TO MEMBERS OF THE COMMUNITIES AND LOCAL GOVERNMENT COMMITTEE INQUIRY

WRITTEN REPRESENTATIONS OF ALTER (Action for Land Taxation & Economic Reform) AN ASSOCIATE ORGANISATION OF THE LIBERAL DEMOCRATIC PARTY.

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LAND VALUE CAPTURE

1 .EXECUTIVE SUMMARY

1.1 In ALTER's submission the only effective way to capture land values is by the introduction of a land value tax (LVT). Current techniques of land value capture such as Community Infrastructure Levy (CIL) and s.106 agreements have no significant impact. However, LVT is not an immediate policy option: it would take at least five years of planning and preparation before it could be introduced effectively. In the meantime ALTER suggests three interim measures that are open to the authorities. These are: (1) the clawback of planning permission gains; (2) the withdrawal of capital gains tax exemption on owner occupied residences; and (3) the selective re-introduction of Schedule A income tax. This executive summary sets out the broad rationale for LVT and for these interim suggestions. Further details details can be found in section 2 (LVT), section 3 (Planning Permission Clawback) and section 4 (Schedule A Income Tax).

1.2 According to a recent study by the Office of National Statistics (ONS), the UK's total assets amounted to approximately £10 trillion (i.e., 10^{12}) in 2017. Land was found to be the UK's most valuable asset, making up more than half of the UK's total net worth. Since 1995 the value of land has increased more than fivefold.

1.3 The land mass of the UK as a whole is a free gift of nature; as a country we pay nothing for it. As the UK cannot dispose of, or sell, its land mass to another country that land mass can have no external market value. If the total market value of land held by individuals/persons amounts to some £5 trillion, as suggested by the ONS, there must exist offsetting "negative" market values or influences to sum to zero.

1.4 These negative values are not recorded in our economic arrangements but they nevertheless exist and are keenly felt. The present housing crisis, which condemns many to the endless payment of rent, is just one manifestation of these negative consequences. The diversion of scarce credit resources--at least £600 billion-- from productive economic activity to unproductive land values is another. So is the ballooning cost of Housing Benefit (currently some £25 billion). Nor should it be forgotten that many locals in scenic rural localities find it impossible to remain in the communities they were born and brought up in because of the demand for second homes.[1]

1.5 The inexorable upward march of land values with its accompanying enrichment and corresponding impoverishment has the potential, if unchecked, to lead to deep seated unrest and could even put at risk the very stability of our political system. Appropriate measures to capture land values and to take the steam out of property prices are therefore an urgent political necessity.

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1 Although it is a commonplace and so perhaps not worth mentioning, there was a time when a man's earnings could pay for the mortgage. Now, because of rising house prices, both parents need to earn. Thus many mothers do not have the option of devoting their time fully to their children. Who can say what the consequences of this might have been for those mothers and their children.

1.6 CIL, which seeks to tax the increase in land values arising from local infrastructure projects, is one form of land value capture. Agreements under s.106 of the 1990 Town and Country Planning Act, whereby the developer typically undertakes to provide some element of social housing, are another. Worthy though these initiatives are, they do not even scratch the surface of the problem. The only satisfactory way to capture the rise in land values is by the introduction of a full blown system of land value taxation (LVT).

1.7 In its fully developed form LVT would apply to all land, whether used or not. Second homes would become much more costly to maintain; holding property out of use--there are an estimated one million empty properties--would become expensive; windfall gains on obtaining planning permission would be a thing of the past; credit resources--at least £600 billion--now tied up in (unproductive) land values would be released for productive purposes; developers' profit would be restricted to the construction of the building itself but still be a commercial rate of profit. Above all, the Government would have a means of controlling property prices.

1.8 Industrial and commercial enterprises would also be subject to LVT. Corporation/ profits tax would have to be correspondingly reduced so as not to increase the overall tax burden on businesses. But it would mean that, for the same level of activity, a business in the regions (where land values are significantly lower) would pay appreciably less tax than one in the South East. This would encourage regional investment and relocation from the South East. LVT would also make it expensive for property development companies and the big supermarket chains to sit on large land banks.

1.9 Unfortunately, the practical difficulties of introducing LVT rule it out as an immediate option, as now explained. Although the valuations required by LVT are well within the competence of HMRC's Valuation Office Agency (VOA), the valuations themselves would nevertheless entail a considerable increase in the VOA's workload. Establishment levels at the VOA, currently some 3,500, would have to be increased significantly to cope with the extra workload and to ensure that values were regularly updated. More importantly, complex transitional arrangements need to be devised for the introduction of LVT in order to ensure that financial institutions, many of whom have lent heavily against property, remain securely based. It could well take five years of preparation before LVT was up and running.

1.10 On the plus side, such a transitional phase would give time for the public to become used to the idea of taxing land values. LVT is difficult to explain and is open to facile misrepresentations (e.g., "the garden tax"). Nor is it immediately obvious to people why land, an inanimate object, should be taxed in preference to income or profit.[2] A transition period would at least allow the case for LVT to be properly made and understood and for the public to become used to it.

1.11 With the government's commitment to the eventual introduction of LVT in place, it could usefully introduce three short term measures to capture land value for the State. First, a planning permission levy could be introduced to collect the entire gain in land value arising from the granting of planning permission. This should not

[2] See W S Churchill's *The People's Rights* for one of the best explanations of LVT.

be seen as a tax but rather as the collection by the government of a value it has created. Each grant of planning permission would be referred to the VOA for the gain to be assessed. This determination would then be attached to the land deeds/register like a garnishee order.[3] The gain thus determined would be a first charge on the proceeds of sale of the developed properties.

1.1 Second, the gain on sale of one's residence should no longer be exempt from capital gains tax. Existing capital appreciation would of course be protected. Capital gains tax would apply only to that part of any gain arising after the change.

1.13 Thirdly, income tax under Schedule A (a tax Schedule in current use), should be reintroduced as a temporary measure pending the eventual introduction of LVT. Under Schedule A, the owner/occupier was assessed for income tax purposes on the net rental value of his property. In its re-introduced form the assessed income would be on that part of the property's annual rental income attributable to the land or site. A local site value co-efficient determined by the VOA would be used for this purpose and applied to the property's assessed annual market rent to obtain the market land rental.

1.14 It is proposed that owner/ occupiers be given a generous discount--say 90%--rendering the tax of little practical significance for them, apart from introducing them to the notion of land value taxation. However, second or third homes would attract the full undiscounted Schedule A tax charge as would empty properties. This should bring more properties onto the market.

1.15 Above all, these measures would send a powerful message that the days of housing being considered as a privileged investment as opposed to the provision of a basic human need--adequate shelter--are numbered.

2. **LVT EXPLAINED**

2.1 A property has two components – the building itself and the land or site on which it is constructed. The building itself deteriorates over time. Like any other manufactured good, its value cannot exceed the new-build replacement cost and is likely to be less than this depending on its age. Therefore any profit arising from an increase in a property's value (in real terms) must originate from the site or land element; it cannot arise from the building. Indeed, depending on its age, the building itself will have depreciated in value.

2.2 LVT is a tax on the land element of a property's value. It is levied on the annual rental value of the site. As site values are community created, the tax would ideally collect for the State the entire annual rental value. This would deprive the site of its exchange or market value. The price of a residential property would then reflect solely the market value of the building itself. In practice, LVT would capture less than the entire land value but this would nevertheless remain the aim.

[3] This is a common form of enforcing a judgment debt.

2.3 Residential building land is rarely rented on its own so it would not be possible to assess the site's rental value from objective market rental data. The annual rental value will have to be calculated or imputed from residential property rents in the market place. A reliable way of doing this exists.

2.4 An an illustration consider the case of a modern three-bedroom house with garage in a typical, popular location in the South East with good transport links and within commuting distance of London. The property is modern having been built 15 years ago. Then, it cost £150,000. Now, it is valued at £500,000. The property is let, the annual rent being £18,000 (£1,500 a month). The re-building cost for fire insurance purposes is approximately £200,000 based on RICS building cost indices. This rebuilding cost is the maximum value the building (as opposed to the land) could have. In reality, some deduction should be made for depreciation or wear and tear, but for present purposes this is ignored. The building's value is therefore at most £200,000. The balance of the property's value, i.e., £300,000, is therefore attributable to the site. This site value of £300,000 is equivalent to 60% of the total value of the property. It follows therefore that 60% of the market rent must be attributable to the underlying land. The annual rental value of the land would then be assessed at £10,800, i.e., 60% of £18,000.

2.5 LVT in its full blown form, i.e., where the whole of the annual land rent was taken in tax, would lead to significantly lower house prices. Just how far residential property prices would fall as a result of LVT is difficult to say. But in the South East site values are reckoned to be on average 50 per cent of the total property value. In the illustrations in paragraph 2.4 the land accounts for 60 per cent. On this reckoning, property prices under LVT could well be half what they are today in the South East. In practice, of course, the impact of LVT would be much less extreme than this. More likely, LVT would act as a brake on rising property prices.

2.6 LVT would also curb the rise in rents. The rent a property commands is determined by the rate of return the landlord expects on his investment. If the investment is lower because it excludes the value of the site, so, too, would be the rent. Earnings could then catch up with rents. Earnings multiples for mortgage finance would likewise fall. Indeed, under LVT much of the attraction of buying over renting would disappear.

2.7 As well as making property affordable and rents acceptable, LVT would also improve the supply of housing. It would do this in three ways. First, there are an estimated one million empty properties in the United Kingdom. LVT would make it very costly to hold these out of use. Many of them would have to be sold, rented out or put to use. Second, under LVT it would be much more expensive to own second or third homes. Many of these would have to be sold, thus becoming available for purchase by local people.

2.8 Third, LVT would remove the present incentive to "house hoard", i.e., to occupy a house very much more expensive than one needs in the expectation of a larger (tax-free) capital gain. Under LVT there would be little prospect of capital gain, let alone a larger one. Housing would become a commodity like cars, washing machines and fridges. Indeed, because of ordinary wear and tear the building itself might even fall in value over time--significantly so if it were not properly maintained.

2.9 Two other benefits both linked indirectly to the housing crisis should also be mentioned. First, with lower market rents (being based primarily on the building value excluding land) it is reasonable to expect considerable savings in the cost of Housing Benefit, currently some £25 billion. Second, most properties are bought with a mortgage. According to Bank of England statistics (Table C1.2), total property lending to individuals was a staggering £1,200 billion at end-2017. If we assume that half of this is attributable to the site or land value, then the credit resources released by LVT could be upwards of £600 billion. This takes no account of lending against commercial property. Such a sum made available to finance productive investment in goods, services and infrastructure would make an appreciable difference to the economy.

2.10 Annual land rental values for all categories of property--residential, industrial, commercial and retail--will have to be established across the country. This will increase the VOA's workload considerably. The VOA currently employs around 3,500 people. It is imperative that the VOA is allowed to increase its establishment to the level required by this significant addition to its workload.

2.11 In view of their potential significance these VOA-determined annual rental valuations will be closely scrutinised. A a consequence land tribunals, which adjudicate differences between taxpayer and the VOA, are likely to see their workload increase significantly too. Adequate provision must be made for this too.

2.12 Once LVT is up and running it will be vital that this important tax is not discredited by out-of-date valuations. This happened with local authority rates and could well happen with council tax, where the last valuations appear to have been in 1991. At a minimum, annual land rental values should be updated every three years. Once the initial work of establishing annual rentals across the country has been completed, the work entailed in updating those values would, of course, be much less.

3 **PLANNING PERMISSION GAIN CLAWBACK**

3.1 On grant of planning permission the Planning Department concerned would notify the VOA and send them details. The VOA would then assess the gain on planning and issue a formal determination. This determination, which would be subject to appeal in the normal way, would then be entered in the Land Registry with the same effect as a garnishee order. Thus as the site was developed, the claw back determination would be a first charge on the proceeds of sale of the relevant properties.

3.2 In arriving at their determination the VOA would use the residual land value approach. From the estimated net proceeds of sale of the relevant properties there would be deducted the cost of construction, including the developer's (reasonable) profit margin and all site preparation costs. The resultant sum would be the amount which the site might reasonably be expected to fetch in the open market. The existing use value of the site, i.e., what it was worth without planning permission, would then be deducted from this amount to give the increase in value attributable to the grant of planning permission.

4. SCHEDULE A INCOME TAX

4.1 Schedule A income tax is chargeable on income from land and property. While still relevant to companies, Schedule A ceased to be applicable to individuals in the 1960s. Under Schedule A owner occupiers were regarded as having an income equal to the annual net rental value of their property, i.e. land and building. That notional income was added to their other income (e.g., earnings under Schedule E) in calculating total taxable income.

4.2 It is proposed here that, as an interim measure pending full introduction of LVT, Schedule A income tax be reactivated. The tax would not be restricted to owner occupiers but would apply to all properties including second homes and empty properties. However, owner occupiers would benefit from a 90 percent deduction, making it, for them, more of a token tax. But owners of second homes and empty properties would be assessed on the full annual rental.

4.3 To enable Schedule A income tax to work the VOA would be required to produce annual rental values for all the country's properties. From these property rentals there would have to be imputed the appropriate land element using the methodology described in paragraph 2.4. Clearly, this would take some years. To render Schedule A a viable interim measure capable of working in reasonably short order, it is therefore necessary to devise a simpler approach--that of self assessment.

4.4 The taxpayer would return two figures--the estimated value of his house and the estimated annual rental value. These estimates would be valid for three years. The VOA would supply HMRC with site value co-efficients on a regional or local basis. When applied to the annual property rental the co-efficient would produce a notional annual land rent.

4.5 For the most part these returned property values and annual rental values, subject to a 90 percent discount, would be of little interest to HMRC. The authorities' attention could be focussed on the rental values returned for second homes and empty properties. For the owners of such properties this tax could be a significant impost detracting from the advantages of ownership.

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