SCOTTISH LAND COMMISSION
COIMISEAN FEARAINN NA H-ALBA

Investigation of Potential Land Value Tax Policy Options for Scotland

Final Report

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Contents

The research team is grateful to the country experts who provided information on systems of land value taxation.

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The authors are responsible for any errors of fact or judgement.

List of abbreviations

ATM – automatic telling machine

AVM – automatic valuation model

GDP – gross domestic product

HABU – highest and best use

LPT – land and property tax

LRPG – Land Reform Policy Group

LVC – land value capture

LVT – land value tax

MPRA – Local Government: Municipal Property Rates Act 6 of 2004 (South Africa)

NZLT – New Zealand land tax

RSA – Republic of South Africa (now South Africa)

SARS – South Africa Revenue Service

SLC – Scottish Land Commission

TLA – territorial local authority (New Zealand)

UAGC – uniform annual general charges

VAT – value added tax

Executive summary

Introduction

The University of Reading has been appointed by the Scottish Land Commission (SLC) to conduct research to assess, with reference to international experience, the potential of land value taxation to contribute to a more productive, accountable and diverse pattern of land ownership and use in Scotland and to identify a set of potential policy options that merit further consideration by the SLC.

The current research is part of a broader agenda to reform the system of land ownership and the functioning of the land market in Scotland, and to reshape the role of the public sector in taking a more proactive stance in delivering development in the public interest. Adjustments in the mechanisms for land and property taxation will be an essential piece of the puzzle in delivering this vision.

Research aims

The key aims of the research are to:

- Discuss the economic rationale for a land value tax and to identify key issues in relation to its implementation.
- Identify and analyse examples of how land value tax has been used around the world.
- Propose a range of policy options in relation to land and property tax reform, including the possible introduction of a form of land value tax for further consideration and analysis by the SLC.

In formulating these options, the Research Team has considered the SLC's strategic objectives in relation to land reform, which are:

- *productivity* – so as to increase the economic, social and cultural value of Scotland's land;
- *diversity* – so as to encourage a more diverse pattern of land ownership that spreads the benefits of land more inclusively; and
- *accountability* – so as to ensure that decision-making takes account of those affected and that responsibilities in relation to land are met.

Research method

The research project comprised three stages:

1. **Review of literature and consultation interviews** with key stakeholders in Scotland.

2. **Case study analysis** of land value taxation in six jurisdictions (Queensland, New Zealand, Estonia, Denmark, South Africa and Namibia).
3. **Policy option formulation** – comprising four broad policy options for further investigation by the SLC. These are based on work conducted in stages one and two, and triangulated through a workshop with Commissioners and staff from the SLC and an expert panel on land value tax.

Current land and property taxation in Scotland

Land and property taxes (LPT) can be classified as recurrent (usually annual) or event-based taxes. In terms of event-based LPTs, Scotland has Land and Buildings Transfer Tax, capital gains tax, inheritance tax, and 'section 75 agreements' (i.e. planning obligations). Scotland also has two forms of recurrent LPT that both tax improved land (i.e. the value of the land as well as the value of any improvements to that land such as structures). These are council tax, levied on domestic properties, and non-domestic rates (business rates), levied on non-domestic property. The taxable entity for both of these taxes is the occupier in the first instance, although landowners become liable if the land and property is unoccupied.

Council tax is based on capital values of houses. It is regressive in two ways: first, because it uses outdated property values, the effective tax rate is lower for dwellings in higher value bands. Second, because house prices tend to be positively correlated with income, council tax is regressive with respect to income as well as house values.

Business rates are based on rental values and revalued regularly. Business rates raise more revenue than council tax despite a far smaller tax base. Consequently, non-domestic properties are taxed much more heavily relative to dwellings. There are a range of reliefs and exemptions for business rates in Scotland. Premises which are exempt include agricultural land and buildings and fish farms, among other uses. Should a form of land value tax be introduced in Scotland, it could potentially sit alongside an adjusted form of these existing LPTs, or replace them entirely.

In summary, the current property tax situation is that much of the land area in Scotland is not valued for tax and / or the occupier is exempted or subject to relief. It follows that currently the tax falls heavily, and for domestic properties regressively, on a relatively small percentage of the land and its owners/occupiers. Existing recurrent LPTs in Scotland could therefore be regarded as acting as a disincentive to bring land forward for development.

What is land value tax?

Land value tax (LVT) is a recurrent tax on landowners based on unimproved land value, usually levied as a percentage of the unimproved capital value of the site. Normally there is an assumption that the unimproved land has the right to be developed in accordance with its 'highest and best use'. LVT is implemented in many countries, though several have moved away from it in part or in whole (e.g. South Africa and New Zealand).

According to economic theory, land value is the price of monopoly: the scarcer and less substitutable a parcel of land is, and the more attractive the location in relation to the market (consumers) and factors of production (labour, raw materials), the more valuable the land. Because land is a 'gift of nature' and does not cost anything to produce, this value net of the value of any improvements may be taxed without harm to economic efficiency and production. Further, it is argued that where land values rise, such as on the grant of planning consent, this is due to the actions of the community, not the landowner or occupier.

In addition to the obvious purpose of raising revenue for government, economic theory suggests that LVT has a range of benefits:

- it can encourage highest and best use of land;
- it can capture the uplift in private wealth that arises due to public investment;
- it may encourage denser development and therefore limit urban sprawl; and
- it may stabilise the price of real estate by reducing and stabilising underlying land prices.

There is, however, little firm evidence that these theoretical benefits have been achieved in the countries that have implemented LVT.

Land value tax: key issues

There are a number of issues which would need to be carefully considered by policy makers should a form of LVT be introduced in Scotland.

Political issues

Politically, LVT can be challenging to implement. Political arguments against LVT centre on the windfall loss incurred by landowners, the difficulty in dismantling centuries of land ownership rights, the impact on other taxes and the potential that a LVT would tax individuals with property wealth but who are cash poor and may not have the ability to pay.

Land registration

LVT requires up to date information on all land ownership, land use and land prices. The register of land ownership must include (legally) identifiable boundaries. A land use map must record permitted land use rights for all sites. Currently, Scotland does not have an up to date and accurate cadastral system of property registration.

The planning system

For a successful LVT, the planning system must be able to specify a permitted land use for each parcel and confirm any development rights in order to value the land. Scotland has a plan-led discretionary system, which is different from zoning systems that delineate permitted uses on an area-by-area basis, conveying development rights to landowners without the need for detailed approval. In a zoning system the assessment of permitted use is more straightforward than a plan-led discretionary system. Such zoning systems are common where LVT has proved to be most sustainable.

Valuation of land

The valuation of land for the purposes of LVT presents the following technical issues.

Revaluations

Regular revaluations of land values are required in order to cope with market volatility and changing real values. There can be high political costs associated with infrequent revaluations and associated, potentially sharp, tax increases. Banding values can simplify administration especially when evidence is scarce, but there may be contention regarding the boundaries of the bands. It should be noted that this is not an LVT-specific issue, but applies to all forms of recurrent LPT.

Valuation method and transactional evidence

The comparison method should ideally be used to value land for the purposes of LVT. This would be achieved by reviewing comparable transactional evidence of land sales. However, given that economic theory suggests that LVT should be levied on unimproved land, and given that there may be sparse evidence of land sales of unimproved land in Scotland, particularly within urban areas, this may be challenging, although not insurmountable.

Highest and best use and the planning system

In order to achieve the objectives of incentivising the optimal use of land and/or diversifying land ownership as part of a LVT system, the land would need to be valued based on its highest and best use (HABU). Therefore, where land is not currently in its HABU, there would be an incentive to develop it to its HABU in order to realise the value upon which LVT liability is calculated. However,

this brings with it challenges associated with how a valuer would go about determining the HABU of the land. This is because it is a matter of judgement and therefore open to challenge.

Unimproved land

In the absence of robust evidence of prices for unimproved land, valuers may need to rely on evidence of prices of improved land and property, and then make adjustments to arrive at a hypothetical unimproved land value. This again is a matter of judgement and open to challenge. Furthermore, there may be difficulties arising from any adopted definition of 'unimproved land'. For example, economic theory suggests that it should be land in its 'original unimproved state' i.e. 'prairie' or 'wild' land which has had no human labour mixed with it at all. However, it may in practice be very difficult to differentiate between land as it would have existed in its 'original unimproved state', and land which has been subject to improvements over many years such that those improvements may have merged with the land over time, such as levelling for example. This could be a particular issue in rural Scotland, parts of which have been managed for centuries.

Land value tax around the world

The research has investigated examples of LVT in Australia (Queensland), Estonia, New Zealand, Denmark, South Africa and Namibia in order to inform the proposed policy options. Australia, Estonia, Denmark and Namibia all currently levy a LVT either at local level, national level or both. New Zealand and South Africa have moved away from LVT after a long period of adoption.

The following key points can be drawn out from the case studies:

- While a uniform tax rate is simple and, on the face of it, equitable, differential tax rates are common. Different rates are usually assigned on the basis of land use.
- Where a LVT exists it does so in combination with other land and property taxes. These might be taxes administered at different levels of government (state and municipality for example) or they might be other forms of tax such as stamp duty or capital gains tax (New Zealand was the only case study where these other forms of tax were not present).
- Regular revaluations are regarded as important, especially for urban land and property where values are high, more variable and more volatile. But revaluations are not always evident, particularly in rural areas. This is because valuations comprise a significant proportion of the administrative cost and they are politically sensitive.
- Exemptions are widespread but it is not a foregone conclusion that agricultural land is exempt; some jurisdictions do tax agricultural land.
- There was little evidence that LVT has any perceptible redistributive effect, helps with breaking up large estates, or with bringing under-utilised land in to beneficial use, although

it was claimed that in Estonia it had encouraged owners to dispose of land not in productive use.

- However, the introduction of LVT on commercial agricultural farms in Namibia is regarded as a success due to the extent of popular and political support and the amount of revenue it has raised to fund the acquisition of land for land reform purposes.
- When the tax is established as a service tax (as opposed to a wealth tax), it is important for tax payers to see the relationship between the tax and services provided.
- Where jurisdictions have moved away from 'pure' LVT (i.e. South Africa and New Zealand), the reasons seem to be both political and technical – a tax on the combined value of land and improvements is easier to administer, understand and communicate to the taxpayer.
- The technical difficulty of how to value unimproved land, while not insurmountable, is considerable and prone to generating confusion and a lack of transparency.
- Political consensus is essential, as is the public's understanding of the tax itself.

Policy issues and options for further consideration by the Scottish Land Commission

The literature review and case study analysis conducted as part of this research has not produced evidence sufficient to provide an assurance that a LVT would deliver the SLC's objectives in Scotland, despite the considerable potential benefits suggested by economic theory. However, it should be emphasised that this commissioned research required a desk-top review of the literature based on a small number of case studies. It is possible that focused empirical work could provide firmer information as to the likelihood of the effectiveness of LVT to deliver the SLC's objectives.

Nevertheless, it has been possible to identify four options which could be developed by the SLC should it choose to further explore the potential of a LVT in Scotland.

Option 1: Extend existing land and property taxes

Option 1 targets rural properties which are currently excluded from the non-domestic rates tax base, potentially including land which is part of larger estates. The land would be taxed based on its annual rental value assuming existing use, including improvements, with the liability falling on the occupier in the first instance. Currently excluded rural properties brought in to the tax base would be valued and taxed based on the combined rental value of the land and the business properties built on that land. In instances where there are no properties, the land would still be taxed based on its annual rental value. This option could be delivered through adjustments to the existing taxation system for non-domestic rates.

Option 2: Reform existing land and property taxes

Option 2 builds on option 1 but is primarily aimed at making the existing LPT system more progressive through reforming existing council tax and non-domestic rates. Council tax could be reformed so as to update the valuations and capture wealth increases since 1991, to conduct regular revaluations, to reform council tax banding to tax higher value properties more progressively and to review reliefs and exemptions. Non-domestic rates could be reformed so as to conduct more regular revaluations, revise relief provisions and exemptions so as to include currently excluded land such as agricultural uses. In this option, the taxable entity would be the occupier in the first instance.

Option 3: Introduce a LVT alongside existing LPTs

The main objective of this option is to introduce a form of LVT which seeks to achieve many of the objectives of a single LVT, but without requiring total replacement of the existing LPT system. All rural land (including land currently exempt from non-domestic rates), non-residential land and residential land (including vacant, under-used and derelict land) would be taxed based on the capital value in its unimproved state assuming HABU with the liability falling on the landowner only. This would in effect represent the introduction of a LVT, with the theoretical incentive for landowners to develop or sell under-utilised land where the HABU value is higher than the existing use value. In terms of the meaning of HABU, it is suggested that it should be defined as 'most profitable permissible development'. Under this option, existing taxes could be reformed as in Option 2, but would be levied based on the value of the buildings only.

Option 4: Introduce a single LVT that replaces existing LPTs

Option 4 represents the most radical intervention as it would replace all existing LPTs with a single LVT on all land. The tax would be based on the capital value of the land in its HABU excluding improvements, with the landowner as the taxable entity. This would mean that the tenants of domestic and non-domestic properties would not pay the tax. Therefore, a proportion of the revenue generated by this option would have to be retained by or provided to local authorities in order to fund local services and infrastructure. In terms of the meaning of HABU, it is suggested that it should be defined as 'most profitable permissible development'.

Further variants

It would be possible to 'mix and match' elements of the various options to produce further variants. Such variants could include:

- Reform of the existing non-domestic rates reliefs as part of option 1.
- Reform the council tax and non-domestic rates systems so that the primary taxable entity is the owner, rather than the occupier. This could, for example, be included as a variant of option 2.

- Include a form of LVT specifically targeting owners of undeveloped residential property, based on capital value of the unimproved land in its HABU. This could, for example, be included as a variant of option 2.
- Include a form of LVT specifically targeting owners of vacant and derelict land with development value, based on capital value of the unimproved land in its HABU. This could, for example, be included as a variant of option 2.

Conclusion

Whatever the SLC and the Scottish Government choose to do, there is ample opportunity to reform Scotland's existing system of LPT in order to introduce a more progressive and equitable system which has the potential to deliver land reform objectives. However, the key would be to work proactively to secure the necessary political and popular support.

1 Introduction

The University of Reading has been appointed by the Scottish Land Commission (SLC) to conduct research to assess, with reference to international experience, the potential of land value taxation to contribute to a more productive, accountable and diverse pattern of land ownership and use in Scotland and to identify a set of potential policy options that merit further consideration by the SLC.

This report is structured as follows:

1. Introduction.
2. Background to the research.
3. Policy and political context for the research.
4. Land and property taxation overview.
5. Land value taxation.
6. International experience of land value tax.
7. Consultation interviews.
8. Policy issues and options.
9. Appendices and references.

2 Background to the research

The SLC was established under the *Land Reform (Scotland) Act 2016* on 1st April 2017. The SLC's purpose is to provide direction, leadership and strategic thought regarding land reform in Scotland. Its strategic vision is of a fair, inclusive and productive system of ownership, management and use of land that delivers greater benefit for all the people of Scotland. The SLC therefore has three strategic objectives:

- *productivity* – so as to increase the economic, social and cultural value of Scotland's land;
- *diversity* – so as to encourage a more diverse pattern of land ownership that spreads the benefits of land more inclusively; and
- *accountability* – so as to ensure that decision-making takes account of those affected and that responsibilities in relation to land are met.

Pursuant to this, the Scottish Government has asked the SLC to conduct research into the potential for a land value tax (LVT) in Scotland. As a starting point for this the SLC has appointed the University of Reading to undertake some initial work to investigate potential options.

2.1 Research methodology

The research project has comprised three stages:

1. **Review of literature and consultation interviews:** This comprised three elements:
    a. A desk-top analysis of existing information relating to the economic rationale for and key challenges associated with land value taxation.
    b. A desk-top review to identify those countries which have introduced a system of LVT whether currently or historically.
    c. A series of interviews with key stakeholders in Scotland with a view to finding out more about the level of awareness regarding LVT in Scotland, and identifying any concerns or aspirations.
2. **Case study analysis**: The Research Team agreed a number of case studies with the SLC, the purpose of which was to develop a deeper understanding of the rationale for the introduction of LVT in the case study countries, the desired policy objectives, and the specific policy instruments employed. The technical issue of the approach to the valuation of land in the adopted regimes was also a focus.
3. **Policy option formulation**: Following the case study analysis, the Research Team identified policy options which would merit further investigation by the SLC. These are based on the case study research and interviews, and were triangulated through the use of a workshop

with Commissioners and staff from the SLC. The Research Team also arranged a panel with a number of experts on land value tax in order to ensure that the right potential policy options were identified, and their implications fully taken account of. The expert panel comprised the following:

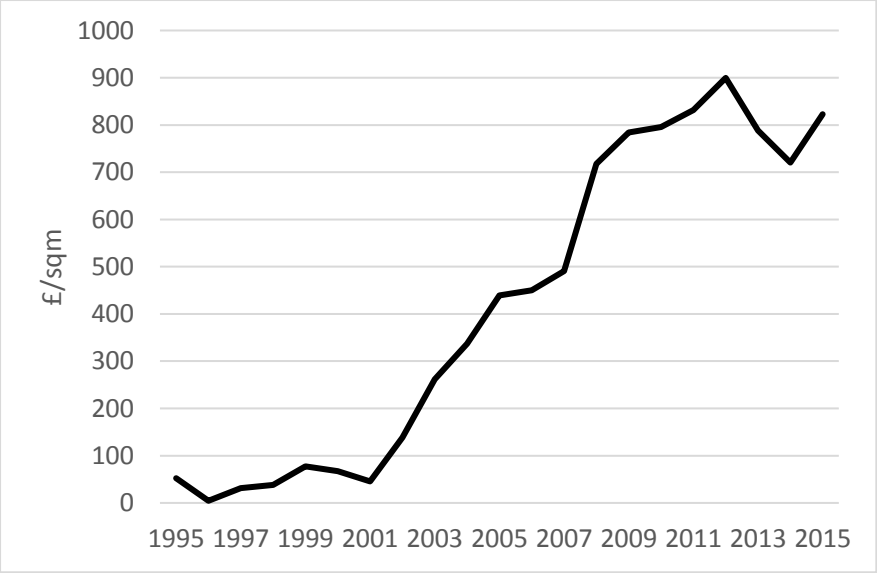
a. Tony Crook – University of Sheffield
b. Riel Franzsen – University of South Africa
c. Richard Grover – Oxford Brookes University
d. Paul Sanderson – International Property Tax Institute
e. Christine Whitehead – London School of Economics

3 Policy and political context for the research

The Scottish National Party announced support for the potential introduction of a LVT at its 2017 conference. In its 2016 manifesto, the Scottish Green Party said that it would work to replace non-domestic rating with a LVT. The current research is therefore part of a wider policy agenda on land and property tax reform.

It also forms part of a policy debate in Scotland regarding the rights and responsibilities of land ownership. This debate is taking place in a context of increasing land values, growing development pressure and a consolidating land ownership pattern. Indeed, there is a growing, unearned land value uplift that is delivering very significant windfall gains to landowners - this is borne out by estimates of residual land values for residential development in Scotland as shown in figure 1. There is a need, therefore, for Scottish policy makers to gather further information on the way in which LVT policies might be introduced.

Figure 1: Residual land values for residential development – Scotland 1995 – 2015[1]



The recent history of Scottish land reform began with the establishment of the Scottish Office's Land Reform Policy Group (LRPG) in 1997. The LRPG published its report of recommendations for land reform measures in 1999 and these were adopted by the Scottish Executive.

The Land Reform Review Group recommended the establishment of a single body with responsibility for understanding and monitoring the system governing the ownership and management of

[1] This graph is based on an annual residual valuation model using ONS house price data for new dwellings in Scotland, build cost information from the BCIS, average dwellings size data from the Scottish House Condition Survey 2013 and standard assumptions regarding other inputs such as developer's profit, finance rate and development period. It is not a record of transaction prices for land.

Scotland's land, and recommending changes in the public interest, where required. This resulted in the creation of the SLC which became operational on 1 April 2017.

The SLC's strategic plan sets out a vision for land reform in Scotland which is situated within a 'cultural shift in understanding of land ownership, its rights and responsibilities' with a 'better balance between public and private interests and an increasingly diverse pattern of land ownership and tenure which properly reflects national and local aspirations and human rights' (Scottish Land Commission, 2017, p.8).

Land, urban renewal and the delivery of housing are 'essential components of the current land reform agenda' in Scotland, with 'the question of who captures the benefit from rising land values, and how this is used' lying at the heart of these issues (Land Reform Review Group, 2014, p.119). This is why one of the SLC's strategic priorities for 2018-21 is to reform the way in which land markets determine the pattern and quality of development so as to address social and economic needs. This will include 'reviewing ownership constraints to the delivery of housing including land banking' and seeking to improve the quality and accountability of decision making relating to land use (Scottish Land Commission, 2017, p.12).

The current research must therefore be seen as being part of this broader agenda to reform the system of land ownership and the functioning of the land market in Scotland, reform the Scottish planning system, reform the land and property taxation system in Scotland, and to reshape the role of the public sector in taking a more proactive stance in delivering development in the public interest, including good places and housing at affordable levels. Adjustments to the mechanisms for land and property taxation will be an essential piece of the puzzle in delivering this vision (Wadsworth, 2018). Indeed, a report recently commissioned by the SLC investigating historical attempts to capture land value uplift in the UK concluded there could be a case for considering the use of recurrent land value taxation complementary to any form of event-based land value capture mechanisms (Jones et al, 2018).

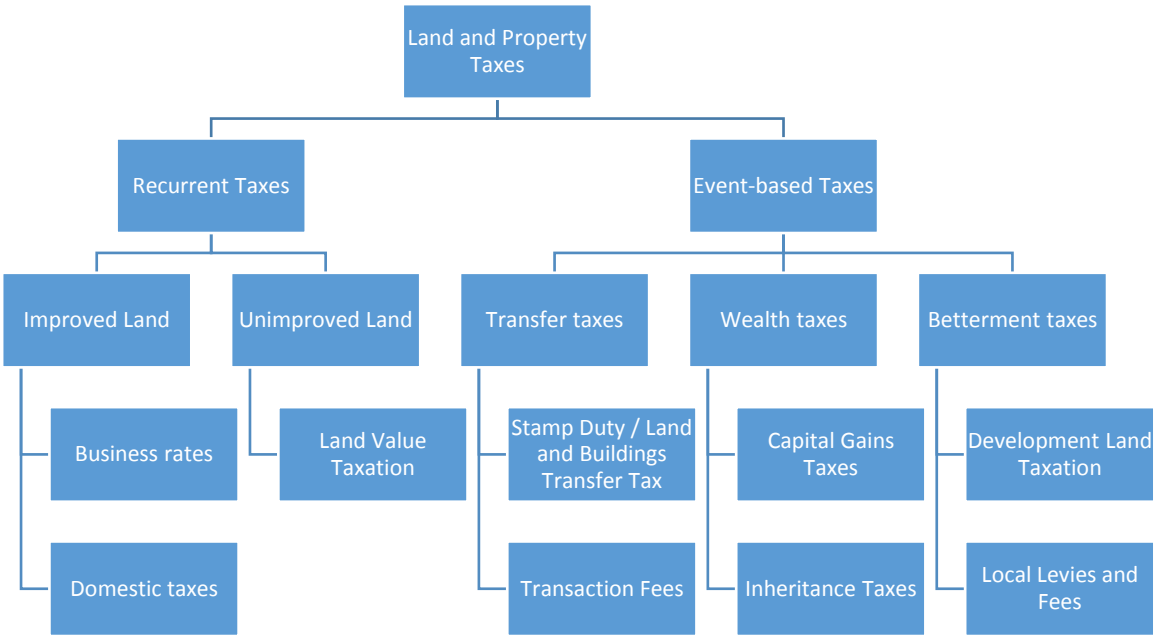
Recent relevant policy and legislative events in Scotland are listed in Appendix I.

4 Land and property taxation overview

4.1 What is land and property taxation?

Land and property taxes (LPTs) can be classified in different ways. Figure 2 categorises them as recurrent (usually annual) taxes and event-based taxes.

Figure 2 – Land and property taxes



The recurrent taxes are usually assessed with reference to value (market capital value, market rental value or cadastral value based on parameters such as land use, location or size) of land and/or improvements to the land, and are often referred to as *ad valorem* taxes. Event-based taxes include:

- Transfer taxes: usually assessed as a percentage (sometimes stepped with thresholds) of price agreed on transfer of ownership.
- Wealth taxes: capital gains tax which accrues to property asset(s) whose value has appreciated over time, and inheritance tax which is charged on the value of property owned at death.
- Betterment taxes (or land value capture): levied on any increase in value attributable to the granting of different land use rights.

Table 1 summarises the key attributes of each of these taxes.

Table 1 – Key attributes of land and property taxes

Type of tax	Description	Recurrence	Liability	Incidence
Recurrent tax	A tax usually levied to help pay for local services	Annual	Occupiers or owners	Occupation or ownership
Transfer tax	% price agreed on transfer of ownership	On transfer	Owners	Transfer
Betterment tax	On increase in value attributable to granting of land use rights	On grant of planning permission or commencement of development	Owners	General, scheme specific
Capital gains tax	Accruing to property asset(s) whose value has appreciated over time	On realisation of chargeable capital gain	Owners	Wealth, Transfer
Inheritance tax	On the value of property owned at death	On death	Owners	Wealth, Transfer

Despite their distortionary effect on market activity (acting as a brake on mobility and reducing market liquidity), most countries levy transfer taxes. For example, the Land and Buildings Transaction Tax is levied in in Scotland. Many countries, especially those with developed or rapidly developing urban areas, also levy betterment taxes. The UK has experimented with this form of taxation in the past but does not currently levy a betterment tax, although there are mechanisms to extract development 'contributions' towards local communities. Appendix II provides some discussion on betterment taxation from a UK perspective, and further detail can be found in a report for the SLC by Jones et al (2018). The relative advantages and disadvantages of recurrent and event-based LPTs are summarised in the quotation from the UN in the box below.

UN 2011 (pp. 41-42):

Whether the tax is the result of changes in possession (transfer taxes, capital gains taxes, inheritance taxes are examples) or changes in land use (betterment levies and development fees), such changes may occur only rarely for any given parcel of land, and it may be decades between such transactions. In good economic times, when many properties are being developed and property trades occur frequently, these one-time levies can be very important sources of local revenue. But governments that rely too heavily on such revenues to fund on-going operations often encounter severe fiscal challenges when economic conditions slow as they have in many countries in recent years. The annual LPT offers the advantage of a more predictable ongoing source of revenue. In addition, the tax rate can generally be much lower than rates associated with one-time levies because the annual LPT is most commonly applied to a much broader base (all properties rather than just those being transferred or developed). On the other hand, including all properties in the base creates both political and administrative challenges.

The focus of the present research is recurrent taxes and LVT in particular.

4.2 Land and property taxation in Scotland

In addition to the event-based Land and Buildings Transfer Tax, capital gains tax, inheritance tax, and 'section 75 agreements' (i.e. planning obligations), Scotland currently has two forms of recurrent LPT that both tax improved land: council tax, which is levied on domestic properties, and non-domestic rates (business rates), which are levied on non-domestic business premises.

4.2.1 Council tax

Each local authority in Scotland currently sets its own council tax rate, administers and collects the tax, and decides how tax revenue is spent. The taxable entity is the occupier of a residential property, although owners are liable when they are owner-occupiers. The liability also falls on the owner when the property is vacant.

There are eight council tax bands, from A (lowest), to H (highest). These bands are based on estimations of the market value of residential properties as at 1 April 1991. Councils currently set the band D tax rate, with the charges for properties in other bands being a fixed proportion of that band D charge. There are a range of reliefs and exemptions available for council tax, including for lower income households, people under the age of 26 leaving care, students, second homes and unoccupied properties. Some of these reliefs are at the discretion of the local authority.

Reforms were introduced in April 2017 to address the problem of lower-banded properties paying more council tax as a proportion of property value than households in the higher valuation bands. These reforms included changing the way tax on the 25% of properties in the four highest valuation bands is calculated, as well as introducing reliefs for low to middle income households in properties affected by the reforms.

In 2016-17 £2.1bn* was billed and £2.1bn (95.8%) was collected by the end of the year (*Before Council Tax Reduction this would have been £2.5bn). According to Policy Exchange (2013) the primary advantages of council tax are that: it is an established system; it is one of the few local revenue-raising options for local government; it allows a limited amount of local accountability; it encourages efficiency as surplus spend over the grant requires higher tax rises; and is relatively cheap to operate and provides stability for households.

The drawbacks are twofold. First, it is regressive in that the tax rate falls as the house price rises. As house prices tend to be positively correlated with income, council tax is also generally regressive with respect to income as well as house prices. The Lyons Inquiry into Local Government found 'a positive and statistically significant correlation between income and property value' (Lyons, 2007, p.229). However, Lyons also noted 'a small but significant minority of low-income households are in

bands F, G and H, of which over half are pensioner households.' (Lyons, 2007, p.230) Second, it uses outdated property values. However, revaluations are politically difficult; it was only political consensus that allowed Wales' revaluation to proceed in the mid-2000s.

4.2.2 Non-domestic rates (business rates)

Non-domestic rates (business rates) are charged on most non-domestic properties in Scotland to help pay for the local services used by businesses. The taxable entity is therefore the occupier of a property, although the liability falls on the owner where the property is vacant/unoccupied. The tax is levied based on a property's 'rateable value' which is generally based on its estimated open market annual rental value. Rateable values are regularly reviewed through revaluations, the most recent of which took effect on 1 April 2017 based on values as at 1 April 2015. The next revaluation will take place in 2022, and every three years thereafter.

Business rates are worked out using the rateable value set by the Scottish Assessors and the tax rate set by the Scottish Government. Individual local authorities administer and collect the tax. Local authorities retain the money collected from rates in the council area to fund local services, including those to businesses.

There are a range of exemptions for business rates in Scotland. Premises which are exempt include:

- agricultural land and buildings;
- fish farms;
- public parks;
- rural premises with Automatic Telling Machines (ATMs);
- oil and gas pipelines; and
- overseas armed forces premises in the UK.

In 2013 the Scottish Government decided that the exemptions for agricultural land and woodland should be retained whereas the Land Reform Review Group thought that the agricultural land exemption should be withdrawn (in phases). Although formerly exempt, Scottish farms and estates with shoots and deer forests have been reintroduced into the valuation roll as part of the *Land Reform Act 2016*. In cases where shooting rights could be exercised, but no shoot actually occurs, such land will still be entered on the valuation roll thereby having a similar function as a land tax. There are numerous reliefs available through the non-domestic rates system, which include:

- small businesses;
- empty/unoccupied property;

- rural (relief for properties that provide key services in designated rural settlements).

In 2016-17 the tax base in Scotland was £2.8bn from 230,000 properties. There was £600m of relief granted including for empty properties. Business rates raise more revenue than council tax despite a far smaller tax base. Consequently, non-domestic properties are taxed much more heavily relative to dwellings. It is no longer a locally administered tax; after World War Two rates provided approximately 50% of local government funding; it is now around 10%. Following the Barclay Review of non-domestic rates in Scotland, the Government plans to retain the tax (Barclay Review, 2017).

5 Land value taxation

5.1 What is land value taxation?

Land value tax (LVT) is a recurrent tax on landowners based on unimproved land value, usually levied as a percentage of the unimproved capital value of the site[2]. In addition to the obvious purpose of raising revenue for government, LVT is widely regarded as having the following benefits:

- it is an efficient tax, it does not distort choices as to how much to invest in improvements (Dye and England, 2010);
- it can encourage the highest and best use of land (Commission on Local Tax Reform, 2015 Vol 3, p.26-7);
- it can capture betterment; the uplift in private wealth that arises due to public investment (IPPR, 2005);
- it can promote reuse of land that may be unused, derelict or vacant (assuming such land is taxable) (Lyons Inquiry into Local Government, 2005, p.76);
- by raising the holding cost of land, it may discourage land banking and speculation and encourage development;
- it may encourage denser development[3] (subject to planning) and therefore limit urban sprawl; and
- it may stabilise the price of real estate by reducing and stabilising underlying land prices. Arguably landowners would face a windfall loss when an LVT is introduced, but the tax should not create any disincentives to buy, develop or use the land in question (Mirrlees, 2011).

[2] Appendix III contains a summary of some key principles of land economy which may be helpful for the reader to review before continuing.

[3] There has been some research into whether LVT encourages development activity (Dye and England, 2010). Four studies looked at the effect of introducing a split-rate LPT (where land is taxed at a higher rate than improvements) to replace the single-rate LPT in Pennsylvania. Mathis and Zech (1983) found no evidence of a relationship between the new tax and building activity in Pennsylvania municipalities. Bourassa (1990) found significant impact on residential building activity in three cities. Oates and Schwab (1997) found a significant impact on building activity but not conclusive due to economic development program that was underway at the time, and Plassmann and Tideman (2000) found a 3-4% increase in residential construction. There was also a study in Melbourne (Lusht, 1992) that found increase in development after introduction of LVT but Anderson (2009) notes selection bias in the municipalities studied. So the empirical evidence for this benefit is not particularly strong.

5.2 The economic rationale for land value taxation

The theoretical case for LVT is strong. Classical and neo-classical economists such as Adam Smith, David Ricardo, John Stuart Mill and Alfred Marshall demonstrated that the economic rent (and its capitalised equivalent, value) which land is able to earn over and above the return generated after optimally employing labour and capital is determined by its scarcity and its location, neither of which are derived from any productive activity on the part of the landowner. Land value is, therefore, the price of monopoly: the scarcer and less substitutable a parcel of land is, and the more attractive the location in relation to the market (consumers) and factors of production (labour, raw materials), the more valuable the land.

Land use planning and regulation, which also are not the result of landowner action, create further scarcity and generate demand, thus increasing the value of land in specific locations. At the land parcel level, the grant of permission to develop land (including changing its use) can generate substantial increases in land value. In societies where governments provide infrastructure, services and amenities, landowners may also benefit from value uplift as a direct result of this publicly funded investment. Land value is argued to be, therefore, the creation of the community and expresses – in financial terms – the right a community has in land held by an individual.

Who receives economic rent depends on who owns the land and the mechanisms in place to collect it. Debate over entitlement to these legal rights over land (including the right to use, exclude others, reap economic benefit, transfer, inherit, etc.) has a recorded history of at least four centuries: whether such rights should be privately owned and state protected (Locke, Bentham) or publicly owned (Rousseau, Marx). As the global population grows and the rate of urbanisation increases, pressure on land resources grows, and the philosophical debate over land rights is intensified by growing socioeconomic concerns over, firstly, access to land for basic human needs and, secondly, access to, inequality and redistribution of wealth (de Soto, 2000).

In countries where property rights are held privately, the combination of private property rights and monopoly land value creates two problems: unearned land value (or wealth) and unequal distribution of that wealth. One means of recovering unearned land value is a tax[4]. Adam Smith argued that a tax on land value would not harm economic activity and would not increase land rents. The idea of a recurrent tax on land value has been propounded ever since with 19th century liberal

[4] A wealth tax, which contrasts with Locke's 'service' tax.

economist Henry George making the most well-known case for a single tax[5] on land value, arguing that it would:

- capture unearned land value and help redistribute land-related wealth;
- pay for the provision of infrastructure services and amenities;
- help mitigate negative externalities and motivate productive use of land; and
- reduce land prices[6] (and land speculation) whilst having no detrimental economic impact on buying, selling, developing or using land.

A single tax on land to replace all other taxes has never been introduced. A wealth tax on such a scale could dramatically reduce land values (and hence property prices) depending on the tax rate. Instead, the idea of a LVT as a single LPT has been advocated, but these are usually at low rates and would capture only a tiny fraction of value. They are, therefore, a small vestige of George's original idea.

In economic terms, land rent is entirely economic rent because land is not a produced input. Its supply is fixed and cannot be affected by a tax. With the same amount of land available, people would not be willing to pay any more for it than before, so the present value of a LVT should be reflected one-for-one in a reduction in land price – an example of 'tax capitalisation' (Mirrlees et al, 2011).

The value of land is the price of monopoly. It is the relative, not the absolute, capability of land that determines its value. The value of land always measures the difference between it and the best land that may be had for free. Linking back to the earlier discussion on ownership of land and property rights, one might accept private land ownership if rent is collected for the benefit of the community.

This provides the economic rationale for taxing land but there are legitimate reasons for taxing improvements too. Occupiers of properties (i.e. improvements to land) consume local services and benefit from local amenities, so this consumption should be taxed. Also, the improvements are valuable assets and increases in value represent a form of investment which should be taxed too.

[5] Henry George's central argument was nationalisation of land ownership with leases granted to the highest bidder under conditions that guaranteed rights to improvements. This is quite a task but has been implemented in some (developing) economies. But, for pragmatic reasons, he advocated a single 100% tax on 'location' (i.e. land) instead. The land tax would replace taxes on wages and goods. The tax would not be levied on improvements made to land unless they had 'blended in' with the land over time. George argued that those who had legitimately acquired land rights should not be compensated for their loss when a land tax is introduced.

[6] Demand for land determines its value. If a tax takes all that value, anyone holding it without using it would have to pay nearly what it would be worth to anyone else who wanted to use it.

Mirrlees et al (2011) suggest that land and improvements should be thought of as distinct bases for taxation, although in most countries taxes are levied on their combined value. They argue that:

- Land, whether used for business or residential property, should be taxed at an arbitrarily high rate on economic efficiency grounds.
- Housing, whether owner-occupied or rented should be taxed as a consumption good and as an investment, the difference being that, for owner-occupied housing, the owner pays both taxes whereas for rented housing the owner pays the investment tax and the renter pays the consumption tax.
- Business property is an input into the production process and, on efficiency grounds, should not be taxed.

For practical and political reasons, Mirrlees et al (2011) do not propose a land tax for residential land use. Instead, they suggest two taxes. First, a Housing Services Tax as a flat rate percentage of rental value (whether actual or imputed). Although the tax would be progressive, they admit that there would be many gainers and losers across the income distribution. For example, the elderly on low incomes living in expensive homes would be losers. They suggest that the introduction of such a tax should be phased.

Second, Mirrlees et al (2011) propose a wealth tax on supernormal returns to savings. A normal rate of return on the purchase price would be tax-free but if (imputed) rent rose about this return then tax is paid on the excess. If the house is sold at a price greater than the purchase price, tax is paid on the capital gain.

5.3 Implementing and administering a land value tax

5.3.1 Political issues

Politically, LVT can be challenging to implement. The political arguments against LVT centre on the windfall loss incurred by landowners, the difficulty in dismantling centuries of land ownership rights and the impact on other taxes. In July 2004 the Select Committee scrutinising the UK Government's Office of the Deputy Prime Minister published a report on local government finance in which it considered the case for LVT (House of Commons, 2004). It concluded that the potential impact on householders was too great.

The principal drawback[7] was perceived to be the penalty on asset-rich / cash-poor householders, particularly as house prices have grown significantly faster than income levels (House of Commons Library, 2014). The tax may not necessarily be related to ability to pay and a mechanism might be required for taxpayers to defer payment until disposal of land. Otherwise poorer households may be pushed out of high value inner city land particularly if areas are regenerated, resulting in problems for the original communities in the area and raising concerns regarding social cohesion (Commission on Local Tax Reform, 2015 Vol 3, p.28). However, by deferring the tax it reduces the probability of securing land use efficiency in a timely manner.

Mirrlees (2011) argued that moving from a property-based tax to a land-based tax would create numerous gainers and losers. Having said that, a council tax revaluation would also create winners and losers, which is perhaps why it has not been attempted in Scotland or England yet. The Lyons Inquiry into Local Government (2005, p.75) noted that 'Replacing council tax and business rates entirely would lead to significant changes in household and business tax liabilities. It might have disadvantages as a local tax, since it is linked to the value of the land under the property, not to the number of households using local services.' More generally, the Commission on Local Tax Reform in Scotland suggested that the tax may be difficult to explain and for people to understand (2015 Vol 3, p.28).

The main losers when switching from an occupation tax such as business rates to a LVT would be land-extensive businesses (IPPR, 2005). Taxing land will raise costs disproportionately on businesses that use relatively more land as a factor input. This explains to some degree the fact that many countries that have a land tax apply special reliefs to agriculture, through full or partial exemptions, or lower tax rates (Norregaard, 2013). Indeed, the 2015 Commission on Local Tax Reform in Scotland stated that an LVT may impact on the sustainability of some land based businesses, particularly farmers (with concerns that farmers are already experiencing difficulties in a challenging economic climate) (Vol 3, p.28).

A LVT is usually levied on owners of land. This can cause confusion over the purpose of the tax. Local taxation is often regarded as a benefit tax, or service tax, to pay for the provision of local infrastructure, services and amenities. Therefore occupiers of land (and improvements to the land) would be the appropriate taxable entities. However, if the tax is also in part a wealth tax designed to capture uplift in value resulting from the provision of local infrastructure, services and amenities, then the landowner would be the appropriate taxable entity. In reality, LVT is a hybrid benefit tax and wealth tax. The confusion stems from the argument that it is an occupation tax that is assessed

[7] It should be noted that this issue pertains to LPT as well as LVT.

by reference to values. Is the tax based on values to capture greater taxes from those with higher value properties or is it based on values because those living in higher value properties will use infrastructure, services and amenities more?

5.3.2 Practical issues

5.3.2.1 Compiling and maintaining a parcel-level register of land ownership, land use and land prices

LVT requires up to date information on all land ownership, land use and land prices. The register of land ownership must include (legally) identifiable boundaries[8]. The land use map must record permitted land use rights for all sites. All taxable land uses need to be identified and classified together with any supporting information that may assist in their valuation. The land price information would be compiled from market transaction information and would include prices, rents, dates and other relevant details.

5.3.2.2 Revision of the planning system

The planning system must specify a permitted land use for each parcel and confers this development right to an applicant upon grant of planning permission. Wightman (2013a) notes that British planning is a plan-led system, which sets the context for site-specific development decisions. Whilst plans may show areas where it is agreed that certain developments will be permitted, it is only when a planning application is submitted that any development can be approved. This is in contrast to zoning systems that delineate permitted uses on an area-by-area basis, conveying development rights to landowners without the need for detailed approval. In a zoning system the assessment of permitted use is more straightforward.

Because the tax is higher in urban areas (where land values are higher) this will encourage denser urban development. Policy mechanisms might be introduced to counter densification, including a 'green space' allowance or minimum densities so that low density occupiers are not unduly taxed. In addition, according to Dunne (2005), LVT needs to account for specific use restrictions such as historic buildings where no redevelopment is allowed, as well as for land over which occupants (tenants) have security of tenure.

Wightman (2013a) notes that, under British planning law, anyone can apply for planning permission for a change of use over any land. Under a system of LVT, local authorities might submit planning applications for land they believe has a higher value use in order to obtain increased tax revenue.

[8] According to the Report of the Land Reform Review Group (2014, p.27), there has been slow progress in developing a map-based register of land ownership in Scotland.

5.3.2.3 Valuing each parcel of land

All land parcels must be valued and this presents several challenges.

5.3.2.3.1 *Valuation method*

Land needs to be valued. This should ideally be undertaken using the comparison approach i.e. by analysing market evidence of comparable land sales. However, evidence of undeveloped land may be scarce. The alternative is to use an approach whereby evidence of the value of land and buildings sold or rented as an 'entity' is analysed to extract the value of the land. Undertaking this can be problematic as the 'residual' method, whereby build costs and other adjustments are subtracted from the total value of the development to arrive at a 'residual' land value, can produce confounding results.

For example, take two dwellings side-by-side. One is three-storey and developed to highest and best use (market value = £1m, build and other costs = £0.5m, so land value = £0.5m), the other is two-storey (market value = £0.7m, build and other costs = £0.3m, so land value = £0.4m). The land value (and therefore the LVT) of the first property is higher. The relationship between property value and build cost is penalising the development of land to highest and best use, which is counterintuitive as far as a land value tax is concerned.

5.3.2.3.2 *Highest and best use*

However, this problem could potentially be addressed by valuing the land on which the two-storey property is constructed, based on its highest and best use (i.e. on the assumption that it is developed to three-storeys). This would theoretically result in the same land tax for both neighbouring properties thereby removing the penalisation of the development of land to its highest and best use, and creating an incentive for the more intensive development of the under-utilised land. However, there are further valuation issues associated with valuing land based on its highest and best use (HABU).

For example, how might the valuer determine HABU? One approach might be to make reference to the planning policy context for each plot of land and make a judgement as to whether the land is developed to its maximum reasonable capacity. However, this would be a matter of fact and degree and would be open to challenge. It would also be labour intensive and costly. This notwithstanding, it is an approach that has been adopted in some countries, but normally where there is a 'zoning' approach to land use planning.

For a zoning approach, zones are identified and the highest and best use is established for each zone, within which property of different types would be taxed based on corresponding tax rates. This approach would need to be designed so as to acknowledge that not all land within such zones

would be permitted to be developed to the zoned HABU by the planning system e.g. land within the setting of a sensitive heritage asset, or land which is used as public open space. Therefore with a zoned approach some method is required to allow for adjustment at the individual parcel level. If accuracy is to be achieved, the use of GIS modelling and automated valuation approaches might be used.[9]

5.3.2.3.3 *Unimproved land*

Whatever the approach to determining HABU, should the tax be based on the unimproved value of land, a HABU valuation may require the valuer to value the land based on hypothetical improvements, the hypothetical value of which would then have to be stripped out to arrive at a hypothetical land value. The problem would be made more complicated if the land were deemed to be in mixed use. Whilst undoubtedly challenging the increased use of automated valuation models (AVMs) and digital mapping as mentioned above may help to address the issues.

The technical issues associated with assessing the value of land based on its unimproved state and assuming HABU may be illuminated by considering how one might tax the unimproved value of the land on which Edinburgh Castle is situated. How might a valuer determine the HABU of this 'unimproved' land? What transactional evidence might the valuer turn to in order to help arrive at a value? It is acknowledged that this is perhaps an extreme example as in most jurisdictions where an LVT is used, there are exemptions for major heritage and protected properties. In reality the problem presents challenges, but the extent to which the end figures would be challenged would be likely to be as much a function of the level of tax imposed as the accuracy and validity of valuation approach.

Perhaps a more fundamental issue is the difficulty in establishing what the 'original unimproved state' of any land is. Economic theory suggests that land in its 'original unimproved state' should be 'prairie' or 'wild' land which has had no human labour mixed with it at all. However, it may in practice be very difficult to differentiate between land as it would have existed in its 'original unimproved state', and land which has been subject to improvements over many years such that those which may have merged with the land over time, such as levelling for example. This could be a particular issue in rural Scotland, parts of which have been managed for centuries.

5.3.2.3.4 *Transactional evidence*

There are relatively few transactions in unimproved land, particularly in urban areas. Land markets are much thinner than property markets (IPPR, 2005). Most market transactions are for plots of land together with buildings (House of Commons Library, 2014). Grover et al (2017) note that the

[9] Such as undertaken in Denmark who have adopted such an approach for many years (see section 8).

credibility of valuations depends on the accuracy of land transaction data. There needs to be a functioning and transparent property market for all classes of property and all locations, not just major urban areas, and media through which buyers and sellers can be informed about market conditions. This is rarely the case for unimproved land.

If transactions in improved land are to be used, how would the value of the land be separated from the value of improvements? This can be challenging in a developed, urbanised property market that is concerned with capital and rental values for improved land. Land in mixed use would need apportionment if the uses are taxed at different rates and this would mean collecting information on floor areas. The impact of value influences (changing transport infrastructure, new development, etc.) would have to be apportioned between the unimproved land and property elements of the real estate interest – not something that is regularly undertaken by valuers. Should LVT be introduced, there would therefore be potential implications for training and education of valuers to accommodate these challenges.

5.3.2.3.5 *Basis of value*

The basis of value must be determined. In order to base a tax on either unimproved or improved land, it is necessary to assess differences in utility. Utility can be measured by assessing how much someone would be willing to pay for an interest in a particular land parcel; a process known as valuation. Thus tax can be based on (usually a proportion of) market value[10] of the (un)improved land. The advantages of using market value as a basis for assessment is that it encourages people to recognise the value of their assets, it relates revenue to economic performance, and market transaction evidence provides an evidence base.

Market values are capital values but tax assessments can also be based on market rental values. Arguably for recurrent (i.e. annual tax) a market rental value is preferable, as it avoids the impact of movements in the investment markets which can skew capital values[11]; however comparable rental data for unimproved land may be more scarce that for capital transactions.

Rental values relate to market conditions but normally reflect existing use rather than how the property might be used if sold on the open market.

Basing the tax on capital market value means that valuations will include 'hope value'. This is the value that purchasers of land pay in excess of the value for the permitted use. It reflects – in financial terms – speculation that there might be a change of permitted use that would increase the

[10] There are other bases of assessment: soil quality for agricultural land; and replacement cost valuations for buildings, but these are usually employed when market transaction evidence is not available.

[11] As evidence of this, London's residential capital market experienced pressure which impacted on prices due to an influx of money from Russia and China and was unconnected with underlying 'utility' value.

value of the land. Thus if a purchaser acquires land at a price that incorporates hope value, he or she will be exposing themselves to an LVT levy based upon that value. This point is illustrated in the text box below.

UN 2011 (p.43):

Agricultural land at a city's edge is often more valuable for its development potential than for its agricultural production. If the land is taxed at its 'market value', meaning its value as developable land, farmers may not be able to continue farming because of high taxes. While many countries simply exclude agricultural land from the LPT base, many others design a system which taxes agricultural land at its agricultural value rather than full market value. Thailand, for example, has established a panel of agricultural experts that assesses the level of agricultural potential for land in different sections of the country. Agricultural land in each area is then taxed based on its estimated agricultural potential rather than full market value.

This could open the way for numerous appeals because an assessment of the existence and extent of any hope value is a matter of judgement. It might therefore be preferable to value the unimproved value of the land based on its highest and best use *as could reasonably be assumed to be permitted under existing local planning policy*, rather than highest and best use including a proportion of value which is assumed to derive from the potential to gain a planning permission for a *different and more valuable* use in the future should planning policy change.

For example, if the valuer were to value a site for LVT purposes where the existing use is light industrial, he or she could only value based on the highest and best industrial use which could reasonably be assumed to be granted by the local planning authority. There could be no element of hope value for change of use to, say, residential if this use is not currently supported by policy. Similarly, if the valuer were to value a site where the existing use is residential, the valuer would be able to value based on the highest and best residential use which could be reasonably assumed to be granted by the local planning authority.

In these examples, although there would be an element of hope value because redevelopment of the sites to a more profitable use would require planning permission which could in theory be refused (e.g. for a higher density development), the assumptions underpinning these assessments of hope value would be less controversial than assumptions underpinning assessments of hope value deriving from a *change of use* to a use which is not currently explicitly supported in local planning policy. Of course, should a planning permission be granted for a change of use (from, say, light industrial to residential), then this could potentially be a trigger event for a new valuation and a new tax liability on the landowner.

If a 'zoned use' approach to planning is taken, this simplifies the issue, but does give rise to the need for 'parcel adjustments' which, for example, a particular site is compromised due to natural contamination or other factors.

5.4 Land value taxation – administration issues

UN 2011 (p.31):

Revenue collected is a function of two policy variables: the value of the legally defined tax base and the tax rate. And three administrative factors: the proportion of all land that should be taxed that appear on the tax list (coverage), the proportion of taxable value that is identified by the valuation process (valuation), the proportion of the tax levied that is actually collected. Total revenue collected will be the product of all these factors, i.e. Base x Rate x Coverage x Valuation x Collection.

5.4.1 Who pays?

Policy makers must decide whether it is the occupier or the owner of land and property which is liable for LPT. In cases where property registration is not complete or where other types of ownership are recognised, it is often the case that occupiers or users of property can be more readily identified. In such cases it may be more practical to assign the tax to those who actually use the land. In some instances, LPTs are levied on both owners and occupiers.

A further consideration is that of charities and public bodies. The exemption from or reduced payment of recurrent property taxes by charities or/and public bodies is common across many jurisdictions. However, by granting special status to charities the tax base is reduced, and an incentive is created to place land within charitable trusts.

5.4.2 Extent of tax base

Economic theory which supports a LVT suggests that all land should be included in the tax base. Land for which there is no current demand – perhaps vacant and derelict land – may have negligible rental value but should still be included in a LVT. Then, depending on policy requirements, the tax rate can be adjusted to stimulate its redevelopment.

Land use may be classified as residential, commercial, etc. often with the intent of applying different tax rates to different classes of property, but a large number of land use categories can lead to difficulties. When does land cease to be agricultural and become recreational – a high ropes adventure course for example? Also some recreational uses are highly profitable and could bear a tax – others are not. Similarly with residential property: land used for affordable housing is not the same as that for open market use.

A broader, more inclusive tax base means that tax rates for everyone can be lower but the UN (2011) notes that taxation of agricultural land or forest land can be politically sensitive. Consequently farmland is often either excluded altogether or taxed at a much lower rate than other property.

Some property may be exempt from the obligation to pay the tax. With each exemption, the tax base is narrowed and the rate necessary to reach the same revenue target will be higher for those who remain subject to the tax. It should be remembered that exempt property still creates a demand for local services. An alternative to outright exemption is to exempt a specific amount of value from the tax.

5.4.3 Tax rate

According to the UN (2011) setting the tax rate at the national or regional level assures uniformity and avoids tax competition. Allowing local governments to set the rate empowers local officials and fosters local autonomy. In some cases national or provincial government establishes a range for the rate, and local governments determine the final rate within that range. If both land and improvements are taxed, it is possible to have a split-rate LPT with a different (usually higher) rate for land than for improvements. Doing this can make it clear what the purpose of each part of the tax is: to tax wealth or to fund local services.

5.4.4 Revaluations

Regular revaluations of land values are required (Connellan, 2004) to cope with market volatility and changing real values. There can be high political costs associated with infrequent revaluations and associated, potentially sharp, tax increases. Banding values can simplify administration especially when evidence is scarce, but there may be contention regarding the boundaries of the bands.

5.4.5 Public understanding and appeals

The lack of market information in relation to land transaction can hinder the appeals process because taxpayers find it difficult to understand land values in the same way that they understand property values. With a tax that is based on improved land values, the taxpayer is generally able to compare personal knowledge of the market value of the property with the tax assessor's valuation. But if the valuation is of unimproved land, the taxpayer may be unable to judge the accuracy or fairness of the tax (UN, 2011).

5.4.6 Responsibilities

Administrative responsibilities are usually distributed between different levels and parts of government. Central government usually has overall responsibility for tax collection and

distribution. Assessment may be undertaken by a combination of central and local government and even sub-contracting to private sector. Collection may be undertaken by local government, central government on behalf of local government or the private sector, and is usually on an annual basis.

It is regarded as good practice to separate assessment of the tax *base* (i.e. valuing individual land and property interests) from the setting of the tax *rate*. The former would be undertaken by professional, trained valuers, made transparent and be open to appeal. The latter would be set by elected politicians possibly within limits set by central government. The rate would then change annually (perhaps indexed to general inflation or to changes in real prices of property).

There needs to be timely and seamless sharing of information between government departments and between central and local government, particularly if custodianship of land ownership, use and valuation information is the responsibility of separate departments or agencies. It is usual for local government (planning and building control) to monitor land use change. It is also important that the process is transparent and that tax payers understand the distinction between the *base* and the *rate* of tax.

5.4.7 Initial rollout of LVT

In their review of international literature, Gibb and Christie (2015) note that there is a risk that introducing LVT may initially lead to significant land value falls as a result of the capitalisation of future tax liabilities into the value of land. This could have significant implications for the economy, particularly in the case of residential land given that residential property values have assumed integral importance to the UK economy due to the 'assetisation' of home ownership since the 1980s. A transitional arrangement might be appropriate, perhaps phasing it in or offering compensation to those initially affected. It may also be advisable to pilot any new tax prior to national rollout.

5.4.8 Summary

To summarise the administrative requirements, any government considering implementing a LVT would need to:

- develop and maintain a register of taxable land, including boundary extents from which areas can be calculated;
- identify relevant taxpayers;
- determine the taxable value of all land parcels;
- determine the tax rate that applies to each property and calculate the tax due;
- prepare and deliver tax bills;
- appropriately respond to enquiries, concerns and appeals from taxpayers; and

- collect revenue and appropriately follow through and resolve tax payment delinquencies.

According to the UN (2011, p.46) 'The best LPT design will be based on the specific local context created by the combination of current property rights, land registration systems, property markets and administrative capacities. In many instances the theoretically preferable may need to give way to the administratively practical.' As Grover et al (2017, p.94) note:

> 'The countries that have successfully introduced value-based recurrent property taxes have had to overcome two main types of barriers. First, there are technical obstacles concerned with how to levy an efficient value-based property tax. These include the comprehensiveness of property registration, the quality and availability of transaction price data, whether internationally recognised valuation standards are followed and the quality of tax collection systems. Second, there are political or governance barriers which stand in the way of satisfactory technical solutions being implemented. Property taxes are widely seen as being unpopular, and work has to be undertaken to convince the public that they are fair and necessary. They require different skills from other taxes levied. Their roles in reducing intergovernmental fiscal transfers and in countering the impact of globalisation on revenue yields are not widely understood.'

6 International experience of land value tax

There are many international examples of LVT, where LVT may be implemented as the sole mechanism for taxing real estate or used in combination with a tax on improvements or a tax on betterment. For example, for a sample of 61 countries the table at Appendix IV records whether each country has a LVT and/or an *ad valorem* LPT. From this, it is apparent that in this sample countries mainly employ LVT in combination with other taxes on property.

To help inform the policy options, the Research Team originally conducted more detailed case studies in five jurisdictions; Australia (Queensland), Estonia, New Zealand, Denmark and South Africa. The jurisdictions were selected based on their comparability with specific aspects of the Scottish context, including:

- concentration of land ownership;
- political, social and economic history of land reform;
- the combination of developed urban areas and relatively un-developed rural areas;
- the combination of relatively high-land value areas and low land value areas; and
- the potential combination of LVT with other forms of land and property tax.

The case studies include examples of jurisdictions where there has been long-term use of LVT at state and local government level (Denmark, Queensland and New Zealand), as well as more recent introduction of LVT (Estonia). The case studies also include examples where jurisdictions have moved away from LVT (South Africa and New Zealand). In addition to these full case studies, the introduction of a land tax on commercial farmland in Namibia has also been introduced as a sixth, outline, case study, given the potential synergies with the SLC's strategic objectives. The following sub-sections summarise the LVT situation in each jurisdiction.

6.1.1 Queensland, Australia

6.1.1.1 Context

Australia has a long history of LVT levied at both state and local government level. It therefore provides a useful insight into the challenges associated with administering such a tax at more than one tier of government.

Australia's experience with taxing land extends from the late 19th century, with the first land tax being introduced in South Australia in 1884 on the unimproved capital value of land. This followed the proliferation of 'single-tax leagues' in Australia as a result of the impact of Henry George's writings (Forster, 2000). A federal tax on the value of land in Australia was later introduced in 1910

with the objective of breaking up large estates and large tracts of under-utilised land, and of financing a nationwide old-age pension plan (Forster, 2000; Smith, 2005).

The first $5,000 of unimproved value was exempt under the federal land tax and the rates were kept low except for very large estates. However, the owners of large estates often escaped the tax by nominally subdividing the land among family relations (Forster, 2000). The federal land tax was later abolished in 1952 because it was not achieving the objective of breaking up large estates and had high administrative costs, among other reasons (Franszen, 2009). In the meantime, the Australian states had introduced their own land taxes, the last of which was Queensland, which introduced its state land tax in 1915 (Forster, 2000).

6.1.1.2 How the LVT system functions

Queensland today has two tiers of LVT: the state level and local government level (council rates), with the latter spent on local services and infrastructure. The taxes are levied on the owners of freehold land. All rateable land is valued on an annual basis by the Valuer General, Department for Natural Resources, Mines and Energy. The valuations reflect the market as at 1 October of the year prior to the valuation becoming effective on 30 June each year (McCluskey, 2005). The Valuer General issues the annual valuations, which are then used to calculate council rates and the state land tax. Council rates are calculated by local councils, and state land tax is calculated by the Office of State Revenue.

Currently, landowners are liable to pay state land tax when the total taxable value of their land is $350,000 or more for companies, trustees or absentees and $600,000 or more for individuals. Most Queensland landowners therefore do not pay state land tax because the value of their land is not sufficiently high. Current exemptions from state land tax include:

- Home exemption on land or the part of land used as a home, available to individuals and trustees in some circumstances.
- Transitional home exemption, available on homes not yet occupied as a primary residence in some circumstances.
- Primary production exemption, available on land used solely for agriculture, pasture or dairy farming in some circumstances.
- Moveable dwelling (caravan) parks exemption, available in some circumstances.
- Charitable institutions exemption, available on land used for some charitable exempt purposes, including as a religious or educational activity, elderly care and ‘promoting the public good’.

In terms of council rates, each council decides the rates and charges for each financial year. Councils must choose between levying a general or a differential general rate on all rateable land. A general rate would be levied equally on the value of all rateable land within the council area. A differential rate would be levied where it is considered that a general rate would result in inequitable outcomes. In this instance, a council could 'determine different categories of rateable land based on land use, access or consumption of council services' with the council able to 'levy a different rate in the dollar for each category' (Department of Local Government, Racing and Multicultural Affairs, 2015). Exemptions from council rates in Queensland include land occupied by the state or a government entity (other than non-exempt government-owned corporations), land in a state forest or timber reserve, Aboriginal land, land used to facilitate specific transport infrastructure, local government land, and land used for religious, charitable, educational or public purposes.

Prior to 2010, Queensland levied local and state land tax on the basis of its unimproved capital value, meaning the value of the land without any improvements of any kind (but with all existing amenities). There are difficulties, however, associated with this definition of land. For example, improvements such as levelling, clearing and filling carried out many years previously become virtually impossible to identify. The *Land Valuation Act 2010* introduced the related (yet different) concept of 'site value' as the basis of value for non-rural land for both state and local land taxes. Site value includes the value of improvements that have merged with the land over time because they have become permanent, require no maintenance and for all practical purposes have become invisible. Unimproved value remains the basis of value for land zoned as rural.

Valuations are conducted annually. This was introduced in order to avoid large variations in valuation which can occur with more infrequent valuations, particularly in highly developed urban areas. However, according to McCluskey (2005), it is questionable whether frequent annual valuations are necessary in more rural areas with more stable land values, particularly when the cost is taken in to account. This view is supported by a survey of Australian valuers conducted by Mangioni (2013). According to Mangioni (2016, p.322), valuations account for over 40% of the cost of administering state land tax across Australia. In other states in Australia, frequency of revaluation varies from annual to five yearly.

The importance of property taxation as a proportion of total tax revenue is very low at federal level. This is because property taxation at this level only comprises government borrowing guarantee levies. Property taxation is much more significant at state level, where it has averaged 38% of total state taxation revenue in the period 2007–2017 (Australian Bureau of Statistics, 2018). Property taxation revenue comprises land tax as well municipal rates, transfer duties and other taxes.

Queensland is in line with this trend, with an average of 37% of its taxation revenue coming from property taxation over the same period. Property tax is the sole source of taxation revenue for local councils.

Across all states in Australia, between 2007 and 2017, land tax comprised an average of 26% of total property taxation, and 10% of total tax revenue at state level. Queensland is in line with this trend, with land tax comprising 25% and 8% of total property taxation and total tax revenue respectively (Australian Bureau of Statistics, 2018). The contribution made by land tax to state tax revenue is therefore important, but does not make up a significant proportion. In Australia as a whole, tax on property amounted to 3.02% of GDP in 2015, up from 2.67% of GDP in 2000. This is above the average for OECD countries.

6.1.1.3 Relationship of LVT with other property taxes

The federal government levies and collects all income tax from individuals and enterprises. The state government revenue base consists of property taxes, employers' payroll and the provision of goods and services. The sole source of taxation revenue for local governments is taxes on property (Australian Bureau of Statistics, 2018). The federal government and the state of Queensland collects the following key property-related taxes in additional to the state land tax and council rates:

- Transfer Duty – Queensland.
- Additional foreign acquirer duty (payable when foreign persons acquire residential land) – Queensland.
- Landholder duty (payable by landholders when they make 'relevant acquisitions; a landholder is corporation or listed unit trust that has land-holdings in Queensland with an unencumbered value of $2 million or more) – Queensland.
- Capital gains tax – Federal government.

6.1.1.4 Valuation of land

Rural land is valued based on 'unimproved value' and non-rural land is valued based on 'site value'. Unimproved value 'reflects the value of the land in its natural, undisturbed condition' and it is 'the amount for which rural land could be expected to sell for without physical improvements such as houses, fences, clearing, levelling and earthworks' (Queensland Government, 2014a). Site value 'reflects what the land would be expected to sell for in its current condition' and 'includes any work undertaken, or materials used, to improve the physical nature of the land to prepare it for development', but excludes structural improvements to the land, such as buildings and landscaping (Queensland Government, 2014b). Ideally valuations based on site value and unimproved value would be based on comparable land sales of 'vacant or lightly improved land', but where these are

not available, improved land sales may be used as comparable evidence, adjusted so as to exclude the value of the improvements.

The provisions of the *Land Valuation Act 2010* allow land to be 'hypothetically developed to its maximum potential and stripped back to produce a land value' thus allowing 'land to be valued based on its highest and best use in cases where the existing improvements do not represent this use' (Mangioni, 2016, p.69).

According to Mangioni (2016, p.73), there is an increasing lack of vacant land sales which has prompted greater reliance on improved land sales when conducting annual valuations of land for tax purposes. This requirement that valuers deduce land value from improved land values has led to a lack of transparency and inconsistency of approaches in the valuation of land, which in turn has led to 'questions as to whether or not land remains the most suitable base on which to assess land tax in highly urbanised locations'. The practice of deducting the value of improvements to arrive at a land value has also raised concerns regarding its impact on the economic efficiency, simplicity and transparency of the land tax. Land tax in Australia has 'constantly been challenged and is one of the more disliked, visual and least understood taxes imposed by governments' (Mangioni, 2016, pp.73-74).

The above notwithstanding, as it is considered impractical to carry out individual inspections of each property each year, market trends in unimproved values are estimated based on property transactions in each land use category. Sales information is therefore analysed in each local government area, and by comparing the analysed unimproved values with existing unimproved values, the market movement in overall land values can be calculated. A percentage factor is then applied to the current value of the properties, which can result in an increase or decrease in value.

Landowners have the right to object to a valuation. An objection to a valuation must be lodged within 60 days of receipt of the annual valuation notice. Landowners who do not agree with the objection decision may appeal to the Land Court within 60 days of the date of issue of the objection decision. Decisions made by the Land Court can be appealed to the Land Appeal Court. Further recourse is available through the Court of Appeal and the High Court. The objection rate is low as a percentage of total valuations, with the average rate of objection across the state being 0.09%, 0.07% and 0.37% for 2014, 2015 and 2016 respectively (Queensland Government, 2014c, 2015, 2016).

6.1.1.5 Evaluation of LVT

Despite problems, Australia has retained LVT since it was first introduced at the federal level in the 19th century. Although there is no longer a federal land tax, land tax remains a source of tax revenue for state governments and is the sole source of tax revenue for local governments.

Despite its longstanding role in the Australian taxation system, according to Mangioni (2016), there remains a significant degree of confusion regarding what state land tax and council rates actually are and what they are for. For Mangioni (2016, p.309) this 'void of understanding paves the way for the tax to be more clearly defined in Australia, which is a unique position from which to reform this tax.' There is also confusion among the general public regarding the basis of value (i.e. site value or unimproved value), how this is calculated, and how it affects their tax liability. According to Mangioni (2016, p.321): 'A basis of value which is understood by the taxpayer will be more accepted, as it removes one layer of valuation mechanics, that is, the stripping back of improved sales in highly urbanised locations, where most of the states' land tax and local government rates are raised.'

6.1.1.6 Relationship with SLC's strategic objectives

LVT was introduced in Australia in accordance with a Georgist agenda, with the federal land tax being specifically targeted at breaking up the large estates, which directly links with the SLC's strategic objective of encouraging a more diverse pattern of land ownership and its desired long-term outcome of a fall in the concentration of land ownership. However, the federal land tax did not achieve this objective and it was partly because of this that it was abolished in 1952.

Land tax in Australia today is levied at state and local government level, and appears to be primarily targeted at raising revenue, particularly for local authorities who rely entirely on land and property tax for their tax revenue. The literature therefore suggests that it is important for taxpayers in Australia to properly understand the relationship between the land tax and the services and infrastructure they receive in return.

This kind of clarity of connection between the responsibilities of land ownership and any tax on land ownership is essential in ensuring that the accountability of landowners to the rest of society and the legitimacy of any associated tax is properly recognised and understood. This would be an important consideration should the Scottish government choose to introduce a form of LVT, and would also be important in the context of the SLC's strategic objectives relating to enhancing the accountability of land ownership.

6.1.2 Estonia

6.1.2.1 Context

Estonia was selected as a case study because it introduced LVT relatively recently. Having declared independence from the USSR in 1991 and reintroduced democratic rule, the new government undertook land and fiscal reforms, moving quickly to restore land to private ownership that had been appropriated by the state during the Soviet era. As a mechanism for privatising state-owned land, where land was not claimed, it was auctioned.

The present land tax was introduced in 1993 as part of these reforms. The aims of the tax were to stimulate more productive uses of restored and privatised land and to provide a source of local government revenue (Malme and Tiits, 2001). As Estonia developed its market economy, the land tax was also seen as a way of stimulating the real estate market and increasing awareness of land values (Tiits, 2008). The aim of encouraging privatisation of land drove the decision to tax government-owned land (Malme and Tiits, 2001). It was also hoped that the land tax project would be instrumental in speeding up the development of new land and sales registries and updating cadastral maps and land records (Malme and Tiits, 2001; Tiits, 2008).

The government's decision to tax only land rather than including property was based on familiar economic arguments regarding the taxation of improvements. However there were some reasons related to the emergence from the Soviet era: there were concerns that residents would become property owners but would not have the ability to pay; there was a practical barrier too as records of land and buildings had been held separately (Malme and Tiits, 2001). In 2000 the government considered including buildings in the tax.

6.1.2.2 How the LVT system functions

All land is classified into zones based on uses such as residential or commercial. A value per square metre or hectare is set for each zone. The tax rates applied to each zone is decided annually by local councils within limits set by national legislation. Currently the tax rate must be between 0.1% and 2.5% of the value of the land apart from agricultural land i.e. that zoned as *area under cultivation* or *natural grasslands* which must be taxed at between 0.1% to 2.0% of the value. Since 1993 the bands of permitted tax rates have broadened. The concession for agriculture was intended to be temporary but, while it has reduced it is no longer seen as a temporary reduction. While municipalities can set different rates for differing land uses, most just set one for the non-agricultural uses and one for agriculture. Most municipalities set rates near the top of the two bands.

The valuation is based on market value of the land only (i.e. exclusive of improvements) and the National Land Board is responsible for all aspects of valuation. Initially the valuations were based on

expert opinion and judgement, but transaction information became central as markets developed (Almy, 2001). There is no revaluation cycle fixed in law, it is for the government to decide when one should be done. The last revaluation was done in 2000 and there is currently no plan for a revaluation.

Although the tax is all distributed to local municipalities, it is a state tax and the National Tax Board is responsible for collection. The contribution to revenue made by the land tax remains relatively modest, and, as the country has grown more prosperous, it has decreased as a percentage of total tax raised and of GDP. In the late 1990s the land tax represented 1.0% to 1.2% of all tax revenues and approximately 0.4% of GDP whereas in 2016 it represented 0.7% of all taxes and 0.3% of GDP. However, Franzen (2009) notes that the revenue from land tax varies substantially between municipalities, and particularly between cities and rural areas and smaller towns. For the largest cities the tax represented less than 5% of their revenue whilst in some rural municipalities the figure could be 30%. As land values have increased, evident in the 2000 revaluation, it has been suggested that the revenue could be higher (Tiits 2008), but that is a political decision.

Land underneath occupied houses and associated yards is exempt, but this is limited to 0.15 hectares in cities and 2 hectares in rural areas. There are very few other exemptions, and largely these are quite narrowly defined. Examples include nature reserves, land under churches, public water bodies and land adjacent to buildings of diplomatic missions. Relief of 50% is given to conservation and similar land.

The collection efficiency of the land tax has always been very high. In 1998 it was 98% (Almy, 2001).

6.1.2.3 Relationship of LVT with other property taxes

Estonia doesn't have specific property taxes other than land value tax. Capital gains are taxed, but as part of income and at normal income tax rates, with exemptions for primary residences. There is a small state fee payable on transfers of property.

6.1.2.4 Valuation of land

In the early days of the land tax, the market economy was not yet developed and the country had neither the legal framework nor the land and price information necessary for valuation (Malme and Tiits, 2001). The National Land Board was given the tasks of developing a valuation method, valuation standards and procedures, as well as the supervision and training of valuers. Not surprisingly, they drew on the expertise of other countries (Malme and Tiits, 2001)

Valuation of urban land was undertaken using the judgement of valuers on market criteria of location, quality and use (Malme and Tiits 2001). This created relative price zones among and within each urban area. The same method was used for rural land, with additional criteria for the soil

productivity. As reliable price information has become available in the newly established National Transaction Register, the valuation has been increasingly based on market transaction data.

Land zoning has still not fully developed and there are often multiple uses on land making it hard to establish the highest and best use value. Therefore values are generally based on the prevailing use (Malme and Tiits, 2001).

The appeal rate is low and can only be made on the grounds that regulations were not followed or if there is an error of more than 20%.

6.1.2.5 Evaluation of LVT

The introduction of the land tax has been instrumental in speeding up the development of new land and sales registries and updating cadastral maps and land records (Malme and Tiits, 2001). According to Tomson (2000), despite the amounts of tax collected being small, it is reported that property owners keeping land idle under the restitution provisions have been encouraged to develop or sell their land.

As a source of revenue for local government it is not particularly significant and has become a lower percentage of total tax revenue over time. But, as Tomson (2000) notes, this is not a problem with land tax, it is simply because the rates are low.

Estonia had always intended to move to a system where buildings were included in the tax base. Its Baltic neighbours of Lithuania and Latvia have both moved in this direction. This was to happen in Estonia once the property market had become established and the necessary infrastructure was in place to enable such valuations (Franzen, 2009). Malme and Tiits (2001) reported that a move to including buildings in the tax base was being considered and that the Ministry of Finance had produced a report which listed the following advantages and disadvantages of such a change:

Advantages:

- increased tax base and tax revenues (estimated as three to five times the current revenues);
- greater equity due to a closer correlation between the property value and ability to pay; and
- potential for revenue growth without raising the tax rate.

Disadvantages:

- tax base expansion highly concentrated in Tallinn, where property values are also the highest;
- potential to discourage new construction and building renovation; and
- disproportionately greater administrative costs.

According to Malme and (Tiits, 2001) the Ministry of Finance report noted that there would need to be administrative reorganisation as the land cadastre and buildings register are not integrated, and the buildings register would need to be updated.

However, this change hasn't happened and Estonia continues to levy a LVT. Youngman (2008) and Tiits (2008) attribute this to political and social resistance to such a change.

6.1.2.6 Relationship with SLC's strategic objectives

The Estonian experience shows that LVT can be used as a tool for reform, even with relatively low tax rates. Whilst the objective was to move land from state to private ownership, nevertheless this is a use of LVT with the objective of stimulating a reduction in the concentration of land ownership, one of the SLC's key objectives.

The Estonian government was concerned to ensure that the poorest members of society were able to become landowners, and this partly drove the decision to use LVT rather than including buildings in a combined land and property tax. This resonates with the priority of the SLC to make land use available to a wide cross-section of society.

As with many LVT systems, agricultural land is treated favourably in terms of tax rate. Concern for the diversity and availability of agricultural land is clearly a priority for the SLC. The Estonian system shows that agriculture can be favourably treated; it also provides for a nuanced approach to tax rates, differentiating between types of agricultural use, although this has not hitherto been used in Estonia.

There is anecdotal evidence that the land tax, even though low, has encouraged some property owners to dispose of land which is not in productive use; this is relevant to the SLC's objective of reducing vacant and derelict land.

6.1.3 New Zealand

6.1.3.1 Context

New Zealand was selected as a case study because, like Scotland, it has a productive rural economy as well as strong service-based economy centred on a small number of major urban regions. Both Scotland and New Zealand are highly developed economies with similar governance structures and population demographics. More specifically in terms of property taxation, New Zealand has a long history of LVT, dating back to the late nineteenth century. Yet in recent years there has been a move away from this form of assessment, and this makes New Zealand particularly interesting as a case study.

Following liberal thinkers of the time such as Henry George and John Stuart Mill, the New Zealand Government introduced a land tax (NZLT) in 1878, believing that wealthy landowners had greater taxable ability but low tax burden compared to the working classes who were generating the bulk of government revenue through tariffs (Gupta, 2016). The nationwide NZLT was the first ever direct tax imposed on New Zealanders. A year later, when land values began to fall and landowners argued that it was unfair to tax a group who received no special benefits, the NZLT was repealed in favour of a tax based on capital (improved) values, but it was then reinstated in 1894.

When first enacted the rate was 1p in the £ (0.4%) but a massive £500 minimum threshold applied, exempting most people. Nevertheless, the NZLT was initially a major source of revenue. In 1895 it represented 76% of the total land and income tax revenue received by the government (Barratt and Veal, 2012). It was also claimed that the tax induced the breaking up of large land holdings. But by 1910 the tax raised only 10% of government revenue and by 1967 the figure was 0.5% (Barratt and Veal, 2012). In 1967 the report of the Ross Committee noted that the tax was no longer effective as a means of breaking up large land holdings and recommended its abolition, although this was not acted upon at that time.

There are several reasons for the decline in the significance of NZLT. The introduction of other taxes (and mainly income tax), the introduction of an exemption for agriculture and a minimum value threshold for residential properties, all of which reduced the tax base. Principal residences were removed from the tax base by the *Land Tax Act 1976* so the tax essentially became a business land tax. The tax was also prone to avoidance, evasion and costly appeals.

By 1982 only 5% of total land value was taxed and the nationwide NZLT was thought to be duplicative due to their similarity to local authority general rate levies (Bush, 2003). The McCaw task force of 1985 noted that the nationwide NZLT had no perceptible redistributive effect and was not an adequate indicator of the taxable capacity provided by wealth (Barratt and Veal, 2012). Then, in the late 1980s, commercial land values in Auckland and Wellington rose and then fell sharply, with tax valuations taking place at the peak. This, according to Keall (2000), caused hardship, for example, where a site was undeveloped (partly due to low NZLT hitherto).

Politically, there was an unwillingness to tax capital and a philosophical policy shift away from taxation of unearned increment to the taxation of income (Barratt and Veal, 2012), goods and sales. Even before the fall in commercial land values, the Labour Party planned to reduce the threshold for paying the tax and the Conservatives promised to abolish it. Labour pre-empted the Conservatives' promise and, under an agenda to shift tax away from LVs and towards goods, services and users, the

nationwide NZLT was abolished in 1992. Hopton (2017) suggests the following reasons for the decline and eventual abandonment of the nationwide NZLT:

- privatisation of land;
- power and influence of wealthy landowners, capitalist in nature and naturally resistant to NZLT;
- rising value of land in general and in developing (urbanising) areas in particular;
- introduction of income tax;
- political see-sawing between right and left;
- fluctuation in revenue linked to market movement of LVs; and
- difficulty in valuing land, especially in urban areas where transactions in land and buildings (as opposed to unimproved land) are more prevalent.

6.1.3.2 How the LVT system functions

From 1912 New Zealand had a system of local property taxation (or rates) that ran alongside the nationwide NZLT, and these rates could be assessed on the basis of land value too. Since the abolition of the nationwide NZLT in 1992, land tax only exists at the local level in New Zealand.

Each territorial local authority (TLA)[12] in New Zealand can levy a property tax. They can do this in several ways: general rates, targeted rates and Uniform Annual General Charges (UAGC). Targeted rates are for services identified in a TLA's funding impact statement and for water supply. UAGC are not related to property value. The aggregate of UAGC and targeted rates must be 30% or less of a TLA's total rates revenue.

By 2011, rates provided 60% of local government income[13], the remainder comes from a mix of investment income, fees and charges and central government funding. In total, rates yielded revenue of around 2% GDP (2008) which is in line with the OECD average, but the yield as a percentage of aggregate housing value decreased from 2.2% in 1980 to 0.65% in 2008. Moreover, between 1991 and 2002 aggregate land value increased at 4.8% per annum on average while GDP per capita grew at around 2% per annum over the same period (Barratt and Veal, 2012).

6.1.3.3 Relationship of LVT with other property taxes

There is no property transfer tax (or stamp duty) in New Zealand – this was abolished in 1999. There is very limited application of capital gains tax and there is no inheritance tax.

[12] There are two levels of government in New Zealand: regional councils (11) and territorial authorities (districts (54) and city (12)) plus Auckland Council. One city council, four district councils and Auckland are unitary authorities and have powers of regional councils.

[13] Local Government in New Zealand (www.localcouncils.govt.nz).

In 2010 the Government Tax Working Group proposed a nationwide land tax at a rate of 1%, which was forecast to raise NZ$4.6bn of revenue and cause a 16.7% reduction in land values. This was at a time that followed a big drop in LVs due to the financial crisis in 2008 so the policy was not adopted. Instead the goods and sales tax was increased from 2.5% to 15%, the top personal income tax rate was reduced from 38% to 33% and the corporate income tax rate was reduced from 30% to 28%.

In the six years following 2010 the value of the taxable land base increased by at least 45%. Also, bank lending has been made more rigorous, interest rates have fallen, immigration has increased and there has been a housebuilding shortfall. In 2016 it was estimated that a 1% land tax would raise NZ$6.7bn. Despite this, in 2017, none of the political parties proposed a nationwide land tax.

6.1.3.4 Valuation of land

General rates can be assessed on the basis of unimproved land value, improved capital value or improved annual rental value of each taxable unit. In the early days of local taxation, annual rental value was widely used because the leasing of Crown land provided evidence for their assessment but, as (unimproved and improved) land began to be traded for capital sums, TLAs could, by resolution, switch to improved capital value as a basis for assessment. Then, at the end of the 19th century, unimproved land value was permitted as a basis if a poll of taxpayers voted for it (Keall, 2000). The proportion of TLAs using unimproved land values rose to 64% in 1956 and 76% in 1966 and by 1982 90% of councils had adopted it as a basis for assessing rates, yielding approximately 80% of local government revenue. However, since 1985 there has been a move away from unimproved land value in favour of improved capital value, and this move has been more prevalent in the larger urban areas (McCluskey et al, 2006).

In 1987 the Labour Government let it be known that it favoured improved capital value and a series of politically controversial measures were undertaken by councils to switch from land values to capital values or at least to run capital values alongside land values. There was also greater use of differential rates depending on land use – residential, rural or commercial, together with increasing use of UAGCs (Keall, 2000). Differential rates are often used to prevent over-burdening of any particular group and to reflect different levels of service provision. They reflect '…an acceptance that pure land value alone may not be an equitable or efficient way to distribute the rating burden' (McCluskey et al, 2006, p.386).

The result is that the use of unimproved land value as a basis for rating assessment is now in decline. By 1999, 69% of TLAs used land value as a basis for rates, yielding 40% of local government revenue. By 2002 it was 66% (McCluskey et al, 2006). TLAs in wealthier areas are tending to adopt capital value. The shift away from land value continued in the new millennium and its significance as a basis

of assessment is now much reduced due to exemptions, thresholds and the growing use of charging direct taxes for particular services (Hopton, 2017). When Auckland Council was created by merging seven TLAs in 2002, it elected to assess rates on the basis of capital value. Prior to that, five used land values, one used capital value and one (Auckland City Council) used annual rental value.

In a study of this shift, Kerr et al (2004) showed that there is a statistically significant negative correlation between income level and value of improvements, i.e. land value as a proportion of capital value increases as income increases. They claim that, at a range of scales and across all TLAs and years studied, their results '…strongly suggest that a land tax is more progressive than a capital value tax. For a fixed amount of total revenue to be raised, richer people will pay more tax in a land system because although their land alone is worth less than their land and house, the value of their land is a greater share of the total land value in the TLA' (p.28). This claim relies on a correlation between land value and wealth. If those with larger buildings use more public services then the case for taxes based on capital value is stronger on the grounds of a service tax rather than a wealth tax.

By 2006/7, capital value had become the assessment basis for the majority of TLAs. Four major cities (Auckland, Wellington, Christchurch and Hamilton) all base rates assessment on capital values, while the majority of regional authorities still use land values (Gupta, 2016).

From 1896 until recent years the government's valuation department assessed land values, capital values and annual rental values but in 1999 the role of the department (now a government agency) was reduced to monitoring valuations undertaken by private values under contract to local authorities and to competing with private valuers for such contracts (Keall, 2000). Therefore, local authorities are responsible for rating valuations, and they are commissioned from registered valuers. Revaluations are undertaken at least every three years.

The Valuer-General regulates the rating valuations industry, administers the Valuers Registration Board and ensure the valuation rolls are maintained to minimum standards. Rate payers have a right to object to a rating valuation. The objection triggers a review of the valuation by the registered valuer. Further recourse is then possible by referring the valuation to the Land Valuation Tribunal and then to the courts.

6.1.3.5 Evaluation of LVT

While the tax revenue as a percentage of GDP has remained relatively constant over several decades (approximately 2% of GDP), since the removal of the nationwide NZLT in New Zealand in 1992, local rates represent the only remaining recurrent property tax, providing approximately 60% of local government revenue.

The rates are assessed in two ways; unimproved land values and improved property values, both in capital (as opposed to annual) amounts. Land value is declining in popularity as a basis for assessment, particularly in urban areas. Yet whereas the nationwide NZLT declined slowly due to a combination of competing taxes, exemptions and reliefs, for local rates assessed by reference to land values it was more abrupt, from 1985 onwards (Hopton, 2017). Politics seems to have been the main reason for this: 'On the one hand, LVTs are theoretically attractive, particularly from an economic efficiency perspective, but, on the other hand, they are politically unattractive' (Barratt and Veal, 2012, p.588).

6.1.3.6 Relationship with SLC's strategic objectives

The primary objective of the nationwide NZLT was to raise tax revenue from a sector of society that had hitherto not paid a significant amount of tax, namely wealthy landowners. It was a tax on their store of wealth – land – at a time that predated income and capital gains taxation in New Zealand. Consequently, in its early days towards the end of the nineteenth century, the national NZLT was a major source of tax revenue.

It was also claimed that the national NZLT encouraged the breaking up of large land holdings. This aligns with one of the SLC's long term outcomes for land reform – to reduce concentration of land ownership in Scotland. By the 1960s, however, the national NZLT was raising only a small fraction of total tax revenue and it was no longer regarded as an effective means of breaking up large land holdings. This is likely due to two reasons in particular. First, the low revenue share compared to income and sales taxes, which had been introduced subsequent to the NZLT. Essentially, because the national NZLT was no longer a significant burden on landowners, its ability to influence landowner behaviour was diminished. Second, the exemptions from national NZLT for agricultural land and principal residences meant that it had become little more than a business land tax and most businesses tend not to be large owners or holders of land.

Following the abolition of the national NZLT in the 1990s, local LVTs remain as part of a range of revenue raising options for local authorities. It was not possible, though, to find evidence to suggest that these local LVTs were introduced as a means of instigating land reform along the lines of the SLCs long term outcomes. Indeed, the evidence shows that there is a shift away from local taxation that is based on the value of unimproved land and towards taxation based on the value of improved land instead.

6.1.4 Denmark

6.1.4.1 Context

Denmark has a long established LVT and the country has many similarities with Scotland. Denmark is smaller in size but the populations are very similar. Both countries have highly developed

economies. Denmark is a very open economy and, according to Jacobsen *et al.* (2013, p.792), has one of the 'most compressed income distributions in the world' and, as the country is not rich in natural resources, its wealth is determined largely by human capital. The rate of homeownership at 62.4% is comparable to the UK but the majority of properties in Denmark are privately owned and since 1967 freehold ownership of flats has been allowed, which was one factor that led to an increase in owner-occupation. A peculiarity of Danish residential property is that many Danes, in addition to their main residence, own a summerhouse. Unlike the UK, tax arrangements have been put in place to facilitate this second home arrangement, not penalise it.

In terms of taxation, Denmark has a very high level of personal tax with a top rate of income tax rates standing at 55.8%; corporation tax at 22% and sales tax at 25%. Social security taxes however are low (0% for employers and 8% for employees). More specifically in terms of property taxation, Denmark charges both a recurrent tax and tax on transfer by sale or inheritance and gifts though with a wide range of exemptions.

To understand the context of current land taxes in Denmark it is important to briefly explain both the history of LVT in Denmark and to record some of the administration and tax reforms that have taken place in recent years to simplify what had become a complex situation and which provide a backdrop to tax reforms.

Lefmann and Larsen (2001) claim that Denmark was the first country in Europe to put into practical operation the taxation of land values; they claim that the very notion of a land tax can be traced back to the 12th Century, when it was known as the *Hartkorn Tax.* The *Hartkorn Tax* fell into disuse but not before a system for registering land had been introduced which has led to Denmark having a full cadastral system. The *Hartkorn Tax* was reintroduced in the 19th century and only finally abandoned in 1902 when a land tax was introduced. This newer land tax, known as *Grundskyld*, owes its form and origins to the introduction of Georgist thinking in the beginning of the 20th century (Vickers, 2009). To Silagi and Faulkner (1994), the impact of Georgism in Denmark is unique, as the principles were already so embedded in popular thinking. Throughout their detailed history of land taxes in Denmark, Lefmann and Larsen trace the close inter-action between political opinion and the success (or otherwise) of tax reforms. They claim that Denmark was 'the first country in the world that had a political party of national influence whose chief aim was to make land value the principal and, if possible, the only source of tax revenue in the country' (Lefmann and Larsen, 2001, p.185).

Although LVT had the backing of all major political parties throughout the 20th century, based on economic grounds and social propensity, it had fallen back in terms of ambition by the beginning of the 21st century. This was the result of a tax shift towards land and property *usage* rather than

ownership, although land tax still remains an integral part of the tax base and property tax continues to fall on the owner, not the occupier. Andelson (2000, p.xxxvii) argues the reduction in influence of land tax may be related to a lack of education 'technical or moral' among the administration, not for economic or social reasons or because tax was deemed a failure. However the overall shift towards indirect and service based taxes was also a driver and saw the introduction of other property taxes notably the *Daekningafgift* for commercial property and the (*Ejendomsvaerdiskat*) for domestic. These are discussed below.

In terms of administration, in the past Denmark had a three tier system, with central government, 24 counties and a plethora of small municipalities. Reforms took place in 1970 to reduce the number of municipalities from almost 1,400 to 275 and the number of counties was halved from 24 to 12. In 2007, counties were replaced by five regions and the number of municipalities was reduced to 98. Importantly for consideration of taxes, only the central government and municipalities have tax raising powers; the regions are primarily funded by grants. One of the aims of these reforms was to provide for an increase of power and funding for the municipal level and to re-distribute tasks and tax raising powers accordingly (Mangioni, 2016). It was only after these territorial administrative and finance reforms that reform of property taxes began and is still proceeding (Lindegaard, 2018b). The sequence of these reforms was, according to Mangioni (2016, p.290) 'exemplary' as it provided a firm platform for 'meaningful' land tax reform.

Another aim of the review was to assist in making Denmark's economy to be more competitive, for, as Jacobsen *et al* (2013, p.792) argue, it 'is under fierce competitive pressure from the rest of the world, not least its European neighbors'. Denmark is noted for having a high level of income taxation, which, though reduced, continues to be high in comparison with other OECD countries. It is estimated to be the 16th highest in the OECD, representing 2% of GDP and 4% of revenues (Lindegaard, 2018a); a figure which Ganghof (2007) estimate exceeds that of the United States.

Denmark is also characterised by high charges on services (through Value Added Tax) but traditionally has lower rates of tax on property (Mangioni, 2016). Reducing the tax base – or rather rebasing from revenue to capital based taxes – has been seen as a way to improve economic efficiency and competitiveness.

In terms of the contribution to government revenues, Milan *et al.* (2016) in their evaluation of contributions across Europe of land taxes, Denmark represents the best practice. According to Muller (in correspondence with the authors), revenue from the 'true' property taxes in 2015 was 1.4% of GDP, 3% of total tax take and 11% of local taxation on average, with the land tax being the

largest contributor. This supports the notion that land and property taxes are low in Denmark compared to income and indirect tax (VAT).

6.1.4.2 How the LVT system functions

The land tax (*Grundskyld*) was introduced in its current form in 1926 (Almy, 2014) but the assessment process is currently under review, both in terms of how land values are assessed and potentially, as part of a wider review of tax measures. It is therefore important to consider the information below as likely to change.

In the past revaluations were undertaken every four years, but are currently every two years, with domestic properties are valued one year and commercial and mixed use the next. The tax has not been without criticism. A report by Rigsvision in 2013[14] concluded that SKAT[15] had not paid sufficient attention to certain aspects of valuations, or in some cases skipping parts entirely. Further it concluded that estimates were wrong in three out of four assessments, leading to uncertainty for home owners. Whilst this was directed towards residential property the result has been a delay placed on the revaluation process whilst a review has been undertaken (Lindegaard, 2018a). By 2017 this review had resulted in legislation to establish better data capture systems using an automated valuation system (Lindegaard, 2018a). In 2018 data for residential units is being collected and analysed and other property (forestry, agricultural, commercial and recreational) will follow in 2019.

Under the new system, which is intended to be revenue neutral, residential valuations are undertaken on a site by site basis but making use of a range of data points, as set out below. The valuations are undertaken by a team of case officers from SKAT and tax is collected by municipalities.

Under the current system, Land Tax is charged on all land and buildings, including agricultural property and assets owned by central or local government, but with some exemptions and reliefs (Muller, 2005). The exemptions are because:

- *The property does not fall to be valued*; these include churches, cemeteries, roads and parks; lighthouses, port installations and similar structures.
- *The property must be exempted;* these include castles and royal residences, embassies and consulates, preserved buildings and community centres.

[14] http://cphpost.dk/news/politics/inaccurate-property-evaluations-may-have-cost-homeowners-millions.html
[15] The Danish National Auditors' Office.

- *The property may be exempted at the discretion of the municipality;* these include schools, hospitals, sports facilities, libraries, district heating plants and properties used for charitable purposes.

Agricultural and forestry land and public buildings pay a reduced rate of Land Tax and people over the age of 65 may defer the Land Tax on one owner-occupied dwelling and summer house until sale or death. Such deferment is registered as a first charge on the land.

Critical to any consideration of Land Value Tax is the planning system. Denmark uses land value maps and operates a strict land use planning regime and utilises land use zoning to a very local level (Vickers; 2009; Lindegaard, 2018a). This means that the highest and best use of land can be taken from the permitted use registers. For historical reasons dating back to the *Hartkorn Tax,* Denmark has detailed records of land use, and to this a permitted use system has been added over the 20th century. Denmark also has full cadastral system.

6.1.4.3 Relationship of LVT with other property taxes

According to Almy (2014) in addition to the Land Tax, Denmark has two other property taxes: a (1961) commercial building tax (*Daekningafgift*) (1961) and a residential real property tax (*Ejendomsvaerdiskat*) (2000), as shown in Table 2.

Table 2: Land and property taxes in Denmark

	Land Tax	**Service Tax**	**Property Value Tax**
Name	*Grundskyld*	*Daekingsafgift*	*Ejendomsvaerdiskat*
Introduced	1926	1961	2000
Coverage	All land with some exemptions in terms of tax paid	Commercial, administration and manufacturing buildings	Owner-occupied dwellings and summerhouses
Basis of Tax	Capital Value of the land	Capital value of the buildings only	Capital value of the property
Taxpayer	Owner	Owner	Owner
Tax beneficiary	Municipalities and Counties (via grant)	Municipalities and Counties (via grant	Municipalities and Counties (via grant

Source: adapted from Mangioni (2016)

This table shows how the role of the Land tax has been eroded over time from being the single property tax to one of three, albeit that the tax take from the *Grundskyld* is still above that from the other taxes. The Property Value Tax, according to Lindegaard (2018b) 'is regarded as an investment tax, to make sure that investment income on properties are not better than financial yields, which are taxed'. Originally this was collected centrally through a withholding tax (Almy, 2001) but this is no longer the case.

In addition to the payment of the three property-related recurrent taxes, property gains and transfer are also charged. Further, when land or property is gifted or passed through inheritance, tax is charged, based on the recipient beneficiary's self-declaration, as long as that is within a set percentage of the recorded assessed value. And when land is sold Stamp Duty is payable based on the higher of the assessed value or the transaction price. Any capital gain to the vendor is charged through the income tax system. A re-zoning tax (*frigørelesafgift*) is payable when rural land is re-zoned as urban. In effect this is a development tax, but payable at the point of change of permitted use – not the point of development.

6.1.4.4 Valuation of land

All Denmark's property taxes, including the Land Tax, are based on capital values (Almy, 2014). The capital value is a cadastral or assessed value that is also used for purposes additional to land tax, such as mortgage applications. Responsibility for undertaking valuations lies with the Ministry of Finance through their agency, SKAT.

Data is usually obtained via self-reporting for use within its computerised mass appraisal system, regarded as one of the most modern in the world and the most transparent in terms of public access to data (Almy, 2014). However, although Denmark has been regarded by some as a 'frontrunner' in terms of its data systems, or possibly because, Denmark is working towards a new system for collection and assessment of data (Lindegaard, 2018a). However the basic principle is unchanged; the Land Tax is based on the market value of the land without any buildings but with any connected services. Market value is defined by Muller (2005) as an average cash payment a sensible buyer would pay. This does not quite equate to the international definition of Market Value as it is an average – not best price – but it is obtained by use of market evidence, though augmented through use of computerised techniques. It also assumes that land is put to its best economic use.

Denmark was an early adopter of computerisation for its land value records, having commenced the process in 1960 (Muller, 2005) and computer-assisted mass appraisal has been used for many years. A key element in establishing value is the Property Use Code. This is an allocated use (out of approximately 40 different uses) and may not necessarily accord to the actual use of the property, which is shown by a Building Use Code. But for the purposes of taxation it is the Property Use Code that is important and ensures that the highest economic use of the asset forms the base line for tax.

Under the newly developed system for residential property there is a four-step process:

- **Step 1:** collect and index six years of market transaction data. Data is collected is from cadastral records, GIS data (which will be made available to the public), building and site

data (including size, shape, slope proximity to facilities and amenities such as coast and open space).

- **Step 2:** find neighbours and calculate an average neighbourhood price based on local sales and own-sales.
- **Step 3:** correct for property-specific features including age, size and construction.
- **Step 4:** value individual land plots.

This technical approach is aimed at providing a transparent result. It is recognised that there are still issues regarding the quality of some data.

There is an appeal system against valuations but since the introduction of regular re-valuations the number of appeals has fallen significantly. All appeals much be lodged within three months of the assessment.

6.1.4.5 Evaluation of LVT

Denmark has often been regarded as an exemplar in terms of LVT. It is longstanding having been consistently in place since 1926 and with forerunners dating back to the middle ages. It has thus been argued to be deeply embedded in the structure of Denmark's tax system (Silagi and Faulkner, 1994). Three factors, other than the historical context, arguably have helped to ensure the longevity of LVT in Denmark. These are: good property records and a strong cadastral system which has provided a firm basis of knowledge both of property details and of ownerships; a tradition of high taxation (but compared with income taxes and indirect taxes such as VAT, the level of tax on land ownership is comparatively low); and the political landscape has been benign towards it.

However, as Mangioni (2016) argues, LVT has been eroded in this century by the imposition of other property taxes. Other factors too have put LVT under pressure. The desire to improve international economic competitiveness is resulting in a desire to reduce income tax. In turn this makes property taxes in general more burdensome by comparison and draws attention to the tax. This may have been part of the reason behind the decision to examine the efficacy of property taxes in 2013: a review which was damning towards SKAT and the accuracy of their work, resulting in a far ranging review of the methodology behind property tax assessments.

This review of method is expensive in terms of manpower for data collection analysis and interpretation, but the development of more sophisticated IT platforms points to high level commitment to remain at the forefront of property value assessment. Yet it remains to be seen whether the approach of starting with property values and separating out land value for a land tax will be maintained. The key may well lie in the political will to ensure that sufficient trained resource is devoted to ensuring the robustness and currency of the assessments.

6.1.4.6 Relationship with SLC's strategic objectives

The longevity of Denmark's land tax lies in political will, good cadastral systems and, possibly, their pro-activity in adopting mass appraisal valuation techniques. These underscore that, should such a tax be introduced in Scotland, investment will be required to ensure that the administrative and valuation issues can be addressed. Furthermore, the planning system in Denmark, based on zoning, lends itself to less contentious planning assumptions. In terms of whether Denmark provides evidence that LVT would help achieve the SLC's objectives, it is hard to say given that it has been in existence for so long. However, some of the characteristics of desired objectives of the SLC are discernible within Denmark's housing supply and land tenure patterns .

Research on comparative tax for the Joseph Rowntree Foundation (Oxley and Haffner, 2010) concluded that the land tax in Denmark does contribute positively to lower house price volatility and greater housing market stability than in some other countries, notably the UK, and could therefore be argued to contribute to the objective of stable housing land supply. However, as they point out, the presence of other taxes and subsidies makes it hard to isolate the specific impact of land tax. Further the tax 'freeze' that has been in place for some years and which reduced the effective rate of land tax has weakened the housing market stabilising impact of the land tax (Pedersen and Isaksen, 2015), perhaps providing further evidence that an effective land tax does indeed aid stability.

In terms of reducing the quantum of vacant and derelict land, the presence of a cadastral system aligned to the land tax system does ensure that there is transparent picture of land ownership which arguably enhances the potential of effectively taxing vacant land with the intention of reducing the amount of it, although there is no firm evidence from Denmark that the land tax has had this effect.

Finally, in relation to changes in the concentration of land ownership, the examination of land tax does not shed much light on the current position, as it has been a factor in the Danish system for so long. Perhaps of greater importance is the Danish experience in respect of agrarian reforms. According to Jespersen (2011), a single set of reforms in the 1780s saw a shift from ownership of agricultural land concentrated in only a few hundred people to a position some 25 years later in which over 60,000 tenant farmers had become land owners. Such reforms were not a result of taxation change, for a land tax was already in place, but political will. Even today, there is a continuing programme to help agricultural tenants become landowners through a system of subsidies and tax benefits to enable land purchase by tenants which has resulted in Denmark having one of the lowest percentages of leased farmland in the EU- estimated at 27% against an EU average of 53% and UK of 43% (Haerling, 2016 quoting Swinnen and Knops, 2013).

In conclusion, the tax system in general in Denmark has acted as a tool to enable the more widely dispersed ownership of agricultural land, but it has also taken political will and a long cultural tradition.

6.1.5 South Africa

6.1.5.1 Context

South Africa has a long history of recurrent property taxation. Property tax was first introduced in the Cape of Good Hope colony in 1836 (Franzsen, 1996). After the establishment of the Union of South Africa in 1910, ratings were charged and collected by local municipalities and this remains the case today.

Most municipal ratings were based on improved capital value. However, in 1914 the Labour Party took control of the Province of Transvaal and passed the Transvaal Ordinance No. 1 of 1916 which allowed for 'site rating' (i.e. rating based on the value of land without improvements). This Ordinance acted as the model for the rest of the country. By 1955, 20 of the 60 major municipalities in Transvaal had adopted site rating, increasing to 100% of the major municipalities by 1979. The use of site rating spread across the rest of then-Republic of South Africa (RSA), so that by 1984 60 of the 125 largest municipalities had adopted it, accounting for 70% of the total value of rating in the Republic (Dunkley, 2000).

However, site value has been just one of three possible approaches to rating available to municipalities. Up until the introduction of the provisions of the *Local Government: Municipal Property Rates Act 6 of 2004* (MPRA), property taxes in South Africa were levied and collected under the terms of four provincial ordinances from the previous constitution, under which municipalities generally had the option to select one of three rating systems:

- a site rating system (i.e. taxing only the land, excluding improvements – a 'pure' land value tax);
- a flat rating system (i.e. taxing the improved value of the land); or
- a composite rating system (i.e. taxing both the land and the improvements, but at separate tax rates).

After 1994 a programme of local government reform was introduced. By this time, the use of the three rating systems had become generally evenly spread amongst municipalities throughout the country. However, the new constitutional and institutional dispensation necessitated an overhaul of the various former provincial property tax systems (Franzsen, 1996; Franzsen and McCluskey, 2000; McCluskey and Franzsen, 2004). A government White Paper (1998) proposed changes to the manner

in which local government was to be financed, citing certain features of the property rates dispensation that required reform.

An important policy decision flowing from this was to abolish the three rating options and to introduce a single uniform system of property tax for the whole country. Property tax in South Africa is now levied on owners of immovable property based on the market value of land and buildings, i.e. improved capital value. South Africa, therefore, no longer has a LVT.

The rating of property is also no longer confined to property in urban areas, as was the case under the 'three rating system'. The law now extends to taxation of properties in formerly untaxed rural areas that now form part of local municipalities. This means that commercial farms and, in principle, subsistence farms and residential properties in informal settlements in rural areas, are taxable. According to Dunkley (2000, p.308), this caused farming communities great upset as most of them had never paid rates and believed that they would receive 'little of value in return'.

6.1.5.2 How the LVT system functioned

Prior to the MPRA and the subsequent abolition of 'site rating', in the mid-1990s the use of the three rating systems was fairly evenly spread across the country, with approximately 34% of pre-1994 municipalities having adopted site rating, 27% flat rating and 39% composite rating (Bell and Bowman, 2002). By 2004, the precise numbers of the three systems was not known, but they were all used in 'meaningful numbers' (Franzsen, 2005, p.156).

Legislation ensured that municipal valuers valued the land, improvements and the total value of each rateable property separately, and then the municipal council chose a method of assessment for rating purposes. The choice was, therefore, a political decision rather than a technical valuer's decision. Only valuers registered with the South African Council for the Property Valuers Profession could be appointed as municipal valuers, which remains the case today.

Provincial laws in South Africa had previously sought to ensure that each rateable property had to be physically inspected by the valuer. However, thanks to a change in the legislation introduced in 2000, physical inspection of the property is now optional, and it is it is now possible to utilise computer assisted mass appraisal systems and techniques.

Under the MPRA, revaluations are currently undertaken on one to five year cycles depending on whether the municipality is urban or non-urban (Franzsen, 2017). Valuation cycles under the pre-MPRA system varied.

There was marked growth in the total amount raised through the property tax in the years leading up to the introduction of the MPRA. For the six metropolitan municipalities the R8.9 billion in

property tax represented 22.4% of the total operating income. At R12.5 billion, or 19.4% of total operating income, for all 284 municipalities, property tax was an important source of own revenue for municipalities (Franzsen, 2005).

The MPRA extended rating to communal land and agricultural properties but has carried forward many of the exemptions from the previous tax base. Current exemptions include:

- At least the first ZAR 15,000 of the market value of a residential property.
- Full exemption for certain types of public service infrastructure and a discount for taxable public service infrastructure.
- Coastline and offshore islands.
- Mineral rights.
- Property used primarily as a place of public worship.
- Parts of national parks, nature reserves, and botanical gardens.

Also, relief is granted by municipalities on the basis of age or disability and the taxpayer's income (Franzsen, 2017). According to Franzsen (2017, p. 392), under the MPRA system collection levels are generally over 90%, although 'across all municipalities, arrears are increasing at an alarming rate'.

6.1.5.3 Relationship with other property taxes

In addition to the municipal property tax, there are currently the following main property-related taxes which are administered by the Commissioner for the South African Revenue Service (SARS):

- Donations Tax;
- Capital Gains Tax;
- Transfer Duty;
- Estate Duty.

Income tax is the main source of the government's income and is levied on the taxable income of persons such as companies, trusts and natural persons (South African Revenue Service, 2017).

6.1.5.4 Valuation of land

The basis of valuation for rating purposes in South Africa is market value. Municipal valuers can choose between a number of accepted valuation methodologies, the choice of which largely depends on the quality and quantity of comparable transaction evidence available (Franzsen, 2005). The methods used under the 'three-rating' system were: comparison method; income capitalisation method; rentals; and residual method.

The comparison method was generally preferred, with the alternatives used when there was insufficient evidence of comparable transactions on which to base a valuation. In the past, when

sites were being valued in their unimproved state, valuations were unproblematic when there was an ample supply of comparable un-developed land transactions in the local market. However, in highly developed inner city areas, evidence of sales of land without improvements was in short supply which made valuing based in 'site value' challenging. In such circumstances, valuers would resort to using sales evidence from adjacent neighbourhoods.

6.1.5.5 Evaluation of LVT

The South African government removed the 'three rating system' through the provisions of the MPRA. This resulted in the abolition of a 'pure' land value tax in the country (i.e. the 'site rating' system). The South African government wished to introduce a single, standardised approach to property taxation to be used by all municipalities, based on the principles of certainty, uniformity, equity and simplicity (Franzsen, 2017). At the same time, the government adjusted municipal boundaries (and, therefore, the tax base) to include formerly untaxed rural land.

The objective appears to have been to bring more land in to the tax base, and to ensure that all municipalities adopted a standardised approach to taxing land. Although the taxation of land without improvements ('site rating') had been widely used by municipalities prior to the MPRA, it was dropped in favour of adopting capital improved value as the single uniform rating system in the country.

The literature is not entirely clear regarding why the South African government opted to abolish site rating as the system had been functioning well in the country and had been widely used. A range of options had been considered during the preparation of the MPRA, including retaining site rating as the single uniform property tax. However, the South African Institute of Valuers, representing the profession in South Africa, officially supported capital improved values as the preferred rating approach at the time of the MPRA reforms, citing lack of public understanding of a land value system, as well as the lack of vacant sales within urban areas as primary reasons.

Further reasons cited in a non-statistically representative survey of South African valuers conducted by McCluskey and Franzsen (2004) include that with capital improved values the valuation roll provides useful data on all improvements and other new developments, capital values provide a more buoyant revenue base than land only and can achieve a better distribution of the tax burden. In addition, it was argued that capital improved value reflected ability to pay rates more appropriately. Furthermore, the advantage of a tax based on capital improved value is that it allows for lower nominal tax rates in comparison with a tax based on land without improvements, thus making it more politically palatable (Mcluskey and Franzsen, 2005).

Dunkley (2000, p.310) reflected that rating based on land without improvements had many beneficiaries in South Africa, but few of them 'understand or are even aware of it' and were therefore not in a position to oppose its abolition. However, McCluskey and Franzsen (2004, p.41) also report that at the time of the MPRA reforms, 'certain interest groups argue[d] against the taxation of improvements, claiming that it would stifle development or even result in the demolition of existing improvements (e.g. farm labourer dwellings)'. They therefore concluded that 'South Africa's property tax reforms are not primarily driven by valuation considerations, but rather by socio-political considerations' (McCluskey and Franzsen, 2004, p.41).

6.1.5.6 Relationship with SLC's strategic objectives

Despite having had some form of 'pure' land taxation in place since 1916, the South African government opted to abolish taxation of the value of unimproved land in 2004. South Africa now no longer has a 'pure' land tax, with the taxation of land being on 'market value', comprising land and buildings as one composite value. The reasons for the South African government's decision not to continue with the option of a 'pure' land tax are not entirely clear, but issues relating to the technical difficulty of valuing land without improvements in the context of scarce comparable transactions evidence are considered to have been a factor, as well as the lack of public understanding of a land value system.

This points to the essential importance of ensuring that there is a comprehensive programme of public education should a form of LVT be introduced in Scotland (or, indeed, should there be any changes to the existing LPT regime) so that it is clear to the taxpayer why the changes are being introduced, and what the desired outcomes will be. This links to the necessity of being clear with the taxpayer whether any change to the LPT regime (including any introduction of LVT) is primarily aimed at raising revenue for local services, or is aimed at taxing wealth, or indeed is aimed at delivering one or more of the SLC's strategic objectives and/or long-term outcomes.

The South Africa case study is also a salient reminder that the valuation difficulties which can arise from a 'pure' LVT are very real and may even have the potential to sow the seeds for a later rejection of LVT on the basis of a lack of transparency around how land is valued and, therefore, taxed. However, as other case studies have shown, these problems are not insurmountable, particularly where there are good levels of popular understanding regarding what LVT is and what it is supposed to achieve.

6.1.6 Land tax in Namibia

Although not covered as a full case study, the introduction of a land tax on commercial farmland in Namibia is worth summarising given its potential synergies with the SLC's strategic objectives. This

tax was introduced in 2004 as part of the post-independence land reform agenda, given the preponderance of white-ownership of commercial agricultural land. Namibia had been a German colony and was administered by South Africa from 1917 – 1990 and gained its independence in 1990 after a protracted military campaign.

After independence, the government sought to create the policy, legal and institutional frameworks necessary to deliver land reform. As part of this, a government Ministry was established which had responsibility for land acquisition and resettlement and the acquisition and redistribution of agricultural land to previously disadvantaged Namibians. As part of this agenda, a tax on commercial agricultural land was introduced in 2004 under the provisions of *Agricultural (Commercial) Land Reform Second Amendment Act No. 2* of 2001, with the objectives of equitable land distribution, enhancement of productivity of commercial agricultural land, curbing speculative holding of land and revenue generation for land acquisition to be spent through the Land Acquisition Development Fund.

The land tax is levied on commercial agricultural land based on its unimproved site value. The revenue which is raised from this tax is allocated to land reform objectives. According to Franzsen and McCluskey (2017) the valuer must consider the carrying capacity of the land (as supplied by the Ministry of Agriculture, Water, and Forestry at the date of valuation), and must disregard the following:

- the value of the improvements on such land;
- any depreciation in the value of such land caused by excessive grazing, bush encroachment, and other bad farming practices on, or poor management of, such land;
- any mortgage or other judicial encumbrance on such land;
- any appreciation of the land value attributed to proximity to a town;
- any appreciation of the land value attributed to tourism or mining potential; and
- any depreciation or appreciation of the land value resulting from a public road or railway line crossing through the land.

The tax rate has been designed so as to seek to discourage ownership of multiple farms. It therefore increases based on the number of properties owned. A Namibian national owning a single farm is taxed at a tax rate of 0.75% (1.75% for foreign nationals). The rate increases by 0.25% for each additional farm owned. The property with the highest value is listed first and taxed at the lowest applicable rate (e.g. 0.75%). The second highest valued property is listed second and is taxed at the next rate (1.0%), and so on for all properties (UN, 2011).

The valuation roll is valid for five years. As at 2015 there had been three rounds of revaluations. The 2002[16] and 2007 valuation rolls had objection rates of 2.8% and 1.7% respectively. This increased significantly to 21.1% for the 2012 roll. Of the 2,584 objections submitted for the 2012 roll, 1,159 objections (45%) related to the valuation. According to Franzsen and McCluskey (2017), the main driver for this increase in objections was that when the provisional 2012 roll was published, farm values had increased significantly since 2007, thereby changing the tax liability for landowners.

According to Franzsen and McCluskey (2017, p.322), the introduction of the land tax in Namibia 'can generally be described as a success'. This success is partly due to the sensitivity with which the issue was handled by the government – the tax was only introduced after extensive consultation with key stakeholders, which succeeded in securing their general agreement. The Namibia Agricultural Union which represents white farmers ended up supporting the introduction of the land tax. This was achieved by the government developing a participatory, consultative and inclusive process through organising meetings and developing a public information campaign through print and electronic media. The public information campaign continued throughout the process from data collection to the valuation court appeals. Since its inception, the land tax has yielded average annual revenue of N$40 million Namibian Dollars and continues to be a significant revenue source to the benefit of the government's Land Acquisition and Development Fund (UN, 2011).

According to the UN (2011), some key lessons which can be learned through Namibia's experience of introducing the land tax are:

- introduction and imposition of land tax requires commitment and strong political will;
- the introduction of a land tax requires inclusive consultation of stakeholders coupled with a dedicated information campaign in order to create the required support;
- appropriate policy, legal and institutional frameworks need to be put in place to support the technical aspects of a land tax;
- valuation and land tax administration institutions need to be properly resourced in order to provide the appropriate technical leadership;
- valuation and taxation processes should be transparent and clearly define the destination of tax collected;
- efficient land administration systems (including cadastral, registration and valuation) facilitate the updating and production of valuation rolls;

[16] The 2004 introduction of the land tax was based on a 2002 valuation roll.

- a land tax regime like any other tax in a democratic society, must provide tax payers an opportunity to appeal against the valuation in a tribunal that allows parties to represent themselves without the exorbitant fees of litigation lawyers; and
- land taxes can be a reliable source of revenue to support land reform and land administration processes.

6.1.6.1 Relationship with SLC's strategic objectives

This case has obvious parallels with the Scottish context and the strategic priorities of the SLC, in that a land tax was introduced in the interests of land reform rather than simply to raise tax revenue. Interestingly, the revenue from this land tax goes towards funding the acquisition of further agricultural land for resettlement, a partial parallel with the Scottish Land Fund, although there are of course significant differences in the historical context which has given rise to the land reform agenda in Namibia compared with Scotland. For example, there is not the same potent mix of colonial history and racial politics at play in Scotland as there has been in Namibia, where these factors could arguably have contributed to the development of the degree of public consensus necessary to support the introduction of the land tax.

Nevertheless, the key contribution of this case study is that it firmly points to the essential importance of securing political support, and support from all key stakeholders, not least potentially powerful parties who stand to have their tax liability increased by such a change.

6.1.7 Summary

In summary, the following points can be drawn out from the five case studies:

- The importance of LVT is dependent on the tax rates levied and the range of exemptions and reliefs that are offered: there is no 'fixed rule'.
- While a uniform tax rate is simple and, on the face of it, equitable, differential tax rates are common. Different rates are usually assigned on the basis of land use.
- Where a land tax exists it does so in combination with other land and property taxes. These might be taxes administered at different levels of government (state and municipality for example) or they might be other forms of tax such as stamp duty or capital gains tax (New Zealand was the only case study where these other forms of tax were not present).
- The basis of assessment was almost without exception capital value (rather than annual rental value).
- Regular revaluations are regarded as important, especially for urban land and property where values are high, more variable and more volatile. But revaluations are not always evident, particularly in rural areas. This is because valuations comprise a significant

proportion of the administrative cost, so the frequency of any valuations needs to be carefully considered.

- Exemptions are widespread but it is not a foregone conclusion that agricultural land is exempt from land tax – some jurisdictions do tax agricultural land.
- There was little evidence from most of the case studies that LVT has any perceptible redistributive effect, helps with breaking up large estates, or with bringing under-utilised land in to beneficial use, although it was claimed that in Estonia it had encouraged owners to dispose of land not in productive use.
- However, the possible exception to this is the introduction of land tax on commercial agricultural farms in Namibia which is regarded as a success due to the extent of popular and political support and the amount of revenue it has raised to fund the acquisition of land for resettlement. This does point to the potential for a LVT to deliver similar outcomes in Scotland.
- When the tax is established as a service tax (as opposed to a wealth tax), it is important for tax payers to see the relationship between the tax and services provided.
- Where jurisdictions have moved away from 'pure' land tax, the reasons seem to be both political and technical – a tax on the combined value of land and improvements is easier to administer, to understand, and to communicate to the taxpayer.
- The technical difficulty of how to value unimproved land, while not insurmountable, is considerable and prone to generating confusion and a lack of transparency.
- Political consensus is essential, as is the public's understanding of the tax itself.

Table 3: Summary of the full case study LVT systems

	Queensland, Australia	Estonia	New Zealand	Denmark	South Africa (under old 'three-rating' system)
Taxation Rate	State Land Tax - See Appendix V Council Rates - Variable	0.1-2.5% 0.1-2% agriculture	Varies	Variable between 1.6% and 3.4%, with a fixed 1% going to the County; the remainder set by and for the municipality.	Varied - determined locally
Method(s) of Assessment	Capital value of unimproved land	Capital value of unimproved land	Capital value of (unimproved) land Capital value of (improved) property Annual rental value of (improved) property	Capital value of land on assumption of 'standard development' (Currently under review)	Varied – but one of the three rating options was capital value of unimproved land
Frequency of Revaluation	Annual	Last revaluation was in 2000, no proposed date for next revaluation.	At least three-yearly	Two-yearly, but frozen since 2011; a new process of assessment is being introduced in 2018-19	Varied (currently can be 1 – 5 years)
Valuation Geography	Units of property	Zonal by land use	Units of property	Units of property- but special rules to cover flatted developments	Units of property
Valuation administration	Valuer General, Department for Natural Resources, Mines and Energy	National Land Board	Local authorities	SKAT (a Ministry of Finance Agency)	Municipalities
Tax Setting Authority	State Land Tax - Office of State Revenue Council Rates - Local government	Local government	Local authorities	Municipalities set the land tax rate within boundaries; Central government set the Land Property Tax	Municipalities
Tax Collecting Authority	State Land Tax - Office of State Revenue Council Rates - Local	National Tax Board	Local authorities	Municipality	Municipalities

	Queensland, Australia	Estonia	New Zealand	Denmark	South Africa (under old 'three-rating' system)
	government				
Average Annual Revenue Raised (total)	State Land Tax: $1082m Council Rates: $3675m (2016/17)	58.4m euros (2016)	NZ$5,389m (2015)	Krone 28,436m (2016)[17]	R14.3bn - rates on property (2003/04)
Average Annual Revenue Raised (as % of total tax revenue)	State Land Tax: 6.5% Council Rates: 22% (2016/17)	0.7% (2016)	60% (approx.) of local government revenue (2015)	11% (approx.) of local government revenue (2016)	19.61% - rates on property (2003/04)

[17] Figures extracted from OECD statistics 9https://stats.oecd.org/Index.aspx?DataSetCode=REVDNK)

7 Consultation interviews

As part of the research project, the Research Team undertook a number of consultations with stakeholders in Scotland. The list of consultees is detailed in Table 4. One consultee agreed to participate on the condition that neither they nor the organisation they represent are named. In addition, the Valuation Office Agency and the Chartered Institute of Public Finance and Accountancy were contacted but did not respond.

Table 4: List of consultation interviewees

#	Consultee
1	Scottish Land and Estates
2	Homes for Scotland
3	Scottish Federation of Housing Associations
4	Federation of Small Businesses Scotland
5	Royal Town Planning Institute Scotland
6	Royal Institution of Chartered Surveyors
7	Glasgow City Council
8	Scottish Government Department
9	Registers of Scotland
10	Community Land Scotland
11	Shelter Scotland
12	Anonymous consultee
13	National Farmers' Union of Scotland

The following key points emerged from the consultations:

- With some exceptions, there is generally a low level of engagement with the specific issue of land value taxation among the consultees, although most of the consultees have been involved in land reform / tax reform / land value capture issues in the past.
- Overall there was recognition that a LVT would require a programme of communication and education for it to be accepted.
- There is considered to be a generally low level of public understanding around land value taxation – so this would need to be carefully managed should LVT be introduced.
- Some consultees expressed the need for further research to be done regarding land value taxation and how it may work within the Scottish context. It was therefore difficult for some consultees to express firm views given the lack of information regarding these points.
- Common aspirations expressed by consultees include:
    - the potential for LVT to incentivise land being brought forward for development (including dis-incentivising land banking);

  - the potential for LVT to incentivise vacant and derelict land specifically being brought forward for development (this was seen as particularly important in an urban context);
  - the potential for LVT to help create a less concentrated and more diverse housebuilding industry with more smaller builders and self-builders;
  - the potential for LVT to help reduce land speculation and, therefore, to reduce land prices and property prices (including making housing more affordable);
  - the potential for LVT to help reduce barriers to development, particularly of affordable housing;
  - the need for LVT to fall across all land categories, including agricultural land;
  - the potential for LVT to help raise revenues to be reinvested in housing stock and the delivery of infrastructure.
- Common concerns expressed by consultees include:
  - technical difficulty in valuing the land without improvements - whilst some did not see this as insurmountable there was an identified need to resource this adequately;
  - lack of quality and easily-accessible information regarding who owns land;
  - the potential for LVT to increase the tax liabilities of certain groups (asset rich/cash poor, community landowners, small businesses, residential landowners, local authorities seeking to deliver affordable housing, housing associations);
  - the potential for LVT to act as a disincentive to invest in Scotland;
  - the potential for LVT to act as a disincentive to purchase land and develop it, particularly in the case of long-term development projects where LVT could increase the cost of holding land while it is being developed;
  - the potential burden that LVT could place on under resourced planning departments who would need to be involved in establishing the highest and best use of land;
  - the potential for LVT to be politically divisive;
  - the risk of unintended consequences of LVT being introduced to try and influence behaviours.
- Some consultees expressed the need for the relationship between the planning system and LVT to be carefully thought through. It would be important to be clear about when LVT liability is triggered. If it is too early in the planning process (e.g. allocation, in principle permission), then this could create an unfair liability on landowners who might still have a legitimately long time to wait before development could actually be delivered.

- Some consultees suggested an easier approach to land tax reform would be to improve existing systems of council tax and non-domestic rates rather than go through the risk, expense and uncertainty of introducing an entirely new tax with lots of new valuation issues.
- It was unclear to some consultees how LVT could help deliver a more diverse pattern of land ownership.
- There was debate as to whether LVT should be a replacement or an additional tax. There was a view that it should be a replacement tax so as not to raise concerns about potentially increasing the tax burden and the administration in dealing with yet another tax. There were mixed views as to how far the replacement could spread (i.e. whether to include transfer tax for example).
- There were concerns raised over the extent to which the Scottish Government would have the necessary powers under devolution to introduce a land value tax and/or replace other taxes with land value tax. This would need further consideration.

8 Policy issues and options

A key purpose of this report is to propose policy options for the SLC should it choose to further explore the potential of a LVT in Scotland. We have identified four options, influenced by the following factors:

- the findings from the literature review and case studies;
- the findings from the consultation interviews with stakeholders;
- advice from an expert panel held on 21 May 2018;
- the Scottish Land Commission's objectives in relation to land reform in Scotland.

It is worth recapping at this stage the SLC's three strategic objectives:

- *productivity* – so as to increase the economic, social and cultural value of Scotland's land;
- *diversity* – so as to encourage a more diverse pattern of land ownership that spreads the benefits of land more inclusively; and
- *accountability* – so as to ensure that decision-making takes account of those affected and that responsibilities in relation to land are met.

Furthermore the SLC would like to understand the potential of a LVT to deliver some of its long term outcomes. These include:

- fewer land constraints to place making;
- fewer constraints to supply of land for housing;
- fall in the area of vacant and derelict land;
- fall in concentration of land ownership;
- increase in community involvement in land management decisions;
- increase in community control of land;
- increase in number of lease or joint venture agriculture holdings;
- improved relations between agricultural landlords and tenants.

The literature review and case study analysis conducted as part of this research has not produced evidence sufficient to provide an assurance that a LVT would deliver the SLC's objectives in Scotland, despite the considerable potential benefits suggested by economic theory. However, it should be emphasised that this commissioned research required a desk-top review of the literature based on a small number of case studies. It is possible that focused empirical work could provide firmer information as to the likelihood of the effectiveness of LVT to deliver the SLC's objectives.

The four options are best conceived of as clusters of policy decisions that are shaped by cross-cutting issues which would need detailed consideration by policy makers. These cross-cutting issues are described in the next section before detailing the policy options.

8.1 Cross-cutting issues

Cross-cutting issues, which include strategic and technical decisions that would shape any LVT options that the SLC or the Scottish Government choose to explore, are summarised in Table 5 and discussed in further detail below.

Table 5: Cross-cutting policy issues

Strategic Issues
Land registration - Scotland does not have a complete register of land ownership. It is not due to be completed until 2024. A strong cadastral system is normally a pre-requisite for a successful LVT.
Relationship with other taxes - Policy makers would need to consider how the introduction of a form of LVT could relate to or replace existing LPTs, e.g. council tax, non-domestic rates, land and buildings transaction tax and inheritance tax, as well as Capital Gains Tax.
Wealth or service tax? - Although LVT is generally considered to be a wealth tax, the case study research shows that it can be/is sometimes used as a 'service' tax. The taxpayer and government would need to be clear on what purpose is being served: wealth distribution or payment for community services and/or general funds.
Tax administration - Policy makers would need to decide which tax administration functions should be carried out by national and local tiers of government.
Tax rates - Policy makers would need to set appropriate tax rates, depending on whether any new tax is an additional or replacement tax. - Policy makers would also need to decide whether there should be differential rates.
Tax base, exemptions, reliefs and thresholds - Policy makers would need to decide on these, taking account of the objectives for the tax.
Taxable entity - Policy makers would need to decide whether to tax landowners or occupiers – or in the case of a 'split tax' both; if landowners, policy makers would need to be aware of the risk of the liability being passed to occupiers through higher rents.
Vacant, under- used and derelict land - A key objective for the SLC is to encourage the development of vacant and derelict land in Scotland (as well as under-used land). However, some land may be vacant, under-used or derelict because of viability issues – such land may need subsidy not taxation.
Community and crofting land - There an agenda in Scotland to encourage the community ownership of land, and crofting owner-occupiers. A croft is a small agricultural unit, and crofters are normally tenants. The impact of any new land and property tax on these groups would need to be carefully considered.

Strategic Issues
Impact on free movement - Policy makers would need to consider the potential impact of any change to the LPT regime on free movement of capital, labour, goods and services.
Impact on company balance sheets - Given that some companies hold development land as assets on their balance sheets, the potential impact of revaluations following the introduction of a form of LVT which negatively impacts land values would need to be carefully considered.
Phasing and transitional arrangements - Phasing and transitional arrangements would need to be considered.
Politics and ability to pay - A change to the LPT regime would need political support. Linked to this is the potential for popular resistance to a LVT based on ability to pay.
Devolved and reserved powers - Scotland has a devolved government, but some powers remain vested in Westminster. This would need to be taken into account in any future work that may be undertaken to develop detailed options for LVT.
Technical Valuation Issues
'Pure' land tax or a hybrid tax - If the Scottish government were to introduce a form of LVT, policy makers would need to decide whether to introduce a 'pure' land tax based on unimproved value, or a hybrid tax with a split rate targeting land and improvements. Valuing land excluding improvements brings with it well-remarked but (based on experience form other countries) probably surmountable, technical issues.
Existing use, current permitted use or highest and best use - Policy makers will need to decide whether to tax existing use, or highest and best use, or indeed permitted use (where this differs from existing). A tax on existing use would not create incentives to bring forward under-developed land. However, the valuation of highest and best use has technical difficulties.
Role of the planning system and the highest and best use of land - Linked to the above point, the planning system would need to be prepared to play a role in establishing highest and best use should this be selected. This has resource and technical implications.
Frequency of revaluations - The frequency of revaluations will be a decision based on balancing pragmatic considerations of administration cost, and the need to avoid dramatic jumps in tax liability when revaluations are carried out. - Policy makers would also need to consider whether a rolling programme is more effective and efficient.

8.1.1 Strategic cross-cutting issues

8.1.1.1 Land registration

Should the Scottish Government introduce a form of LVT, it would ideally require a complete and up-to-date land registry. This is because in order to levy a LVT, it would be necessary to correctly identify the extent of land ownership of the various plots of land being valued, and to correctly identify the taxable entity. Any inaccuracies in the determination of the extent of the plots of land

being valued could result in objections and appeals which would potentially be time-consuming and costly to deal with. One of the key lessons from the case studies is the importance of a good cadastral system to support the tax.

Scotland does not yet have a complete register of land ownership. Further to the provisions of the *Land Registration (Scotland) Act 2012*, in May 2014 Scottish ministers asked the Keeper of the Registers of Scotland to register all public land by 2019 and to complete the land register by 2024.

8.1.1.2 Relationship with other taxes

It would be important to consider how any new form of LVT relates to existing taxation. This includes LPT such as council tax, non-domestic rates, land and buildings transaction tax and inheritance tax. The relationship with Capital Gains Tax should also be considered, as this tax can also tax land value. The tax base and taxation rates of existing taxes may need to be adjusted to accommodate the changes introduced by a LVT; alternatively some other LPTs could be abolished entirely. Policy makers will need to decide whether an objective for a new tax is to increase LPT revenue or remain revenue neutral but with a change in who bears the burden.

Based on findings from the consultation interviews and case studies, if a LVT is seen as simply an additional tax it might present more issues regarding acceptability and indeed administrative cost than if it is a replacement tax. For example, if a LVT is introduced as an additional tax without any adjustments to the existing taxation regime, then this could reduce the degree of acceptability to taxpayers where their liability is increased over and above that which they already pay. However, if a LVT is introduced and presented as a tax which replaces some of the existing tax liabilities for landowners, then this could increase the degree to which the LVT may be accepted. However, it should be noted that in either scenario if the tax liability on land which is currently excluded from the tax base or subject to reliefs were to increase, then this may also meet with resistance. What is also seen as key is that any changes are clearly communicated to offset the perception that LVT is simply a way of collecting more tax revenue.

8.1.1.3 Wealth tax or service tax

A key justification from economic theory for a LVT is that it taxes wealth stored in the value of land, and is therefore a mechanism for the redistribution of that wealth. It was not originally theorised as a ‘consumption’ or ‘services’ tax. However, as we have seen from the case studies, LVT is sometimes used to collect tax revenue from the users of local services and infrastructure in order to fund them (i.e. a service tax).

This is an important consideration because, in the interests of transparency, taxpayers should be able to understand why they are being taxed. If the objective of a LVT in Scotland is to tax wealth, then this should be communicated and justified. Similarly, if the objective is to collect revenue to fund local services, then this should also be communicated so that tax payers understand what they are getting in return. This might be easy to identify in built up urban areas where landowners are significant beneficiaries of local services and infrastructure. However, landowners in rural locations are not such heavy users of public services and infrastructure and might therefore question both the principle of a service tax and the level of the tax rate.

8.1.1.4 Tax administration

Linked to the question of whether a LVT in Scotland would be a wealth tax or a service tax are questions relating to the administration of such a tax. Policy makers would need to decide whether the following functions should be carried out by local government or a national government department or agency:

- valuation of land (including whether self-assessment should be permitted);
- setting of taxation rates;
- collection of tax revenue;
- spending of tax revenue;
- appeals and objections arbitration.

These are all technical policy administration decisions, and political decisions.

8.1.1.5 Tax rates

The amount of tax collected will depend on the tax rate, alongside land values and the tax base. The tax rates would need to be set taking in to account the relationship between the new tax and the existing taxation regime in Scotland, and whether the new tax is additional or a replacement, in part or whole, for the existing base.

Policy makers would need to decide whether there should be a single tax rate for all taxable land, or whether there should be different tax rates for different types of land (either by use and/or location). Following on from the discussion of tax administration, if it is decided that tax rates should be set at the discretion of the local authorities in Scotland, then it should be understood that this may introduce a degree of tax competition between local authorities.

8.1.1.6 Tax base, exemptions, reliefs and thresholds

Economic theory suggests that the tax base for a land value tax should be all land. However, as we have seen from the case studies, there are often exemptions, notably for certain heritage or/and

charity assets. Currently in Scotland, there are a range of exemptions of liability for non-domestic rates including agricultural land and buildings. In addition, there is a range of reliefs available to some types of land such as charity land and property.

The decision would have to be made as to whether to bring all land in to the tax base for a LVT, or to continue to allow some exemptions (and reliefs). This decision would have to be made in relation to other considerations e.g. whether the tax is a wealth tax or a service tax, the political risk associated with bringing previously excluded land and property in to the tax base, and the interaction with other taxes etc. It should be noted that if the tax base were increased to include agricultural land, but a charitable exemption were to continue, there could be an incentive for owners to place their land in charitable trusts.

In addition, the threshold value which triggers a tax liability for various types of property would need to be considered, as well as whether it would be taxed at progressive rates.

8.1.1.7 Taxable entity

Policy makers would need to decide who the taxable entity should be, the landowner or the occupier? Economic theory suggests that it should be the landowner, and it would be by taxing the owners that the SLC's objectives with regard to land reform may be more likely to be realised.

There is always the risk that landowners would pass on their new tax liability to the occupiers of their land indirectly by increasing the rent. This would only be possible in markets where there is strong demand for land and an inelasticity of supply. In such markets, there may therefore be the unintended consequence that tenants end up paying the landowner's tax liability, with the underlying land value being little affected. However, if the LVT were to be a replacement tax and the tax base is widened to include some parcels currently exempt, the overall occupation costs might still be neutral or reduced if the landowner passed on the cost.

However, in markets where there is an ample supply of land compared with tenant demand (such as in more rural locations) landowners may not be able to pass on their new tax liability to tenants as easily. Rents may therefore be little affected, with the landowner's tax liability being reflected in lower land values over time.

8.1.1.8 Vacant and derelict land

Economic theory suggests that a LVT would encourage the development of vacant and derelict land because of the increased tax liability, creating an incentive to sell the land or develop it. However, this would only work in cases where land can be viably developed. Land in poor market areas with little development pressure or land in need of remediation may not have sufficient value on which to

levy a LVT. If a tax were to be imposed on such land it could further decrease the likelihood of the land coming forward for development. What such land may need is subsidy, not taxation. However, a LVT could be effective in cases where there is land banking by owners or developers who have obtained options to develop.

8.1.1.9 Community and crofting land

Scotland has community landowners, crofter owner-occupiers and tenant crofters. The impact of any new LVT on these groups would need to be carefully considered. For example, it would be important not to dis-incentivise potential community landowners from acquiring land or to increase the tax liability of existing community landowners to the extent that their operations become unviable. Of course, over the longer term, any increased tax liability for land would be reflected in lower land values so it may be a case of designing appropriate phasing and transitional arrangements.

8.1.1.10 Potential impact on free movement of capital, labour, goods and services

Given Scotland's membership of the economic union of the United Kingdom, it would be essential for policy makers to carefully consider any potential impact of a change in the LPT regime on the free movement of capital, labour, goods and services. In particular, it would be important for policy makers to consider the potential impact on inward investment.

8.1.1.11 Impact on company balance sheets

Given that some companies hold development land as assets on their balance sheets, the potential impact of revaluations following the introduction of a form of LVT which negatively impacts land values would need to be carefully considered.

8.1.1.12 Phasing and transitional arrangements

Policy makers would need to consider whether there should be phasing and transitional arrangements to a new taxation regime in order to moderate the impact on winners and (particularly) losers over a period of time. The case studies and interviews pointed to divergence of practice and views on this point.

8.1.1.13 Politics and ability to pay

Any change to the taxation system would require sufficient support in the Scottish Parliament and would also need to be sufficiently justifiable to the taxpayer so as to avoid any significant political fallout for the party (or parties) in power. These political considerations could potentially limit the Scottish Government's appetite for radical change.

Furthermore, the 'asset rich / cash poor' problem whereby landowners who are wealthy in terms of land assets, but do not generate an income from that land and are therefore not able to easily meet the annual costs of a land tax (e.g. 'poor widows') means that the introduction of such a tax could meet significant popular resistance. However, it should be remembered that the current council tax regime already taxes land (and property) and that this burden falls on asset rich and cash poor households. It would therefore be a question of what at rate the tax is set and the resultant liabilities in comparison with those under the present taxation regime, together with any reliefs, but bearing in mind that any relief system will place extra burden elsewhere.

8.1.1.14 Devolved and reserved powers

Although it is not within the remit of this research project to advise on the constitutional arrangements under which any reform to land and property taxation in Scotland may be achieved, it is important to note that this must be a significant consideration for policy makers.

8.1.2 Technical valuation cross-cutting issues

8.1.2.1 'Pure' land tax or a hybrid tax

The valuation of land is a well-remarked challenge in relation to a LVT. A key decision that would need to be made is whether the tax should be a 'pure' land tax or a 'hybrid' land tax. A 'pure' land tax, in accordance with economic theory, would tax the unimproved value of land only, whereas a 'hybrid' land tax would tax land as well as improvements either at a single composite tax rate (as is currently the case with council tax and non-domestic rates), or at a split rate whereby the unimproved land and improvements are taxed at different rates.

A 'pure' land tax and a 'split rate' tax both come with the technical challenge of valuing the unimproved value of the land which is difficult to do because, with the exception of undeveloped land, land and improvements are not traded separately thereby rendering comparable land transaction evidence scarce particularly in built up areas. Furthermore, it may not be possible to identify the original unimproved state of land where the land has been subject to improvements over many years, such that they have merged with the land (such as levelling and planting). This may be a particular issue in rural Scotland, parts of which have been managed for many centuries.

The Queensland case study demonstrates how this issue has been addressed in parts of Australia, where the land is valued not in its 'pure' unimproved state ('prairie state'), but including improvements which have merged with the land over time. Furthermore, one way in which the issue of separating out the value of land and improvements would be to tax *changes* in property value, on the assumption that such changes will be primarily driven by shifts in underlying land value, rather than shifts in the value of the improvements.

A decision would also have to be made as to whether to tax land based on its annual rental value (as with non-domestic rates) or its capital value (as with council tax). In practice data availability may drive this decision. An annual rental figure has been argued to take out the distortions caused by economic swings in investment markets and is thus often preferred. It should be remembered that when the council tax was introduced there was very little open market residential lettings data but a lot of evidence of capital transactions values. With the changes to overarching residential letting legislation combined with market changes, there is now much greater evidence of residential rental values, albeit that they are not held centrally, unlike capital transaction values which are lodged with the land registry.

8.1.2.2 Existing use or highest and best use

Another key technical valuation decision would be on what basis the land should be valued. For example, should it be based on the value of the land in its existing use, or should it be the value of the land in its highest and best use (HABU)? Determining the value of land in its existing use would be a pragmatic solution as it would be easier to determine existing use than HABU, but this would not have the effect of creating any incentive to develop or sell land which is currently not developed to its potential. Valuing land based on its existing use only would therefore render any associated land tax as being primarily a revenue raising tax, rather than a land reform tax.

However, if land is to be valued based on its HABU then this brings with it technical difficulties associated with determining what the HABU of land actually is. These are discussed in section 5.3.2.3. Although these valuation issues are not insurmountable, they are very difficult to address in a way which offers sufficient transparency or accountability. They are therefore open to challenge and appeal.

8.1.2.3 Role of the planning system and the highest and best use of land

Following on from the above discussion is the role of the land use planning. The planning system is the mechanism by which the existing use of land is formally classified, and by which the HABU of land could reasonably be determined. This would be through existing land designations and use classes, as well as through changes to designations and use classes through plan making and the grant of new planning permissions for changes of use and more intensive use. There would need to be systems set up for valuers to be made aware of both the existing planning context and any possible changes to the planning consent for land being valued.

There also arises the question of the timing of planning events and the timing of valuations and tax liabilities. Take, for example, a large plot of greenfield or brownfield land which is being promoted for residential development through the planning system. It may have to pass through various

stages from promotion, to allocation in planning policy, planning permission in principle, matters specified in conditions / full planning permission, and discharge of planning conditions. Policy makers would need to carefully consider at what stage the new tax liability for 'residential land' would fall on the landowner.

Should it be while the land is being promoted through the development plan? In which case the land would need to be valued including a proportion of 'hope value'. However, there would be no guarantee that the promotion of the land would be successful, so the landowner may have been unjustifiably taxed at a higher rate should the promotion of the land fail.

Should it be once the land has been allocated in the development plan as residential land? Or when the land has planning permission in principle? In these instances, the potential for the land to be developed to its HABU is much clearer. However, it could still be some time before the land is actually developed. This could be because much needed local infrastructure needs to come forward first, or because the market is experiencing a downturn, or because of the unpredictable and discretionary nature of the development management system. In the meantime, the landowner would be paying a land tax based on a HABU which the landowner is unable to deliver due to circumstances beyond their control. This could affect the viability of such developments, thereby harming the potential for the land to be developed. On the other hand, it could incentivise the landowner to sell plots of land to smaller developers. This might create a more diverse supply of housing, but it also might harm the place-making objectives which the planning system seeks to achieve through comprehensive development of larger sites.

Should the tax liability be triggered when the land has full planning permission? In this situation, the development would be likely to be commenced within a few years of the grant of the permission. However, if the liability is only triggered once planning permission for a new or more intense use is granted, then this risks confounding the objective of using a land tax to incentivise the development of under-utilised land to its HABU because the liability is only triggered when the land is in the process of being developed to its HABU anyway.

That said, triggering the tax liability at the grant of in principle or full planning permission may have the potential to target land speculators who use the planning system to increase the value of land without serious intentions to develop as the tax may act as an incentive to dispose of the land, or complete the development more quickly. However, in the short term, in the context of residential land the developer (who may be different to the original landowner) would need to balance this tax liability against the risk of creating an oversupply of housing in the local area, thereby reducing house prices and harming viability (having already paid for the land). Although good for the local

community, developers would be unlikely to countenance creating such an oversupply unless the land tax liability is very high, in which case there would in any case be a very real risk that developments would be rendered unviable. This would be a short-term risk, until the effects of the land tax are reflected in lower land values, thereby allowing developers to pay less for land at the outset in order to cover their later tax liability. In order to avoid this outcome, there would need to be transitional arrangements.

All this would be likely to increase the workload of planning authorities. These issues demonstrate the difficulties associated with the interaction of the planning system and the valuation and taxation of land based on its HABU. If the liability comes too early then it potentially unjustly penalises landowners who may not get planning permission, or may not get planning permission for a very long time. If the liability comes too late, then much of the incentive to develop under-utilised land may be removed. These difficulties may be partly why an event-based land value capture mechanism has been preferred in the past. Nonetheless with sufficient resources, including a commitment to professional education and training, the valuation and planning issues related to LVT can be addressed.

8.1.2.4 Frequency of revaluations

Finally, there is the question of how frequently any revaluations of land should be carried out. Should they be annual, thereby removing the risk of significant jumps in tax liability in developed areas with volatile land values? Should they be less frequent, thereby reducing the significant administrative burden and cost that would come with frequent revaluations? Or perhaps there could be differential revaluations, with land in more developed areas revalued more frequently than land in more rural areas with more stable land values? In Denmark for example they operate a system whereby domestic properties are revalued one year and non-domestic the next. More regular revaluations has been found to reduce the number of appeals.

Also, if it is decided that one of the planning events detailed above should trigger a new tax liability, should the valuation and calculation of liability be conducted at the same time as the planning event, or should it be conducted during the next mass round of revaluations? If the former, then this would ensure that tax liabilities are levied immediately with no 'tax holiday' until the next round of valuations. On the other hand, the frequency and number of planning events may create significant amounts of work for valuers in between the regular revaluation rounds, with all the associated administrative costs, which would not be justifiable if frequent revaluations take place. A compromise is to have, say, five yearly revaluations with an indexation of values on an annual basis, taken from aggregated transaction data.

It should be pointed out the issue of frequency of valuations is not an LVT-specific issue; it relates to all recurrent property taxes. Failure to keep the valuations current will lead to the tax becoming discredited, as has been argued to be the case with council tax and, in the past, with business rates.

8.2 Policy options for further analysis

The above cross-cutting issues will shape any policy options which the SLC or the Scottish Government choose to explore. With this in mind, four broad policy options are proposed for the SLC to consider. These cover a spectrum of degrees of intervention, and a range of priorities from primarily revenue raising, to primarily land reform. The options are summarised in Table 6 overleaf.

Table 6: Draft policy options

		Factors								
		A. Basis of value		B. Basis of assessment		C. Assessable entity			D. Taxable entity	
	Policy option	Existing use value	Highest & best use	Annual rental value	Capital value	Unim-proved land	Improve-ments	Improved land	Owner	Occupier
1.	**Extend existing LPTs**									
	Extend Business Rates tax base to include: - All agricultural land and buildings - Forestry enterprises - Rural leisure activities	✓		✓				✓		✓
2.	**Reform existing LPTs**									
	Reform Council Tax: - Create additional bands - Revalue - Introduce regular revaluations	✓			✓			✓		✓
	Reform BR: - More regular revaluations - Remove relief on empty premises (after initial discount period) - Extend the valuation roll - Extend tax base as per option 1	✓		✓				✓		✓
3.	**Introduce a LVT alongside existing LPTs**									
	New supplementary LVT on: - Rural land - Vacant, under-used and derelict land - Non-residential land - Residential land		✓		✓	✓			✓	
	Reform Business Rates	✓		✓			✓			✓
	Reform Council Tax	✓			✓		✓			✓
4.	**Introduce a single LVT that replaces existing LPTs**									
	Abolish Council Tax and Business Rates and replace with LVT on all land		✓		✓	✓			✓	

8.2.1 Option 1: Extend existing LPTs

Option 1 targets rural properties which are currently excluded from the non-domestic rates tax base, potentially including land which is part of larger estates. The land would be taxed based on its annual rental value based on existing use, including improvements, with the liability falling on the occupier in the first instance. Currently excluded rural properties brought in to the tax base would be valued and taxed based on both the combined rental value of the land and the business properties built on that land. In instances where there are no properties, the land would still be taxed based on its annual rental value. This option could be delivered through adjustments to the existing taxation system for non-domestic rates.

Currently excluded land uses which could be brought in to the tax base include:

- agricultural land and buildings;
- fish farms;
- oil and gas pipelines; and
- overseas armed forces premises in the UK.

The main objective for this option would be to bring more land which is part of large estates in to the tax base, and also to incentivise the development and cultivation of such land by increasing the tax liability of holding land, given that the liability for non-domestic rates falls on the landowner where the land is vacant/unoccupied. However, in instances where the currently excluded land is occupied, the liability would fall on the occupier.

This option could therefore potentially create new tax liabilities for:

- some business occupiers and owner-occupiers;
- some owners of non-domestic land where the property is vacant/unoccupied.

This option has the following potential benefits:

- It could bring agricultural land in to the tax base. This could have the effect of increasing the land tax liability of the owners of large estates where the land is unoccupied. This is aligned with the SLC's objective of ensuring that responsibilities in relation to land are met.
- By bringing more rural land in to the tax base, this option could potentially incentivise rural landowners to enhance the productivity of currently under-utilised land by either developing it more productively, or letting it to a tenant who will develop it more productively (and take on the tax liability), or by selling it to a developer where the land is developable. This is aligned with the SLC's objective of encouraging a more diverse pattern of land ownership

that spreads the benefits of land more inclusively. However, in order for this to be achieved, the tax rate would have to be set at a sufficiently high level, which could impact on more marginal rural agricultural businesses if the tax rate is uniform.

- It would not require significant changes to the existing taxation regime but would require an adjustment to the existing exemptions. The new additions to the tax base would then have to be valued and the appropriate tax rate set. By extending the base, if revenue neutrality is desired, it could potentially lower the tax rate for those properties currently in scope.

This option has the following potential risks:

- Given that the taxable entity would be the occupier in the first instance, this option would not specifically target the owners of land where the land is occupied by a party which is different to the landowner.
- By bringing more rural premises in to the tax base under the existing system, the new tax liability would affect not just wealthy owners of large estates which are un-tenanted, but also less wealthy rural landowner-occupiers and tenants. The thresholds and tax rates would therefore have to be carefully considered so as not to harm rural businesses. This would be a challenge considering the objective of seeking to incentivise a more intense use of land and more diverse pattern of land ownership by increasing holding costs through taxation. This option might therefore require careful targeted use of phasing of the new tax or time-limited reliefs.
- There would be political risk associated with this option given that the tax liability of some larger rural landowners and occupiers, as well as smaller and more marginal agricultural businesses, may be increased.
- This option would have only limited potential to achieve the SLC's objectives in relation to encouraging a more diverse pattern of land ownership and to bring vacant and derelict land in to productive use so as to improve land supply for housing. This is primarily because the valuation of land would be based on its existing use under the current non-domestic rates regime, and not on its highest and best use. Furthermore, residential land would not be covered by this option.

8.2.2 Option 2: Reform existing LPTs

Option 2 builds on option 1 but is primarily aimed at making the existing LPT system more progressive through reforming existing council tax and non-domestic rating.

Council tax could be reformed in some or all of the following ways:

- Conduct a revaluation for all residential property in Scotland so that the council tax system is based on up-to-date valuations and can therefore capture the wealth increase since 1991 and reflect any redistribution of residential property values across the country.
- Implement regular revaluations of all residential property in Scotland, so that the council tax system keeps pace with changes in the value of residential property and associated wealth increases.
- Reform the council tax banding so that the bands are more nuanced, and capture variation in property value (and wealth) across different parts of a local area, including the introduction of more bands at the top end so as to more fairly tax high value properties as a proportion of value. The current bandings do not equitably reflect the distribution of dwellings across the value range. The top end of the distribution is now more stretched than it was in 1991.
- Introduce a shift from 'banded' capital values to individual capital values. However, this would require more expenditure on valuation to ensure accuracy and could lead to a greater number of appeals.
- Review the existing reliefs and exemptions available for council tax to ensure that they remain equitable whilst recognising that the larger the number and types of reliefs, the further away the tax is from promoting change in ownership and encouraging more beneficial and intensive use.

Non-domestic rates could be reformed in some or all of the following ways:

- Implement more regular revaluations of non-domestic property in Scotland, so that the business rates system keeps pace with changes in the value of non-domestic property.
- Revise relief provisions for empty/unoccupied properties, potentially reducing the initial discount period and removing any relief following the expiry of this period.
- Extend the valuation roll to include agricultural land and forest land.
- Extend the tax base to bring in some currently excluded land and property, including large agricultural premises as per option 1.

The main objective for this option is to make the existing LPT regime in Scotland more progressive. This option could potentially create new tax liabilities for:

- some residential occupiers and owner-occupiers;
- some business occupiers and owner-occupiers;
- some owners of vacant residential property; and
- some owners of non-domestic land where the property is vacant/unoccupied.

This option has the following potential benefits:

- It could bring agricultural land in to the tax base. This could have the effect of increasing the land tax liability of the owners of large estates where the land is unoccupied. This is aligned with the SLC's objective of ensuring that responsibilities in relation to land are met.
- By bringing more rural land in to the tax base, this option could potentially incentivise rural landowners to enhance the productivity of currently under-utilised land by either using it more productively, or letting it to a tenant who will use it more productively (and take on the tax liability), or by selling it to a developer where the land is developable. This is aligned with the SLC's objective of encouraging a more diverse pattern of land ownership that spreads the benefits of land more inclusively. However, in order for this to be achieved, the tax rate would have to be set at a sufficiently high level, which could impact on more marginal rural agricultural businesses if the tax rate is uniform.
- This option would bring vacant and derelict rural land currently excluded from the non-domestic rates system in to the tax base. Further it would, through the valuation process, allow greater transparency as to what land would be viable to develop and what would not due to lack of effective demand or adverse characteristics of the land itself.
- By reforming council tax to be more equitable, the existing LPT regime would be made more progressive. In the case of owner-occupiers, this is aligned with the SLC's objectives of ensuring that responsibilities in relation to land are met.
- This option would not require significant changes to the existing taxation regime in comparison with options 3 and 4. It would require an adjustment to the existing exemptions and reliefs. The new additions to the tax base would then have to be valued and the appropriate tax rate set. By extending the base, if revenue neutrality is desired, it could potentially lower the tax rate for those properties currently in scope.

This option has the following potential risks:

- Given that the taxable entity would be the domestic and non-domestic occupier in the first instance, this option would not specifically target the owners of land where the land is occupied by a party which is different to the landowner.
- By bringing more rural premises in to the tax base under the existing system, the new tax liability would affect not just wealthy owners of large estates which are un-tenanted, but also less wealthy rural landowner-occupiers and tenants. The thresholds and tax rates would therefore have to be carefully considered so as not to harm rural businesses. This would be a challenge considering the objective of seeking to incentivise a more productive use of land

and more diverse pattern of land ownership by increasing holding costs through taxation. This option might therefore require careful targeted use of phasing of the new tax or time-limited reliefs.

- There would be political risk associated with this option given that the tax liability of some larger rural landowners and occupiers, as well as smaller and more marginal agricultural businesses may be increased.
- Reforming business rates so as to remove a degree of relief on vacant/unoccupied property would also be an unpopular move with Scotland's business community. This could also create a significant political barrier to implementation.
- By reforming council tax to update the valuations and create a more progressive banding system, this option would create a potentially significant numbers of 'losers' i.e. those living in properties which are currently undervalued, or those living in high value properties where their wealth is not sufficiently captured by the existing banding system. This would potentially create a significant political barrier to implementation, unless sensitive phasing provisions were introduced. One further option might be to roll up residential LVT liabilities for asset rich / cash poor individuals so that they are payable upon death.
- This option would have only limited potential to achieve the SLC's objectives in relation to encouraging a more diverse pattern of land ownership and to bring vacant and derelict land in to more productive use such as (but not restricted to) housing. This is primarily because the valuation of land would be based on its existing use under the current non-domestic rates regime, and not on its highest and best use.

8.2.3 Option 3: Introduce a LVT alongside existing LPTs

The main objective of this option is to introduce a form of LVT which seeks to achieve many of the objectives of a single LVT, but without requiring a total replacement of the existing LPT system. All rural land (including land currently exempt from non-domestic rates), non-residential land and residential land including vacant, under-used and derelict land would be taxed based on the capital value in its unimproved state assuming highest and best use with the liability falling on the landowner only. This would, in effect, allow for full or partial reform of existing property taxes but adding in to the tax base assets not currently included. It would see the introduction of a LVT, with the theoretical incentive for landowners to develop or sell under-utilised land where the highest and best use value is higher than the existing use value. In terms of the meaning of 'highest and best use', taking into account the discussion at section 5.3.2.3, it is suggested that it should be defined as 'most profitable permissible development'.

Occupiers of business premises would still be taxed as under the existing or reformed non-domestic rates system, but based on the rateable value of the buildings only (i.e. net of the underlying unimproved land value), with the liability falling on the landowner where the buildings are vacant/unoccupied. This would in effect represent a split-rate taxation system for non-domestic land and premises, with the owners of non-domestic land taxed based on the unimproved value of the land, and the occupiers of the land taxed based on the value of the improvements only.

Similar to the above, occupiers of residential property would still be taxed as under the existing council tax system, but based on the capital value of the buildings only (i.e. net of the underlying unimproved land value), with the liability falling on the landowner where the buildings are vacant/unoccupied. This would also in effect represent a split-rate taxation system for residential land and premises.

The taxation rate for owners of vacant and derelict land (whether residential or non-residential) could be set at a higher rate than for developed / occupied land so as to act as an additional incentive to bring the land forward for more beneficial use. This is something that currently happens in South Africa, where there are a variety of tax multipliers for vacant land in various cities, ranging from 4 to 6.5 times the tax for occupied residential property. If introduced in Scotland, this may require the adoption of reliefs or exemptions where land is vacant and derelict for viability rather than land speculation reasons.

The rationale for these adjustments to the non-domestic rates and council tax regimes while introducing a LVT is that the service tax function of non-domestic rates and council tax is retained, while the underlying LVT is a wealth tax. It would this give greater transparency regarding the purpose of tax.

This option could potentially create new tax liabilities for the following groups:

- residential occupiers and owner-occupiers;
- residential landowners;
- business occupiers and owner-occupiers;
- owners of non-domestic land; and
- owners of vacant and derelict land.

This option has the following potential benefits:

- It could bring more agricultural land in to the tax base. This could have the potential effect of increasing the land tax liability of the owners of large estates where the land is vacant/unoccupied. This is aligned with the SLC's objectives of ensuring that responsibilities

in relation to land are met, and also potentially the objective of reducing the concentration of land ownership should landowners seek to sell-off parcels of land as a result of the new tax liability.

- By bringing more rural land in to the tax base, this option could potentially incentivise rural landowners to enhance the productivity of currently under-utilised land by either developing it more productively or by selling it to a developer where the land is developable. The incentive to do this would be increased where the value of the land in its highest and best use is higher than the value in its existing use. This is aligned with the SLC's objective of encouraging a more diverse pattern of land ownership that spreads the benefits of land more inclusively. However, in order for this to be achieved, the tax rate would have to be set at a sufficiently high level, which could impact on more marginal rural agricultural businesses if the tax rate is uniform.
- By creating a new tax liability for the owners of vacant and derelict land based on its highest and best use (excluding any improvements), this option could potentially incentivise the owners of such land to enhance its productivity by either developing it or selling it to a developer.
- As all non-domestic vacant land would have to be valued under this option, it has the benefit of clearly identifying land parcels with no or negative value which requires grants or incentives to bring them back into beneficial use. This is aligned with the SLC's objectives of increasing the economic, social and cultural value of Scotland's land, and of stimulating a more active approach to developing land in the public interest.
- By creating a new tax liability for the owners of non-domestic land based on its highest and best use (excluding any improvements), this option may have the theoretical effect of incentivising the more effective development of such land in cases where it is under-utilised. This is aligned with the SLC's objectives of increasing the economic, social and cultural value of Scotland's land, and of stimulating a more active approach to developing land in the public interest.
- By taxing the owners of residential land based on its highest and best use (excluding improvements), this could potentially incentivise the development of such land where it is not currently developed to its potential. As the majority of residential landowners are owner-occupiers of homes which can reasonably be considered to represent the highest and best use of residential land, this tax would primarily affect the owners of residential development land (depending on the tax rates). This is aligned with the SLC's objectives of

increasing the economic, social and cultural value of Scotland's land, and of stimulating a more active approach to developing land in the public interest and for housing.

- By taxing domestic and non-domestic occupiers only on the basis of the value of the improvements net of the underlying value of the land, this option could potentially retain a service tax function.

This option has the following potential risks:

- Despite the suggestions of economic theory, there is little conclusive evidence from the secondary research that this option would be effective in helping the SLC meet its strategic objectives, although it would almost certainly provide a stimulus to development where development value exists.
- By bringing some rural land in to the tax base under the existing system, the new tax liability would affect not just wealthy owners of large estates, but also less wealthy rural landowners. The thresholds and tax rates would therefore have to be carefully considered so as not to harm rural businesses.
- There is a risk that landowners would pass on any new tax liability to tenants though higher rents in markets where there is a high demand for land and buildings and inelasticity of supply.
- Defining 'vacant and derelict' land will undoubtedly be a challenge. At what point does land become not just vacant but also derelict? Any such definition risks being challenged by speculating landowners causing administrative difficulties and delays.
- Some vacant and derelict land may be vacant for 'good reason' e.g. its development is unviable due to adverse market conditions or contamination. This option would therefore not encourage the development of such land, but would act as a further barrier, unless there is a mechanism in place for reliefs where it can be demonstrated that development is unviable. However, should there be a minimal or negative land value, the tax liability would be zero. This is an important point, because it means that the owners of land with a very low (or negative) land value would not have their tax liability increased on the introduction of a LVT unless and until their land is deemed (through any periodic revaluation process) to be viable for development to a more productive use, thereby increasing the land value and triggering a tax liability.
- There would be increased political risk associated with this option. This is because such a change to the taxation system may be strongly resisted not just by larger landowners and owner-occupiers of residential property, but by the owners of non-domestic property. For

the latter group, this option could present a very significant change compared with the current system, because under the current system the owners of non-domestic land are only liable for land and property tax if the land is vacant / un-tenanted (empty rates relief notwithstanding).

- This option would effectively bring all land in to the tax base, and would target the owners of land. Any such change may have an effect on the attractiveness of Scotland for investors. It would be crucial that if such a change were to be considered, that policy makers design the tax so as to not unduly dis-incentivise inward investment.

8.2.4 Option 4: Introduce a single LVT that replaces existing LPTs

Option 4 represents the most radical intervention as it would replace all existing LPTs with a single land value tax on all land. The tax would be based on the capital value of the land in its highest and best use excluding improvements with the landowner as the taxable entity. This would mean that the tenants of domestic and non-domestic properties would not pay land and property tax. Therefore, a proportion of the revenue generated by this option would have to be retained by or provided to local authorities in order to fund local services and infrastructure. In terms of the meaning of 'highest and best use', taking into account the discussion at section 5.3.2.3, it is suggested that it should be defined as 'most profitable permissible development'.

The main objective for this option would be to bring all land in to the tax base for LVT based on highest and best use as a form of wealth and service tax, while removing any land and property tax liability for tenants.

This option has the same potential benefits as for option 3 with the addition of the following:

- Simplicity of the tax base with only one tax chargeable and the replacement of two taxes with only one universal land tax. This could have administrative advantages and give transparency.
- It leaves the option open in the future for the possible introduction of a local property services tax so that it becomes clear as to a differentiation between taxing wealth and contributions towards the cost of provision of community services.

This option has the same risks as for option 3, with the addition of the following:

- Despite the suggestions of economic theory, there is little firm evidence that this option would have the desired affects in relation to the SLC's objectives, although it is likely that it would yield some results in terms of stimulating development. However such stimulation could be achieved without the very significant change that such a radical option presents. It

might be deemed to be politically risky given the limited evidence that it would deliver fully on the desired outcomes.

Table 7: Alignment of the above policy options with selected Scottish Land Commission objectives

	Productivity	**Diversity**	**Accountability**	**Encourage Development of Vacant and Derelict Land**	**Stimulate More Active Approach to Developing Land in the Public Interest (including for housing)**
1. Extend Existing LPTs	Could potentially increase productivity of some rural land by incentivising it being brought in to more productive use through increasing the tax liability of occupation (and ownership where the land is vacant / unoccupied).	Could potentially enhance diversity of land ownership and occupation of some rural land through increasing the tax liability of occupation (and ownership where the land is vacant / unoccupied).	Could potentially enhance accountability of land ownership and occupation by extending the tax base to cover currently excluded land.	Limited potential to achieve this objective.	Limited potential to achieve this objective.
2. Reform Existing LPTs	Could potentially increase productivity of some land by incentivising it being brought in to more productive use through increasing the tax liability of occupation (and ownership where the land is vacant / unoccupied).	Could potentially enhance diversity of land ownership and occupation of some land through increasing the tax liability of occupation (and ownership where the land is vacant / unoccupied).	Could potentially enhance accountability of land ownership and occupation by extending the tax base to cover currently excluded land, and by more progressively and efficiently taxing wealth tied up in land and property.	Limited potential to achieve this objective.	Limited potential to achieve this objective.
3. Introduce a LVT alongside existing LPTs	Could potentially increase productivity of some land by incentivising it being brought in to more productive use through increasing the holding costs for landowners where the existing use is less valuable than the HABU.	Could potentially enhance diversity of land ownership through increasing the holding costs for landowners where the existing use is less valuable than the HABU, thus in theory prompting some landowners to sell land to avoid the tax liability.	Could potentially enhance accountability of land ownership by extending the tax base to cover currently excluded land, and by more progressively and efficiently taxing wealth tied up in land.	Could potentially encourage the development of vacant and derelict land by incentivising it being brought in to more productive use through increasing the holding costs for landowners where the existing use is less valuable than the HABU. This would only work where the land has development value.	Could potentially encourage more land to come forward for housing, where such land is being held speculatively by increasing the holding costs of owning such land.
4. Introduce a single LVT that replaces existing LPTs	As above.	As above.	As above.	As above.	As above.

8.3 Further variants

In order to keep the number and complexity of the proposed options manageable, further permutations have not been discussed. However, it would of course be possible to 'mix and match' elements of the various options to produce further variants, including:

- Reform of the existing non-domestic rates reliefs as part of option 1.
- Reform the council tax and non-domestic rates systems so that the primary taxable entity is the owner, rather than the occupier. This could, for example, be included as a variant of option 2.
- Include a form of LVT specifically targeting owners of un-developed residential property, based on capital value of the unimproved land in its highest and best use. This could, for example, be included as a variant of option 2.
- Include a form of LVT specifically targeting owners of vacant and derelict land with development value, based on capital value of the unimproved land in its highest and best use. This could, for example, be included as a variant of option 2.

Accordingly, policy makers could view the various elements of the options as a 'policy toolbox' with which various options could be developed. It should also be noted that, following the recommendations of Mirrlees et al (2011)[18], there may be potential to use the taxation system in ways other than introducing a LVT to help deliver the SLC's objectives. For example Mirrlees et al (2011) suggested the introduction of a wealth tax on supernormal returns to savings, which in the context of house sales could contribute to stabilising house prices and, therefore, residential land values.

8.4 Conclusion

The research detailed in this report comprising a literature review, stakeholder interviews, case studies and expert panel discussions collectively point to a strong case for land and property tax reform in Scotland. The literature has pointed to a strong theoretical case for an introduction of LVT. It is argued that a LVT would support the objectives of moving land into its most beneficial use and of imposing a tax burden that is widely spread and based progressively on wealth.

Despite this, with the possible exception of the Namibia case, it has not been possible to find conclusive evidence regarding the potential of a LVT to deliver the SLC's objectives in Scotland. This may in part be due to the nature of the research which included a desk-top review of a small number of case studies. It may be the case that outcomes related to some of the SLC's objectives are being

[18] Summarised on page 27 of this report.

met in some of the selected case study jurisdictions, or indeed in other countries, but primary research would be required to determine this.

Nevertheless, although extremely attractive in theory, the findings from discussions and international case studies point to a number of constraints and barriers to a full implementation. The Research Team has therefore developed, and tested against expert opinion a range of options for consideration, depending on the political will for change and the resources that could be made available to both research and develop detailed proposals. A key consideration would be a detailed analysis of the interplay with other taxes on land and property and the extent of continued reliefs and exemptions.

At the simplest level, a reform of business rates to widen the tax base would create some incentive to bring land forward; further reform of council tax would overcome the regressive nature of the tax (as set out in options 1 and 2). Both these actions have the potential to deliver some change and lead to increased social equity. But they come with expense and political risks and would not fully address the SLC's objectives. However, adjustments to the existing business rates and council tax systems would be possible from technical planning and valuation viewpoints.

A more radical option would be to introduce an additional tax on land, rather than extend the business rate scope. This could be combined with creating a split between land and property within the existing tax takes, thus making it explicit what is geared towards a tax on wealth and what a tax on community services (option 3). Although presenting a range of technical valuation and planning issues, this option could be viewed as a 'halfway house' towards an LVT. The fourth option would be to do away with existing property taxes and replace them with an extended LVT. However we question whether the fundamental prerequisites, such as robust and complete ownership records and sufficient valuation resource exist to make this a feasible option at the present time.

Given that no option could provide a complete solution to the SLC's objectives and that no option has been developed in sufficient detail so as to form a basis for recommendation for implementation, the suggested options are put forward as a policy 'toolbox' which the SLC can use to consider its next steps.

In summary, whatever the SLC and the Scottish Government choose to do, there is ample opportunity to reform Scotland's existing system of LPT in order to introduce a more progressive and equitable system which has the potential to deliver land reform objectives. However, the key would be to work proactively to secure the necessary political and popular support.

Appendix I: Relevant policy and legislative events in Scotland 2014 - 2018

Ownership Body	Event and Date	Summary
Land Reform Review Group	The Land of Scotland and the Common Good - Final Report of the Land Reform Review Group (2014)	Made recommendations for land reform in Scotland, including further research into the potential for Land Value Taxation.
Scottish Government	A Consultation on the future of Land Reform in Scotland (2014-2015)	Consulted on measures for further land reform, including on a range of potential provisions for the Land Reform Bill.
Scottish Law Commission	Discussion Paper on Compulsory Purchase no.159 (2014)	Invited views as to what the law on compulsory purchase in Scotland should be, and how it should be set out.
The Commission on Local Tax Reform - established jointly by the Scottish Government and the Convention of Scottish Local Authorities	Just Change – A New Approach to Local Taxation 2015	Recommended the abolition of the present council tax system in Scotland and expressed a belief that a system of land value tax is promising, but gaining a full understanding would require further analysis.
Scottish Government	*Community Empowerment (Scotland) Act 2015*	Amended the Land Reform (Scotland) Act 2003 to extend the community right to buy to all of Scotland and introduced powers to make provision for community bodies to purchase neglected, abandoned or detrimental land where the owner is not willing to sell that land, among other provisions.
Scottish Law Commission	Report on the consultation responses to Discussion Paper on Compulsory Purchase (2016)	Summarised the responses to the public consultation on the Discussion Paper.
Scottish Parliament	*Land Reform (Scotland) Act 2016*	Established the Scottish Land Commission, requires the Scottish government to publish a statement of land rights and responsibilities every five years, and introduced the community right to buy land to further sustainable development through a forced sale, among other provisions.
Crawford Beveridge, Petra Biberbach and John Hamilton on behalf of Scottish Ministers	Empowering planning to deliver great places - An independent review of the Scottish planning system (2016)	The report recommended that mechanisms for planning authorities to take action to assemble land and provide infrastructure upfront should be established as soon as possible. The report expressed support for a LVT.
Scottish Government	Review of Planning Scottish Government Response (2016)	Set out the government's response to the review of the Scottish planning system, including a pledge to consult on a White Paper on planning reform, to inform a Planning Bill to be brought forward in 2017.
Scottish Government and external consultants	Research Project to Identify and Assess the Options for the Introduction of an Infrastructure Charging Mechanism in Scotland (Stage 1 & Stage 2) (2016)	Published in December 2016, this report focuses on the options for an infrastructure charging mechanism to be applied through the planning system in Scotland. Further research was then commissioned.

Ownership Body	Event and Date	Summary
Scottish Government	Places, People and Planning – A consultation on the future of the Scottish planning system (2017)	Included consultations on the introduction of an infrastructure levy, and on the improvements to section 75 planning obligations.
Scottish Land Commission	Making More of Scotland's Land Our Strategic Plan 2018 to 2021 (2017)	Sets out the SLC's strategic plan, focusing on four core areas of work: land for housing and development, land ownership, land use decision making and agricultural holdings.
Scottish Government	Scottish Land Rights and Responsibilities Statement (2017)	The statement seeks to inform policy and practice around land issues in Scotland. It is underpinned by six principles, including that the overall framework of land rights, responsibilities and public policies should promote, fulfil and respect relevant human rights in relation to land, contribute to public interest and wellbeing, and balance public and private interests.
Scottish Government	Council Tax reform 2017	Changes to council tax were introduced to protect household incomes and make local taxation fairer.
Kenneth Barclay, on behalf of the Scottish Government	Report of the Barclay Review of Non-Domestic Rates 2017	The report makes 30 recommendations regarding the non-domestic rates system in Scotland to better support business growth, long term investment and reflect changing marketplaces. The report concluded that there was 'very limited support' for the introduction of a LVT, but expressed report for further research.
Scottish Government	Programme for Government 2017/2018	Confirms planning, climate change and Crown Estate bills will be introduced.
Scottish Government	*Planning (Scotland) Bill 2017*	Seeks to introduce a range of measures including provisions in relation to the system of development plans; the opportunities for community engagement in planning; the effective performance of planning authorities' functions; and a new way to fund infrastructure development through an infrastructure levy.

Appendix II: Land value capture or betterment taxes

Background

Betterment refers to an increase in land value. Taxing betterment is justified in circumstances where the land value increase is not the result of the landowner, in other words it is 'unearned'. For example the government can increase land values through planning and regulation, infrastructure provision, environmental improvement and improving service delivery and image of locality. In such cases, it is argued, at least some of the betterment should be captured for the community, known as 'land value capture' (LVC).

Both LVT and LVC are assessed on the basis of land value but LVT is levied on a regular, usually annual, basis whereas LVC is triggered by events, usually the granting of development rights.

Both kinds of planning (development regulation and forward planning) affect land values. Development regulation (land use controls, building controls) restricts the amount of land for each use and that will mean differential land values (Evans, 1983). Forward planning (deciding where a new train route should go, a new bypass or a new town) will provide location advantages to affected land. In societies where governments fund the provision of infrastructure, services and amenities the case for LVC is strong since, it is argued, the landowner benefits as a direct result of this publicly funded investment.

LVC is often levied as a proportion of the uplift in value that is realisable when planning permission is granted, and valuations are required to determine the size of the uplift. This is usually the increase from the existing use value of the land to the market value of the land with planning consent for the development. In some cases, estimation of existing use value is straightforward – agricultural land for example. In other cases it is not so easy – urban land may be capable of being used in different ways, subject to planning, and the highest and best existing use would need to be determined.

Estimation of market value is usually undertaken in one of two ways: by comparison with sale prices of similar sites, where such comparables exist; or by estimating the 'residual' value of the land having estimated the development cost and value of the completed development. Clearly, the first method is easier, however, development sites are often different in many respects and comparison is not possible. This means that the residual method is often relied upon, but the method suffers from several problems, both in terms of the model itself and in relation to inputs into the model.

National land value capture

During the 20th century, the UK was a laboratory for national land value capture instruments. A 100% development charge (tax) was introduced as part of the *Town and Country Planning Act 1947* but it

failed because landowners opted to hold rather than sell. It was repealed in 1953. A 'betterment levy' was introduced in 1967 at a rate of 40% on 'projects of material development' (sales, lettings, development activity and the receipt of compensation for planning and compulsory purchase decisions). This was more like capital gains tax than a development tax as it was not payable on grant of planning permission. It was abolished in 1971. The *Finance Act 1974* introduced another higher rate capital gains tax called a 'development gains tax' but this was replaced in 1976 when the Labour Government introduced a Development Land Tax at 80% of the land value uplift. The rate was reduced to 60% in 1979 before being abolished altogether in 1985. Finally, Barker's Planning Gain Supplement (a tax on the 'windfall gain' enjoyed by landowners when planning permission is granted for residential development) was passed into law in 2007 but repealed two years later before implementation following lobbying from landowners, developers and local government.

These attempts at national LVC failed for a mixture of political and practical reasons: political uncertainty resulting from 'ping-pong' government was undoubtedly a significant factor; the taxes were often introduced following a boom but implemented *after* or *as* markets collapsed; and the complexity and potential for avoidance also took its toll. No betterment tax seems capable of successfully capturing the full unearned land value from all landowners because the tax is event-based, relying on the action of a landowner to apply for planning permission for development. Even Denmark only taxes 50% of the land value uplift when farmland is rezoned as urban land.

Landowners can opt to wait, and in a rising and perhaps uncertain market, this option has value, particularly if the development land tax policy is perceived as a transient one. Needless to say, landowners who don't seek planning consent earn implicit land value gain regardless of whether it is realised or not. In addition, anticipation of public investment in a locality can lead to land banking. During the period of hoarding, because there is no private investment, the property economic value remains unchanged. Yet the land value increases due to forthcoming public investment. There is, therefore an overall loss if economic efficiency as the land is withdrawn from productive use and is held solely for the purpose of speculation.

Local land value capture

Local LVC instruments often take the form of impact fees, planning gain, infrastructure levies, and so on. These are administered locally, charged at the point at which the gain is realised and are well suited to hypothecation.

The UK has now given up with national attempts to tax betterment. Instead England and Wales have local land value capture instruments: 'Section 106' Planning Obligations and Community Infrastructure Levies. Scotland also has Planning Obligations (known as 'Section 75 agreements', in

reference to the *Town and Country Planning (Scotland) Act 1997*). Scotland has no Community Infrastructure Levy at present, but powers to introduce one are included in the *Planning (Scotland) Bill 2017*.

As well as posing the same valuation challenges as national policies, there can be significant transaction costs associated with local LVC instruments and they are unable to redistribute revenue between high and low value areas. It is questionable whether local level LVC adequately captures land value uplifts that result from public investment. Furthermore, they might be regarded as a piecemeal solution unable to handle major projects without specific regulation.

For some, planning obligations are necessary to mitigate the 'burden' on the community created by new development – more traffic or additional school places for example. For many, they are a way of securing benefits for the wider community from unearned uplifts in land values created by planning permission; benefits such as social housing and new infrastructure. For others, they are a burden; yet another regulatory cost on enterprise holding back the growth of the economy, restricting the supply of new housing and preventing job creation. In reality, there is probably an element of truth in all of these characterisations.

In summary, although now once more under some active consideration, LVC is still perceived as problematic and likely to stall development; LVT on the other hand, in theory at least, would not.

Appendix III: Basic principles of land economy

Land economy – some key concepts

There are some basic principles of land economy which underpin the rationale and justification for land value taxation. Some key concepts are summarised below.

The inelasticity of supply of land

There are three factors of production: land, labour and capital. Of these, only land has no cost of production and is in fixed supply. In the language of economics, the supply of land is *inelastic* which means that the supply of land cannot increase in response to changes in the level of demand. Although the *total* supply of land can be considered to be *perfectly inelastic,* meaning that its supply cannot change at all, the relative supply of land for various uses can change: the planning system can allocate different uses to parcels of land and therefore adjust the supply of land for a particular use and thus create shifts in relative supply. This point notwithstanding, land supply is considered to be highly constrained and relatively inelastic.

Sources of land value

The value of land arises from its limited supply and is considered to be a *residual* deriving from the use or uses to which the land is put after paying for the costs of various factors of production (Ricardo, 1817). Land is not therefore generally in demand for its own sake, but it is in demand as a factor that is used in the production of goods and services. As a result, the demand for land is considered to be 'derived demand'.

The use to which land can be put depends in large part on its location. Land cannot be moved. This characteristic in combination with the limited supply means that the value of land is intimately linked to the physical, social and economic characteristics of its location.

Where land is not put into productive use, the value of the land will be based on the best alternative use to which the land could be put. Therefore, even land which does not currently benefit from an income generating use can be valued by reference to a theoretical alternative income generating use to which the land could reasonably be put.

Under these conditions, the value of land refers to an income stream generated by land as a factor of production (either currently or in its best alternative use). This is called 'economic rent'. This rental income can be 'capitalised' over a period of time to produce a 'capital value', which is the basis upon which an exchange price will be considered.

Economic rent

Whereas 'rent' colloquially refers to the periodic payments made by an occupier of land or property to the owner of that land or property for the right to occupy it, the term 'economic rent' has a specific meaning within classical economics: it is any payment accruing to a factor of production over and above the payment that is *necessary* to keep it in production. Economic rent is therefore a *surplus payment* deriving from the limited supply of a factor of production.

If the supply of a factor of production is relatively *elastic* such as labour (i.e. the supply could respond relatively easily to increased demand, such as in the case of the supply of retail workers), the payment required to keep it in production would be relatively close to the *necessary* payment. This is because any surplus payment required as demand for new retail workers increased would be short lived in theory, as more labour could be relatively easily employed to meet the increased demand, thereby keeping the cost of labour relatively stable.

However, because land is in limited supply (inelastic) and is spatially fixed (monopoly position), any surplus payment required to keep it in production in the context of increasing demand would endure over the longer term. Indeed, in economic terms, all of the value of land is considered to be economic rent because the land has no cost of production (it is a gift of nature) and, therefore, its value is a surplus derived from its limited supply and fixed location. This economic rent can be taxed without any distortive effects on the economy (McCluskey and Franzsen, 2005).

Appendix IV: Summary of land value tax and land and property tax around the world

Albania	Tax on agricultural land based on area, category, zone and land quality and a tax on urban buildings based on area. No revaluation since 1994.
Armenia	Tax on agricultural land based on cadastral income and on non-agricultural based on cadastral value, and a tax on buildings and units in buildings plus other structures, based on cadastral rental value.
Australia	*Australian Capital Territory:* state land tax (not on commercial property). Land value or land and improvements may be taxed, while exemptions are wide and varied. Local government tax based on three-year average land values. *Northern Territory:* no state land tax, only local government taxes based on land values, three-year revaluations. *New South Wales:* state land tax. Usually annual revaluations. Local government tax is also based on land values (three-year revaluations) plus standard charges. *Western Australia:* state land tax plus local government taxes (based on land value for rural land and gross rental value for urban land) plus other charges. *Victoria:* state land tax plus local government taxes based on capital value of land and improvements. *Queensland:* state land tax plus local government taxes based on land value. *Tasmania:* state land tax plus local government taxes based on annual rental value, although some municipalities moving to capital value. *South Australia:* state land tax plus local government taxes based on land value or capital value (Adelaide is based on annual rental value).
Austria	Uniform property tax based on capital value, supplemented by a local property taxes with different rates depending on land use. The last revaluation was in the 1980s.
Belarus	Land tax on agricultural and forest land and land of transport facilities, based on area, use, stage of development, zone and population. Property tax on certain buildings and improvements to land, based on insurance value for natural persons and balance sheet value for legal persons.
Belgium	Property tax based on cadastral or actual rental value, supplemented by local property taxes for which regional governments set the rate but rental values are determined by central government. These values are based on notional 1975 values adjusted for inflation.
Brazil	State level tax on rural land and municipal level taxes on urban property based on capital value of improved land.
Bulgaria	Property tax based on normative value if owned by natural persons and balance sheet value if owned by legal persons.
Cambodia	Property tax based on assessed market values of land and buildings is being piloted in a number of urban areas.
Canada	Many provinces levy a property tax based on current land value. A number of provinces have annual reassessments where market activity warrants while others have longer periods between valuation periods. Local and provincial authorities administer the taxes and tax rates.
Chile	National property tax on urban and rural property. Non-agricultural land is assigned a value based on the zone in which the land is located.
China	A residential property tax was introduced in 2011 with pilots in Shanghai and Chongqing.
Croatia	Tax on country cottages and rest centres, based on age and size. A property tax, based on value, was introduced in 2013.

Cyprus	Property tax based on capital value.
Czech Republic	Tax on agricultural and forest land and developed land, based on area and regulated price, plus a tax on buildings and other structures, based on area and a locally determined coefficient that varies with the population of the city. Tax rates differ depending on land use.
Denmark	Municipal land taxes based on value, plus a state property tax on owner-occupied dwellings and summerhouses, based on value. There are also municipal service taxes on commercial buildings, based on building value. Properties are revalued every two years.
Estonia	State level land tax based on capital value, with differential rates depending on land use.
Finland	Property tax based on capital value with different rates for dwellings and other uses. Agriculture and forest land is exempt.
France	Property tax, housing tax and a tax on business buildings and equipment, all based on annual cadastral rental value. To compensate for the lack of revaluations, coefficients are used to update values but they are at less than current market levels.
Georgia	Land tax based on area, with differential rates for agricultural and non-agricultural land. A tax on buildings and units of buildings and structures on land of natural persons, based on insurance value, and a tax on property of enterprises, based on balance sheet value.
Germany	Tax on land & buildings and agricultural machinery and livestock, based on fiscal values, which are usually lower than market values. Taxation varies by region and municipality both in terms of the valuation date used to generate the notional value and the tax rates. There are different rates for agricultural/forest land and other property. Urban land values are based on average prices per m2 and farmland is valued on the basis of soil classifications.
Greece	Municipal property taxes are based on the area of the property and the land it occupies. Adopted in late 2011 a new square-meter tax at varying rates is collected with electricity bills.
Hong Kong	Property tax calculated as a percentage of rateable value but with a very low tax rate unchanged for years, now giving rebates.
Hungary	Land tax and a building tax, both based on area and value. Tourist tax on holiday houses based on area and a communal tax per property based on a flat rate.
Iceland	Property tax based on capital value, with different rates depending on property type. Properties are revalued annually.
India	State-level and urban level property taxes. These taxes have evolved from annual rental values to area-based and capital value based assessments.
Ireland	Residential property tax based on capital value bands, plus a commercial property tax based on annual rental value.
Italy	Communal tax on property based on cadastral annual value. Local government business tax on occupiers of business property, based on occupied areas of buildings, with differential rates based on business activity and area. Tax on residential properties reintroduced.
Japan	Property tax where the 'standard tax rate' is set in law and local governments are expected to adopt this rate in setting local taxes.
Kazakhstan	Agricultural and urban land taxes based on area, property tax based on book value for businesses and area for persons. Agricultural land tax differentials are based on soil type and area type, other land differentials are based on plot area and regional factors.
Kosovo	Property tax based on capital value with use-type differentials.
Latvia	A residential property tax on buildings complements the existing land tax. Unused land is taxed at twice the rate applied to developed land. There are use-type differentials. Revaluations are every five-years.
Lithuania	Tax on agricultural land and an enterprise real estate tax, both based on tax value. There are separate taxes on land and buildings at the moment but the aim is to introduce a unified tax based on market values, with different rates for various land use types.
Luxembourg	Property tax based on capital value, with different rates depending on land use.
Macedonia	Property tax based on capital value, with different rates depending on land use.
Mexico	Property tax based on market value
Moldova	Land tax for rural areas based on area and a building tax for rural areas based on balance sheet value. Property tax for urban areas based on capital values, with local differentials based on owner type and property type.
Montenegro	Property tax based on capital value, with different rates depending on land use.
Namibia	Central government land tax on the value of agricultural land, and municipal urban property

	taxes.
Netherlands	Municipal property taxes based on capital values. For residential properties the tax is in two parts: for the occupier and for the owner. There are four-yearly rolling revaluations.
New Zealand	Local governments can choose the basis for their land and property tax. Use of land value as a basis peaked in the 1980s since when they have been switching to property value.
Norway	Local governments have discretion around taxing residential, industrial, and commercial property.
Poland	Agricultural and forest land taxes based on area. Urban property tax on buildings, based on area. Differential rates for property types. Agricultural and forest buildings are exempt.
Portugal	Municipal property taxes with different rates for urban and rural property.
Romania	Urban land tax based on area. Tax on buildings based on balance sheet or insurance value. Different rates for different towns and cities and zones within them. Agricultural rates are lower and depend on use.
Russia	Land tax based on agricultural cadastral value. Property tax on inventory value of buildings owned by persons and balance sheet value of property owned by enterprises.
Serbia	Property tax based on book values for businesses and useable area and average sales price for persons. Agricultural and forest land is valued at five times its cadastral income.
Singapore	Property tax based on annual rental value.
Slovakia	Land tax and a building tax, with differential rates for building type, city size and location in city, and for land use category.
Slovenia	Municipal charge for use of building land, based on area. Property tax on buildings and parts of buildings, based on normative value. Differential rates based on land use.
South Africa	National property tax based on capital values.
South Korea	Property tax where land and buildings are taxed at different rates.
Spain	Rural land tax and urban land tax, both include value of improvements.
Sweden	Property tax on dwellings and industrial buildings based on fixed charges and capped at roughly 75% of market value. New housing is exempt for the first five years and taxed at half the regular rate for the next five years. There are different rates depending on land use. Separate values of land and buildings are determined for single-family houses. For other types of property total value and land value are estimated, and building value is the difference.
Switzerland	Land tax, which includes value of improvements.
Taiwan	Land value tax, reassessed every three years, plus a land value increment tax, which acts like a capital gains tax. To discourage speculation there is a variation on how much is charged depending on how long property has been held. In 2011 a vacant land tax was re-instated with the explicit intent to discourage land speculation and hoarding; local governments have the discretion to set the vacant land tax rate between two to five times the standard land tax rate.
Turkey	Municipal property tax. Buildings are assessed using depreciated construction costs, urban land by area and street, and rural land by type. There are different rates for land and buildings.
Ukraine	Land tax based on capital value of land or area, and a tax on buildings based on area. If land has an estimated market value then the tax is one percent of the estimated value. All other land is taxed based on land area.
UK	Property tax based on the annual rental value of non-domestic accommodation and the capital value of domestic accommodation.
US	Most states have property taxes, which vary by state and by county. Hardly any have land taxes.
Vietnam	Area-based tax on non-agricultural land (excluding housing)

Appendix V: Queensland state land tax rates as at 2018

Rates for individuals

Total Taxable Value	Rate of Tax
$0–$599,999	$0
$600,000–$999,999	$500 plus 1 cent for each $1 more than $600,000
$1,000,000–$2,999,999	$4,500 plus 1.65 cents for each $1 more than $1,000,000
$3,000,000–$4,999,999	$37,500 plus 1.25 cents for each $1 more than $3,000,000
$5,000,000 and over	$62,500 plus 1.75 cents for each $1 more than $5,000,000

Rates for companies, trustees and absentees

Total Taxable Value	Rate of Tax
$0–$349,999	$0
$350,000–$2,249,999	$1,450 plus 1.7 cents for each $1 more than $350,000
$2,250,000–$4,999,999	$33,750 plus 1.5 cents for each $1 more than $2,250,000
$5,000,000 and over	$75,000 plus 2.0 cents for each $1 more than $5,000,000

All currency AUS dollars.

Glossary

Ad valorem tax	A tax which is levied as a proportion of the value of the good(s) being taxed. An example of this kind of tax is VAT.
Basis of assessment	The basis on which a *valuation* is conducted. In the context of the use of this term in this report, bases of assessment include *rental value* and *capital value*.
Basis of value	The fundamental measurement assumptions of a *valuation*. In the context of the use of the term in this report, bases of value include *existing use value* and *highest and best use* value.
Benefit tax	Tax related to the cost of providing public services. See *service tax*.
Business rates	A recurrent tax levied on non-domestic property. See *non-domestic rates.*
Cadastral value	The value of a property for tax purposes.
Capital value	The likely price an asset would sell for on a specified date. See *market value*.
Comparison method	A valuation method whereby an asset is valued based on the analysis of comparable transactions in the market.
Council tax	A *recurrent tax* levied on domestic property.
Development value	The value which could potentially be realised if a plot of land was to be developed to a more valuable use than the existing use.
Economic rent	Any payment accruing to a factor of production over and above the payment that is necessary to keep it in production.
Event-based tax	A tax which is levied upon the occurrence of a specific event. An example of this is the Scottish Land and Buildings Transfer Tax. See *land and property tax* and *recurrent tax*.
Existing use value	The value of a plot of land in its existing use. See *development value* and *highest and best use*.
Highest and best use	The use of a plot of land or a property which would produce the highest value. This could be different to the existing use. However, should the highest and best use be assumed to be different to the existing use, the assumptions regarding any potential for a change of use to the highest and best use would need to be based on reasonable assumptions, taking in to account the constraints of the land use planning system. See *development value*, *existing use value* and *hope value*.
Hope value	The value that purchasers of land pay in excess of the value for the permitted use. It reflects – in financial terms – speculation that there might be a change of permitted use that would increase the value of a plot of land.

Land and property tax	Tax which is levied on land and/or property.
Land value tax	A recurrent tax on landowners usually based on *unimproved land* value, usually levied as a percentage of the unimproved *capital value* of the site.
Market rental value	The amount that would be paid on the open market to rent a property on the basis of a notional lease. See *rental value*.
Market value	The likely price for which an asset would sell on a specified date. See *capital value*.
Non-domestic rates	A *recurrent tax* levied on non-domestic property. See *business rates*.
Rateable value	The value of a property arrived at by professional assessors which is used to determine the rates payable. In Scotland, the rateable value is established by the *Scottish Assessors* and the rates are payable on non-domestic property only. See *non-domestic rates* and *Scottish Assessors*.
Recurrent tax	A tax which is payable periodically e.g. monthly or annually. An example of this in relation to land and property taxation is *non-domestic rates*. See *land and property tax* and *event-based tax*.
Rental value	The amount that would be paid on the open market to rent a property on notional lease terms. See *market rental value*.
Residual land value	The value of a plot of development land which has been arrived at using the *residual method* and which represents the value of land which has (re)development value.
Residual method	A method of valuing development land whereby build costs and other adjustments are subtracted from the total value of the planned development to arrive at a *residual land value*.
Scottish Assessors	Independent public officials who establish the rateable value of property listed on a local *valuation roll*.
Service tax	Tax related to the cost of providing public services.
Tax base	The total value of assets which are taxable. If a type of asset (such as agricultural land) is excluded from the tax base, it means that it is not taxable.
Taxable entity	The individual or business which is liable for a tax. In the context of *land and property tax*, the taxable entity could be the owner and/or the occupier of land and/or buildings.
Tax rate	The rate at which a tax is set. In the context of *land and property tax*, it may be expressed as a percentage of the value of the asset. See *ad valorem tax.*
Unimproved land	In economic theory relating to *land value tax*, unimproved land is that which has been subject to no improvements whatsoever e.g.

	'prairie' or 'wild' land. In practice, however, legal definitions of unimproved land may vary. Some definitions may, for example, include land which has been subject to improvements which have merged with the land over time (e.g. levelling and drainage).
Valuation	The estimation of the value of an asset on a specified date; normally undertaken by a qualified professional.
Valuation roll	A public document which contains a list of all properties that generate a *land and property tax* liability for the *taxable entity*.
Wealth tax	A tax on personal assets, sometimes with the objective of wealth redistribution.

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