Submission by ALTER - Action for Land Taxation and Economic Reform to the Commission on Local Tax Reform in Scotland

Intro ALTER by John Howell

ALTER [**A**ction for **L**and **T**axation & **E**conomic **R**eform] is a group of Liberal Democrat members pressuring the Party to adopt a policy of shifting the burden of taxation from work & enterprise and onto the site value of land.

Intro to Land Value Taxation by John Howell

Before 1066, public revenue to cover the 'three necessities' (defence, roads, & administration of law) was raised from land rent. Families with good land paid more than those on poor land. Nobody saw any advantage in holding more land than they could use so there was always land left empty to absorb population growth or immigration. It was a robust system in which everyone kept what they produced, and only paid according to unearned advantages such as natural fertility or access to water, conferred on them by their location.

Unfortunately, in the medieval period, the principle of 'public revenue from rent' (today called LVT) was not much applied to newly-forming market towns and ports. The considerable benefits of urban land values fell instead into the hands of financiers and traders occupying key waterfront or market locations. Hence governments resorted to customs duties on trade in goods, and so public revenue began to be taken from the value of production instead of land.

Today the natural justice of obtaining public revenue from the value of land a person holds has been forgotten. Land value, which is created publically by the community at large, has become a source of *private* revenue, while private income from a person's work, is regarded as the source of *public* revenue. This basic contradiction distorts all modern economies, and indeed most economic debate.

Gradually diverting land rent to public revenue would end speculative hoarding of vacant or underused sites, freeing land for growth or newcomers. Meanwhile, removal of taxes on labour and enterprise would revive production, especially for marginal areas and trades. Falling unemployment and reduced welfare costs would reduce tax burdens generally. A more balanced, stable and just economy would emerge and serve as an example for others.

The most immediate and practical reform is to put both Council Tax and Business Rates, onto a site-value basis. At present, Council Tax is very regressive, with cheap properties paying 1-2% pa of capital value, compared to .01% or less at the top end of the market. This is because of the price of expensive properties is much more related to site value, which the council tax does not take into account. The regressive nature of Council Tax has also been aggravated by its having remained largely frozen in recent years.

Obtaining the economic benefits of applying site-value reform to the Council Tax must mean homes in expensive locations paying more than at present, and this, for the poorer income groups in those areas, will necessitate a very gradual implementation and transitional reliefs. But the process would also be helped by reduced unemployment and higher take-home earnings.

Proposals to replace property tax with Land Value Tax

Land Value Tax (LVT) is rooted in the fact that, unlike labour or capital, land has no production cost and a fixed supply. Excluding buildings and other improvements, locations derive their value from surrounding public investment – not to private effort or ownership. Liberal Democrats believe such value belongs to the community and should be recovered accordingly. ALTER favour replacing Council Tax and Uniform Business Rates (UBR) with a LVT on the location value of land alone – not capital improvements like drainage or buildings – encouraging the optimal use of land, its 'Highest and Best Use' (HABU), automatically stimulating growth and development within democratically determined planning limits.

On the basis of current capital values, a ~3% rate for residential with a 8% rate for businesses and vacant land (the initial LVT rates) would raise enough to replace both Council Tax and Business rates and Stamp Duty Land Tax. Longer term LVT rates would converge to a single rate, which could raise enough Tax to reduce Scottish Income tax rates by the maximum 10% allowed under the Scotland Act.

As most economists agree, it is impossible for a tax on location value to be passed on. Tenants, both firms and families would therefore be exempt from LVT, the charge inevitably falling on the landowning beneficiaries of unearned location values, but in place of 'deadweight' taxes

Local and National LVT rates
Two LVT rates should be set; one nationally and one locally, to create a combined LVT rate, administered nationally and collected by the income tax system as in Denmark. In the Scottish context, this would allow land prices to gradually converge over time from current extremes caused by the council tax cap of 3x the lowest band which under taxed high value properties compared to the old rates system. Initially Scotland could set a national rate of 1% then let councils set a low local rate, say 0.6% as in the Danish example in high value areas to reduce the increase in tax becoming too extreme in the early years of LVT.

Valuation methods
The fact that Council Tax is based 1991 valuation, shows that land values only need to be accurate relative to each other, not accurate to current market value. For example in some countries LVT is calculated on a discounted land value which is based on the income value of the land. Income values are far more stable than sales values, which are more prone to boom and bust.

Residential locations would contribute a slightly larger share of the total yield than at present, as LVT would be levied on empty and second homes (often exempt from Council Tax), so ending rebates or subsidies for the asset rich.

If LVT was aimed at only replacing revenue from existing property taxes, a quarter of Scottish households, residing in Council Tax bands E to H, would see a tapered increase, but the 75% of those households in bands A to D would get a tax cut or no increase in tax over Council Tax. Only the top 10% of households would see a significant increase in Tax.

Farmland
The rental value of all farmland in Scotland is very low and not currently subject to Tax. LVT on farmland would be controversial and raise little revenue. Rather than exclude farmland and risk creating a loophole, it would be better be have an allowance of say £10,000 per hectare on all land types, thereby excluding almost all Scottish agricultural land from LVT. High value agricultural land of £12,000 per hectare would only pay tax on £2,000 of the value. An average industrial hectare in Scotland in 2012 had a location value of about £1m, with an agricultural hectare averaging just over £4,000.

Benefits of Land Value Tax to Scotland

The net effect of LVT on Scottish government revenues should initially be neutral, merely replacing existing property taxes and including some transitional reliefs with a gradual transition to a single LVT rate. This transition period would allow time for individuals and companies to reallocate their investments away from land speculation toward productive uses without economic shocks.

Replacing bad taxes
The regressive Council Tax, with its tax breaks for empty properties and second homes has made the housing market dysfunctional. Business rates with their exemption for disused buildings and vacant sites, contribute to inefficient land use and urban decay. Both taxes penalise property improvement; LVT allows the benefits of maintenance and improvement to remain with the owner. Land and Buildings Transaction Tax depresses property transactions and reduces labour mobility by increasing the cost of buying a home. Abolishing LBTT is important to the smooth transition to LVT by stimulating the volume of housing sales.

Stimulating construction
LVT will cause an increase in construction, particularly in cities where there are significant areas of vacant land or under used property. In Pennsylvania LVT was shown to increase construction by 16% for every 1% of LVT over towns with property tax (land + building values), so a 3.4% LVT rate as Copenhagen has, could increase construction by over 50%. Land held for speculation or simply neglected will become uneconomic to just leave unimproved. Owners will develop such sites to their ‘Highest and Best Use’ or sell to others who will. There will be a significant increase in land sales, creating opportunities for developers to optimise the full potential of Scotland’s most important natural resource. Existing properties will be improved to increase their rental return as all such improvements go untaxed. Enterprise will be rewarded while holding out for unearned income will be penalised. LVT is unique in compelling wealth to be used productively and economic activity to increase, rather than suppressing both as other taxes do.

Raising investment and consumer spending
As soon as a future Scottish government announces the introduction of LVT, land owners, developers and investors will start reallocating resources to more productive use – to avoid tax and benefit from new opportunities. Housing transactions will be stimulated as buyers will no longer face the burden of LBTT and property owners will look to rebalance their investments. While landlords may try to increase rents and pass on the tax, they will find this very difficult in the short term and impossible in the long term as the supply of new and improved property increases. Home owners and tenants in council tax bands A to D would be better off and more likely to spend their tax saving than any trickle down tax cuts to the rich. As consumers increase their spending and housing transactions increase, the knock on effects will create new employment and further raise consumer confidence, creating a virtuous economic cycle for investment and growth.

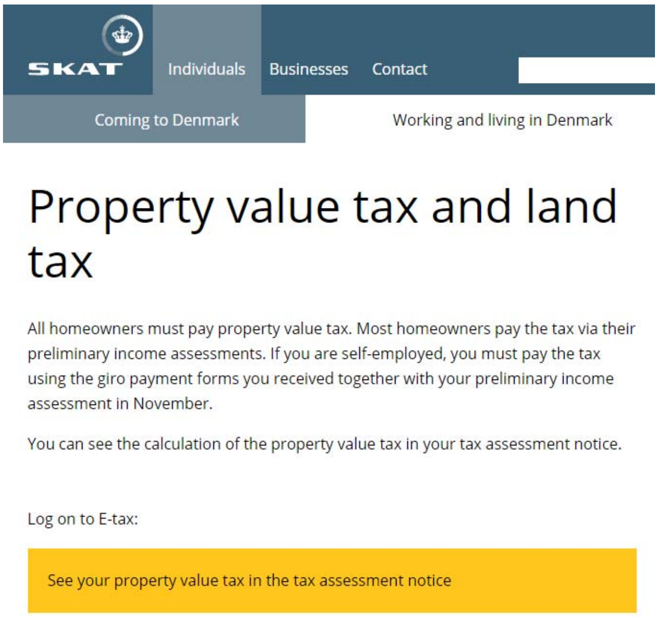
Increasing Infrastructure finance
With LVT it would become easier to finance such development as loans or bonds can be raised against projected LVT revenues from the increase in land values that occurs as result of new infrastructure. Financing infrastructure projects would be faster and cheaper, as an assessment of likely rises in land values is far easier to estimate and prove than questionable cost-benefit analysis.

Improving wealth distribution
LVT will redistribute wealth not by taxing incomes, which is too late in the cycle of economic activity and can be avoided, but by stopping rent seeking and the accumulation of unearned wealth. LVT is a far more progressive tax regime than Income tax ever has been or ever will be. The extremes of land values will reduce as low value areas benefit from reduced taxation and higher value areas revert to the relative values of 25 years ago, before the arrival of the regressive Council Tax. Work and enterprise will be rewarded and non-productive speculation reduced. A more equitable distribution of wealth will gradually emerge, reversing the trend of the last 30 years and more.

Denmark as Model for Scottish Land Value Tax

Danish Land Tax Rates as % of Land Value

	To Counties	To Municipalities	Combined
Maximum %	1.0	2.4	3.4
Minimum %	1.0	0.6	1.6
Average %	1.0	1.3	2.3



Modelling a Scottish Land Value Tax on the existing Danish model has political and practical advantages over trying to recreate a Scottish Land Value Tax from scratch. Denmark has had LVT since 1926 and it is a well established, online system with regular computer based revaluation every 2 years. The population of Denmark is a similar size to Scotland's, so the Danish system could be adopted to speed implementation and avoid the usual UK government IT project calamities.

If there was something is rotten in the state of Denmark, there is not much evidence of it now, with high per capita GDP, a current account surplus of over 6% GDP (~3x China's), high quality public services, low levels of inequality, good housing and ranked 3rd happiest country on Earth by UN (UK 21st). While decades of Land Taxation are not the only reason for its success, it's clearly been good for Denmark's economy and society.

By modelling a Scottish Land Tax on the Danish system it would significantly reduce risks when introducing a new tax, which is important when modern politicians appear very nervous to replace a clearly regressive Council Tax based on 1991 2nd gear valuations.

The Danish system is not perfect, it's not a pure land tax, and it's a split rate property tax with the land value tax ~ 3x the rate of the building value. (e.g. 3% LVT and 1% on building value) But it is a functioning system in a successful EU state with decades of experience Scotland can call on. Split rate property taxes have also been used in Pennsylvania as way to gradually migrate from property taxes (land + buildings) to an increasing proportion of Land Value Tax over time.

Denmark is currently undergoing a property boom caused by negative interest rates driving savings into property, which as building costs have not increased will all flow into increased land prices. Scotland should use land rental income valuations to avoid volatile increases in tax caused by property speculation.

A paper presented to the OECD on Property Taxes and Valuation in Denmark by Anders Muller, provides an indication of how a Land Tax could work.
http://www.andywightman.com/docs/muller.pdf

Scotland could rapidly start implementing LVT within one parliament

As a migration method, Scotland could convert the existing council Tax into a charge on owners of the land instead of the occupant as a first step, and then start valuing land on one or more Council Tax bands a year, starting with the top bands, working down the bands from H to A. There are 2.4 million households in Scotland, but fewer than 12,000 in Band H. By starting with band H, experience of valuation methods; training administration staff, debugging IT systems and setup of appeals tribunals etc could be gained on small numbers of properties with low LVT rates in year one, while the system becomes established and gradually increasing rates in future years . With so few homes needing valuing, LVT for Band H could start in the following tax year after the legislation is passed and act as pilot for the following CT bands. The alternative is spend 5 years valuing the all land of 2.4 million households, just in time to take the system live by the next election, with press coverage of every teething problem.

Advantages of introducing LVT to one or more CT bands a year

- Tax could be introduced within 12 months of it becoming legislation for top CT band
- 1st year only need to value the land of less than 12,000 properties in Band H
- 2nd year only 110,000 band G properties need valuing, 3rd 375,00 band F etc
- 1st year scrap LBTT to reduce any fall in property & land values
- It would stimulate construction (feel good factor) before lower bands are taxed.

Conclusion

LVT increases the costs of holding land while reducing the cost on the buildings. This reduces profits from land speculation while increases the return on capital from buildings on the land. It creates a more completive market for land, whereas the current system encourages accumulation of land by rewarding land speculation, while taxing improvements to the buildings on the land.

Therefore LVT would be a real reform of Scotland's property taxes that would simulate the Scottish economy, addressing poverty, unemployment and growing inequality. The alternative would be little more than tweaking the current system. The housing market would remain as dysfunctional as it is today, with the same level of private construction which the UK has had since mid 70's. Even if Scotland was able to raise money to build more public housing, it would not release enough land to build on to create a significant increase in supply as it did in 1960's.

In the longer term a single LVT rate on all land will give Scotland an economic advantage, with lower taxes on income. Scotland will attract more high-paid jobs and a rekindled spirit of enterprise in a more confident Scotland. Within a few years Scotland could be creating jobs and businesses at a faster rate than either England or the rest of Europe.