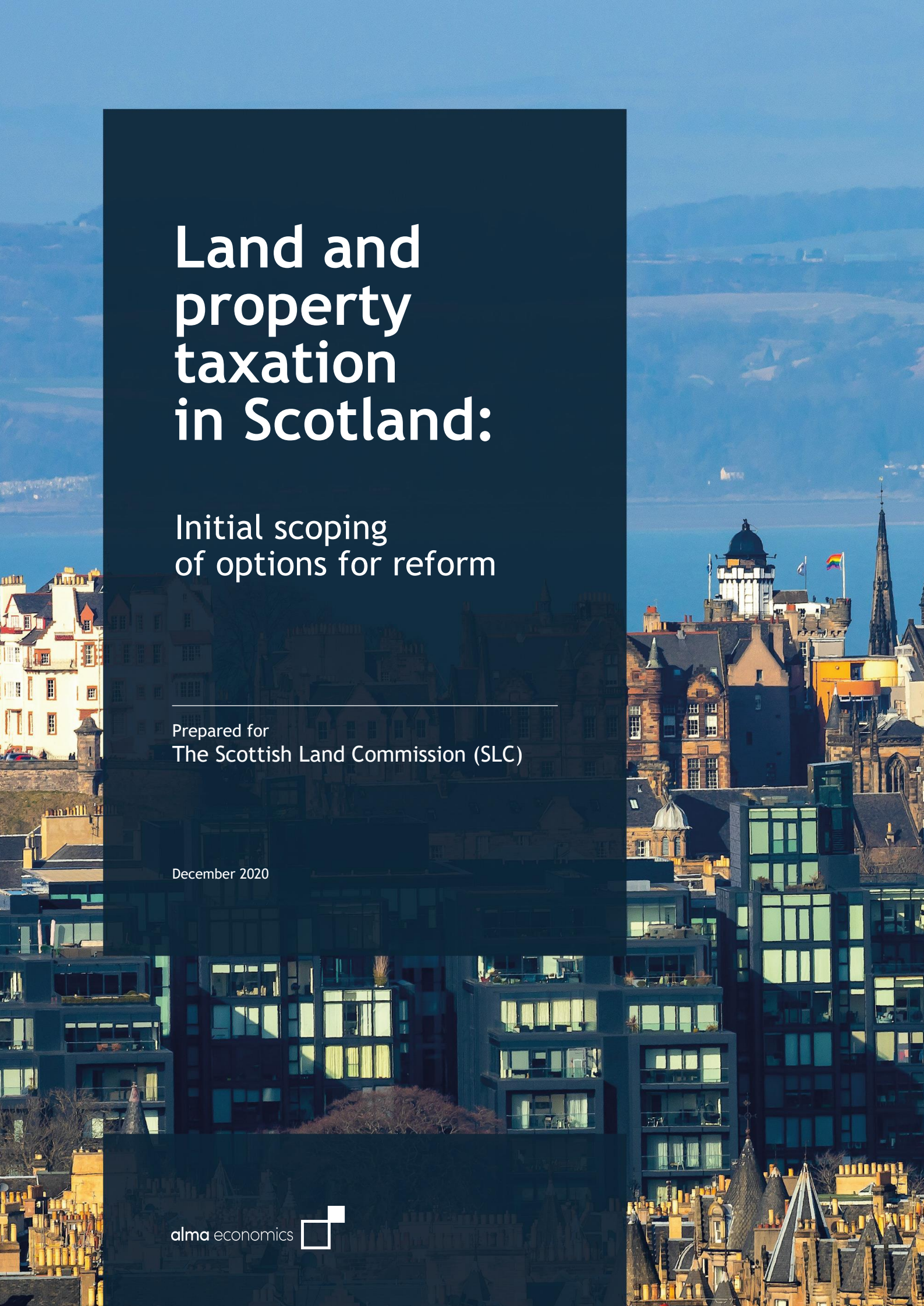

Land and property taxation in Scotland:

Initial scoping of options for reform

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Executive summary

Taxes on land and property can serve as a powerful tool for helping Scotland develop a robust, resilient wellbeing economy. As part of its first-in-the-world Land Rights and Responsibilities Statement, the Scottish Government has committed to empowering communities and creating inclusive, sutainable economic growth, a goal that has become even more pressing given the disproportionate impact of the Covid-19 pandemic on the most deprived areas of Scotland. In this challenging environment, well-designed tax instruments can enable the Scottish Government to achieve a number of objectives: stimulating economic recovery, working towards fiscal sustainability and pivoting towards a regionally-focused development model that provides the basis for a more dynamic, productive and fairer economy.[1]

The Scottish Parliament has responsibility for a wide range of taxes, including council tax, non-domestic rates and Land and Buildings Transaction Tax (LBTT), which could be used as levers to achieve land reform objectives, as well as the option of introducing new local taxes designed to fund local authority expenditures. Corporation tax and inheritance tax also have the potential to influence land ownership and use, though these are reserved taxes that require action from the UK Parliament, while income tax is partially devolved. However, land and property currently represents a small proportion of the total tax base, with just 12% of all public sector revenue across reserved and devolved taxes in Scotland raised through taxes fully or partially levied on land and property. These taxes have the potential to fund crucial fiscal measures to stimulate demand, and their ability to effectively incentivise behavioural change allows them to play a key role in reducing inequalities and empowering individuals and communities in Scotland to live up to their fullest potential.

Taxes on land and transactions involving land are widely used around the world to raise revenues, reduce inequality and promote more effective land use and management. These taxes contribute to creating a fairer economy by targeting economic rent, or gains in land value derived from public policy as opposed to individual landowner actions. In addition, they often serve as an important source of revenue for financing public services and infrastructure, and recent research has demonstrated that they are the least distortive type of tax in terms of long-term growth compared to other tax instruments such as taxes on corporate or personal income.

By shaping household and business behaviour, taxes can help achieve long-term outcomes for land reform, such as expanding the supply of land for housing, reducing the amount of vacant and derelict land and increasing community ownership. A review of international evidence shows that well-designed taxes can complement existing Scottish Government policies working towards land reform:

- **More diverse land ownership**: Land in Scotland currently benefits from a wide range of tax incentives, including reduced liabilities for non-domestic rates, inheritance tax (through Agricultural Property Relief and Business Property Relief) and capital gains tax (through rollover relief). While many community bodies are eligible for charitable status, which offers similar tax exemptions, providing further tax incentives on community ownership or purchase of land could increase the number of communities exercising control over land. Alternatively, tax incentives that enable unbroken transfer

[1] This aligns with the policy recommendations outlined in the Advisory Group on Economic Recovery's June 2020 report: https://www.gov.scot/publications/towards-robust-resilient-wellbeing-economy-scotland-report-advisory-group-economic-recovery/

of land ownership across generations could be reduced to diversify patterns of land ownership.

- **Reducing the number of vacant and derelict sites**: A number of major cities have implemented higher tax rates on vacant sites, especially urban and agricultural lots, to encourage their use. Other governments have imposed a split-rate system, which levies higher rates on land relative to development. However, successful implementation of these policies requires consideration of the unique characteristics of local communities, including patterns of land use as well as business models of landowners. To address the unique needs of brownfield sites that may require significant investment before they are able to be developed, tax credits for expenditures on remediation, similar to the existing Land Remediation Relief programme in the UK, have been successful in encouraging investment into derelict sites.
- **Expanding agricultural tenancies and joint-venture farming:** There is mixed evidence on the ability of taxes to influence specific agricultural practices such as succession planning or sustainable environmental practices. However, recent reforms to income tax and succession planning in Ireland hold promise in their potential transferability to Scotland. If used to encourage activities such as tenant farming, potential tax instruments must carefully consider farm size, organisation and existing arrangements between agricultural landlords and tenants.
- **Expanding the supply of land for new housing:** The wider evidence base suggests that the supply of land for new housing is likely to be relatively unresponsive to a tax on the value of land. Alternatively, betterment levies, tax increment financing or development impact fees can help cover the costs of new infrastructure development and increase the amount of land available for development. The success of these policies is closely tied to their ability to serve as a source of local government revenues, low administrative burdens and transparent design.

This report concludes by proposing a number of areas for further research into potential reforms to land and property taxation that build on Scottish Government policy objectives. These areas for further research are based on policy objectives that draw from the Scottish Government's National Performance Framework and Land Rights and Responsibilities statement as well as the strategic objectives of the Scottish Land Commission, including diversity of land ownership, stewardship, productivity, accountability and fairness. This preliminary list of policy options is not comprehensive. Instead, they would be added to during further research ahead of narrowing down to a small list of firm proposals based on in-depth analysis of options.

Assessment of tax measures under each area for further research would include examining behavioural effects, impacts on receipts, distributional implications as well as legislative and administrative issues. While the specific criteria used to judge effectiveness would vary from policy to policy, they would ultimately be measured by their ability to work towards the Scottish Government's National Outcomes as part of the National Performance Framework.

1. Introduction

Land ownership, management and use are shaped by a wide variety of factors, including government policies and regulations, geographic location, existence of nearby infrastructure and other public services and markets for housing and agricultural commodities. Each of these factors can be influenced by a broad range of tax instruments that target land sales, purchase or usage. These instruments can have a variety of purposes, including raising revenue, capturing increases in land value, encouraging sustainable development or incentivising affordable housing, among others.

One of the most common forms of taxes designed to achieve land reform objectives is a tax on land value. Economic theory makes a strong case for taxing land value due to its ease of enforcement and ability to capture unearned windfall gains, known as economic rent, without distorting individual or business behaviour. However, implementing taxes on land is often challenging: valuation is subjective and often opaque, and taxes may be politically unpopular, which is a common feature of taxes not attached to income flows. In addition to taxing land directly, a number of other tax instruments can provide direct and indirect incentives for particular land-use decisions. If policymakers pay close attention to appropriate tax design, administration and enforcement, these tax instruments, as part of a broader land reform package, can serve as a powerful tool in promoting a fairer, more productive economy.

Under the provisions of the Land Reform (Scotland) Act 2016, the Scottish Government has developed a Land Rights and Responsibilities Statement outlining key principles around ownership, use and management of land to guide land policy and practice in Scotland. This statement, the first to articulate rights and associated responsibilities with respect to land in Scotland, sets out a vision for the relationship between the people of Scotland and their land and takes a human-rights approach through promoting respect for economic, cultural and social rights and internationally accepted guidelines. The Scottish Land Commission (SLC), the primary public body overseeing land policy in Scotland, is committed to supporting realisation of the Land Rights and Responsibilities Statement's principles through expert guidance and advice.

This report explores potential options for using taxes to help implement the key principles upheld in the Scottish Government Land Rights and Responsibilities Statement and to work towards the outcomes of the National Performance Framework. Taxes impacting land use can serve as a powerful tool to foster a fair, inclusive and productive system of land ownership, management and use that benefits all people of Scotland, generates broadly-shared economic growth and empowers communities. By reviewing cross-country experiences with taxes impacting land use and both theoretical and empirical evidence on their effectiveness, including UK-specific discussions in the Mirrlees and Barclay Reviews, this report works towards improving the Scottish Land Commission's understanding of the impact of tax policy and land ownership and use. In addition to reviewing the wider literature on property taxation, key insights were informed by speaking with a number of policy stakeholders in Scotland. The conclusion of the report identifies a series of areas for further work through making greater use of land in Scotland and sharing the benefits of land more widely.

Wider context

Taxes on land and property as a proportion of overall taxation

The Scottish Government has seen its powers over taxation grow in recent years. Scottish tax

revenues reached £21 billion in 2018-19, which accounts for over half of total budget funding and around 65% of the resource funding available to the Scottish Government (Scottish Government 2019). The four primary sources of tax revenue are Scottish income tax, Land and Buildings Transaction Tax, Scottish landfill tax and non-domestic (business) rates. While income tax is primarily set by the UK Parliament and administered by HM Revenue and Customs, the Scottish Government has the ability to set tax band thresholds (excluding personal allowance) and rates on non-dividend, non-savings income. The majority of the total £17.4 billion in devolved tax revenue raised in Scotland reflects taxes on labour income (£11.5 billion), with just £5.7 billion coming from taxation of land or property. The UK as a whole collects just 12% of total tax revenues from taxes on use, ownership or transfer of land or property, which is significantly less than goods and services (32%), personal income (27%) or social security contributions (19%) (OECD 2019). Though it is generally not possible to estimate the proportion of reserved tax revenues receivable from Scotland, the 2018-19 Government Expenditure and Revenue in Scotland (GERS) report geographically apportioned HMRC data and estimated that 12.3% of all public sector revenue across reserved and devolved taxes was raised through taxes fully or partially levied on land or property (Scottish Government 2019).[2]

The changing policy landscape due to Covid-19

The current Covid-19 pandemic has already changed the policy landscape significantly. At the time of writing, it has led to a significant reduction in economic activity, with estimates suggesting that over 30% of workers in Scotland may have been furloughed in addition to rising unemployment and increased risk of companies going into administration (Spyropoulos and Laabid 2020a).

It is still too early to know the full economic impact from Covid-19, but early evidence suggests it has disproportionately affected low-income families. For example, in the UK only 1 in 4 workers in the bottom 20% of wage earners are able to carry out their work duties remotely compared to 3 out of 4 workers in the top 20% (Spyropoulos and Laabid 2020b). This will be an important part of shaping the policy response during the recovery.

In the short run, government policy is required to support the economic recovery in Scotland. This is likely to require a role for expansionary fiscal policy, which can be delivered at least partly via tax reliefs on a temporary basis or as part of structural reforms to boost productivity and to increase redistribution. While taxes that shape land use are unlikely to present many options for short-term fiscal stimulus (in part because they represent a small proportion of existing taxes), structural reforms to these taxes could provide a critical productivity and revenue boost to support the recovery and ensure fiscal sustainability over the medium and long run.

[2] This includes council tax, non-domestic rates, capital gains tax (CGT), inheritance tax, stamp duties, Land and Buildings Transactions Tax (LBTT) and Scottish landfill tax.

2. Existing land and property taxes in Scotland

- While fiscal policy in Scotland is generally a reserved matter, the Scottish Parliament has responsibility over a range of taxes, including local taxes designed to fund local authority expenditures.
- Land in Scotland is currently subject to Land and Buildings Transaction Tax (LBTT), council tax and non-domestic rates.
  - The LBTT functions similarly to an income tax, with charges proportionate to actual property prices and different tax rates applying to the portion of the purchase price within specified tax bands.
  - Council tax and non-domestic rates are levied on property values for households and businesses, respectively
- Each of these taxes has its strengths and weaknesses. While the LBTT was introduced relatively recently (2015), the Scottish Government has commissioned reports examining potential reforms to both council tax and non-domestic rates.

Under the Scotland Acts 1998, 2012 and 2016, the UK and Scottish Parliaments share responsibilities over policy: reserved matters remain the responsibility of the UK Parliament alone, while the Scottish Parliament has authority to legislate on devolved matters (any issue that is not a reserved matter). While fiscal policy is generally a reserved matter, the Scottish Parliament has control over a specific set of taxes: earnings income above the personal allowance, local taxes such as council tax and non-domestic rates and the Land and Buildings Transaction Tax (LBTT). In particular, the Scotland Act 1998 devolved powers over any “local tax to fund local authority expenditures”. Thus, the Scottish Government has the ability to introduce new forms of taxation in Scotland in the absence of any limiting statute from Westminster and if the revenue would be used to fund local authority spending only. In addition, the Scotland Act 2012 allowed the Scottish Parliament to create new taxes (including on activities not currently taxed under the UK tax code) with prior consent of Westminster, though the Scottish Government has not yet indicated a desire to use this power.

Land and Buildings Transaction Tax

The Land and Buildings Transaction Tax was introduced in Scotland in 2015 to replace the UK-wide Stamp Duty Land Tax (SDLT). This tax is administered and enforced by Revenue Scotland, with support from Registers of Scotland. It is levied on residential and commercial land and buildings transactions where chargeable interest is acquired. Similar to an income tax, LBTT follows a “slice” system: charges are proportionate to actual property prices, with the percentage rate for each band only applying to the portion of the property price above the specified threshold. Non-residential leases are subject to the lowest rates, followed by non-residential properties and residential properties (taxed at the highest rates). Additional features of LBTT include:

- Individuals acquiring additional residential properties are required to pay the Additional Dwelling Supplement, a supplementary charge of 4%.
- First-time buyers do not pay LBTT up to a purchase price of £175,000, higher than the

usual residential property zero-rate threshold of £145,000.

There is a lack of consensus about whether taxes on property transactions are an efficient tax, as the level of transactions is relatively sensitive to the level of taxation. OBR (2017) apply a behavioural factor in which a 1 percentage point increase in SDLT reduces prices by 1.5% and transactions by 4.5%, i.e. the transactions effect is three times greater than the price effect, whereas for most property taxes the majority of behavioural impact is on prices. However, LBTT still has the beneficial property that it has a tax base that is not part of Scottish GDP and thus reduces GDP less than taxes on income or profits.

Non-domestic rates

Non-domestic rates provided 21.3% of all funding for local authorities in 2018-19 (Berthier et al. 2019). For these rates, businesses are required to pay 49p for each £1 of their property's rateable value, and this level is set nationally across Scotland. Businesses with a rateable value greater than £51,000 are required to pay an additional large business supplement of 2.6p per £1. Revenue raised from business rates is collected centrally, then re-distributed to local authorities using a formula agreed upon with the Convention of Scottish Local Authorities (COSLA). This formula is based on local authorities' latest mid-year income returns, and higher revenues are balanced out with a reduced Scottish Government grant to ensure that local authorities with fewer businesses or lower property values receive disproportionately more grant funding.

A significant tax relief for non-domestic rates is empty property relief, in which empty properties get 50% relief from non-domestic rates for the first three months they are empty and 10% discount after that. In the case of empty industrial properties, the 100% relief applies for a period of six months. The Fresh Start program, designed to incentivise development of empty properties, provides businesses with 100% relief during their first year occupying an empty property if the property has a rateable value of less than £65,000 and had been previously empty for at least six months.

In addition, 16 enterprise areas have been set up across Scotland focusing on the life sciences, manufacturing and low carbon/renewable industries. To encourage businesses to move to these areas, the Scottish Government has offered a discount on non-domestic rates over a three-year period and enhanced capital allowances, along with other incentives.

As highlighted by Mirrlees et al. (2011), the current system of non-domestic rates discriminates in some cases between different types of businesses through exemptions. Perhaps most relevant to land policy, business rates are currently levied at reduced or zero rates on unused or undeveloped land, which encourages landowners to use land inefficiently as developed properties face higher tax burdens than vacant land. The 2016 Barclay Review considered reforms to local business taxation to better support business growth and long-term investment. In its final report, the Review outlined a broad range of proposals, in particular a local land value tax that would exist alongside business property taxes.

However, there is a case to be made that business rates are overall an economically efficient tax as the majority of business rates incidence falling on prices. Bond et al. (2013) demonstrate empirically that for tenants, the majority of the impact of business rates is capitalised in rents, so each £1 of business rates charged is associated with nearly a £1 reduction in pre-tax rent. This means that the majority of the incidence of business rates will fall on landlords rather than tenants.

Council tax

Council taxes provided 17.9% of all funding to local authorities in 2018-19 (Berthier et al. 2019). In line with the other constituent countries of the UK, the amount paid for council tax is determined by property values that fall within eight pay bands. Thresholds for these bands are based on property valuations conducted in April 1991. While the ratios between these bands are set centrally by the Scottish Government, the specific amount of council tax across local authorities can vary up to a maximum annual increase of 4.79%. As with non-domestic rates, council tax revenues impact funding received as part of the Scottish Government grant. The current system allows for reductions for second homes or short-term empty and unfurnished homes if for sale/rent or in the process of renovating. Councils have the option of imposing a 100% surcharge for properties that have been empty for at least one year.

Council tax has several important advantages: evasion is difficult; revenues are stable from year to year, which helps with future planning; and taxing housing allows scarce housing resources to be used more effectively (Crawshaw 2009). However, valuations have not been systematically updated since 1991, which introduces significant inequalities between local areas based on differences in the growth rate of house prices. The current system is also generally regressive, with council tax as a percentage of property value lower for higher value houses (which serve as a rough proxy for income).

There have been several attempts at introducing broad reforms to council tax in Scotland. The 2006 Burt Review examined potential local tax reforms, recommending replacing the existing council tax system with a local property tax set as a proportion of total property value. In addition, a 2015 report jointly published by the Commission on Local Tax Reform and Convention of Scottish Local Authorities supported abolishing council tax in favour of multiple tax instruments, including a tax on domestic property (The Commission on Local Tax Reform 2015). However, the Scottish Government has favoured a more incremental approach: council tax rates were frozen between 2007-2008 and 2016-17, after which the Scottish Government raised ratios for the four highest bands and granted councils the authority to increase council tax up to a maximum amount each year.

3. The case for taxes to shape land policy

- Since most taxes have spatial consequences, there are a broad range of tax instruments that can be used to shape land use, ownership and management patterns.
- Four key aspects to consider when designing a new tax:
  - Economic efficiency,
  - Administration and compliance costs,
  - Fairness, and
  - Transparency.
- Land is generally a very good tax base because:
  - Taxation of land does not reduce the amount of it, whereas taxes on incomes and profits reduce incentives to generate them,
  - Land is a natural tax base for local revenue-raising, and
  - Land taxes can incentivise productive land use.

What makes a good tax?

Trade-offs are inherent in taxation: while taxes are necessary to finance government spending on vital public goods and services, they have a significant impact on individuals' and businesses' behaviour, often in negative ways. The vast majority of taxes push up prices (the "price effect") or discourage the activity they are taxing (the "quantity effect"), reducing overall economic activity. In addition to these short-term behavioural effects, taxes can also have significant long-term (or dynamic) effects that are often less well understood. Finally, who actually bears the burden of paying the tax (economic incidence) may not align with the individual legally responsible for paying the tax (legal incidence). A "good" tax is therefore a tax that achieves its intended goal (such as raising revenue) while minimising potential negative short-term and long-term impacts. It is also important to consider potential opportunities for individuals to find ways to not pay the tax via aggressive tax planning, tax avoidance and tax evasion, which reduces the intended impacts of the tax.

The Scottish Government has proposed four aspects to consider when designing a new tax:

- **Proportionality to ability to pay:** There are two primary ways of measuring fairness in taxation, horizontal equity (those with equal ability to pay should pay the same) and vertical equity (those with greater ability to pay should pay at least as much).
- **Efficiency:** By driving a wedge between the price paid by buyers and the price received by the seller, taxes may prevent mutually-beneficial transactions from taking place. The loss of welfare from these transactions is called deadweight loss by economists, and a good tax should minimise this excess burden. In addition, a good tax should seek to minimise how much it distorts incentives.
- **Convenience:** A good tax should be as simple as possible for authorities to collect/enforce and for taxpayers to pay.

- **Certainty for the taxpayer:** A good tax should be designed in a manner that is straightforward for taxpayers to understand.

These aspects closely align with the principles proposed as part of the 2011 Mirrlees Review of the UK tax system. In this report, assessment of current land tax policies in countries around the world will be based on these four aspects. The proposed framework will also take into consideration the Scottish Government's and Scottish Land Commission's broader objectives, including impact on diversification of land ownership, vacant and derelict land, agricultural land access and housing.

An overview of taxes on land

Taxes are an effective tool to achieve land reform objectives because they provide incentives that influence decision-making around land use, ownership and management. In addition, they allow for market mechanisms to determine the most suitable model of land use in a given location. In contrast, planning regulations may be overly rigid because they must specify when and how particular forms of land use occur. This means that there is a trade-off between flexibility and predictability: whereas traditional land-use planning is able to influence what is happening with a particular land holding, tax instruments do not affect land use directly but instead influence general patterns by incentivising private actors to behave differently. Ultimately, well-designed tax instruments, when developed in conjunction with the planning system, are able to set the right incentives that encourage individuals, businesses and communities to make decisions in line with land reform objectives. These tax instruments can also reduce the need for specific planning regulations, increasing the flexibility of the planning system. A framework for systematic monitoring and evaluation is key to addressing increased levels of uncertainty, allowing for policymakers to better understand what does and does not work and respond quickly if needed.

Since most taxes have spatial consequences, there are a broad range of tax instruments that can be used to shape land use and management patterns. Taxes on the value of property are the most common, though other policies include transport-related fiscal instruments (such as fuel taxes), financial support for farmers through direct and indirect subsidies, land value capture mechanisms, tax credits for redevelopment and rehabilitation and use-value tax assessments (OECD 2017). The instrument that arguably has the most direct impact is taxing the value of land, an approach used by over 30 countries, including Denmark, Japan, South Korea and both the United States and Australia at the sub-state level.

Economists have put forth a number of arguments for land taxation:

1. The supply of land cannot be altered in response to tax, and landowners only suffer a windfall loss on announcement (Mieszkowski 1972).[3] Unlike income taxes, taxes on land are hard to avoid because land cannot be hidden. In general, taxes on immovable property, especially residential property, are the least distortive in terms of long-term growth compared to other tax instruments such as taxes on corporate or personal income (OECD 2008).

2. Since land (and property taxes more generally) are largely local taxes and the value of land is frequently determined by community effort (infrastructure or planning permission, for example), then these taxes can be seen as a charge for local

[3] In practice, the supply of land is somewhat elastic as the amount of land available for development is affected by planning regulations. However, as this is a policy variable, changes to the supply of land due to tax policy can be compensated for by relaxing regulations.

government services.[4]

3. The tax base is more stable and therefore more predictable than taxing personal or corporate income, as property values do not fluctuate as much during business cycles (Joumard and Kongsrud 2003). In particular, taxes on immovable property can dampen the inherent boom-and-bust cycle of property markets. The dampening effect has remained stable over the last 50 years, including during and after the 2008 financial crisis, though the relationship is weak (Blöchliger et al. 2015).
4. Land taxes can help internalise potential negative externalities of land use by reducing development pressure or re-directing development towards areas already well-connected by infrastructure. A pure land tax incentivises landowners to put land to best use (as the land tax is a fixed cost paid whether or not the land is used for production).

However, introducing a tax on land values in the UK has been historically difficult. Despite introducing the first betterment tax in the world in 1909, an Incremental Value Duty levied at £1 for every £5 of value, the UK has failed five times to implement sustainable development taxes in the post-World War II era. The latest attempt at UK-level reform, the 2004 Barker Review, dropped consideration of a planning gain supplement in favour of extending the existing system of planning charges.

More broadly, implementing a new tax on land value, whether to supplement or replace the existing council tax and non-domestic rates system, generates several categories of winners and losers:

- Owners of properties with a high land to capital ratio (car dealerships, large rural estates) will experience an increase in tax liabilities, while owners of properties with a low land to capital ratio (high-rise office buildings) will see their tax liabilities decrease.
- The economic incidence of a land value tax falls on landowners (freeholders), while the economic incidence of the current system of council tax and non-domestic rates falls on occupiers. While in theory this difference should not matter (Kay and King 1990), switching to a land value tax may impose significant transitional costs for Scottish business premises currently let on long-term leases.
- Land valuation is also subjective and often difficult to carry out at a reasonably disaggregated level. If the number of previous transactions are low, it becomes difficult to separate out the value of the land from the value of the overlying structures. Good assessment practices, such as frequent reappraisals, generate winners and losers as some relative rates would decrease while others would increase.

Finally, land taxes suffer from a general lack of awareness and knowledge among the UK public. A 2015 report by the Commission on Local Tax Reform found many concerns into how land taxes would work in practice, including potential application to tenement properties, properties with mixed residential and commercial components, rural areas (especially agricultural land and crofting) and non-domestic properties (The Commission on Local Tax Reform 2015).

Despite the significant advantages of a tax on land value compared to taxes on labour or capital income, there are a number of political economy concerns around such a tax that must be carefully addressed as part of tax design. As a result, the OECD has recommended that a

[4] This view comes from the model in Tiebout (1956), but was also held by Henry George in the 19th century.

combination of taxes as well as land-use planning will be more effective at incentivising landowners to change their behaviour, protecting specific land plots or fostering specific land use patterns (OECD 2017). In line with this guidance, this report will examine a broad range of tax instruments to achieve land reform objectives, taking into account interactions with the broader fiscal structure and planning system in Scotland.

The range of tax instruments to achieve land reform objectives potentially also includes reforms to council taxes and non-domestic rates to increase their equity and efficiency, which have been discused extensively in Mirrlees et al. (2011), Hughes et al. (2018) and Adam et al. (2020). However, like taxes on land value, reforms to council tax and non-domestic rates have long faced significant political opposition and would be relatively difficult to implement.

Evidence on the impact of land taxes

Assessing the impact of existing land value taxes is challenging. First, economic theory suggests that switching to land value taxes should lead to lower prices, increased investment, higher employment and less urban sprawl. However, the effect on labour market outcomes is likely to be small compared to other economic factors and government policies, and there is limited data available on construction activity. In addition, confounding variables make it difficult to directly compare jurisdictions with land taxes and those without. While it is possible to control for variables such as interest rates and population growth that would otherwise impact new investment activity, there may be other differences in tax regimes that drive differences in outcomes.

In general, existing research on land value taxes has examined a number of economic impacts: development intensity (Song and Zenou 2008; Cho, Kim and Roberts 2011), sustainable development (Wenner 2018), land ownership patterns (Poudyal and Hodges 2009) and tax burden (Wyatt 2018). A full literature review of the impact of land value taxes was previously carried out by the Scottish Land Commission in 2018 (Hughes et al. 2018).

4. Diversification of land ownership

- Land ownership remains highly concentrated in Scotland, a product of historical relationships between owners and tenants during the 18th and 19th centuries. Many estates have maintained a continual pattern of ownership for decades, if not centuries.
- Over 90% of land is classified as agricultural or forestry, which benefit from relief on non-domestic rates, inheritance tax and capital gains tax by private estate owners. The favourable fiscal environment for these types of land may have pushed up the price of agricultural land, limiting the number of new landowners.
- The Scottish Government has developed several policies to address concentrated land ownership, including community right-to-buy. If designed correctly, tax policies could incentivise greater take-up of these policies as well as encourage innovative models to achieve diversity in ownership.

Policymakers and academics have long recognised that Scotland's concentration of land ownership is among the highest in the world. Hindle et al. (2014) estimated that around 57% of rural land was held under private estates, 13% by public bodies, 3% by community organisations and 2% by environmental organisations. In particular, 1,252 owners held 67% of privately held rural land, which ranks as one of the most concentrated patterns of land ownership in Europe. In addition, the rural land market experiences relatively little turnover, with 50% of the estates surveyed in Hindle et al. (2014) held in ownership for at least 50 years.

This pattern of concentrated ownership largely grew out of two significant events: enclosure (landlords taking over land previously held by tenants) and the Highland Clearances (the large number of tenant evictions between 1750 and 1860 to allow landlords to use their land for more profitable uses). The Crofters' Holdings (Scotland) Act 1886 attempted to restore the balance of power between owners and tenants by granting security of land tenure to crofters, individuals who held and worked small agricultural units, and developing the Crofters Commission to arbitrate in disputes. Land reform accelerated under the Labour government elected in 1997, which established the Land Reform Policy Group (under the guidance of then-Scottish Office Minister of State Lord Sewel) and the Scottish Land Fund to support rural communities to purchase land. This was followed by several important pieces of legislation aimed at making it easier for communities to purchase the land they live on (Bryden and Geisler 2007):

- The Abolishment of Feudal Tenure etc. (Scotland) Act 2000 replaced the long-standing system of feudal superiorities and tenure with a system of outright ownership.
- The Land Reform (Scotland) Act 2003 created a legal framework for responsible access to land and established a mechanism for community right-to-buy, allowing community interests to register an interest in land and purchase that land at market value once offered for sale.
- The Agricultural Holdings (Scotland) Act 2003 established a framework for agricultural

tenancies, including provisions for right-to-buy and use for non-agricultural purposes.

- The Community Empowerment Act (Scotland) 2015 extended community right-to-buy to communities of all sizes, including those in urban areas. The scope of eligible land was extended to land that was abandoned, neglected or causing harm to the environment.
- The Land Reform (Scotland) Act 2016 extended community right-to-buy to sustainable development, empowering ministers to compel land sales if they furthered sustainable development.

While estates often positively impact communities by creating jobs and spending in local businesses, they have also been shown to diminish community capacity (Fischer and McKee 2017). These potential negative impacts were supported by a 2019 SLC report, which found that concentrated land ownership often caused significant and long-term damage to communities, including weakened social cohension and constraints on economic development (Glenn et al. 2019). In response to these concerns, the Scottish Government has generally emphasized community ownership as one way of strengthening economic growth (by encouraging development of resouces that may be overlooked by private investors) and local democratic governance over land use and management (Hoffman 2013).

Agricultural Property Relief

As discussed earlier, Agricultural Property Relief (APR) exempts individuals from paying any inheritance tax on the agricultural value of land and property (50% if the land is under a long-term letting arrangement). Individuals can pay tax upon death or through transfer payments over ten-year instalments. Proponents claim this relief helps prevent the sale or break-up of family businesses upon death due to high tax liabilities, especially in the case of one side of the family wanting to continue the business and the other side does not (Chamberlain 2016). In this situation, the relief makes it easier for the first side of the family to buy out the second due to less-restricted cash flow. In addition, farms will be able to make succession plans more easily without having to fear unexpected tax charges upon intergenerational transfer.

It is unclear if the relief, as currently structured, actually achieves its intended objective of protecting family farms. There is currently no data on how long businesses are held after death, and inheritors are still able to sell farms immediately afterwards without incurring any capital gains or inheritance tax liabilities. In addition, investors may purchase farmland aiming to benefit from agricultural property relief (so they can pass their wealth to their children tax-free). The appeal of agricultural land as a wealth-maximising strategy may be one potential factor driving rapidly increasing prices of farmland, although recent qualitative research by HMRC has found this was not a key driver of land purchases, perhaps due to low levels of awareness of APR (HMRC 2017). Large farms also tend to be corporate structures that do not face inheritance tax liabilities but would potentially stand to gain if smaller family farms were brought to market if APR was removed or reduced.

One potential reform that has been proposed is limiting Agricultural Property Relief to working farmers as opposed to investors, though this may discourage entrepreneurs from purchasing farms to introduce new innovations and modernise farming practices. In addition, legally defining “working farmer” is challenging, as farmers may not derive their entire income from farming (such as income from wind turbines) and relief should not be lost upon retirement. While a definition based on time spent working on a farm makes more sense (compared to farm income), it would be very difficult to monitor and enforce in practice.

In January 2020, the All-Party Parliamentary Group for Inheritance and Intergenerational Fairness published a report examining potential reforms to the inheritance tax, including agricultural property relief (APPG for Inheritance and Intergenerational Fairness 2020). Its final recommendations included eliminating agricultural property relief, with potential for a more limited 50% reduction in relief or a cap on total relief set at £5 million or £10 million. However, these reforms introduce complexity as well as potential horizontal equity problems: it is unclear why inefficient small farms should be taxed at lower rates than inefficient large farms. Alternatively, requiring that farms are held for a certain period of time after death can ensure relief is targeted primarily at family farms, but this may lead to problems of avoidance.

Community ownership

As described earlier, the Land Reform (Scotland) Act 2003 granted communities the ability to apply a register of interest in land and have first option to buy when the land is put up for sale. The Community Empowerment Act (Scotland) 2015 extended this right to compulsorily purchase abandoned or neglected land or land that is causing environmental harms – unlike the broader community right-to-buy, which could not be used to force sales. Only community bodies can register an interest in land, with eligible organisations including companies limited by guarantee, Scottish charitable incorporated organisations and community benefit societies.

Community right-to-buy aligns with a number of the Scottish Land Commission's objectives by directly targeting reuse of VDL sites, increasing diversity in land ownership and providing mechanisms for expanding the supply of housing, as applications of interest are usually only approved by Scottish Ministers if they show sustainable development benefits for the land and community. Organisations eligible for community right-to-buy are eligible for charitable status, which exempts them from most taxes and reduces their non-domestic rates liability by 80%. In addition, community landowners can benefit from agricultural property relief, exemption from non-domestic rates and other benefits described above. To further encourage take-up of community ownership, potential instruments include expanding CGT rollover relief for owners who voluntarily transfer land to community bodies. Alternatively, an acceptance-in-lieu scheme, which enables the Scottish Government to designate land and buildings under certain circumstances as suitable to be accepted in lieu of certain tax liabilities such as inheritance tax, may provide additional incentives for transfers of land to community bodies.

Alternative forms of ownership

Tax instruments can be used to encourage take-up of a number of different models of land ownership in addition to agricultural holdings and communal land, such as collaborative estate governance, local housing cooperatives, smaller-scale private ownership and social enterprise/development trusts. However, other than tax policies to shape agricultural land ownership and use (explored in chapter 6), there has been relatively little international experience with these types of tax instruments. Thus, designing effective tax policies that encourage a diversity of ownership models requires careful consideration of the desired models of ownership, the relevant stakeholders involved and the existing tax burden associated with each of these stakeholders. In addition, taxes can be used to directly reduce the concentration of land ownership. While inheritance and estate taxes have traditionally been used to dilute concentration of land or business ownership, implementing an annual tax on the value of land holdings above a certain area and concentration threshold could achieve a similar effect, though further research is required to consider potential unanticipated spillover effects.

5. Vacant and derelict land

- Many of Scotland's nearly 11,000 hectares of vacant and derelict land (VDL) remain undeveloped due to high costs of remediation and challenging market conditions.
- Any tax instrument that successfully incentivise reuse of VDL sites must impact how owners and developers make their cost-benefit calculations when deciding whether to redevelop, sell or keep the site vacant.

In 2019, the Scottish Vacant and Derelict Land Survey recorded 10,926 hectares of vacant and derelict land spread out across 3,510 sites, with nearly 30% of Scotland's population living within 500 metres of a vacant or derelict site. While a large proportion of these sites have been marked as suitable for redevelopment by the planning system, just 8% of these sites are re-used annually, in part due to unclear ownership and high costs of rehabilitation, especially for older and larger sites. In addition to the opportunity costs of remaining undeveloped in terms of housing and other public services, these sites can negatively impact community health, damage the environment and alienate local communities. While it is important to have a supply of available land for development, allowing land to remain vacant over the long-term due to structural barriers to development may have negative consequences: nearby VDL sites may deter potential new businesses and residents, leading to a cycle of decay as businesses start to decline, local residents lose their jobs and property values fall, making redevelopment difficult to start again, much less sustain.

The UK government has implemented a number of tax relief programs to help offset expenditures spent restoring contaminated land. First, as part of Land Remediation Relief, owner-occupiers can claim 150% relief and developers 50% relief on corporation tax for land remediation, including removal of asbestos, treatment of harmful organisms, cleaning up contamination or breaking out buried structures. In addition, Derelict Land Relief allows a deduction up to 150% for expenditures bringing long-term derelict land (vacant since April 1998) back into use. Finally, companies can claim a payable credit from HMRC if they incur a loss in an accounting period during which they incur expenditures on remediation. This tax credit is 16% of the total value of Land Remediation Relief. Beyond these programs, there are a wide range of available funding sources for local organisations, individuals, businesses and councils to bring vacant and derelict land back into use, including the Vacant and Derelict Land Fund currently distributing £11.4 million across five local authorities.

Taxes on vacant and derelict land

As discussed earlier, a tax on land value is one avenue of incentivising development on vacant and derelict land by increasing the relative return on investment on developed land compared to undeveloped land. Due to the political challenges of implementing a general land value tax, another more-targeted option to encourage land development is taxing VDL sites. This type of tax is primarily designed to change landowner behaviour rather than raise revenue. Even if the cost of purchasing VDL sites is relatively low, these sites frequently compare unfavourably to greenfield sites in suburban and rural areas due to required demolition, decontamination and encumbrances (taxes and liens) before development can begin.

Governments that have implemented this type of tax vary how they structure the tax, who benefits from the tax and what penalties are imposed to enforce the tax, though not all of the following policies are directly applicable to the UK due to differences in the planning system:[5]

Location	Land definition	Fee structure
Harrisburg, Pennsylvania, United States	All properties	Foreclosure on land = 3% of assessed land value Improvements = 0.5% of assessed value of improvements
Washington, D.C., United States	Vacant land, blighted/ruined property	5% of assessed market value (vacant land), 10% of assessed market value (blighted/ruined property)
Vancouver, Canada	Non-primary residences	1%
Seoul, South Korea	Land left vacant for a minimum of two years	• 5% instead of 2% on improved lots • 7% if left vacant for more than 3 years • 8% if left vacant for more than 5 years • 9% if left vacant for more than 7 years • 10% if left vacant for more than 10 years
Marikina City, Philippines	Land area greater than 1,000 square meters, one-half of which remains unimproved Residential lots, regardless of land area, one-half of which remains unutilized or unimproved	Additional levy at the rate of 2.5% per year on the assessed value of the property
Bogotá, Colombia	Land that is subject to urbanization but has not yet been developed, and land that has already been urbanized but has had no construction yet	• Vacant properties = 30% of the assessed value • For improved properties in urban areas, rates from 0.4% (residential use) to 1.5% (financial institutions)
Recife, Brazil	Undeveloped properties	Progressive property tax (IPTU) with 5% yearly increases.

Formal evaluations of VDL site taxes are rare due to difficulties identifying an appropriate control group and accounting for confounding factors (such as broader economic conditions or the introduction of non-tax policies that also impact development). Anecdotal evidence from Washington, D.C., which set its tax rate for blighted parcels at 12 times the rate of ordinary parcels in 2011, suggested that landowners filed for building improvements to avoid paying the higher tax rate but did not ultimately build (Povich 2017). Legislation in 2017 subsequently increased the size of the fine for noncompliance and limited the duration of exemptions. In

[5] In particular, the UK does not use a zoning system to regulate land use, relying instead on development plans set out by local and regional governments.

addition, tax rates need to be set sufficiently high to change behaviour: a review of the progressive property tax scheme in Brazilian municipalities found that yearly increases did not influence landowners to alter their behaviour due to rates initially being set at a low level (Afonso, Araujo and Nobrega 2012). With future values of land still likely to be higher than current values even discounting for the progressive property tax, landowners are incentivised to hold onto undeveloped land rather than sell or develop it.

The key challenge with this type of tax is how vacant land should be defined. For example, when comparing a single-family home on a 1 hectare land parcel or a 100 m^2 parcel with no development, which should be considered vacant? As shown by the table above, local and national governments around the world have adapted varying definition based on time period or proportion of the land parcel that is vacant. In addition, this type of tax may be difficult to enforce – generally, governments will levy interest charges as a penalty. Finally, it is important to consider the specific reasons for low re-use rates of VDL sites in Scotland. If land facing development constraints is taxed, landowners are likely to sell the land more quickly rather than investing in development, so a tax on this type of vacant land might not be optimal. Responses for long-term stalled sites from local authorities in a 2018 review of VDL sites were manifold and site-specific, though it seems that lack of progress can be attributed to a combination of development viability (market demand, land value expectations) and increased costs of rehabilitation (Scottish Land Commission 2019).

In addition to broader taxes on all vacant land, a number of OECD countries offer discounts on land taxes for agricultural land specifically to incentivise farming practices and reduce the amount of vacant agricultural land:

- South Korea exempts landowners from paying property taxes if they are actively farming their land and the land belongs to the farm land pension programme.
- Landowners in Japan that lease their land through a Farm Land Bank pay half their real estate tax liability, while idle land that has not been cultivated or leased out is taxed at 180%.
- Lithuania offers a 33% discount on land taxes for cultivated land (the reduction is withheld if any abandoned land is found on the landowner's holding).
- Costa Rica offers farmers a 40% discount on land taxes for adopting soil conservation practices.
- In the Czech Republic, no property taxes are paid on reclaimed agricultural land for five years and reclaimed forest land for 25 years.

Split-rate taxation

Another tax instrument for incentivising development on VDL sites is a split-rate tax system that levies higher tax rates on land relative to development. By reducing the relative tax penalty on development, owners are less likely to tie future valuation of their land to price appreciation, reducing speculative activity.

Existing research has found that two-tier systems tend to increase development, though the long-term impacts on urban sprawl and density are unclear. The magnitude of this impact is proportional to how high the tax on land is set relative to the tax on improvements. There is a small but positive impact on the amount of land converted for development.

15 cities in the state of Pennsylvania, United States have implemented this form of taxation,

the largest of which included Harrisburg and Pittsburgh. These cities raised their tax rate on land to four and five times the level of rates on improvements, respectively.

- In Harrisburg, the number of vacant plots fell 88% and total real estate value increased fourfold in the two decades following introduction of the tax, though this evidence is anecdotal rather than causal (Goldstein, Jensen and Reiskin 2001).
- In a more formal analysis, Oates and Schwab (1995) compared Pittsburgh to other cities in the Midwestern United States that did not implement a higher tax rate on vacant land. They found that the additional revenue generated by a land value tax allowed the Pittsburgh city government to offer additional tax abatements on development, leading to a 70% increase in building permits. Thus, the split-tier tax system was more successful at generating broad economic growth rather than the specifically-targeted goal of incentivising development on VDL sites. However, Pittsburgh was forced to abandon the split-rate system in 2001 after residents protested steep tax increases (up to 81% on land and 43% on improvements) after reassessment of property values, a reminder of the challenges of implementing a land tax reliant on politically-difficult property assessments.
- Plassman and Tideman (2000) found that split-rate taxation in Pennsylvania increased residential construction by 3-4%. In addition, Banzhaf and Lavery (2010) found that the split-rate tax increased the number of housing units (instead of producing larger units), leading to a more dense pattern of development, an effect confirmed by Yang (2014) using a more in-depth panel dataset.

Empty Property Relief

While the Scottish Government has slowly reduced the levels of empty property relief available to businesses to incentivise development of vacant and derelict sites, the Barclay Review of non-domestic rates noted that many businesses had developed ways to take advantage of the reduced tax liability on empty property by occupying a small portion of the property (with a single pallet of stored goods, for example) to re-set the relief period and qualify for another relief – for low rateable properties, landowners could claim the more generous 100% Small Business Bonus Scheme relief with no incentive to bring the property back into use. To ensure that empty properties were all subject to the same relief, the Barclay Review recommended eliminating empty properties from the Small Business Bonus Scheme, a policy adopted by the Scottish Government which went into force in 1 April 2020.

More controversially, the Barclay Review also recommended restricting empty property relief for listed buildings to a maximum period of two years (previously indefinite) and levying a 10% surcharge on land that had been vacant for at least five years. The government advisory group tasked with implementing the recommendations of the review decided against adopting this recommendation. It expressed concern that listed buildings might be difficult to bring back into productive use and that local authorities are often the target of relief for listed buildings. Restricting relief may incentivise developers from working on these properties, and if listed properties fell into further repair developers would become less and less likely to invest in them. In response, the Scottish Government agreed to restrict empty property relief for listed buildings to five years instead of two. On the proposed surcharge for properties vacant for at least five years, the group argued that many long-term empty properties were unavoidably vacant (such as landlords refusing to renegotiate long-term leases) and the surcharge would penalise ratepayers holding onto currently unproductive properties. As a result, the Scottish Government has dropped plans to implement this surcharge.

A 2014 report by the Institute for Fiscal Studies examining empty property relief in England suggested the structure of short-term relief followed by a much smaller discount may encourage demolition of empty properties (Emmerson, Johnson and Miller 2014). As the land underlying an empty site is itself untaxed, this puts governments in a difficult position, as they have to choose between incentivising demolition (taxing empty properties) or disincentivising development (exempting empty properties). In practice, the Scottish Government moved to reform empty property relief in 2016, restricting 100% relief on empty properties to six months (from previously an indefinite amount of time). Despite numerous warnings from industry groups that the reform would push owners to demolish industrial sites, it is unclear if demolition rates actually rose in response to the reform, though anecdotally some property owners blamed restrictions on empty property relief for their decision to demolish.[6]

Given the above discussion, it is critical to examine the specific reasons why land remains derelict or vacant in Scotland. If, in line with the Barclay Review advisory group, most vacant and derelict sites are involuntarily empty due to the costs of development or other unfavourable situations, implementing a tax on vacant and derelict sites will unfairly punish owners of these sites.

Tax incentives for regeneration

The Business Premises Renovation Allowance (BPRA) scheme was introduced by the UK Government in 2007 to help regenerate vacant commercial properties in disadvantaged areas. It provided a 100% initial allowance or 25% straight-line allowance for renovation expenditures bringing disused properties back into commercial use. The scheme was abolished in 2017.

A number of countries (especially the United States) offer certain property exemptions for businesses. While these have not been shown to be effective in promoting long-term economic development, if properly designed they may be able to help revamp distressed areas (Kenyon et al. 2012). This type of tax policy has been implemented in the UK through enterprise zones, which provide businesses with lower tax rates and decreased levels of planning control to stimulate economic growth. The UK government first implemented 11 enterprise zones in 1981-2, which generated £3 billion in investment and 58,000 additional jobs before being wound up in 1995 (Tyler 2011). The UK government launched a further round of 44 enterprise zones in 2011, including four zones across 15 sites in Scotland, that provided a similar set of incentives through business rate discounts, enhanced capital allowances and tax increment financing schemes (TIF). Preliminary research by the Centre for Cities found that only 17,307 jobs had been created in five years across the 24 English zones instead of the 54,000 jobs forecasted by the UK government (Centre for Cities 2019).

Retrospective evaluations of enterprise zones created in the 1980s provided mixed evidence on their impact: these zones proved to be expensive, with each job created costing the public sector £17,000 (in 1994-95 prices). In addition, 41% of jobs created were relocated from elsewhere in the UK, with the zones “pushing around demand” rather than creating new economic activity (Larkin and Wilcox 2011). While these zones overall were largely successful at encouraging regeneration of brownfield areas (with notable success stories including Salford and the Isle of Dogs), many were located in areas that did not have a clear path to sustainable growth, including areas poorly connected to public transport or skilled labour

[6] For example, see https://www.pressandjournal.co.uk/fp/business/north-of-scotland/1286454/property-firm-to-demolish-office-block-to-avoid-huge-new-business-rates-bill/ and https://www.thecourier.co.uk/fp/news/local/dundee/592433/historic-dundee-building-demolished-due-to-business-rates-bill/

markets. These evaluations highlighted the important role of employment and skills support to complement capital spending and property redevelopment, and that careful attention must be paid to the nature of chosen sites and their comparative advantages to prevent competition between local areas (Sissons and Brown 2011, Ward 2020).

As part of its broader Regeneration Strategy, the Scottish Government has also supported area-based initiatives (ABI) through revitalising town centres (such as the Bute Island Alliance), encouraging community-led programmes (Broomhill, Greenock) or investing in physical regeneration of the built environment (Clyde Gateway). These initiatives have historically been funded by a combination of the Scottish Government (such as the Scottish Partnership for Regeneration in Urban Centres fund, which provides loans and equity investment) and market-based systems (Christie et al. 2017). However, as part of the increasing devolution of national fiscal and policy powers, there is room for tax instruments to provide additional revenue to fund regeneration-targeted subsidies as well as incentivise regeneration directly, especially with regards to derelict land.

6. Agricultural land access

- Agricultural land in Scotland benefits from a wide range of tax incentives, including exemptions from non-domestic rates, Agricultural Property Relief and Business Relief from Inheritance Tax and the ability to offset operating costs against income.
- There is mixed evidence on the ability of taxes on specific agricultural practices (such as succession planning, investment in innovation and sustainable environmental practices) to change behaviour, with tax effectiveness largely driven by careful design.

Taxes on agricultural land in Scotland

Tax policy on agricultural land in the UK has changed little since the early 2000s:

- Agricultural land and any buildings involved in production are exempt from non-domestic rates.
- Agricultural Property Relief (APR) exempts individuals from paying any inheritance tax on the agricultural value of land and property (50% if the land is under a long-term letting arrangement)
- Farming businesses not eligible for APR can instead claim Business Relief at full market value on any asset owned for at least two years.
- Transactions of agricultural land are subject to the usual rates of capital gains tax (10% and 20%), and farms structured as companies are required to pay corporation tax.

The United Kingdom follows the vast majority of OECD countries in providing generous tax concessions to owners of agricultural land, including relief on annual property taxes as well as sale and inheritance by other family members.[7] Despite the ubiquity of agricultural tax concessions, very few studies have been conducted on the economic and social impact of these concessions, and existing studies largely draw from general, whole-economy models rather than focusing specifically on the agricultural sector. Evaluations of concessions is challenging for several reasons:

- Cross-country comparisons are difficult because some countries grant tax concessions specifically for owners of agricultural land, while other countries extend the same concessions to mines, fisheries and small and mid-size enterprises (SMEs).
- It is generally more difficult to quantify lost revenue due to concessions compared to budget outlays from other forms of tax expenditures such as credits or subsidies.

[7] In this context, a tax concession refers to tax policies that 1) result in foregone tax revenue, and 2) lead to differential treatment that favours a specific economic sector.

Evidence on the impact of agricultural taxes

There are three main avenues through which taxation of agricultural land can impact the economy: farm transfers and structural adjustments, investment and innovation and sustainable development. Each of these areas will be examined in turn in the following sections.

Fully or partially exempting agricultural land from inheritance tax is important from an equity standpoint: since family farms often need to be refinanced with each passing generation, exemptions prevent undue burden on the successor landowner and possible refinancing. Research from the United States suggest that few US farms are currently subject to estate taxes as minimum thresholds have increased and owners of agricultural land that do face estate tax liabilities are largely able to pay taxes due without partial liquidation (Tax Policy Center 2020). Other countries have had success requiring landowners to identify a designated successor long before intergenerational transfer takes place:

- A 2005 report by the OECD concluded that agricultural tax reliefs are likely to lead to an increase in land prices, making it difficult for individuals from non-farming families to enter the agricultural sector (OECD 2005). In particular, these reliefs impact the willingness of farmers to increase their scale of operations through purchasing additional land and of existing owners to sell their land. A subsequent OECD report suggested that these tax reliefs, in addition to reducing the ability of other tax measures to encourage structural change in the industry, may play a role in wealth maximisation strategies through inheritance tax shelters (OECD 2020).
- Leonard et al. (2017) found a tax policy in Ireland designed to phase land management or agricultural land transfer before death largely failed to achieve its intended outcomes due to high inheritance tax thresholds if the inheritor was a child. While interviews with farmers found they were highly concerned with how taxation might impact their transfer decisions, results from a microsimulation model suggest relatively little impact on farm income projections under a range of transfer scenarios.
- Geoghegan, Kinsella and O'Donoghue (2017) found that tax incentives in Ireland were able to encourage land leasing arrangements and improve farm land mobility, though profits varied by type of farm – long-term leases were more profitable for cattle and tillage farm landowners. Take-up was low due to limited impact on smaller farms, and adjusting the tax incentives to better account for average farm sizes increased the number of long-term leases.
- Glauben et al. (2009) found that tax policies in Germany successfully incentivised farmers to make succession planning arrangements, but only for the subset of farms who transferred ownership before death. Transfer arrangements were also determined by age of current manager and farming operation profits. As these factors are usually beyond policymakers' control, this research suggests limitations in governments' ability to shape succession planning.

Most literature on investment and innovation for the agricultural sector examines the impact of depreciation policies on farm capital investment, though as with estate taxes, 1) this literature largely focuses on economy-wide models rather than the agricultural sector specifically, and 2) quantifying the relationship between taxation and innovation is not straightforward. There are varying definitions of "innovation" outcomes, and businesses may adopt a variety of responses, making it difficult to consistently measure the impact of the tax policy.

- A large number of studies in the United States have concluded that accelerated depreciation has led to greater investment levels, though with different results based on specific types of assets. Williamson and Stutzman (2016) found that a 1 USD increase in Section 179 expensing increased farm investment by 0.32 USD, while Polzin, Wolf and Black (2018) found that farms increased investment the most in 10-year (single-purpose agricultural structures, such as manure pits) and 15-year (drainage facilities, water wells and forms of erosion control) asset classes.

More generally, tax credits have been effective at increasing innovation, though the magnitude of this impact varies significantly based on programme design. 29 out of 36 member states in the OECD offer general R&D tax incentives that can be used for farm input suppliers or food processing companies, though with lower uptake in the agricultural sector than other economic sectors.

- A recent literature review funded by the European Commission found that R&D tax credits successfully incentivised R&D investment but did not translate to increased levels of innovation, with companies prioritising projects that yielded greater private returns rather than greater social returns (CPB et al. 2015).
- Harris et al. (2009) found that the introduction of R&D tax credits in the UK in 2000-02 generally had a positive impact on output across a range of manufacturing sectors, with Bond and Guceri (2012) finding a similar positive impact on R&D intensity, though only for high-tech subsectors.
- Thum-Thysen et al. (2017) found that R&D tax incentives stimulate innovation, with stronger effects for younger firms and SMEs and weaker effects if the incentive scheme is unpredictable, unstable or lagged. By contrast, Appelt et al. (2016) found that higher R&D tax incentives favoured incumbent firms.

In general, research in this area offers few definitive conclusions on whether R&D tax credits have successfully achieved their intended objectives, with credits difficult to remove once in place due to their political popularity, In addition, there is relatively little evidence on potential spillover effects, including capitalisation of tax concessions in property values and increased incentives to purchase agricultural land to reduce inheritance tax liabilities. It is plausible that farmers, particularly those with larger landholdings, run annual losses to reduce their tax burden, instead accumulating wealth through a steady increase in property values. This ultimately disincentivises productive use of farmland, reducing productivity and employment.

Tax credits are not the only means of incentivising innovation – taxes on emissions or other negative environmental externalities are often effective at changing behaviour and increasing adoption levels of new technologies (see OECD (2010), which found that a tax on NOx emissions in Sweden significantly increased the number of firms using abatement technologies). In addition, a number of countries have implemented “producer levies”, a hypothecated tax that raises revenue from agricultural landowners specifically designated for research activities and market promotion. The majority of funds raised in the United States is directed towards market promotion, though with some spillover effects on higher bushel per acre yields (Alston, Freebaim and James 2003). In its review of Australia’s Rural Research and Development Corporations (RDCs), a 2011 report found that RDC-funded research led to a broad range of successful research projects, with a 1 AUD investment yielding a return of 5.56 AUD after 10 years and 10.51 AUD after 25 years (Australian Government Productivity Commission 2011).

Finally, taxes may help increase environmental sustainability by changing the behaviour of

agricultural landowners. There is mixed evidence on the impact of taxes on fertiliser to reduce usage. Rates in Finland, Austria and Sweden yielded only marginal reductions in nitrogen use and runoff, in part due to the relatively inelastic demand for fertiliser – tax rates sufficiently high to change behaviour would have been politically infeasible (Lankoski and Ollikainen 2003, Hardelin and Lankoski 2018). On the other hand, Norway has experienced success reducing pesticide use, and Estonia's tax on water pollutants has helped reduce the rate of emissions (OECD 2017, OECD 2020). Holtze, Kühl and Hyldebrandt-Larsen (2018) found that Denmark's tiered classification of pesticides based on environment and health risks successfully encouraged farmers to substitute more harmful for less harmful pesticides, reducing overall pesticide usage by 40%.

Expanding access to agricultural land

Recent research has shown that access to land is generally the largest barrier to new entrants to farming (European Access to Land 2018). In particular, high land prices in Scotland offer an attractive investment opportunity relative to returns from agricultural production, increasing competition for the limited supply of available farmland. More rural areas face difficulties accessing required infrastructure for maintenance and transport. Uncertainties around tenant right-to-buy have also encouraged landlords to retain as much control over land as possible, with tenancies becoming increasingly replaced by contract farming arrangements.

The existing system of agricultural taxation in Scotland, as described above, potentially impacts land availability for new farmers in a number of ways:

- The re-introduction of sporting rates in 2016 may lower land prices due to capitalisation.
- LBTT may impose a steep tax burden on new farmers purchasing or leasing land as well as any gifts from existing farmers/landowners (if there is a mortgage or other debt associated with the land, unless the buyer had a previous relationship with the seller).
- Farmers and landowners who lease land must report this earned income above the Personal Allowance to HMRC, though losses may be offset against maintenance expenditure and rental income.
- Agricultural Property Relief dissuades transfer of asset ownership before death, as 100% relief is granted on transfers made after death but gifts in which the donor dies within seven years are taxed on the value of the farm at transfer. In addition, many agricultural assets (farm machinery and equipment, derelict buildings, crops and livestock) are not eligible for relief, which may force inheritors to reduce the size of farming operations or leave the industry entirely.

7. Housing

- One important factor to increasing the number of new builds in Scotland is the supply of available and viable land for development.
- The low price elasticity of land in the UK means the supply of land is unlikely to increase significantly in response to a direct tax.
- Alternatively, governments around the world have implemented betterment levies, tax increment financing or development impact fees to help cover the costs of new infrastructure development, which may increase the amount of land available for development. Research on the impacts of these programmes has yielded mixed results.
- Community organisations can also increase land available for development through right-to-buy and compulsory purchase orders.

In 2018-19, 22,273 homes were built in Scotland. Even though this was the first year housing completions reached 20,000 units since the 2008 financial crisis, growth still fell short of the 26,000 new homes required each year to meet housing demand, just 80% of pre-crisis levels and much less than the shortfall of 80,000 homes slowly building up over the past decade (Bramley 2018). The Scottish Government has not formally adopted an all-tenure housing target but has worked extensively with developers through the National Housing Trust Initiative to secure delivery of affordable housing, in addition to initiatives such as Help to Buy (Scotland) and Help to Buy (Scotland) Small Developers.[8] One potential way to increase the number of housing builds is expanding the supply of land available for housing. Tax policies that increase the flexibility of the housing market may help resolve potential issues around access, pricing and the planning process, putting the right incentives in place for additional development.

In general, imposing direct taxes would be unlikely to increase the supply of land available for residential development, as landowners are only slightly responsive to increases in the price of land in making more land available for development. In other words, the price elasticities of supply and demand for housing as a proxy for land in the UK are low (Barker 2004). In addition, as highlighted by the Barker Review there are a number of challenges to implementing a land value tax to increase the supply of land for development:

- Taxing land not currently in development may only provide a small incentive effect, as landowners already benefit from receiving large windfall gains through the uplift in land value resulting from planning permission.[9]
- Taxing land allocated for development as part of local authority development plans might face issues of unfairness, as local authorities are responsible for which land is allocated for development and thus subject to tax.
- Taxing land with outlined planning permission may lead to more “off-the record” discussions between developers and local authorities, as developers would want development applications to be decided as quickly as possible to reduce potential tax liabilities.

[8] The last target was set in 2007 to reach 35,000 new builds annually by 2015.

[9] In economics, windfall gains refers to profits that occur unexpectedly due to factors outside the receipient’s control.

The unique characteristics of each land parcel are more likely to be addressed by changes to the planning system, which is responsible for setting prices and thus is better-suited to balance the costs and benefits of residential development. However, tax instruments can be used to capture value such as windfall gains as well as change the relative attractiveness of different types of land for development.

Land value capture

To address potential concerns around infrastructure delivery and funding, some governments have sought to capture increases in land value due to planning permission, public infrastructure works or other forms of land use regulation changes either directly or indirectly. These increases in land value are partially captured through capital gains tax, but exemptions such as rollover relief decrease its effectiveness. Land value capture policies can capture the *unearned increment* (increase in land values due to general economic or community trends) or *betterment* (increase in land values due to a specific policy decision) (Alterman 2012). Revenue raised from land value capture is then used to fund public services such as transit, parks and affordable housing.

Land value capture instruments are supported by an extensive literature and have been used by a wide range of countries around the world (Smith and Gihring 2006). Each of these instruments provides a mechanism through which local authorities trade anticipated future income for a present benefit. The three most commonly used instruments include:

Instrument	Characteristics
Betterment levy	Aims to capture general value created by provision of public services Focuses on landowners, can target specific groups of beneficiaries
Tax increment financing	Anticipated growth in property tax revenues used to securitise bonds to fund infrastructure investment
Joint development	Partnership between public and private operators and developers to share costs of infrastructure investment

Betterment levies

In general, betterment levies shift the burden of funding infrastructure from the public to the specific private landowners that benefit most from the infrastructure development. Types of levies include government purchase of land (with re-sale at developed land prices or long-term leases), uniform land value tax, tax on income from sale of land and taxes on specifically the unearned increment. While a betterment levy is seen as an effective, equitable way of funding public investment, previous UK governments in the 20th century have not been able to successfully maintain public support for such a levy. As explained by Maxwell and Vigor (2005), property owners sought to delay transactions in the hope that lobbying against the tax would succeed. In addition to conflicting political perspectives, these taxes were also highly complex and implemented during periods of volatile property prices, ultilmately deterring development and encouraging land hoarding instead of increasing the availability of land (Cullingworth et al. 2015).

The 2004 Barker Review recommended introduction of a national betterment levy known as the Planning Gain Supplement, which would capture 20% of the increase in land values due to planning permission being granted. This proposal received pushback from the developer

community, which feared the increase in financial liability due to the planning gain supplement co-existing alongside indirect value capture mechanisms (such as section 106 agreements). The Labour government ultimately decided to adopt a Community Infrastructure Levy (CIL), which combined direct and indirect value capture by tying its formula to the additional floor space allowed by the planning permission. Local authorities have discretion on how to apply the levy, which is currently in force in England and Wales, including rates, public uses and geographic range. Affordable housing is specifically excluded from the Community Infrastructure Levy and is currently delivered via planning obligations between developers and local authorities.

The Scottish Government previously commissioned a report in 2004 to develop a methodology to capture land value uplift around transport facilities (Whelan 2004). This suggestion has received pushback from key stakeholders. A 2018 report by Homes for Scotland argued that a significant portion of semi-urban Scotland consisted of allocated but undeveloped land, so land value capture would be negligible outside of Edinburgh. Moreover, land value capture would have limited impact in the post-industrial central belt due to the required clean-up costs from contamination placing significant downward pressure on land values.

The 2018 report *Land Value Capture* compiled by the Housing, Communities and Local Government Committee raised the possibility of a betterment levy in England to incentivise release of land from landbanks and to shift the burden of taxation from developers (under section 106 agreements) to landowners (House of Commons 2018). Land for residential use would face higher tax rates due to the larger increase in land value from residential planning permission. One important challenge in administering this tax are land options, which allow landowners to sell exclusive permission to purchase land in the future to a specific developer, usually at a discount from market value. The market for land options thus distorts the true price of land, and it is unclear at which point a tax on landowners would be imposed.

Betterment levies have not been widely adopted due to difficulties in quantifying the precise increase in land value from infrastructure investments or planning permission. Recorded land values account for two-thirds or less of observed variation in the price of land (Peterson 2009). Garza and Lizieri (2016) analyse the *Captura de Plusvalia*, a land value development tax on windfall gains from infrastructure or regulatory interventions in Bogota, Colombia. Using data from 2000-10 and spatial panel estimation techniques, they find that the tax reduced land prices while having no statistically significant impact on new construction.

In comparison, Alterman (2012) examines Israel's betterment levy, which has been in place in its current iteration since 1981. Local planning commissions enforce a 50% levy on the real increment in land value, which is paid upon sale of the property or application for building permission. An additional 25% tax is charged on the unearned increment upon sale of the property, with an exception for single private residential units. Levy is applicable on both private land and public land with long-term leases (similar to freehold tenure). Alterman concludes that the levy has remained successful due to its importance as a source of revenue to local governments, plot-specific appraisal and rates that are uniform, non-discretionary and high enough to justify their administrative burden.[10]

[10] A robust evaluation of the Israeli betterment levy is challenging, as the 50% levy has been applied uniformly since 1981 across all of Israel (so no potential control group exists).

Tax increment financing

Tax increment financing (TIF) allows local authorities to use expected increases in tax revenues to fund current infrastructure development. It is currently used in 47 states and Washington, D.C. in the United States for urban renewal, affordable housing and public infrastructure. State governments are responsible for creating a TIF district that meets certain requirements such as property abandonment or an aging housing stock. As businesses move in to the TIF district and property values rise, local governments re-direct property tax revenues from the higher property values to pay for redevelopment in the TIF district. TIF is effective at fostering public-private partnerships and generating widespread public support for local investments, but often suffer from lack of transparency, displace jobs from competing businesses in surrounding neighbourhoods and may foster fiscal competition between nearby local governments (Merriman 2018). In addition, most states require a "but for" clause that requires developers to certify the project would not have gone ahead in the absence of the TIF district, but in practice this clause has been weakened to allow for almost any project to proceed.

Evidence on the impact of TIF on economic development is mixed, with some studies finding weak positive effects on property values, building permits and home sales and others finding neutral or even negative impacts (Stewart 2016; Yadavalli and Landers 2017; Skidmore and Kashian 2010). In general, TIF can be a successful tool to build trust between parties and enhance public-private partnerships for development, but often fail to live up to their promises due to inconsistent design, lack of transparency and uneven levels of monitoring. TIF is currently used in four projects in Scotland (Glasgow's Buchanan Quarter, Fife's Energy Park, Oban and Grangemouth), but these projects have not yet been formally evaluated.

Other forms of land value capture instruments

Local governments in the United States have also relied on development impact fees, especially if local property tax revenues are not sufficient to fund expansion of public services required by new residential and commercial development. These fees impose one-time charges on developers: in exchange for approving a development project, developers are required to finance a portion of the costs of investment in public services. In theory, expanding availability of key infrastructure such as water, sewage and roads increases the amount of land that can be developed (Nelson and Moody 2003). Impact fees can reduce uncertainties associated with development by providing developers with a reasonably steady supply of buildable land. As with betterment levies and TIF, evidence on the impact of development impact fees is mixed. An early review of studies conducted in the United States by Evans-Cowley and Lawhon (2003) found that development impact fees drive increases in housing prices in communities with no reasonable housing substitutes and that tax burden and infrastructure enhancements are capitalised in property prices. Impact fees may also reduce the price of land, though this is driven by a decline in the demand for land due to developers shifting to smaller lot sizes (Ihlanfeldt and Shaughnessy 2004; Magliocca, McConnell and Walls 2014).

Finally, while undeveloped land will increase in value once planning permission is granted, often the largest gains in value comes from existing developed land nearby. Non-domestic rates capture a proportion of this gain in value for commercial properties, but no equivalent mechanism exists for residential properties. To address this, Roukouni and Medda (2012) proposed that the Greater London Authority and Transport for London implement two mechanisms as part of the Crossrail project:

- **Zonal assignment of stamp duty land tax**: distributes the uplift in property values from transport investment (called the transport premium) embedded in stamp duty receipts to fund the projects that created it.
- **Transport premium charge**: levied on existing property values in areas with new or significantly upgraded transport facilities. This is designed to capture uplift from rented premises otherwise not covered by stamp duty land tax.

These proposals were later formally adopted as recommendations by Transport for London in its 2017 report *Land Value Capture* (Transport for London 2017). In addition, the Royal Town Planning Institute has suggested eliminating primary residences' exemption from Capital Gains Tax (Royal Town Planning Institute 2018). Revenue raised from these proposals could be targeted towards regenerating and improving productivity in low-demand areas.

Community-led initiatives

Land banking, in which governments (often at the local level) purchase land needed for current and future urban expansion, has historically been a popular way, especially in northern and central Europe, to promote a better land and development policy than through private land markets alone. In the "classic" mode of land banking, governments develop the land before leasing or selling it back, with added value from the planning permission granted as well as infrastructure provided (Bourassa and Hong 2003). While the classic mode of land banking has decreased in popularity since the 1990s, a similar approach has been implemented in the United States through community land trusts: non-governmental organisations purchase individual sites targeted for affordable housing development (Bourassa 2007). Many of these organisations benefit from property tax relief. To support community right-to-buy, including compulsory sale orders for vacant and derelict land, one potential option is providing LBTT relief on specific transactions targeting land for residential development as well as affordable housing units already belonging to community organisations.

8. Areas for further research

Introduction and policy objectives

Building on the detailed review of the academic literature and international experience in chapters 2 to 7, this chapter presents a number of policy areas for further research. Each of the areas discussed below contributes towards a range of policy objectives set out in the Scottish Government's National Performance Framework and Land Rights and Responsibilities Statement as well as the Scottish Land Commission's strategic aims. The areas for further research outlined below are designed to serve as a foundation for more specific, in-depth options for land and property taxation reforms in Scotland that have been thoroughly researched, including costings, assessments of behavioural impacts and legal analysis.

As a general approach to designing policy options, there are three main aims: (1) reduced taxation of activities to incentivise, (2) increased taxation of activities to discourage, and (3) options for revenue-raising to raise funds to help realise Scotland's National Outcomes and support the transition to a wellbeing economy. These aims will form the basis for full impact assessments of specific policy options, which require modelling behavioural effects, direct and indirect impacts on tax receipts, distributional implications and potential administrative challenges.

The options below contain a range of policy ambitions given current Scottish legislative powers. The category representing the lowest level of ambition is reforms to reserved taxes because in such cases all the Scottish Government can do at present is to advocate for changes or for future devolution of these taxes. Reforms of existing Scottish taxes are more ambitious in that current legislative powers already exist to take forward these options, but within the context of existing legislation. Proposals for new taxes that are possible under current Scottish legislative powers represent the highest level of ambition. One important component when considering the potential for each policy area is to assess to what extent they are feasible under current law, though the upcoming review of the Fiscal Framework may change how policy options are classified.

It is often best to consider a mix of policy options as a package of measures that make sense when implemented as a single programme of reform. For example, tax-cutting measures can be coupled with tax-raising measures to create an overall programme of reform that is revenue-neutral. There is also the option of grouping tax-raising measures with the Scottish Land Commission's proposals for spending increases. This opens the option of hypothecation, in which the revenues from a specific tax or tax increase are ring-fenced for use on a particular spending measure, either by law or just presentationally. For example, National Insurance Contributions are hypothecated and not directly available for general expenditure by the government.

The proposed policy objectives to guide areas for further research are outlined below. Each principle is mutually supportive, working together to help deliver Scotland's National Outcomes:

Productivity

This objective refers to reforms to encourage more productive use of land in Scotland. Importantly, this objective should take a broad definition of productivity that goes beyond measured economic activity to encompass the economic, social and cultural aspirations of the

Scottish people. Productivity can be increased by changing land use to more productive uses, such as bringing vacant land into use, remediating derelict land or simply making more productive use of land without changing its current use.

Fairness

This objective refers to reforms designed to share the benefits of land and property in Scotland more evenly and to reduce inequalities derived from the existing tax system.

There are different ways of assessing fairness. One standard definition in economics refers to the concepts of horizontal equity (those with equal ability to pay should pay the same) and vertical equity (those with greater ability to pay should pay at least as much). Vertical equity can also be considered under the concepts of whether a tax schedule is “progressive” so that a higher percentage tax rate is paid by those with a higher ability to pay. This is a feature of taxes such as income tax, LBTT, inheritance tax and capital gains tax. In general, taxes for which those with higher ability to pay face a lower percentage tax rate, or “regressive” taxes, should be avoided, although for some policies fairness considerations may be outweighed by their effectiveness at generating behavioural change.

Diversity of land ownership

This objective refers to reforms that promote a range of scales of ownership and management, including attracting alternate sources of capital such as small-scale private ownership to support development. While communities have expressed a number of concerns around concentrated land ownership, as highlighted by previous Scottish Land Commission research, it is important to note that there is not any one optimal scale or pattern of land ownership or management infrastructure. Thus, policies to meet this objective should retain sufficient flexibility for communities to tailor solutions for increasing diversity of land ownership to their specific needs. In addition, policies should consider how existing ownership and fiscal structures impact the public interest and how they relate to community-owned land as well as Common Good land.

Good stewardship

This objective refers to reforms to manage land use in ways that safeguard and enhance the natural capital value of land to meet the societal, economic and environmental challenges that Scotland currently faces. These include sustainable use of food and timber, reducing greenhouse gas emissions, protecting biodiversity and wildlife habitats and preserving soils for future generations of Scottish farmers and crofters. Good stewardship aligns with the principle of sustainable development in the Land Rights and Responsibilities Statement in working to meet the current needs of Scotland’s people without compromising the ability of future generations to meet their own needs.

Accountability

This objective refers to reforms that empower communities to influence decision-making around land use, ensuring that adverse effects from changes to the community are mitigated and benefits are maximised. Accountability means awareness of how decisions around land use impact people’s lives, not just land owners or tenants, as well as broader social goals such as housing, employment and social justice. One way of doing this might be encouraging more democratic, community-centred governance around development and land use: community ownership of land may allow them to develop plans based on changing

environments and identify land uses that meet their specific sustainable development needs.

Examples of policy options to explore

This preliminary list of policy options is not comprehensive. Instead, they would be added to during further research ahead of narrowing down to a small list of firm proposals based on analysis of options.

Policy	Productivity	Fairness	Diversity	Stewardship	Accountability
Corporation Tax super-deductions	✓				
Tax reductions for redevelopment	✓		✓	✓	
Tax increases on unproductive land	✓	✓		✓	
Enterprise areas around derelict sites	✓		✓	✓	
Removal of Agricultural Property Relief		✓	✓		✓
Adding agricultural land to valuation roll for business rates	✓		✓		✓
Reforms to council tax bands		✓			
Land Value Tax on concentrated private estates	✓	✓	✓		✓

Corporation Tax super-deductions for development expenditure

R&D Tax Credits are generally thought to be one of the most successful tax interventions for encouraging an activity that the government is trying to incentivise. For SMEs, these allow each £1 of expenditure by firms to create a £2.30 deduction against their corporation tax liability, which is known as a "super-deduction". These also have the feature that for loss-making firms it is possible for taxable losses to be traded for rebates against a fraction of their qualifying R&D expenditure.

This model could be applied to particular types of productive development expenditure, such as remediation spend on derelict land. This would incentivise brownfield development, bringing forward some activity that otherwise would not have taken place. Super-deductions could also be applied to other development activities that are desirable to incentivise.

Corporation Tax is currently a reserved tax so this option could not be implemented directly by the Scottish Government, but representations could be made to HM Treasury to advocate for such a measure as a UK-wide intervention.

Business Rate or Council Tax reductions for redevelopment activities

An alternative to super-deductions would be to apply a deduction against future business rates or council tax on property that is developed from a source that is desirable to incentivise. For example, where derelict land is redeveloped, a partial relief could be applied to the business rates or council tax of the new property for the first few years of the property.

The foregone revenue of such a scheme could be relatively low to the extent that it brings forward significant redevelopment activity. Where a property is built that otherwise would not have been, even receiving a lower rate of council tax or business rates for the first few years after it is built would represent additional revenue, although revenue would be foregone on properties that would have been built in the absence of this incentive. Both business rates and council tax are devolved taxes, so this type of reform should be possible under current Scottish legislative powers.

Increase taxes on unproductive land

An alternative to the tax relief proposals described above would be to tax land more heavily to the extent it is currently used unproductively. For example, once buildings become derelict they no longer have council tax or business rates charged on them. This enables owned buildings to be left in a derelict state with no ongoing charges.

An option here would be to apply council tax or business rates to derelict buildings. Alternatively, the Scottish Government could introduce a new derelict tax on derelict land or buildings. In either case, by raising the cost of owning derelict land or buildings, a new incentive is created to end the unproductive use of the land. Whether existing taxes are used or a new tax is introduced, both of these options are possible under existing Scottish legislative powers.

Create additional enterprise areas around derelict sites

One option to break the cycle of community decay from derelict sites is creating enterprise areas that target the neighbourhoods surrounding these sites. By providing a broad range of tax incentives, including non-domestic rate discounts and enhanced capital allowances, governments can address potential concerns around “first-mover disadvantage”: businesses who are followers can benefit from infrastructure development and jobs growth created by the first mover. In addition, focusing enterprise areas specifically on derelict sites reduces potential negative impacts on existing businesses and renters while providing a foundation for broad, sustainable economic growth. This type of reform is possible under current Scottish legislative powers, as the Scottish Government has already implemented four enterprise areas across 16 sites.

Remove or reduce Agricultural Property Relief for Inheritance Tax

Agricultural Property Relief provides 100% relief against inheritance tax subject to qualifying criteria. This relief is deliberately designed to enable agricultural land holdings to be bequeathed without causing the recipient to have any need to break up the holding. The total cost of this relief has been estimated by HMRC to be over £300m per annum on a UK-wide basis and reduces incentives for increased diversity of land ownership. In addition, this relief opens up opportunities for aggressive tax planning, as high net-worth individuals can make purchases of agricultural land to minimise their inheritance tax liabilities. Inheritance tax is currently a reserved tax so this option could not be implemented directly by the Scottish Government, but representations could be made to HM Treasury to advocate for such a

measure as a UK-wide intervention.

Add agricultural land to the valuation roll for business rates

Agricultural land is currently not taxed by business rates or council tax, so there is no charge on annual ownership. However, as noted above, charges on annual ownership create an incentive for land to be used productively. If the current owner cannot identify a productive use, they are incentivised to then sell parts of the land to other owners who can. Thus, this reform could improve diversity of Scottish land ownership while also boosting land use productivity. Business rates are a devolved tax in Scotland, so this measure could be taken forward using existing tax powers. This would be a legislatively and administratively easier way to extend the tax base compared to more radical options such as introducing comprehensive Scotland-wide land value taxation.

Reform council tax bands to make the structure more progressive

Under the current council tax system, council tax as a percentage of property value is lower for high-value properties than for low-value properties. Even though some individuals may be "asset rich, income poor", there is generally a very strong correlation between income and house value, so on average council tax is charged at a lower proportion of income for higher earners, which creates a regressive tax structure. While the Scottish Government previously adjusted rates for the four highest bands (Bands E-H) as part of a package of council tax reforms in 2017, the overall council tax system still remains regressive, with the narrow spread between bands indicating a weak relationship between property values and council tax rates. One option for reform would be to introduce new higher rates of council tax. Currently, all Band H properties are taxed equally within each local authority even though the highest value Band H properties are materially more valuable than those toward the bottom of the band. This form of taxation would reduce incentives for owning more property than is needed, improving diversity, and would also raise accountability with the relatively wealthy making a fairer contribution. Another option for reform would be to address the regressivity within the existing band system by raising rates for higher bands and/or reducing rates for lower bands, although this kind of reform can be politically difficult due to creating a mix of winners and losers.

Implementing a land value tax on concentrated private estates

A potentially more comprehensive option than the reforms discussed above would be to implement a land value tax only on private estates with local monopolies on land ownership (which would apply only to a relatively small number of high net-worth individuals). In contrast to a comprehensive system of land value taxation, the vast majority of people would be unaffected, but the reform would have the desirable feature of broadening the tax base to tax land that is currently not taxed or only very lightly taxed. Introducing a new charge on concentrated estates would disincentivise privately-held local land monopolies, increasing the diversity of land ownership in Scotland. The specific design of the tax could draw on existing anti-trust policies used by the Competition and Markets Authority, with the tax slowly phased in after crossing a minimum threshold of concentration in the local land market. There would also be the option of introducing reliefs within such a tax, e.g. for enabling community use of part of a concentrated landholding. This would reduce revenues but further improve accountability.

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Annex A: Methods

The work informing this report involved four stages: searching and identifying relevant literature, appraising and prioritising studies based on data quality and methodology, reviewing selected studies in-depth and drafting a report highlighting key findings and themes. To conduct our literature search, we followed a hybrid methodology combining the UK Civil Service's Rapid Evidence Assessment toolkit and the *What Works Scotland* evidence bank approach, seeking to capture a broad range of key papers across academic and grey literature as opposed to an exhaustive list of published and unpublished studies. Our search was guided by two research questions:

1. What tax policies impacting land use have been implemented by other countries? Why were these policies implemented, and do these aims align with the policy objectives of the Scottish Government and Scottish Land Commission? To what extent were these tax policies effective at meeting their intended aims?
2. What reforms have been proposed by previous policy discussions and reviews of the UK and Scottish property taxation systems? Do these reforms have parallels in other countries, and to what extent are they effective?

To answer these questions, we used the following mechanisms:

- Keyword database search for academic papers and books in ABI/Inform, EBSCO, HeinOnline, JSTOR, Project Muse and Sage
- Keyword search in Google Scholar and Google Search for academic and grey literature
- Search for literature published by cross-country organisations such as the OECD, EU Commission, World Bank and the Lincoln Institute of Land Policy
- Search for literature published by UK think tanks such as the Institute for Fiscal Studies, Institute for Public Policy Research and the Joseph Rowntree Foundation
- Search for publications by the Scottish Government and UK House of Commons, including government-commissioned reports and reviews
- Inductive snowballing search through references listed in previous literature reviews

The following search strategies were employed:

Keywords	Search criteria
"council tax", "non-domestic rates" OR "business rates" (including any exemptions or relief programmes) OR "tax" AND "property" OR "land" (and variants) AND "housing", "vacant" (and variants), "land ownership", "development", "community ownership", "land reform", "land supply" OR "land use"	Published in English Peer-reviewed study, review of studies, grey literature or policy proposals by charities and other organisations Published after 2000, except for papers identified in the literature as being of central importance Focused on OECD countries[11]

[11] We also sought to identify tax policies adopted by non-OECD countries noted as being particularly effective or innovative.

For each peer-reviewed study, we sought to identify research aims, methods, geographic scope, type of tax policy examined and key findings. Studies were assessed based on their methodological rigour and quality, in particular excluding older evaluations that used methods not designed to address confounding factors. However, we did not adopt a formal framework; data limitations, methodological challenges and a limited number of real-world examples have led to relatively few high-quality evaluations of taxes impacting land use to be carried out, and many previous policy proposals are based on arguments made from economic theory.

Annex B: Land valuation and alternatives

Overview

A land value tax incentivises landowners to bring vacant land into development, as they would pay the same amount of tax if the land had property on it. Countries have adopted a broad range of definitions for land value and the appropriate tax base, each with their strengths and weaknesses**.** The classic definition of land value comes from Turvey (1957), which states "the market value of the freehold with vacant possession free from any encumbrances other than easements or restrictions on user imposed by or under an Act of Parliament on the assumption that there are no buildings or works upon the land or anything growing except natural growth." In practice, the most common ways of defining land value are as follows (Binswanger-Mkhize, Bourguignon and van den Brink, 2009):

- **Market value**: The property is valued as if the rights over it were sold currently in a hypothetical market reflecting all current conditions in the location without any duress by a willing seller to a willing buyer, unencumbered by any loans or other financial obligations.
- **Prairie value**: The property is valued as if there were no improvements or any geographical advantages relating to infrastructure or improvements, as if on a virgin prairie beyond the frontier of public infrastructure.
- **Use value**: The property is valued based on "highest and best use" in situations where the value of the land includes the potential for future development, usually for urban residential use. Agricultural land often is valued only on current use (that is, agriculture), not on the basis of potential future uses.

In addition to these uses, countries have also used annual rental value, or the rent that can be reasonably expected in a fair market transaction. This definition is advantageous because the tax will not raise or lower rental levels in the short-term, but can be more challenging to implement if data on actual rent payments is difficult to obtain or if rent control measures exist. While land value and rental value align if the current use of the property is its best (most profitable) use, these bases yield different tax amounts if an individual purchases land at a price independent of its current use in the hope of putting it towards a different, more profitable use in the future. Using land value as a base is more effective at discouraging speculative use by closely approximating a tax on real property wealth, while rental value as a base more closely meets the "ability to pay" requirement by tracking the annual realised cash income owners will use to pay the tax, at the cost of reducing incentives to develop unimproved sites. Finally, other options that have been adopted include original purchase price and area-based measures, which will be discussed at the end of this section.

While valuing land has historically been a key challenge in implementing a land tax, the Valuation Office Agency (VOA) in the UK currently publishes some data on land values, comparing similar plots valued differently due to location. A mechanism is already in place for non-domestic property, as every local authority has a ratings list which is also collected by the VOA. This data was used by the Institute for Policy Research and the University of Bath to produce an estimate of land value tax revenues in London (Barnaby and Pearce 2017). In a 2015 report by the Committee on Local Tax Reform, the Scottish Assessors Association estimated that a full revaluation of all residential properties to discrete values would cost between £7.5 and £8.5 million and take at least three years, with the potential number of

appeals increasing the cost and time required. Switching to Computer Assisted Mass Appraisal (CAMA) techniques could speed up the revaluation process if developed alongside more traditional valuation techniques. Valuation of land would require around twice the time and cost, as land values would need to be disaggregated from property values over a number of years.

Alternative approaches to valuation

If a market-based valuation is not possible, other options include the use of land valuation professionals (South Africa) or self-assessment systems for tax systems based on property characteristics.

Land area taxes

In situations where it is difficult to establish an explicit market-based tax base, it may make more sense to levy a statutory formula-based tax on objective grounds to increase efficiency and reduce administrative burden. A tax on land area (with a fixed amount of tax paid per unit of area, often adjusted by a fertility or location factor) significantly reduces costs of assessment and may provide a stronger incentive to make efficient use of land. However, individuals who own land in less desirable or undeveloped areas are forced to pay the same amount of tax as individuals who own land adjacent to urban areas that may be highly desirable for development. As a result, this tax base has gradually been phased out in favour of *ad valorem* taxes (the Netherlands) or special provisions that recognise gradations in value for parcels that are the same size (Tel Aviv, Israel). However, these modifications remove the straightforward approach that makes a land area tax appealing. Land area taxes are particularly popular in transitional countries such post-communist Eastern Europe due to an absence of well-established land registries or markets, which increases the administrative burden of a value-based tax.

Alternatively, a parcel tax requires all landowners to pay a flat tax, irrespective of how much land they own or its designated use. This type of tax is frequently supported by the benefit view of property taxation: all landowners should contribute a certain amount to the provision of public goods and services such as infrastructure.

Land use taxes

Some countries have established land taxes based on specific property characteristics, one of which may be market value. In 1993, Estonia introduced a tax on market value that explicitly included consideration of area, location, quality and land use. It has been followed by other countries implementing such a hybrid approach, including Latvia, Lithuania and Slovenia. A tax on land use could help internalise negative externalities by setting different tax rates based on the social/environmental costs of different uses of land.

There has been relatively little research conducted on the effectiveness of land use taxes. One such study, Polyakov and Zhang (2008), used a random parameters logit model and data on land-use conversion from Louisiana, United States, to conclude that land-use changes are generally inelastic with respect to property taxes.

Land taxes as an anti-speculation device

One potential use of a tax on land is to counteract the negative social and economic impacts from a rapid increase in land prices. In particular, a number of governments have expressed interest in using taxes as a deterrent to land speculation – buying land in expectation of selling

the land at a profit when its price increases as opposed to using the land for a specific purpose. For example, the US state of Vermont has implemented a land gains tax that ranges from 5% (for land held at least five years that gains less than 100% of value) to a maximum of 80% (for land is held for less than three month that yields gains over 200%).

Designing a tax that specifically targets speculation is difficult for a number of reasons. First, it is not straightforward to define what “speculation” means with legal precision. For example, the United States previously exempted agricultural land from full capital value taxation to protect family farms, but speculators found a way to take advantage of this provision by carrying out a nominal level of agricultural activity. To counteract this, states have tried to distinguish between bona fide farmers and speculators (via price paid for a property or applications for a land use zoning change), but as these two are not mutually exclusive categories bona fide farmers should not be prevented from selling land if market conditions are favourable.