Centre for Policy Studies

Pointmaker

TAXING MANSIONS

THE TAXATION OF HIGH VALUE RESIDENTIAL PROPERTY

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SUMMARY

- Recent proposals for a "Mansion Tax" claim that it would be a precisely targeted and efficient tax that would be paid only by the very wealthy, and that high value residential property makes an unfairly modest contribution to tax receipts. These claims are flawed.
- A Mansion Tax is a tax that would not take account of the individual's ability to pay that tax. It would unfairly penalise those on low incomes living in certain parts of Britain where property happened to have substantially increased in value during the recent property boom or, in the case of elderly owners, during their period of ownership.
- It would be very complex to administer and collect. Accurate valuations of high value individual properties (which are by definition illiquid) are difficult to establish as:
  - there is little comparable transactional evidence;
  - an individual property's value is determined by the interaction of many different, often intangible, attributes.
  - there would also be a high likelihood of legal dispute and calls for revaluation.
- The UK already has by far the highest property tax take of all OECD countries (at 4.2% of GDP compared to an average of 1.8%).
- High value residential properties already make a high tax contribution:
  - their Council Tax bills are twice the national average.
  - the highest 1.6% of sales yielded £1.2 billion in stamp duty in 2010. This is equivalent to 26% of all residential stamp duty. The new upper 5% Stamp Duty band will have add around £290 million a year. Tightening up evasion would add another £150 million or so a year (assuming one in 10 transactions over £1 million avoid stamp duty).
  - the top 0.7% of housing stock held at death contributes 36% of inheritance tax receipts from residential property.
- It is likely that a Mansion Tax would raise, at most, £1 billion – the equivalent of 0.2% of total tax revenues. But the damage it could do could be far greater, particularly if it undermined the UK's attraction to international entrepreneurs and investors.

INTRODUCTION

In the 2011 budget George Osborne stated that the Government would look at tax on very high value properties, following scrutiny of the taxation of high value residential property by both their Coalition partners and the media.

Proposals for a so called 'mansion tax' were first made by Vince Cable at the 2009 Liberal Democrat conference. At that time the Liberal Democrats proposed an annual levy equivalent to 0.5% of a residential property's value to the extent that it exceeded £1m. It was estimated that such a tax would be levied on 250,000 tax payers and generate receipts of £1.1 billion.

By November 2009, the Liberal Democrats amended that proposal, instead suggesting a tax of 1% on the value above £2m. It was estimated that this would affect a reduced number of taxpayers, to perhaps 70,000 to 80,000. This proposal was subsequently included within the 2010 Liberal Democrat Party manifesto.

Since the formation of the Conservative-LibDem coalition there have been no formal proposals for a mansion tax, though various alternatives have been discussed. In January 2012, both the Business Secretary and the Deputy Prime Minister called for an annual tax of 1% of a property's value above a £2 million threshold.[1]

Though technically a separate issue, there has also been political focus on stamp duty on high value properties. Since the introduction of a 5% rate of tax for sales over £1 million from 6 April 2011, there has been some scrutiny of the avoidance of payment of the tax. It has been reported that the Chancellor "will use his Budget to curb evasion and avoidance of taxes on very high value properties, an area which the Treasury believes is particularly open to abuse."[2]

The superficial attractions of a Manson Tax

At first sight, it does appear that the proposed Mansion Tax has some attractions. Advocates claim that:

- it would be precisely targeted at the very wealthy;
- such a tax would offer less room for tax avoidance than other forms of taxation;
- it would raise significant sums for the Treasury at a time when the nation's finances are in very poor condition;
- high value residential property makes an unfairly modest contribution to taxation receipts.

A PROFILE OF HIGH VALUE RESIDENTIAL HOUSING

There are no definitive statistics available for the number of residential properties in the UK whose value exceeds £1 million or £2 million. The last comprehensive valuation of the UK's housing stock was undertaken for council tax purposes in 1993. Even then, the valuation exercise was undertaken to place properties into value bands, rather than to provide a precise valuation on a property-by-property basis.

There are however, various sources of information regarding the number of sales of houses at or above these price thresholds.

HMRC Transactions Data

HMRC data indicate that over the four years from 2007 to 2010:

1 Our calculations suggest that this would also raise about £1 billion (assuming no evasion or avoidance).

2 *Financial Times*, 4 January 2011.

- 0.8% of residential property sales were at prices between £1 million and £2 million, accounting for 5.0% of the total value of property sold.
- A further 0.3% of residential property transactions were at prices over £2 million, accounting for 6.5% of total sale proceeds.

Therefore the top 1.2% of properties (all those above £1 million) accounted for 11.4% of total sales proceeds.

There are roughly 22 million owner-occupied and privately rented houses and flats in the UK. Assuming that sales in these four years were roughly representative of the value of total housing stock, this would indicate that there are in the order of 255,000 residential properties with a value of over £1 million; and about 74,000 properties with a value in excess of £2 million.

Land Registry Data

Sales data is also available for England and Wales from the Land Registry, though it is known to undercount transactions, particularly at the top end of the housing market.

However, it is useful in showing the geographical distribution of transactions. In particular, sales of both £1 million plus and £2 million plus properties are heavily skewed to London and the South East. These two regions accounted for 81% of sales of £1 million plus property in England and Wales in the period from 2007 to 2010; and 91% of £2 million plus properties.

Distribution of £1m and £2m plus sales by Region (England and Wales)

Region	Over £1m	Over £2m
London	57.2%	71.5%
South East	24.7%	19.2%
East of England	7.3%	3.5%
South West	4.5%	3.1%
North West	2.5%	1.7%
West Midlands	1.3%	0.4%
Yorkshire and The Humber	1.1%	0.4%
East Midlands	0.9%	0.3%
North East	0.4%	0.1%
Wales	0.2%	0.0%
	100%	100%

Source: Land Registry

Further analysis shows the extent to which any property-based wealth tax would hit particular housing markets within London and the South East. Properties within Kensington and Chelsea and the City of Westminster account for 1 in 5 of

NUMBER OF SALES AND SALES VALUES OF UK DOMESTIC PROPERTY, 2007 – 2011

Lower Price Limit	Transactions (thousands)				Value (£ million)			
	2007	2008	2009	2010	2007	2008	2009	2010
40,000	120	88	82	78	7,172	5,259	4,935	4,701
75,001	146	94	90	83	13,043	8,364	7,987	7,368
100,001	197	116	101	103	22,727	13,421	11,610	11,899
125,001	188	103	115	92	26,234	14,416	16,022	12,815
150,001	185	100	118	92	30,187	16,394	19,532	15,138
175,001	160	79	65	78	30,170	14,867	12,243	14,755
200,001	254	133	119	136	58,198	30,507	27,222	31,310
250,001	104	51	45	55	29,059	14,222	12,535	15,409
300,001	185	94	86	112	70,325	35,947	32,849	42,981
500,001	58	31	29	41	39,593	21,423	19,585	28,148
1,000,001	**12**	**7**	**6**	**10**	**16,310**	**9,759**	**8,652**	**13,239**
2,000,001	**4**	**3**	**3**	**4**	**17,990**	**14,794**	**11,963**	**17,201**
Total	**1,613**	**899**	**859**	**884**	**361,010**	**199,373**	**185,135**	**214,964**

Source: HMRC Table 16.1

the £1 million plus sales in England and Wales; and just 10 London boroughs and neighbouring counties account for 60% of this market.

Such locations would bear a disproportionate burden of any property based wealth tax given the distribution of value.

10 Counties and London Boroughs with the highest number of £1m plus sales (as a % of £1 million plus sales in 2007 – 2010)

	2007 - 2011
Kensington and Chelsea	12.1%
City of Westminster	10.1%
Surrey	10.0%
Wandsworth	4.5%
Richmond upon Thames	4.3%
Camden	4.3%
Hammersmith and Fulham	4.2%
Hertfordshire	4.1%
Buckinghamshire	3.3%
Barnet	2.7%
	59.6%

Profile of £1 and £2 million property

Regional and local house price differentials also have a bearing on the nature of property that would be caught by a property based wealth tax in different locations.

This varies significantly across the country, as demonstrated by the examples of properties with an asking price of £1 million as at November 2011. These include:

- a one bedroom flat on a 20 year lease in central London;
- a four bedroom mid-terrace home in SW6;
- a five bedroom detached Victorian house in Barnet; and
- a five bedroom farmhouse in Yorkshire.

This suggests that applying an arbitrary threshold for a mansion tax would result in taxing many family homes, albeit very heavily concentrated in affluent parts of the country.

Ownership Profile

Evidence from Savills' own research, which includes information on the motivation of buyers and sellers, provides some insight into how this applies to high value housing stock. The following analysis is based on five years of deal book information covering the period from 2007 to 2011 inclusive.

Outside of central London the great majority of properties sold for in excess of £1 million have been occupied by their sellers as their main residence, the proportion varying from 76% in the case of London's suburbs to 85% within the commuter zone.

There are some notable exceptions, for example in second home hotspots such as those of coastal south west of England.

Central London is a different story. Here less than half of sellers of £1 million plus property have occupied that house or flat as their main residence, with property investment accounting for one in seven properties, and refurbishment and redevelopment accounting for 7% of sales.

Within central London, foreign nationals account for 31% of sellers of £1 million plus properties and 53% of buyers, reflecting a shift towards overseas ownership of central London housing. Second home owners have accounted for just under one in four sellers and one in three buyers over the past five years. This second home ownership is characterised by high levels of ownership by foreign nationals.

Whilst this may result in some undesirable leakage from the UK tax system, this is more a function of the operation of that tax system, than the taxation of property itself.

That leakage will have been offset by the introduction of the non-doms tax levy in the 2008/09 tax year. This started at £30,000 and is set to be increased to £50,000 for those living in the UK for more than 12 years with effect from 5 April 2012.

An additional blanket tax charge would place a further tax burden on the majority of owners, already covered by the UK tax system.

CURRENT CONTRIBUTION TO TAX RECEIPTS

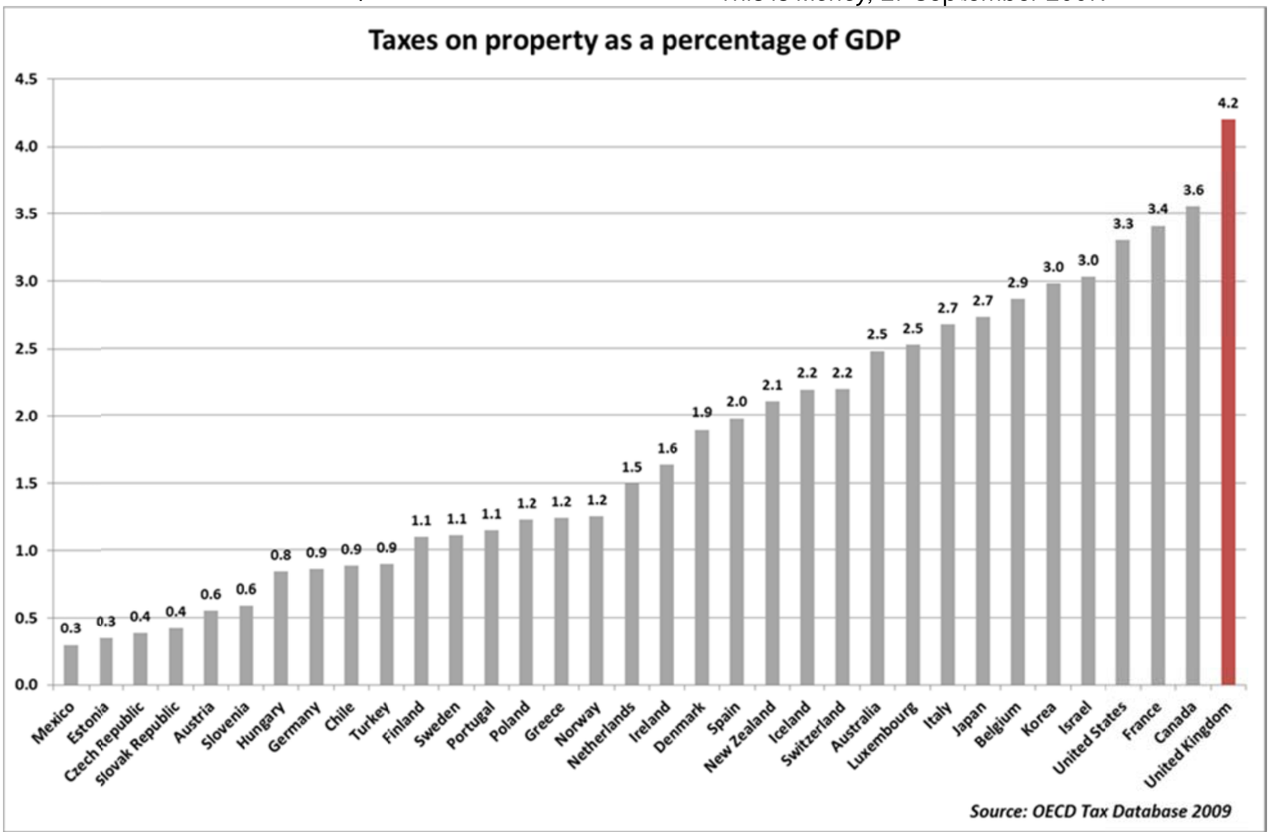
One reason given for the Mansion Tax has been the assumption that high value residential property makes an unfairly modest contribution to taxation receipts.

That assumption has been largely based on the distribution of council tax receipts. For example, in an article Vince Cable has stated:[3]

"The [other kind of] unfairness relates to local tax. Council tax was introduced in the early Nineties as an alternative to Mrs Thatcher's hated poll tax...

How is it fair that the richest people in the country pay the same council tax, or less, on their £30 million palaces as a family in a three-bedroom house in the suburbs? Britain's richest man apparently has a mansion in Kensington costing him £40 a week in council tax – not much more than nurses or pensioners pay on a small house or flat in my South-West London borough."

[3] *This is Money*, 27 September 2007.



However, this argument is based on the false premise that Council Tax is the only tax charged on property. The following pages detail the other taxes charged on property (and show that high value residential property does make a disproportionately large contribution to both stamp duty and inheritance taxes). The result, as the chart above shows, is that the UK has by far the highest charges on property of any country in the OECD countries (at 4.2% of GDP compared to an unweighted average of 1.8%).

Council Tax payments from high value properties may be relatively modest…

We estimate that Council Tax of £27 billion will be charged in England in 2011-12. It is set at a local authority level to raise taxes specifically to pay for defined local government services. It is a local tax, not a central tax.

Nor are Council Tax rates intended to be uniform. Any attempt to change this would also go against the move to greater localism which all main parties now espouse.

Council Tax is based on eight council tax bands. This has practical advantages, not least in terms of the less onerous valuation requirements for assessing such a tax. Additionally a tax with a capped liability will tend to treat less harshly the capital-rich income-poor households who may have seen their home appreciate in value.

There are just over 130,000 properties in the highest council tax band (Band H) in England, accounting for 0.6% of the housing stock.

The average council tax charge for these properties for 2011/12 is £2,927 per annum. This varies from £1,374 per property in Wandsworth to £3,383 per property in the Unitary Authority of Rutland.

These properties are forecast to generate council tax receipts of £318 million in the 2011/12 tax year, equivalent to 1.2% of the tax take.

In terms of their collective tax take, properties with the top band of council tax, Band H, currently account for 0.6% of the housing stock of England but are expected to generate 1.2% of the council tax receipts, of approximately £318 million in 2011/12. Despite receiving the same services, the average Council Tax bill for this Band is £2,423 (compared to a national average of £1,174).

COUNCIL TAX PAYMENTS BY BAND, 2011-12 (ENGLAND ONLY)

	Number		Proportion of Total	
	Properties	Council Tax	Properties	Council Tax
Band A	5,723,665	4,567,000,000	24.8%	16.9%
Band B	4,514,420	4,371,000,000	19.6%	16.2%
Band C	5,011,074	5,676,000,000	21.8%	21.0%
Band D	3,525,935	4,591,000,000	15.3%	17.0%
Band E	2,173,835	3,521,000,000	9.4%	13.0%
Band F	1,147,791	2,213,000,000	5.0%	8.2%
Band G	807,924	1,784,000,000	3.5%	6.6%
Band H	131,241	318,000,000	0.6%	1.2%
Total	**23,035,885**	**27,042,000,000**	**100.0%**	**100.0%**

Properties within the next highest band, Band G, account for a further 3.5% of the UK housing stock and generate 6.6% of council tax receipts of around £1.75 billion.

...but other tax contributions are high

The top 4% of residential properties therefore generate just under 8% of Council Tax receipts (or about £2 billion).

In addition to this, high value properties also make a disproportionately high contribution towards other taxes; particularly stamp duty and inheritance tax.

The calculations in the following pages estimate that:

- In 2010, the top 1.6% of housing sales in the UK (i.e. sales of properties worth over £1 million) raised 26% of associated stamp duty receipts; or £1.2 billion. That tax revenue mismatch is likely to have risen in 2011, as the 5% stamp duty charge for property sold for over £1 million takes effect.[4]

- In 2008/09 the top 0.7% of the housing stock held at death contributed to 36% of the inheritance tax receipts from residential property.

STAMP DUTY

Figures from the HMRC show that revenues from Stamp Duties on residential property saw almost an sevenfold increase (or 670%) between 1997-98 and 2007-08. Over the same period the average UK house prices rose by 185% while the number of annual transactions were 8% *lower* in 2007-08 compared to 10 years previously.

This substantial increase in stamp duty income is a result of increased rates of stamp duty for more valuable residential property. Before July 1997, stamp duty was paid at 1% of the sale value on properties sold in excess of £60,000. After that, new rates of stamp duty were introduced for properties sold for over £250,000 (1.5%) and £500,000 (2%). From 2011, a new rate of 5% was introduced for properties over £1 million.

The current rates of Stamp Duty are now:

Up to £125,000	0%
Over £125,000 and under £250,000	1%*
Over £250,000 and under £500,000	3%
Over £500,000 and under £1,000,000	4%
Over £1,000,000	5%

* 0% for first time buyers

This graduated scale of stamp duty (whereby higher rates of tax are charged on the entire proceeds of sale once a threshold is breached) means that higher value properties share a disproportionately high burden of stamp duty.

HMRC transaction data indicate an aggregate UK stamp duty liability from the sale of residential property of just under £4.7 billion in the 2010 calendar year (somewhat higher than recorded tax receipts). HMRC figures suggest that sales of property worth in excess of £1 million accounted for 1.6% of all sales and 14.2% of the sale proceeds in this year. Our calculations suggest that these sales contributed to 26% of the corresponding stamp duty tax take (i.e. £1.2 billion).

In 2011, Savills is forecasting receipts of £1.4 billion for residential property sales of over £1 million, 30% of the residential stamp duty bill.

[4] We calculate that had the extra 1% Stamp Duty been charged for the whole of the 2011 calendar year, it would have raised an additional £290 million.

Avoidance

Higher rates in stamp duty have resulted in avoidance measures designed to mitigate the effect of the tax. The 2011 budget included provisions to close certain specific stamp duty loopholes.

Closing some avoidance measures could usefully be considered (including proposals to tax residential property shell companies as residential property).

There is no accurate way of determining how much is lost through either evasion or avoidance. The Treasury estimates that around £250 million may be lost a year; while other estimates suggest that between £500 million and £1 billion of stamp duty is effectively lost annually.[5]

A survey of Savills network of agents suggests that estimated levels of stamp duty avoidance are likely to be overstated. This survey found that, within central London, the use of offshore special purpose vehicles only accounted for 1 in 10 sales over £1 million within our study. Other identifiable stamp duty avoidance measures were adopted in a further 11% of cases.

The survey found that, outside of Central London, stamp duty avoidance is rarely used (in about 4% of transactions). There, it was employed only where schemes were marketed aggressively by either specific solicitors or estate agents.[6]

However, there was little evidence of some stamp duty avoidance or planning outside central London; in our survey, fewer than 4% of sales of over £1 million outside central London involved this sort of tax planning.

So while there is little doubt that closure of stamp duty loopholes would increase the revenue from this tax, it is questionable as to whether it is sufficiently prevalent to warrant a wholesale change in the way that high value property is taxed. If they were to account for one in 10 transactions, the average additional stamp duty take from closing these loopholes would be just over £150 million a year over the next five years.

INHERITANCE TAX

In contrast with stamp duty, the tax take from inheritance tax is relatively small. The total inheritance tax bill in the UK was £2.4 billion in 2008/09, with just 15,500 death estates out of 272,000 that were notified for probate paying IHT.

Within those estates paying tax, the value of residential property accounted for one third of the total value of all assets.

However together with other chargeable assets, the tax payers nil rate band is available to be offset against such assets. Subject to the value of gifts made in the seven years prior to death, that nil rate band stands at £325,000 per person. Any unused nil rate band from a spouse's estate can be added to this figure. According to figures from HMRC the average addition to the nil rate band was £133,500 in 2008/09 because of this extra allowance.

That means that the majority of residential property would effectively be covered by the nil rate band, meaning that a disproportionate amount of the tax would be chargeable on estates containing high value property worth in excess of £1 million.

5 *The Times*, 26 November 2011.

6 Savills surveyed a sample of 392 sales over £1 million of which 154 were located in Central London.

Because the nil rate band can be offset against all chargeable assets it is difficult to establish the precise inheritance index attributable to residential property. Subject to this qualification, we have estimated the tax take on high value residential property by using HMRC data regarding

- the composition of estates chargeable to tax and
- the amount of tax paid on those estates, having regard to the reliefs available on various classes of non-residential property.

Figures published by HMRC show that 1,456 estates comprising total assets worth in excess of £2 million were taxed in 2008/09. Of these 1,173 (81%) comprised residential property with an average value of £1.13 million.

Having offset reliefs against non-residential property and divided the nil rate band between chargeable residential and non-residential property on a pro rata basis by reference to value, the total inheritance tax take from residential property can be estimated as £831 million in 2008/09, just over one third of the total tax take. We also estimate that of this just under £300 million was charged on property included in estates with a value of over £2 million.

That means that in 2008/09 we estimate that the top 0.7% of the housing stock held within estates at death generated 36% of the inheritance tax revenue from residential property.

Avoidance

The prospective tax liability from inheritance tax results in various forms of tax planning particularly amongst the capital rich, income poor. In its simplest form this may involve downsizing with some proceeds of sale being passed down generations. In other circumstances, the property itself may be gifted down a generation.

There has also been more complicated tax planning where owners who wish to remain in their property but pass the majority of value out of their estate. Such owners have used so called Lady Ingram schemes or subsequent variations. Such tax planning was sufficiently widespread to warrant the introduction of a pre-owned assets tax, designed specifically discourage the use of these schemes in 2005.

A MANSION TAX – THE ISSUES

The potential attractions of proposals for a Mansion Tax were listed on page 2 of this paper. These are now scrutinised in the light of the above evidence.

Is it targeted at the very wealthy?

The biggest problem with the Mansion Tax proposal is that, of all taxes, it is the least connected to the ability to pay. This is exacerbated by the extent of price growth over the past two decades.

A Mansion Tax would not be linked with income. It therefore risks imposing an unfairly tax the asset-rich, income-poor.

Consider the plight of the low income widow whose family prudently saved for years to buy the property of their dreams. It is difficult to envisage a case in which forcing her out of that home, because of an inability to pay this new tax, could be considered fair.

And there are plenty of people in this category. Analysis of Savills deal book suggest that 31% of properties in London worth over £2 million have been in the same ownership for over 10 years, and 15% have been owned for over 20 years. The Savills prime London index shows that price growth over the period has been +89% in the past 10 years and 426% in the past 20 years.

Profile of length of ownership of sellers in London 2010-11.

Sale Price	Over 10 years	Over 20 years
Over £1m	27%	12%
Over £2m	31%	15%

In addition, the way in which high value residential property is clustered in a handful of locations (mainly in central London) adds to the intrinsic unfairness of the proposal. A household on modest income which has lived in one of these areas could find themselves expected to pay a substantial annual tax bill out of proportion to their ability to pay. This could impact particularly severely on elderly households with limited incomes.

How do you value "Mansions"?

Introducing a high value property tax would be highly complex, not least because of the difficulty of establishing accurate valuations of individual properties, particularly at the top end of the market where:

- comparable transactional evidence is very scarce; and
- an individual property's value is determined by the nuances of its individual attributes. Factors such as location, position, architectural style and balance, layout and quality of accommodation, can all have a significant bearing on valuation.

As a valuation based tax, where the liability would be based on a precise valuation of an illiquid property, it would also be relatively costly to administer, with a high likelihood of dispute.

This is likely to be exacerbated by calls for regular revaluation of property to account for changes in local market conditions (a topical example might the effect of HS2 on house prices in the Chilterns) and/or the testing of valuation on a subsequent disposal (such provisions being available within the inheritance tax system on the disposal of property within one year of death).

Equally many valuable properties, most obviously stately homes, will already have a disproportionately high cost of upkeep, not least because of their listed building status. There is a risk that a further tax burden on these properties would place financial pressure on their associated ownership, deflecting funds from their maintenance. Other taxes – most particularly inheritance tax – make provision for this with the availability of heritage relief.

Transaction based taxes, such as stamp duty and capital gains tax, are based on sale proceeds; and so are comparatively simple to calculate. However, even they have the ability to distort the profile of transactions by creating artificial thresholds in the market, which can itself reduce the efficiency of the tax (as has been seen since the introduction of the new £1 million stamp duty threshold since April 2011). Such distortions are likely to be exaggerated further by a tax on high value property.

Furthermore it is likely to result in calls for exemptions, discounts or deferments, for example from those where the payment of such a tax would result in hardship or owners of large listed building where the tax burden needs to be weighed against the upkeep of heritage assets.

Do high value properties really make an unfairly modest contribution to tax receipts?
Higher value properties pay over twice as much Council Tax as the national average – and yet receive the same level of services. In addition, the top 1.6% of housing sales raised 26% of associated stamp duty receipts; or £1.2 billion, while the top 0.7% of the housing stock held at death contributed to 36% of the inheritance tax receipts from residential property.

As the UK already pays the highest levels of property tax in the OECD, it would seem strange to seek to increase the burden on a category which is already making such a large tax contribution. In this context, the the case for a mansion tax is highly questionable.

Would a Mansion Tax raise significant proceeds for the Treasury?
Advocates for a Mansion Tax have suggested that it could generate about £1 billion. This is equivalent to about 0.2% of total UK tax receipts – the equivalent of a rounding error.

On the other hand, the potential risks associated with this tax should be weighed. It would severely undermine Britain's (and more particularly, London's) position as one of the world's leading business locations. If only a handful of the new class of international wealthy were no longer to come to Britain, then the resulting loss of tax revenue would be far greater.

DO WE NEED A WEALTH TAX?

Tim Knox

Our governments tax our incomes. They tax our consumption. They tax gain from our investments. They tax our guilty pleasures. They tax our deaths. Now, there are proposals to tax our living wealth.

This strikes at the heart of the importance of aspiration and of property ownership.

Yes, we work hard to earn money to sustain our lives. But most people of aspiration earn income in an attempt to become wealthy and acquire property. They pay tax on their income and use the remainder to invest. A mansion tax based on property values is therefore a discouragement to aspiration. The probable result: brain drain and capital flight.

There are other obvious dangers. A supposedly highly targeted new wealth tax will, over time, spread to include more people as politicians seek new funds for their pet projects. And calls for rate hikes at times of crisis will be inevitable. How long would it be before the threshold at which a Mansion Tax was paid was reduced? How long would it take for rates to increase?

Yes, there is a pressing need for reform to our tax system based around Adam Smith's principles of fairness, simplicity, certainty and efficiency. Closing the opportunities for stamp duty avoidance would be a sensible measure. But for economic recovery, the UK does not need new complex taxes targeted at the aspirational and successful. It needs lower, simpler taxes aimed at encouraging, not penalising, wealth.

Tim Knox is Director of the Centre for Policy Studies

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