

# Replacing business rates: taxing land, not investment

Introducing the Commercial Landowner Levy



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# Contents

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Acknowledgements	3
About the authors	3
Foreword from Andrew Dixon	4
Foreword from Sir Vince Cable MP	5
Key messages	6
Detailed list of recommendations and costings	8
<b>Section 1: Introduction</b>	<b>10</b>
<b>Section 2: Ending the economic harm of business rates and stamp duty</b>	<b>13</b>
<b>Section 3: Simplifying the tax system</b>	<b>18</b>
<b>Section 4: Taxing vacant premises and land</b>	<b>25</b>
<b>Section 5: Valuing land</b>	<b>28</b>
<b>Section 6: Putting it all together</b>	<b>36</b>
<b>Section 7: Transition and local government finance</b>	<b>46</b>
Appendix – land valuation methodology	50

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The recommendations, and any errors, are of course the authors' alone.

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# Foreword

ANDREW DIXON

As a full-time angel investor and founder of the Liberal Democrat Business and Entrepreneurs Network, I frequently hear complaints about the business rates system, which – as is becoming increasingly clear – is simply not fit for purpose.

While we have all heard about the crisis facing our high streets and the burden business rates place on companies, the problems with this badly designed tax run far deeper. Contrary to what every competent economist would recommend, business rates – by taxing the value of a business's machinery and premises – are a tax on investment itself.

The result is a higher bill for the ambitious entrepreneur who decides to expand her factory space or add solar panels to the roof, and a lower one for the speculative landowner who chooses to leave his commercial plot derelict or unused. This is undoubtedly contributing to Britain's recent miserable productivity performance, and holding back the crucial investment required for our economy to thrive in the 21st century.

This groundbreaking report sets out a way forward. It proposes the replacement of business rates with a new tax – the Commercial Landowner Levy – based solely on land value and paid by landowners. Not only would this remove the existing disincentive to invest, it would also spare millions of small businesses that rent their premises the unhelpful administrative burden of business rates. The report's recommendation to abolish stamp duty on

commercial property transactions is also a welcome one, which I believe would likely lead to an increased supply of commercial premises.

Those sectors of the economy that invest the most – including manufacturing and clean energy – would be the biggest beneficiaries from the Commercial Landowner Levy, while businesses in the most deprived parts of the country would also receive substantial tax cuts. In fact, 92% of the country would pay lower business taxes as a result of the switch, a crucial fact given Britain's unenviable status as one of Europe's most regionally unequal economies, and the difficulties facing retailers in today's uncertain economic environment.

The report itself contains far more detail than can be covered in a brief foreword, and I urge you to read it in full for a complete picture of the transformation we are proposing. I am delighted that former Business Secretary and Leader of the Liberal Democrats, Sir Vince Cable, is supporting these recommendations. The Liberal Democrats have been passionate advocates of land value taxation, but we hope that this ambitious piece of work will have an impact that extends far beyond narrow party lines.

Last but not least, I would like to thank Adam Corlett, Dominic Humphrey and Max von Thun for their excellent contributions, without which this work would not have been possible.



# Foreword

SIR VINCE CABLE MP

Land value taxation is an idea whose time has come. It is a policy with a long Liberal heritage, from David Lloyd George's attempt to introduce it through his "People's Budget" of 1909 to current, longstanding Liberal Democrat support. And it has been endorsed by organisations from across the political spectrum, most notably the Institute for Fiscal Studies, the Institute for Public Policy Research, the Adam Smith Institute and most recently, the Economist.

I myself have long been interested in the potential of land value taxation, which is why I agreed to chair the All-Party Parliamentary Group on Land Value Capture set up last year to develop innovative proposals in this area.

The case for a land value tax is perhaps strongest when it comes to commercial property. Business rates, a badly designed policy to begin with, have become an unacceptable drag on our economy. Putting aside the recent botched revaluation that has inflicted serious harm on thousands of small businesses, business rates are a tax on productive investment at a time of chronically weak productivity growth and a burden on high streets struggling to adapt to the rise of online retail.

That is why I am delighted to introduce this excellent report, which – based on rigorous analysis and brand-new data – sets out what I believe is the right way forward. It

was put together by Andrew Dixon, founder of the party's Business and Entrepreneurs Network, who shares my view that business rates are no longer fit for purpose. Its call for the replacement of business rates with a tax on land value mirrors current Liberal Democrat policy, while providing the empirical evidence and practical detail that have until now been missing.

Introducing a tax on commercial land, or what the report calls the "Commercial Landowner Levy", would progress many of my priorities as Liberal Democrat Leader. Because of the highly unequal way land value is distributed in Britain, it would significantly reduce business taxes in the poorest parts of country, helping bring about the regional rebalancing that is so badly needed. And by only taxing land and not the productive capital above it, it would remove a major disincentive to investment, boosting productivity and accelerating the UK's industrial revival.

I am very grateful for all the research that has gone into producing this report. It will greatly aid my party's efforts to campaign for the replacement of business rates with a land value tax. But if this aspiration is to become a reality, support will have to come from across the political spectrum, something this work will be crucial in achieving.



# Key Messages

**1** Business rates are harmful for the economy because they directly tax capital investment in structures and equipment rather than taxing profits or the fixed stock of land.

**We would abolish the broken business rates system and replace it with a Commercial Landowner Levy – taxing only the land value of commercial sites, not productive investment.**

Removing buildings, utilities and other physical capital from taxation would boost business investment, in turn increasing productivity and wages.

**2** Britain's economy is characterised by profound inequalities between its regions, and business rates are a drag on commercial activity in struggling areas.

**In England, the Commercial Landowner Levy would cut business taxes in the vast majority (92%) of local authorities – particularly outside the South East – helping to rebalance Britain's divided economy.**

In places like Oldham, Blackburn, West Bromwich, Barrow, Middlesbrough and 92 other local authorities, average taxes would be cut by over 25%, significantly lowering the cost of doing business there.

**3** Britain's high streets are in crisis.

**The Commercial Landowner Levy would give a much-needed boost to struggling high streets across the country, by cutting taxes for retailers in most areas.**

Businesses in the most deprived areas would see the biggest fall in their bills, while some shops in expensive areas would see small tax increases. At the same time, many online retailers are not paying their fair share of tax, with profit shifting by multinationals a serious problem. But this will only be achieved through international cooperation and reforms to Corporation Tax, which are not the focus of this paper.

**4** Business rates particularly disadvantage manufacturing and the country's infrastructure relative to less capital-intensive sectors. They also punish investment in renewables and improving energy efficiency at a time when these are needed more than ever.

**The Commercial Landowner Levy would give a big boost to the manufacturing sector and make it cheaper for all businesses to invest in renewables or other new technology for their premises.**

Average bills for manufacturing premises would go down by 22%, and taxes on the country's energy, internet and rail infrastructure would also likely fall significantly.

**5** Where public investment increases land value, that uplift should help fund the investment. But business rates are revalued infrequently, rise only with inflation and are only partly based on land values.

**Rather than increasing tax bills when businesses improve their premises, the Commercial Landowner Levy would concentrate on capturing increases in land values driven by public and community investment.**

This land value capture would help make the business case for new publicly-funded infrastructure around the country, while businesses investing in their own property would not face higher taxes as a result.

**6** Non-residential stamp duty land tax further reduces the return on investment in premises and means commercial property is not allocated as efficiently as possible.

**Non-residential stamp duty should be abolished, making the commercial property market more efficient, simplifying taxes for small businesses who want to own or change premises, and further boosting investment.**

London and the South East would be the biggest winners from this particular tax cut.

**7** Business rates are paid and administered by the occupier, even if many small businesses in a community rent from a single major property company.

**The Commercial Landowner Levy would be paid by the owner not the tenant, sparing over half a million SMEs the bureaucratic burden of property taxation.**

61% of small to medium sized businesses in England with premises – and even greater proportions in retail and manufacturing – would no longer have to worry about

property tax, although most rents would need adjusting to reflect this tax shift from tenants to landlords.

**8** Business rates are based on valuations that are usually considerably outdated. Even with triennial revaluations in future, values will always be between 2 and 5 years out of date. And the tax is designed to rise when rents fall, such as in a recession, to keep revenue unchanged in real terms.

**With annual revaluations and greater flexibility, the Commercial Landowner Levy would better reflect local economic conditions, and avoid large infrequent changes.**

This would support businesses in difficult economic times, and raise additional tax revenues in good times.

**9** Business rates are assessed and administered on the basis of over 2 million premises in England and Wales, but often these are in the same building or on the same bit of land.

**The Commercial Landowner Levy would be far easier for local authorities to collect, with fewer plots of land than rateable business premises.**

The number of bills would be reduced to 800,000, saving councils and businesses time and money.

**10** While replacing business rates with a Commercial Landowner Levy would represent a major change to the tax system, it would not be without precedent.

**The successful experience of countries across the world shows that taxing land rather than property is possible, and indeed optimal.**

Estonia, Australia and Denmark all have land taxes, with Estonia repeatedly topping the International Tax Competitiveness Index. Estimating land values is not necessarily difficult: our calculations using existing data find that land on average makes up around 75% of commercial property value in England and 60% in Wales.

**11** Empty properties and derelict land are currently undertaxed, reducing supply.

**We would end exemptions for empty and derelict premises, and use this to lower bills for all.**

In struggling parts of the country the impact of this on landowners would be limited, as the Commercial Landowner Levy would be low in these places. In contrast the impact would be greatest where new supply is most sorely needed.

**12** Business rates feature well-intentioned relief for small businesses. But the structure of this relief involves sharp step-changes in tax bills that disincentivise businesses from investing in their premises, and landlords can simply charge higher rent where tenants receive relief.

**The Commercial Landowner Levy would have a single simple rate (per nation, as a devolved tax), but to increase help for small businesses the 'Employment Allowance' would be doubled, giving every employer a £3,000 a year tax cut.**

This would spare tens of thousands of small businesses from paying employer National Insurance, and allow businesses to take on one extra full-time employee tax-free.

**13** Business rates are a crucial part of local government financing.

**Central funding and redistribution between local authorities would be adjusted to ensure that a tax cut for local businesses does not leave councils worse off.**

Tax retention schemes could also continue.

**14** Transitioning from business rates to the Commercial Landowner Levy should be done carefully.

**While most businesses would receive a large tax cut, any business receiving a tax increase would have the change phased in over 4 years. And responsibility for paying bills would be moved to landlords when contracts are renewed or rents reviewed.**

A transition introduced after the next planned election in 2022 would be complete by 2027.



## Detailed list of recommendations and costings

### *Ending the economic harm of business rates and stamp duty*

- 1 Business rates should be abolished and replaced by a 'Commercial Landowner Levy' based on the value of the land only.
- 2 Non-residential stamp duty land tax should be scrapped at the earliest opportunity.

### *Simplifying the tax system*

- 3 Tax should be paid by owners, not occupiers.
- 4 The Employment Allowance for employer National Insurance should be doubled from £3,000 to £6,000 in place of small business property tax reliefs.
- 5 Some reliefs, such as for charities, should continue under the Commercial Landowner Levy but with consultation on whether this is the best way to help them.
- 6 Charitable relief should be removed from private healthcare and private schools.

### *Taxing vacant premises and land*

- 7 Commercial land should be taxed regardless of whether the buildings above it are occupied.
- 8 Tax should also apply to empty commercial sites, including in cases where the property itself has been demolished
- 9 The Commercial Landowner Levy would not apply to agricultural land, forests, parks, public roads or religious grounds.

### *Valuing land*

- 10 The VOA should calculate land values, using a computerised approach as a first step.
- 11 Valuations should be based on the best permitted use.
- 12 Either rental or capital values could be used.
- 13 Values should be updated each year and be as up-to-date as possible.
- 14 The Land Registry should be completed and kept in public ownership, and commercial land value data made public.



*Putting it all together*

- 15** The Commercial Landowner Levy tax rate would be 59p per £1 of land rental value in England and a 67.5p rate if introduced in Wales.
- 16** Alternatively, a tax on capital values would need to be around 3% per year in England and around 3.4% in Wales.
- 17** These figures would represent a tax cut initially, as part of a detailed package of policies, but are likely to be at least revenue-neutral in the long-term.

*Transition and local government finance*

- 18** For the large majority of properties receiving tax cuts, bills could either move to a land-value basis

immediately or be phased in over a 4 year period.

- 19** For the minority facing tax increases, the new system should be phased in over a 4 year period.
- 20** The responsibility for paying tax should move to landlords for new contracts, at commercial Rent Reviews or in year 4 of the new tax – whichever comes first.
- 21** The change should not affect local government finances, with redistribution between local authorities adjusted to ensure no immediate change in local revenue, and the retention policy continued if desired.

Estimated costings in England for this package of changes are shown below, all based on figures for 2017-18 for consistency. Costings for the Welsh government are given in Section 6.

**Summary Table: Estimated policy costings****2017-18, England (except SDLT and NICs)**

Baseline net business rates revenue, £m		25,589	
	<b>Extra revenue</b>	<b>Reduced revenue</b>	
Replace NDR on property values (at 48 & 49.3p) with CLL on land values (at 59p)		2,007	
Abolish small business rate relief	1,537		
Boost Employment Allowance from £3,000 to £6,000		2,000	
Abolish empty premises relief	853		
Extension to derelict property	85		
Remove charitable relief from private schools & hospitals	110		
Use part of cancelled Corporation Tax cut	1,911		
Abolish non-residential SDLT (inc. knock-on land value rise)		1,911	
Reduced valuation costs for VOA	None assumed		
Reduced collection costs for councils	47		
<b>Total</b>	4,543	5,918	<b>Net change</b> -1,375
<i>Other potential considerations</i>			
Extra revenue if land values grow with NGDP (not CPI) – after 5 years	1,574		
Extra revenue if land values grow with NGDP (not CPI) – after 10 years	3,674		
Benefit of higher economic growth	None assumed, but potentially large		
Optional temporary cost (year 1) – full tax cuts immediately rather than phasing in		2,000	

# Section 1: Introduction

## There is little support for the current business rates system

Business rates<sup>1</sup> have a long history, dating back to at least 1601 in one form or another. But dissatisfaction with the system is rife at present. In part, this reflects specific problems created by a delayed revaluation that caused taxes to be based on 2008 values for too long, and then substantial disruption when values were updated. Concern also reflects some medium-term trends, most notably the rise of online retail and the general uncertain business environment surrounding Brexit. But even at the best of times business rates are a bad tax, as this report will show.

One small indication of the unpopularity of business rates is shown in Figure 1, which gives the results from a small survey of 491 entrepreneurs.<sup>2</sup> Although this is only a small part of the population, what is clear is that business rates are seen more negatively than other taxes by business

owners, with almost two thirds viewing rates as very or quite damaging to UK entrepreneurship.

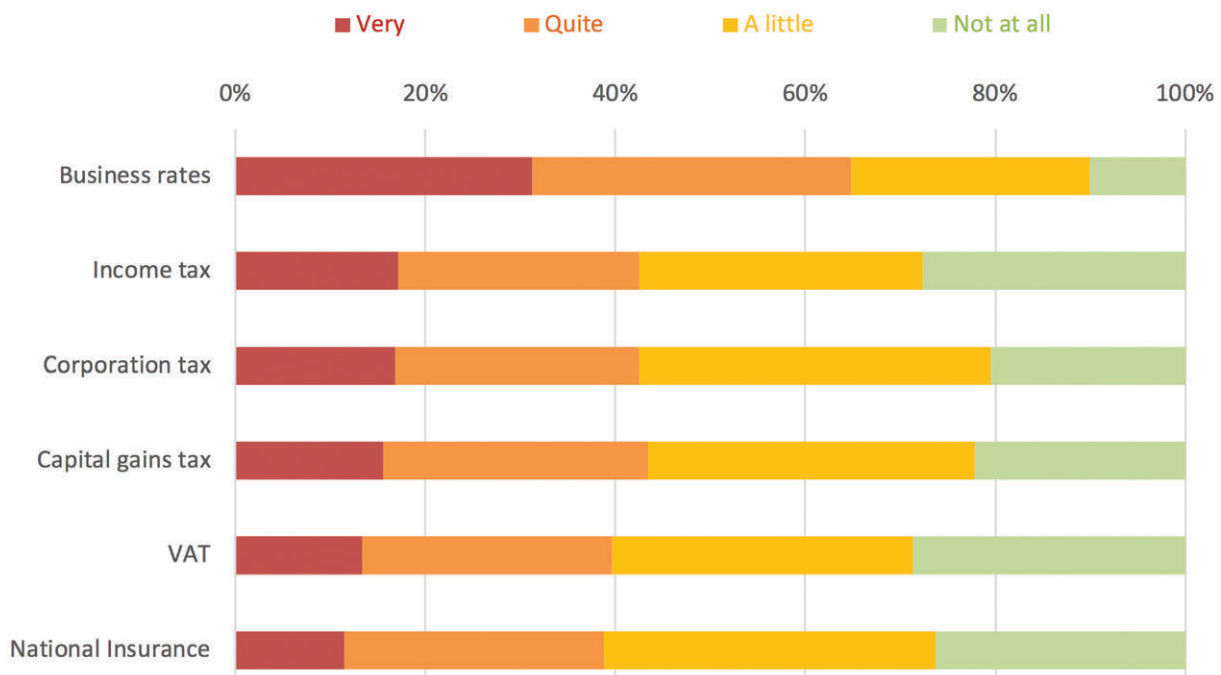
The failings and unpopularity of business rates are particularly notable given the theoretical support for property taxation among economists of all stripes. Done properly, property taxation can be the least economically harmful,<sup>3</sup> and the hardest to avoid, of all taxes. Indeed, both theory and evidence show that blanket cuts in business rates would simply allow rents to rise faster (particularly where they are already high)<sup>4</sup>, predominantly benefiting landlords rather than businesses. So even if the government could find the huge sum of £30 billion a year to abolish business rates, that would not seem a wise move in isolation.

A new system is needed that does not repeat the mistakes of business rates, and builds on long standing, non-partisan expert support for land value taxation as a pro-business policy.

1 Properly known as non-domestic rates, but we use the common name in this paper  
2 All Party Parliamentary Group for Entrepreneurship, *Tax Reform*, July 2018

3 OECD, *Tax policy reform and economic growth*, November 2010  
4 Stephen Bond et al., *Who pays business rates?*, Fiscal Studies, 1996

Figure 1: Survey of business owners – “To what extent do you think the following taxes are damaging to the success of entrepreneurship in the UK?”



Source: All Party Parliamentary Group for Entrepreneurship, *Tax Reform*, July 2018. Excludes those who did not answer.

## **There are particular concerns about the high street and multinationals, though business rates are only part of the story**

There is little doubt that many parts of retail are struggling, and this can be contrasted with the success of online shopping giants. Reform is clearly needed, though we should be careful to address the right problems.

Some argue that it is unfair that a company using premises on the outskirts of town might pay much less in business rates than one in a prime location. But this is no more reasonable than arguing that it is unfair that rents are higher in town than out of town. This is how property taxes should work. Where demand for land is high, property spending should go partly to the community (through taxation) as well as the private landowner. And where demand for land is low, there is little economic or moral justification for high taxes. A 'level playing field' does not mean that property costs should be the same everywhere.

However, it is right to say that the same tax rules should apply to all, and that many multinational companies have taken advantage of their opportunities for shifting profits to lower-tax jurisdictions. Small businesses paying UK corporation tax feel rightly aggrieved that they may be paying higher tax rates than much larger competitors. This though is a question for the corporate tax system, rather than for this paper. No reform of business rates is going to fix the taxation of multinational companies' profits, though the replacement proposed in this report would certainly help struggling high streets.

In part, the struggles of some retail chains are not down to any unfairness in the tax system, but rather down to changing tastes and technologies. It is competition in action, and where that competition is fair, we should be less concerned about shifting property uses. City and town centres remain key to communities but we should allow the market to be flexible in adapting to changing preferences.

As this paper will show, business rates – and commercial stamp duty too – could be replaced by a tax that is more responsive to changing market conditions, is lower in struggling areas especially, and does not impede property transactions or new investment.

## **Business rates reform should help rebalance the economy**

As well as helping the high street, a complete replacement of business rates has the potential to help UK manufacturing. As explored in Section 2, any capital investment currently results in an immediate increase in business rates, depressing levels of investment. At a time of significant business uncertainty, low productivity growth and a need to encourage investment in the production and use of greener technologies, this is profoundly unwelcome.

At the same time, business rates are an obstacle to public investment. Utilities and railways pay business rates on the value of their physical capital, again disincentivising improvements. And while land value uplifts produced by new infrastructure could potentially play a role in funding investment – e.g. new rail lines – business rates do a very poor job of capturing any of these gains.

## **This report offers a detailed blueprint for replacing business rates with a commercial land value tax**

Much work has been done on the economic and moral arguments for land value taxation (LVT). Unlike almost all other taxes, land value taxation does not produce deadweight losses (economic harm), as the supply of land – unlike the supply of labour or investment – cannot be reduced. We do not intend to repeat those arguments in detail here. Nor do we look at residential property – though Council Tax is certainly in need of its own overhaul. Our focus is on business rates.

We are not the first to suggest replacing business rates with a land value tax. Indeed, it has been Liberal Democrat policy for many years, and has been suggested by politicians in the Labour, Conservative and Green parties too (including Andy Burnham, Nick Boles MP and Caroline Lucas MP). It has also been recommended at various times by organisations and individuals as diverse as the Adam Smith Institute, the Institute for Public Policy Research, the Tony Blair Institute for Global Change, the Institute of Economic Affairs, the Economist, former Observer editor Will Hutton and Financial Times commentator Martin Wolf, among many others.

The 'Mirrlees Review' of the tax system for the Institute for Fiscal Studies also concluded that business rates (and commercial stamp duty) should be replaced in this way. But detailed proposals and modelling have been limited, not least due to a lack of land value data.

For simplicity, and to concentrate on where the knowledge gaps are greatest, our focus in this paper is on England and Wales. But most of our findings and recommendations are also applicable to Scotland and Northern Ireland.

### A brief history of business rates and the land tax movement

- 1601** Tax on property – the beginnings of the rates system – was formalised in the Poor Relief Act
- 1776** Adam Smith argued in the Wealth of Nations that ground-rents are perhaps the best tax base
- 1848** Marx and Engels called for “abolition of property in land and application of all rents of land to public purposes”
- 1869** The Valuation (Metropolis) Act introduced quinquennial revaluation in London
- 1879** Henry George released his popular and influential book, 'Progress and Poverty' (which sold more copies in America in the 1890s than any other book except the Bible)
- 1896** Lower rates introduced for agricultural land
- 1909** The 'People's Budget' of David Lloyd George attempted to introduce land valuation and limited taxation
- 1910** The Valuation Office was created
- 1920** The 1909 attempt at land valuation and taxation was terminated
- 1925** Quinquennial revaluation was introduced outside London
- 1931** Land value taxation was included in the Finance Act but quickly repealed
- 1939** Herbert Morrison MP attempted to introduce a tax on land rental values for London
- 1950** Rates valuation was centralised in the Valuation Office
- 1978** Milton Friedman referred to land value taxation as “the least bad tax”
- 1990** Rate setting was nationalised (and domestic rates abolished except in Northern Ireland)
- 2013** George Osborne postponed the 2015 revaluation by 2 years, and 50% business rates retention was introduced.
- 2018** Increases in business rates moved to CPI rather than (higher) RPI inflation
- 2021** Revaluation will occur 4 years after the previous one, and will then become triennial

# Section 2: Ending the economic harm of business rates and stamp duty

## Introduction

This section explores why business rates are a fundamentally poor tax, and why they should be replaced with a tax on the value of the underlying land alone.

### Policy recommendations in this section:

- **Business rates should be abolished and replaced by a 'Commercial Landowner Levy' based on the value of the land only**
- **Non-residential stamp duty land tax should be scrapped at the earliest opportunity**

## What business rates tax

Business rates are a tax on the annual rental value of non-residential land and buildings. This does not include most contents (e.g. desks, computers, inventory, fittings and fixtures). But it does include the structure itself, as well as a range of 'plant and machinery':

To understand why business rates are a bad tax – and how complex the current system is – it is worth considering just what kinds of 'plant and machinery' are included:<sup>5</sup>

- 'Class 1' – Plant and machinery "intended to be used mainly or exclusively in connection with the generation, storage, primary transformation or main transmission of power in or on the hereditament"
- 'Class 2' – Plant and machinery "used or intended to be used in connection with services to the hereditament or part of it" – i.e. "heating, cooling, ventilating, lighting, draining or supplying of water and protection from trespass, criminal damage, theft, fire or other hazard"
- 'Class 3' – Other infrastructure such as lifts, electricity fittings, pipe-lines and railway lines
- 'Class 4' – Other major immovable structures, including blast furnaces, bridges, tunnels, chimneys, dams, walkways, masts, radio telescopes, turbines and generators, boilers, reservoirs, silos, vats and other industrial equipment.

So business rates are a tax on fixed, long-term investments, as well as on land values. If a new building, dam, blast furnace or even radio telescope is built, why should a

recurring tax be paid on that new capital? And if an existing property is improved through the addition of a lift, solar panels, air conditioning or new lighting, why should its tax bill increase? Where investments lead to profits, it is of course reasonable to tax businesses and/or individuals to fund public services, but taxing investment itself has little rationale.

The respected Mirrlees Review of the tax system makes this point unambiguously:<sup>6</sup> "it is an important principle of the economics of taxation that an efficient tax system should not distort choices firms make about inputs into the production process, and hence that intermediate goods – those used in the production process – should not be taxed. [...] Taxing non-domestic property is inefficient, and should not be part of the tax system."

The same is not true of land, however. "Land is not a produced input; its supply is fixed and cannot be affected by the introduction of a tax." We will not repeat the long history of arguments in favour of taxing land here but, as the review puts it – paraphrasing Nobel Laureate William Vickrey – "business rates are a combination of a desirable tax on the land and an undesirable tax on the buildings."

## Exempting new plant and machinery from business rates would be an improvement, but not an ideal solution

Given the structure of business rates, a lot of the discussion around reforming the tax has centred around manufacturing equipment. And there is certainly a strong case for change. For example, after Tata Steel made a £185 million investment in rebuilding a Port Talbot blast furnace in 2013, the business rates bill for the site went up by £400,000 a year.<sup>7</sup> Clearly this is a disincentive to invest (and note that the future of the Port Talbot plant was in doubt soon after).

EEF (The Manufacturers' Organisation) has led calls to have some (Class 4) equipment removed from valuation, at an estimated cost of over £1 billion a year.<sup>8</sup> They noted

<sup>6</sup> James Mirrlees et al., *Tax by design*, September 2011

<sup>7</sup> Financial Times, *Budget plan to exempt new machinery from rates bill*, February 2016

<sup>8</sup> Financial Times, *Budget plan to exempt new machinery from rates bill*, February 2016

<sup>5</sup> *The Valuation for Rating (Plant and Machinery) (England) Regulations 2000*

that 42% of manufacturers said they would invest more “if plant and machinery is removed from the calculation of business rates”.<sup>9</sup>

To reduce the cost of such a tax cut, a good deal of thought has been given to exempting only *new* investments. The government seriously considered some version of this proposal ahead of the March 2016 Budget. In fact, it was a part of the Budget plans until being removed at the very last minute, and so ended up being part of the OBR’s fiscal forecast despite not going ahead.<sup>10</sup> The exact nature of the aborted policy is unknown, but we do know that it was forecast to boost business investment in 2020-21 by 0.5% (around £1 billion) – an indication of some of the gains that could be had from business rates reform.

However, there is a strong case that exempting only new investments would be disadvantageous to those who had already made investments. And reform focused on ‘Class 4’ plant and machinery only might be considered unfair on properties where value comes from other forms of infrastructure. Yet removing many forms of rateable plant and machinery – like lighting or heating – from a building’s

valuation is considered “operationally challenging” due to the integral nature of these.<sup>11</sup>

In addition, the taxation of buildings themselves is harmful in just the same way as taxing plant and machinery. Commercial buildings are fewer, shorter, smaller and of lower quality than if future business rates bills were not a consideration when investing in their construction.

Rather than add new reliefs and exemptions to a system that is already fiendishly complicated, it would be more effective to simply stop taxing buildings and structures entirely and move to taxing only the underlying land value.

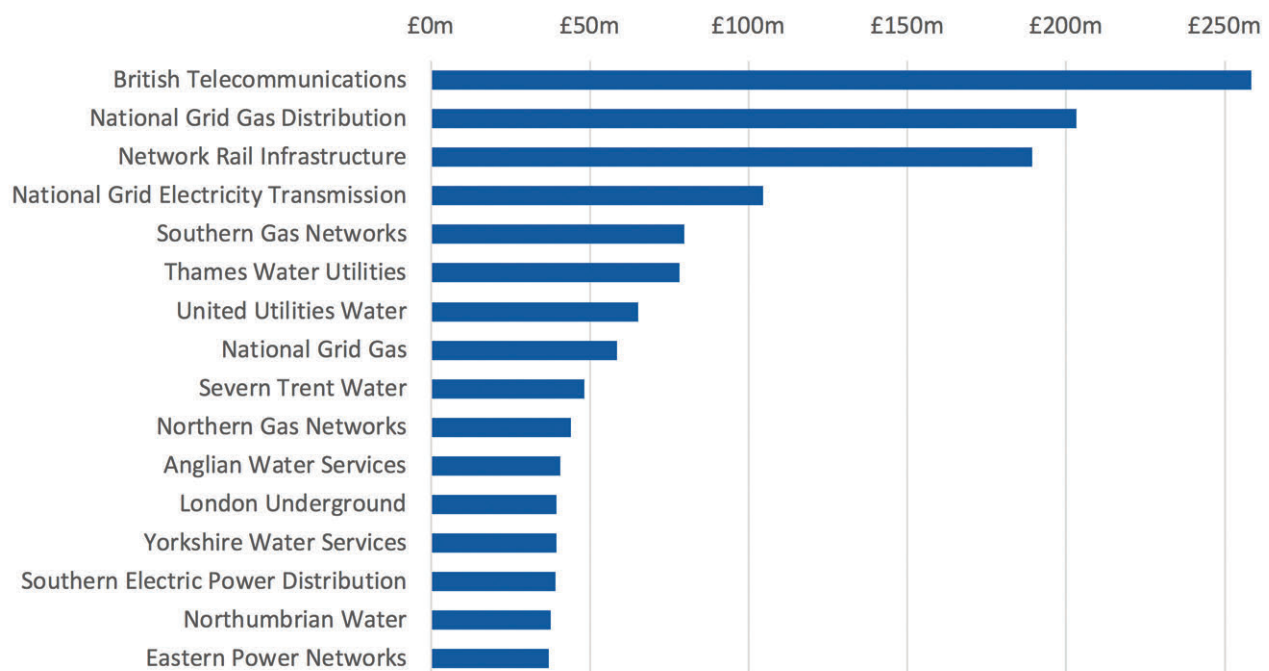
There are many potential names for such a tax, traditionally including ‘land value tax’, ‘site value tax’ and ‘location value tax’. For a replacement of business rates specifically, we suggest the name ‘Commercial Landowner Levy’, emphasising that the tax would only apply to non-residential land and that it would be paid by owners rather than tenants (as explored in Section 3).

9 EEF, *The inclusion of plant and machinery in business rates is holding back manufacturing investment*, March 2016

10 OBR, *Economic and fiscal outlook*, March 2016

11 House of Commons *written question 135257*, 13 April 2018

Figure 2: Largest estimated central rating list business rates bills, England, 2018-19



Source: Standard multiplier applied to values from VOA, Central rating list - England

## Green energy and infrastructure

The downside of business rates is particularly clear when it comes to the country's energy supply and its other infrastructure. It is generally recognised that a great deal of investment (both private and public) will be needed to drastically reduce greenhouse gas emissions and improve the country's creaking physical infrastructure. But business rates are a tax on any such investment.

An indication of this can be seen in the 'central rating list' – the VOA register of infrastructure that is too geographically widespread to be rated on a local authority level. As Figure 2 shows, Network Rail will likely pay around £190 million in business rates this year, with BT paying over £250 million, and large bills for electricity, gas and water suppliers.

Where utilities are using (or in some cases simply holding) valuable land, it is right that they should pay tax to encourage its efficient use. But the main element of taxation here is very likely not on the value of land but on the physical capital of railways, cables (even if underground), pipelines and other infrastructure. And any new investment only leads to higher bills.

A new relief has recently come into force for new fibre-optic broadband installations for a period of 5 years, recognising the problem,<sup>12</sup> but it would be far simpler to not tax infrastructure in the first place.

Like other infrastructure, new renewable generation must also pay business rates. This includes onshore wind farms, large solar farms, even emerging energy storage businesses and (in future) electric vehicle charging points.

If a firm installs solar panels on its roof, this will increase its business rates bill. For example, if a retailer spends £60,000 on solar panels which increase the property's annual rateable value by £3,000, their annual tax bill would then rise by £1,479. Similarly, improving a building's energy efficiency – e.g. its lighting or heating – is likely to result in a higher tax bill.

We should ask not just whether business rates are fit for purpose, but what that purpose is: why does the UK have a solar panel tax, a railway line tax, and a water infrastructure tax?

<sup>12</sup> gov.uk, *Business rates boost for broadband*, April 2018

## Economic impacts of moving to the Commercial Landowner Levy

A move to taxing only the value of land would increase business investment. In particular, investments that would previously have been uneconomical due to their tax implications would become viable. Increased investment would increase the UK's stock of capital, in turn giving productivity, GDP and wages a much-needed boost.

Some indication of the scale of possible economic gains is given by the OBR's modelling of a tax cut for some plant and machinery, which they estimated would boost business investment by 0.5%. We can also look at previous HMRC and OBR modelling of corporation tax cuts, in which higher post-tax profits are modelled as attracting extra investment.<sup>13</sup> Although corporation tax is rather different from business rates, it seems reasonable to assume that cutting business rates for physical structures should have an even greater effect on investment, for a given cost. Corporation tax affects profits, but business rates apply regardless of whether profit is made. As a result, the effect on marginal investment decisions is particularly great (while land taxation should have no impact on investment decisions).

Removing business rates from physical structures would amount to a £6 billion per year tax cut in England.<sup>14</sup> Given this, and related government modelling, we think a complete switch to a Commercial Landowner Levy could boost business investment by at least 1% (around £2 billion a year),<sup>15</sup> and productivity and GDP by 0.4% (around £8 billion) in the long-term. Figures several times greater than these would also be plausible.

The fiscal gains from any such impact would be large. A 0.4% increase in GDP is worth around £3 billion a year to the Treasury in increased revenue. Given great uncertainty around these impacts, we do not include them in our policy costings, and official modelling should be commissioned. But, as discussed further in Section 6, gains of this magnitude would result in the Commercial

<sup>13</sup> Previous government modelling has suggested that corporation tax reductions of around £8 billion a year would increase investment by 2.5-4.5% (in the long term) and boost GDP by 0.6-0.8%. See HMT/HMRC, *Analysis of the dynamic effects of Corporation Tax reductions*, December 2013. Elsewhere, the OBR has modelled 1p corporation tax reductions as boosting investment by 0.4-1%. See OBR, *Policy costings and our forecast*, March 2014

<sup>14</sup> See Section 5 and the Appendix for more discussion of our method.

<sup>15</sup> Business investment was £195 billion in 2017 (see ONS series NPEK)

Landowner Levy being at least revenue neutral, if not revenue raising.

## A land tax would be far more effective at land value capture

As well as increasing business investment, the Commercial Landowner Levy may also help make the case for new public investment.<sup>16</sup> It is well established that new infrastructure like rail links can dramatically increase local property values, and that there is a good argument for ‘capturing’ some of these private gains to fund the investment. For example, the Jubilee line extension in London produced an estimated local land value uplift of 52 per cent.<sup>17</sup>

Some land value capture schemes have been devised, but business rates do a poor job. Revaluation is infrequent (see Section 5), tax revenues in aggregate are deliberately linked to inflation rather than property values, and rather than taxing only land (where the uplift occurs) business rates are also a tax on physical capital (like solar panels) that will not receive such uplifts.

Rather than taxing private investment in buildings and machinery, the Commercial Landowner Levy would concentrate on capturing publicly-created land value uplifts. Planning for new transport links, for example, could then take into account the fact that Commercial Landowner Levy revenues would naturally increase as a result, helping to make the case for new investment and so further improving the country’s infrastructure.

As Financial Times commentator Martin Wolf has put it:

*“Increases in land values give not only a good indication of the benefits of infrastructure investments, but also provide an efficient and just way of financing their costs. It is efficient to tax these values because the tax would reduce the size of a windfall, while other taxes used to pay for infrastructure reduce effort, penalise the division of labour or discourage capital accumulation. It is also just, because the chief beneficiaries would bear the cost.”<sup>18</sup>*

<sup>16</sup> John Muellbauer, *Housing, debt and the economy: a tale of two countries*, NIESR, August 2018

<sup>17</sup> TfL/GLA, *Land value capture*, February 2017

<sup>18</sup> Martin Wolf, *Land tax is something to build on*, Financial Times, June 2006

## Scrapping non-residential stamp duty land tax

Stamp duty is another tax on commercial property, this time upon purchase. For freehold properties, there are 2 tax rates of 2% (between £150,000 to £250,000) and 5% (above that). So buying a £500,000 property, for example, would come with a tax bill of £14,500.

This has two major impacts. First, like business rates, it reduces investment by increasing future taxation when a building’s value goes up (including immovable plant and machinery) and suppresses the amount of stock built in the first place. Note that while this tax is paid by the purchaser, it acts to reduce how much the owner can sell for. Secondly, it reduces the volume of transactions, leading to an inefficient allocation of stock. This is because some transactions that would take place – where one party places more value on a property than the existing owner – become uneconomical due to stamp duty.

Non-residential stamp duty should therefore be abolished. It raises only £3.4 billion in England and Northern Ireland, £200 million in Scotland (as Land and Buildings Transaction Tax) and £100 million in Wales (Land Transaction Tax). Moreover, abolishing this stamp duty would push up land values – and with a Commercial Landowner Levy this would automatically recoup a significant part of the revenue loss.

Like replacing business rates, abolishing stamp duty would boost investment and economic welfare. Some guide to the gains to be had from this policy come from Australia (discussed further in Section 5), where there has been substantial debate about the economics of property taxation. Indeed, the Australian Capital Territory is in the process of abolishing its stamp duty and raising its land tax.

One paper argues that “given estimates of the inefficiency costs of stamp duties, abolishing stamp duties in all states and replacing them with a broad-based land tax could add \$9 billion a year to GDP”,<sup>19</sup> though this includes residential stamp duty, which we do not look at in this paper. Similar modelling for New South Wales suggested a boost to investment of 2% and to output of 0.9%.<sup>20</sup> And

<sup>19</sup> Grattan Institute, *Property taxes*, July 2015

<sup>20</sup> KPMG, *Economic modelling of property tax reform options*, February 2016



other modelling looking only at abolishing non-residential stamp duties (offset by a sales tax increase) estimated a net benefit of \$3-4 billion.<sup>21</sup> Note that UK GDP is around double Australia's and has approximately similar stamp duty rates.

Although business rates replacement and stamp duty abolition would both certainly have significant economic benefits, we do not assume any gains for the purpose of our policy costings. But these benefits should be a key motivation for reform.

<sup>21</sup> Deloitte, *The economic impact of stamp duty*, December 2015



# Section 3: Simplifying the tax system

## Introduction

Like any tax, business rates are an administrative burden for businesses, requiring time and money. Reliefs can help small businesses reduce their tax bill, but make the system harder to understand and use. They also create perverse economic incentives, and the ultimate beneficiary is often the landlord rather than the tenant. The Commercial Landowner Levy would seek to reduce the administrative burden of business rates, not least by vastly reducing the number of businesses that pay it.

### Policy recommendations in this section:

- **Tax should be paid by owners, not occupiers**
- **The Employment Allowance for employer National Insurance should be doubled from £3,000 to £6,000 in place of small business property tax reliefs**
- **Some reliefs, such as for charities, should continue**

**under the Commercial Landowner Levy but with consultation on whether this is the best way to help them**

- **Charitable relief should be removed from private healthcare and private schools**

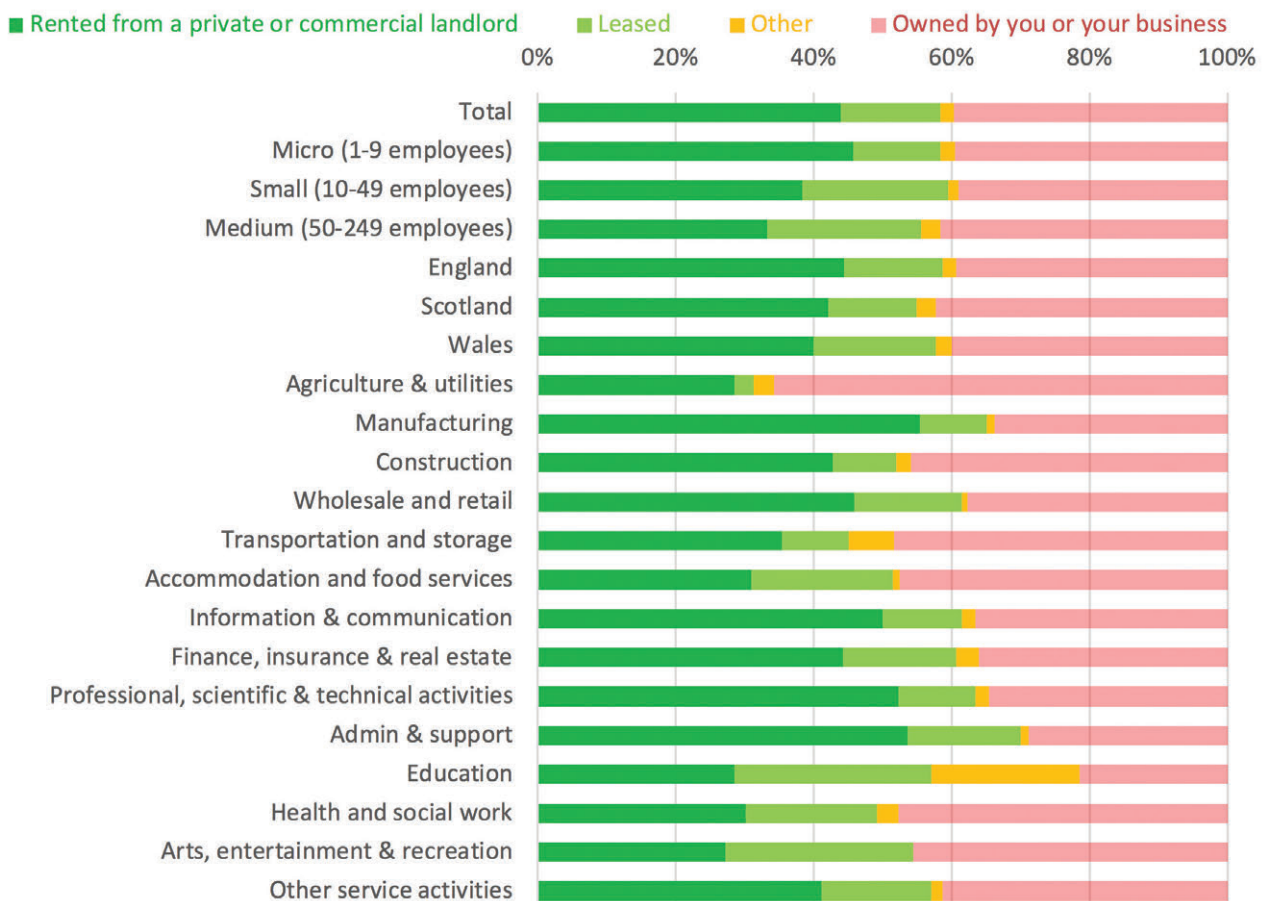
## Moving tax from occupiers to owners

Business rates have always been paid by the occupier – primarily to save the effort of tax collectors in centuries past having to track down the owner. But in many other countries (see Section 5) property taxes are levied on the owner rather than the current occupant.<sup>22</sup>

The case for moving the tax burden to owners is perhaps best illustrated by the example of a shopping centre,

<sup>22</sup> This is also true of residential taxes, where taxing owners is the norm, e.g. in Ireland, the Netherlands, Denmark, Singapore and the US.

Figure 3: The proportion of SMEs renting and owning, 2017 – “Which of the following describe your organisation’s main premises?”



Source: BEIS, Longitudinal small business survey 2017, May 2018, GB

which might be home to 30 separate businesses renting from a single property company. At present each business must get to grips with the business rates system and make their own payment. Were the tax to be paid instead by the property company, it could manage and combine the payments previously made separately by 30 companies.

Our analysis shows that there are far fewer land plots than business ‘hereditaments’. Whereas business rates are based on over 2 million records in England and Wales, using units of land instead would reduce this to around 800,000, a 61% reduction. Furthermore, landlords are likely to change far less often than occupants, reducing the tax administration – on both the government and private sides – caused by a change in tenants. Note also that the ‘staircase tax’ controversy – in which a firm with two adjoining units might receive two separate business rate bills – would never have happened under a land tax.<sup>23</sup>

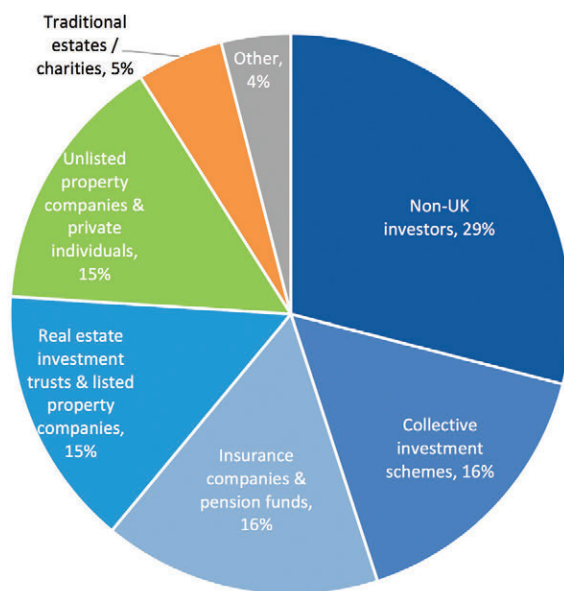
Moving the tax burden to owners would be its own simplification. For small businesses just starting out and not in a position to buy property, they would no longer need to know the details of business rates or its replacement, and their time could be spent on developing their business rather than on tax administration.

Strikingly, only 39% of small to medium sized enterprises (SMEs) in England (and excluding the 25% without premises) own their own main premises.<sup>24</sup> In Wales the figure is 40%. This implies that of the 1,360,000 businesses with 1-249 employees in the UK,<sup>25</sup> around 340,000 have no premises; around 410,000 own and would continue paying tax; and 590,000 currently renting and paying business rates would pay nothing under the Commercial Landowner Levy.

In some sectors the impact would be even greater. Only 34% of manufacturing SMEs own their premises, and just 37% of retail/wholesale SMEs. So around two thirds of SMEs in these important sectors would be taken out of property tax entirely.

Of course, while this change would be of great value in reducing the bureaucratic burden on SMEs, rents may be expected to rise to offset some or all of the tax cut for

Figure 4: Who owns non-owner-occupied UK commercial property, by value, 2016



Source: Property Industry Alliance, Property Data Report 2017

tenants. But even if a company’s tax bill went down by £20,000 (moved to the landlord instead) and their rents rose by the full £20,000, they would clearly be no worse off.

And for companies who do own their own premises, nothing would change with the shift from taxing occupants to taxing owners.

But who are the commercial landlords who would be asked to take on more administration? Figures from the Property Industry Alliance show that this is mostly a large-scale, professional sector. The largest owners are overseas investors, owning 29% of property value, compared to just 15% owned by unlisted property companies and private individuals.

Clearly, moving the responsibility for paying tax from occupants to landlords would mean moving the burden of tax administration – and the risk of future property tax changes – to organisations that are better able to deal with them. Indeed, it seems natural that property companies should pay property taxes – rather than the restaurants, manufacturers, retailers and other businesses that rent from them.

23 For more details see gov.uk, *Legislation introduced to help businesses affected by unfair ‘staircase tax’*, March 2018

24 BEIS, *Longitudinal small business survey 2017*, May 2018

25 BEIS, *Business population estimates 2017*, November 2017

## Small business reliefs

In England, there are two main policies designed to help smaller businesses with business rates.

First, smaller premises – those with a rateable value below £51,000 – pay a marginally lower ‘small business’ rate of 48%, rather than the ‘standard’ rate of 49.3% (using the values for 2018-19).<sup>26</sup> Note that this is a tax cut for those with less valuable premises rather than for small businesses *per se*, though of course the two may often be the same.

Second, there is ‘small business rate relief’, costing £1.7 billion in 2018-19. This reduces tax bills to zero for premises worth less than £12,000 a year, but (usually) only if those are the business’s only premises. There is partial relief between £12,000 and £15,000.

For the most part, similar reliefs exist in Scotland, Wales and Northern Ireland but with different thresholds. All of

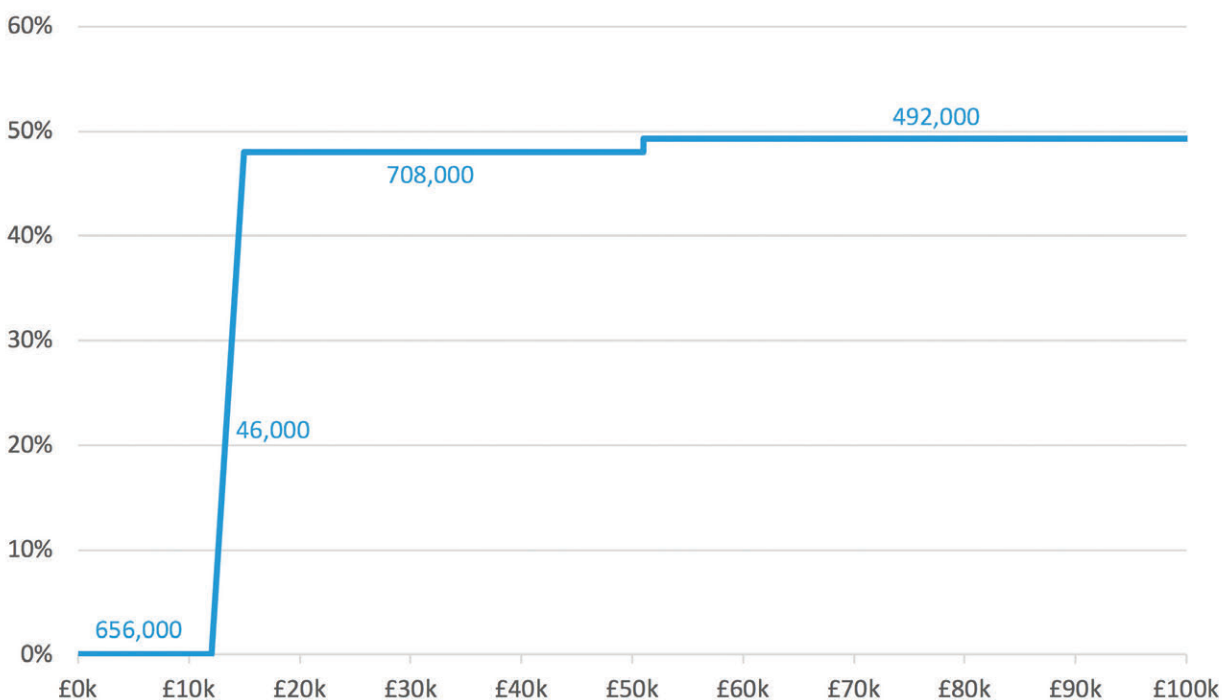
<sup>26</sup> Sometimes this is presented instead as large businesses paying a supplement.

these thresholds tend to be fixed and do not naturally rise in line with inflation or rents.

The combined impact of these discounts is shown in Figure 5. This gives the effective tax rate for each value (assuming the business has only one property). The reliefs mean that tiny increases in rental value can lead to big changes in business rate bills: for example, a property worth £50,000 a year would use the small business multiplier (48%) and have a bill of £24,000, but one worth £51,000 would use the standard multiplier (49.3%) and face a bill of £25,143.

This effect is particularly stark where small business rate relief is rapidly tapered away from full relief to nothing, producing a damaging “cliff-edge” effect that can hold businesses back from improving their properties or expanding into larger ones. For example, the cost of occupying premises worth £12,000 a year would be £12,000 (with no business rates to pay), but the cost of premises with a rental value of £15,000 a year – 25% higher – would be £22,200 including business rates – 85% higher.

Figure 5: Effective tax rates by annual rental value (England), 2018-19, and number of hereditaments in each band (as of December 2017)



Source: Numbers of hereditaments taken from MHCLG, National non-domestic rates collected by councils in England: forecast for 2018 to 2019, February 2018, Table 4

Another way of demonstrating this is shown in Figure 6, which looks at the marginal increase in tax for each £1,000 increase in rental value. Where small business rate relief is tapered away, and where the small business rate ends, marginal tax rates exceed 100%. For example, going from an annual rental value of £12,000 to one of £13,000 results in an annual tax increase of over £2,000.

Although created with the best of intentions, small business reliefs can clearly create strong disincentives to improve properties and grow one's business, and make the business rates system harder to understand.

If tax were paid by landlords, with most small businesses no longer paying the tax themselves, the case for these reliefs would be weakened. It would also be harder to implement help in this form. Giving relief to 'small landlords' instead would not be a good way of targeting resources, and giving relief on the basis of the tenant – while possible – would remove much of the simplicity of having a landowner-based tax.

A Commercial Landowner Levy should therefore apply a single tax rate (per devolved nation), making the system simpler and more investment-friendly. As will be seen in

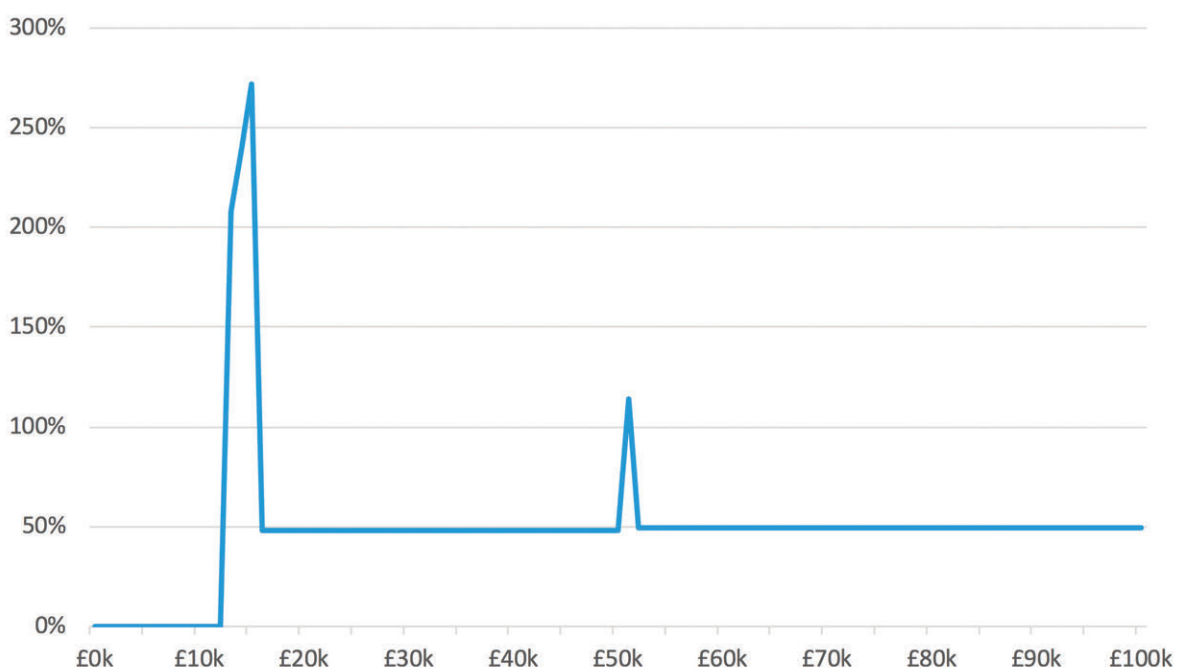
Section 6, a tax cut overall – and particularly for poorer parts of the country – would help ensure that the Commercial Landowner Levy would be a welcome change for business. And the tax system can help small businesses in other, more efficient ways. As argued below, money saved by removing complex reliefs should be entirely redirected to help small businesses with their employment costs rather than their rents.

## Doubling the Employment Allowance

Rather than subsidising land use, a better way to help small businesses would be to reduce other taxes for them. The 'Employment Allowance' currently reduces each business's employer National Insurance bill by £3,000 a year, benefiting 1.2 million businesses.<sup>27</sup> This is equivalent to allowing them to hire 3.7 full-time workers on the National Living Wage or 1 worker on the median full-time wage before having to pay any employer National Insurance. The £1.7 billion cost of small business rate relief in England would be almost sufficient to double the £3,000 allowance to £6,000 – equivalent to 7 full-time

<sup>27</sup> HMRC, *Employment Allowance take-up statistics: 2017 to 2018 full-year estimate*, May 2018

Figure 6: Marginal tax rates for each £1,000 increase in annual rental value (England), 2018-19



workers on the National Living Wage or 2 workers on the median full-time wage.<sup>28</sup> Additionally, this would increase the number of businesses paying zero employer National Insurance by tens or hundreds of thousands.<sup>29</sup>

The Employment Allowance policy would cost somewhat more than small business rate relief (and note that it would inevitably apply UK-wide while business rate reliefs are devolved). A £3,000 tax cut would be greater than the value of small business rate relief for most businesses, including for those in the least valuable premises, for whom the relief is worth less. Small business rate relief is worth between £0 and a maximum of £5,760 depending on the rental value, but switching to taxing land values would bring its own tax cuts for less expensive areas (see Section 6).

In addition, at least some of the value of the existing relief is likely to go to landlords by supporting higher rents. To

28 The current cost of the allowance is £2.1 billion in 2017-18, but the marginal costs of further increases would be smaller as the smallest businesses have already been taken out of tax.

29 For comparison, the 2016 increase from £2,000 to £3,000 was predicted to take 90,000 employers out of tax, and the initial £2,000 allowance was predicted to take 450,000 out of tax.

quote the standard textbook on rating, “Reliefs become translated into an ability to offer higher rents so the benefit of the relief ends up in the freeholder’s pocket. [...] There is therefore a likely benefit in having targeted reliefs in the short-term but reliefs should, perhaps, not be long-term or permanent.”<sup>30</sup>

Overall, it would seem greatly preferable for the tax system to reduce the taxation of salaries – supporting higher employment and/or higher wages – rather than reducing taxes on rents, particularly once the value of the building is removed from the property tax.

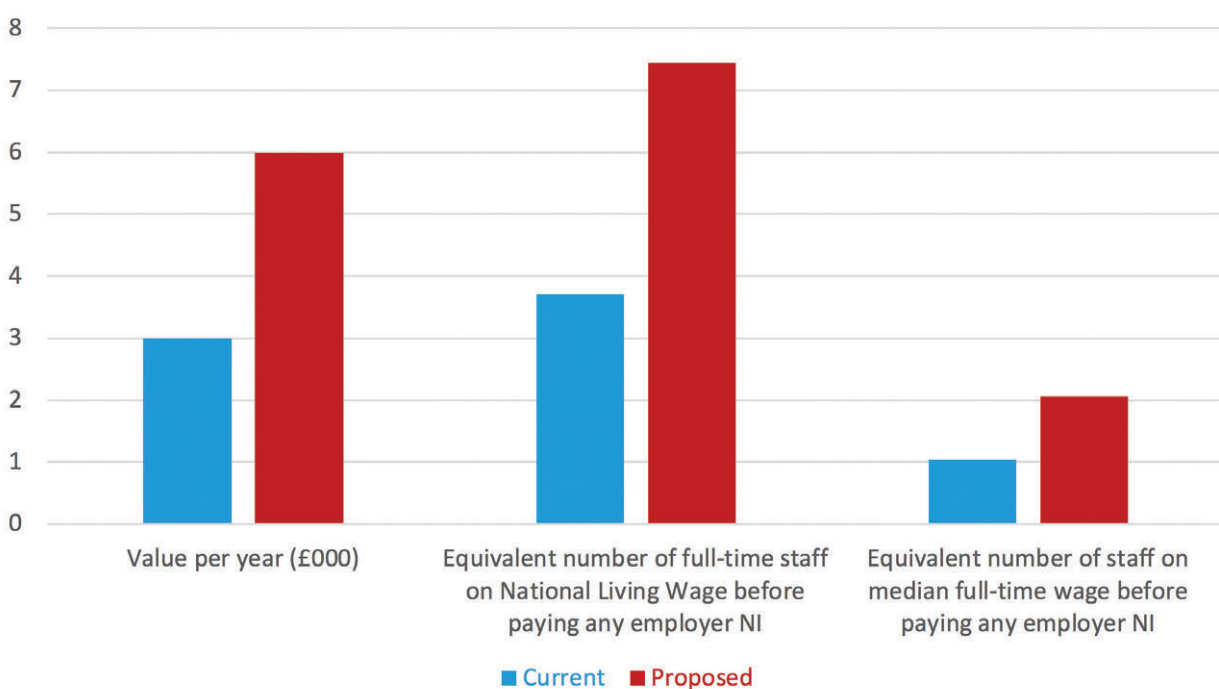
Combined with the other policies in this paper, a large number of businesses would find themselves removed from paying either employer National Insurance (due to the Employment Allowance), property tax (as they rent), or stamp duty land tax (as it would be abolished).

### Charity relief

Small businesses are not the only organisations to receive relief in the current business rates system. Charities

30 Patrick Bond & Peter Brown, Rating Valuation Principles and Practice

Figure 7: Comparison of a £3,000 and £6,000 Employment Allowance



Source: Uses the April 2018 National Living Wage and the April 2017 median full-time wage (from the Annual Survey of Hours and Earnings) updated to 2018

receive a mandatory 80% relief, and councils can top this up to 100% with discretionary relief – though in practice only an average of 2.5% discretionary relief is provided.<sup>31</sup> In total, this relief will cost £1.9 billion in England in 2018-19.<sup>32</sup>

But this large tax discount does inevitably come with incentives that cause problems:

- A potential oversupply of charity shops rather than private sector businesses
- Controversy over the position of public sector hospitals and many schools, compared to private ones with charitable status<sup>33</sup>
- Local government outsourcing work to newly created charities to avoid business rates (a curious example of government itself engaging in tax avoidance)<sup>34</sup>
- Landlords avoiding rates on empty premises (discussed in Section 4) by striking deals with charities, such as filling a small part of the premises to benefit from relief for all of it

And again, it is likely that this relief ultimately in part lines the pockets of landowners rather than charitable activities.

The 2012 Morgan Review of business rates in Wales suggested that the rate of relief should be reduced, or limited to a certain number of charity shops per area.<sup>35</sup> But we do not recommend such changes here. Instead, charity tax relief should continue under the Commercial Landowner Levy, with the landowner receiving some relief if the property is occupied by a charity (though where a plot of land has multiple occupants the relief would only be in proportion to that charitable occupation).

This would add some complexity to the tax, but would ensure that charities were not negatively affected by the change. In addition, many charities would benefit from the higher Employment Allowance and the abolition of stamp duty. In the longer term, the government should consult with charities on whether there may be more

effective ways of helping them for the same cost.

Some changes should be made, however, to limit the scope of charitable relief. Private schools and healthcare facilities often have charitable status and benefit from the relief while (most) public sector schools and hospitals do not.<sup>36</sup> It is right that those private bodies should be taxed when they own land just as other businesses and the public sector do. Following the Barclay Review in Scotland, relief has been removed from private schools.

In England and Wales, the relief has been valued at £104 million a year for private schools and £10 million a year for private healthcare.<sup>37</sup> Removing charitable relief from these institutions as part of a new tax would allow rates to be lower for all businesses and for the NHS and public sector schools.

## Other reliefs

There are a number of reliefs other than for small business and charities.

Pubs receive £1,000 off their business rates bill (though they lose this if their rateable value is £100,000 or over). But this scheme is not currently set to continue beyond 2018-19. The end of this scheme would be more than offset by the £3,000 increase in Employment Allowance.

Around 4,000 community amateur sports clubs receive mandatory relief of 80% in England.<sup>38</sup> Such relief could continue under the Commercial Landowner Levy. But if it did, its scope could be reduced somewhat. In Scotland, the Barclay Review found that prestigious golf clubs (including Donald Trump's) were receiving large amounts of relief, and this has now been restricted. Clearly there is a difference, for example, between local bowling clubs and major golf courses, and any tax relief should reflect this beyond Scotland too.

Although relatively minor in terms of national cost, the

31 NCVO, *Tax and reliefs*

32 MHCLG, *National non-domestic rates collected by councils in England: forecast for 2018 to 2019*, February 2018

33 e.g. BBC, *NHS call for equality over private hospitals' tax break*, August 2017

34 Scottish Government, *Report of the Barclay review of non-domestic rates*, August 2017

35 BBC, *Charity shops: One third could close if rates help cut*, November 2012

36 Note that some forms of schools such as academies and foundations are charities and do receive relief, while others do not. It would make sense for all forms to be treated equally and pay property tax in full, with school budgets increased accordingly.

37 See research from CVS at BBC, *NHS call for equality over private hospitals' tax break*, August 2017 and *The Guardian*, *Private schools to save £522m in tax thanks to charitable status*, June 2017

38 MHCLG, *National non-domestic rates collected by councils in England: forecast for 2018 to 2019*, February 2018

government has created 'enterprise zones', one element of which is that businesses moving to the area receive a business rates discount for a number of years. While such policies could potentially continue under the Commercial Landowner Levy, the tax reduction the Levy would bring in parts of the country with low land values (discussed in Section 6) would render them unnecessary. And there is evidence that these reductions simply push up rents in any case.<sup>39</sup>

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<sup>39</sup> Shaun Bond *et al.*, *The impact of enterprise zone tax incentives on local property markets in England: who actually benefits?*, Journal of Property Research, September 2012

There are other reliefs, including local discretionary powers. But all of those, as well as the above, are relatively minor and decisions regarding these should not make a material difference as to how business rates should be replaced. In this paper we do not assume any extra revenue from changes to these. The exception is relief for empty premises, which we turn to in the next section.



# Section 4: Taxing vacant premises and land

## Introduction

As a tax on occupants, business rates have traditionally only fully applied to occupied property. But a tax on land ownership suggests a different approach – one that does not subsidise under-utilisation of real estate and can help boost supply. This section explores how.

### Policy recommendations in this section:

- **Commercial land should be taxed regardless of whether the buildings above it are occupied**
- **Tax should also apply to empty commercial sites, including in cases where the property itself has been demolished**
- **The Commercial Landowner Levy would not apply to agricultural land, forests, parks, public roads or religious grounds**

## Empty buildings

After relief for small businesses and charities, relief for empty premises is the most expensive exemption in the business rates system. Unoccupied properties are

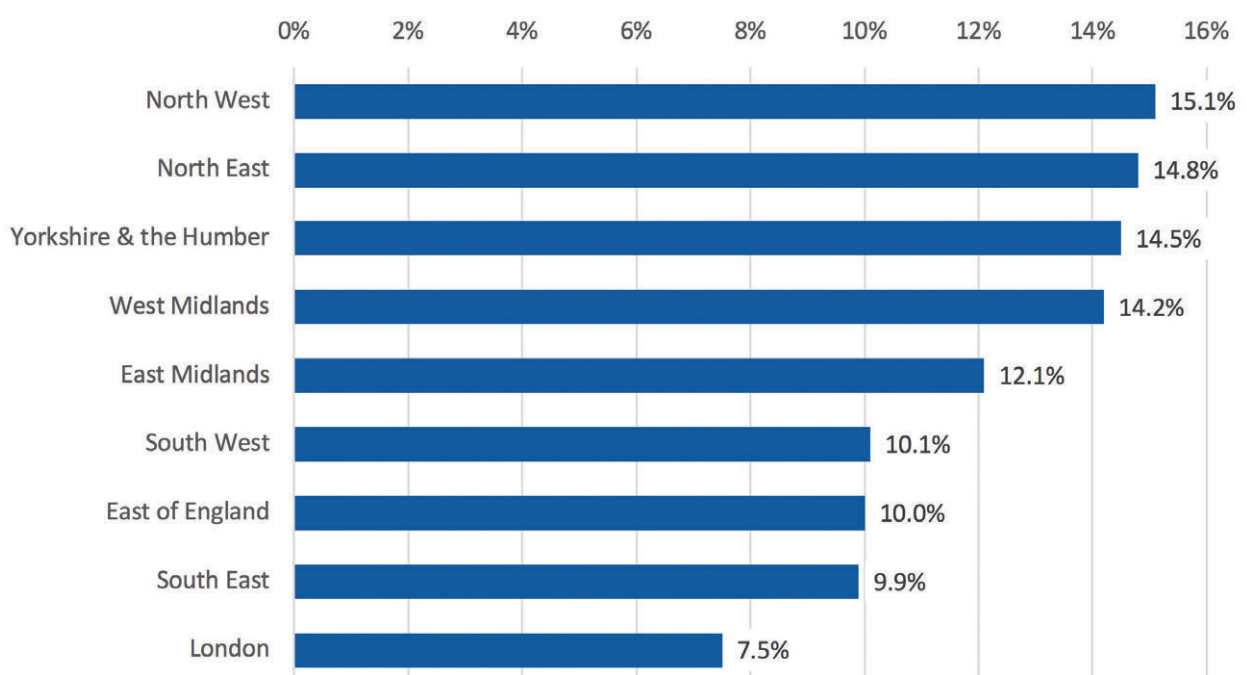
exempted for 3 months (6 months for industrial premises) at a cost of over £800 million a year in England. Prior to 2008, properties also received at least 50% relief beyond that initial period.

This rule can be somewhat gamed by having the premises occupied for 6 weeks or more, after which time another 3 month exemption can apply. Another option available is to come to an agreement – even a token one – with a charity, to qualify for charity relief instead. Empty listed buildings and properties with a rateable value below £2,600 are also exempt.

With a tax based on the owner rather than the occupier, relief for empty premises makes even less sense than at present. Given that one of the intentions of the new tax is that liabilities would not change every time the occupancy changed (saving administrative work both for the government and landowners), a lack of occupant should not affect the tax bill.

While abolishing this relief would not be popular with landowners, its value is already limited, and the revenue raised would be used to lower rates overall. Thus, in the

Figure 8: Retail and leisure vacancy rate by region of England, H1 2017



Source: The Local Data Company, Retail and Leisure Trends Report, September 2017

long run, the average landowner would not pay more as a result – but those who kept their property empty for longer than others might. And abolishing the relief entirely could be expected to marginally increase property supply.

Most importantly, it should be noted that where there are a high number of empty premises it is likely that land values are also low. Figure 8 shows that the highest vacancy rates are in the North of England while the lowest are in London – broadly the opposite of the land value distribution (as demonstrated in Section 5). So landlords may have to pay more tax on their empty premises, but these bills may be low due to weak land values and over time those in depressed areas will most likely be significant beneficiaries (see Section 6).

Similarly, the times when vacancy rates rise, such as recessions, will also be the times when land values fall – delivering a tax cut for owners (unlike in the business rates system).

Finally, it should be noted that if a landowner has a small property on a large plot of land then the Commercial Landowner Levy would better encourage them to make use of the unused portion (either themselves or by selling it on), subject to planning permission.

### Premises incapable of beneficial occupation and vacant land

As well as properties receiving empty buildings relief, and empty properties where business rates are paid, there are others that are not deemed rateable at all due to their condition. A range of damage or development work can result in a property being removed from the rating list, but there are no good figures on the number of such properties.

This exemption, like many others, can lead to perverse behaviour. Properties may be deliberately ‘vandalised’ (e.g. “partitioning, suspended ceilings, lighting, heating” or other utilities might be removed),<sup>40</sup> or major construction work begun, in order to make the property

ineligible for business rates.<sup>41</sup> At the extreme, there are many examples of properties having been simply demolished to avoid business rates.

In contrast, the Commercial Landowner Levy would be based on the best permitted use (see Section 5) regardless of the state of the property. Just as improving the building would not lead to a higher bill, nor would vandalising it lead to a lower bill. This would remove these damaging incentives, and reduce the ability of property companies to simply hold onto vacant, partially-damaged properties for speculative purposes (while benefiting from police and fire services and other public infrastructure). These unoccupied properties might often be considered ‘brownfield’ sites that could be used for housing. With the Commercial Landowner Levy, the incentive would be to seek agreement on redevelopment, rather than for continued speculation.

A conservative estimate is that taxing commercial sites that are now no longer on the rating list might raise around £80 million a year in England – 10% of the amount of empty buildings relief.

### Agricultural and other land

Agricultural land is exempt from business rates and we propose that this would continue under the Commercial Landowner Levy, though this should be reviewed on a regular basis. In addition, depending on the details of Britain’s departure from the EU, this exemption could be assessed at the same time as other subsidies to ensure that environmental, economic and distributional goals are achieved in the most effective manner possible. Regardless, however, valuation could be done for all land as an open, public good alongside a complete registry of land ownership (discussed further in Section 5).

Most agricultural land is of relatively low value, in any case. But there may be a separate case for policies that try to capture the huge value uplift that occurs when planning permission for residential use is acquired (e.g. community land auctions or changes to compulsory purchase compensation), or policies that tax property developments that ‘drip feed’ homes onto the market very slowly through

<sup>40</sup> Dunlop Heywood, *Top 20 ways to reduce your empty property business rates liability*, May 2016

<sup>41</sup> e.g. The Independent, *Buildings destroyed after rate relief is abolished*, August 2008 and Evening Express, *Housebuilder to demolish empty Aberdeen office block to avoid increasing business rates*, July 2017

slow build-out rates.<sup>42</sup> But these are outside the scope of this paper.

Land value tax may however raise some questions about the definition of 'agricultural land'. Given that the tax would attempt to ignore the value of any structures, it might be considered odd to have an exemption based on the land's use. For example, if solar panels or wind turbines were erected on farmland, would it become liable for the Commercial Landowner Levy? The decision may have little consequence in terms of tax bills due to the low

value of most farmland, but for this reason a slightly broader definition of agricultural land might be considered.

We see little need to include forests and parks in the tax. And the same applies to roads and other public spaces. In most cases, these will have little if any market value anyway due to planning restrictions, but for public reassurance and administrative ease if nothing else, all these uses should simply be exempt from the Commercial Landowner Levy. For the same reasons, churches, cemeteries and land under other religious buildings would continue to be exempt from tax.

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<sup>42</sup> e.g. The LGA has asked for councils to have the power to "charge developers full council tax for every unbuilt development from the point that the original planning permission expires"



# Section 5: Valuing land

## Introduction

Section 2 set out the strong economic arguments for taxing only the land underneath a property, exempting physical investment above it. But is it actually possible to work out commercial land values? This section demonstrates that this can be done and sets out our own estimates of land values across England and Wales.

### Policy recommendations in this section:

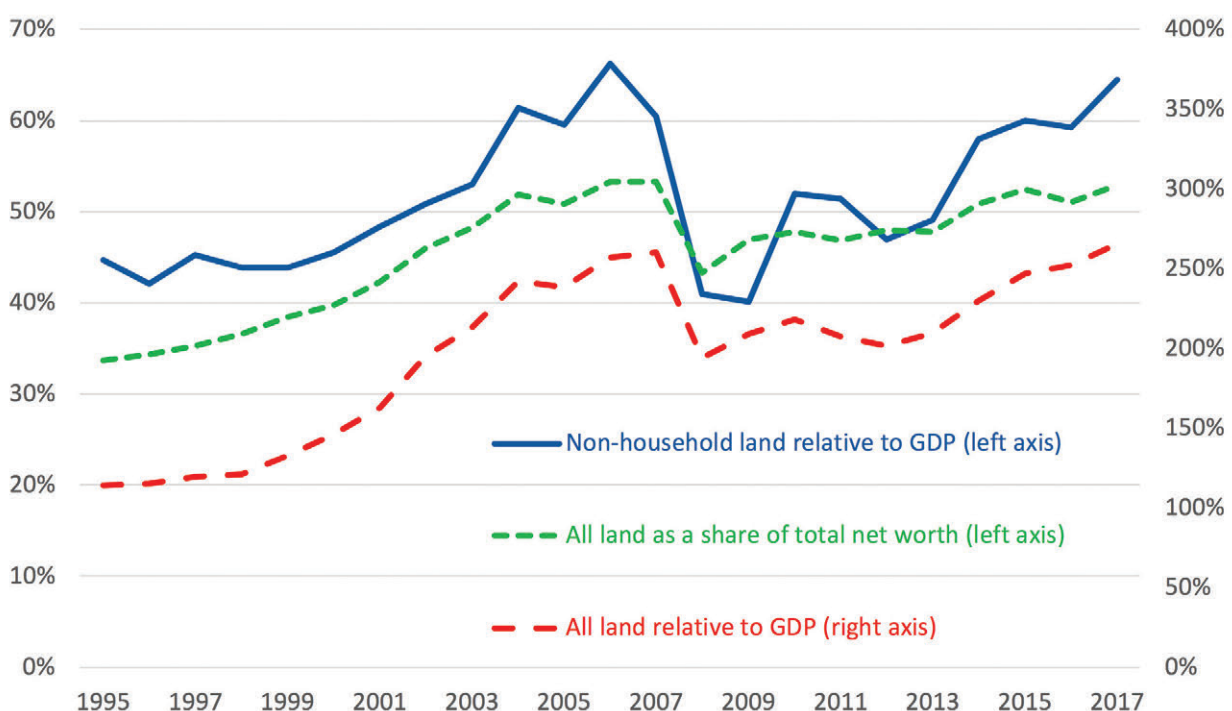
- **The VOA should calculate land values, using a computerised approach as a first step**
- **Valuations should be based on the best permitted use**
- **Either rental or capital values could be used**
- **Values should be updated each year and be as up-to-date as possible**
- **The Land Registry should be completed and kept in public ownership, and commercial land value data made public**

## The value of all the UK's land

There are already some limited statistics about land values. Recently, the Office for National Statistics (ONS) has included in the National Accounts a separation of land value from the value of the structures on top of it. Of the country's £10.2 trillion of net worth in 2017, £5.4 trillion (53%) is ascribed to land value. As Figure 9 shows, the importance of land has grown relative both to national income (GDP) and to other assets – particularly in the early 2000s. Land now makes up the majority of the country's net worth – more than all of its buildings, net financial worth, machinery, equipment and other assets combined – and a record 266% of GDP in 2017.

The ONS also breaks this land wealth down into different sectors. The majority (£4.1 trillion) is the land beneath people's homes, but £1.3 trillion is owned by business, the public sector and non-profit institutions. A rough estimate of how a commercial land tax might replace business rates can therefore be made by comparing rates revenue

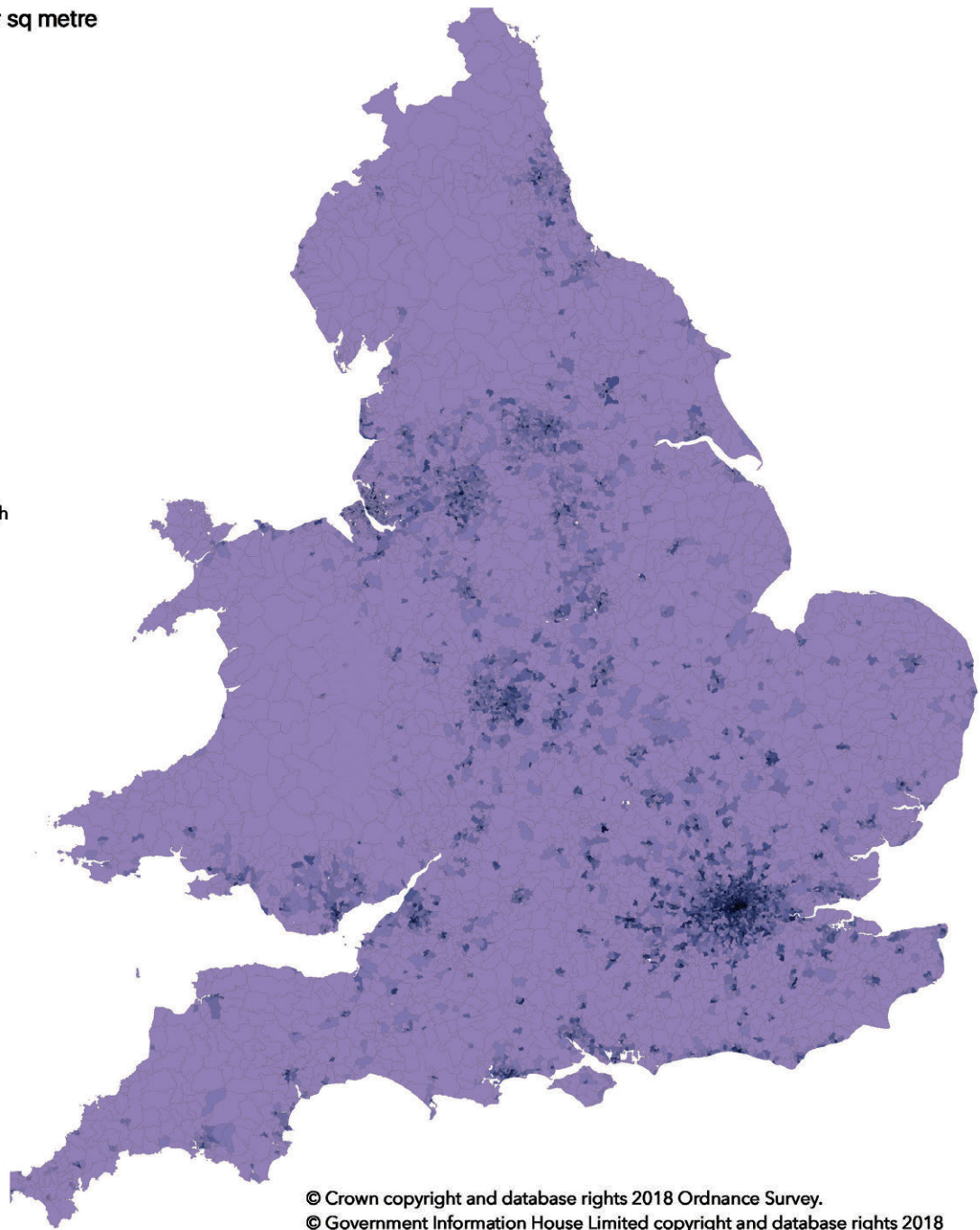
Figure 9: Land value in the National Accounts



Source: ONS, United Kingdom National Accounts: The Blue Book 2018, July 2018, National Balance Sheet

Map 1: Average land values across England and Wales

Annual £ per sq metre



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Source: See Appendix for details

(£30 billion) with this £1.3 trillion of land value, which would imply a tax rate of 2.3% per year on capital values.

However, this assumes a broader scope than business rates (e.g. by including agricultural land), and ignores the fact that reform must be roughly revenue-neutral within each nation separately, due to devolution. It also tells us nothing about how a land tax would affect different parts of the country and different industries. At present however, the ONS does not produce sub-national or detailed sectoral estimates of land values.

## Our estimates of land values

In this paper we create our own detailed estimates of commercial land values. This builds on previous work, but has not been done before for England and Wales.<sup>43</sup>

To do this, we use data on rental values across the country, their floorspace and use, and the area of the plots of land beneath them. All of this data is publicly available. With these, a hedonic regression method is able to deduce what part of the value is attributable simply to location. In short, it is assumed that differences in typical rental value per square metre between postcode sectors for each type of commercial use are the result of location; and that the cheapest 5% of properties nationally have no land value. These location premia per square metre are then joined with data on the size of each land parcel and summed for each plot, giving the land value of that plot. More detail is provided in the Appendix.

Our results are shown in Map 1. Predictably, the highest land values are to be found in Westminster and the City of London.

Importantly, we estimate that land makes up around 75% of commercial property value in England, and 60% in Wales, as shown in Figure 10. Note that the greater these shares, the less difference there would be between a land value tax and a property value tax (if a property's value were 100% land then there would be no difference between the two). In addition, the lower the value of land as a share of property value, the higher the headline tax rate needs to be for a given level of revenue – perhaps leading in turn to lower political viability.<sup>44</sup>

43 Ronan Lyons and Andy Wightman, *A land value tax for Northern Ireland*

44 Enid Slack, *Alternative approaches to taxing land and real property*, World Bank

These figures differ from those implied by the ONS, though their data is UK-wide and covers a broader range of buildings and structures. The ONS figures suggest land makes up only 41% of commercial property value (and 72% of residential value). As discussed in the Appendix, we believe this difference may reflect the fact that their method involves subtracting the *current* cost of construction for a property to determine land value. In reality, however, the actual value of UK buildings constructed often many decades ago will be considerably lower than the cost of a new replacement. We believe in this case that our hedonic method is superior.

In Section 6 we use our land value estimates to model a land tax and its impacts across the country.

## International experience

Further evidence that land valuation is perfectly feasible comes from international experience. This includes Estonia, Australia and Denmark, all discussed below, as well as Jamaica, Kenya, New Zealand, South Africa, certain parts of the US and more.<sup>45</sup> It should also be noted that in China, for instance, land is generally state-owned and the sale of land-use rights contributes a large share of local government revenue<sup>46</sup> – but clearly their legal system has very different foundations to the UK and the countries below.

Estonia has repeatedly topped the 'International Tax Competitiveness Index'.<sup>47</sup> This is partly because of – not despite – a land tax (they list as one of its most positive features that “its property tax applies only to the value of land, rather than to the value of real property or capital”). However, this has not been revalued since 2001,<sup>48</sup> as regular revaluation was not legislated for.

Every state/territory in Australia has some form of LVT (except for the Northern Territory). While in the past a small number have used rental value,<sup>49</sup> all now use capital value. New South Wales (the most populous state) and some others exempt main residences.

45 Enid Slack, *Alternative approaches to taxing land and real property*, World Bank

46 Yinqiu Lu and Tao Sun, *Local government financing platforms in China: a fortune or misfortune?*, IMF, October 2013

47 Tax Foundation, *2017 International Tax Competitiveness Index*, October 2017

48 European Commission, *Country Report Estonia 2017*

49 Enid Slack, *Property taxation in Australia*, World Bank, June 2003

Denmark has been carrying out land valuation and taxation for around 100 years, influenced by Henry George just as the People’s Budget of 1909/10 in the UK was.<sup>50</sup>

These three examples are examined in detail in Table 1.

### How should land values be calculated?

We have shown that it is possible to calculate land values using data about commercial property values across the country. We have used existing VOA valuations, but data on property transactions and/or commercial rents could equally be used. And HMRC of course have more detailed data than we have access to. Land valuation would likely be a mix of these kinds of imputed values (using whole-property prices) and data on actual vacant land plot prices, though for particular locations these can be few in number.<sup>51</sup>

50 K J Kristensen, *Land valuation in Denmark (1903 - 1945)*

51 See Stewart Smith, *Land tax: an update*, NSW Parliamentary Library Research Service, April 2005

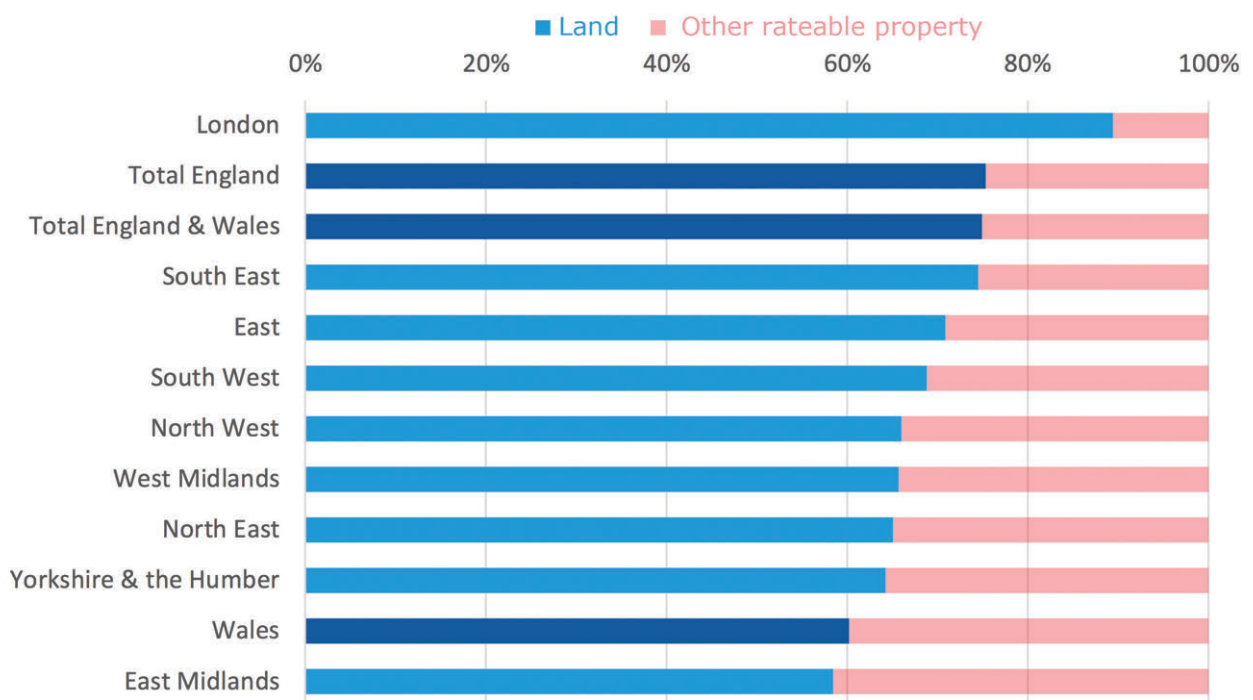
In today’s world – and with AI and big data being key parts of the UK’s industrial strategy<sup>52</sup> – this kind of automated approach should be the mainstay of valuation, rather than ubiquitous on-site inspections. Detailed checks of such automated results, and appeals against them, would be required too of course. But after a land value had been well established, adjusting those values in line with market conditions would require less intervention.

An important question, however, is just what is meant by ‘value’.

Take as an example a one-storey office space in an area where three-storey development were very likely to be permitted. Should the land value be based on its current use or the ‘best possible’ use (i.e. three-storey development)? As with empty or derelict land, we think it is right that land value taxation should try to further encourage land to be put to its best use – boosting the

52 BEIS, *Industrial Strategy: building a Britain fit for the future*, November 2017

Figure 10: Land value as a proportion of total commercial property value, by region



Source: See Appendix for details

Table 1: International examples of land value taxation

	Estonia <sup>54</sup>	New South Wales (Au.) <sup>55</sup>	Queensland (Au.) <sup>56</sup>	Denmark <sup>57</sup>
<b>Revenue goes to</b>	Localities	State	State	Counties and municipalities
<b>Set by</b>	Local within limits	State	State	Part nationally, part locally
<b>Paid by</b>	Owners (mostly)	Owners	Owners	Owners
<b>Overall scope</b>	"Land under home" recently exempted	Principal place of residence exempt. Vacant land included	Vacant land included	Includes most uses
<b>Basis</b>	Capital value	Capital value	Capital value	Capital value
<b>Rates</b>	Varies locally (and even by location) from 0.1 to 2.5%	1.6% (+\$100) above \$629,000 threshold per person or company, and 2% above \$3,846,000	For individuals, rates range from 1 to 1.75%, above a \$600,000 threshold. For companies, rates range from 1.5 to 2%, above a \$250,000 threshold	Varies locally from 1.6% to 3.4%
<b>Frequency of valuation</b>	1993, 1996, 2001	Annual, with tax based on value as of July 1st of the previous year (generally averaged over 3 years)	Annual, with tax based on value as of June 30th of the previous year	Every 2 years (since 2003), with indexation in between, though increases were capped
<b>Exemptions</b>	Agricultural land has a lower maximum rate. Churches, roads and some national parks exempt.	Agriculture exempt.		Lower (max) rate for agriculture. Churches, roads, parks etc. exempt. Reduced tax for some government property.

supply of property and reducing rents. This would be another change from business rates, which are based purely on the current use.<sup>53</sup>

Although the English planning system is vague in comparison to some countries (e.g. those with explicit zoning), 'best possible use' (or 'highest and best use') should also reflect what development is (likely to be) permitted. Where a community has decided that certain kinds of development are not currently allowed, landowners should not pay tax as though they were. So,

to tweak the example above, a one-storey office space in an area where three-storey development were fairly *unlikely* to be permitted should not be taxed as though height were unrestricted.

This means that some speculative value may be excluded from the Levy. But, in this way, landowners would have an incentive to put their land to best use (e.g. building upwards in the example above), while not being unfairly punished for not developing beyond what was locally permitted at present. Conversely, local authorities would have a strong incentive to be permissive towards development.

Such an approach would be in line with those countries that already have land value taxes, where values are based on the most productive potential use and take planning

53 One limitation of our modelling (see Appendix) is that we cannot include this change in approach.

54 See Tambet Tiits, *Land taxation reform in Estonia*, October 2006 and Republic of Estonia Tax and Customs Board

55 See NSW Government

56 See Queensland Government

57 Anders Muller, *Property taxes and valuation in Denmark*, September 2000



Table 2: The government's current plan for revaluations

Year	Revaluations	Distribution of business rates based on values from
2009-10		1 April 2003
2010-11	Revaluation	1 April 2008
2011-12		1 April 2008
2012-13		1 April 2008
2013-14		1 April 2008
2014-15		1 April 2008
2015-16	(Delayed)	1 April 2008
2016-17		1 April 2008
2017-18	Revaluation (postponed from 2015)	1 April 2015
2018-19		1 April 2015
2019-20		1 April 2015
2020-21		1 April 2015
2021-22	Revaluation (previously planned for 2022)	1 April 2019
2022-23		1 April 2019
2023-24		1 April 2019
2024-25	Revaluation (assuming new 3-year schedule)	1 April 2022

regulations into account.

Finally, a minor distinction should be noted between taxing 'unimproved' land values and taxing 'site values'. In both cases, buildings and other such additions to the land are excluded from valuation, but there there may be some improvements to the structure of the land itself that should be included. For example, should an empty plot of land that has been cleared and levelled be given a higher value than one that has not? The international norm is to include these improvements in the value.<sup>58</sup>

## Should rental or capital values be used?

An important question is whether property tax should be based on rental (annual) value or capital (market) value. Business rates are based on rental value but, as noted in Table 1, most countries with land-based taxes use capital values. Both approaches have been suggested at different times in UK land value tax proposals. In theory, there should ultimately be little difference between the two (assuming a similar approach to best permitted use in both). For example, a property may have an annual rental value of £20,000 and a capital value of £1,000,000. In this

<sup>58</sup> See Stewart Smith, *Land tax: an update*, NSW Parliamentary Library Research Service, April 2005 and *Queensland Government* for Australian discussion

case a tax of 50% on the rental value or of 1% on the capital value would both result in a sum of £10,000 per year.

In this report we focus on rental values, as data is more readily available for these and because this would involve less change from the status quo. Theoretically, there is also more justification for a tax on rents (a flow) than on stocks of wealth:<sup>59</sup> land value tax may be seen as the government taking a fraction of land rents.

But a tax on capital values has the attraction of a lower headline rate. And if the tax were to move from occupants to owners (explored in Section 3), there is some symmetry in also moving from rental to capital values. In practice, the decision may come down to politics (what polls better) and practicalities (what is easier for the VOA).

## How often should revaluation take place?

The final important question is how often values should be updated and therefore how up-to-date they can be. The existing business rates structure has not done a good job of ensuring that taxes are an up-to-date reflection of

<sup>59</sup> Enid Slack, *Alternative approaches to taxing land and real property*, World Bank

market conditions. So far, revaluations have been scheduled every 5 years. Then the planned revaluation for 2015 was delayed until 2017, resulting in major disruption when bills finally had to adjust to 7 years of relative price changes.

On top of that, even when revaluation kicks in, it is based on values from 2 years earlier. So, at a minimum, values are always 2 years out of date. The government has taken a step to improve this, with revaluation moving to a triennial schedule, though as a transition the next will take place 4 years after the last. These plans are shown in Table 2. Even under the new system, however, values will be a minimum of 2 years out of date and a maximum of just under 5 years old.

Even within the current business rates system, more frequent revaluation would be desirable. Where economic conditions deteriorate, either nationally or locally, this should be reflected through lower tax bills as soon as possible. And when bills must rise, saving up the pain of revaluation rather than having smaller changes each year does no one any good, and increases the political incentive to further delay revaluation, exacerbating the problem. There is ample historical and international evidence that this downward spiral can be terminal for property taxes.

However, business rates are not truly linked to property values, as levels of revenue overall are linked to inflation instead. It is only the *distribution* of values that matter for business rates revaluations. In contrast, the Commercial Landowner Levy would be intended to rise and fall with land values. As such, annual revaluation would become yet more important (though this feedback would itself help to stabilise land values). What's more, during a transition away from business rates (discussed further in Section 7) – and by scrapping commercial Stamp Duty – land values might adjust to reflect those changes, further increasing the need for frequent updates.

As explored in Section 3, the Commercial Landowner Levy

would bring simplifications (fewer plots and fewer changes) that would free up VOA resources and make more frequent revaluation achievable. However, as set out above, revaluation should be more of an exercise in 'big data' than in physically inspecting each plot each year. For the same reasons, we believe the VOA could be tasked with moving to basing each year's tax bills on values from (at most) the April before rather than the April 2 years earlier. As far as possible, a fair property tax for businesses should reflect current market conditions.

## Open data

Data on the geography, ownership and value (either rental or capital) of land should form a valuable public resource. It would also help the UK further develop as a world leader in the burgeoning fields of geographic information systems and 'PropTech', in keeping with the government's new 'Geospatial Commission'.<sup>60</sup>

The Land Registry records land ownership, but is currently incomplete, as Figure 11 shows, with 15% still unregistered in 2017.

The needs of a Commercial Landowner Levy (linked to ownership) would help complete the register. HM Land Registry has a target of full registration by 2030, with the potential for "area-by-area compulsory registration" in the 2020s,<sup>61</sup> but it should be more ambitious in these timings. In addition, plans to privatise the Land Registry, which were dropped in 2016, should not be revisited.

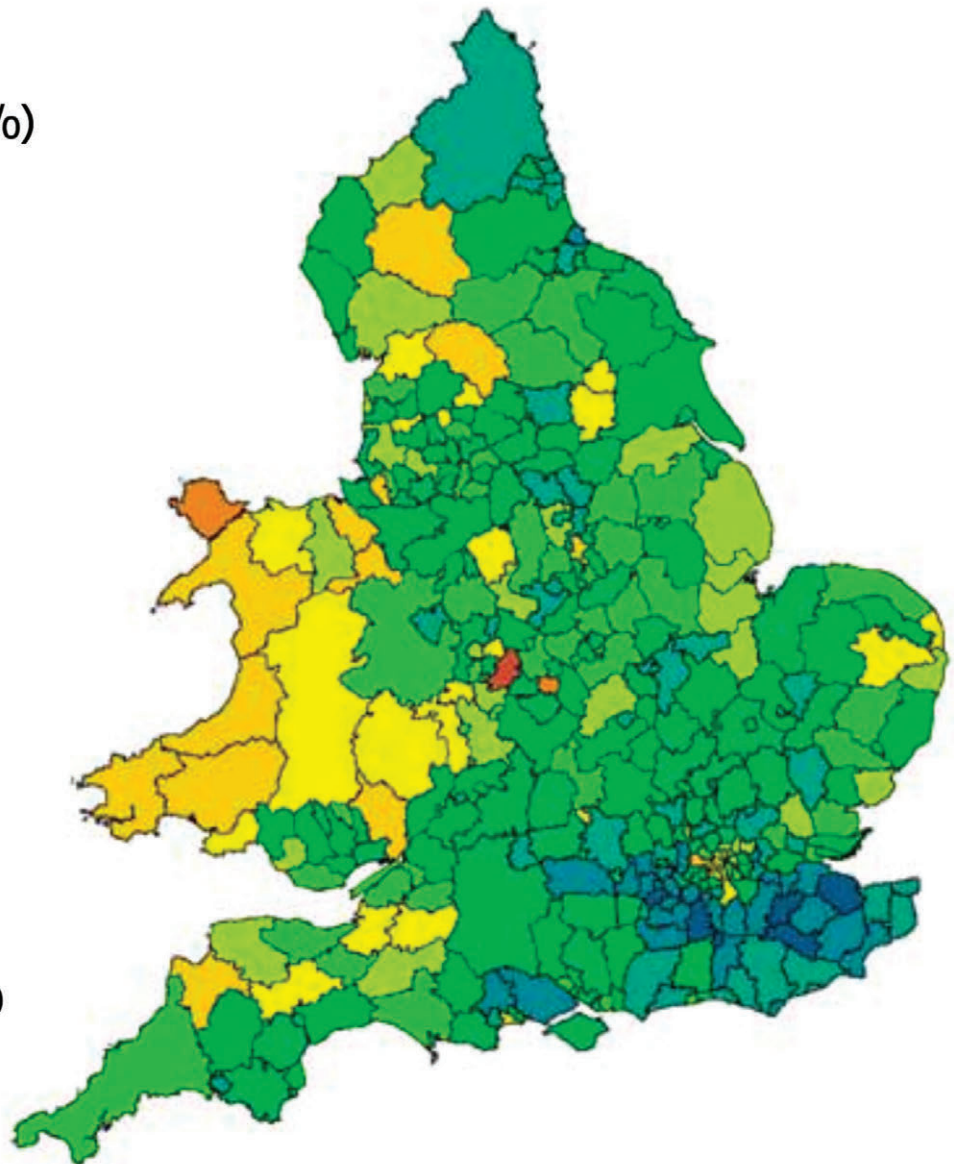
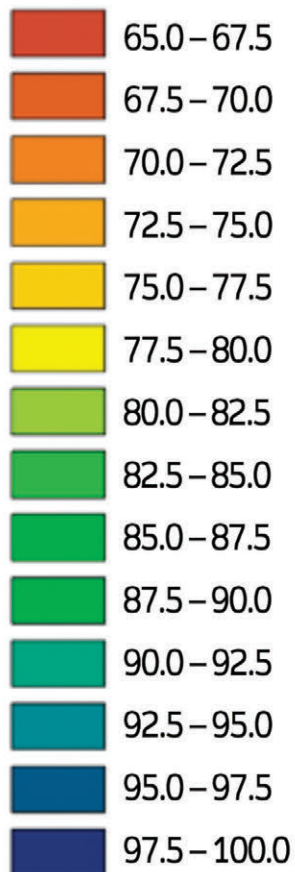
To add to the Land Registry, commercial land value data should be an open resource – providing comprehensive valuations updated each year. This would be a great resource for businesses, researchers and planners alike.

<sup>60</sup> gov.uk, *Chancellor to unlock hidden value of government data*, November 2017

<sup>61</sup> HM Land Registry, *Business Strategy 2017-2022*, November 2017

Figure 11: Current Land Registry completeness

## Registered (%)



Source: HM Land Registry, Business Strategy 2017-2022, November 2017

# Section 6: Putting it all together

## Introduction

The theoretical case for the Commercial Landowner Levy is clear. But this section seeks to go beyond the theoretical and model exactly what tax rate would be needed, and what regions and sectors would benefit most.

### Policy recommendations in this section:

- **The Commercial Landowner Levy tax rate would be 59p per £1 of land rental value in England and a 67.5p rate if introduced in Wales**
- **Alternatively, a tax on capital values would need to be around 3% per year in England and around 3.4% in Wales**
- **These figures would represent a tax cut initially, as part of a detailed package of policies, but are likely to be at least revenue-neutral in the long-term**

## Determining the Commercial Landowner Levy rate

In Section 5 we set out our estimates of land values across England and Wales. These estimates allow us to model a commercial land tax and its impacts for the first time.

We showed that land is around 75% of commercial property values in England in total, and 60% in Wales. It follows that a tax on the land value only would need to have a higher rate to raise the same amount in revenue. Note that simply removing structures from business rates valuations while maintaining existing multipliers would cost over £6 billion a year in England. For pure revenue-neutrality we estimate that the Commercial Landowner Levy would need to have a rate of 63% in England and 83% in Wales.<sup>62</sup>

However, we believe an overall tax cut would be appropriate for a number of reasons.

62 It should be noted that these tax rates are fundamentally different in nature from those for, say, income tax or VAT. A 100% tax on rental value here would mean that the annual tax and annual market rental value were equal (whereas a 100% income tax would reduce disposable income to zero). Such rates could in fact go above 100%, and poundage (e.g. 59p per £1) may be a more accurate term. An alternative way of presenting the tax would be to calculate the tax collected as a share of the rent plus the tax (which, in theory, would likely be what the rent would rise to if there were no property tax) so if tax and rental value were equal this would be expressed as a tax rate of 50%, not 100%. However, this distinction is less important at low tax rates and for simplicity we do not explore it further in this paper.

First, business rates are deeply unpopular at present, with shops struggling across the country (though rates are far from the only cause). Second, the switch to a Commercial Landowner Levy would be a major change and a short-term tax cut would ease the transition (discussed further in Section 7) and increase the popularity of replacing business rates – making it politically easier to realise the long-term economic benefits of the change. And, third, even with a tax cut, commercial land would still be taxed at a significantly higher level than land for residential use is (via Council Tax).

Any tax cut should not lead to a reduction in local government funding, however, and so the difference should be made up instead by central government.

We suggest a Commercial Landowner Levy tax rate of 59p per £1 of land rental value in England and a 67.5p rate in Wales. As discussed in Section 5, a strong case can also be made for taxing capital values rather than rental values. Given the typical relationship between rents and capital values (with rental yields of around 5% being a good rule of thumb), capital tax rates of around 3% per year in England and around 3.5% in Wales could also be used.

Table 3 presents our proposed policy package as a whole. This includes replacing business rates with the Commercial Landowner Levy; replacing small business rate relief with a more valuable Employment Allowance boost; and scrapping stamp duty (funded by reversing a fraction of recent Corporation Tax cuts, such as keeping the rate at 20% instead of 19%).<sup>63</sup> It also includes using money raised from taxing empty properties and derelict land, and from removing the charitable exemption for private healthcare and private schools, to reduce taxes for all businesses.<sup>64</sup>

Overall, it is a tax cut of £1.4 billion in its steady state, before taking into account factors that should boost revenue significantly in the long run but which are difficult to predict with any certainty, discussed below. There is also the option of an even more generous transition plan, discussed further in Section 7.

63 The corporation tax rate fell from 20% to 19% in 2017-18 and on current plans will fall to 17% in 2020-21. Both the Liberal Democrat and Labour manifestos in 2017 committed to cancelling or reversing these cuts.

64 Note that many of these costings should only be considered rough estimates, with little data available in many cases. In addition, there will be many interactions between individual elements that we cannot assess.

Table 3: Estimated policy costings for England, based on 2017-18 figures

**2017-18, England (except SDLT and NICs)**

Baseline net business rates revenue, £m		25,589	
	<b>Extra revenue</b>	<b>Reduced revenue</b>	
Replace NDR on property values (at 48 & 49.3p) with CLL on land values (at 59p)		2,007	
Abolish small business rate relief	1,537		
Boost Employment Allowance from £3,000 to £6,000		2,000	
Abolish empty premises relief	853		
Extension to derelict property	85		
Remove charitable relief from private schools & hospitals	110		
Use part of cancelled Corporation Tax cut	1,911		
Abolish non-residential SDLT (inc. knock-on land value rise)		1,911	
Reduced valuation costs for VOA	None assumed		
Reduced collection costs for councils	47		
<b>Total</b>	4,543	5,918	<b>Net change</b> -1,375
<i>Other potential considerations</i>			
Extra revenue if land values grow with NGDP (not CPI) – after 5 years	1,574		
Extra revenue if land values grow with NGDP (not CPI) – after 10 years	3,674		
Benefit of higher economic growth	None assumed, but potentially large		
Optional temporary cost (year 1) – full tax cuts immediately rather than phasing in		2,000	

Table 4: Estimated policy costings for Wales, based on 2017-18 figures

**2017-18, Wales**

Baseline net business rates revenue, £m		977	
	<b>Extra revenue</b>	<b>Reduced revenue</b>	
Replace NDR on property values (at 49.9p) with CLL on land values (at 67.5p)		200	
Abolish small business rate relief	109		
Boost Employment Allowance from £3,000 to £6,000		-	
Abolish empty premises relief	31		
Extension to derelict property	3		
Remove charitable relief from private schools & hospitals	4		
Use part of cancelled Corporation Tax cut	44		
Abolish non-residential SDLT (inc. knock-on land value rise)		44	
Reduced valuation costs for VOA	None assumed		
Reduced collection costs for councils	3		
<b>Total</b>	195	244	<b>Net change</b> -49
<i>Other potential considerations</i>			
Extra revenue if land values grow with NGDP (not CPI) – after 5 years	56		
Extra revenue if land values grow with NGDP (not CPI) – after 10 years	130		
Benefit of higher economic growth	None assumed, but potentially large		
Optional temporary cost (year 1) – full tax cuts immediately rather than phasing in		30	

Table 4 shows similar calculations for Wales, with a net tax cut of around £50 million a year before taking into account those other considerations. (Note that in this paper we have not modelled reform in Scotland or Northern Ireland. However, the Employment Allowance costed above includes a tax cut for businesses there, while the SDLT abolition would benefit Northern Ireland in addition to England. It is also implicit that the abolition of stamp duty in Scotland could also be funded through the slightly higher UK corporation tax rate.)

Despite an initial tax cut, there are two reasons why the Treasury should be positive about these policies from a fiscal perspective.

First, this tax reform would boost business investment and therefore – over time – productivity and incomes. As set out in Section 2, a plausible 0.4% increase in GDP would be worth around £3 billion a year in increased revenue (more than double the cost above). However, this is only a rough, illustrative figure and official modelling should be commissioned as a priority when possible.

Second, from 2018 onwards business rates revenues are

designed to rise in line with CPI inflation. One effect of this link (and the RPI link before it) is that rates keep rising in between revaluations regardless of economic conditions, while at revaluations, if rental values have dropped (as happened in the recession), business rates must rise. This is not the way any sensible tax should operate, and is one of the fundamental causes of the great unpopularity of business rates in recent years. Yet linking revenue to inflation also means that business rates are (unlike other taxes) forecast to steadily fall relative to the size of the economy, as Figure 12 shows.<sup>65</sup>

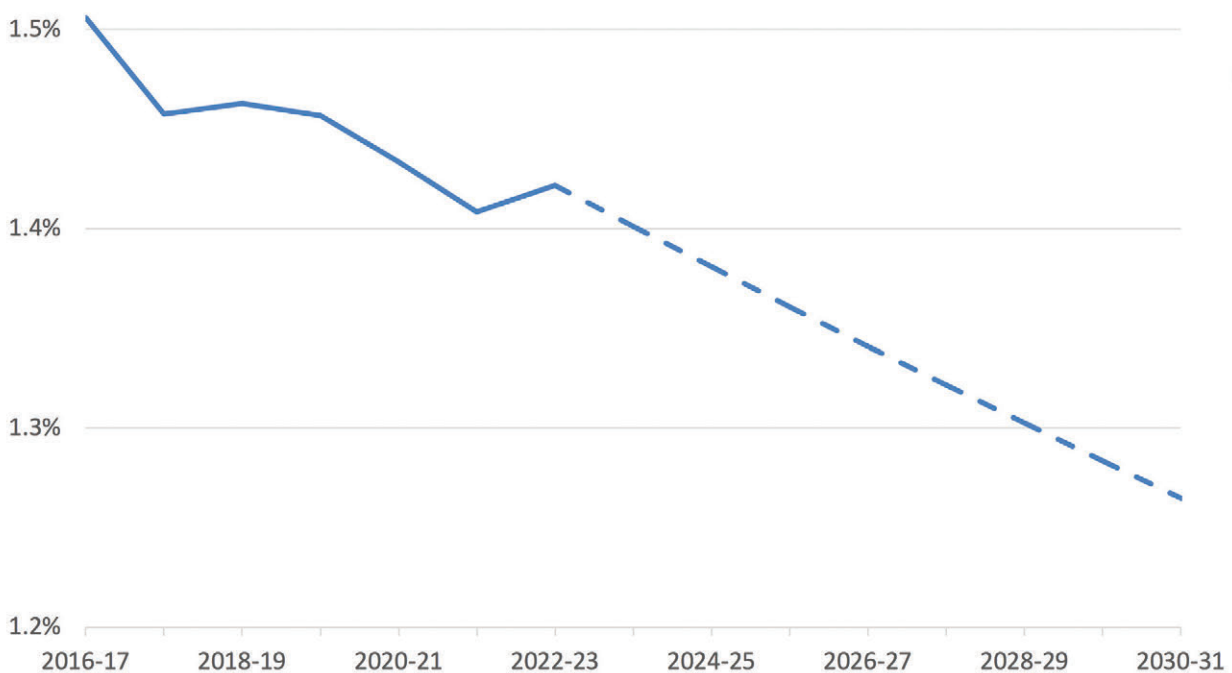
Unlike business rates, the Commercial Landowner Levy would rise and fall with land values (either rental or capital). If there were a recession, tax levels would fall to cushion the blow – again unlike business rates. But, conversely, if land values rise, taxes would rise in line with them. Over the long-term, the safer money is on commercial land rents rising faster than inflation.<sup>67</sup> Note

65 We ignore the potential impact of additions or removals of properties to/from the rating list.

66 OBR, *Fiscal sustainability report*, July 2018

67 Good data is not publicly available but for some historical discussion see Sotiris Tsolacos, *An econometric model of retail rents in the United Kingdom*, The Journal of Real Estate Research, 1995 and The Economist, *Shop 'til you drop*, September 2015

Figure 12: Projected business rates revenue relative to the economy



Source: OBR, *Economic and fiscal outlook*, March 2018 up to 2022-23; then rising with CPI (2% a year) with NGDP growth of 3.5%.<sup>66</sup>

that the OBR assumes that earnings and profits rise in real terms over time, that private residential rents rise in line with earnings, and that house prices rise faster than earnings. As shown in Figure 9, land values have risen considerably faster than national income since 1995. So, even despite any disruption from online competition, it would be odd to assume that commercial land rents in London, for example, will fall in real terms over the long-term.

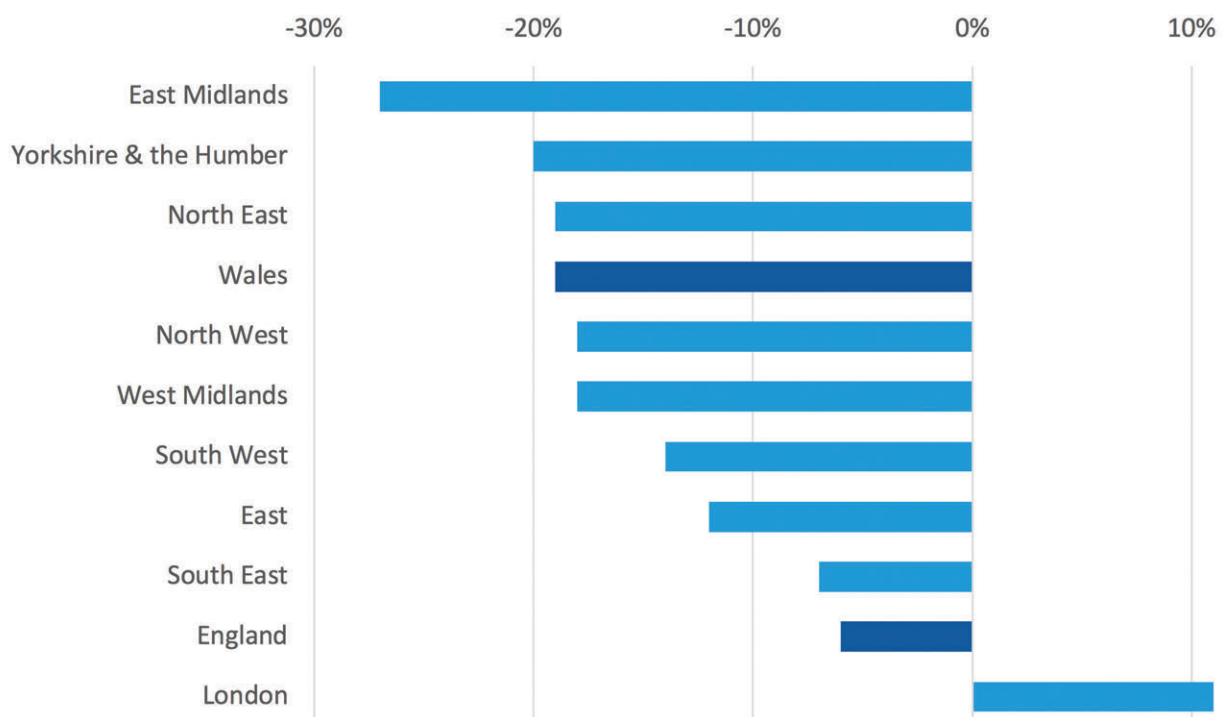
If – as expected – rents do rise faster than CPI in future, the Commercial Landowner Levy would rapidly overtake business rates in revenue raised, despite the initial tax cut. Indeed, it would only take 4 years of rents rising in line with projected national income to make our policy package revenue-neutral. On the other hand, if rents fall in real terms, which would likely only happen due to economic weakness, then the tax system should follow suit – which the Commercial Landowner Levy would do but business rates would not.

## Regional impacts

In Section 5 we showed that land value makes up a particularly high proportion of total property value in London, and a relatively low proportion in the East Midlands. These differences mean that replacing a property-value-based tax with one based on land value will have uneven effects across the country, acting to shift the tax burden slightly towards the most prosperous regions and away from the least prosperous.

Using the tax rates set out above, together with our modelling of land values across the country, Figure 13 shows what the effect on average bills in each region would be. There is an overall tax cut of 6% in England, but the cut is larger in every region except London, which sees an 11% rise. The North East would see a tax cut of 19%, and the North West and West Midlands tax cuts of 18%. The largest cut, however, would be in the East Midlands (likely due to the relative importance of manufacturing

Figure 13: Change in total tax bill by region



Source: See Appendix for details

there, as well as low land values)<sup>68</sup>, where taxes would be lowered by 27%.

This shows only the switch from property to land value taxation, and not the full suite of changes, which cannot be modelled. Abolishing non-residential stamp duty would benefit London and the South East most – as shown in Figure 14 – offsetting some of the London tax rise.

Replacing small business rate relief with the increased Employment Allowance – both largely limited to one per business, rather than one per property – would have a more complex range of effects but would have relatively minor regional impacts compared to the changes shown above. Nor is our suggested transitional protection included here.

What would these changes mean for England’s geographic disparities? In part (and a good reason for not adopting an even lower rate), property tax cuts would be absorbed by landlords, as rents would be able to rise faster. So

commercial land values might be expected to rise in much of the country and fall in London. But tenants in poorer parts of the country would benefit too, as the supply of commercial land and property is more flexible in these places, meaning tax cuts are more likely to be ‘incident’ on occupiers there than in, say, London, where landowners are more likely to have to absorb any tax rises. The evidence from previous business rate reforms lends credence to this point of view.<sup>69</sup>

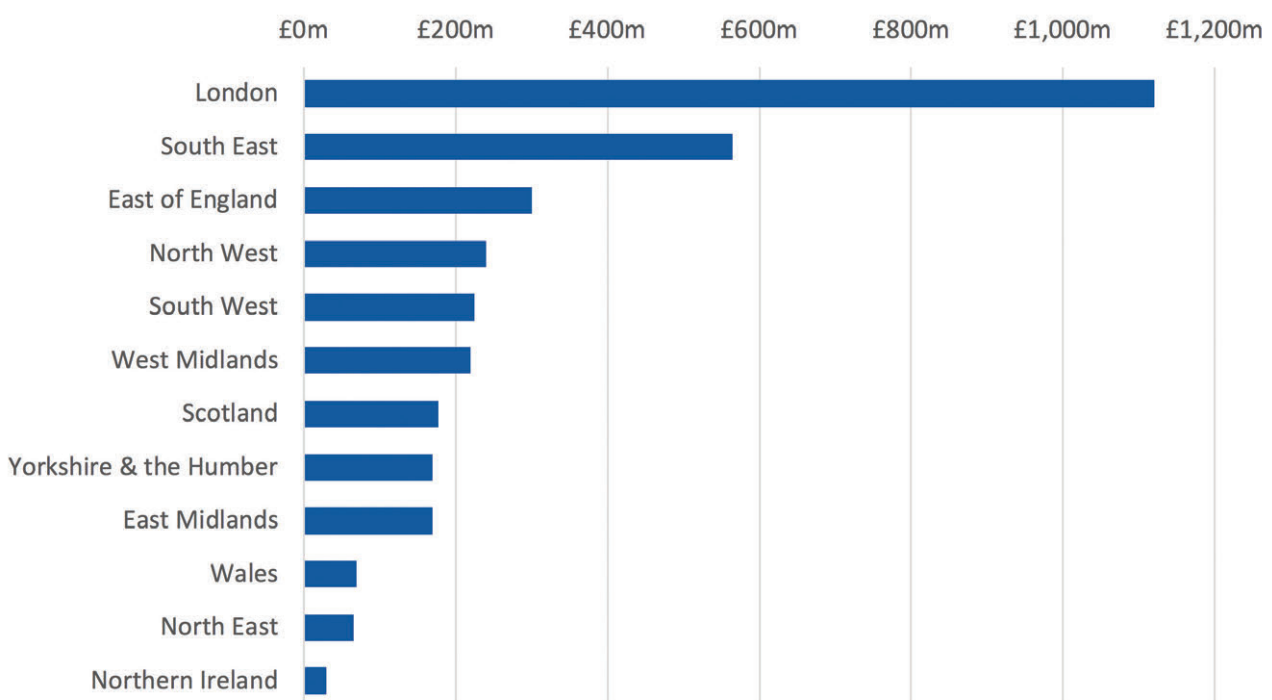
It should also be noted that many properties belong to businesses with a presence across the UK, and so for many companies geographic changes will average out for them (though likely still giving a net tax cut in most cases).

But, with large tax cuts, existing businesses in poorer parts of the country would have more cash to spend on staff or investment. And with the post-tax cost of using property particularly lowered in those areas, the incentive to locate business activity in poorer parts of England or Wales would be increased.

68 House of Commons Library, *Manufacturing: statistics and policy*, January 2018

69 As discussed earlier, see Stephen Bond et al., *Who pays business rates?*, Fiscal Studies, 1996

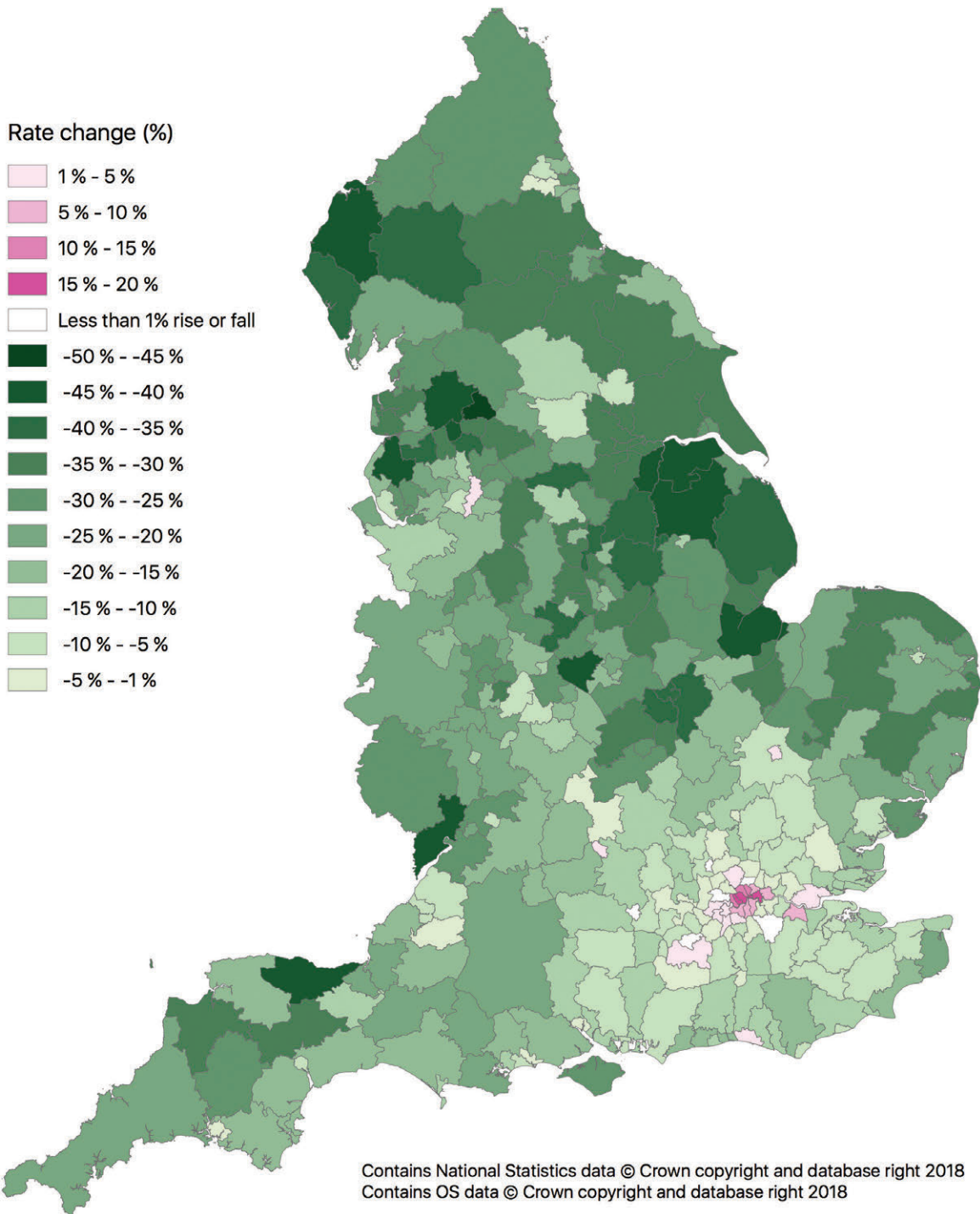
Figure 14: Commercial stamp duty revenue by region/nation, 2016-17



Source: HMRC, *UK Stamp Tax statistics 2016 to 2017*, September 2017



Map 2: Change in total bills by billing authority, England



Source: See Appendix for details

### Local authority impacts

We can also look beyond regional averages to assess the impact in each local authority. Map 2 shows the impacts of the switch from property taxation to land taxation.

Of the 326 billing authorities in England, 299 (92%) would see a tax cut. 14 others would see a rise of less than 5%, while the remaining 13 would face larger rises. Unsurprisingly, the largest increases would be for Westminster (with a 17% rise overall, before considering transitional protection), the City of London, Kensington and Chelsea, and Tower Hamlets. Conversely, although London as a whole would be paying more, many less prosperous boroughs, such as Barking and Dagenham, would still receive a tax cut.

Many parts of the country would receive very large tax cuts, with 134 seeing average bills fall by over 20%. As Map 2 shows, some of the largest gains would be in Lincolnshire (e.g. Lindsey, South Holland and North Lincolnshire) and Lancashire (e.g. Pendle, West Lancashire, Hyndburn, Ribble Valley, Chorley and Rossendale).

Figure 15 presents these same results in another format, with the 326 English billing authorities ranked from largest tax cut to largest tax rise. Although the average (mean) tax cut overall would be 6%, the median tax cut would be just over 17%.

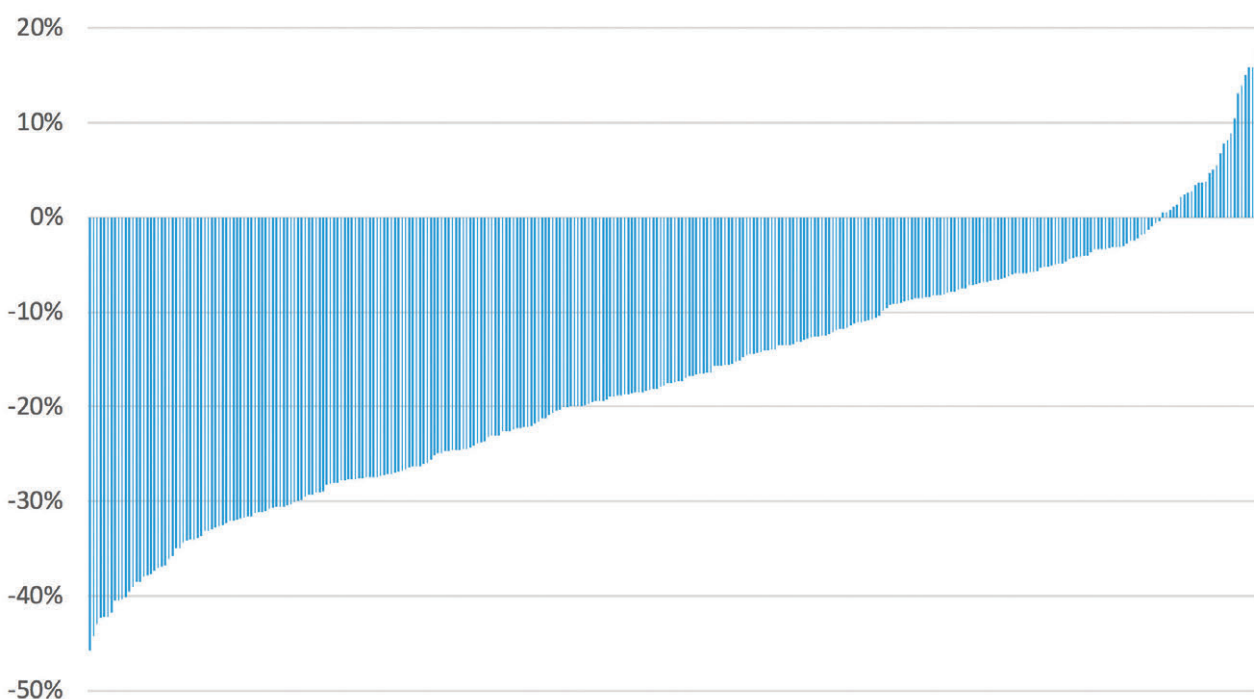
Our results for Wales are shown in Map 3. Here, before accounting for changes in reliefs or other taxes, there would be a tax cut in almost every local authority (with Cardiff having a 0.1% rise). The largest tax cut would be in Blaenau Gwent, one of the poorest parts of Wales, where average bills would be halved. Tax cuts would also be particularly large in Anglesey and Powys.

### Sectoral impacts

We can also model the impacts of reform on different property uses. Figure 16 shows the impact for those uses that make up the vast majority of business rates revenue.

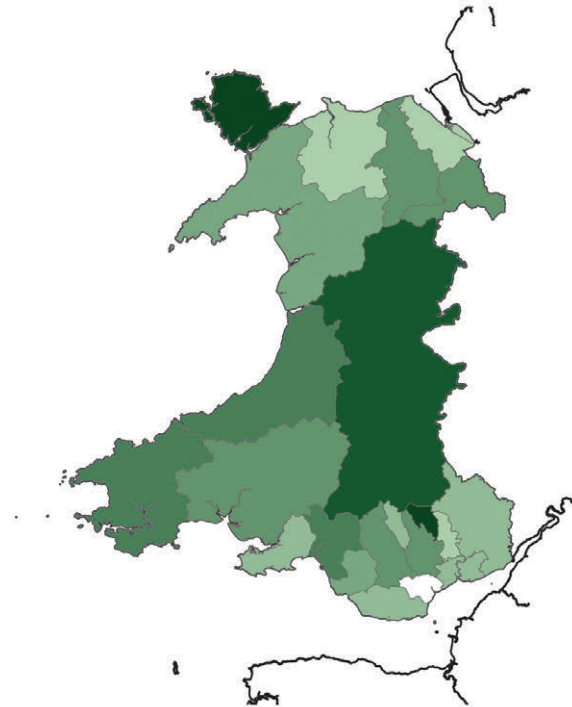
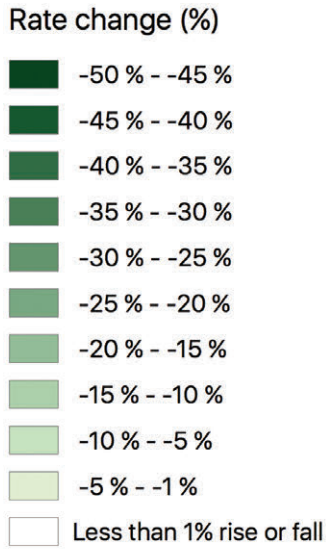
Manufacturers (factories, workshops, food processing centres, printing works etc.) would see a particularly large tax cut of 22% on average, reflecting their locations and the high amount of physical capital required – which

Figure 15: Change in total bills by billing authority, England, ranked



Source: See Appendix for details

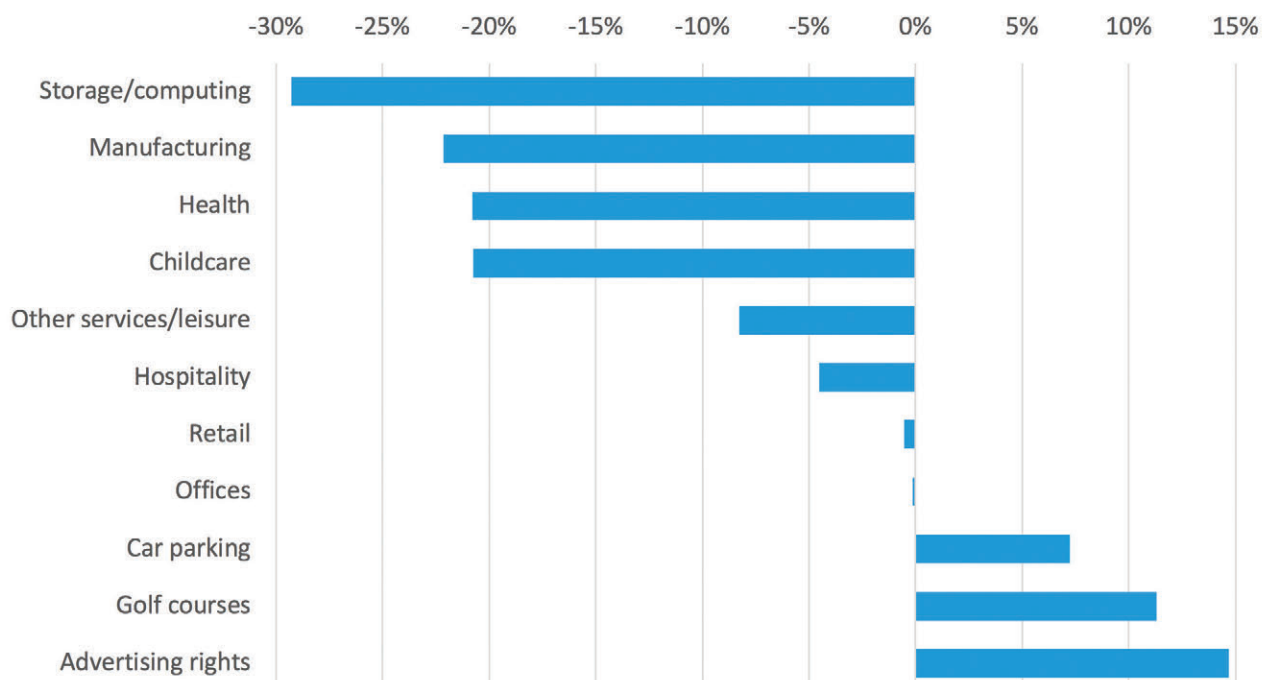
Map 3: Change in total bills by billing authority, Wales



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 Contains OS data © Crown copyright and database right 2018

Source: See Appendix for details

Figure 16: Average change in tax bills by sector



Source: See Appendix for details

would no longer be taxed. Surgeries, pharmacies and nurseries would also receive very large tax cuts.

In our modelling, the few major uses to see significant average tax rises include car parks, advertising rights (billboards etc.), golf courses and car washes. In general, these industries might be considered to be those that are heavy on land use and light on physical infrastructure; and/or where location is a particularly important determinant of revenue.

Of course, for any given use the tax change will vary substantially across the country, and averages may be misleading. Shops in central London, for example, may see small tax increases – though in such high-demand areas (where rents are already as high as tenants can

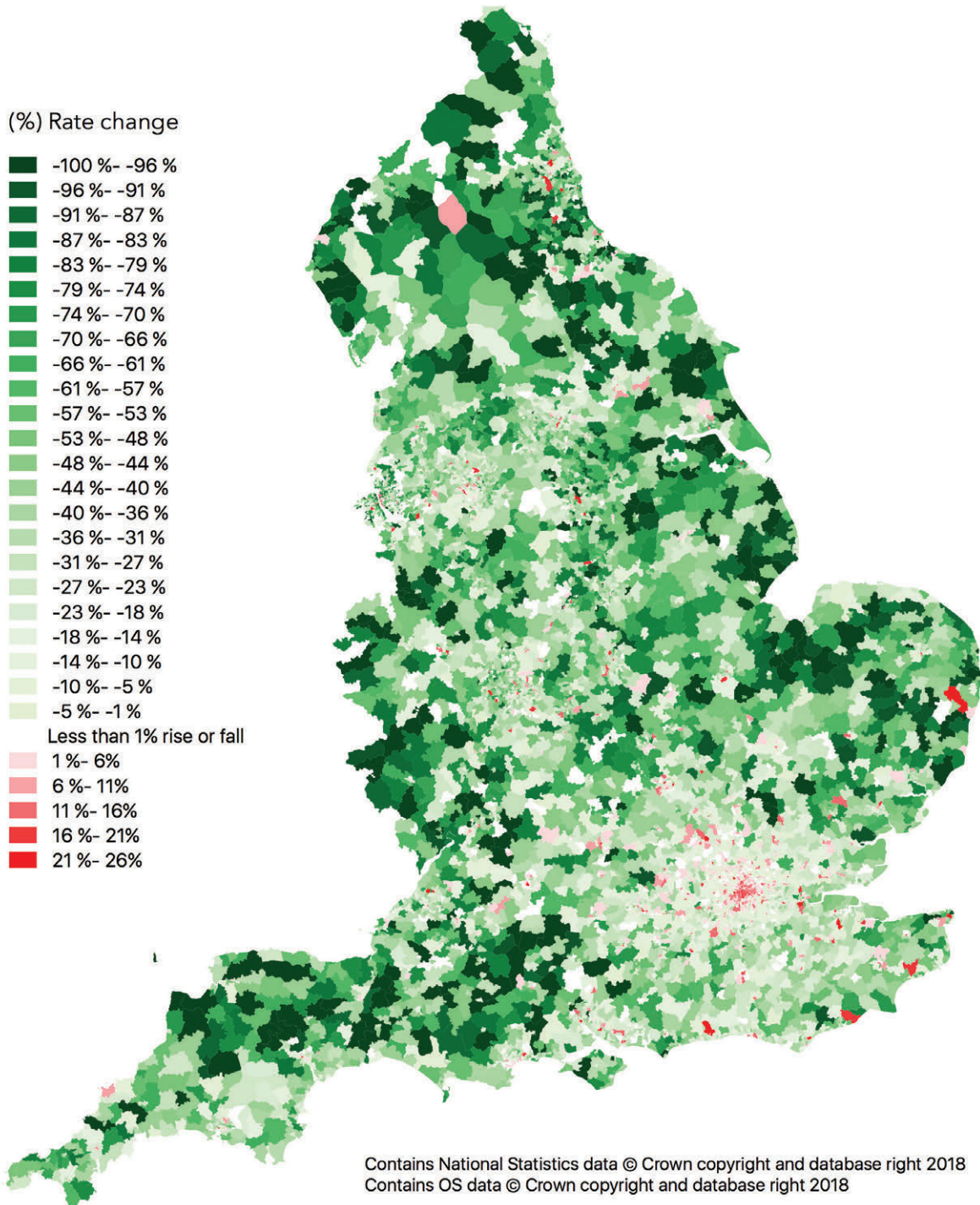
afford) these changes may be absorbed by landlords rather than tenants.

But where the ‘high street’ is struggling, the fact that the Commercial Landowner Levy would be based on (almost) current market conditions would ensure that taxes would be low. As Map 4 shows, moving to the Commercial Landowner Levy would mean large tax cuts for shops across most of the country.

These results imply that business rates – as an economically distortionary tax (unlike a land value tax) – bias the economy towards London and away from manufacturing. The Commercial Landowner Levy would help struggling high streets and rebalance the economy both geographically and sectorally.



Map 4: Change in total bills for shops by billing authority, England



Source: See Appendix for details

# Section 7: Transition and local government finance

## Introduction

Entirely replacing a major tax with another, although similar in some respects, must be done carefully. A period of transition would be needed to move responsibility for paying bills to landlords. And for the minority whose taxes would rise this, at least, changes in bills should be implemented slowly. The Commercial Landowner Levy must also work for local government, as well as businesses. This section explores these practicalities.

### Policy recommendations in this section:

- **For the large majority of properties receiving tax cuts, bills could either move to a land-value basis immediately or be phased in over a 4 year period**
- **For the minority facing tax increases, the new system should be phased in over a 4 year period**
- **The responsibility for paying tax should move to landlords for new contracts, at commercial Rent Reviews or in year 4 of the new tax – whichever comes first**
- **The change should not affect local government finances, with redistribution between local authorities adjusted to ensure no immediate change in local revenue, and the retention policy continued if desired**

## Transition

Replacing business rates with the Commercial Landowner Levy could not be done overnight. As shown in Section 6, tax bills would fall for most but would rise for a small minority, and any increases should be phased in. At the same time, the VOA itself would need time to develop and improve its land valuations, and for land values themselves to stabilise. And the burden of tax must be moved from occupants to owners with the minimum of disruption.

But nor should a transition be too drawn out. Table 5 shows an example roll-out with a policy announced in 2022 (the next election according to the Fixed-term Parliaments Act) though if the current government were to adopt this policy then progress could clearly be made far sooner.

One policy that should be implemented overnight is the scrapping of commercial stamp duty. This should be done at the earliest opportunity to avoid a decline in

transactions as businesses waited for the tax's expected abolition.

The VOA should also be instructed as early as possible as to what would be expected of it. In Table 5 it is assumed that the VOA could produce land valuations within 2 years. While this may be a fast pace by the standards of some government schemes, we showed in Section 5 that it is quite possible to quickly produce an initial estimate of land values using existing data.

For the switch from basing tax on property values to using land values (and associated changes in reliefs) two separate groups should be considered. For a small minority – largely those in the wealthiest parts of the country – where the new Commercial Landowner Levy bill would be higher than their existing business rates bill, that change should be phased in over 4 years. For example, if a property's business rates bill (including any relief) would have been £1,000 and its new Commercial Landowner Levy would be £1,100 if applied in full, then in the 2nd year of transition the bill would be £1,050: a 50-50 mix of the 2 calculations. In this way, those seeing tax increases would experience only small changes in their bills each year.

But for the great majority set to receive a tax cut, we suggest there are two options. One – and our preference should fiscal circumstances allow it – would be to apply any tax cut in full on day 1 of the policy. But this would result in the tax cuts being immediate while any tax rises were phased in over several years. As shown in Section 6, this would add several billion pounds to the cost of the policy in its first few years, albeit temporarily. The cheaper option for the Exchequer would be to phase in the tax cuts over 4 years as well.

Slightly more complex is the separate transition from taxing occupants to taxing landowners. For many businesses of course – those that own their premises – this distinction is irrelevant. But for rented properties this must be done in a way that is consistent with existing contracts and that allows rents to adjust if necessary. Otherwise, while tenants would get a tax cut, landlords might be burdened with a new tax without being able to increase rents accordingly. We therefore propose that the responsibility for paying tax should move to landlords at the following points (whichever comes first for each premise):

Table 5: Example roll-out of the Commercial Landowner Levy

	Year of policy	Existing business rates schedule	Commercial Landowner Levy schedule	Changes in stamp duty, NICs and payment responsibility	Rates transition <sup>71</sup>
<b>2021</b>	-3	<i>Revaluation (based on 2019 values)</i>			100% BR
<b>2022 (election)</b>	-2		Policy announced. VOA instructed to switch basis and schedule. Legislation.	Non-residential stamp duty scrapped immediately	100% BR
<b>2023</b>	-1				100% BR
<b>2024</b>	1	<i>Revaluation (based on 2022 values)</i>	Land valuation (based on 2023 values) <sup>72</sup>	Responsibility switches to owners for new lease and rental contracts, and at rent reviews. Employment Allowance doubled	Switch to land values. <sup>73</sup> 100% CLL for most. 25% CLL, 75% BR where bills rise
<b>2025</b>	2		Revaluation (based on 2024 values)	Responsibility switches to owners for new lease and rental contracts, and at rent reviews	100% CLL for most. 50% CLL, 50% BR where bills rise
<b>2026</b>	3		Revaluation (based on 2025 values)	Responsibility switches to owners for new lease and rental contracts, and at rent reviews	100% CLL for most. 75% CLL, 25% BR where bills rise
<b>2027 (election)</b>	4	<i>Revaluation (based on 2025 values)</i>	Revaluation (based on 2026 values)	Compulsory switch and rent review for any remaining contracts (except those due to expire in 2027 anyway)	100% CLL

1 For all new rental or leasehold contracts: given that the average lease length is now 7.5 years,<sup>70</sup> many leases would need to be renewed within the 4-year transition period. And even prior to this becoming a legal requirement it would be likely that some new contracts would future-proof themselves in this way

2 Where rent reviews take place (often every 3 or 5 years): allowing tenants and landlords to agree a reasonable rent adjustment, if needed, at the same time as the

landlord becomes responsible for property tax.

3 In the 4th year of the policy, when the minority of contracts remaining would be required to shift the burden of taxation to the landlord.

To aid with this transition, tenants should be given government advice on how to assess whether any associated rent rise is reasonable or not, in case some landlords tried to take advantage of any confusion. For

<sup>70</sup> Property Industry Alliance, *Property data report 2017*

<sup>71</sup> Here we show the more expensive option of applying any tax cuts immediately rather than phasing them in. One advantage of this approach is that tenants would receive the full tax cut *before* the incidence moved to their landowner and rents were renegotiated. This would make it more likely that the tenant would benefit from the tax cut rather than the landowner.

<sup>72</sup> Note that the business rates component of bills during the transition could be based on the previous rates, without a revaluation. This would remove the need for the VOA to keep valuing properties as well as land, smooth the transition, and ensure penalties against investment were removed immediately. However, the business rates component could easily be moved in line with increases or decreases in land values during the transition (without requiring a separate valuation) to reflect changing market conditions.

<sup>73</sup> Note that until the tax burden were completely moved to landowners rather than tenants, some apportionment of Commercial Landowner Levy land-plot bills between hereditaments would be temporarily required.

most businesses, such advice may be unnecessary, with market rents naturally adjusting to reflect tax changes, but some guidance through this one-off transition would be helpful.

The Mirrlees Review for the Institute for Fiscal Studies concluded that “significant adjustment costs would be merited if the inefficient and iniquitous system of business rates could be swept away and replaced by an LVT.”<sup>74</sup> This is certainly true and, while it is also true that any major reform will cause some disruption, we believe a transition such as the one above would be best way to minimise those adjustment costs.

## Local government finance

This is not a paper about how local government should be financed. But business rates are a major component of local authorities’ funding, and their finances have already been squeezed hard by central government. Our proposal must therefore work for local government as well as for businesses.

Most importantly, although our proposal represents a large tax cut for businesses in poorer parts of the country (as shown in Section 6), it is crucial that this does not mean a large revenue cut for those councils. It would therefore need to be accompanied by offsetting changes in the existing redistribution of funds between councils. But this is quite possible within the existing framework of transfers. In addition, our policy includes an upfront cut in property taxes overall, and this should be borne by central rather than local government.

The business rates retention policy – first introduced under the Coalition – could also work equally well under the Commercial Landowner Levy if desired. That is, any growth in revenue (from the latest baseline) could accrue to the local authority alone – to give it the greatest incentives for development. Indeed, annual revaluation would improve those incentives, which may currently be weak.<sup>75</sup> And, as discussed in Section 2, land taxation does a better job of capturing value uplifts that stem from new infrastructure and other local improvements than

<sup>74</sup> James Mirrlees et al., *Tax by design*, September 2011

<sup>75</sup> Neil Amin Smith et al., *100% business rates retention may lead to divergences in English councils’ funding without promoting growth*, IFS, March 2018

property taxation.

This facet of the Commercial Landowner Levy would greatly reduce the need for complex value capture schemes and local variability in business rates (such as the Crossrail business rate supplement or the general ability of combined authority mayors to increase the business rates multiplier to fund new infrastructure). Instead, with revenue linked directly to local land values, and with annual revaluation, infrastructure-related price uplifts would automatically boost local revenue.

The downside of a strong link to land values, however, is that it might make local government finances more volatile. At present, business rates rise quite predictably in between revaluations – the downside being that those can then mean large changes for councils. Under the Commercial Landowner Levy, revenue could vary each year – but without those larger jumps every few years. Note however that the tax itself would help to stabilise values.

That said, the fact that the Commercial Landowner Levy would fall (in line with land values) in a recession – supporting businesses and the economy – would be a downside for councils, and this should be offset through some form of counter-cyclical central government grant or other reform to local government finances.

Fundamentally, however, the fact that business rates are now intended to rise only in line with CPI inflation means that the tax will continue to decline in relative terms, with other taxes and wages generally growing faster than inflation. With each year, therefore, the need to completely reassess how local government should be financed grows. A Commercial Landowner Levy linked to land values rather than arbitrary revenue targets would help resolve this long-term challenge.

Finally, as noted earlier, given that the number of plots of land is considerably smaller than the existing number of ratepayers, collection costs for councils – which totalled £93.2 million in England in 2016-17<sup>76</sup> – would be more than halved, saving them tens of millions of pounds each year.

<sup>76</sup> House of Lords written question HL8978, 26 June 2018



## Interactions with domestic property taxes

Council tax and residential stamp duty are outside the scope of this paper. Although definitely in need of reform, we do not believe it is necessary or useful to try and replace these taxes at exactly the same time as replacing business rates. As the Mirrlees review concluded, “There is a strong case for introducing a land value tax. In the foreseeable future, this is likely to mean focusing on finding ways to replace the economically damaging business rates system with a land value tax.”<sup>77</sup> But the relationship between the domestic and non-domestic property tax systems is of course important.

In particular:

- 1 It should be noted that business property is currently taxed at a much higher rate than domestic property, and this would continue under our approach.<sup>78</sup>

For example, consider a £200,000 home with an annual rental value of £10,000. If around 75% of its value came from the land, and our tax rate of 59p were applied, this would mean a tax bill of around £4,425 a year. In contrast, under council tax the property may have a bill of around £1,400 (if in Band C under the average council). Applying the Commercial Landowner Levy exactly to residential property would therefore result in radical tax rises. On the other hand, lowering taxes for non-residential property to a similar level to residential would be extremely expensive.

<sup>77</sup> James Mirrlees et al., *Tax by design*, September 2011

<sup>78</sup> This goes back to the previous ‘rates’ system in which domestic property faced a lower poundage than non-residential.

- 2 Mixed-use properties with both residential and non-residential units on the same plot of land do not pose a problem for the Commercial Landowner Levy. The land’s rated value would be calculated with regard to its permitted commercial use, so property approved in part for commercial use and in part for residential use would not include the latter use in the land valuation. In New South Wales, value is apportioned into residential and non-residential components for some mixed-use properties.<sup>79</sup>

- 3 Abolishing non-residential stamp duty as we have suggested but not abolishing residential stamp duty may require some legislative care to prevent abuse, though the two taxes already have different rates and thresholds. One minor risk is that residential property could be converted to commercial use, transferred without stamp duty, then converted back to residential. But it is well within the ability of government to prevent this by including anti-avoidance provisions. In addition, the stamp duty treatment of mixed-use properties and of 6 or more residential properties bought in a single transaction – both currently treated as commercial property – may need revisiting. Ultimately, however, abolishing non-residential stamp duty should (on top of its other benefits) be considered a useful test bed for abolishing residential stamp duty in the future.

Any major tax change such as that proposed in this paper would – and should – involve a great deal of consultation by government. Unlike that government process, this paper cannot address every detail, but it is to be hoped that it makes progress in giving a blueprint for the replacement of business rates.

<sup>79</sup> NSW Government, *Land tax exemptions and concessions*

# Appendix – land valuation methodology

To estimate commercial land values across England and Wales, and thus model our Commercial Landowner Levy, we use three main datasets:

- The VOA's 2017 non-domestic rating list, as published online – for values and business classifications. *Protected by Crown copyright*
- HM Land Registry INSPIRE Index Polygons – for freehold area and location © *Crown copyright and database rights 2018 Ordnance Survey 100026316; This information is subject to Crown copyright and is reproduced with the permission of HM Land Registry.*
- Ordnance Survey AddressBase Plus – for address verification and spatial joins *AddressBase plus data is used under the terms of Ordnance Survey's data exploration licence and was made possible by access to Geovation. Geovation is a joint initiative by Ordnance Survey and HMLR. © Crown copyright and database rights 2018 Ordnance Survey 100060078. © Government Information House Limited copyright and database rights 2018.*

## Calculating the business rates paid for each business premise

### Why?

To model the existing business rates system, as our baseline for change. The rating list does not include actual business rates paid.

### How?

By applying published multipliers for 2017-18 to the adopted rateable value (as determined in April 2017). For Wales this means a single multiplier (49.9p), and for England a small business multiplier for premises valued below £51,000 (46.6p) and a standard multiplier for those above (47.9p).

### Results and caveats

This approach does not allow reliefs to be modelled accurately. In particular, we cannot establish eligibility for small business rate relief. So our modelling compares business rates and the Commercial Landowner Levy both without reliefs. We assume that the figures provided in the VOA dataset for adopted rateable value and property type are correct.

## Matching addresses to geographic locations

### Why?

To match business premises to their underlying freehold land parcels (see next step), addresses must first be transformed into precise geographic locations. This also provides a useful data validation process, checking that addresses are correctly formatted and can therefore be relied upon when looking at impact by geographic region.

### How?

Using a lookup code for the majority of entries which connects the two datasets and, for the remainder, using a text string matching algorithm with a confidence interval of 80%.

### Results and caveats

Not all addresses could be matched. As a result around 6% of records were removed from the data set at this step. It would be possible to improve this process in future, with further work.

## Matching business premises to their underlying freehold parcels

### Why?

We need to know the underlying freehold land area (from the Land Registry) for each premise (in the VOA data).

### How?

Using the longitude and latitude of addresses determined in the step above, we can link these to parcels of land in the INSPIRE cadastral dataset. The INSPIRE dataset is a record of freehold land boundaries maintained by HM Land Registry.

### Results and caveats

For this study only commercial data was analysed. If a business shares a freehold with a residential property this is not recorded in the VOA data. This might result in some land being undervalued if the business property is effectively subsidised by the rents of residential property (which are typically) higher.

Not all geometry points could be matched to the underlying parcel, as in some cases the cadastral polygon was missing from the dataset. A further 5% of records were removed from the dataset at this point.

## Establishing location premia and land values

### **Why?**

This is the most important step – attempting to split out land value from property value for each premises.

### **How?**

Property value is a combination of three factors:

- Location value
- Building value
- Planning value (what use that building has been granted through the planning system by the community)

We are looking to isolate location value from the other components of property value.

Within the data set we have the property's location and its business type classification as given by the VOA (grouped into 238 classifications). This gives the current planning use. The VOA also gives the square metre rental value it has applied to the property to generate the rateable value (though following analysis of this data we remove some values due to apparent input errors and 1 outlying result). (Note, as discussed in Section 5, that this data is based on the current use of properties, which may not be the same as the best possible use for that site.)

We can isolate the location value through a simple regression methodology. This is the same 'hedonic regression' methodology used by Wightman and Lyons in a similar study for Northern Ireland, and noted by the OECD and ONS as a recognised standard.

We compare rental costs per square metre for properties of the same business type. Then, for a given business type and area, we assume for now that remaining differences between properties stem from location value. To quantify this, we look at the square metre value at the 5th percentile for each business use, across England and Wales. At the 5th percentile and below (i.e. for the cheapest 5% of properties) we assume location value is worth £0 and that the rental cost stems entirely from the building itself, accounting for historic build costs.

To further control for variations in building quality and subsequent variation in rental value, the median location

value in each fixed geographic area is used rather than individual premises. The chosen geographic unit is the 'postcode sector'. There are 9,700 postcode sectors in England and Wales and each postcode sector contains approximately 3,500 addresses.

The ratio between an area's typical rental value (per square metre) and that at the 5th percentile nationally, for a given business type, gives us the proportion of that value that comes from the building rather than the location. Subtracting this ratio from 1 gives us the proportion that stems from the location, or 'location premium multiplier', for each record. (This methodology generates some negative land values which whilst potentially theoretically correct distort the results and subsequent calculations. Negative multipliers were replaced with a 0 multiplier, as applied to the lowest 5% of records. This results in approximately 36,000 units of land having tax bills of zero in the proposed levy.)

Land values for business premises are thus calculated as the sum of the adopted rateable value of premises on a piece of land multiplied by the corresponding location premium multiplier for its business type for that postcode sector.

### **Results and caveats**

This methodology differs from that of the ONS (see Section 5). The ONS use the indirect residual method for their land value estimates: a method that subtracts the cost of construction (today) from the sale price of a property. It is problematic in areas where there is a large quantity of historic property at low value (as is common in the UK). In such areas a residual method could not be accurate as the construction cost is unknown and applying modern construction costs to historic properties would give erroneous values. The ONS acknowledge the hedonic regression method as one of the four approaches for calculating land value from rental or sales figures, but cite a lack of data as their limiting factor when deciding on which methodology to use. We believe in this case that our hedonic method is better.

Where more than one business type exists at a location we have used the multiplier for the highest valued business. This is consistent with land value theory which suggests that land should be taxed at its highest and best use.

## Calculating the Commercial Landowner Levy rate and its impacts

### **How?**

The method above gives total land values for England and for Wales. Using these, we can calculate what Commercial Landowner Levy rate would be needed to raise a given amount of revenue. Using that rate, we can then also determine how much would be paid in different regions or by different sectors, and how this compares to business rates.

### **Results and caveats**

Two adjustments are needed to give overall tax change results and allow comparison with other policy costings. First, revenue changes are scaled up to account for records that were lost in the matching processes (note that these unmatched records account for similar proportions of the total both by number and value, suggesting that this does not skew the results). Second, our analysis does not include the central list, and so revenue changes are scaled up to reflect this too.