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**LOCAL GOVERNMENT FINANCE REVIEW
COMMITTEE CONSULTATION:**

Local Taxation in Scotland

SUBMISSION BY

SCOTTISH ESTATES BUSINESS GROUP

15th March 2005



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1. BACKGROUND

SEBG represents a group of progressive land-based estates with significant agricultural and rural business interests. It aims to promote a modern business approach in the management of Scotland's land resource in ways which deliver social, economic and environmental benefits. The group seeks to secure a sustainable and prosperous future for rural areas.

Estates are proven business models that assist the development of smaller rural businesses, and landowners and estates have a vital role to play in the ongoing and future development and prosperity of Scotland.

2. OVERVIEW

SEBG's overarching view of taxation for local government services is that whatever system is used should:

- be broadly based, with all those who might utilise or benefit from the services which it finances being required to pay some portion of costs of delivery;
- exhibit a very clear and close link to the delivery of those services;
- take account of ability to pay, with support mechanisms available to those in need;
- be efficient, fair and cost effective to administer.

3. REVIEW OF OPTIONS

The **Council Tax**, introduced in 1993 to replace the Community Charge, throws its net widely across the community which benefits from the local authority services provided, as well as maintaining a direct link between service provider and user. The administration required to deliver it has been in place for some time and works relatively efficiently, with collection rates improving in recent years.

Whilst concerns may be raised in some quarters that the Council Tax is not sufficiently progressive, it should be a relatively simple and administratively straightforward matter to adjust tax bandings to be more responsive to current property market conditions. The addition of a further band or two at the top end of the range, together with widening of the lower market value bands would do much to help address any inequity that may have worked into the system in recent years.

The Council Tax Benefit Scheme, which as the consultation points out has a large number of recipients, is well established and any move to a totally new method of raising local government funding would also necessitate costly and disruptive root-and-branch change to this important support mechanism.

The **Local Business Rates** system which supports local domestic taxation is another complex structure which is well established and operating relatively efficiently. By being based on a well developed system of potential rental value, the tax takes into account location, infrastructure and other effects on property potential, as well as being relatively easy to administer. It also is able to maintain a clear link between location and local authority, something which would inevitably be lost under a company tax system.

In contrast to the Council Tax and Local Business Rates, a **Local Income Tax** would break the link between tax payer and local services since it would necessarily need to be collected nationally. Whilst it might be broadly based, it is also a tax for which there are numerous evasion dodges for those who are not part of the PAYE system.

Scotland already has experience of a **Poll Tax** and as a result, the system is already badly discredited. A significant level of payments remains outstanding more than a decade after the short-lived Community Charge system was abandoned, partly because of its lack of regard to ability to pay. Its reintroduction to Scotland would be anathema. Any proposal to reintroduce the system in Scotland would be unlikely to be widely accepted, a prerequisite for high levels of collection.

Tourism is currently Scotland's largest industry, contributing over £4 billion to Scotland's economy and supporting more than 200,000 jobs. It also contributes heavily to local taxation through non-domestic rates. The imposition of a **Sales Tax** or **Tourist Tax** in Scotland would have a major and negative effect not only on prospects for growing the Scottish economy but also on livelihoods, particularly in rural areas which would be likely to be badly affected by the imposition of extra costs on very competitive markets. Were such taxes to be applied in Scotland alone, the effect would be to export economic activity and hence jobs, impacting most heavily on rural areas. Further, any link with local authority services would be lost.

A **Land Value Tax** (LVT), an annual charge on the rental value of land and valued at the optimum use of the land in question, is the final option floated in the consultation document. It would be illogical to resort to a tax developed specifically to encourage the development of underutilised land, in order to finance local services for the whole community. The system would be inequitable, being much more narrowly based than other practical revenue raising methods and would take no account of ability to pay. It would be administratively very difficult to maintain as well as costly to introduce.

Given the lack of widely available information or discussion about the implications of LVT, and since its impact would be felt particularly by those who own land in rural Scotland, SEBG has focused on this option and considered in detail the core issues as identified by the consultation, as they relate to LVT. Our comments on each follow.

4. RESPONSES TO QUESTIONS – Q14

Question 14: Would there be advantage in introducing the Land Value Tax as a replacement for the Council Tax? What are the reasons for your views?

Any assessment of whether LVT - an annual charge on the rental or capital value of land, valued at the optimum use of the land in question – would be an effective replacement for the well-established Council Tax needs to compare the two different forms of revenue collection against the basic principles as already set out which SEBG believe should form the basis of any equitable taxation to fund local services.

i Breadth of base

Since LVT would be based on ownership, it is likely to have a narrower base than Council Tax, which is charged on occupation, thereby impacting more heavily on current home owners.

ii Link to local service usage

By limiting the application of local taxation to those whose own property rather than including those who occupy it, some linkage with use of local services is lost.

iii Link to ability to pay

As the consultation document points out, currently 24% of all households and over 40% of pensioner households receive partial or full relief via Council Tax Benefit because of insufficient income levels. Disposable income does not necessarily equate with capital ownership. So were the local tax system to be changed to the narrower-based LVT approach - which would necessarily impact more heavily on those owning their homes - then some form of support mechanism would need to be found to assist those without adequate resources to meet their increased liability.

Further, additional support would be necessary, over and above replacement for the Council Tax Benefit system, to help even out the way LVT would impact at an individual property level. By way of illustration, take the example of two similar neighbouring properties, one occupied as his home by a pensioner and the other accommodating perhaps two or three separate business activities. LVT, a tax on site *potential*, would require the pensioner to pay the same level of tax as the total due from the neighbouring businesses, based on *potential* economic activity of the two plots of land and hence their prospective rental value.

It would also be ironic were home ownership – which has seen major growth in Scotland following encouragement by successive governments – to be used to target a new local tax, were LVT to replace the present Council Tax.

iv **Efficient, fair and cost effective to administer**

As a novel tax for the UK, the introduction of LVT as a replacement for Council Tax would necessarily require the establishment of a new structure of assessment and collection. This would not only necessitate the restructuring of the current property valuation system to take account of future site *potential*, but of necessity would also need to be closely associated with Scotland's planning system – already under review following criticisms that it is failing to deliver on various counts, for example economic activity.

Scotland's current planning system is currently widely regarded as a disincentive to development. Yet how the planning system operates is fundamental to the operation of LVT. Perception and performance of the planning system is unlikely to be improved if its role were to be expanded to become an essential element in the operation of a new local tax system based on future economic potential – and necessarily planning consent.

Land acquires a scarcity value owing to the competing needs of the community for living, working and leisure space. Any tax on land could not therefore be judged as even-handed, with tax liability varying according to local - and changeable - circumstance. Where lack of development is due to personal choice, for example those with large gardens, pony paddocks or crofts, then can it be right for society to target these personal resources for revenue generation?

These issues are explored further below, but on all counts, LVT performs less well than the current system of Council Tax allied to support for those less able to pay. **For these reasons, SEBG considers there would be no advantage – and indeed considerable disadvantage – were the Council Tax to be replaced by LVT.**

5. **RESPONSES TO QUESTIONS – Q15**

Question 15: How well does the Land Value Tax address each of the core issues outlined in the checklist?

Proponents of LVT argue that the tax does not distort market mechanisms or damage the economy, and that it is easy to administer because land ownership is simpler to track than income or sales transactions. However, closer investigation of how such a tax might work when set against the background of Scotland's economic and social structures must raise serious doubts as to the efficacy of LVT as a realistic alternative to the Council Tax.

- **Effect on the economy / economic growth:**

A tax on land, payable regardless of whether or how well the land is actually used, would operate in total isolation from, and take no account of, the needs of the local community. Whilst it might provide a spur to development in urban areas with gap sites and areas needing regeneration, it would have a counter effect on rural areas, where proposed development may be at the expense of the natural environment or the needs and desires of rural communities.

One consequence of LVT might be for potential development activity to be drawn away from major centres of population. The effect would be encouragement of urban creep between centres of population and out into the countryside. The inevitable effect of this type of unbridled development, the effect of the tax, would be to increase the need for transport from urban centres to suburban and rural areas, already less well served by public transport, so increase costs as well as road use – working entirely counter to any environmental or green strategy.

So whilst development is seen by LVT proponents as a “good thing”, such an approach fails to recognise that there are other objectives – social, environmental – which could be threatened by it.

Proponents of LVT also claim the tax cannot be passed on to a tenant who is already paying the full market rent. However, the economic reality would be that were such a new tax to be imposed on landholders, then commodity prices would be forced up due to pressure on market rents, given the landlord’s need to earn a satisfactory return on capital.

There is also an inherent risk that such a tax, if applied in Scotland but not elsewhere, would create a competitive disadvantage for Scotland’s businesses.

- **Fairness:**

Much of the value of land is drawn from the operation of the planning system, which would be required to exercise control over proposed land developments. However, in doing so, planning constraints would work directly against one of the arguments of LVT proponents, that the tax would be not only simple but equitable.

It could also be argued that since it would be raised on *potential* rather than actual land value, LVT would be based on an assumption of future planning consent which may or may not materialise. It cannot be regarded as equitable for a tax to be levied on land on the basis of an assessment of (speculative) potential which has yet to be realised.

A further irony of LVT is that whilst some see it as a mechanism to encourage urban development, it would have a particularly devastating impact on rural business activity. Rural industries are often primary in nature with weak bargaining power, and consequently low returns with which to pay LVT. Were such a tax to be applied across Scotland, the large majority of which is rural, then it would inevitably undermine the viability and therefore sustainability of Scotland’s rural communities.

It is also questionable whether LVT, when applied across remote rural local authority areas, would deliver the levels of funding required to support those local services needed by rural communities, which are necessarily more costly to deliver than in other areas.

If Council Tax were to be replaced by LVT, with other taxes remaining, then the effect of this narrowing of the tax collection base and loss of link with users of local services would be a double “hit” on businesses, which already are required to pay non-domestic business rates.

- **Preventing avoidance / collectability:**

Proponents of LVT argue that once the system has settled down, landholders will not be faced with complicated forms and demands for information and revaluation would become relatively simple. However, and to the contrary since land values can fluctuate widely according to the demand for it at any particular time (and with demand driven by a number of factors), the complex revaluation process would be required on a regular basis if it is to offer any semblance of fairness. Frequent revaluations to reflect changed circumstances brought about by infrastructure, employment, services and so on would be costly as well as administratively burdensome.

Further, any assessment of potential economic value inevitably will be subjective and fraught with difficulty over planning assumptions and viability. The valuation assessors with responsibility for rating already find business rating valuations based on existing use to be complex and difficult. Adding alternative uses and the value such alternative uses would generate into the calculation would make a difficult task almost impossible.

The inevitable consequence, a rash of valuation appeals – on each and every revaluation – would only serve to exacerbate an already tortuous appeal process and thereby serve to discourage potential development, irrespective of the needs of local communities. The tax would in effect sterilise rural development.

LVT might appear relatively straightforward to apply in urban areas, for example where planning designations already exist, but the zoning of a site for a particular use does not necessarily guarantee that such a use is a viable option. The scene would certainly be set for complexity and valuation dispute. As a consequence it would necessarily be extremely costly to administer, contentious and a clear disadvantage when compared to the current system.

- **Stability / predictability:**

Proponents argue that LVT, fully and properly applied, would remove the speculative element from land pricing and so put an end to boom and slump cycles. However, it should be remembered that other factors impact on value, for example where demand outstrips supply, price increase would be inevitable – and lead to increasing, and unpredictable, levels of tax on land holders.

Further and as already set out above, since LVT would be based on *potential* rather than actual land value, its assessment must necessarily be speculative, since the tax would be based on a subjective assessment which had yet to be realised.

- **The relationship to the Benefits system:**

LVT takes no account of ability to pay, an essential element of any equitable tax system. Land is an asset which cannot be liquidated readily, but once liquidated, obviates any tax liability based on land ownership.

Should this form of taxation be introduced despite all the difficulties its adoption would introduce, a totally new system of support would be needed for those without the resources to support their landholding.

- **Buoyancy:**

LVT has been put forward by proponents as a natural source of public revenue, since tax is already levied on 2 of the 3 means of production – labour and capital – but practical experience of LVT in other countries has seen it applied alongside and not in place of existing local taxes.

Given the proportions of government spending to GDP, it is doubtful that a land tax could be the sole source of government revenue and its flexibility to accommodate a wide range of economic circumstances is open to question.

Varying political preferences about the levels of local expenditure would also serve to exacerbate likely fluctuations in LVT levels.

- **The cost of collection:**

The introduction of any new tax will inevitably be complex and require a new bureaucracy to monitor its collection. It is questionable whether such expenditure would be justifiable in the light of continuing questions about the efficacy of LVT in addressing the core issues of local taxation.

- **Who collects the tax:**

The introduction of LVT would necessitate the setting up of a new tax collection system in addition to a complete register of land values. Given their volatility, this would need to be updated on a very regular basis.

- **Shift to a new system: timing and transitional arrangements:**

Any totally new tax, as LVT would be for Scotland, would be required to fit into the existing, and already complex, structure of fiscal measures. In addition, land taxation can be expected to have a major bearing on land prices and land use, significantly impacting in turn on business valuations and activity with consequent knock-on effect on the Scottish economy.

Were LVT to be introduced in Scotland as a replacement for the Council Tax, but not applied to the rest of the UK, then the economy could expect to see a net outflow of commercial investment, since Scottish operating costs would be made less competitive than in other parts of the UK. The inevitable outcome would be a contraction of economic/business activity and loss of jobs to Scotland. There would also be an impact on pension scheme asset values.

- **Other factors**

A number of factors would need to be resolved, were LVT to be introduced to Scotland:

- how would multi-use sites be assessed for valuation, for example a building with a commercial section on the ground floor, residential property above with commercial leisure facilities and a bar in the basement?

- how would the tax be apportioned for multi-ownership sites, for example Buchanan Street developments, Glasgow?
- who would be liable for valuation?
- would LVT cover residential land, commercial land or both?

6. CONCLUSION

SEBG welcomes the current review of options for local taxation in Scotland and believe the Committee is right to develop a series of core issues against which any prospective replacement for the current system must be measured.

Whilst the various systems of revenue-raising will score differently according to the various issues against which each is measured, SEBG believes that four basic principles must underpin any local taxation system. It must:

- be broadly based;
- exhibit a very clear and close link to delivery of the services it funds;
- take account of ability to pay;
- be efficient, fair and cost effective to administer.

The inherent risk of any major overhaul must be that a relatively effective, widely drawn and generally accepted, simple to collect source of revenue could be removed, only to be replaced by a badly thought through and inequitably applied new system of dubious effectiveness at disproportionate cost to deliver.

With the above principles in mind, SEBG believes that the current system of a domestic property tax supported by non-domestic rates / tax, with some adjustments where appropriate to take account of property market developments and current conditions, would be the most efficient and cost-effective solution to the current review of local government taxation.

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