

S | E | B | G

PLANNING-GAIN SUPPLEMENT:

**Consultation by HM Treasury, HM Revenue and Customs
and Office of the Deputy Prime Minister**

RESPONSE BY

SCOTTISH ESTATES BUSINESS GROUP

27th February 2006



**PLANNING-GAIN SUPPLEMENT:
Consultation**

**RESPONSE BY
SCOTTISH ESTATES BUSINESS GROUP**

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. SEBG is committed to rural economies and its members work hard across Scotland to stimulate enterprise and economic development.

2. SEBG – OVERVIEW

To secure a continued growth in opportunity and make available more and better quality homes, the UK Government is seeking to build sustainable communities supported by new investment in transport, schools, health centres and local services. This is a laudable aim which SEBG fully supports. SEBG members currently manage in excess of 3,000 private let properties across Scotland, mostly in rural areas, so the issues of delivering affordable rural housing are ones with which the organisation has much experience. A number of our members are actively engaged in innovative schemes to tackle the increasing shortage of affordable homes to rent or buy which is threatening the sustainability of many of Scotland's rural communities.

However, the Group has major concerns that the proposal to introduce a Planning-gain Supplement (PGS) as set out in the consultation paper will not only fail to deliver the Government's aims for it of improving the means of funding infrastructure to support the expansion of housing supply. SEBG believes it will also be a disincentive to and actively work against the very developments which are expected to deliver those desired aims.

As reported in the consultation paper, previous attempts to capture the gains from development through development gains taxes (DGTs) have proved costly and complex to administer and resulted in land being held back from development. Since PGS would essentially be a DLT, there is a clear danger that it would produce similar results, with consequent implications for the provision of future housing.

We suggest that the best way to free up housing supply is to ensure that the planning system identifies sites which could come forward for development. In our experience, when sites do come forward for development, any infrastructure constraints such as sewage, water supply, roads, are addresses through the release of land value, with the cost of rectification being met by the landowner / developer who takes the issue of resolving the constraint into his own hands.

Our main concerns about the proposed PGS fall into two distinct areas – why such a tax would deter rather than support development, and practical difficulties including the application of a reserved mechanism – the raising of tax revenues – to the devolved areas of planning and development.

2a. Impact of a PGS on development

The aims of the proposed PGS are set out in the consultation as:

- to reduce the scope for planning obligations
- to make planning obligations more transparent
- to assist the improvement of infrastructure to support the expansion of housing
- to make more land available for housing; and
- to encourage housing development

However, SEBG believes the impact of a PGS as proposed could work against these aims:

- In capturing some of the increased value of land through planning consent through imposition of the PGS, developers would be required to make a payment greater than that required under the current planning obligations regime, which for Scotland is based on S.75 of the Town & Country Planning (Scotland) Act 1997. The effect would be either:
 - to put up the cost of subsequent development including house prices
 - to lead to lower prices being offered by developers for land, which in turn would lead to less land being offered for sale and fewer developments consequently being taken forward
- Since planning obligations would be retained for environmental works related to the site and for affordable housing provision, and would be additional to the PGS, the economic viability of development projects would be reduced, leading to the abandonment of some formerly attractive investment projects.
- The PGS as proposed would act as a disincentive to early development, once planning permission had been granted. With PGS being based on planning gain – the difference between the land value with full planning permission (PV) and the value of the land in its current use (CUV) - its cost as a proportion of overall development cost of the project would fall over time as site value increases. Since planning consents usually are granted for a five year period, the economic case for a delay to the start of development would be strengthened, particularly where investment capital was required for the project to go ahead.
- Payment of the PGS as proposed would be required at the commencement of development, a time when returns for the project may not have begun to appear, thereby causing a further “up-front” financial burden which might have implications for the viability of the project.

- The “up-front” issue is also a relevant one for local authorities. It is intended that local infrastructure development would be funded from the revenues raised by application of PGS at the time development begins. Yet local authorities are routinely required to “pump prime” developments by ensuring the necessary infrastructure required to encourage and underpin them is already in place before projects commence.
- Many projects involve development for rent rather than sale. The effect of a PGS would be either to raise the rent to be charged, in order to cover the increased cost of the development, or to reduce the number of economically viable rental projects, potentially restricting any increase in supply of affordable property for rent. This is particularly relevant for residential development for rent in rural areas – in many of which there is already a significant lack of supply.
- Irrespective of the level at which it might be set, the very existence of the new tax would act as a new risk to offset the advantages of potential development.

For these reasons, SEBG believes that rather being a spur to development, imposition of the PGS as proposed would, on the contrary, deter development, reduce the supply of available land, limit the amount of housing becoming available and raise house prices. We are particularly concerned about the effect this may have on the provision of affordable housing in rural areas.

2b. Practical difficulties of introducing a PGS in Scotland

i. Implications of a PGS for Planning Obligations in a devolved administration

PGS is intended to fund the provision of new local community services such as schools, health centres, and public transport and also strategic regional infrastructure. According to the consultation, the use of planning obligations would be confined to site-specific matters related to the development and to the provision of affordable housing. The consultation also makes explicit that reforms to planning obligations would accompany the introduction of PGS.

However, this raises a fundamental issue in connection with the devolved administrations, since the UK Government is proposing to intervene in areas of planning which, in Scotland, is the responsibility of the Scottish Parliament. For PGS to work as intended, it would require the scaling back of planning obligations under S. 75 of the Town & Country Planning (Scotland) Act 1997 to restrict developer contributions imposed by local planning authorities to matters relevant to the environment of the development site and affordable housing. Increasingly local authorities are using S. 75 agreements in Scotland to secure financial contributions for a variety of community projects unrelated to the development site. In the Scottish Borders, for example, a levy is to be applied of £1500 on each new house to assist in the funding of the re-opening of the Waverley Line from Galashiels to Edinburgh.

If there is no reform of the planning legislation in Scotland to parallel the changes to planning arrangements in England which are to accompany introduction of PGS, it is of concern that developers in Scotland could be required not only to pay PGS but also to continue to suffer additional local planning obligations beyond site-specific matters. This might benefit local authorities in the short term but would act as a disincentive to development. It would also disadvantage developers in Scotland vis-à-vis the rest of the UK and run counter to the principle of equitable and uniform tax treatment between England and the rest of the UK.

The consultation proposals fail to acknowledge and address the clear conflict which would arise were they to be applied to a devolved administration which operates to a different legislative basis than that of other parts of the UK. Further, the proposals take no account of the reality that priorities and policy may differ across different administrations. Whilst the Westminster Government might envisage that scaling back of developer contributions is a key tenet of the proposed new tax, a Scottish administration may take a different view, particularly when the practical application of that tax requires a change to legislation for an area devolved to the Scottish Parliament.

Given the implications of application of a PGS in Scotland and its impact on Scottish planning legislation, a joint consultation exercise which included the Scottish Executive's proposed approach might have helped to shed some light on these issues. Nevertheless, SEBG stands ready to engage in any subsequent Scottish consultation on the practical implications of a PGS for Scotland and lend what support we can to seeking an equitable solution to Scotland's housing supply concerns.

ii. Complexity and cost of valuations

The assessment of planning gain would require before and after valuations to be obtained. For the tax to be fair this must be based on actual valuations. The alternative of average valuations would act to penalise developers in some cases and benefit them in others. However, actual valuations would inevitably be complex and costly. Assessing the value of land with planning permission (PV) would require consideration of infrastructure costs for the development such as roads, drainage, sewage treatment etc and of the affordable housing policy of the local authority. It would also require consideration of housing construction costs and the assessment of the market value for housing in the area at the time planning consent was granted. Current use value (CUV) would also be likely to be less than straightforward in many cases. The potential for disputed valuations would be considerable, with costly appeals and delays to the commencement of development.

It should be borne in mind that the main reasons that the taxation of development gains has failed in the past have been the problem of expensive and complicated valuations and the risk of dispute. The introduction of a betterment levy under the Land Commission Act 1967 and Development Land Tax in 1976 both foundered as the costs of valuation proved out of all proportion to the amount of tax being collected.

It is assumed that PGS will be a first charge to tax and CGT a second charge, although the overlap with CGT is not addressed in the consultation paper. To avoid double taxation the effect of PGS would be to reduce the chargeable gain to CGT and as a consequence the CGT revenues to the Treasury. In order to establish fully the net revenues to be generated from PGS, at whatever rate is adopted, an assessment of the cost of collection, the cost of administering the distribution of PGS revenues and the loss of CGT revenues would also be required.

iii. Phased and large scale developments

PGS would be payable at the time development commences. In some larger developments landowners may enter into agreements for particular parts with different developers or only with one developer for an initial phase. However, it is not clear who would be responsible for PGS in cases where more than one developer were involved with only a single planning consent, or how an assessment would be calculated in cases where the developer has legal occupation only to part of the development site.

For large scale developments there may be phased entry and payment by instalments as development proceeds. By imposing PGS at the start of development this may front load costs of development unreasonably on the first phase. Some phasing of PGS should be available where a development was to be undertaken in phases.

iv. Outline Planning Consent

The consultation paper refers only to full planning consent. It is common for developments to be granted outline planning permission and for an application for reserved matters to be made subsequently. The consultation paper proposes that PGS should be payable at the time development commences, yet there are no transitional arrangements where outline planning permission is obtained prior to the introduction of PGS. This could penalise developers in cases where they have acquired land with outline planning permission or entered into an option to acquire land at an agreed price subject to receipt of planning consent. Some transitional measures would be required to be provided where options were put in place or outline planning permission granted before the introduction of PGS.

v. Extinguishment / Variation of Planning Consent

Planning consents have a defined life, usually five years. In the event of a planning consent not being implemented or a variation being made to an original consent, then PGS would require to be extinguished or reassessed on the basis of the revised approval. This raises the issue of abortive or subsequent valuations being required which would add to the cost of administration and of development. A provision for repayment of PGS should be available in cases where a development is not completed in accordance with the terms of a planning approval.

3. DETAILED ISSUES RAISED IN THE CONSULTATION PAPER

3.1. PGS and the devolved administrations

SEBG has already highlighted the potential conflict which might arise from the application of a reserved measure - taxation - to the devolved responsibilities of planning and development. The way in which the PGS is proposed to operate, through liaison of HM Revenues and Customs (HMRC) with local authorities for the distribution of funds raised by the PGS, also creates issues of concern. There is currently no direct line of command between HMRC and Scottish local authorities. The Scottish Executive has already acknowledged, in an answer to a Scottish Parliamentary Question, that any funding to be returned to Scottish local authorities would be distributed through the Executive:

(S2W-21906)(Answered 24 January 2006)

Murray Tosh (West of Scotland) (Con): *To ask the Scottish Executive, further to the answer to question S2W-21459 by Malcolm Chisholm on 19 December 2005, what information it has on whether all revenue raised in Scotland from planning gain supplement will be returned to Scotland; whether the money will be paid directly to local authorities by HM Treasury or transferred to the Executive for distribution, and whether revenue raised in respect of development in a local authority area will be returned in full to that local authority.*

Malcolm Chisholm: There is currently little information available on these issues in addition to that contained in the consultation paper Planning Gain Supplement: a consultation, issued by HM Treasury in December. These are issues on which views can be expressed on the consultation and we will discuss them further with HM Treasury. I can however confirm that, since HM Treasury has no direct funding relationship with Scottish local authorities, the money returned to Scotland, however, it may be assessed, will be distributed through the Executive.

Since it is for the Scottish Executive to decide how it wishes to distribute funding received from the Westminster Government, it would be for the Executive to decide whether, and if so, how, it intended revenues drawn from collection of the PGS to be allocated to local authorities. Currently there can be no guarantee that the scheme proposed and ultimately to be approved by Westminster would be applied in the way envisaged.

SEBG would wish to see appropriate measures put in place to provide transparency and accountability to the Scottish Parliament for the dispersal by the Scottish Executive of the funds. The Group believes that safeguards should be applied, if necessary through legislation, to ensure that Scottish developers would not be disadvantaged by the new arrangements, or subjected to charges by local authorities over and above those to be applied under the PGS regime. The scale-back of planning obligations would need to be enacted north as well as south of the border, with PGS revenues distributed to Scotland to be ring-fenced for the purposes for which they were raised.

Further, the Group is concerned that although it is not proposed to introduce the PGS before 2008, timing of the consultation on and preparation for arrangements will be going on at the same time as the Scottish Executive's Planning Bill - which makes significant changes to the way the planning process is to be operated north of the border - will either be following its legislative route through the Scottish Parliament, or will be in the process of being applied by local authority planning departments.

SEBG would want to be reassured that these two major policy approaches were capable of being implemented effectively at the same time without major negative impact on the development of Scotland's infrastructure that they both are intended to support.

3.2. Valuing Planning Gain

Valuation methodology

Scotland presents a diverse mix of economic, social and environmental conditions with local circumstances being very different even between neighbouring communities, let alone between the for example the Highlands and the Borders, Dumfries and Galloway and the North East, or between the far-flung and remote islands and the Central Belt. As such, it is to be expected that that the use of average valuations for the purposes of a PGS would carry very little if any public confidence. The perception of unfairness of the proposed system would be magnified were such an approach to be adopted. Such a wide variation in consequent land values must necessitate the use of actual rather than average valuations in the calculation of PGS.

Some account also needs to be able to be taken in situations where values have fallen rather than risen, and where developments have commenced but have either not been completed or have been taken over by an alternative developer.

Actual valuations and self-assessment

Whilst actual valuations would present a more equitable application of the proposed PGS, the use of self-assessment, particularly with the need to obtain two valuations, would add a further cost and therefore disincentive to prospective development.

3.3. Paying PGS

Payment

As set out above, the requirement that PGS should be paid on the commencement of development fails to account adequately for those situations where more than one developer may be involved in a project with a single planning consent, or where individual developers have legal access only to part of the development site. Should a PGS be implemented, there would be both a need for greater clarity as to who was to be responsible for payment, and some provision for phasing of payments in those circumstances where the development was to proceed only in stages.

Securing compliance

Again, as set out above, SEBG is concerned that there are currently no direct lines of operation between Scottish local authorities and HMRC. Funds raised by PGS would require to be channelled through the Scottish Executive, with accountability to the Scottish Parliament for their application. Similarly, the involvement with Scottish local authorities with HMRC as the body responsible for collecting the PGS revenues would need to be clarified and appropriate measures applied to ensure transparency and accountability.

Transitional arrangements

As the consultation paper makes clear, should a PGS be implemented, it would be important to the operation of the new scheme, as well as to its credibility, that appropriate interim measures are introduced, to allow for example for those cases where permissions have been granted but development yet to commence.

3.4. Scope

Greenfield and brownfield land

Whilst the proposed tax rate has yet to be fixed, it would be important that a lower rate were set for brownfield sites, to encourage their development. Enterprise zones or areas with other special development status, including those areas designated by Scottish local authorities for special treatment, should be exempt from PGS.

Minimum thresholds

It will be particularly important for Scotland's rural areas and communities that the measures should not impact disproportionately on small developments. Returns on projects in remote and rural areas can be expected to be more economically vulnerable than those for areas of population, but at the same time, the need for them may be much greater. Provision of 2 or 3 units of housing or a business premises for a remote community, for example, can make the difference between its future economic sustainability and its collapse.

If the UK Government is sincere in its support for measures to underpin and encourage the future sustainability of remote settlements, small-scale projects, whether residential or non-residential, should be excluded from the application of PGS.

Interactions with taxes

The consultation paper tries to argue that whilst the amount a landowner may receive from the sale of development land would be lower where PGS is factored into the land price, his CGT liability would also be potentially smaller. Nevertheless, the net effect would still be a lower return than might otherwise be expected, and act as a disincentive to the releasing of land for development. PGS therefore risks leading to a reduction in rather than an expansion of land made available for development – which runs counter to the stated objectives of the PGS scheme.

3.5. Financing Infrastructure Through the Planning System

The case for scaling back planning obligations

SEBG recognises the points made by the consultation paper about weaknesses in the current system of planning obligations. There is certainly a lack of certainty and transparency about developer contributions and a feeling that planning consent is sometimes “bought or sold”. Whilst in principle the Group would welcome moves to bring greater clarity to the process, we are concerned, as set out above, about the practical implications of a new regime of scaled back obligations being implemented south of the border whilst it would necessarily be left to the Scottish Executive and Scottish Parliament to decide on and legislate for the regime of developer obligations to be applied in Scotland.

3.6. Allocating PGS Revenues

Options for allocation

PGS needs to be a credible and transparent method by which revenue is recycled within the locality from which it originated, a local tax for local initiatives to facilitate local infrastructure. Current revenue collected through S.75 agreements in Scotland is collected locally and recycled locally. However, PGS would be collected centrally with a consequent loss of any transparency that revenue was being recycled to benefit the area in which it was raised.

If PGS is to be successful in delivering increased investment in local infrastructure and increased housing provision – and to be generally accepted as such - it should not be used as a vehicle to siphon off resources from one area or region to the benefit of another. This would be particularly so in Scotland, where hard-pressed local authority areas would be loathe to lose the infrastructure funding support currently delivered through developer contributions, only to see the resources directed to other Scottish authorities. Concerns would also be raised if there were to be a net loss of infrastructure funding from Scotland to other parts of the UK.

SEBG believes the more equitable approach, should a PGS scheme nevertheless be implemented, would be to distribute PGS revenues to the local level as grants in direct proportion to the revenues raised. This would have the advantage of offering both local communities and developers greater certainty and clarity, as they would be able to see a direct link between PGS revenues and the funding of the local infrastructure needed to support growth.

Polly McPherson
Scottish Estates Business Group
27th February 2006