiary ones. The main ways consist of the old local property tax dating from 1601 (at least) and the new Development Land Tax dating from 1976. In addition, a number of titles are applied currently to taxes that rest on land value, for example, betterment charges, income tax, capital gains tax, stamp duties, and value added tax; in the future, there also is the potential for a wealth tax.

Local Property Tax (Rates)

I recently have set out the features of the United Kingdom rating system in some detail (Prest 1978). This paper will be a precis of that discussion. The amount of tax payable in any one year is a function of two variables: the rateable value of the property and the rate in the British pound. assessed Value The rateable value is in principle equal to the annual rental acceptable to both landlord and tenant assuming that the latter pays Millage Rate for repairs. It therefore embraces both land and buildings and is concerned solely with current, as distinct from potential, usage of a site. Rateable values are supposed to be reappraised every five years (and ad hoc if, say, major improvements are made to a property) but in England, if not Scotland, this principle has been honored more in the breach than the observance during the postwar period. Whereas rateable values are determined in principle on a uniform national basis, the rate in the pound is fixed each year by the individual local authority according to the amount of revenue it needs to raise, given its expenditure commitments and other sources of finance (principally central government grants nowadays).[1] So, if the rateable value of a property is, say, £400 and the rate in the pound in a given year is 75p (or 75 percent), then the tax liability for that year would be £300, and £320 if the poundage were 80p.

Various features of the rating system have to be appreciated. First, it applies to commercial, industrial, and domestic property; machinery is included, as well as industrial buildings. At the same time there are many concessions and exemptions, e.g., agricultural land is totally exempt, buildings of charities are 50 percent exempt, and there is substantial alleviation in respect of domestic property. The major features that distinguish the British system sharply from those found in other countries are that (1) it is explicitly a tax on annual rather than capital values RENT and (2) it is a tax on occupiers rather than owners, with the consequence that traditionally no tax was payable if a building was unoccupied, though this practice has been modified somewhat in recent years.

Many criticisms have been levelled at the tax over the years, e.g., that it was a deterrent to property development, that it bore harshly on lower income groups, and so on. However, its supporters have argued that the tax has many advantages, such as predictability of yield and ease of administration, which made it extremely suitable as a base for local finance. The most recent of many occasions on which these arguments have boiled over was during a major review of local authority finances by a Committee headed by Sir Frank Layfield (Local Government Finance 1976). After a good deal of evidence for and against the present form of the tax, the Layfield Committee argued strongly for retaining it in much the same form as at present except for two important changes: (1) assessment of domestic property in England and Wales on the basis of capital values, on the grounds that there was no longer sufficient worthwhile evidence to determine annual values and (2) rescindment of the exemption of farmland, on the grounds that the exemption was an anachronism. Not entirely surprisingly, the government subsequently indicated (Local Government Finance 1977) that it favored the first but not the second of these recommendations.

1. Of the total local government revenue of some £15b, each year 30 to 35 percent comes from rates, about 15 percent from property income (including rents of publicly owned housing) and the rest from grants.

Development Land Tax

In sharp contrast to rates, Development Land Tax (DLT) is a completely new tax, initiated on August 1, 1976. It is closely related to a sister Act, the Community Land Act of 1975, which effectively provided for the ultimate nationalization, or at any rate municipalization, of development rights in land. The DLT itself can be thought of as a set of interim provisions that will prevail until the ambitions of the Community Land Act are fully realized. However, not even the most fervent supporters of the legislation envisage that the millenium will arrive quickly, so it is worthwhile to examine this "temporary" phase in some detail. The temporary phase may be short-lived for an entirely different reason; if the Conservative Opposition is returned to power, the entire legislation may be repealed.

The essence of DLT is that it is a very special capital gains tax. It is levied on the difference between the value of land after the granting of planning permission for change of use or redevelopment and something resembling the current use value (to be defined more precisely below). It should be noted that the tax is mainly on increases in value associated with *changes* of land use category; insofar as land values increase while remaining in a particular use category, the capital gains tax (CGT) generally applies, but not the DLT. The DLT has a single 60 percent rate; the first £50,000 of development value became exempt as of June 12, 1979.[2]

DLT differs from the usual run of capital gains taxation in being tied, at least in part, to accruals rather than realization of gains, because the tax has to be paid at the commencement of material development or on realization (whether by lease or sale), whichever takes place first. It also differs in not making any allowance for the possibility of losses, presumably on the grounds that they would be extremely rare. It is not surprising that, like most capital gains in most countries, there is no indexing for inflation.

The interaction with other taxes is carefully established in the legislation; essentially their base excludes the amount on which DLT is levied. Thus, if a builder makes a gain of £500,000 on land for which permission for building development is given, he pays DLT on this sum; however, this £500,000 is *excluded* from his trading profits for income tax or corporation tax purposes. Nor, as we saw earlier, is it subject to CGT.

Without going into the details of an extremely complex piece of legislation, a few more points are sufficiently important to warrant mention. It

2. See *Economist*, June 16, 1979, p. 75.

was stated earlier that the basis for the calculation of tax was roughly current use value. In fact, there is a choice of three bases;[3] the taxpayer can choose that which is most to his advantage, i.e., the highest of the three. Various categories of landholders are exempt (in whole or in part) from the tax, for example, small owner-occupiers, charities (in part), and nonresidents; the same applies to land devoted to certain uses, for example, agricultural or forestry usage. There is no constructive realization on the occasion of a bequest or a gift; the recipient simply takes over the donor's base value. Arguments about hardship occasioned by payment of tax before realization have been countered by provisions for payment by installments. In addition, when land is acquired net of tax by a local authority, there is a provision for splitting the net profits from disposal in the ratio of 40:30:30 (changed in November 1978 to 30:50:20) between central government, the local authority concerned, and all other local authorities.

To date, the record of the tax is not overly impressive. In the financial year 1977/78, only £6.6 million was collected in revenue, while costs of public administration amounted to about 25 percent of the total, which is a high proportion by any standard. In fact, it appeared that the productivity of the staff engaged in assessing and collecting the tax was such that each staff member was only managing to make one assessment every two months, i.e., a total of six per annum. Nor has the land-purchasing record of the local authorities in England and Scotland under the Community Land Act been of a scintillating character. In England, for instance, local authorities were only able to make some 150 acres of land available for development in the first 2½ years of operations. Whether this was because of or despite the large number (135 in all over three years) of officially issued instructions, advice, and orders under the Act[4] is a matter for conjecture. At the same time it should be observed that the Welsh part of the scheme was working much more effectively in the sense of purchasing and releasing land for development. So the conclusion can be drawn that if one wants to implement land acquisition policies of this sort, a special statutory land authority, as is found in Wales, is likely to be more effective than the standard local authority organization that has the responsibility for implementation in England and Scotland.

Before leaving DLT, it would be useful to take a glance at the later stage envisaged in the 1975 legislation. The plan was for local authorities to

3. *Either* 110 percent of current use value at date of disposal plus expenditure on improvements *or* acquisition cost plus cost of improvements and increase in current use value since acquisition *or* 110 percent of acquisition cost plus cost of improvements.

4. See *The Times* (London), November 7, 1978.

buy all land that is on the point of development on the basis of current use values. In other words, none of the development gain would accrue to the private sector, and the tax as such would disappear. Therefore it would be more correct to depict the situation as one in which public sector powers will be able to abolish private sector gains rather than to levy a tax at a rate of 100 percent. In other words, we cross the boundary from purely tax measures on development gains to their direct acquisition by the public sector.

Other Land Related Taxes

There are many other taxes impinging on land in the United Kingdom today, but none of them is nearly as important as rates and DLT. Therefore, a mere summary will suffice.

Capital Gains Tax

The normal capital gains tax (maximum rate 30 percent) applies to land gains other than those taxed under DLT.

Stamp Duties

These are essentially a tax at 2 percent of sales values on transactions in various capital assets, including land.

Income Tax and Corporation Tax

These apply to land rents; there is no tax on the land rental component of imputed income from owner-occupied property.

Capital Transfer Tax

The normal progressive schedule is applied to transfers of land by gift or bequest.

Value Added Tax

Land transactions are exempt.

Betterment Charges ("special assessments")

Charges have been levied for many years on landowners specifically benefitting from improvements executed by local authorities, e.g., drainage provision. It could be argued that these charges are not taxes in the strict sense but it is better to include them to provide a comprehensive picture.

Wealth Tax

If a wealth tax is enacted, as seems highly probable if a Labor Government is re-elected in 1979, land holdings will certainly be chargeable under it.

Antecedents of the Current Position

A full account of the evolution of the present arrangements would require much more space than a single article, so all that can be done here is to paint with the broadest of brushes. Even so, everything which does not relate to the development of the local property tax and the national development land tax must be omitted.

Roots can be envisioned at three different levels; academic thinking, popular movements, and government enquiry and action. Taking *academic thinking* first, there is a long tradition of argument in favor of urban land taxation. Confining oneself to the United Kingdom only, the line of argument can be traced through many of the famous economists of the past from Adam Smith onwards. We can give some flavor of this history by referring to the writings of J. S. Mill and A. C. Pigou.

Mill (1848, rpt. 1969, pp. 818–21) essentially took the view that land rent justifiably could have been taxed from the time of Adam and Eve onwards. Nevertheless, he was acutely conscious of two limitations on any attempt to tax away the whole of current rent payments to landlords. First, he recognized that rents might include payments for landlords' improvements and therefore not fully correspond to the notion of a true surplus. Second, whatever undeserved surpluses might have accrued to landowners in the past, the present generation may well have bought land at prices based on the expectation that current and expected returns would not be subject to any special tax. In other words, a special land rent tax would impose a capital loss on a largely different set of people from those who had over the generations enjoyed capital gains from land rentals. So Mill's proposal was to exempt the present value of land from any impost, but instead to tax new future increments in value, unless it could be shown that these were the fruits of individual effort, enterprise, and so on. In other words, Mill advocated a capital gains tax on certain land value increments after a given date.

Pigou's views (1947, chaps. XIV and XVI), paralleling those of Marshall (1926, 1920), were somewhat different. Pigou clearly distinguished between what he called taxes on public value of land (i.e., that element of land value which cannot be attributed to individual initiative, enterprise, and so on) and taxes on unexpected windfalls. In the former case, he argued that there was a strong case for heavy taxation on efficiency grounds, a case more or less parallel to that for taxing monopoly revenue. At the same time, he was hesitant about the equity aspects. However, he did take the view that unforeseen gains, or windfalls, should be taxed heavily, the analogy there being wartime excess profits taxation. He did not fail to see the point that some gains do not fall neatly into either the anticipated or the unanticipated box, and he therefore spent some time on the interaction between the two tax bases. The upshot is that Pigou, unlike Mill, can be claimed as academic authority for both a tax on land values and a tax on unanticipated increments in land values, though it should be added that he had no great expectations of raising vast sums of revenue by either means. Such is the sort of legacy that was left by nineteenth and early twentieth century academic discussion of land taxation.

When we turn to *popular movements,* there are two, or perhaps three, major ones to be distinguished. Henry George made a great impact on England, as elsewhere, and the 25 years or so before World War I saw a great deal of discussion, both verbally and orally, of the propositions that land values are socially and geologically created, that landowners have no right to them, and that taking away rents from landlords would amount to depriving robbers of what they should never have had, rather than an unwarranted expropriation of property rights. There is still support today in the United Kingdom for site value taxation (e.g., the views of the Liberal Party) which stems back to the popular movement sparked off by Henry George and his immediate followers. However, it cannot be said to be a major force in the way that it was before 1914.

The other popular movement in the United Kingdom is the long tradition in Labor Party circles, stemming from the early Fabians, that the appropriate way of dealing with unearned increments was to be found in land nationalization. This is a battle cry susceptible of many different meanings; it may be questioned whether some of those who have chanted it for so long have ever distinguished clearly between these meanings or even understood that there were any distinctions to be made. The concept can in fact mean anything from state ownership of all land interests (whether freehold, long leasehold, or even short leasehold) to the vestment in the state of future land development rights—and perhaps not all such rights and perhaps even then only on the basis of compensation. If land nationalization is taken to mean the transfer of development rights to the public sector, it is obviously much nearer to Henry George's position than if it implies, say, major State acquisition of freehold and long leasehold interests in land. Even so, it would not be identical in mechanics or effects.

Whatever the variety of meanings sheltering under the land nationalization umbrella, there can be no doubt that it has been a powerful influence politically. This has been especially so in the context of the town planning movement, which could be considered a third major popular force from some viewpoints. Attempts to regulate the layout of towns encountered many problems before World War II, most especially in trying to tie in development charges and compensation payments to the system of granting (or refusing) permission for development. What actually happened in the 1940s was a fusion of land nationalization and town planning arguments, culminating in the 1947 Town and Country Planning Act, which effectively nationalized development rights and tied in the whole process of compensation and betterment to that of planning legislation.

This brings us in turn to roots at the *government* level. There has in fact been a vast amount of such activity over the years. There have been many official commissions and committees that have discussed site value taxation or land increment taxation or both, ranging from the Royal Commission on the Housing of the Working Classes in 1885, to the well-known Uthwatt Committee Report of 1942, to the Layfield Committee of Enquiry into Local Finance of 1976. Various governments have issued White Papers stating their views on the arrangement of land taxes, e.g., in 1944, 1965, 1974, and 1977. Many bills have been introduced into Parliament over the years, some being privately promoted (such as a London County bill in 1938 to introduce site value rating) and others officially sponsored. Legislation has resulted on a number of different occasions, but it has also been repealed soon afterwards, e.g., legislation of 1910 repealed in 1920, 1931 in 1934, 1947 in 1953, 1967 in 1971, and so on. Over the years, there have been major divisions of opinion between the political parties about the appropriate method of levying land taxation., There is little reason to expect that the most recent legislation to reach the Statute book, the Development Land Act of 1976, will become settled land tax policy.

Points at Issue

The motivations of people advocating heavy land taxation or extensive state intervention in land policy will be mentioned first; this will be followed by an examination of some of the emotional forces which have come to the surface. Finally some of the confusions of thought in this whole area will be outlined.

One powerful *motivation* has been the equity argument in one shape or another. Some 70 to 80 years ago the cry for special land taxation was well grounded in the comparison between the splendid houses and grounds of the aristocracy at that time and the slum-dwelling conditions of many of the working population – witness the famous Lloyd George statement that "dukes cost more than battleships to maintain and did not even have any scrap value." In more modern times the emphasis has shifted to the large profits said to have been made by "speculators" in urban development and redevelopment. So the plea for taxation of unearned increments in one form or another was backed by an appeal to distributional arguments, though usually in general terms and without any supporting statistical evidence on the probable effects on the distribution of income or wealth.

Another theme, although a much less powerful one, was that of efficiency arguments for site value taxation, either in terms of income effects generating fuller usage of partly utilized land or the substitution effects of encouraging building and improvements as a result of the replacement of a general property tax by a site value tax. However, these standard arguments by academic economists have never had much impact at political levels. Although town planning has often had an aesthetic aspect, supporting arguments have also frequently been made for it on efficiency grounds by appealing to externality and merit wants principles.

Others used nationalization of land as the supreme objective – sometimes without thinking what the phrase meant or even realizing that it might have different meanings. One example of a recent set of proposals is found in Brocklebank et al. (1974), which calls for the compulsory conversion of all freeholds and leaseholds extending for periods in excess of 99 years into 99-year leases from the Crown. By this means all land would eventually revert to the Crown and would then be leased at an appropriate rental, thus permitting the abolition of the rating system. The justification for these proposals was:

> It would in our view be better to concentrate exclusively on the nationalisation of land (at the expense of proposals to nationalise bits of industry) on the grounds that this is *the greatest* source of power and undeserved gains, of ill-directed enterprise and undesirable social pressures; as well as being a source of hardship for the victims of land speculation" (Brocklebank et al. 1974, pp. 14–15; italics in original).

There are innumerable examples of *emotional* overtones to discussion in this field, the above quotation being one example. Sometimes the case for heavy taxation is based on the proposition that land gains may be sudden and individually large.[5] Taxes on windfalls can be supported easily; as such, however, that is no justification for singling out land windfalls from other windfalls. Even though any single land transaction may yield a substantial gain, the position is quite different depending on whether such gains recur regularly or not. After all, it is normally held to be a disadvantage of a progressive income tax that it hits fluctuating incomes more than stable incomes when there is no averaging system. The general feeling that somehow land gains are of special character, and as such are an appropriate basis for heavy taxation, may owe something to the older idea among economists that economic rent was solely an attribute of land. Whether this explanation is correct or not, any reader of Parliamentary debates on the subject in the United Kingdom might be forgiven for thinking that land policy was a matter on which passion dominated intellect, giving rise to such gems of doubletalk as the proposition in the 1960s that a levy on land was not a tax on land.

Undoubtedly, neither discussion nor policy has been helped by a good deal of *confusion* in the land taxation area. As an example, we might take the distinction between a site value tax and a land value increment tax. Each of these taxes has been cited as a means of recapturing "unearned increment for the community" without much attention given to the various possible meanings of unearned or increment or community. In fact, the two taxes are likely to differ considerably in both coverage and timing, because a full site value tax would cover all land values (and not just those increments accruing after a certain date) and would also be on an accruals rather than a realization basis. Although the Layfield Committee (Local Government Finance 1976) did not make such an elementary mistake, its discussion of site value rating was clouded by the argument that the Community Land Act and Development Land Tax Act had made such rating irrelevant. This conclusion simply does not follow, as I have argued elsewhere (Prest 1978, p. 48).

More generally, there has been little discussion of the way in which particular land taxes should relate to more general taxes, e.g., a site value tax to a net worth tax and a land value increment tax to a capital gains tax. Nor has the interrelation between national and local taxation requirements received much attention.

Given this record of politically inspired proposals, emotional reactions, and confused thinking, it is not surprising that the economic

5. This sort of argument was put forward in the House of Commons by the chancellor of the exchequer in 1973 when advocating a change in land taxation arrangements. (*Hansard,* Commons, 17 December 1973, Col. 957)

arguments for differential land taxation, whether of an equity or efficiency character, have often disappeared from sight. It does not follow that we should have a better system of land taxation in the United Kingdom if economic analysis had not been buried under the avalanche, but at least we might have had a clearer idea of the arguments for and against it.

Conclusion

The main roles in land taxation in the United Kingdom today are played by the old rating system and the new land development taxation, although a number of other taxes have walk-on parts. The present tax mix-up was preceded by many years of academic and popular discussion, as well as a vast amount of activity at government level. However, for many years there have been conflicting motivations in demanding government action on land, although these underlying viewpoints have often been obscured by emotional outbursts or faulty reasoning.

References

Brocklebank, J., N. Kaldor, J. Maynard, R. Neild, and O. Stutchbury. 1974. *The Case for Nationalising Land.* London: Campaign for Nationalising Land.

Local Government Finance Report of the Committee of Enquiry. 1976. Sir Frank Layfield, chairman. Cmnd 6453. London: Her Majesty's Stationery Office.

Local Government Finance 1977. Cmnd 6813. London: Her Majesty's Stationery Office.

Marshall, A. 1926. "Memorandum on the Classification and Incidence of Imperial and Local Taxes." In *Official Papers by Alfred Marshall,* ed. J. M. Keynes. London: Macmillan.

Marshall, A. 1920. *Principles of Economics.* 8th ed. London: Macmillan.

Mill, J. S. 1848 Reprint 1969. *Principles of Political Economy.* New York: Kelley.

Pigou, A. C. 1947. *A Study in Public Finance.* 3d ed. London: Macmillan.

Prest, A. R. 1978. *Intergovernmental Financial Relations in the U.K.* Research monograph no. 23. Canberra: Center for Research on Federal Financial Relations, Australian National University.