■ CHAPTER THREE

General Taxation and Taxes on Land

We now study the case of Britain in order to consider how LVT (or site value rating [SVR], as it is termed locally) might harmonise with the extant taxation system in the U.K., particularly with respect to the U.K.'s membership in the European Union.

Revenue Currently Raised by U.K. Taxes

How does the U.K. government currently raise revenue?[1] Table 1 shows the sources of government revenue forecasts for 2001–2002, classified into the groups in the HM Treasury financial statement and budget report for 2001, e.g., income tax, national insurance, nondomestic property tax, etc.[2]

Adam and Frayne summarise this Treasury source as follows:

> Total government receipts are forecast to be £398.4 billion in 2001–02, or 40.2% of U.K. GDP. This is equivalent to roughly £8,500 for every adult in the U.K., or £6,600 per person. In 2001–02, the largest single source of revenue for the Government will be taxes on income, both personal and corporate. Approximately £104.1 billion, or 26.1% of total current receipts, will be raised from income tax, with a further £62.6 billion from National Insurance contributions and £37.8 billion from corporation tax. These three sources alone will account for just over 50% of total government revenue. Some £125.0 billion, or 31% of revenue, will be raised by taxes on expenditure, with VAT accounting for £61.3 billion and council tax £14.7 billion. The remainder will be raised by other indirect taxes, including excise duties on petrol, alcohol and tobacco, which will raise a total of around £36.8 billion. Taxes on capital will provide a further £13.0 billion for the exchequer. (2001, 1–2)[3]

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1. This chapter describes the nature and extent of the general taxation system in the U.K. at present, that is to say, covering England, Wales, Scotland, Northern Ireland and the Scilly Isles, but excluding the Channel Islands and the Isle of Man.
2. A further summary description of the U.K. taxes listed in Table 1 can be found in Annexe 1 to this chapter.
3. A more detailed treatment of this range of U.K. taxes may be found in the IFS (Institute of Fiscal Studies) Briefing Note no. 9, "A Survey of the U.K. Tax System," at www.ifs.org.UK/taxsystem/taxsurvey.pdf.

TABLE 1 Original Analysis of Sources of Government Revenue, 2001–2002 Forecasts

Source of revenue	Forecast 2001–2002 (£bn)	Percentage of total (%)
Income tax (net of income tax credits)[a]	104.1	26.1
National insurance contributions	62.6	15.7
Capital taxes		
Capital gains tax	2.5	0.6
Inheritance tax	2.3	0.6
Stamp duties	8.0	2.0
Value added tax	61.3	15.4
Other indirect taxes		
Petrol duties	22.5	5.6
Tobacco duties	7.6	1.9
Alcohol duties	6.7	1.7
Betting and gaming duties	1.5	0.4
Vehicle excise duty	4.5	1.1
Air passenger duty	1.0	0.3
Insurance premium tax	1.8	0.5
Landfill tax	0.5	0.1
Climate change levy	0.8	0.2
Customs duties and levies	2.1	0.5
Corporation taxes		
Corporation tax	37.8	9.5
Petroleum revenue tax	1.6	0.4
National nondomestic rates	17.5	4.4
Oil royalties	0.6	0.2
Council Tax	14.7	3.7
Other taxes and royalties	9.5	2.4
Interest and dividends	4.8	1.2
Gross operating surplus and rent	20.5	5.1
Other receipts and accounting adjustments	1.4	0.4
Current receipts	**398.4**	**100.0**

[a] Gross income tax minus income tax credits

Source: HM Treasury, *Financial Statement and Budget Report, 2001* (www.hm-treasury.gov.U.K./Budget/Budget_2001/Budget_report).

What Is Land?

Having looked at taxation in the U.K. in general, we now turn specifically to the nature and characteristics of land, and introduce its suitability as a tax vehicle.

Land as Terra Firma

In dealing with landed property taxation, we employ the meaning of *land* as land for development—that element of natural resources that is used, or that could be used, for physical development, that is, change of use via mineral extraction or construction. In that context, *land* is thereby limited to the earth's surface (terra

firma), the minerals below the surface, and the air and sun above. It is this meaning of land—that of space—that is the platform for associated socio-economic activities, to produce development and thereby the *development value* that can be taxed.

Land as terra firma is uniquely and significantly different from other economic resources (Lichfield and Darin-Drabkin 1980, 12–13; Gaffney 1994, 39–42). And because it is unique, it attracts policies that are also unique. Land is the platform of all human activities, aside from certain telling exceptions, such as space travel. And because raw land is "God-given" or a "gift of Nature," its original qualities are available without any human activity whatsoever. However, human activity is usually needed for improvements that facilitate human use of land: infrastructure and buildings. Land also has unique qualities as a factor of production: it is fixed in location, it is immobile and immovable, and the supply of it cannot be expanded (with only minor exceptions such as reclamation). In addition, land has a special place in society, in that, for example, no state can be said to be independent that does not control its own land, and no individual can be said to be independent who does not have freedom of access to a part of that land. It is over possession of land that people have fought wars for centuries.

Because land holds this special significance, societies throughout history have found it necessary to restrict absolute ownership of any portion of the land against the rest of society; they have not done this for automobiles, television sets and so on. Thus, it has been generally accepted that any individual's use of terra firma need be subservient to some overriding control, for example, by tribal chiefs, nation-states, federal governments or international agreements. Of course, this notion of land's special place in society also raises the question of its special relationship with taxation, but before we explore this, let us look at land in a different capacity.

Land as a Legal Concept and as Construed for LVT

In physical terms, land combines the raw earth and mankind's improvements to it. In British legal parlance, "land includes buildings and other structures, land covered by water, and any estate, interest, easement, servitude or right in or over land" (Interpretation Act 1978, s. 5 and Schedule 1). So, in our interpretation of extant land taxation, it is relevant to consider how far the ownership and/or occupation of land, as this form of property is usually understood in the context of LVT, is already subject to taxation of one sort or another. (We examine this aspect of interdependence later in this chapter.) However, there are also other definitions of land more concerned with providing a vehicle for LVT, and for our purposes here we adopt the following definition from Lichfield and Connellan:

> The share (of assessed taxation)…would depend upon the value of the land disregarding any buildings or any other improvements upon it. With undeveloped land its value would reflect any potential for development…. The fundamental idea of site value presents no difficulty. It is the value of each site estimated as at the valuation date upon the assumption that any buildings or other improvements on it did not exist, but that everything surrounding it remained as it is. That is to say that the site is to be valued as if it alone were unimproved but that it enjoyed whatever advantages arise from its situation, the road system, the public services, the proximity of shops, places of entertainment, schools, churches and every other convenience of civilisation. These are in fact the advantages that have always been bought whenever a vacant site has been purchased. (1998, 65)

Current U.K. Taxes that Impinge on Land

LVT is only one form of taxation on land; others are listed by Graham (1986, 1001) as taxes that currently impinge on land in England and Wales:

- income tax and corporation tax;
- capital gains tax;
- inheritance tax;
- stamp duty;
- value added tax; and
- rates and council tax.

Income Tax and Corporation Tax

Individuals are liable to income tax, which is levied on earnings and profits at the *ad valorem* rates of 10 percent (lower rate), 22 percent (basic rate) and 40 percent (higher rate) in 2000–2001. The tax on the profits, etc., of companies is called corporation tax, which is charged at the current main rate of 30 percent, with a small companies' rate of 20 percent (dependent on level of profits).

Investment income from land. Rental profits are taxable as income under Schedule D (income and corporation taxes) and include unfurnished and furnished lettings, rent charges, way leaves, mineral royalties, tolls, premiums and woodlands. However, under Schedule A (income and corporation taxes), as Price points out, there is no charge on rents as such, but only on the profits that arise from rents and similar receipts from land (Income and Corporation Taxes Act 1988, s. 15):

> The general principle is that the profit is calculated by: (i) taking the gross amount of rent or other sum which is receivable during the year of assessment (whether or not it is actually received in that year); and (ii) deducting certain allowable expenditure which is made within the year. (1994, 4)

MacLeary (1991, 30) further specifies that the profits arising from rents and other receipts from land include rents under leases, rent charges, ground annuals, feu duties and other receipts arising as a benefit to an individual as a consequence of the ownership of an interest in land. Although rent is given its ordinary meaning, that meaning is extended to include any payments made by a tenant in the area of costs incurred in repair and maintenance, provided that such payments are also classified as rent payable under the lease. In circumstances where a premium is paid then, if the lease is granted for a period of 50 years or less, part of that premium is also treated as rent.

Trading in land. If a taxpayer is regarded as "trading in land," then the "trading profit" is taxable under Schedule D as income tax or corporation tax. The question of such trading has been the subject of judicial decisions; the position is summarised by Price:

> It seems that a person will carry on a trade if:
> (a) he buys land which is capable of producing a profit on re-sale, or he buys and develops land in a manner which is capable of producing a profit;
> (b) he sells the land to one or more purchasers;
> (c) he does so for the purpose of producing a profit;
> (d) he does so recurrently or habitually; and
> (e) he does so in a commercial manner. (1994, 28)

Capital Gains Tax

When a taxpayer disposes of interest in land, that disposal may give rise to income tax liability, if the proceeds of the transaction are to be taken into account when computing trading profit. If the disposal of the interest in land does not give rise to income tax liability, the transaction will consist of the disposal of a capital asset, and, in principle, the taxpayer will have to pay a capital gains tax (CGT) on the increase in the value of the asset during the period in which the taxpayer owned it.

There is a basic distinction between income tax liability and CGT liability, but s. 98 of the Finance Act of 1988 has provided for the harmonisation of the rates of income tax and CGT. For individuals, CGT is charged at the same rates as income tax, with certain exemptions. Companies pay corporation tax at their applicable tax rates on their capital gains.

Prior to the April 1998 budget, to take account of inflation, if a disposal was made after 5 April 1982, the original cost and enhancement expenditure might be increased by indexation in proportion to the increase in the Retail Price Index from that date. However, the Finance Act of 1998 provides for indexation to be frozen from April 1998 for those within the charge to capital gains tax. The proposals will mean that for assets acquired before April 1998 and disposed of after

5 April 1998, the figures to be used for calculating the indexed rise will be as set out in a table published in May 1998. The calculation should be based on the fact that there had been a disposal in 1998. No indexation allowance will be available for any period after April 1998.

Inheritance Tax

Inheritance tax, which applies to lifetime gifts and to an estate upon death, was introduced by the Finance Act of 1986, following the abolition of capital transfer tax (CTT). Inheritance tax is based on the value of the assets owned by the taxpayer; broadly, the net value of the taxpayer's assets is known as their estate. A transfer of value is any disposition made by a person resulting in a reduction of the value of the estate. For inheritance tax purposes, each taxpayer has what might be called an "IHT history," with a principle of accumulation that is carried over to death. The tax is based on a combination of the value of taxable gifts that the taxpayer made during the last seven years of their life, and the value of the taxpayer's net worth upon death (Price 1994, 125).

The basic rules of valuation are that assets, including landed property, are to be brought into account at the price that they might reasonably be expected to fetch if sold in the open market at the time of transfer. The price is not reduced, on the ground that the market is flooded as a result of the whole of the property being notionally placed on the market at the same time. The principles, which are applied in determining the market value, are the same as those that apply for the purposes of CGT.

Stamp Duty

First imposed in 1694, the stamp duty was levied not on transactions (e.g., conveyance of landed property) themselves but on the document under which the transaction was effected. In general, ad valorem stamp duty is payable on every instrument whereby any property, or any interest in any property, is conveyed or transferred on sale (Stamp Act 1891, s. 54). However, as of 1 December 2003, stamp duty land tax (SDLT) replaces stamp duty for landed property transactions, whether or not completion takes place. (For the amount of duty, see Annexe 1.)

Value Added Tax

Value added tax (VAT) is a tax on the supply of goods and services, if the supply is a taxable supply (as defined) and made by a taxable person (as defined) in the course of that person's business. Supplying in the course of business, for VAT purposes, includes buying, selling, leasing, renting or hiring out of land or buildings on a regular basis. This could include the sale of freehold land and the sale or grant of leasehold land (exceeding 21 years), but various exemptions affect sales by builders. If applied, the full rate of VAT is currently 17.5 percent.

Rates and Council Tax
Rates and council taxes are levied on occupiers of landed property (land plus improvements and buildings) for local government revenues. In view of their special relevance to LVT, they are examined in detail in Chapter 4.

Interdependence of the Various Land Taxes

In general terms, imposing LVT affects the open market value (OMV) of land. The measure of OMV is at the heart of other land taxes, such as capital gains tax and inheritance tax. Thus, for example, if the obligation of the landowner to pay LVT reduces the OMV of that land, then other taxes that impinge on the land are consequently liable to fall.

For the purposes of this book, it is not necessary to trace through the detail of this process. However, in introducing any change in landed taxation, such interconnections between land taxes ought not to be ignored or glossed over. To date, a literature search has not revealed much detailed comment on this particular issue, but it is interesting to note Andelson on the subject.

> Obviously, some economic rent is appropriated by public authority in all countries through other means—most notably income, estate and capital gains taxes. But (with a few exceptions such as South Korea's differential levy on capital gains) in most cases it is lumped together with other returns in such a way as to defy separate identification, hence cannot be dealt with in these pages. One should note, however, that land tends to enjoy so many special tax advantages that there is reason to believe that the land-based portion of public revenue from these sources is much smaller than might otherwise be supposed. (2000, Introduction, xx)

Integrating LVT into the U.K. Tax System: Consequences of EU Membership

In later chapters, the question of how to fit LVT into the U.K. tax system will be examined in some detail, but at this stage we make the preliminary assumption that, given the political will, there should be no legal impediment to introducing LVT as either a substitute property tax or an entirely additional tax. But before considering any fundamental changes to the existing U.K. general taxation system, it is important to recognise certain aspects of the Treaty of Rome, particularly articles 95 and 100, under which the U.K. surrenders a modest part of parliamentary sovereignty to the European Union (EU). As MacLeary (1991) points out, these provisions are mainly designed to prevent discriminatory taxation between member states. More progressively, they give the EU the power to harmonise taxation between member states by the use of directives. In this way, for example, uniformity in the application of value added tax and of company taxation is being pursued. It is also true that the EU itself can raise taxes for EU

revenues, which derive in part from a proportion of VAT, customs duties and agricultural levies collected in the U.K.

How far, then, and in what specific respects could the U.K.'s freedom to impose LVT be restricted by membership in the EU? Might it be necessary to get EU agreement, or uniformity of action by all EU countries, for any LVT provisions that the U.K. wished to introduce? It seems reasonably clear that, under the European treaties and directives now existing, there would be no formal restriction on U.K. freedom of action on LVT. But tax harmonisation is a controversial issue. In recent years, for example, there has been a furore over the U.K. government's refusal to accept the "withholding tax" proposal, supported by other EU member states, which is designed to harmonise taxation of savings income in the form of interest payments from direct investment.

Nevertheless, we see no specific reason why other member states should object to the introduction of LVT in the U.K. But, if it were argued that the reduction of taxes to be replaced by LVT would give the U.K. an advantage over other EU countries in investment and trade, which would be contrary to the rules of fair competition, this might become one of a set of miscellaneous issues to be horse-traded against others in some future negotiation among EU governments. Accordingly, on balance we think it right to assume at the present time that, if the U.K. government decided to introduce LVT, membership in the EU would not prevent it from doing so. Moreover, since property taxation exists in all of the countries in one form or another, LVT seems a likely candidate for investigation on harmonisation. The prospects for LVT are there, since it exists already in part within general property taxation, and the case for its retention and expansion can logically be argued (Lichfield and Connellan 2000b, 22–24).

LVT and the Prospects of Taxation Shift

In Chapter 1, we outlined the prospects of taxation shift, which included LVT and eco-taxes, and here we add a brief comment on its effect on the general tax position of the U.K. Eco-taxation follows the definition used by the European Commission (ATW Research 1996, 3), namely, that it is based on a physical unit (or proxy for it) of something that has a proven specific negative impact on the environment. It can be a tax (unrequited payments to government) or a charge (requited payments for which a service is provided by some public body generally in proportion to payment made), and these are examples of economic and financial instruments that are designed to modify market behaviour with a view to achieving government objectives (DETR 1993).

We have already suggested that introducing and enhancing these taxes could form part of a tax shift program that would radically alter the application and conception of U.K. taxes. But as we have pointed out, the U.K.'s membership in the EU may inhibit tax reform, so this aspect has to be recognised.

Summary

We have seen that certain taxes already impinge on the taxation of land (in its wider interpretation), but there are recognised difficulties in tracing the ultimate effects of such interdependence among taxes. We have also suggested that the cited definition of *land* for use with LVT would support alternative taxation (i.e., LVT combined with taxation shift) and would fit in with the overall U.K. taxation system. The wider implications of such a taxation shift have still to be considered (see Chapter 16).