Submission

RICS

The Commission on Local Tax Reform

Call for Evidence

RICS Submission

June 2015

Contents

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1. RICS

RICS is the principal body representing professionals employed in the land, property and construction sectors.

In Scotland, the Institution represents 11,800 members comprising chartered surveyors, associate surveyors, trainees and students.

Our members are required to keep up to date with current practice through a programme of lifelong learning.

RICS members practice in sixteen land, property and construction markets, and are employed in private practice, central and local government, public agencies, academic institutions, business organisations, non-governmental organisations and the third sector.

Our members understand the whole lifecycle of property, from land management and measurement, through planning, environmental impact assessment, investment appraisal, to managing the construction process and advising on the most efficient use of buildings.

2. RICS Expertise

RICS represents and supports a large number of specialisms spanning the built and natural environments, with 17 professional groups setting standards, developing guidance and providing information to the industry on best practice.

We are viewed by major financial institutions and world governments as the 'gold standard' when it comes to professional regulation in the property sector, and as part of our Royal Charter the Institution has a commitment to provide advice to the government of the day and, in so doing, has an obligation to bear in mind the public interest as well as the interests of our members.

RICS in Scotland is therefore in a unique position to provide a balanced, apolitical perspective on issues of importance to the land, property and construction sectors.

3. Role of the RICS in Property and Construction Markets

RICS promotes and enforces the highest professional qualifications and standards which ensures the consistent delivery of standards – bringing confidence to the markets our members serve.

Our members' expertise covers property valuation and management; the costing and leadership of construction projects; development of infrastructure; and the management of natural resources, such as mining, farms and woodland.

We also work at a cross-governmental level, delivering a single, international standard that will support a safe and vibrant marketplace in land, real estate, construction and infrastructure, for the benefit of all.

4. The Role of the RICS in Property Taxation

RICS has in place guidance and regulation on valuation and conduct. Assessors are not covered by the RICS Red Book, but are covered by ethics and the code of conduct and all Assessors must be members of the RICS.

RICS members have the capacity to supply the skill set, professionalism and knowledge in order to meet any challenges of any land and property related tax.

The current appeal system is robust open and honest, and RICS members appear as advocates and expert witnesses. All must act ethically and, as witnesses, know their duty is to the court, not to clients or employers when providing their professional opinion of value.

RICS is well placed to supply any required advice on any land and property matter and volunteers its expertise in the Commission's evidence gathering.

5. Scotland's Current system of Council Tax and the RICS View

Overview

RICS believes that a property-based taxation system is the most effective form of contributing to local services.

This is because, firstly, the fixed nature of property facilitates collection, and the concealment of domestic property would prove very difficult.

Secondly, with the onus to pay being on the occupier, and not the owner, the collection rate of council tax is over 95% in Scotland.

Thirdly, the administrative costs of collection are relatively low.

Fourthly, council tax is the only property based tax set at a local level. Administrations need a broad range of taxations to balance the fluctuations of other taxes, such as income tax which is dependent on the level of employment. With the tax due being based on property value, it means taxation is linked to changes in locality, although revaluations would have to take place to truly reflect such changes. This is particularly important when an individual's wealth and, therefore, their ability to pay, can be broadly identified through the property they reside.

Detriments of the Current System

Hurried Legislation

RICS has previously contributed to Scottish Government and Parliamentary consultations and requests for evidence on local taxation, such as the Burt Committee, Local Government Finance Review, and Committee of Inquiry – Local taxation in Scotland. It was the view of the RICS membership that the current legislation was developed, and introduced, too quickly which resulted in the omission of some important legislative provisions.

Revaluation

The most prominent omission from current legislation is the lack of mechanisms for revaluations. As such, there is no statutory reflection of fluctuations in property prices, which is a key component of any property tax. In addition, a revaluation would reflect house price inflation at the local level.

At present, there is no taxation increase to householders who have improved their property during their ownership tenure (see *Benefits of the Current System*). It is probable that regular Revaluations will pick up home alterations or improvements, and ensure correct band is allocated, if the Scottish Government feels that this is appropriate.

A Different Market with New Properties

When undertaking valuations, chartered surveyors compare the physical and locational features of the property to be valued with those of houses which are already sold around the valuation date (1 April 1991).

Similarly, new properties are valued by application of the Comparative Principle of Valuation, but under the assertion that they stood in their current location. This requires investigating sales evidence on, or around, 1991 for similar properties in that locale.

The domestic property market in 1991 is not the same market as 2015. Properties have joined the market which were rare, or may not have existed, in 1991.

There are more properties which have ultra-low energy use and carbon emissions, which are built using sustainable materials. There was little demand for these types of properties in 1991; however, due to the significant upturn in environmental awareness, and the increase cost of energy bills, these types of homes are becoming more prevalent and sought after.

RICS members in Scotland make valuation judgements on a daily basis, as would be the case here; understanding those valuation judgements and explaining them to the lay person is a different matter. However, the current system allows a new council tax payer to lodge a proposal and the banding would be tested through the appeals process where required. However, if there were regular revaluations, sales evidence is more likely to be available as these properties enter the market.

Regressive Taxation

RICS recognises that the council tax charged, as it currently stands, in Scotland is regressive in nature i.e. as a house value increases, the relative tax burden does not increase proportionately. The table below illustrates the regressive structure as a result of the currently used multiplier.

Council tax band	Upper limit (1991 values)	Multiplier
A	£27,000	6 / 9
B	£35,000	7 / 9
C	£45,000	8 / 9
D	£58,000	9 / 9 (i.e. 1)
E	£80,000	11 / 9
F	£106.000	13 / 9
G	£212,000	15 / 9
H	n/a	18 / 9 (i.e. 2)

Number of Bands

Within the current council tax system, the range of bands does not properly reflect the current scale of property values, particularly with any property over £212,000 at April 1991 falling within Band H.

Furthermore, at present, the mean council tax paid in Scotland is band D (average), the valuation of which is £45,001 to £58,000 at 1st April 1991. Although Band H properties have a value at least four times that of a Band D property, they pay a maximum of twice as much in Council Tax as the Band D property.

<u>Benefits of the Current System</u>

Whilst the current legislation was rushed, there are, however, benefits to the current system that should remain in any new or reformed property based local taxation system. These include:

- A robust appeal system – this has, over time, ensured that cases have proceeded to local valuation appeal committees, and the higher courts (and resultant decisions) have clarified the interpretation of the legislation;

- A stable and understandable tax base - valuation of such property assets is very much 'business as usual' for chartered surveyors and the taxpayer, generally, has a good knowledge of the value level of their property;

- Understanding of the council tax system - after 22 years, the system is, generally, easily understood by tax payers;

- Well-maintained and improved housing stock – as there is no taxation increase to householders who have improved their property during their ownership tenure and no decrease for properties allowed to fall into disrepair, improvements and maintenance of houses has been encouraged;

- Low-resource burden - the costs and eases of administering council tax is relatively low;

- Local Accountability – reliefs set at a local level assist in keeping administrative costs of the tax down and takes into account local conditions relative to service provision – the most obvious example here would be properties in rural and urban environments.

Recommendations

1. <u>Revaluations</u>

If the current Council Tax style of property tax remains in place, then RICS recommends that frequent revaluations of domestic properties are included in future legislation and that they take place at least every five years. Whilst this could lead to an increase in appeals, and therefore an increase in costs, it would make the taxation system more transparent, whilst improving public understanding i.e. the public, in general, comprehend the system and better understand the more up to date value of property.

Whilst regular revaluations would pick up on improved properties – likely leading to an increase in value – many would deems this as fair, as the value of a domestic property should reflect the current physical characteristics of the property, and the appropriate band applied.

Regular revaluations would also assist in by-passing potential problems that surface with new “types” of property, properties that gain an increase in market interest e.g. those that have ultra-low energy use or carbon emissions.

RICS does not recommend the use of indices on a national level as although they are practical and cheaper to use, they only reflect trends. This means they are not accurate, and do not reflect the variances that location can make to the domestic market, e.g. ‘hot spots’ (Edinburgh, Glasgow and Aberdeen) and the local market for rural locations etc.

2. <u>Banding System</u>

RICS recommends keeping a banding system. However, we make this recommendation on the proviso that the following amends are made:

i. The current, regressive multiplier is revisited – the ratios should be widened between the top and bottom of band range. The decision on the proportions should lie with Government administrations;

ii. Alterations are made to the band thresholds;

iii. More bands are created.

If the above amendments were implemented, the local tax system would remain as effective as it presently is, but may also be considered fairer. These suggestions would also increase flexibility for the administrative authority.

Observations for consideration

1. Home improvement and revaluation

In relation to revaluing a property that has undergone significant improvement, the commission should consider whether the physical changes to the property, under a revised system, should be taken into account at the date of sale (as is currently the case) or if they should be reassessed at the time of Revaluation.

2. Council tax cuts

RICS acknowledges that various groups and stakeholders have called for council tax cuts for domestic properties that fulfil certain criteria; for example, a council tax cut, or reimbursement for more energy efficient properties.

RICS does not believe that this would be a workable component of the council tax system. This is primarily because some properties are able to be improved (from an energy efficiency perspective) with greater ease, and less cost, than others. Additionally, many tax payers can simply not afford to make improvements. It would seem that a council tax cut of this nature would reward those who have the ability to make such improvements and 'penalise' those that are maintaining; for example, listed buildings where such improvements, because of planning restrictions, might not be possible. This would appear unfair. Furthermore, as mentioned earlier, the current system is understood by tax payers, and adding further complexities to the system may impact on this understanding.

RICS believes that if this proposal is deemed to have merit, it should not form part of the valuation but instead be granted and administered by the collection departments of the local authorities.

We would suggest this 'category' of benefit is sought through other means.

3. Reliefs and exemptions

RICS acknowledges that the treatment of second homes is not consistent across Scotland; that prison cells are considered domestic and pay Council Tax instead of rates; university halls of residence pay no council tax as students are exempt from payment; and self-catering units (with an intent to let for 140 days annually) pay no rates or council tax.

RICS suggests the Commission consider these reliefs, issues and exemptions.

4. Water payments

At present, charges for water services (a utility) are included in council tax bills. This, essentially, links them to domestic property valuation.

In the interests of transparency, RICS suggests the Commission consider whether water bills should remain part of council tax billing or not.

6. Reform of Local Taxation – Possible Alternatives and the RICS View

6.1 Land Value Tax

RICS acknowledges that Land Value Tax (LVT) has been tabled before and, notionally, the system appears reasonable and attractive. However, RICS would argue there is a lack of comparable data upon which to accurately set the values – comparable data is a key component in the mechanism of valuation.

LVT suggests that two identical adjoining plots, one with a multi-million pound building and the other a small prefab will attract the same liability. Even though local taxes contribute to local service provision, this hypothetical scenario would be deemed unfair in the eyes of the latter's owner (or occupier). Conversely, due consideration should be given to the instance of two adjoining properties, similar in size etc, where one has a significant extension – would that dwelling be liable to pay extra tax, having increased in value, despite not creating any new wealth or income?

Furthermore, the LVT approach might lend itself to the maximisation of development of land, much to the perceived detriment of existing occupants in a locality for whom it would be unreasonable and, also, perhaps lead to over-development and, feasibly, over-supply – both of which would add the burden on local services. However, there is a belief in Scotland that we are facing a housing shortage at present as a result of a lack of available land and the costs to purchase it. Whilst care needs to be taken not to progress too quickly and disadvantage existing housing owners, there are arguments being discussed that LVT could help stimulate the building of more homes and make them more affordable.

Consideration must also be given to potential disputes as to what is, or is not, the correct development appraisal for a given site or plot. The valuation of land is not, as is often believed by those not involved in the field, a simple matter of deducting the build cost from the value of the land plus building. Development appraisals are renowned as the most difficult form of valuation to pin down with any semblance of reliability or accuracy. This could substantially increase the cost of assessment of Local Taxation, as it is much easier to carry out capital valuations based on open market sales, than a series of residual valuations. If a more simplified methodology is used, assigning land values on a rate per sqm basis in a particular area, this may lead to substantial anomalies and consequent appeals. For example, a long, narrow site might be suitable for only one house, but a site of similar area which is wider and less deep might be suitable for two houses, yet a system based on a rate per square metre would assess them both at the same rate.

One theoretical difficulty is that, for economists, land value taxation works best if the taxpayer is the landowner; this encourages landowners to develop land to its highest and best use, as they will otherwise be paying land value taxation as if the land was in that use anyway. If occupiers continue to pay in an LVT system, it might not achieve this aim and there could be substantial disputes and anomalies. However, if the landowner pays, then there could have serious problems in identifying the beneficial owners, particularly if companies owning land are registered offshore. Indeed, there might be an incentive for some to do this, to minimise their tax liability. Until we have a Land Registration system which is able to identify the beneficial owner of all land, then this will remain a difficulty and tracing owners will add to the cost of collection.

RICS raises a number of questions relating to the general principles of LVT and whether it will be easily understood:

- Will the valuation be based on Encumbered Land?
- Will the valuation consider potential use or will the basis of valuation be on the current planning for the particular site?
- How will multi-storey buildings, and the land they sit on e.g. local authority multi-storey properties and luxury developments of this nature, be classified and/or valued?
- In relation to mixed-use developments, where there is a mix of commercial and domestic use e.g. tenement buildings?
- Would LVT be equitable in the hypothetical instance where a low-value affordable-housing is built on high-value sites?
- Will the appeal system cope with the lack of understanding of another form of tax, and the subsequent increase in appeal loads and costs?
- If there was a movement towards LVT, the method and timing of Revaluations should be included in the legislation.
- Would it be paid by the occupier, as now, or would it follow classical economic theory and be paid by the landowner?
- Residential occupiers understand the current system of open market capital valuation; could an LVT system be made understandable to the extent that they could, as now, take forward their own appeals without professional help?

In summary, RICS believes that whilst there is research which indicates that LVT would stimulate development and make more land available to build homes at more affordable prices, LVT is not a suitable alternative to council tax. The main reason being that LVT lacks evidence, and there is an imperative need to ascertain ownership. According to the Land Reform Review Group's *The Land of Scotland and the Common Good* report and the Scottish Government's *A Consultation on the Future of Land Reform in Scotland* document, there are numerous envelopes of land in Scotland where the current owner is not known. The recently published Land Reform Bill recommended the creation of a register of land-owning beneficiaries – this would need to be completed and regularly maintained to enable LVT to work.

LVT is a complex system that may be understandable to certain professionals, such as chartered surveyors, economists and accountants, but not to the public (a significant advantage of the current system). It might also be difficult to explain to local taxpayers how such a system would work. Whilst the public may understand open market value and can relate to that, it is likely that their understanding of the intricacies of residual valuation will be negligible.

Furthermore, there is a significant amount of information on the housing market, for ease of comparables and valuation, and very few analysable development land sales in Scotland.

6.2 Local Income Tax (LIT)

RICS has already stated our preference of a property-based local taxation system. However, for verification, we have considered a local income tax, and have the following points to make.

Firstly, regarding volatility, if the working population declines (as it did for over five years during the recession) so does tax revenue. This would leave a gap in revenue generation – thus putting a greater tax onus on fewer tax payers.

On the contrary, should national (or local) employment increase, it is likely that tax payers would expect a tax cut to compensate.

The Commission should have to consider the potential obstacles of collection; namely, who would be responsible for collection i.e. local authorities or national government, and where the tax be 'charged' i.e. where tax payer resides or works. If the latter, there would be areas in Scotland, that comprise many commuter towns, that would have less revenue generated to pay for local services.

A property-based tax is another type of tax that assists government in spreading any risk in a drop in tax revenues. Therefore, it would not be beneficial to Government to reduce number of ways it can generate revenue.

6.3 Taxing at a Flat Rate – Personal Tax

In keeping with verification on the benefits of a property-based local taxation system, RICS considered a flat rate taxation system.

First, and foremost, this tax is similar to the 'old' Community Charge which was a deeply unpopular. The Burt Review (2006) suggested that 52% of Scotland tax payers believed the 'poll' tax to be unfair; this is very significant.

Secondly, this model is no longer used as a significant source of revenue by any major country – possibly due to the fact that the tax is applied, irrespective of a tax payer's ability to pay. This is not fair.

Finally, RICS has concerns of the instability of revenue generation as a result of mobility. Mobility of people in Scotland - especially among young people – is high, and this would cause difficulties in collection which, in turn, makes the tax and the revenue generated unstable.

6.4 The Local Property Tax (LPT)

RICS acknowledges that LPT was raised as an alternative to local taxation by the Burt Review in 2006. In considering its similarity to the current council tax regime, there are a host of benefits.

RICS understands that under LPT, tax is charged as a percentage of the value of the property (the Burt Review suggested 1%). Like the current system, LPT is based on the market value of a property and is backed by a considerable quantity of market evidence from the previous buying and selling of property. It is therefore likely to be comprehensible by the tax payer. As illustrated previously, this is a key benefit of the current structure and tax system. LPT is also dependent on regular Revaluation of domestic properties, which would also be welcomed.

As a property based tax, the collection of LPT should be easy, evasion would be difficult, and revenue generation would be stable. Additionally, like another benefit of the current system, those liable to pay are owner-occupiers and tenants, as well as owners of second homes and unoccupied properties. However, because each property is individually valued, the cost of valuation will be greater than in a banded system.

As the professional body for property professionals, RICS accepts that valuation is not an exact science and that there have to be levels of tolerance incorporated into any valuation. The LPT does not allow this and, as such, it is envisaged that the numbers and complexity of appeals would, certainly in the first instance, have a significant impact on the ease of administration of the valuation “register”. These tolerance levels may be seen, depending on the number and breadth, as corresponding to the levels of banding applied to the new, or amended, property tax.

Also, because information is so easily available for house sales, the number of appeals may well increase substantially from the current level.

Whilst the use one all-encompassing percentage rate for domestic properties in Scotland could negate the current regressive system, due consideration has to be given to the instance where a house worth £1m pays ten times more than a house valued an £100k, even though they are in the same locality and receive the same quantity and quality of local services. There may be a perception of unfairness in this instance. It should be noted that using the suggested 1% charge, the occupier of a £100k house would be liable to £1000 per year, whilst the occupier of a house worth £1m would be liable to pay £10000.

In considering the fluctuations within the house price map of Scotland around ‘hot’ spots i.e. high house prices, such as Edinburgh, Glasgow and Aberdeen, it is likely that under an LPT regime, these local authorities will be in receipt of more revenue than less affluent regions in Scotland.

This is where a band system, with a top band, covering house values above a certain value, may be considered to be more workable than LPT. The Burt Review discussed minimum and maximum payments but, ultimately, perceived the fairness as a matter of political perspective – RICS shares this view.