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Mini Review

On implementing a land value tax

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There is a strong theoretical case for a recurrent tax that is levied on landowners based on the value of unimproved land. The key arguments are that such a land value tax would be a) efficient because it would provide a broad and easily identifiable tax base; b) just because it would be correlated with wealth and could be used as a means of re-distribution; c) un-distortive because it would not disincentivise improvements in the way that a tax on buildings can; and d) beneficial for development by creating an economic incentive to bring forward under-utilised land if it is valued based on its highest and best use.

Key words: Landowners, efficient, stakeholders, policymakers

INTRODUCTION

However, although there are instances of land value taxation in various forms around the world (including in Namibia, Estonia, Denmark and parts of Australia and the Americas), these are relatively few and far between Instead, governments have tended to prefer to tax land and buildings based on their combined value, or to use event-based taxation to capture a proportion of development value (Dye et al., 2010, Mirrlees et al., 2011, Foldvary et al., 2017). For example, by virtue of 2004 legislation, the South African government abolished a form of land value taxation that had been in place for many decades in favour of a property tax that is levied on the value of land and buildings (Franzsen et al., 2017).

In a paper I co-authored with colleagues at the University of Reading (Hughes et al., 2020), we reviewed the existing academic literature concerning the operation of actually existing forms of land value taxation around the world, past and present. We found that there are important practical issues that can act as a disincentive or barrier to the introduction of a land value tax, or which would require careful consideration by any policymakers committed to its introduction.

LITERATURE REVIEW

Purpose of the tax

Some of the theoretical benefits of land value tax are to do with its potential to influence behaviour (e.g. bringing land forward for development), or its relationship with political objectives (e.g. wealth redistribution). Others are to do with its revenue-generating potential (e.g. paying for local services). It would be essential for policymakers to be clear about what objectives they are seeking to achieve. This would be to ensure that the tax is properly designed to maximise the potential of achieving its objectives, but also so that governments can clearly and convincingly communicate this rationale to taxpayers to maximise the potential for political acceptance. For example, if the tax has a redistributive (rather than solely revenue-raising) objective, this would need to be carefully handled. The Namibian experience is instructive here. A form of land value tax on commercial farmland was introduced there as part of post-independence land reform and was partly designed to discourage ownership of multiple farms (United Nations, 2011). This was considered to have been handled with sensitivity via extensive consultation with stakeholders, including white farmers, and has subsequently been judged a success (Franzsen et al., 2017).

Land administration

Crucially, for a land value tax to be operational there would have to be a complete and accurate register of taxable land ownership so that the taxpayers can be correctly identified. This may be a major undertaking in countries where such a register does not already exist. The idea of a land value tax developed in a context in which there were usually systems of land ownership with a single, identifiable owner on whom the

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tax could be levied. However, in contexts in which there are other forms of land ownership (such as customary land), careful thought would need to be given regarding the identification of the taxable entity. The limited introduction of a land value tax on commercial farmland in Namibia has been successful partly because there was a relatively transparent system of ownership of such land.

Valuation

A land value tax should properly be levied based on the value of unimproved land - that is to say, the value of the land excluding any value attributable to structures on the land, or any other improvements such as crops. However, it is difficult to conduct a valuation that separates the value of land from any improvements as these are not typically traded separately. There may not be sufficient comparable evidence of unimproved land sales on which to base a valuation and alternative approaches, such as a residual valuation in which the value of the improvements are subtracted from the total value to derive the land value, can be subject to considerable uncertainty. This poses the risk that the resultant valuations may be complex and may not be seen by the taxpayer as being sufficiently robust, and so could be open to challenge. Such issues were part of the reason that South Africa moved away from land value taxation (McCluskey et al., 2005). These challenges are not insurmountable - for example, Milan et al. (2016) advocate the Danish approach of using GIS modelling with hedonic pricing techniques. However, to address these valuation issues adequately would require a well-resourced and trained body of government valuers who are able to conduct regular valuations of all taxable land.

Development

One of the theoretical arguments in favour of a land value tax is that it could incentivise the development of land if the valuation is based on the highest and best use of land, rather than existing use (although this would only be effective where there is sufficient value to make development viable). However, as discussed, it is difficult to conduct a valuation of land in its existing use excluding improvements and attempting to determine what this value should be assuming the land is developed to its highest and best use adds an additional layer of complexity and uncertainty. Furthermore, if this is going to be considered by policymakers, then they would need to be clear about how such a system of taxation would interact with the urban planning system, which is the institution by which land use (and, therefore, highest and best use) is determined.

Tax base and rates

The most equitable approach to land value taxation would be to levy the tax on all land at the same rate. However, this could bring the tax into conflict with the ability of some taxpayers to pay as some landowners may be asset-rich but cash poor (the so-called ‘poor widow’). In practice, there are often differential tax rates, reliefs and exemptions that may affect different types of land, from residential, to agricultural, to church, to state-owned land. Ultimately, such decisions are political. However, what land to include in the tax base, what threshold rates should apply to various types of land, how progressive rates should be set, whether payment on some kinds of property (such as that owned by older people) should be deferred would all need to be carefully considered. Getting these judgements right would not only be important for the economy (for example, so as not to extinguish viable agricultural businesses by setting the rate too high) but also for political acceptance (for example, by not being seen to penalise the most vulnerable).

Relationship to other taxes

The idea of political acceptance runs through many of these points. The relationship with other forms of taxation is no different. The introduction of a new form of tax, such as a land value tax, would be unlikely to obtain political acceptance if it was perceived as significantly increasing the liability of taxpayers. Therefore, how any new tax interacts with existing forms of property tax should be an essential consideration. The tax base or tax rates of existing property taxes may need to be adjusted in response to the introduction of a land value tax, or abolished entirely.

Governance and administration

Decisions about the rationale for the introduction of a land value tax should be closely related to how it is administered – in particular, by what tier of government. In actually-existing forms of land value taxation there are a variety of means of administration and collection. For example, in some jurisdictions such as Queensland, Australia there is a state (sub-federal) form of land value tax as well as a local tax (Mangioni, 2016). It would make sense for a land value tax whose revenue will be used to pay for local services to be locally administered. A tax that has more wealth redistributive objectives or is used to fund the central administration could be administered centrally. However, it would be important for taxpayers to clearly understand why the tax is being collected.

CONCLUSION

These are some of the issues with which policymakers past and present have grappled when considering the introduction of a land value tax. However, given that land value taxation in some form is currently in operation in various places around the world, including in Namibia, it is clear that challenges can be overcome given sufficient planning, resources and political will. There would need to be investment in the capacity and expertise of valuers, a well-resourced and transparent land register, careful consideration as to the objectives of such a tax and correspondingly assiduously designed rates, reliefs and exemptions. Most importantly of all, it would be essential for any government seeking to introduce a land value tax to consult with stakeholders and clearly communicate its rationale and objectives to ensure that the tax is considered legitimate and fair.

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