

■ CHAPTER NINE

## *LVT in Principle: Criteria for Choosing Options*

In Part III, we explore ways that LVT might be implemented in Britain in the future. In this chapter, we consider various criteria for choosing a method of LVT that could be introduced. Our list of criteria, drawn from examples from other countries and from past practical valuation experiments nearer home, provides a starting point from which to derive workable LVT proposals for present-day Britain. In recalling the successes and failures of introducing LVT, as enumerated in Parts I and II, we must keep in mind George Santayana's pointed aphorism: "Those who cannot remember the past are condemned to repeat it."

### **World Survey**

Andelson in his survey (1997, 9) presents a formidably long list of countries where LVT in some form is, or has been, used: Argentina, Canada, Chile, Jamaica and other Caribbean states (Barbados, Belize and Montserrat), the United States, Denmark, Finland, Germany, Hungary, certain East African nations (Kenya, Malawi, Tanzania, Uganda, Zambia and Zimbabwe), South Africa, Abu Dhabi, Hong Kong, Singapore, Japan, South Korea, Papua New Guinea, Australia and New Zealand. He points out, however, that the degree to which LVT is actually used around the world is too slight to provide definitive data, and there is a paucity of hard empirical evidence for its success in practice. Yet, Andelson argues the evidence that does exist is consistent, and its cumulative weight, if not entirely conclusive, is at least impressive.

In his latest edition, Andelson (2000, 97, 129, 205, 239) adds Colombia, Estonia, Great Britain and Mexico to his list, but he still maintains that the implementation of LVT overall has been extremely modest, and its impact, although genuine, has been all too often blunted by countervailing policies, usually at other levels of government; this has been the case particularly in Britain. Despite this realistic acceptance that Georgism has not yet truly arrived,

Andelson is not inhibited from making his peroration to action, as can be seen in an excerpt from the final paragraph of his introduction:

Like Plato's ideal city, the full Georgist paradigm has been realised nowhere on earth. Only in pale and evanescent glimmerings here and there may faint terrestrial traces of its lineaments be glimpsed. But it remains a steady vision in the heavens. It is not, as in the *Republic*, too sublime for human nature, necessitating a "second-best" substitute like the city of Plato's Laws, better adapted to man's frailty; rather, it is eminently applicable to the problematic human situation. (Andelson 2000, xl)

Andelson here voices the hopes of the Georgist fundamentalists, claiming some measure of success for Georgism around the world, but with the proviso "better sober realism than naïve complacency." He also clearly expresses impatience that the full Georgist paradigm is not widely established as a living and working reality.

But from our research standpoint, in light of more than 100 years of history of attempts at implementing LVT in Britain, together with our understanding of current political prospects, it seems that the argument for gradualism is a more realistic approach (Connellan 2002b).

### **Definitions of Land Value**

McCluskey and Franzsen (2001) explain, in their review of LVT at the local-government level in South Africa, Kenya, Australia, New Zealand and Jamaica, that when values are assigned to land, the definition of land value must mirror the market within which the property is traded. One of the major issues affecting LVT assessments has been the variety of definitions of land value that have been applied. Essentially, three terms are used interchangeably: site value, land value and unimproved value. Each of the jurisdictions examined by McCluskey and Franzsen defines these terms, and, generally speaking, land value and site value are much closer together in their meaning and interpretation. Land value and site value are normally taken to mean the value of the undeveloped land based on highest and best use and assuming that all adjacent infrastructure is in place. Unimproved value is the value of the land in its original condition (marsh, forest, etc.). However, due to its hypothetical nature, the use of unimproved value as a standard for LVT is now declining, and more reliance is being placed on site value. Clearly, a realistic and concise definition of land value is needed in order to provide a defensible assessment.

### **Prospects for the Basis of Appraisal**

Mass appraisal approaches are now seen as an essential element of the appraisal process. They involve valuation of many properties as of a given date, using standard procedures and statistical testing (IAAO 1990, 88). Land value systems

would tend to facilitate this approach more readily than other systems by virtue of the fact that fewer variables need to be collected (Fibbens 1995, 61–67). Australia, New Zealand and several states in South Africa have developed computer-assisted mass appraisal systems (CAMA) (McCluskey and Adair 1997, 211). Essential to any mass appraisal procedure is having access to quality data; inherent within this is a process of quality control (Gloude-mans 2000, 20).

There is little doubt that geographic information systems (GIS) will have a significant impact on the mass appraisal process, by facilitating more frequent and regular revaluations. One other clearly evident aspect is the need to standardize valuation practices throughout a country via one central assessment body, as in Jamaica, New Zealand and Australia. This has distinct advantages in maintaining standards and in ensuring that equity issues are appropriately addressed.

New approaches to land valuation have also been considered by German et al. (2000, 4–5), particularly from experience gained in Lucas County, Ohio (which includes the city of Toledo), where they have determined that sophisticated and less expensive GIS technology can be used for full integration with CAMA for spatial analysis. Using the same research source in Lucas County, Ward et al. (2002, 15–48) reported further to the International Association of Assessing Officers (IAAO) on the assessment industry's need to integrate CAMA econometric modelling with the geospatial analysis capabilities of GIS.

### **Revaluations**

One of the most important features of any property tax system is its ability to keep value assessments in line with open market values. A failure to regularly revalue creates inequities and distorts the distribution of the tax burden, with correspondingly large changes following any future revaluations. McCluskey and Franzsen (2001, 74–76) confirm that, as a general principle, systems based on LVT tend not to be as volatile as systems based on improved value, because LVT ignores increases in value due to improvements. However, it is important that changes in land values due to market movements, rezoning and highest and best use need to be reflected with an appropriate frequency of revaluations. In the U.K., the lack of revaluations over past decades has given rise to serious assessment and administration problems, discussed in Chapter 4.

### **Two-Rate Property Taxation in the U.S.**

Hartzok describes the experiences of Pennsylvania's cities with two-rate taxation. A standard property tax is actually comprised of two types of taxes, one on building values, and the other on land values. The two types have very different impacts on incentives and development results:

Pennsylvania's pioneering approach to property tax reform recognizes this important distinction between land and building values through what is known as the split-rate or two-tier property tax. The tax is decreased on buildings, thereby giving property owners the incentive to build and to maintain and improve their properties, and the levy on land values is increased, thus discouraging land speculation and encouraging infill development. This shifting of the tax burden promotes a more efficient use of urban infrastructure (such as roads and sewers), decreases the pressure towards urban sprawl, and assures a broader spread of the benefits of development to the community as a whole. (1997, 205–206)

Hartzok comments also, on the need for a gradual transition process:

There is a lesson here in the “art of tax improvement.” It is necessary to move to the two-rate system while maintaining a revenue neutral tax base, at least initially. Another key is to move gradually. One generally accepted guideline is to shift no more than 20% of the taxes off buildings and onto land each year for a period of five years, or 10% each year for a period of ten years, in order to fully shift all taxes off buildings and onto land value.

Such a gradual transition, combined with community education, allows the citizenry to make the adjustments required, particularly to orient away from expectations of speculative gain in real estate land price escalation and towards investment in the development of affordable housing and business activities. Obviously, as buildings are taxed less their value might rise, while the value of the more heavily taxed land should fall. While more research of these types of effects is needed it would appear from the longer continuation of this tax policy in areas that have tried it that it meets with voter approval. (1997, 212)

In relation to the progress of two-rate taxation in Pennsylvania, Oates and Schwab (1997, 5–19) have researched the impact of urban land taxation on the city of Pittsburgh. They found that in 1978–1980 the city restructured its property tax system by raising the rate on land to more than five times the rate on structures. In the 1980s Pittsburgh experienced a dramatic increase in building activity, far in excess of other cities in the region. Their analysis suggests that, while a shortage of commercial space was a primary driving force behind the expansion, the reliance on increased land taxation played an important supporting role by enabling the city to avoid increases in other taxes that would have impeded development. This conclusion, they argue, is fully consistent with the traditional view that LVT is neutral and that it “provides city officials with a tax instrument that generates revenues but has no damaging side effects on the urban economy. In this way, it allows the city to avoid reliance on other taxes that can undermine urban development” (Oates and Schwab 1997, 19). The political difficulties accompanying long-delayed revaluations led to a repeal of two-rate taxation in Pittsburgh, although it continues in a number of small Pennsylvania cities (Connellan 2001b).

### Reviewing Options for the U.K.

We now consider a framework in which to derive a workable proposal for LVT in present-day Britain. In discussing the range of options for implementing LVT, some basic questions arise: Why is such a tax to be imposed? What are the intended achievements and objectives? How does LVT help further these objectives? Are there better ways to achieve the same ends?

#### *Political Pressures*

Imposing a land value tax clearly has to be a political decision. But what is the thinking behind it? Is policy guided by political idealism or by pragmatic opportunism? Is the decision in advance of public opinion, or is it trailing it?

#### *Ethical Considerations*

Is the LVT designed in line with a political philosophy aimed at distributing wealth by equalising incomes (“from him who hath to him who hath not”)? In such a context, are all landowners (at whom the tax is to be targeted) to be equated among the “haves” for the benefit of all nonowners, who are classified as deserving recipients? It is interesting that, in order to support the LVT proposals in the Finance Act of 1910, landowners were practically demonised in Parliament by then Chancellor of the Exchequer (and later Prime Minister) Lloyd George, who equated them with the hated “colliery [coal mine] owners” in his arguments comparing wealth and income derived from land ownership with that from coal mines (Prest 1981, 72, 109, 123).

In the course of the prolonged debates on this Finance Act, Winston Churchill, speaking in support of the Liberal government’s proposals, said:

The landlord who happens to own a plot of land on the outskirts of a great city . . . watches the busy population around him making the city larger, richer, more convenient . . . and all the while sits still and does nothing. Roads are made . . . services are improved . . . water is brought from reservoirs one hundred miles off in the mountains and—all the while the landlord sits still. . . . To not one of these improvements does the landlord monopolist contribute and yet by every one of them the value of his land is enhanced. . . . At last the land becomes ripe for sale—that means the price is too tempting to be resisted any longer. . . . In fact you may say that the unearned increment . . . is reaped by the land monopolist in exact proportion not to the service, but to the disservice done. (Quoted in Hagman and Misczynski 1978, 17–18)

Churchill, in the same debate, said, “the unearned income derived from land arises from a wholly sterile operation” (Hansard 1909).

But to return to our examination of ethical considerations, if the benefit of the tax is to accrue to the “community,” who or what is exactly intended by this

aspiration? And will its definition vary according to the particular attributes of the tax in question?<sup>1</sup>

### *Economic Considerations*

Henry George (1879, 153–161) argues that landowners have no rights to such ownership (of the land itself, excluding improvements), and thus the community should benefit by 100 percent taxation of those rights, without dire economic repercussions: “[T]he value that attaches to land itself is a value arising from the growth of the community, and can be taken to the last penny without the slightest degree lessening the incentive to production.”

But what are the equity perceptions in such deprivation by taxation when the existing landowner has acquired these rights by purchasing them in good faith for market value and without prior warning of impending confiscatory process? (Prest 1981, 28)

### *Raising Revenue*

The main reason for introducing LVT could be as straightforward as to raise revenue to augment local or central government coffers. It could be an entirely additional tax or substitute partially or wholly for other taxes.

### *For Local or National Benefit?*

Is LVT to be a local tax for local purposes (which might influence local land policy), or is it to be administered on the national level, for the benefit of the wider community?

### *Value Capture of Development Gains*

Land value can be captured by way of a development gains tax (see Chapter 13) on an “occasion of change,” which is a quite different procedure from a site value rate that is levied annually. The political reasoning behind such capital value impositions varies, but it is likely a response to a public perception that landowners are undeservedly reaping large profits from rising land values.

### *Town Planning*

Another political reason to impose LVT could be to fashion or promote a certain type of land use. Georgists have long contended that LVT on the basis of highest and best use will encourage development at the right time in the right place by, for instance, penalising owners of vacant sites for withholding those sites from the market for speculative reasons (Wilks 1964, 11). In contrast, other

1. Prest (1981, 127, 182) considers the definition of *community* and illustrates how its ambiguity can obscure the issues.

landowners might be partially or wholly exempted from LVT in the encouragement or pursuit of ecological conservation policies.

### *Wider Aspects of Taxation Policy*

Robertson (1998a) advocates introducing higher taxes and charges on the use of common resources, particularly energy and land, and reducing and perhaps eventually abolishing taxes and charges on employment, income, profit, added value and capital. Such advocacy aims to shift the burden of taxation away from the producers of wealth and towards the nonproductive elements. LVT could play a part in this wider process.

## **Choices: Variants of LVT Applications**

### *Trigger Mechanisms*

The design and ambit of LVT requires choosing which way to apply the tax; this choice may be influenced or even dictated by the initial policy decisions previously mentioned. But what mechanisms might be used to initiate the imposition of such taxation? The tax could be introduced upon the occasion of a number of events. For instance, the tax could be applied to certain classes of landowners after a certain day, or it could be levied when certain defined events occur, such as the disposal or demise of an interest in land, the grant of planning permission, the completion of a development project, or a change in the way land is used.

The type of trigger event chosen is inevitably linked with the design and ambit of the LVT. The following paragraphs set out a range of choices between different applications.

*Additional tax or complementary?* Will the tax run de novo, as a brand-new, additional tax, or will it run alongside existing land taxes, in partial or complete substitution? For example, could an existing rating system based on the annual value of combined hereditaments of land and buildings be split into two separate taxes, chargeable at different rates, as in some cities in Pennsylvania (Hartzok 1997, 212)?

*Valuation base.* Is the basis of land valuation for assessment purposes to be existing use—which the Expert Committee on Compensation and Betterment (Uthwatt 1942, 138) describes as “the value of the site as actually developed at the date of each valuation” following the *rebus sic stantibus* rule of the extant rating system—or is it to be the value of the highest and best use that can be reasonably envisaged?

*Plan-led or market-led?* If land is to be valued on its highest and best use, which would include projecting the land's development value, is this valuation to be strictly plan-led, governed by indications of future use in the approved development plan (see Chapter 14), or is it to take into account the additional influence of market indications of "hope value," irrespective of any firm development plan proposals or approved planning application?

*Valuation method.* Should the land valuation method be targeted at the capital value of sites or at their annual value? If the latter, can the annual value of land be appraised from direct rental evidence, or does it have to be derived from capital values by a decapitalising process? And is sufficient data available for assessment purposes?

*Impact: One-off hit or continuous assessment?* Is the assessment a year-by-year tax that continues for the foreseeable future, or is it a one-time charge, based on certain events predetermined by government? The latter process normally focuses on capturing the difference between two capital values (usually with and without the potential of development value), and it relates to actual realisations of such value differences rather than estimated accruals. As we have seen, development gains taxation is usually classified as a one-off operation that occurs upon the occasion of a particular act of development, but value can be captured by other LVT means on an accruals basis, independent of realisation (see Chapter 12).

But what we are also highlighting here is a fundamental difference between two types of LVT, namely site value rating (SVR)—an annual, ongoing tax—and development value capture taxes. In Chapter 10 we set out proposals that address the possibility of running these two types of land value taxes in tandem.

*Single or multiple valuation baselines?* Is the tax to be derived from a single-stance valuation or from different valuation baselines? For example, LVT could be based at a recurring fixed annual percentage (say 1 percent) of the capital value of a site at its highest and best use, or the tax could be levied at the time that planning permission is granted for development, and based on the difference between the site's value with the benefit of the consent and its value without it. Another possibility would be a continuous tax on the site's incremental value (on a ground rental basis) over a base valuation as of a certain day, and these levels of value could be directed either to its existing use, as envisaged by Uthwatt (1942, 136); to its highest and best use; or to a combination of the two—one eventually melding into the other as a form of gradualism. It is interesting to note that Uthwatt (1942) only went so far as to recommend an annual levy of 75 percent on assessed ground rents on an incremental basis only and related to existing-use site values; details of this Uthwatt scheme are provided in Chapter 10 (Annexe 5).



*Level of taxation.* If a land tax were levied at a rate equal to 100 percent of net income accruing (including capital gains), there would be no inducement whatsoever to hold land as an asset, either for the sake of current income or for capital appreciation (Hicks 1959, 242; Prest 1981, 38–39; Andelson 1997, 3). A 100 percent tax on ground rent of land at its highest and best use could very well confiscate the whole of a site's value and distort the land market entirely. Some amelioration of such draconian impact would seem prudent (see Chapter 10).

*Who pays?* Most arguments over LVT are about whether it is fair to the landowners. But some consideration should be given to equation theory. In Britain, tenants currently commit to a certain amount of rent as well as rates, since the extant property tax falls on the occupier, not the landowner. If the tenant were relieved of the rates bill, this could be argued to be only a short-term gain to the tenant, as eventually the tenant would have more money available to pay the owner in rent. In such circumstances, if additional rent accrued to the owner, some of it could be allocated to the site value; consequently, the LVT assessment, as an annual impost, would change to reflect this increase, and the owner's taxation position would not improve. If the owner pays LVT, and the tenant is paying a full market rent that reflects those circumstances, the owner's LVT liability (as existing or as heightened in the future) could not be passed on to the tenant.

A concomitant question is how to impose and distribute a land value tax if there is a hierarchy of leasehold and sub-leasehold interests on a particular property (see Chapter 10). Another analogous example is how to apportion income tax liability from imputed Schedule A (income tax) assessments.

*Cushioning LVT (gradualism).* Prest (1981, 170) warns of the danger of being too precipitate in introducing LVT. To heed that advice, various cushioning devices could be introduced to ameliorate the effects of LVT:

- exemptions (e.g., agricultural, private housing, etc.);
- incremental levies (Uthwatt 1942);
- current values as against potential values (or moving gradually from one to another);
- indexation of gains or increments (from a base date, as with capital gains tax);
- direct amelioration via selected tax breaks, etc., on targeted uses (e.g., charitable and amenity uses), in accordance with land policy objectives;
- gradually moving from increases on current value increments to potential value increments; and

- equilibrium values as if the tax thereon were payable, in anticipation of full capitalisation—termed by Prest (1981, 37–38) as some sort of Chinese puzzle (but mathematically solvable!).

### *Interdependence of the Various Land Taxes*

In this process of reviewing options for LVT, we need to recognise that all of the various taxes on land interact with one another and that LVT would affect the level of revenue raised by other land taxes. As mentioned in Chapter 3, in general terms, imposing LVT in some form on land affects the open market value (OMV) of that land, and OMV is at the heart of other land taxes like capital gains and inheritance tax.

### **Benefits of LVT**

What then are the arguable benefits of taxing land value?

- *Economic:* LVT would not affect other taxes (except if the process of capitalising the LVT reduced the value of land, in which case the other taxes that are based on the value of land would be affected). LVT is also a tax that cannot be shifted—the landowner could not pass on the burden of the tax to a tenant, for example, because it is assumed that, in market terms, the tenant is already paying as much rent as is affordable and/or appropriate for the land concerned and therefore could not also undertake his landlord's LVT liability.
- *Efficiency:* LVT would be cheaper, quicker and easier to assess (see Wilks [1974] on his Whitstable surveys). From an administrative viewpoint, it would be easier and cheaper to bill and collect LVT from landowners—there are fewer owners than there are occupiers, and if there were any difficulty in identifying the owner, the demand could be made on the occupier, who would then be entitled to pass on the payment of LVT by deducting it from the rent paid to his landlord (and so on, up through a hierarchy of ownership interests).
- *Effectiveness:* LVT is more effective as a taxation instrument than current rates in Britain for exacting contributions towards government expenditures, because it is a tax on owners rather than on occupiers and because it is a tax on land only, rather than on the combination of land and the buildings and improvements thereon. Furthermore, LVT as an annual tax is an effective means of capturing all those increases in land value, which occur because of community actions and not because of the efforts of landowners.

- *Equity:* The proponents of LVT have long held that taxing landowners on their land values is an equitable means of extracting value capture from wealth and even incomes that have not been earned by those landowners. This value is arguably created by the community in various ways over time, for example, by implementing surrounding facilities and infrastructure, and is something that should and could be recouped for the benefit of the community by way of LVT.

**Summary**

The above options are certainly not exhaustive, and further investigation will no doubt reveal more, but they do indicate the likely range of choices from which we propose to build a rationale for recommendations for LVT. In our view, what does emerge thus far, in the context of proposals for Britain, is support for the case for gradualism. Any acceptance of new and changed land taxation by politicians and the general public alike will have to be weaned by stealthy progression rather than by challenging confrontation.