

The case for using annual Land Value Taxation to tackle the housing problem

Introduction

The Labour Land Campaign (LLC) recognises the Government's generally good record on economic policy since 1997 providing for strong economic growth and stability over the last decade. However, there are genuine concerns about the continuing high inflation in house prices and the chronic under supply of affordable housing.

The Bank of England has been given the unenviable task of trying to restrain the property boom with only one tool - higher interest rates - which provide increased unearned incomes to the lenders of money and at the same time impact adversely on businesses and workers who are trying to create prosperity.

At the same time, public dissatisfaction at the pressure Council Tax places on pensioners and others on low incomes is growing. The Lyons Review of Local Government Finance has singularly failed to answer the questions around local taxation and paying for local public services.

This paper therefore deals with the housing crisis caused both by the house price spiral and the shortage of affordable housing with its unfair class bias. There are huge levels of over-indebtedness and a dangerous intergenerational imbalance whereby young people have huge difficulty in entering the housing market. Against this, existing taxes such as the unfair council tax and the inequitable stamp duty cause undue pain to many. This paper therefore sets out a case for taxation reform, replacing ineffective taxes with an annual Land Value Tax that should form a key policy for Labour's 4th term which many would support.

The Housing Crisis

The UK is facing an unprecedented housing crisis, one which requires radical new policies aimed at systemic change. The current crisis combines both chronic housing poverty with soaring housing wealth: the issue is therefore fundamentally about the distribution of wealth and its negative impact on social justice.

Private housing wealth has grown exponentially over the last decade - rising to £3.3 trillion in 2005¹ - increasing the wealth gap between those who own property and those that do not. While the value of homes in the UK has risen 50-fold in the last 30 years, the distribution of housing wealth is highly unequal with the wealthiest tenth of households possessing five times the housing wealth of the poorest tenth.²

The high cost of housing has a direct impact in creating homelessness, with more than 116,000 homeless children living in temporary accommodation and more than 900,000

¹ S. Wilcox, UK Housing Review 2006/2007, University of York 2007

² B. Thomas and D. Dorling, 'Know your place: inequalities in housing wealth', in S. Regan (ed), The Great Divide: an analysis of housing inequality, Shelter 2005.

children growing up in overcrowded conditions.³ Housing wealth also generates social inequality in the form of differential access to public services as wealthy families use their housing market power to gain access to the best services, especially schools, leaving poorer households concentrated in worse off areas. The affordability crisis is also a matter of intergenerational inequity as younger generations are excluded from homeownership. Few young people can afford to buy a home today without assistance from parents and grandparents who have themselves benefited from house price growth.

In 2003 the Government commissioned Bank of England economist Kate Barker to conduct a review of the problem, which concluded that house price inflation could only be controlled through a massive increase in house building. There is no doubt that historically low levels of house building, especially of social homes, has contributed to the crisis. Ever since the Conservative government of the 1980s scrapped the council house building programme new housing supply has failed to keep up with rising demand caused by a growing population and falling household sizes. But increasing supply alone will not solve the problem of soaring house prices which are driven by massive borrowing, expectations of future house price growth and a very favourable tax treatment of private housing wealth. Nor will supply side measures tackle the social justice consequences of unequal housing wealth.

Housing and Taxation

Housing is the greatest source of private wealth in Britain. The value of the UK's private housing stock rose by £400 billion in 2006.⁴ There are two crucial points about this wealth: it is almost entirely unearned; and almost completely untaxed. No homeowner has earned the average 78% rise in their asset wealth over the last five years - it is a windfall benefit for the rich, largely derived from a healthy macroeconomic climate and public investment into services and infrastructure. Being in the catchment area of a good school can add tens of thousands to a house's value - value that is created by the school, but privatised by homeowners.

Yet few homeowners are taxed on this wealth, thanks to their special exemption from Capital Gains Tax. Stamp Duty, which is levied on hard pressed buyers, not the seller cashing in on their gains, raised a mere £5.4 billion over the year - an effective tax rate of barely over 1% - while Inheritance Tax is routinely avoided by the rich. Council Tax is notoriously regressive and is levied on occupiers, not owners, meaning that those who own no property have to pay as much as those who do. Furthermore, the failure to rerate Council Tax since 1994 means that the level of tax paid now has little or nothing to do with the value of the property.

The only other property tax, the Business Rate, suffers from similar problems as Council Tax and actually rewards owners that leave their property derelict or their land idle. Instead of taxing unearned wealth, Britain currently places the tax burden squarely on work, production and consumption - all positives that should be encouraged, not penalised.

³ Marc Francis, Building Hope – The case for more homes now, Shelter 2005

⁴ Halifax, 15.01.2007

One of the proposals in the Barker Review into the lack of supply and responsiveness of housing in the UK was for a Planning Gain Supplement (PGS), a form of Development Land Tax, which the government is now preparing to implement. This would be levied on developers building new homes and is intended to capture some of the uplift in value created when planning permission is granted in order to provide public funds to support new housing with infrastructure and services.

While the principle of capturing land value increases for the public is sound, development taxes are the wrong way to do it. This method of taxation proved to be not only ineffective but harmful to the economy when previous Labour governments introduced it in 1947, 1967 and 1976. On each occasion the result was that developers and land owners stopped building and waited for an incoming Tory government to scrap the tax.

LVT and Housing

The best alternative - and most appropriate - tax available is an annual Land Value Tax (LVT) on all land, net of improvements on it, based on the optimum value for permitted use of each site established through the existing planning system. Whereas the Planning Gain Supplement only provides revenue for the exchequer once in the lifetime of a development an annual LVT would provide revenue from land values on a continuing basis. Furthermore, as landowners can avoid PGS by postponing the development of their site, PGS discourages or delays development whereas LVT encourages land use.

Introduction of a Land Value Tax would have many beneficial effects on the housing economy of Britain. It would increase supply and encourage the provision of affordable housing by encouraging owners of empty and underused sites to either develop their landholdings or sell. It would end the current preferential treatment of homeowners over renters, rebalancing the tax playing field and making renting a more viable option for those who want to.

By taxing land value - which is inherently locational - rather than property value, LVT does not tax owners based on the quality of their buildings and so creates incentives for owners to add value by improving their property rather than speculating on the basis of location.

Most importantly, by taxing some of the increase in housing wealth LVT would reduce the incentives to speculate in the market and so reduce pressure on house prices. In the long run, house prices should rise in line with earnings rather than exponentially so that future generations can afford homes as good as those their parents were able to buy.

Why an annual LVT

The principles of a fair and just tax are pretty straightforward. They should bear as lightly as possible on production. They should be cheap and easy to collect. They should be certain ie they should be difficult to avoid. And lastly, and most importantly for us in the Labour Party, taxes should bear equitably on taxpayers giving each no unfair advantage or disadvantage. LVT fulfils all these principles. It is an annual tax on a percentage of the value of all land.

An annual Land Value Tax would be simple to apply, provide a sure source of revenue to government, be difficult to avoid and bear least on those least able to afford it. It recognizes that every individual helps create land values through their work, their community activities and their spending. Every new investment, as well as existing services and businesses - public and private - helps create land values, whether it is in public transport, business, leisure facilities, schools, hospitals, airports, regenerating neighbourhoods, homes or jobs.

By including land that is currently kept idle or underused or unoccupied it encourages better use of land, particularly in towns and cities, as landowners will not hold land out of use if they face an annual charge. Use of urban brownfield sites will actively contribute towards protecting the rural environment and the avoidance of urban sprawl. Derelict sites and buildings that encourage anti-social behaviour will carry as much tax as productive sites thus stimulating more efficient land use and hence more jobs and enterprise opportunities. Over time it will bring about a real redistribution of wealth on an individual and regional basis. It provides revenue for public infrastructure, new developments and services.

The proposed LVT is not being put forward as an additional tax burden. LVT should be used to replace Council Tax, Business Rates and potentially other taxes which all have a detrimental effect on the housing market and the national economy. It will have been noted that most other taxes do not comply with the precepts for a fair and just tax.

Steps needed before the introduction of LVT

The two steps necessary before LVT can be put into effect are the Registration of Land Ownership and Valuation of each plot of land.

Land registration would take 5 to 10 years to complete under present arrangements. It is proposed that government should set down a timetable for land owners, say 9 or 12 months, to register their land holdings. If not registered after that time the land would be forfeit to the state to be auctioned for use on a leasehold basis.

Valuations should be carried out on all land by professionals by area and location based on the optimum permitted use under planning law. The valuation methods, including the latest technologies of computer-aided mass assessment and geographical information, should be in the public domain and therefore open to scrutiny. An appeals procedure on valuations set should be in place. Once established land valuations will be much simpler to assess than valuations on properties, and should be revalued on a fixed timetable, not one that can be changed to suit short-term political considerations.

Implementing LVT

In our view an annual LVT should be established through a levy by local authorities to replace Council Tax, Business Rates and Stamp Duty. It will still be essential to retain the existing redistribution arrangements for supporting local authorities to compensate for the unequal

distribution of land values and the different needs of communities. Further steps to replace other less effective or inequitable taxes should be considered once this scheme is in place.

As with any tax change, there will be winners and losers. As a progressive tax shift, those with substantial housing wealth can expect to pay more, especially those who own more than one home, while those who own less valuable homes or none at all should gain.

Owners will, of course, seek to pass the LVT on to tenants and leaseholders. The market should ensure that, other things being equal, tenants would not have to pay more than under current arrangements for rent and council tax. For leaseholders the amount passed on would depend on the type and length of lease taking account of leasehold and reversion values. Thus the leaseholder should not have to pay more than under the current taxation system.

The introduction of a homestead allowance is considered necessary to tackle inequities of income and wealth - and as recognition that housing is not just a productive financial asset but a basic human right. This allowance should apply to both owner and tenant occupied houses but should not apply to empty sites or homes or to untenanted additional homes. This allowance would be analogous to the current personal allowance applied to income tax. The value of the allowance would be a flat sum for all householders, say £1000 per annum, so that the homeowner with a £1200 LVT bill would pay only £200 but a wealthy landowner with a home on valuable land with a £10,000 LVT bill would pay £9000.

There is also the situation of the asset rich and income poor to be taken into account. The homestead allowance should diminish this problem. The issue for this group of people should be resolved by allowing the tax to be deferred in whole or in part until the property is sold or transferred and then repaid with interest. This approach could also be applied to small or marginal businesses, but subject to a time limit of, say, five years.

Transitional arrangements could readily be made for those who have taken out a mortgage shortly before the introduction of LVT and are affected by a reduction in house prices.

Recommendation

In consequence, the Labour Land Campaign calls on the Government to examine this submission and come to a positive conclusion. The LLC recommends that the Government through the Treasury consider the introduction of an annual Land Value Tax to replace Council Tax, Business Rates and potentially other taxes and, as a first step, take the preliminary steps necessary on land registration and valuation.

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