

# The Commission on Local Tax Reform

Evidence from Iain McLean FRSE, FBA, Professor of Politics, Oxford University.

Thank you for issuing this call for written evidence. I am an academic who has been publishing and researching in this area for many years. List of relevant publications available on request. I would be happy to give more detailed evidence, oral and/or written.

I structure my response around the options offered in your online questionnaire, which I have also answered.

## 1. Local tax should be based on.....

*The value of the land you own.* This is for reasons first set out by Adam Smith in *Wealth of Nations* (WN) Book V. I am pleased that the Cabinet Secretary for Finance referred to this in his speech introducing Land and Buildings Transactions Tax (LBTT).

A land value tax is the best of all taxes for three reasons.

- Land doesn't move and can't be hidden.
- Land tax best satisfies Smith's canons of taxation (proportionate to benefits received; certain; convenient; non-distorting – see WN V.ii.b, p. 825 in the Glasgow edition)
- It taxes ground-rents, which Smith calls 'a still more proper subject of taxation than the rent of houses' (p. 843), because 'no discouragement will thereby be given to any sort of industry'.

What Smith called ground rent is what his successor David Ricardo, followed by modern economists, have now defined as 'economic rent': that is, a payment to asset owners in excess of the amount needed to bring the asset into production.

Land owners in Scotland often receive their economic rent in the form of asset appreciation rather than cash, but this does not lessen the force of Smith's and Ricardo's argument.

A land value tax (LVT) would replace both Council Tax and Uniform Business Rates (and might make LBTT redundant). On domestic property, the tax base is the excess of the market price of the property over the market price of the property in the part of Scotland where it is lowest. Property prices are easily found on estate agents' websites, and so the tax base is not in principle hard to calculate. In areas of low property prices, the tax liability would be zero; in areas of high property prices, it would be proportionate to the scarcity of the land on which the property sits.

In the first year of domestic LVT, its yield should be set to equal the aggregate yield of Council Tax (CT) in the previous year. Most taxpayers would therefore pay less under LVT than under CT.

Asset-rich but cash-poor householders would be able to defer their liability, and for it to become a first charge on their property when it is sold or when the owner dies. The tax liability on rented property should be on the owner, not the tenant.

On commercial and industrial premises, the same principle applies: the tax base is the value of the land on which the property sits, regardless of the value or condition of the buildings on it. This can be calculated on the same basis as calculating the base for domestic property tax: the tax base is the excess of the land value over that under similar property in the lowest-cost parts of Scotland.

This would be better than UBR, because it does not burden the occupier with a tax on the value of property used for the business (which is distortionary).

On agricultural, sporting, and recreational land, the same principle applies. This has the merit that land of great scenic value (e.g., that owned by the National Trust for Scotland) would have zero or minimal tax liability because no economic activity takes place on it; but land on which economic activity does take place is taxable in proportion to its scarcity.

As with domestic property, the yield of LVT on non-domestic property in year 1 should be set to equal the yield of UBR in year 0. Most businesses would therefore pay less in the first year of the new system.

## 2. Should property tax be locally or centrally levied?

In principle, it should be levied by local authorities. The tax base of Scottish local authorities is currently very weak in relation to the cost of the services they provide. This creates a vertical fiscal imbalance, which is bad for both local and central government.

However, this is subject to a couple of qualifications:

- The Scottish Government has a duty to control the overall yield of local taxation, as it is responsible for balancing the government budget overall, and also for any controls such as those suggested above to equate the yield of the new taxes in year 1 with the yield of the old taxes in year 0;
- The Scottish Government needs to oversee redistribution from areas where the tax yield is high (and relative need for local spending may be low) to areas where the tax yield is low (and relative need for local spending will usually be high).

## 3. If Council Tax remains, how should it be reformed?

This would be a very poor substitute for a land tax, as your online questions show. Council Tax is not: easy to understand; fair; simple; clearly linked to local services; progressive. It does not protect the poor, nor does it give control to councils over their tax receipts. Leaving Council Tax in place would mean leaving Business Rates in place, although they are almost (not quite) as bad.

As an interim measure, however, Council Tax could be easily reformed to be progressive, simply by making it pro rata to property values, with a zero rate for the lowest-valued properties. As noted above, it is easy to value houses and flats, as estate agents' websites now do that at no cost to Revenue Scotland or the Valuation Agency.