

Lyons Inquiry – Final Report, Chapter 6

Land and property taxation

6.41 In the chapters that follow I consider a number of different types of tax that could contribute to local government revenues. Two of the most important local taxes (council tax and business rates) are both forms of land and property taxation, and are examined more fully in Chapters 7 and 8. In order to set that discussion in context it is useful to summarise the benefits and drawbacks of these types of tax, based on the very wide literature on these issues.

Taxation of economic rent

6.42 Most economists would agree that there is a strong case for levying taxes on land. Land is in fairly fixed supply, and much of its value will therefore be what economists call ‘economic rent’¹, which can be taxed without altering the incentives to use the land. The fact that much of the value of land is the result not of the actions of the owner, but the activity and investment of the wider community — for example, by providing transport connections, desirable schools or accessible markets — makes the case for such taxation even stronger. Taxing only the value of the land, not the use to which it is put, or the buildings and other improvements constructed on it, could also ensure that there is no distortion created by the tax system between the types of activity that might be undertaken on the land.

6.43 Land value taxes have been proposed on a number of occasions in the past, perhaps most notably in the Budget of 1909, because of these advantages. A number of groups, from the Land Value Taxation Campaign to the British Retail Consortium, supported the idea of a land value tax in their submissions to the Inquiry. For example, the BRC argued that:

Land Value Tax (LVT) has a number of advantages. These include not distorting behaviour in the same way as taxes on income and profits do, LVT's potential effectiveness in incentivising the efficient use of land (as all land would incur a charge even when it was not being used for productive activity.) and taxing land values could also enable local governments to profit from some of the increase in value as a result of a prosperous local economy

Taxing property to widen the tax base

¹ ‘Economic rent is a complex economic concept and definitions vary. Broadly speaking it means the difference between the return made by a factor of production (i.e. land, labour or capital) and the return necessary to keep the factor in its current occupation.

6.44 There are also some arguments in favour of taxing the property built on the land, as well to widen the as its basic value as land. In general, taxes should be applied to as broad a base as possible in order to reduce the tax rate needed, and thus the potential distortions created. Taxing the value of improvements as well as land values can help to expand the size of the property tax base, and a number of land value taxes used around the world actually levy a tax on improvements for this reason². On the negative side, however, the taxation of the value of property as well as the land value could distort activity by discouraging investment in development and improvements.

Economic stabilisation

6.45 Well designed taxes on the use of land and property can in theory contribute to the stability of the property market, and thus to the stability of the economy overall. With a flat rate tax on up-to-date property values, tax bills would tend to increase during periods of growth, and fall during downturns. In an upturn, the cost of consuming a particular amount of property would therefore tend to increase, reducing demand for it and motivating property owners to make full use of their property (for example by renting out a room). In a downturn, the opposite would occur, helping to soften the impact, and these effects should reduce the magnitude of changes in property prices³.

Reducing other taxes

6.46 Raising tax revenues through land and property taxes has the additional advantage that it other taxes could allow for reduced taxes on profits and incomes, thus reducing the disincentive to effort and success that such taxes can create.

Administrative savings

6.47 There are also a number of advantages to land and property taxes from an administrative advantages perspective, related to the fact that land and property are in the main immobile, and relatively straightforward to identify for taxation purposes. As a result, they are difficult to avoid and cost-effective to collect because those liable to tax cannot move their property elsewhere to avoid taxation, or hide their property to evade taxation. Indeed, some tax experts argue that the ability of large multinational companies to reduce their liability to taxation on their profits by moving profits between different countries will make property taxes increasingly important in the future because they are less easy to avoid.

² NERA Economic Consulting, Options for Reforming Local Government Funding, Lyons Inquiry, 2005.

³ Muellbauer, J., Property, Land and Taxation after the Barker Review, 2004.

6.48 A further advantage cited is that the yield from property taxes is predictable and stable, due to the fact that the tax base can be measured reasonably easily and is unlikely to change rapidly from year to year. This is particularly true of council tax in its current form; other property taxes, particularly if they reflect changes in actual property values, might fluctuate more.

Advantages as local taxes

6.49 Land and property taxes are used around the world as local taxes, and there are a number of reasons for this. The relative simplicity of assessment and collection and the difficulty of evasion, mentioned above, are all important. In addition, taxing property locally has the advantage that it can provide a strong connection between the tax people pay and their residence in an area. Taxes on property value reflect residents' (and owners') financial stake in a community and its prosperity, and their interest in local services and investment, which themselves impact on the desirability of property in a given area.

6.50 There can be tensions between the different possible purposes of land and property taxes. For example, the regular revaluations needed if the tax is to remain up-to-date may make bills and revenues less predictable for taxpayers and tax authorities, and create administrative costs, and the variable rates of tax needed to fund local authorities' different spending choices could be in conflict with the consistent rate of tax desirable to perform a market stabilisation function. These tensions need to be borne in mind when considering reform.