

## Why Everybody is Wrong About the Land Value Tax (Except Me)

Sam Bowman (Adam Smith Institute) | 29<sup>th</sup> June 2017

**Conservatives laid into Labour's manifesto pledge to consider replacing council tax and business rates with a land value tax (LVT). They've dubbed this a 'garden tax' and claimed that it 'could' triple property tax bills to £4000 per household.**

It's a bit silly to call this a 'garden tax', since council tax valuations already include gardens. Unless the Tories are proposing to exempt gardens when we calculate how much a property is worth, they too favour a 'garden tax'. If they think there should be special tax breaks for garden ownership, they should come out and say so.

The main difference between LVT and the current council tax and business rates tax system we have right now is that the current system is appraised on the value of the entire property, instead of just the land it sits on.

That makes existing property taxes a partial tax on productive investment, which gets us less investment in buildings and improvements than we'd get without that tax. If you invest in the quality of your property by building an extra floor or by renovating the retail space, your tax bill will be higher. To really appreciate how bad this is, consider the fact that heavy machinery is included in business property valuations, so you will be taxed heavily for setting up a new electric car factory on a previously derelict bit of brownfield.

Council tax is less harmful in this regard. It's more like a tax on consuming housing, akin to VAT, but the lack of revaluations makes it uneven across the country and it still distorts people's consumption.

### Good simplification

A LVT is better overall and especially better than rates because the supply of land is so inelastic that it is basically fixed. That means that taxing it doesn't reduce the amount of it we get, unlike most other taxes. And we don't penalise people for developing their own land as we do now.

It would also be nice not to tax business property so much more than we tax residential property. Rates are nearly 50 per cent of rental values, where council tax can be extremely low – my bill is equivalent to one sixteenth of the annual rental value of my flat. That gives landowners an incentive to prefer more residential property than normal supply and demand factors would warrant.

Overall, then, ceasing to tax property improvements and machinery would be a good simplification. But the policy is less attractive than many of its advocates think.

One false claim made in favour of the LVT is that it would force the land to be used 'more productively'. But there is already a sort of 'tax' on owning land and not using it as productively as possible: opportunity cost. If you choose to use your land as a garden instead of a block of flats to rent out, you are 'paying' the cost of doing so in the rent you're forgoing. Adding an additional tax to that would make things less efficient even if it raised GDP numbers – a bit like taxing leisure time, it would increase cash output at the cost of actual wellbeing.

Here's another. LVT supporters talk about the economic rents that accrue from land ownership, and suggest that these rents need correcting with an LVT. But I'm not convinced. The price of a given piece of land, sold today, will reflect whatever future profit its buyer and seller expect it to make. And last time that piece of land was sold it will have reflected all the future profits its buyer and seller expected it to make then. And so on.

### **Undeserved windfall**

Of course these expectations will often turn out to be wrong, but are they any more likely to underestimate than overestimate things? Why would they be? I'll grant that anyone who themselves or whose families acquired the land, whether by homesteading it or by violently stealing it, has enjoyed an undeserved windfall, but once it's sold, land is surely going to be priced like any other asset – reflecting the expectation of future gains and losses.

The biggest problem comes when you try to replace other taxes that don't relate to property by raising the LVT rate. The reason is that future taxes will capitalise into the value of the the land today. In the UK land and property taxes are almost entirely borne by the landowners, not the renters.

If buyers know that they'll have to pay £10,000 in tax on a piece of land they valued at £100,000, they'll only be willing to pay £90,000 for that land. The tax lowers the returns from land ownership which is reflected in the value of the land. The current owners of land are the ones who bear the full cost of future tax bills. (Similarly, when a new school is announced somewhere, house prices rise to incorporate the future value of living near that school. Even local government debt capitalises into property values!).

That might be economically efficient, but it would be quite unfair. Land is just one of many assets you might want to invest in, and there's no particular reason that it should be taxed more than others. In the UK, we tend to keep the rules of the game constant, rather than doing specific cash-grabs from particular asset owners, even when it's economically efficient. The supply of redheads is extremely inelastic too, but it would feel extremely unjust to slap a fat levy on them nonetheless.

All in all, then, a LVT would be a sensible improvement on the current system of property taxation in Britain. But as a replacement for other taxes or a revenue-raiser in general, not so much.