

## Urban renaissance

# Land gain tax tests resolve of developers

A land value gains tax could hold back investment in important development projects, warns **Richard Iliffe**

Last month's pre-budget statement confirmed chancellor Gordon Brown's intention to introduce a planning gain supplement (PGS) on windfall gains in land value arising from planning permission.

Perhaps the unaccustomed prospect of an economic slowdown has encouraged creativity at the Treasury. Annual growth forecasts have been halved from the 3.5 per cent predicted as recently as last May. It certainly looks as though the supplement is viewed as generating cash at a lower social and political cost than from a less targeted increase in taxation.

Whether there is enough fat in the system to bear the burden and whether the PGS will produce the desired results is less clear. The problem and the solution are intimately familiar to cash-strapped local planning authorities. For years they have chafed against government restrictions limiting section 106 payments to compensation for the additional burdens that can be linked directly to developments.

While schemes need to be of a certain size before their impact can be identified, small projects can place a cumulative impact on infrastructure that outweighs that of all the major projects put together. This has led to a gradual shift in the theory and practice of planning gain. The courts have found that it may be legitimate for authorities to pool contributions towards major infrastructure projects, a measure now recommended by Circular 5/05.

Meanwhile, a tariff on all development has been on the cards for some time. Sections 46 to 48 of the Planning and Compulsory Purchase Act 2004 promise regulations allowing developers to pay an optional metre of retail floor space if they do not wish to incur the delay and cost of negotiating a section 106 agreement.

The PGS consultation (*Planning*, 9 December 2005, p2) recognises this shift. It proposes that an "overwhelming majority" of funds will be remitted back to local and strategic infrastructure in the region from where they are derived, with a "significant majority" recycled to meet local priorities. This revenue would not have to be spent directly on projects related to those which generated the funds. How much can be creamed off by the government for other purposes will no doubt emerge over time.

The consultation paper argues that the PGS is a more transparent and administratively more efficient means of extracting

excess value than planning obligations. If the supplement were being proposed as a straight alternative to section 106 agreements most developers would almost certainly welcome the change. The system is frequently criticised for delays and pilloried for inconsistency.

But while the consultation envisages a significant curtailment of section 106, it does not contemplate its abolition. The chancellor proposes to remove infrastructure and off-site considerations, with the slack being taken up by the PGS, while retaining streamlined section 106 agreements to secure social housing and site-specific environmental and amenity obligations. This may be the worst of both worlds – an increased tax burden and continuing delays for major strategic sites due to section 106 negotiations.

The PGS may well render many large developments uneconomic or stall them for long periods while financial viability studies are revisited. Many land options might not be taken up at all, while others will be sat on until the position is clarified or the terms of the option come up for renegotiation. At best, some delay may result while developers seek to determine their potential financial exposure under existing agreements.

The consultation proposals may offset these effects. The PGS will not come into effect until 2008, creating a powerful incentive for developers to bring forward schemes already in the pipeline before the tax bites. The government is also considering a lower rate for brownfield land, which would boost recent efforts to achieve more than 60 per cent of new homes on previously developed sites.

Since 1945 various governments have imposed development gain taxes but none have succeeded due to their complexity, unpopularity and failure to generate the expected revenue. It seems clear that more thought has gone into designing the PGS than went into any of its predecessors. However, the biggest delay in the system derives from a simple lack of

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**Infrastructure: supplement expected to be pumped back into local improvements**

resources, particularly human resources in the form of planning officers and local government lawyers to process the case-load of applications. The mechanism might only serve to increase this burden.

The chancellor talks about a "modest levy". Although its exact level is unclear, recent speculation is that a rate of around 20 per cent is being considered. This would raise considerable sums for the Treasury and would accord well with the Barker review's analysis that a rate of 17.5 per cent would be appropriate in most areas of the country, although it would impose a heavy burden on a few.

Even at 20 per cent, which is far lower than previous development taxes, the fear remains that the PGS will fail to achieve the objective of increasing housing land supply. It may even materially reduce the amount of housing land brought forward. The consultation paper seeks to soften the blow by raising the possibility of offsetting PGS payments against other taxes as an allowable business expense, as well as

permitting phased payments to allow for cash-flow difficulties.

However, the supplement is still likely to represent a net increase in the financial burden above that currently imposed by planning obligations. It is by no means clear that development land value taxation can be made to work. History is not encouraging and the government's affordable housing targets are ambitious.

The Barker review concluded, and the chancellor seems willing to bet, that the supplement will generate the desired financial and social benefits without jeopardising other government priorities. However, developers already labouring under a heavy burden of section 106 payments may respond that this is a step too far.

**Planning Gain Supplement: A Consultation can be viewed via [www.PlanningResource.co.uk](http://www.PlanningResource.co.uk).**

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