PAYING FOR LOCAL SERVICES:

RATES AND THEIR ALTERNATIVES by HENRY LAW

This survey discusses the British local rating system and considers the main alternatives. The recommendation is that the present system should be retained, but with modifications which would overcome the major drawbacks.

CONTENTS

Introduction		3
The present system and how it works		3
Objections to the present system		5
The alternatives		9
1	Local Income Tax	9
2	Local Sales Tax	10
3	Community Charge	11
4	Variations on the present system	12
Conclusion		18
Appendix A	How land value rating would work in practice.	19
Appendix B	Land value rating - a plan for phased introduction.	20
Appendix C	Land value rating and the businessman.	22
Appendix D	Land value rating and the farmer.	23

The author wishes to thank all those who have helped to produce this paper, especially Vic Blundell, Barbara Sobrielo, Richard Mernane and Roger Sandilands.

Published by The United Committee for the Taxation of Land Values Ltd.
177 Vauxhall Bridge Road London SW1V 1EU 01-834-4266

May 1986

INTRODUCTION

LOCAL RATES, in their present form, would probably take first prize for being Britain's most unpopular tax. Local rates are a property tax, raising about £20 billion a year. This covers about half the expenditure of Britain's local authorities, the remainder being paid by Central Government. There has been a vocal demand for change. Public debate on the issue is dominated by the image of the poor old widow living in the same house that she has occupied since she got married, and who has to pay the same amount in rates as her neighbours, a middle-aged couple with five strapping sons, all of them earning good wages. On the commercial front, we hear of businesses being forced to close or move away by the insatiable demands of spendthrift councils, who have been elected without their having had any say in the matter; business rates are held up as a classic case of "taxation without representation".

Various reforms have been suggested. The 1986 Green Paper has proposed that Domestic Rates should be replaced by a "Community Charge", with business rates remaining in their present form but at an amount fixed by Central Government. The Labour Party proposes to supplement the existing system with a Local Income Tax. The Liberals have also come out in favour of a Local Income Tax, but as a total replacement for domestic rates, a solution which is also supported by their partners in the Alliance, the SDP.

THE PRESENT SYSTEM AND HOW IT WORKS.

British local rates are an annual levy on an assessed valuation, set each year by the local authority, as an amount per pound of the valuation. Where there are two tiers of local authorities, such as district councils and county councils, the lower tier authority, usually the borough, is responsible for collecting the rate, and the higher authority, the county council, collects its revenue from the borough as a fixed "precept". The precept covers the cost of services not provided by the borough, such as the fire service and the police. Rates are also levied by water authorities, again based on rateable values, although there is a growing tendency for commercial consumers to pay directly for water delivered by a metered supply.

The schedules of valuations are prepared by a staff of valuation officers attached to the Inland Revenue. Theoretically, these valuations are meant to be the actual rental value of the properties, taking land and buildings together as a unit, and including machinery and plant. The values are supposed to be revised regularly. In practice, this has not happened in recent years because governments have succumbed to the temptation of deferring the valuations, being fearful of a possible outcry following a shift in the rate burden. In England and Wales, there has been no valuation since 1973, although one was conducted in Scotland in 1985.

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

At one time, rates were payable only on occupied premises, but changes were made in the early 1970's, following widespread public concern over empty office blocks. Local authorities were then given powers to levy a proportion of the total rates on empty premises. An important exception to the rating system occurs in Britain's Enterprise Zones, which were an experimental scheme introduced in 1980; businesses in the Enterprise Zones enjoy a package of concessions, including freedom from planning controls and a ten year "rates holiday".

From an administrative point of view, rates work well. The system is flexible, being suitable for all tiers of local authority. Since the amount that can be raised from the rates is predictable, councils can make their budgets with assurance. There is no opportunity for avoidance or evasion, although the rate rebate system (for those on low incomes) is vulnerable to false claims. Collection costs are very low, being about 1·5% of the yield, which makes local rates amongst the most efficient of all taxes.

Despite the obvious merits of rates, so far as the mechanics of the system are concerned, a widespread feeling exists that this method of raising local revenue is fundamentally unjust. As we study each of the objections in turn, we shall see to what extent they are valid.

OBJECTIONS TO THE PRESENT RATING SYSTEM.

1 RATES ARE UNFAIR BECAUSE A SINGLE PERSON LIVING IN A HOUSE PAYS THE SAME AS A WHOLE FAMILY WITH SEVERAL WAGE-EARNERS.

2 RATES ARE NOT RELATED TO ABILITY TO PAY.

3 RATES LEAD TO LACK OF ACCOUNTABILITY.

4 RATEABLE VALUES ARE HYPOTHETICAL OR OUT OF DATE.

5 RATES PENALISE IMPROVEMENTS.

6 RATES HARM THE ECONOMY.

1 RATES ARE UNFAIR BECAUSE A SINGLE PERSON LIVING IN A HOUSE PAYS THE SAME AS A WHOLE FAMILY WITH SEVERAL WAGE-EARNERS.

The unstated assumption here is that rates are in some way different from other household expenses. If wage-earning spouses, children, lodgers and tenants choose to share a house, then their contribution to the household expenses includes a share of the rates, just as it includes the cost of other services such as lighting and heating. Like all other household expenses, the cost per head will be less if shared. Most of the infrastructure services provided by local authorities cost much the same to provide, irrespective of the number of people living in the house; councils have to pay for the police and fire services, and to sweep, light and maintain roads, regardless of the number of occupants in a house.

So far as the personal local authority services are concerned, these tend to be "consumed" largely by children and pensioners. There would be as much justification for charging rates according to the number of schoolchildren or old people in a household, as there is for relating the payment to the number of adults.

It is important, also, to bear in mind that the cost of providing infrastructure services varies in different areas; the implicit cost of amenities such as schools and parks is greater in areas where land values are high. Nor are these benefits there to be enjoyed equally by all, because their availability varies from one area to another. Since property values, and hence rateable values, are a fair measure of the quality of the infrastructure, rates are closely related to the public services on offer.

2 RATES ARE NOT RELATED TO ABILITY TO PAY.

This objection does not bear close examination. The 1986 Green Paper on Rates, for example, rests much of its case on this point, but the statistics given in the Green Paper itself suggest that rates are actually quite well related to ability to pay. After allowing for rebates, rates payable range from 2% to 4% of household income; the lower figure applies to households with incomes under £50 a week and over about £300 a week. For those with earnings between £50 and £300 a week, the proportion of their income which is paid in rates is nearer to the 4% level. At the bottom end of the income scale, the rate rebate system appears to be working effectively.

This suggests that, on the whole, domestic rates are broadly related to household income, a result which is only to be expected, since better-off households tend to occupy houses which are more expensive, and have higher rateable values.

3 RATES LEAD TO LACK OF ACCOUNTABILITY.

This objection has been summed up in the phrase "Poor linkage between those who vote and those who pay" ; 35 million people in England are entitled to vote at local elections, but only 18 million are directly responsible for paying domestic rates, and of these, only 12 million actually pay their rates in full. And because business ratepayers have no vote at all, the rating system is described as "Taxation without representation", a slogan recalling the injustice which sparked off the Boston Tea Party.

The comparison is melodramatic, but the notion that a direct connection should exist between voting and taxpaying does not bear close examination. Using the same line of reasoning, it could be argued that there should be special votes for car drivers, cigarette smokers or whisky drinkers, all of whom pay large sums of money to the government; taking the idea to its logical conclusion, it would follow that voting ought to be weighted according to the amount of tax paid, with pensioners and the unemployed being disenfranchised.

Because of the extent to which taxes are passed on, around the economy, it is not, in reality, possible to establish who pays what. And with about half of all local government spending financed from national taxation, there is no doubt that everyone makes a contribution, even if it is only an indirect one.

This is not to say that the concept of accountability can be disregarded; there is no doubt that in a democracy, politicians are accountable to the electorate for their actions. The fallacy is to assume that some taxes are more effective than others in encouraging electors to be vigilant about the way that government spends public money. Such a suggestion ignores many of the reasons why public bodies do not spend wisely. In the case of local authorities, the major problem must surely be, not the rating system, but the quality of the politicians (of all colours) whom we elect. Other causes of waste are the built-in tendency of all bureaucracies to keep on growing, a system of budgeting that leads to an annual spending spree just before the end of the financial year, and fear of future cuts, which makes council officers expand their departments, so that there is more to cut back from when the savings have to be made.

4 RATEABLE VALUES ARE HYPOTHETICAL OR OUT OF DATE.

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

In the domestic sector, there is insufficient evidence of real domestic rental values, for the simple reason that government legislation has effectively abolished the free market in rented residential property. But there is nothing hypothetical about annual market rental values, because they are the primary measure of the value of real estate. It is selling prices which are derived from annual values, and not the other way round; the selling price is the capitalisation of the rent at current rates of interest, with a speculative element added on to allow for the expectation of increases in value in the future.

5 RATES PENALISE IMPROVEMENTS.

This objection to the rating system is the one which receives least attention, yet it has more substance than any of the others. Because the present rating system is, in principle, a charge on occupation, rates act as a fiscal wedge at two points; they are a disincentive to development and occupation.

Anyone who improves a house by building a garage or converting it into flats, is penalised by having to pay more rates. This is clearly a discouragement, and it is also unjust, because such improvements add nothing to the occupant's ability to pay.

In the commercial sector, the consequences of charging rates on improvements are far more damaging; rates penalise enterprise. This is particularly harmful to industry, because installed plant is rated. There is no charge on a derelict site or a vacant factory, and an old building with obsolete machinery is subject to lower rates than a well equipped modern one. Industries like steel and chemical manufacturing are badly affected by the rating system, because the value of the plant accounts for a high proportion of the total valuation.

6 RATES HARM THE ECONOMY.

Some of the economic consequences of rates have already been dealt with, but a few further points remain to be made.

In the short-term, rate increases are a burden falling on the tenant. Sudden large increases may involve the tenant in a total occupation cost which is more that the business can bear, and since leases customarily contain upwards-only revision clauses, it is rarely possible to go back to the landlord to negotiate a lower rent; in extreme cases, the rate rise could lead to bankruptcy.

In considering the long term effects of rates, it is important to remember that rates are essentially a tax on rents, and are, in part, a tax on the rental value of land. "Rent", in this context, can take the form either of actual payments made by a tenant to a landlord, or as an "imputed" rent enjoyed by an owner occupier.

Economic theory predicts, and observation confirms, that taxes which fall on the rental value of land are ultimately borne by the owner of the land. Ultimately, therefore, the consequence of the rate charge is to depress rents and land values; by increasing occupants' costs, the rate lowers the selling price which the land can command on the market. In effect, money which would otherwise be paid out in rent is going instead to the local authority to pay for public services.

This is borne out by the findings of an exhaustive survey, conducted by the Department of Land Economics at Cambridge University. The study found that there appears to be little or no correlation between industrial location and rates or increases in rates, a result which contradicts the commonly held view that businesses are being destroyed by punitive rates. The research team suggested that their observations could be explained by the process mentioned above, whereby commercial rates are passed backwards onto landlords when new leases are negotiated.

The main economic effect of domestic rates is more straightforward; they promote the efficient use of resources by discouraging under-occupation; this is the corollary to the case of the poor widow, and her neighbours with the five strapping lads.

The real reason why rates have been singled out for popular attack in recent years is surely that, for most people, they are the only tax which is paid directly. There is also a widespread feeling that the money is not well spent, perhaps because local government waste is more visible than central government waste. The method of taxation is then held to be the problem.

ON BALANCE, the conclusion must be that the case against rates is weaker than popular sentiment would indicate.

THE ALTERNATIVES

In recent years, official studies of the possible alternatives to rates, have come down in favour of four main options.

These are:-

1 LOCAL INCOME TAX (LIT).
2 LOCAL SALES TAX.
3 COMMUNITY CHARGE (POLL TAX).
4 VARIATIONS ON THE PRESENT SYSTEM.

1 LOCAL INCOME TAX.

The advantages claimed for Local Income Tax are:

* The yield rises with inflation.

* It would expand the local tax base by including all those who now pay income tax.

* It is related to ability to pay.

* It would be suitable for all tiers of local authority, and the rate of LIT could be set by each council.

* It would promote accountability.

To replace domestic rates by LIT would mean, on average, an extra 4•5p in the pound on income tax. Simply converting present domestic rates to LIT would produce a range of local income taxes from 2•5p to 11p in the pound. Probably the most straightforward way of administering LIT would be to deduct it at source, at a standard national rate, with adjustments made at the end of each year. In this scheme, which was devised by a Liberal Party study group, the rate would be set intentionally high, so that most taxpayers would be claiming refunds from the local authority where they lived. This would save employers the chore of deducting PAYE at many different rates, and it deals with the problem of taxing investment income.

Unfortunately, most of the advantages claimed for LIT in any form are illusory. The cost and trouble of administration of Local Income Tax would be very great, despite computerisation. Even then, and with the comparatively simple scheme outlined above, there would be problems. Town Halls would have to handle a deluge of claims every April, with local authorities having to juggle their cash balances, as large sums were being paid out in refunds on the basis of a rate fixed twelve months earlier. Local authority treasurers would also have the headache of not knowing how much revenue they could expect each year, which would add to the difficulties of budgeting.

The introduction of Local Income Tax would have inequitable consequences. In a 1982 report, the Association of Metropolitan Authorities (which supports LIT) admitted that "the abolition of domestic rates would create a windfall gain for owner-occupiers, but a smaller, if any, gain to future house buyers, who would pay a higher price for their housing, reflecting the lower taxation on house-ocupation."

This prediction is supported by evidence from the Irish Republic, where house prices rose sharply following the abolition of domestic rates. We also have, as evidence, the well-documented rises in rents and property values in Britain's rate-free Enterprise Zones, which were mentioned previously. Replacing domestic rates by LIT would come as a useful bonus to those with second homes, who would presumably pay the tax on only one of them. This would place an additional burden on permanent residents in holiday areas, where many of the properties are second homes.

Because conditions vary greatly in different local authority areas, tax rates would vary widely between different authorities; people would be tempted to lodge themselves in addresses of convenience in low-tax areas. Some councils might even decide to set themselves up as local income tax havens! It would become very difficult to keep track of mobile individuals, who would be able to run rings around the system; many of them would, no doubt, turn up in the LIT-havens. A further problem with LIT would be the wide variation in tax yields in different areas. This would make it necessary to equalise the income between the rich authorities and the poor ones, on such a scale as to completely obscure the principle of accountability which is one of the chief aims of local income tax.

The main objections to local income tax are, above all, the objections to income tax itself. Income tax is inequitable; the wealthy and the self-employed manage to dodge income tax by an endless variety of more-or-less legal devices. For every loophole closed, a new one opens up. These problems stem from a fundamental cause; it is impossible to say precisely what "income" is. In all the millions of words of income tax law, "income" is never defined, and legislation can never be drawn tightly enough to tidy up all the grey areas.

2 LOCAL SALES TAX.

Local sales tax would operate as a local supplement to Value Added Tax (VAT), and be collected by the VAT system. Small businesses at present below the VAT threshold would have to be included, and it would impose a serious additional burden on them. Pricing stock at different rates of local VAT would cause problems for shops, especially chain stores. Revising the prices when the tax rate changed would cause more trouble, and with both local and national rates liable to change, it would be very difficult to place advance orders for stock at certain times of the year.

The yield would be unpredictable, especially in tourist areas. The tax would also be what is known as "lumpy": the rate of tax could be changed only in large steps - with a 5% rate of Local Sales Tax, a change of 1% in the rate would give a 20% change in yield. It would be almost impossible to make sure that the tax was paid by the people who were intended to pay it. Although the the local sales tax is not intended to be a tax on business, the system could not exempt business consumers whilst making sure that the individual consumer paid; at present, firms which are registered for VAT can reclaim the tax, but it would be an administrative nightmare to make provision for firms to reclaim VAT at differing local rates.

The local sales tax would also open up opportunities for evasion; it would encourage moonlighting and promote the Black Economy, particularly in the service sector. It would also cause real hardship, as VAT applies to essentials such as clothing and building repairs, and it would be difficult to exempt or relieve pensioners and poor people from the burden of having to pay local sales tax.

A further difficulty with a local sales tax is that people do not always shop in the area where they live and would be paying tax to another authority. Shopping habits would be distorted; cross-border and mail-order shopping would boom as people took advantage of the anomalies that a system of local sales taxes would create.

3 COMMUNITY CHARGE

The principle behind a Community Charge (or poll tax) is that everyone pays the same amount; with the rebate system that would be necessary, it would, effectively, be paid by every working adult, and would operate as a coarse form of Income Tax.

The 1986 Green Paper has suggested that the Community Charge should ultimately replace the present Domestic Rate, and estimates that an annual figure of about £110 would be needed to raise the same amount. The list of taxpayers could be compiled from the electoral register, or possibly from other records such as those held by the health service.

A Community Charge would pose serious problems of enforcement. The 1986 Green Paper proposes that a special register of residents should be compiled, but the electoral register will inevitably be used as a cross-check; many people might prefer to have their names left off the register rather than pay the tax. Teams of investigators with inquisitorial powers would be needed to make sure that people registered and paid. It would be difficult to collect the tax from people who moved frequently, and so far as mobile individuals were concerned, councils would often end up having to write off unpaid tax as bad debts.

The Community Charge would share some of the drawbacks of Local Income Tax. It would also open up whole new vistas of tax evasion; ingenious individuals could lodge themselves (for tax purposes) in addresses of convenience in areas where the local council had decided to set the Community Charge deliberately low.

In addition to these practical difficulties, there are serious objections to the concept in principle; it is fundamentally unjust. A tax levied on all residents would be regressive, as it would be entirely unrelated to ability to pay. The Community Charge would be 4% of household income for households with a weekly income of £75 - £100, but only 1% for households with a weekly income of over £500.

There would also be an impact on property prices. Because people in more expensive properties and in small flats would find themselves paying less than their present rates, the market values of these classes of property would rise considerably. Thus the only benefit would be to existing owner-occupiers.

4 VARIATIONS ON THE PRESENT SYSTEM.

There is a large number of permutations here, especially when options for both domestic and commercial rates are considered. Possible variations are of two kinds. The first would involve limiting the freedom given to local authorities in setting rate levels, by, for instance, "rate capping". A more fundamental change would be to reform the method of valuation, and there are two main options here. One is to use capital values instead of the present annual rental values. The other possibility is to use land values instead of the present composite value of both land and buildings together.

Neither of these would affect the method of administration, and so the simplicity, efficiency and fraud-proof qualities of the present rating system would be preserved.

USE OF CAPITAL VALUES.

The call for the use of capital values has come about because of the virtual disappearance of the rental market in domestic property; on the other hand, most people are familiar with capital values. Unfortunately, using capital values as a basis for property taxes has a fundamental disadvantage that is rarely appreciated: the tax reduces its own base by cutting it by an amount equal to the capitalisation of the tax payable. As taxes are increased, the capital or selling value of the property is eroded, necessitating an even higher rate of tax to maintain the same revenue.

This is because, as mentioned earlier, selling prices are essentially the capitalised rental values; annual values, capital values and interest rates are closely related. A further drawback of relying on capital values is that they tend to move erratically; several times in the past thirty years, house prices have risen steeply in a very short period.

For these reasons, then, selling prices are not very suitable as a basis for rating valuation. In practice, however, where direct evidence of rentals is scarce, there is no reason why capital values should not be used for guidance, as a way of determining annual values.

LAND VALUE RATING (LVR)

The other possible change is to a system of land value rating. This would work in exactly the same way as the present system, but the valuation would be the annual rental value of the land alone, disregarding buildings and improvements, which would, in effect, be de-rated. All land, including vacant and agricultural land, would be subject to the rate, and the valuation would be on the assumption that the land was at its maximum likely permitted use.

This method of raising local revenue would have a number of advantages.

1 Land is permanent and holds the core of the value. There is no possibility for avoidance or evasion, as land cannot be hidden or moved.

2 Administration of the rate would be simpler than the present system, which is already one of the most efficient of all taxes. With no need to take account of buildings and improvements, land value registers are easier to compile than the present valuation lists.

3 The yield is predictable, and buoyant in the long term, because land values rise even faster than the rate of inflation.

4 It is suitable for all tiers of local authority.

5 LVR is in accord with the benefit principle. The value of land is the market value of the location; it is what people are willing to pay for the benefits which are available at that site, in the way of amenities and productive advantages, both natural and man-made; it measures the true value of the infrastructure. Thus, a rate based on land values is related both to ability to pay and benefits received.

6 LVR would recoup increases in land value due to public investment in improvements such as motorways and subsidised transport, as well as serving as a clawback mechanism to recover increases in land value resulting from special arrangements and subsidies, such as the Common Agricultural Policy and the Enterprise Zones, whilst these persist.

7 The burden on both householders and commerce would be reduced, as the tax base would be widened; vacant and agricultural land, not rated at present, would be brought into the rating system, and under-used land would be rated at its true value.

OBJECTIONS TO LAND VALUE RATING

Unfortunately, in the past, committees of enquiry have dealt rather perfunctorily with land value rating, and they have raised a number of objections which, on close examination, turn out to have little substance. These are:-

1 THE "POOR WIDOW" WOULD PAY AS MUCH AS HER WAGE-EARNING NEIGHBOURS.

2 RISING LAND VALUES COULD FORCE PEOPLE TO MOVE FROM CERTAIN AREAS.

3 THE RATE WOULD LEAD TO OVER-DEVELOPMENT AND LOSS OF AMENITIES.

4 LVR WOULD PENALISE THE SUBURBAN HOUSEHOLDER WITH A LARGE GARDEN.

5 PLANNERS COULD RAISE LAND VALUES ARTIFICIALLY BY RE-ZONING.

6 IT IS UNJUST TO LEVY A TAX ACCORDING TO POTENTIAL VALUE.

7 IT WOULD BE DIFFICULT TO ESTABLISH THE VALUE OF MANY SITES.

8 A LAND VALUE RATE COULD NOT RAISE SUFFICIENT REVENUE.

9 THE RATE WOULD BE PASSED ON IN HIGHER RENTS AND LEAD TO WIDESPREAD PRICE INCREASES.

1 THE "POOR WIDOW" WOULD PAY AS MUCH AS HER WAGE-EARNING NEIGHBOURS.

This problem was considered earlier, in the discussion of objections to domestic rates. In any case, this objection applies to many taxes - such as Value Added Tax, for example. The solution lies in designing the system of welfare benefits to ensure that pensions and the social security system are adequate. An alternative approach would be to defer collection of the rates due until after her death, when the unpaid rate would become a charge on her estate.

2 RISING LAND VALUES COULD FORCE PEOPLE TO MOVE FROM CERTAIN AREAS.

Only in the most exceptional cases would there be dramatic increases in land value, such that the rate became a burden.

In any case, even without the pressure of increased rate charges, the land market operates, so as to encourage people to move from areas of high value to areas where land values are lower. Tenants are squeezed out by higher rents, and owner-occupiers move on to reap the windfall increase in value.

This pressure is by no means undesirable, since it ensures that a valuable community resource is allocated efficiently. When the land market is functioning freely, a site goes, in theory, to the user who can make the best use of it; individual enterprises locate themselves in the cheapest position consistent with their needs.

Changes in patterns of land use are, then, a natural process and the introduction of land value rating would certainly tend to discourage "fossilisation". If, for social reasons, it was decided that uses should be fixed, this could be achieved by, for instance, planning control; the restrictions on use would automatically be reflected in the valuation.

3 THE RATE WOULD LEAD TO OVER-DEVELOPMENT AND LOSS OF AMENITIES.

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

Even in the absence of planning control, land value rating would not lead to this kind of over-development; developers may build speculatively, but only where an underlying demand already exists. They do not do so where there is no conceivable demand.

4 LVR WOULD PENALISE THE SUBURBAN HOUSEHOLDER WITH A LARGE GARDEN.

Not so; a large suburban garden does not have a particularly high value unless it also has development potential; planning policy is rarely favourable to this form of development and, in most cases, problems of access to rear gardens would make it impracticable.

5 PLANNERS COULD RAISE LAND VALUES ARTIFICIALLY BY RE-ZONING.

The idea that planning consent increases the value of land is widely held, but it is an illusion. What really happens is that the consent releases a latent value. LVR would, however, capture the increase in land value released by planning consent, and in doing so, it would remedy a long-standing deficency in the planning system.

6 IT IS UNJUST TO LEVY A TAX ACCORDING TO POTENTIAL VALUE.

One of the cardinal principles of LVR is that no one would be taxed upon a value which could not be realised. A garden, a golf course or a tract of agricultural land would be rated and taxed on that value only, if any superior use was limited by planning restrictions.

One of the aims of land value rating is to encourage beneficial development; this is not possible when taxes are levied or increased only if development or redevelopment takes place. With a system of LVR, all land would be treated the same, for tax purposes, regardless of whether it is developed or not. Anyone who holds land vacant is doing so out of choice. If that site is capable of being developed, the owner is depriving others of its use; an owner always has the option of disposing of it.

7 IT WOULD BE DIFFICULT TO ESTABLISH THE VALUE OF MANY SITES.

It has been argued that the present planning system would make it difficult to value land because of uncertainty about the likely permitted use. But in practice, planning authorities are usually able to state precisely what development would receive permission and what would not. In pilot land value surveys conducted in Whitstable in 1963 and 1973, the valuer reported that less than 1% of the hereditaments presented problems due to uncertainties of this kind; of these, serious doubts concerning development potential arose in only about 0•1% of cases.

8 A LAND VALUE RATE COULD NOT RAISE SUFFICIENT REVENUE.

There is very little evidence either to suppport or refute this statement. So far as British conditions are concerned, the only substantial body of information comes from the Whitstable surveys mentioned above. The first of these, conducted in 1963, produced results which surprised the surveyors themselves, who had expected the total value of the land to be much lower than it actually was; the survey revealed a large amount of vacant but developable land in the town centre, which had not been liable for rates. The second (1973) survey indicated that the total value of all the land was about 20% higher than the rateable values, as assessed the previous year, and thus a similar poundage would have raised the same revenue as the present rating system.

The favourable evidence of these surveys suggests that it is quite possible that LVR could raise the revenue required, and it indicates the need for further studies.

9 THE RATE WOULD BE PASSED ON IN HIGHER RENTS AND WIDESPREAD PRICE INCREASES WOULD FOLLOW.

A rate based on land values is a direct tax on its rental value. It does not fall on the user and cannot be transferred from the landlord to the tenant. This is because the value of a piece of land is, by definition, the maximum that anyone will pay in order to use it. If a tax is levied on that rent, it does not make anyone willing to pay more, nor does it enable the owner to demand more; the tax is a subtraction from the rent. To suggest that landowners could pass the tax onto tenants is to imply that the owners do not already get as much as they can for their land, and that they could put up the rent whenever they wanted to.

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

CONCLUSION.

With the exception of land value rating, all of the alternatives to the present rating system suffer from serious drawbacks, both in their underlying principle and practical application.

LVR could be expected to have a number of beneficial effects. It would eliminate the penalty on improvements which is one of the chief drawbacks of the present rating system. A land value rate would encourage owners of vacant property to bring it into productive use. Rents and land prices would fall to competitive levels as vacant land would have to be developed in order to yield the rent with which to pay the rate. This would stimulate the economy by encouraging the efficient use of a limited resource.

Land value rating would preserve all of the advantages of the present system, which it would closely resemble, whilst eliminating some of the drawbacks and at the same time expanding the tax base. As a practical alternative which is used in a number of other countries, it merits further attention.

In the first instance, there is a need to gather information about the operation of LVR where it is practised abroad. Further valuation surveys should then be conducted on the lines of the two Whitstable exercises, to establish what practical problems would need to be resolved, and to assess the amount of revenue which could be raised by LVR. If the results proved favourable, there would then be various alternatives. It would, for instance, be possible to introduce LVR in selected areas, either through a pilot scheme covering a number of towns or a region of the country, or by enabling legislation giving local authorities the opportunity to choose between changing to LVR or continuing with the present system. But no government can claim that it is sincerely trying find alternatives to the present rating system unless it examines LVR conscientiously.

Henry Law

APPENDIX A

HOW LAND VALUE RATING WOULD WORK IN PRACTICE.

In practice, land value rating has proved essentially simple and straightforward, as was found when the Rating and Valuation Association conducted pilot land value surveys in Whitstable in 1963. This is because a row of houses standing on identical plots all have the same assessment; once the value has been determined for one property, it will be the same for all. This is in contrast to the present rating system, where improvements such as extensions, garages and conversions have to be taken into account.
With Land Value Rating, the relevant value is that of the bare site, assuming that it is at its maximum permitted use. In built up areas, where undeveloped sites change hands only rarely, actual transactions in the land itself are rarely available as a guide to value, and it is then necessary to extract the value of the land from the total value of the property.

For urban sites, there are two basic ways of doing this. The first of these is the "residual method", which relies on the assumption that the value of the land is the total value of the property, less the depreciated cost of constructing the building. In some instances, the value of the land could be nil or even negative, if the cost of demolition is taken into account.

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

The two methods can produce realistic and consistent results, bearing in mind any special considerations that may apply in the valuations.

The valuations themselves would be prepared in exactly the same way as at present, by teams of valuers, supplemented as required by additional temporary staff. Alternatively, the work could be done by private surveyors, interpolating their own valuations from a series of bench-mark values determined by the official valuers. With a bench-mark system, it could even be possible to compile the valuation lists on the basis of self-assessment by owners, with provision for refunds later in cases of over-payment. In this way, valuation lists could be prepared relatively quickly.

APPENDIX B

LAND VALUE RATING: A PLAN FOR PHASED INTRODUCTION.

One of the characteristics of LVR is that it is a very flexible way of colllecting public revenue. There are many possible options around the general principle and details of the transition from the present rating sytem would need to be worked out. The following plan is only one amongst many alternatives, and is put forward as an illustration and basis for further discussion.

STAGE 1 (year 1)

A Domestic Rates

The sum at present raised from existing rates to be raised by a local land value rate; domestic rates to be fixed by local authority.

B Commercial Rates

The sum at present raised from commercial rates to be raised from a uniform national land value tax, and revenue assigned to local authorities.

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

STAGE 2 (years 2 - 5)

The rate support grant to be phased out and replaced by a national land value rate equalisation scheme, to transfer resources from areas where land values were relatively high to those where values were relatively low. For this purpose a uniform national land value rate precept would be levied. This would make it possible to reduce the burden of other taxes. National rates could be collected by local authorities as a precept, just as county rates are collected now. Details would be as follows.

A Domestic Rates

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

B Commercial Rates

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

APPENDIX C

LAND VALUE RATES AND THE BUSINESSMAN.

Some of the implications of LVR on business have already been discussed.

The principal advantages are:

1 Because the rate would have to be paid regardless of whether premises were derelict, vacant or in use, landlords would be encouraged to price land and buildings into use. This would lead to increased competition between landlords, and therefore lower rents, with obvious benefits to the business community.

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

LAND VALUE RATING AND THE FARMER.

Farm land and farm buildings (but not farmhouses) have been exempt from rates since 1929. Although this concession was intended to help a farming industry which was in difficulties at the time, the benefits did not go to the farmers. The cut in rates was, within a season, absorbed by the landowners, who were able to charge higher rents. This is precisely what happened more recently when businesses in Britain's Enterprise Zones were exempted from rates in 1980.

Althought there is no justification for the privileged position of agriculture, the reintroduction of rates would have a harmful effect on agriculture. Rates, in their present form, would discourage works such as land drainage, and in upland areas, the burden of rates on buildings could put some farmers out of business altogether, leading to abandonment. Dairy farmers would suffer because they have more buildings than arable farmers. Other sectors of agriculture would also be harmed, in particular, specialists such as horticulturalists with greenhouses, fruit growers and fish farmers.

These objections would not apply if agricultural rating was introduced with the basis of the valuation being the value of the land in its unimproved state. Agricultural land value rating would not discriminate against farming activities which required buildings. Owners of marginal land would pay little or no rates at all; indeed, because farmhouses would no longer be liable for rates, upland farms might well be subject to lower rates than they are at the moment.

Since most of the benefits of the Common Agricultural Policy end up in enhanced agricultural land values, a land value rating system would operate as a clawback mechanism. Conversely, if the CAP is dismantled, land values will drop. This would be reflected in reduced valuations, and hence lower rates.

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

Although recent changes to the CAP have led to a fall in farmland prices, they are still high in relation to the earning capacity of the land; the introduction of rating for farmland would remove some of the speculative froth from values, which would fall to levels which were more in line with earning capacity, thus giving the genuine working farmer a better chance to buy a farm and get started.

AGRICULTURAL RATING AND FOOD PRICES.

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

AGRICULTURAL RATES AND WILDLIFE.

An incidental side-effect of agricultural land value rating would be the benefit to wildlife. Designated areas, such as sites of scientific interest or archaeological importance, restrict operations and tend to depress land values. This is why farmers object to them.

If farm rates were based on land values, the system would automatically compensate for the economic disadvantages of having to protect wildlife habitats or sites of archaeological importance. This is a more practical compensation mechanism than the present one, which pays farmers not to undertake damaging operations.

Henry Law

Further information is available from:-

United Committee for the Taxation of Land Values
177 Vauxhall Bridge Road London SW1V 1EU 01-834-4266