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USING A LAND VALUE TAX TO FUND LOCAL GOVERNMENT: TECHNICAL APPENDIX

NOTES, ASSUMPTIONS AND METHODOLOGY

Assumptions underlying policy packages:

- **Land coverage:** all policy options presented above consider a land value tax on land only on which property eligible for business rates currently sits – ie currently developed, commercial land. Therefore it excludes undeveloped land, agricultural land, and residential land.

- **Baseline for comparison:** The modelling assumes that by 2024-25, the Business rates system will move to 75% retention system, where local authorities retain 75% of business rates intake in aggregate, in line with current government policy. Therefore the baseline for comparison applies this rates regime to projected total business rates intake in 2024-25. The amounts of additional revenue raised in 2024-25 by the proposed packages relate to extra revenue raised on top of that baseline. Projected total tax intake from business rates in the baseline scenario using our business rates retention model (details here) using local authority level projections of growth (or decline) of total rateable value based on historical growth in rates since 2015, adjusted to match the OBR projection, and redistributed amongst authorities according to current government plans.

- **Revenue neutrality to central government**: all options are fiscally neutral from a central government perspective, compared to current expected plans. Under current plans of a move to 75% business rates retention by 2021/22, approximately 25% of business rates will be passed to central government and will not be returned directly to councils in the form of controlled, un-ringfenced income, worth approximately £7.0bn in 2024/25. We have similarly ensured all packages pass up this amount to central government.

- **Behavioral effects:** The packages we propose aim to raise an additional £4bn and £5bn to be kept by local authorities. To account for potential revenue loss due to behavioral effects, the rates are set to generate £4.4bn and £5.5bn respectively, allowing 10% of revenue loss in both cases. However, receipts could also be higher once the tax base is widened to include any land not currently in within the current business rates base.

- **Discounts and exemptions:** all options remove the empty property discount. This had a value of £880 million last year, and retaining this discount could have incentivised landlords to leave properties unoccupied to avoid tax once the statutory incidence is switched to the landlord. Removing this discount incentivises more efficient use of properties, as landlords are encouraged to rent them out rather than keep them empty to avoid tax or hold out for higher rent offers. We preserve sufficient income set aside for all other existing discounts, however we make no prescription over how these might be

allocated or reallocated in a future system; these should be discussed with relevant stakeholders to determine appropriate discounts.

- **Protections for business owners affected by the change in tax:** businesses who own and occupy their own property will on average face an increase in tax, which will particularly hit businesses in high land value areas (such as town centres). To protect these businesses from any increases over their bill under a continued business rates regime, a proportion of the empty property discount could be topsliced to compensate them. Our indicative calculations, assuming rateable and land values distributed amongst these businesses as they are over all businesses, suggest that taking into account such a topslice and behavioural effects, all packages will raise more than £3 billion in revenue by 2024/25 – sufficient to ensure that the funding gap for non-social care services does not widen further. The impact on business owners who rent will depend on how much of the new tax landlords pass on to them. To help protect these businesses, the government could provide advice or enact policy to prevent excessive and sharp rent rises. In addition, we have preserved all other existing discounts (excepting section 31 grants described above); a proportion of these could be reallocated to target towards specific types of businesses who need extra support.

- **Geographical impact:** we have not specified how the new land value tax/property taxes should be distributed. However, we considered the effects on the regions of England of the different packages. If the land value tax (or land value proportion of the tax in the hybrid packages) is fully redistributed amongst councils according to need, all regions will be better off in aggregate under all our packages than they are under the current system.

- Estimates of land and property values were based on rateable value of business properties, which roughly corresponds to the annual rent they pay on their premises. An alternative approach in taxing land and property is to tax their capital values (values corresponding to what the property/land could be sold for in an open market). Equivalent capital tax rates are provided for illustration, assuming approximate 5% yield (rental value) as a proportion of capital value. More information can be found at https://www.savills.co.uk/research_articles/229130/277331-0

ADDITIONAL NOTES

Throughout this blog, we focus only on the areas of local government spending over which councils have direct control. Councils also receive funding for education, but this is mostly passed right on to academies and other institutions rather than being part of the councils' responsibility.

All monetary figures presented in this blog are in real terms, 2019/20 prices. Figures have been deflated using the OBR's latest estimates of the GDP deflator.

Proportions of land value as proportion of total rateable value were based on the data kindly shared by Adam Corlett and Dominic Humphrey, an analysis originally produced in Corlett, A., Dixon A., Humphrey, D. & von Thun, M. (2018). *Replacing business rates: taxing land, not investment*. The estimates were derived via hedonic regression approach that produced estimates

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of land value as proportion of total rateable value (as currently assessed and recorded by the VOA for all business properties) at local authority level, using 2017-18 data. While these proportions are likely to shift over time, a reasonable assumption for the near-term period is that they will not change to a huge extent, and direction of any changes is difficult to forecast – therefore the same estimates of proportions of property value attributable directly to land were applied to modelling done for 2019-20 and 2024-25. For policy options with separate property tax, property value was calculated as a difference between estimated land value and total rateable value in given local authority. See the paper by Corlett et al. for full details on the exact methodology for estimating land values from rateable values.

DATA SOURCES

Ministry of Housing, Communities and Local Government. (2019). *National non-domestic rates to be collected by local authorities in England (various years).*

Office for Budget Responsibility [OBR]. (2019). *March 2019 Economic and fiscal outlook: Charts & Tables.*

Corlett, A., Dixon A., Humphrey, D. & von Thun, M. (2018). *Replacing business rates: taxing land, not investment.*

Valuation Office Agency (2019) *Non-domestic rating: stock of properties including business floorspace, 2019*

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