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Common Weal Policy

# A PROPERTY TAX FOR SCOTLAND: REPLACING THE COUNCIL TAX AND TAXING LAND

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# KEY POINTS

— The Council Tax is widely recognised as being unfair, inefficient and outdated and is in need of replacement. Fortunately, this policy area is fully devolved to Scotland so a replacement to the Council Tax can be implemented without delay.

— There is a strong case for a more effective form of wealth taxation, both to fund local government and reduce inequality. With Council Tax being the largest single tax on wealth, replacing it therefore represents an important opportunity to establish a fairer system of wealth taxation in Scotland.

— Based on five key principles for a good tax system, three options for a replacement tax are assessed: A Local Income Tax, a Land Value Tax and a Property Tax. The fairest, easiest to administer and collect, hardest to avoid and easiest to understand is found to be a Property Tax.

— This report therefore sets out the details of a Property Tax to take the place of the Council Tax. The Property Tax would tax land and any buildings upon that land and would be calculated as a proportion of the total property value.

— The vast majority of properties are valued on the basis of both the land and the building (very few houses are sold separately to the land they are on or attached to), meaning the value of the property can be assessed based on the average value of houses in the surrounding area.

— A 'house profile' would be created based on the floor area of a house and data analysis would be used to work out its value based on the sale prices of similar houses in the area. This would create an accurate and annually updated valuation without the requirement for any manual valuation. A small number of properties and large land holdings are more complicated to value, but the report explains how this would be done.

— At a rate revenue-neutral with the Council Tax, the Property Tax would make 60 per cent of households better off and 40 per cent worse off compared to the Council Tax. For most households made worse off, the increase in tax liability would be modest. Only the most valuable houses (those in Band H under the Council Tax) would incur significantly more tax, at an average of £2,300 more per year.

— The tax on land would then raise revenue additional to the that estimated in the revenue neutral calculations. However, since there is still missing data on land values it is not possible to estimate exactly how much that would be.

— It is proposed that the changes are phased in over five years and that a system of exemptions is put in place. This will be particularly important in the case of small farms.

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# THE CASE FOR CHANGE

Despite Council Tax having serious flaws, lawmakers have so far shied away from carrying out the radical overhaul necessary to fix local government taxation. This section outlines these flaws and presents the case for change.

## A brief overview of Council Tax

Council Tax was introduced in 1993 following the *Local Government finance act 1992* as a replacement to the widely derided 'Poll Tax'. It is a system of property taxation which is levied by local authorities on all domestic properties in Scotland. Council Tax revenue goes towards funding the public services provided by local authorities.

A household's liability is decided according to a system of bands. Each property falls into one of eight bands, A - H, with band A incurring the lowest tax liability and band H the highest. Councils choose the band D rate autonomously with the other bands being a fixed proportion of the band D rate. These proportions are set out in law. The band which a property falls into is decided according to its market value in April 1991. New houses built since the introduction of the tax are taxed according to what their value would have been in April 1991, had they been built.

A system of exceptions and reliefs is in place for groups who are judged less able to pay, such as students, single occupier households and those whose income is low relative to the value of their property, for example pensioners.

Since its introduction, Council Tax has faced widespread criticism and calls for its replacement from across the political spectrum have grown in recent years. Amongst others, the IPPR, the Resolution Foundation and the Adam Smith Institute have all advocated abolishing the Council Tax[1,2,3].

Alongside lifting a freeze which had been in place 2008-09, in 2017 the Scottish Government enacted reforms which aimed to address such criticisms and make Council Tax fairer. The multipliers for the four highest bands were increased and extra relief was provided for households with incomes below the median income for their band. However, whilst a moderate improvement, the reforms failed to address fundamental problems of Council Tax. Council Tax therefore remains a deeply flawed tax.

## Why council tax is unfit for purpose

Objections to Council Tax centre around a simple fact; it is a deeply unfair tax. In 2016, The Commission on Local Tax Reform (CLTR) found that the poorest households faced an effective tax rate five times that of the richest households[5]. It was this regressivity which the 2017 reforms attempted to address. However, in order to merely make council tax proportionate the CLTR concluded that, "[it] would require the tax on the highest value homes to be 15 times the tax on the lowest value homes". The changes made in 2017 fall well short of this mark. Council Tax is therefore still profoundly regressive.

This regressivity stems from a number of factors. Firstly, the bands used to determine the tax rate are wide with each property within them being taxed at the same rate. Since Council Tax is applied evenly across each band, the lowest-value properties within a band face a significantly higher effective tax rate than the highest-value properties.

Secondly, the structure of the bands is not directly proportional to the value of properties. The increases in the tax rate between bands is small compared to the corresponding rise in property values and for properties with values above £212,000 (at 1991 prices) the banding system stops altogether. This means that the highest-value properties command a tax rate of no more than three times that of the lowest value households despite being, on average, worth 15 times more[6].

Thirdly, the Council Tax calculations are still based on house prices in 1991. The fact that these prices are 28 years out of date means that Council Tax has completely failed to make accomodation for differences in price changes over that time. Any property which has risen in value more slowly than the national average will attract a disproportionately large Council Tax bill and vice versa. Since house price inflation has varied significantly across Scotland, there are significant inter-regional inequities. Compounded by the loose proportionality of the banding system, this means Council Tax revenue has failed to keep track with the increase in property wealth which has occurred since its introduction.

Lastly, regional differences in house prices exacerbate the existing regressivity. In areas where a greater proportion of properties fall into the top bands, local authorities can set lower tax rates to provide a given level of services. Since in areas where properties fall primarily in the lower bands rates have to be higher, this further exacerbates the difference in effective tax rates between poor and affluent regions.

In addition to being regressive, Council Tax is highly inefficient. The exemptions which exist for the least well-off households create poverty traps as high marginal tax rates discourage work. Discounts for second homes mean there is inefficient use of space in desirable locations. Similarly, discounts for single people encourage the conversion of multi-family properties into single luxury residences thus reducing housing supply.

Combined, these factors represent the case for change; whilst the least well off continue to contribute a larger share of their wealth than the rich, Council Tax will remain grossly unfair and unfit for purpose. But why replace Council Tax altogether instead of making changes within the current structure?

Some suggested reforms which have gained publicity in recent years include the so-called 'mansion tax' proposed by Labour and the Liberal Democrats which would increase the tax paid on the most expensive properties. Whilst falling on the top end of the wealth distribution, the revenue earned from such a tax would be relatively small as few houses would liable under the tax. Moreover, it remains unclear whether local authorities, the Scottish Government or the UK Government would control the tax and which body the revenue would accrue to. A 'mansion tax' could therefore complicate and potentially exacerbate issues of regional variance and distribution.

More drastic reforms were proposed by the then-Labour MP Chris Williamson in what has been dubbed the 'Williamson Model'. The proposal advocates much larger increases in payments in the top bands than were made in Scotland in 2017 including a doubling of the tax paid in the top band. Such a change would go further towards generating sufficient funding for local authorities if it were applied in Scotland.

However, neither these nor similar proposed reforms would address many of the central problems of Council Tax. They fail to address the issue of outdated property values, the regessivity with respect to property values remains, as do the problematic banding system and bad incentives. Instead of carrying out minor tweaks, these issues could best be addressed through fundamental change in how property is taxed in Scotland.

## The case for wealth taxation

As well as addressing existing problems, replacing Council Tax presents a significant opportunity to radically change how wealth is taxed in Scotland.

In June of 2018, the Resolution Foundation published a report which found that household wealth – property, financial assets, possessions and pensions - had exceeded one trillion pounds in Scotland for the first time [5]. However, whilst aggregate wealth has increased, the report also highlighted that the gains have been very unequally distributed across class, generation and region.

Wealth grew at a much faster rate than incomes over the past decade, increasing from five times GDP to over seven times GDP, and is now almost twice as unequally held as income. A quarter of Scottish people have less than £500 pounds of net savings and 7% have none or are in debt. That a large section of Scottish society has missed out on the wealth boom severely hinders social mobility as it means it has become much harder to close wealth gaps by earning and saving. To illustrate, the average household would now need to save all of their £25,500 income for 43 years to join the top 10% wealthiest households (those with assets over £1m)[7].

Since it is the older generations who tend to own assets, it is people belonging to these generations who have primarily benefited from the uplift in Scotland's wealth rather than the young. No generation since 1965 has seen higher wealth than those before them at the same age. Moreover, home ownership amongst people aged 25-34 has fallen from 48% in 2004 to 32% in 2016. Instead of earnings, the size of your inheritance is therefore on track to become the primary determinant of lifetime living standards. Nevertheless, millennials are not set to come in to their inheritance until their 60s. Even those lucky enough to be in line for a sizeable inheritance will likely raise children and have lived the majority of their working lives before receiving it.

The final key finding of the report details the extent to which regional divides have emerged. Currently, the average house price in Edinburgh is more than 2.5 times what it is in East Ayrshire. Scotland is therefore in danger of following the same path as England, with the Central Belt becoming the equivalent of London and the South East. If the Central Belt begins to suck in a disproportionate share of resources and investment, as London does, it will be the living standard of Scotland's more deprived communities which will suffer.

Clearly, then, the current distribution of Scotland's wealth is severely skewed. This is largely down to the fact that, despite the huge increase in aggregate wealth which has occurred, wealth taxation has failed to adapt to ensure the growth is shared equitably across society.

Older generations capturing a disproportionally large share of the increase in Scotland's wealth as the working age population experiences little or no increase in living standards presents a looming fiscal crisis. To take the example of healthcare, the Scottish Government projects a 3.5% increase per annum in health expenditure between 2016/17 and 2023/24[8] (although concern has been raised about the reliability of these projections[9]). Yet, relying on the usual income and consumption taxes which now fall on a stagnant working population is only going to prove increasingly challenging. In order to spread the burden, taxing the growing stock of wealth now increasingly concentrated amongst older generations – the main beneficiaries of increased health spending – is a prudent and necessary step. To Scotland's benefit, the largest wealth tax – Council Tax – is fully devolved. It is therefore within the Scottish Government's power to make significant progress in addressing the current wealth imbalance and to tackle growing inter-generational tensions by introducing a replacement tax which is fit for purpose.

# THE CASE FOR A PROPERTY TAX

There is a general consensus amongst the main political parties in Scotland that Council Tax in its current form is unfit for purpose. However, disagreement exists about what are appropriate reforms. With the Scottish Greens securing a commitment to convene cross-party talks on a Council Tax replacement in return for their support for the SNP Government's 2019-20 budget, the space has been created to decide the future of Council Tax and local government taxation more broadly. This section makes the case for why Council Tax should be replaced with a Property Tax.

## The Principles of a Good Tax

Before discussing the existing options for replacing council tax, the principles of what makes a good tax should be made clear. This report proposes that there are five principles against which options for Council Tax replacement should be assessed - that it is:

— Easy to calculate.

— Easy to collect.

— Hard to avoid.

— Easy to understand.

— Fair and socially just.

The first three principles are self-explanatory. Having a tax which is easy to calculate and collect will reduce the scope for errors and will minimise the size and cost of the infrastructure necessary to facilitate collection. If a tax is difficult to avoid it will help maximise revenues and protect a sense of cohesion amongst taxpayers as in theory everyone will be paying their way.

If a tax is easy to calculate and to collect, the likelihood is that it will be easy for the taxpayer to understand. It should not then be difficult for an individual to know how much they are liable to pay and through which mechanism they make their payment. However, in addition to knowing how they are being taxed, it is also vital that taxpayers know *why*. If it is difficult for an individual to understand why they are being taxed a government cannot reasonably hope to gain public support for their revenue raising agenda.

Similarly, a tax will also not gain public backing if it is judged to be unfair or socially unjust. Opinion on what qualifies as a fair tax is obviously unlikely to be unanimous, but broad consensus is necessary if a tax is to be accepted by, and work for the benefit of, society as a whole.

When developing a new tax these five principles should therefore be adhered to as far as possible. No tax is perfect, but neither is it overly ambitious to expect competency in each. The following section will discuss the various proposed alternatives to Council Tax according to how well they fulfil the above principles and explain why Common Weal has reached the conclusion that a Property Tax should replace the Council Tax.

## The Options

There exist at least three viable options for replacing Council tax: A local income tax, a land value tax (LVT), and a Property Tax. Each is addressed in turn.

### Local income tax.

SNP party policy had previously been to introduce a local income tax but it has now backed away from this option[10]. However such a tax remains an option for funding local services in place of the Council Tax.

There are a number of ways a local income tax could be implemented but in principle it remains the same as national income tax. The key difference is that local income tax revenues would be put solely towards funding local authorities. Since taxpayers are already familiar with the principle of a progressive tax on income, in this respect a local income tax will be easily understood by the public. Some argue that a local income tax would be more closely linked to peoples' ability to pay and it would therefore also be fairer than an LVT or a Property Tax. It is indeed true that a local income tax provides a more obvious link to ability to pay as the tax is levied on present earned income rather than illiquid assets. However, is questionable whether it follows that it is therefore the fairest tax of the three.

A local income tax would do very little to address the existing wealth inequalities highlighted in the previous section. Cash-poor, asset-rich households would pay very little local tax despite often being wealthier overall than those with higher income but few assets. Moreover, the CLTR highlighted in its report that it would be difficult to apply to all forms of income if a local income tax was implemented based upon the existing HMRC framework[11]. Wealthy individuals who receive a significant amount of unearned income, for example from savings, dividends or investments, could therefore end up paying far less local tax than they should.

A local income tax could instead be collected by Revenue Scotland under a framework uninfluenced by Westminster. However, this approach would provide practical difficulties of its own. Replicating the PAYE system used in the collection of national income tax would mean businesses would need to deduct income tax for Revenue Scotland as well as HMRC. Introducing this costly extra layer of administration would face resistance from businesses. Whilst PAYE is the most efficient way of collecting income tax, requiring taxpayers to instead file tax returns could be used to shift the administrative burden. However, this would mean significantly increased collection costs and since 75% of Scottish taxpayers do not submit tax returns it would also likely raise issues regarding public understanding and acceptance[12].

An aspect in which a local income tax is unquestionably at a disadvantage to its alternatives is ease of avoidance. One of the main appeals of taxes on land and property is since neither can be moved or concealed such taxes are extremely hard to avoid. The same is obviously not true of income taxes. Anti-avoidance measures would therefore have to be taken which would likely be costly and it is unclear how successful such action would be. Unsuccessful anti-avoidance action would further undermine a sense of fairness.

Further practical difficulties prevent a local income tax from being an attractive option. For example, if the tax were to be levied and collected by Revenue Scotland, since it is a Scotland-wide body it would be very difficult to vary the tax rate at the local level.

Another reason why a local income tax would be undesirable is that there is an inherent benefit in taxing land and property. There is evidence that both serve to constrain house prices and therefore place a dampener on unsustainable rising house prices which create serious risks of economic failure. Moreover, a local income tax has no power in shaping incentives for how land and property are used.

## Land value tax (LVT)

Once the goal of moderating the housing market and incentivising a more socially-beneficial and economically-productive use of land and property has been established, the question then follows by which tax mechanism can this be achieved. An LVT is one such proposal which has been gathering traction in recent years.

An LVT is a levy on the value of land only. Since land is not produced by any private individual and has value because of its scarcity alone, supporters of LVT argue that this value should be returned to the community. Government infrastructure developments which increase the value of private land in the surrounding area would in theory therefore pay for themselves via higher tax revenues. The value of developments to land of any kind is discarded. Any capital improvements made to the land such as building houses, installing a water supply or improving drainage therefore do not affect the taxable value. Proponents argue that an LVT would therefore incentivise efficient and sustainable land use as improvements are untaxed and land banking – holding land purely as an investment – is discouraged since an uplift in value would increase the tax bill. Since it is impossible to sell the vast majority of housing separately from the land it sits on this mechanism would therefore also serve to constrain rising house prices. An LVT therefore fulfils these goals.

A further advantage of an LVT compared to a local income tax is that an LVT would be very difficult to avoid. Unlike income, land cannot be easily concealed or moved offshore. Supporters argue that LVT is therefore the ‘least worst’ tax as it causes minimal distortion to economic activity.

However, while an LVT may be attractive in principle, there are many instances where it is hard to see how an LVT could be applied in a way that feels fair and could be easily understood by taxpayers. For example, should the correct tax bill for residents of tower blocks and tenements be determined by the fraction the land their flat covers or by the size of the flat? How will tax bills be calculated when flats in the same block differ in size? What if only some have access to a garden? Moreover, it is difficult to see an LVT gaining public support when a small cottage and a mansion sitting on plots of land of equal value would incur equal tax bills. Introducing a set of caveats and exemptions could perhaps go some way to ameliorate the inherent inequities of an LVT but this would be costly and cumbersome to implement and would result in a tax which would be even more difficult for the public to understand.

An LVT would also be harder to assess than a Property Tax. To calculate LVT the value of the land has to be extracted from the market value of the property as a whole. Some supporters of LVT argue that this would in fact be easier than valuing land and improvements collectively. In his paper advocating the introduction of and LVT Andy Wightman MSP states:

> “Valuing land alone is considerably easier than valuing land and buildings together since only the only factors to be taken into account are the location of the land and the [highest and best use].”[13]

Wightman suggests land valuation will be a simple process of taking the market value of the property as a whole and subtracting the depreciated replacement costs of the buildings[14]. However, given that knowing the market value of the property as a whole is a necessary condition for calculating LVT, it is unclear how this is a simpler process than calculating a Property Tax. Whereas a Property Tax would simply be levied on this market value, an LVT would add another layer of calculation and complexity. Overcoming the ambiguity in how one would calculate the replacement costs of the buildings would alone be more complex than calculating a Property Tax.

Gardens and landscaping present additional difficulty for LVT calculation. A beautiful, well maintained garden will add a considerable amount to the market value to a property compared to if it were a neglected, overgrown wasteland. However, it is ambiguous where the threshold between unimproved land and established garden will lie. If gardens aren't counted as improvements to the land, taxpayer's bill will be influenced by the value of their garden. If gardens are counted as improvements to the land, this will be one more thing for which the replacement value will need to be calculated.

With increased process and procedure comes increased scope for disagreement and objections from taxpayers. Therefore, it is likely that the number of appeals under an LVT would be significantly higher than with a Property Tax. Increased appeals would mean increased administration costs and a reduction in the efficiency of the whole process.

## Property Tax

The preceding sections established that it would be wrong to stop taxing a key component of wealth by introducing a local income tax and that an LVT would be difficult to implement and understand compared to a Property Tax. The advantages of a Property Tax are not solely a result of the shortcomings of alternatives, however. There is an inherent benefit in taxing property.

Firstly, a Property Tax would better address wealth inequalities than an LVT. Behind private pensions, property wealth is the largest component of household wealth in Scotland[15]. It is therefore important for governments to retain the ability to redistribute this wealth. Since a Property Tax applies directly to property values, it will be a more accurate and effective method of doing so than an LVT.

Secondly, a Property Tax would allow a greater ability to limit house price fluctuations than an LVT. Like a Property Tax, an LVT constrains house price rises. However, it does so indirectly. Since houses are inseparable from the land they sit on, a house buyer would take account of any land tax and adjust the price they are willing to pay for the house accordingly. If a buyer expects LVT to rise, they will be willing to pay less for a property (and vice versa). However, LVT is not proportionate to property values. In theory therefore, assuming land values are equal, an increase in LVT would reduce the selling price of a two-bedroom bungalow by the same amount as a six-bedroom mansion. Advocates of LVT highlight how it could be used to limit land banking; a tax of 100% of the rental value of the land would mean "speculation in land is killed stone dead"[16]. Nevertheless, the influence of an LVT does not extend to speculation in property itself. Only the location value of a property is taxed under LVT. The value of the building itself is untaxed. Therefore, an LVT would only serve to dampen fluctuations in this location value rather than the value of the entire property. As a tool for moderating the housing market an LVT is therefore blunt and relatively ineffective compared to a Property Tax.

The argument that an LVT would create desirable incentives for land use has already been discussed. It is not true however that similar improvements to land use could not be achieved when introducing a Property Tax. For starters, equalizing the VAT rate for renovations with the current full exemption enjoyed for new constructions would be an instant way of improving land and building use; the incentive to demolish and rebuild buildings rather than improve their existing condition will be removed. Moreover, a Property Tax following the specific proposals made in this paper would avoid discouraging the improvement of building quality.

In terms of stimulating the development of new properties on disused land, Common Weal's paper *Good Houses For All; how Scotland can build unlimited homes without subsidy*[17] explains how combining the roles of a Scottish National

Investment Bank and Local Authorities to develop a program of housebuilding for social rent can tackle this issue directly rather than through a system of incentives. This program would enable houses to be constructed to the highest possible standards of energy efficiency, rented or sold at extremely affordable rates and developed in sufficient quantity to meet demand in any given year and area. This public house builder would thus act as a direct competitor to the private market which would have to increase quality and/or decrease price to effectively compete. A program of buying land at 'existing use value' (i.e. buying unused land at its current rate rather than its value after houses are built on it regardless of the existence of any planning permission to build houses on the land) would greatly reduce land banking for speculative reasons. Furthermore, it should be stressed that this proposal is for a Property Tax on property held as buildings *and* land and so would also apply to the undeveloped land only (and thus act as a de facto LVT) to further discourage such speculation by creating a cost to hold land where there is not (yet) an income stream from the rent or sale of buildings on it.

For taxpayers, a Property Tax will be easier to understand than an LVT since with the Council Tax they are already familiar with a recurrent tax based upon property values. Retaining a tax based upon property values also means that less new infrastructure will need to be introduced to facilitate collection than if introducing an LVT. Furthermore, advances in 'big data' – the technology used to collect and analyse large amounts of data – mean that there will no longer need to be manual revaluations of house prices, a key reason why some have been reluctant to abandon Council Tax. Reliable algorithms now exist which can determine the market price of given property based upon the selling prices of similar properties in the area.

## Summary

After evaluating all three options it is clear that Council tax should be replaced by a Property Tax.

A local income tax is unsuitable because it would mean the removal of taxes on land and property. This would mean inherent benefits of such taxes are lost. The tax would also therefore be unfair as people who have significant wealth in forms other than cash income would not being paying their fair share. Advantages include that it would be easy for taxpayers to understand and for liabilities to be calculated. However, a local income tax would also be easy to avoid and difficult to collect, especially if the tax was to be varied at a local level.

An LVT addresses most of these problems. Being a tax on a fixed asset means it is very difficult to avoid. It would be more fairly linked to people's wealth and it could therefore be used as a lever to help address current wealth inequalities in Scotland. Additionally, it would provide a limited ability to curtail house price fluctuations. However it raises other problems; an LVT would be considerably more difficult for taxpayers to understand than alternative taxes and there exists significant practical barriers to implementation and collection. Albeit for different reasons, like local income tax there are also many instances where it would be unfair.

In comparison, a Property Tax will be easier to understand, calculate and collect. It will be similarly hard to avoid but will allow better control of house price fluctuations. Moreover, since it provides a closer link to total wealth it will be fairer than an LVT or a local income tax.

As demonstrated, on all five measures of a good tax a Property Tax performs better than both LVT and local income tax.

Now that a Property Tax has been demonstrated to be the best replacement for Council Tax, it remains to establish what form the tax should take. The following section sets out in detail Common Weal's proposal for how a new Property Tax should operate.

# THE PROPERTY TAX

## Defining Property

Before progressing any further, it is first necessary to define exactly what is meant by property in the context of the proposed new taxation system. In this case, a “property” refers to a given plot of land and any developments made to it as one collective asset. Land is any terrestrial territory not covered by sea and can be used for a range of purposes from mining and agriculture to recreation and housing or simply be conserved in its natural state. Developments could include buildings, landscaping, drainage or any other infrastructure. The amount of tax levied would therefore be determined according to the combined market value of the land and any such developments – ie. the property value.

For the majority of the housing stock in Scotland the house price is inclusive of the value of the land which the property sits on. This – in almost all cases – will include the gardens surrounding the property as in most cases the garden would be sold as part of and along with the house. The owner of a typical property could not reasonably expect to sell their house and garden as separate assets. In this case Property Tax will be levied on the market house price.

Land held without an attached property will also be taxed based on its value so that the total Property Tax owed by a particular owner will be based on the total value of their owned buildings, their owned land or the combination of both.

Where using this conception of property could have significant impacts to tax liability is when a property sits on a considerable amount of land. At present, the value of the property alone determines the Council Tax band. Under the Property Tax the land owned by the occupier of the property will be taxed in addition to any buildings.

## The Principles of the Property Tax

The Property Tax is simply a levy on the on the property value as determined by the combined market value of the property and any surrounding land also owned by the property owner.

Property Tax will replace Council Tax and will continue to be levied and collected by local authorities. The collecting authorities will continue to have a degree of autonomy over setting the tax rate but central government will retain the power to rebalance across councils via adjustments to the block grant where significant disparities in the value of the housing stock exist.

## Property valuation

Calculating Property Tax liabilities requires knowing the combined market value of the land and any buildings built upon it for every parcel of land in Scotland. Basing Property Tax on present market house prices means updating the 1991 house prices which are used to evaluate Council Tax. The prospect of carrying out costly and time-consuming revaluations manually has contributed to inertia in progressing toward a new system of local taxation. However, by removing the need for manual revaluations, advances in data technology have since helped pave the road to reform. Now algorithms can be used to value properties automatically. The process, sometimes called Computer Aided Mass Appraisal (CAMA), uses the selling prices of similar properties in the area to evaluate the market value of a given property. If this sounds in any way outlandish, it is what online property firms such as Zoopla have been doing for years. Adopting an algorithmic approach to property valuation dramatically reduces the work required to update property valuations from 1991 prices. Rather than being necessary for every property in Scotland, manual valuations will now only be necessary for exceptional cases where no similar properties have sold in the surrounding area.

For the majority of the housing stock, knowing the house profile (see below) and the selling price of similar properties in the area will be sufficient to calculate Property Tax liabilities. Databases of this information currently exist. House profiles can be derived from title deeds and house sales data held by the Registrars of Scotland (RoS) - a government body responsible for maintaining “20 public registers that provide for the registration of legal documents in Scotland”[18]. CAMA can therefore be applied to most of the housing stock with little difficulty.

Where implementing Property Tax becomes more difficult is when houses sit on significant parcels of land. This includes, for example, farms, country estates and remote countryside dwellings. To calculate property tax liabilities the land must be valued in addition to the house itself. A similar CAMA process can be used to value land but additional information is required. Valuing land in such cases requires knowing the following:

— How land ownership is divided between different parcels

— The location of each land parcel

— Which parcels correspond to which houses

— How each land parcel is used

Unfortunately, there are not currently complete map-based databases of land use and land ownership. The most complete existing database of land ownership is held by RoS. RoS is currently transferring land and property deeds from the outdated Sasine Register to the map-based Land Register, a process governed by the Land Registration etc. (Scotland) Act 2012. The land register currently contains 65% of land and property titles and 31.7% of land mass with a targeted completion date of 2024[19]. There is not currently even an incomplete map of land use suitable for carrying out valuations so one will have to be established as part of the implementation process. Of course, there are many other valuable outcomes from such a process, not least transparency and the ability to inform policy.

Complete implementation of the Property Tax will not be possible until maps of land use and land ownership have been completed. Establishing such maps should therefore be a priority in order to facilitate the transition away from Council Tax. Nevertheless, for the majority of the housing stock little to no extra infrastructure is needed to implement the Property Tax. The body which currently values properties for the purposes of Council Tax, the Scottish Assessors Association (SAA), can adopt the role of implementing and operating CAMA to value properties for Property Tax using the sales data held by RoS. The SAA would also continue to handle appeals against valuation decisions. Using the valuations made by the SAA, local authorities will be able to levy and collect property tax in much the same way as Council Tax is currently collected.

## House Profile

A common criticism of property taxes in relation to land taxes is that they disincentivise the improvement of buildings. The typical argument is that since improving a given building increases its value, if that value is taxed property owners will be discouraged from making improvements as doing so will incur a higher tax bill. Policymakers do not want to disincentivise homeowners from making their property safer, more energy efficient or more livable. Replacing faulty electrics, installing loft insulation or refitting an outdated bathroom, for example, improve the quality of the housing stock to the benefit of society as a whole. On the other hand, not all 'improvements' increase the quality of a property. Building an extension or carrying out a loft conversion do not improve the quality of a property but rather increase its size. Increasing the size of a property whilst not harmful is not socially beneficial in the same way improving the quality of a property is. There is therefore no reason why the uplift in property value resulting from an increase in size should avoid taxation.

In addition to potentially inhibiting improvements to properties, there is also a concern that a Property Tax could even lead to private landlords deliberately running down a property in order to diminish their tax bill. A system of quality-based rent controls, as proposed by Common Weal, could be used to counteract this[20].

To avoid inhibiting quality improvements whilst still capturing increases in value resulting from increases in house size the proposed Property Tax will adopt the concept of a 'house profile'. In essence, the house profile corresponds to a property's usable square meterage and the concept works to specify what will and what will not alter the value of a property for the purposes of property taxation. Improvements made to the existing building, such as installing double glazing, will not increase the property's square meterage so will therefore not increase the house profile and will therefore not increase the taxable value, even if the sale price increases. (The taxable value is based on the value of houses of the same profile in the area, not the value of an individual house.) Improvements which do increase the square meterage, either upward by way of a loft conversion or outwards through an extension, will increase the house profile and therefore the taxable value.

The square meterage of each property is specified in the title deed so this can be used to work out the house profile of existing properties. Any changes to house profiles will be picked up through the planning system as all major building work requires planning permission and the building warrants contain detailed information about how the work will alter the property. Any building work which does not require planning permission will not alter the house profile.

To calculate taxable value en mass using the house profile system the CAMA algorithm will have to be able to determine the market value of a property given the house profile and the location. To facilitate this a universal database of house profiles will need to be created by collating title deeds and digitizing these records if not done so already.

# PROPERTY TAX AND THE RENTAL SECTOR

Currently, the Council Tax is generally paid by residents of a property rather than the owners of the property so that, with the exception of specific cases, a renter pays – in addition to their rent – the same tax as they would if they owned the property. However, the owner of the property generally pays no additional Council Tax no matter how many properties they own. Landlords may be responsible for paying Council Tax on multiple properties only if circumstances meet certain criteria such as (but not limited to) if the property is in multiple occupancy (i.e. a tenant only rents a bedroom within the property), the property is housing asylum seekers or is a care home, or if the occupants are renting temporarily due to emergency repairs on their primary dwelling.

There is therefore a very strong case to be made that the Property Tax should be paid by the owners of the properties regardless of whether they live in it, they rent it out or the property is vacant. For owner-occupiers, the transition from Council Tax to Property Tax should be relatively trivial but the transition from "occupier pays" to "owner pays" will have a much more substantial impact on Scotland's rental sector depending on the precise circumstances of the property.

## Private Rental Sector

In the private rental sector the owner would be responsible for the Property Tax though it would be expected that the landlord would pass some or all of the tax on to the renter in the form of additional rent.

This may cause complications with the relation to Income Tax – especially where the owner would generate substantial "income" from this additional rent and raises the possibility of double taxation on this additional rent. There is also the possibility of accusations of rent being raised by more than the actual Property Tax thus renters may not realise the savings they would get in cases where the Property Tax is lower than Council Tax or may result in renters being even more out of pocket than they would be in cases where Property Tax is be higher than the Council Tax it replaced.

Both of these problems may be solvable or manageable by regulating that the Property Tax due by the property is clearly marked on rental agreements and the amount of Property Tax passed on to the renter is included as a clear and separate line in the contract. Renters could then complain to the appropriate regulator if they believe that the Tax passed to them was more than they owed.

This, itself, would not stop the landlord from increasing the base rent as well as including the Property Tax. Additionally, the Property Tax is levied based on the value of the property and is thus at least partially linked to the quality of the property (barring the impacts of land and property speculation). To limit the ability of landlords to increase rent without at least increasing the quality of the properties, the introduction of Property Tax must be coupled with the introduction of a quality-based rent control system as advocated by Common Weal and Living Rent.

## Social Rental Sector

In the case of social rental housing, the owner of the house would likely be a housing association or the same local authority as that which would be paid the Property Tax. Housing associations would be likely to treat this situation as would the private sector and pass the Tax on to the tenants. Councils could treat this situation in the same way but there also could be an incentive to choose to not pass on that tax. While this may have budget revenue implications for the Council, it could also be an aid to make social housing substantially cheaper than the private sector and could be coupled with an extensive program of social housebuilding – especially extremely high quality zero-carbon, passive efficiency housing – designed to disrupt the private market and encourage the redevelopment of housing in line with the requirements of a Green New Deal and Scotland's zero-carbon ambitions. The full feasibility of this potential option lies outwith the scope of this report especially as it may interact with the EU with regard to State Aid subsidy laws.

## Short-Term Lets

Currently in Scotland, Council Tax is paid by the occupants of short term lets on properties (typified by the model used by AirBnB) if the property is let out less than 140 days per year and Business Rates are paid if the property is let out for longer than this.

As the responsibility for payment is already with the owner of the property there should be no logistical barrier involved in switching to a Property Tax. There may, however, be challenges involved around the cross-over between Council Tax and Business Rates. While the scope of this current Property Tax is focused on domestic rather than non-domestic properties, the cross-over between these two categories raises the possibility of reconciling Property Tax and Business Rates to ensure that there is no tax advantage to be gained from short-term letting for more than 140 days as it has been shown that these kinds of short term lets have a particularly deleterious impact on the supply of long-term rental housing – especially in high pressure areas.

## Vacant Properties

One of the purposes of the Property Tax should be to try to maximise the use of Scotland's housing stock so the case for the owner paying Property Tax while a building is vacant is at least as strong, if not stronger, than the case for them paying Council Tax while the property is vacant. It may be that short vacancies – on the order of a few weeks or months during a temporary absence or when a property is between tenants – could apply for discount or exemption in a manner similar to the current Council Tax policies around vacant homes. With regard to longer vacancies – more than 12 months – local authorities have the right to either remove the Council Tax discount or to charge double Council Tax. Continuing this policy – and encouraging a move towards the latter option – should be considered with the Property Tax.

As the Property Tax is levied based on the value of the property there may be a temptation to allow vacant dwellings to run down rather than to occupy them. Given that the value of the underlying land likely makes up a large proportion of the total property value – perhaps even exceeding the value of the overlying dwelling – this impact may be limited. If the Property Tax is revalued at the point of occupancy rather than de-occupancy then a vacant property would continue to be levied at its last occupied rate regardless of its condition after an extended period of vacancy.

If this approach is taken then buildings vacant at the point of the introduction of the Property Tax may need to be rated either at their value at the date of introduction or evaluated based on their period of last occupancy.

# THE PROPERTY TAX IN PRACTICE

This section sets out as far as possible using publicly available data what the Property Tax will look like in practice. First, the Property Tax rate necessary to be levied on houses to replace current council tax revenues is established. Then follows an outline of how this revenue-neutral Property Tax will affect current homeowners and how it compares to Council Tax. Lastly there is an analysis of how land now being taxed in addition to property will affect typical landowners in Scotland.

## Determining the Revenue Neutral Rate

Table 1 illustrates how the revenue neutral Property Tax rate was derived. Column two shows the median house price in each Council Tax band in April 1991 – the date to which all Council Tax property valuations are backdated. Band H includes all houses with a 1991 value greater than £212,000. However, statistics detailing the median Band H house value are not available. For the purposes of modelling the median value is assumed to be £212,000. The estimated contribution for Band H properties is therefore a minimum. However, despite the high values of the individual properties, they only make up 1% of chargeable dwellings and so make a relatively small contribution to total council tax revenues. Adopting this assumption will therefore not significantly alter the estimated revenue neutral rate.

### Table 1: Revenue neutral rate

Sources: SAA, UKHPI, Scottish Government

| Council Tax Band | Median house price Apr 1991 | Median house price Feb 2019. | No. properties | Total value | Potential CT Yield 2019 | Potential Property Tax Yield |
|---|---|---|---|---|---|---|
| A | £13,500 | £52,230 | 549,321 | £28,691,261,285 | £442,000,000 | £180,754,946 |
| B | £31,000 | £119,936 | 604,511 | £72,502,932,350 | £565,000,000 | £456,768,474 |
| C | £40,000 | £154,757 | 429,365 | £66,447,141,251 | £455,000,000 | £418,616,990 |
| D | £51,500 | £199,249 | 361,886 | £72,105,547,912 | £426,000,000 | £454,264,952 |
| E | £69,000 | £266,955 | 359,880 | £96,071,920,530 | £555,000,000 | £605,253,099 |
| F | £93,000 | £359,809 | 210,178 | £75,624,039,838 | £395,000,000 | £476,431,451 |
| G | £159,000 | £615,158 | 133,935 | £82,391,209,127 | £304,000,000 | £519,064,618 |
| H | £212,000 | £820,211 | 14,318 | £11,743,779,518 | £41,000,000 | £73,985,811 |
| **Total** | | | **2,663,394** | **£505,577,831,810** | **£3,183,000,000** | **£3,185,140,340** |

Column three shows this median house price inflated to February 2019 values (the most recent available) using Scotland wide data from the UK house price index (UKHPI)[21] being used to estimate that since 1992 house prices have increased by 387%. The data on local authority Council Tax revenue is provided by the Scottish Government[22,23] and number of houses in each Council Tax band is derived from data from the Scottish Assessors Association[24]

The last two columns show the estimated total value of the housing stock in Scotland and the 2019-2020 Council Tax yield, excluding exemptions. Knowing these two statistics is sufficient to estimate the revenue neutral rate:

— A Property Tax rate of 0.63% of property value will be revenue neutral with Council Tax.

— A property tax rate of 0.48% will be revenue neutral if considering Council Tax revenue net of discounts and reductions

**Table 2: Contributions by Council Tax band**
Sources: UKHPI, Scottish Government

| Council Tax Band | Property Tax at 0.63% | Share of Property Tax | Share of Council Tax | Percentage Change |
|---|---|---|---|---|
| A | £180,754,946.00 | 5.70% | 14.00% | -59.10% |
| B | £456,768,474.00 | 14.30% | 17.90% | -19.20% |
| C | £418,616,990.00 | 13.10% | 14.30% | -8.00% |
| D | £454,264,952.00 | 14.30% | 13.40% | 6.60% |
| E | £605,253,099.00 | 19.00% | 17.40% | 9.10% |
| F | £476,431,451.00 | 15.00% | 12.30% | 20.60% |
| G | £519,064,618.00 | 16.30% | 9.50% | 70.70% |
| H | £73,985,811.00 | 2.30% | 1.30% | 80.50% |
| **Total** | **£3,185,140,340.00** | | | |

## Setting the Property Tax Rate in Practice

The Property Tax base rate would be set nationally to prevent a similar situation to Council Tax arising where wealthier local authorities can set lower tax rates. With affluent local authorities maintaining the standardised tax rate, this will allow central government to divert more of the block grant it gives to local authorities to councils in relatively deprived areas. Setting a national base rate will also prevent any race to the bottom between local authorities seeking to attract and retain their tax base.

However, a degree of flexibility would be allowed either side of the national base rate to allow councils to adjust the Property Tax rate to suit local priorities. To illustrate, if the base rate was set at 0.63% and the degree of variation allowed was 0.1%, councils would be able to set the Property Tax rate between 0.53% and 0.73%. Determining precisely the optimal degree of variation to use in practice will require further, more in-depth research. For the purposes of modelling the Property Tax in the following sections a uniform rate of 0.63% is assumed.

## Comparison with Council Tax

Using the flat rate of 0.63%, Table 2 shows total Property Tax contributions by Council Tax band in relation to equivalent Council Tax contributions, excluding exemptions.

Under property tax 60% of properties (bands A – C) will be made better off. The 1,053,933 dwellings (40% of properties) in bands D – H will be made worse off.

Charging each household the same percentage of their property value means that the Property Tax outlined here is a proportionate tax. Rectifying the regressive nature of Council Tax necessitates large swings at either end of the property value distribution. Whereas band A properties contribute 14% towards Council Tax revenue, they only contribute 5.8% towards Property Tax. This is equivalent to almost a 60% reduction in their tax bill. At the higher end, band H properties experience an 83% increase in their tax bill and would now contribute 2.3% instead of only 1.3%. Swings are more moderate in the intermediate bands. Bands C, D and E experience a 7.3% reduction, a 7% increase and a 9.5% increase respectively.

**Table 3: Average annual contribution per dwelling.**

Sources: UKHPI, Scottish Government

| Council Tax Band | Property Tax | Council Tax | Difference |
|---|---|---|---|
| A | £329.05 | £804.63 | -£475.58 |
| B | £755.60 | £934.64 | -£179.04 |
| C | £974.97 | £1,059.70 | -£84.74 |
| D | £1,255.27 | £1,177.17 | £78.10 |
| E | £1,681.82 | £1,542.18 | £139.64 |
| F | £2,266.80 | £1,879.36 | £387.44 |
| G | £3,875.50 | £2,269.76 | £1,605.74 |
| H | £5,167.33 | £2,863.53 | £2,303.80 |

Table 3 breaks down the difference in annual contributions by individual households. It is assumed property values are distributed equally within Council Tax bands ie. the median property value of a band is the median of the upper and lower limits of that band.

The median band A property will pay £456.93 less in Property Tax than they currently do in Council Tax. The average band B and C properties also experience significant reductions in their annual bill. The 83% increase in the band H tax liability translates to a £2,307 increase in the annual tax bill.

The swings in tax bills at either end of the property spectrum may seem substantial but this simply shows the extent to which poorer households are paying too much under Council Tax. Additionally, the realised reduction in the average annual bill for lower value properties will be smaller as the above analysis does not account for the exemptions and reductions these properties currently experience. Nevertheless, this does not take away from the gains to be made from fixing Council Tax. Addressing the regressivity of Council Tax and ensuring that the least well off in society are not shouldering a disproportionately large share of the burden will allow for a more streamlined and less resource-intensive system of reliefs and exemptions. Since property owners will be paying a fairer amount under Property Tax from the outset, there will be fewer cases where the tax bill needs to be corrected.

It is important to note that this analysis considers only average effects in Scotland as a whole. Considerable variation exists both between and within local authorities. The distribution of property values and across Council Tax bands will vary within each local authority and across different regions of Scotland. For example, almost 60% of chargeable dwellings in East Renfrewshire were in bands E – H. On the other hand, in Inverclyde fewer than 20% of dwellings fall into these bands.

# TAXING LAND

## Agriculture

Almost 80% of land in Scotland is used for agriculture[25]. The effects of land now being taxed in addition to housing will therefore primarily affect the farming industry.

Table 4 shows estimates of the additional revenue which would be gained when Property Tax is applied to agricultural land, assuming the same rate of 0.63%.

Again, presented here is the aggregate Scotland-wide impact. However, arable and pastoral farmland are treated separately due to the significant difference in average land values. The total property tax revenue which would be gained is almost £220m. As this land is currently not taxed, this revenue would be additional to the revenue raised from buildings even when the Property Tax is set at the “revenue-neutral” level of 0.63%.

How property affects individual landowners will of course depend upon the size of the land holding. The distribution between landholdings in Scotland is very uneven. As of 2020, 9% of holdings cover 200 hectares or more each and these encompass 78% of Scotland’s agricultural land[26]. On the other hand, 52% of holdings are comprised of less than 10 hectares each. These holdings accounted for just 1.6% of Scotland's total agricultural land. Based on Scottish land pricing data[27], a large holding of 200 hectares (495 acres) of prime arable land valued at £14,000 per acre would incur an annual Property Tax bill of £43,589 (plus the Property Tax for any dwellings on this land) at the 0.63% rate. Conversely, a small 10-hectare (24.7 acre) dairy farm valued at £2,500 per acre would be charged an annual Property Tax of £389 on its land.

It is recognised that many farms, particularly smaller ones, do not earn a lot of income and an additional tax, even at low levels, could be an onerous burden. It may be that the Property Tax includes a 'tax-free; band of a certain area or value of agricultural land (which could encourage more smallholdings and the breaking up of large estates) or that agricultural subsidies are increased to compensate smaller farmers –particularly if the subsidy is tied to the farm reforming its practices along agroecology principles.

## Shooting Estates

Between 1,000,000 and 1,500,000 ha – 12% to 18% of Scotland's total land mass – are maintained as grouse moors by estates[28]. This land is made up of huge individual land holdings and ownership is therefore concentrated in very few hands.

These landowners claim that grouse shooting is a fragile business and would therefore likely strongly object to these vast expanses of land now incurring a tax. These landowners also claim that grouse shooting is the only possible use for this land and that it is therefore the status quo which will bring the greatest benefits to local economies. However, many groups contest this claim and advocate a democratisation of Scotland land alongside a move away from what is in fact an economically inefficient and environmentally damaging land use practice. Common Weal recently published a report in conjunction with Lateral North which supports this movement[29]. In fact, Common Weal found that almost any land use other than grouse shooting would create more value and more jobs per hectare. An inability to pay a tax on grouse moors could therefore be seen as a further argument for a more productive use of that land.

It has not been possible to estimate the value of revenue from shooting or other estates as reliable estimates of land values are not available. For this reason it is also impossible to estimate the total revenue that the land element of a Property Tax would bring in. However it is possible to look at an individual example. A sporting estate for sale which comprises a five bedroom house, 370 acres of moorland, 670 acres of woodland and 73 acres of grazing land has been valued for sale at offers over £2.4 million[30]. This estate would currently pay only £2995.44 per year in Council Tax on the house with no tax due on the surrounding land. Under the proposed Property Tax set out in this paper and levied at the revenue-neutral 0.63% rate the whole estate would be liable for tax of £15,120 per year.

## Phasing in the Property Tax

Special care will have to be taken to ensure that the Property Tax is introduced in an appropriate manner. Due to the big swings in tax liability at the extremes of the property value distribution, a sudden switch to the Property Tax could be difficult for property rich, income poor households to manage. Moreover, with farmland being newly taxed under this scheme there could be some issues with affordability within the agricultural sector, especially for smallholdings.

The Scottish Greens have suggested a five-year phase-in period where the fraction of tax paid under a new system of taxation increases by 20% each year. To illustrate, households will initially be paying only Council Tax and no Property Tax. After one year, households will pay 80% of their Council Tax bill and 20% of their Property Tax bill. After two years, households will pay 60% of their Council Tax bill and 40% of their Property Tax bill, and so on until by the end of year five households are not paying any Council Tax and are instead paying their full Property Tax bill.

Another suggestion had been made whereby Property Tax is only introduced at the point of sale so new buyers would factor in the tax to the affordability of the property. However, this would mean it would take decades to complete the transition to a Property Tax. It also might discourage wealthy homeowners from moving if they neither want to downsize nor are willing to incur a higher tax bill.

## DISCOUNTS AND EXEMPTIONS

Devising a complete framework of discounts and exemptions is beyond the scope of this paper. However, there are some key issues that policy makers should consider when taking this proposal forward.

As shown by the analysis carried out in this paper, properties at the lower end of the property value distribution will experience a sizeable reduction in their tax bill when switching to the Property Tax. However, this analysis did not take account of the various forms of relief currently afforded under Council Tax. A transition to Property Tax without its own set of discounts and exemptions could therefore still involve an increase in tax liability for certain vulnerable households. In-depth further analysis will have to be carried out to understand for which households the reduction in tax liability is less than the relief they currently benefit from and vice versa. Once it is known how the transition to the property tax affects households who currently receive relief (eg. students, pensioners, low income families), a new system of discounts and exemptions can then be developed which ensures vulnerable households are still protected.

As already mentioned, introducing the Property Tax could present new issues of affordability as land value would now be included in the taxable value. This could potentially pose the greatest problem for smallholders who are operating on already very tight margins. Further research is needed to ensure appropriate measures are identified and implemented to protect smallholders from being unfairly impacted by the tax.

Although similar issues of affordability could arise for Highland estates which maintain grouse moors, there is only a very weak argument for granting similar exemptions. Using land for grouse shooting is uneconomical and environmentally damaging so, rather granting exemptions to allow this practice to continue, the Property Tax could be used as a lever to discourage maintaining land as grouse moors.

Nevertheless, care still should be taken to fully understand how affordable a Property Tax would be under alternative land uses in case the rate at which the Property Tax is set on grouse moors might inadvertently also disincentivize more desirable land uses.

Just as the Property Tax could be used to discourage harmful land use, it could also be used as a means to encourage desirable land use. Discounts and exemptions should be considered for land used in environmentally or ecologically beneficial ways. This could include rewilding land to encourage the regeneration of native plant and animal species of the use of land to produce renewable energy.

## CONCLUSION

This paper has established that Council Tax is unfit for purpose. Despite attempts to address its flaws, it remains an outdated, inefficient and regressive tax. It is clear that Council Tax therefore needs to be abolished and replaced with a new system of property taxation. Common Weal proposes that this system should take the form of the Property Tax set out in this paper.

A Property Tax, as outlined here, will remedy the regressive nature of Council Tax whilst being comparatively easy to understand and implement. It will provide the most effective constraint on house price fluctuations, relative to other proposed replacements to Council Tax. The framework outlined in this paper also means that potentially unwanted incentives concerning property maintenance will be mitigated. The Property Tax therefore represents the best available replacement for Council Tax and a huge step forward to achieving a socially just tax on property wealth.

The time for replacing Council Tax is long overdue. The Scottish Government should not delay in implementing these recommendations and begin the transition to a fair and equitable tax for all homeowners in Scotland.

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