Pointmaker

THE SHRINKING CASE FOR A MANSION TAX

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SUMMARY

- The flaws in proposals for a Mansion Tax are well-established:
  - it would raise insignificant revenues, yielding at best an estimated £1.2 billion (equivalent to less than one quarter of one per cent of current tax revenues)
  - 80% of affected properties would be in London
  - as valuations in this part of the market are inherently subjective, it would be expensive and complex to administer and collect
  - it would take no account of an individual's ability to pay the tax and would be based on crude gross, not net, calculation of wealth
- Any case for a Mansion Tax has been diminished even further by significant tax reforms introduced since it was first mooted five years ago:
  - In 2009, stamp duty was levied at 4% on the sale of properties worth over £2 million. Today, the average effective rate is 10%. This means, on a like-for-like basis, an additional £1 billion will be raised from stamp duty on property worth over £2 million.
  - the large increase in both property prices and tax rates over the last five years has compounded the tax paid on transactions of individual properties. For example, the tax paid on a house now being sold in SW London for £2.5 million has increased by 405% since 2009.
  - the introduction and recently increased rate of the Annual Tax on Enveloped Dwellings has added at least another £100 million a year to the tax paid by "Mansions", closing the loopholes which existed when the Mansion Tax was first proposed.
- Given the above reforms, and given the impact that a Mansion Tax would have on property values (and thereby other property tax revenues), a Mansion Tax could also significantly erode existing property taxes. Savills forecasts that at least £1 in every £6 raised by a Mansion Tax would be lost in stamp duty and inheritance tax receipts.
- The wider economic impact of a Mansion Tax is impossible to quantify but would only be far greater, not least in seriously undermining the attraction of the UK (and London in particular) to overseas buyers, including those seeking to invest in businesses here.

INTRODUCTION

Proposals for a Mansion Tax were originally put forward by the Liberal Democrats in 2009, and have since been adopted in various forms by the Labour Party, the SNP, the Green Party and at least some parts of Plaid Cymru.

Advocates of a Mansion Tax claim that it will raise between £1 billion and £2 billion a year. It is also undeniably a popular measure (a September 2014 poll by YouGov found that 72% of respondents support, and 18% oppose, introducing a new tax on properties worth over £2 million).

A popular tax is of course a rarity. At a time when all parties recognise the need to reduce the deficit, its political attractions are clear. But just because a tax is popular does not mean that it would raise significant sums for the Exchequer, nor that it would be efficient, nor fair.

1. A TAX BUILT ON POOR FOUNDATIONS

1.1 The proposed Mansion Tax would not raise significant revenue.

The Labour Party's proposals aim to raise £1.2 billion – equivalent to less than one quarter of one per cent of current tax revenues. It would also be inefficient. Because of the potential negative impact on the value of the asset being taxed, it would be very likely to result in leakage from other taxes such as stamp duty, inheritance tax and capital gains tax.

1.2 It would be a tax heavily focused on one region: London.

Of the 97,000 properties which would be affected, it is estimated that 80,000 are located in the capital.

1.3 It would be a crude tax

A Mansion Tax would not differentiate between those who have the means to pay and those who do not.

- It would not account for whether the person liable pays their fair share of other taxes or has sought to mitigate them through tax avoidance strategies (unlike the existing Annual Tax on Enveloped Dwellings).
- It would not account for an individual's net property wealth, because it would not take into account the level of debt secured against the property in question. A person owning two properties worth £1.9 million each with no mortgage debt would pay no tax, but perversely a person owning a single property worth £2.1 million with a £1. 5 million mortgage would be caught by the charge.
- It would not account for the costs of upkeep of some of the country's most important listed buildings.

1.4 It would be difficult and costly to administer for both the taxpayer and HMRC.

It is anticipated that a Mansion Tax would require home owners who are potentially liable to the tax to obtain and bear the cost of a valuation of their own property in order to determine both the scale of the charge and whether they are liable.

Valuation is far more subjective in this sector of the market compared to mainstream housing. It is more difficult to arrive at an accurate valuation of a property, resulting in a much wider margin of error. As a consequence it is likely that HMRC would wish to review a relatively high proportion of valuations, particularly those that are close to band thresholds.

For example, a property close to the £2 million threshold might be valued somewhere between £1.8 million and £2.2 million, the precise figure being dependent on the subjective view of the valuer who conducts the valuation (a true market value only really being established at the point of sale).

If the taxpayer were to obtain a valuation at the bottom end of this range, they would not declare themselves liable for the tax. However HMRC would probably want to review this valuation. It is difficult to see how HMRC could do this without initiating a significant valuation exercise. If the case were borderline, it seems inevitable that there would be a formal dispute, the resolution of which would take time and be costly to resolve.

The narrower the value ranges within each band, the more valuations are likely to require verification – with potential for disputes and subsequent expense. Though Labour has yet to confirm details of the precise tax deduction, it has indicated that the charge will be no more than £3,000 per annum for property worth between £2 million and £3 million. It is estimated that over 40% of those properties that would be affected by the Mansion Tax, would be in this bracket, raising gross revenue of just £121 million.

1.5 What might the tax look like?

Little other detail regarding the charging structure and incidence of the tax has been provided by the Labour Party. Furthermore the Shadow Chancellor has recently indicated that these details will only be released after the General Election (in the event that the Labour Party forms the next government).

In the absence of this information Savills has modelled the scale of the tax on the basis of a progressive charging structure, taking into account the anticipated distribution of values for property affected.

This analysis indicated that in order to raise gross revenue of £1.2 billion the charge for properties worth between £3 million and £5 million would need to be in the order of £7,000, rising to £125,000 for properties worth more than £20 million (as shown in Table 1).

2. FURTHER EROSION OF FOUNDATIONS

In addition to all of the above practical difficulties, any justification for a Mansion Tax has been significantly eroded by recent reforms to the taxation of high value property.

Since the Mansion Tax was first proposed, the tax burden on high value residential property from existing taxes has increased significantly. Furthermore new taxes have been introduced to tighten the tax net on those previously avoiding certain elements of the pre-existing tax regime.

This means two of the key arguments adopted by proponents of a Mansion Tax have been significantly undermined by measures already introduced by the current government:

- Transaction taxes on properties worth over £2 million are now much higher relative to other UK properties. That means any further taxation in this area is difficult to justify on grounds of fairness.

Table 1: Estimated Mansion Tax bands

Value Band	Estimated Number	Average Value £m	Charge	Tax Raised £m
£2m – £3m	40,300	£2.49	£3,000	£121
£3m – £5m	30,600	£3.82	£7,000	£214
£5m – £10m	17,300	£6.79	£18,000	£311
£10m – £15m	5,200	£12.37	£41,000	£213
£15m – £20m	2,100	£17.73	£71,000	£149
£20m+	1,500	£26.50	£125,000	£188
All	**97,000**	**£4.92**	**£12,000**	**£1.2bn**

- High value properties now make a far greater absolute and proportionate contribution to capital taxes than they have ever done previously. Consequently a Mansion Tax would have a greater capacity to cannibalise existing tax receipts, making it a less efficient revenue raiser than its proponents realise.

Furthermore, given the extent to which taxes on high value properties have already been substantially increased, any additional taxation is likely to have a disproportionately negative effect on intangible questions such as the UK's reputation as a safe place for foreign investment.

2.1 How has the tax burden on high value property increased since a Mansion Tax was first mooted?

When a Mansion Tax was first proposed by the Liberal Democrats in 2009, the rate of stamp duty (SDLT) for a property worth over £2 million was 4%. That level was increased to 5% in April 2011 and then 7% in March 2012. The measures announced in the 2014 Autumn Statement mean that the average effective rate of tax over £2 million now exceeds 10%.

At the 4% rate, the total amount of SDLT revenue raised from the sale of properties worth more than £2 million in 2013 would have been just over £700 million. Under the new stamp duty regime, the sum raised was £1.8 billion – an increase of £1.1 billion, or 257%.

Even before the latest increases in high value property tax rates, the top 1.6% of residential property sales over £1 million accounted for 34% of all residential property SDLT receipts. The new reforms mean that they now contribute 45%.

2.2 How are individual properties affected?

The number and value of properties sold above £2 million has risen significantly since 2009. That has compounded the increase in the tax raised from the sale of single property now worth over £2 million.

Analysis undertaken by Savills suggests a property currently worth £2.5 million in SW London would have been worth £1.75 million in December 2009. Had that property sold in 2009 the property would have generated SDLT revenue of £70,120. In contrast, if the same property sold in early 2015 it would now generate £213,750 – an increase of 405% in the amount of SDLT payable. This would now fund the starting salary of ten nurses, up from three and a half only five years ago.

Similarly a central London property currently worth £5.5 million would have been worth just short of £4.0 million at the end of 2009 with an associated SDLT liability of £160,000. The same property would now carry a stamp duty bill of £572,000 – a 382% increase. The tax revenue generated would now fund the starting salary of almost 27 nurses up from just under eight, five years ago.

2.3 What other measures have been introduced to address tax avoidance?

In 2013 the Annual Tax on Enveloped Dwellings (ATED) was introduced on properties worth over £2 million, predominantly where they were owned within corporate structures in a way that potentially avoided their exposure to inheritance tax and future stamp duty.

As such the ATED was a targeted means of taxing high net worth individuals who were not perceived to be making a fair tax contribution, while incorporating a number of reliefs to avoid genuine investors and developers being charged. This new tax raised £100 million in the 2013/14 tax year and a further £108 million between April and November 2014.

The ATED charges originally started at £15,000 per year for a property worth between £2 million and £5 million, rising to £140,000 for a property worth over £20 million.

In the Autumn Statement these charges were raised by 50% plus inflation, so that the charge for a property valued at between £2 million and £5 million are now in the order of £23,350 in 2015/16, while that for a £20 million property would be £218,500.

Not only do these increases add to the tax burden borne by high value residential property, but they serve as a reminder that once introduced there is no guarantee that a tax will not be increased substantially. Further, Labour's hypothecation of Mansion Tax revenues to the NHS raises this risk substantially.

2.4 What impact have recent tax measures had on property values?

The successive increases in stamp duty to 5% and then 7% have been a contributory factor to a period of subdued price growth in London – in particular in properties valued at around £2 million. Beyond the capital the effect has been even more pronounced, creating an observable threshold in market activity at £2 million.

While it is too early to determine the precise impact of the further stamp duty changes introduced in the 2014 Autumn Statement, the evidence to date suggests that the additional charges have resulted in a proportionate downward adjustment in property values. In the fourth quarter of 2014, the value of £2 million+ properties fell by 4% according to Savills prime London housing indices. Furthermore those index results indicate that the threat of a Mansion Tax may have caused a softening in the market even before the Autumn Statement.

2.5 What impact would a Mansion Tax have on property values?

It also seems certain that the imposition of a Mansion Tax would cause a further adjustment in the value of residential property.

Using estimates of the prospective annual charges, Savills have also examined the potential impact of a Mansion Tax on property values. This impact would be dependent on the valuation band in which a property is situated – whereby a greater impact is anticipated for higher band properties, due to annual charges likely being more aggressive.

This said, there is also a possibility of a depreciative effect trickling down to the £1 million to £2 million market, as shown below in Table 2.

Table 2: Depreciative Effect

Scenario	Sector	2015
No Mansion Tax	All Prime London	-0.5%
Mansion Tax	£10m+	-10.0%
	£5m - £10m	-8.0%
	£3m - £5m	-6.0%
	£2m - £3m	-4.0%
	£1m - £2m	-2.0%
	All Prime London	-5.0%

2.6 What impact would a Mansion Tax have on other tax revenues?

This negative impact on property values would of course further erode revenues from other property taxes over the longer term.

On the basis of these calculations, Savills has forecast that stamp duty revenue of at least £160 million would be forgone each year due to the imposition of a Mansion Tax, with a further reduction of at least £35 million in inheritance tax receipts

Over time this figure is likely to increase as capital rich, income poor households roll up the tax and any interest accruing until their death or in some cases dispose of the property (the Labour Party has said that that those on incomes of less than £42,000 could defer the annual charge until the property is sold).

That would lead to at least £1 in every £6 raised by a Mansion Tax being lost in stamp duty and inheritance tax receipts.

3. CONCLUSION: THE WIDER ECONOMIC IMPACT

In addition to the above inherent flaws in a Mansion Tax, such a measure would carry a wider economic risk: it could make the UK – and London in particular – significantly less attractive to domestic and overseas investors, with significant consequences for the whole of the UK.

For example, a Mansion Tax could affect:

- Direct Household Expenditure: In February 2014 Ramidus Consulting estimated that households who have bought property worth more than £5 million in the past 10 years in the borough of Westminster contribute £2.3 billion a year to the UK economy based on their household expenditure alone.
- The wider UK business interests of ultra-high net worth individuals who live full- or part-time in the UK.
- The attraction of London to employees in high value industries such as the financial and business services sector, and the growing tech sector.
- The prime London development industry. Savills forecast that over the next five years this prime development pipeline will be worth £44 billion.

It should be remembered that wealthy overseas investors operate in a particularly competitive global environment. A Mansion Tax would send a strong message that such investors in the UK would be facing a punitive and uncertain tax regime – a message which poses perhaps the greatest risk of all.

THE MANSION TAX: AN APPEAL TO ENVY

Tim Knox

There is an urgent need for reform of the British tax system, based around Adam Smith's principles of fairness, simplicity, certainty, and efficiency. That the Mansion Tax is unfair, complex, uncertain and inefficient should be clear from the above analysis.

It is also a wealth tax. In the UK, the most recent attempt to introduce such a tax was made by Denis Healey (in 1976). In a memo marked "secret", HM Treasury then advised that the proposed wealth tax "would produce little revenue, be extremely difficult to administer and risk serious damage to the economy". Denis Healey later noted that: "We had committed ourselves to a Wealth Tax: but in five years I found it impossible to draft one which would yield enough revenue to be worth the administrative cost and political hassle." And the inherent difficulties of a wealth tax are not unique to the UK: Austria, Denmark and Germany abandoned them in 1997, Finland and Luxembourg in 2006, Sweden in 2007 and Iceland in 2014. Even President Hollande has recently reformed the French wealth tax in an attempt to limit some of its more grotesque side-effects.

It is also a hypothecated tax. Labour has indicated that the net proceeds (of £1.2 billion) of a Mansion Tax would be directed to its NHS 'Time to Care' fund of £2.5 billion, designed "to fund an additional 20,000 nurses and 8,000 GPs by 2020." Yet NHS net expenditure for 2014/15 is forecast to be £113 billion. In other words, the supposed revenue from a Mansion Tax would add just 1% to health spending. A rounding error. And it should be recognised that hypothecation of this sort opens the door to fiscal creep, whereby the tax may be gradually broadened, deepened, and justified by successive governments – as has occurred recently with both Stamp Duty and the ATED.

Ultimately the proposed Mansion Tax is little more than an appeal to envy, and should not be presented as an integral part of any coherent manifesto. Consider, for example, Labour's and the Liberal Democrat's support for the Dilnot proposals to reform long-term care for the elderly: these were intended to address the concern that many individuals are today driven to sell their homes to pay for their long-term care in old age. That is considered to be a bad thing for the individuals concerned. So where is the coherence in the same parties now proposing a policy which could similarly drive cash-poor, asset-rich households to sell their houses?

No. For economic recovery, the UK does not need new taxes targeted at the aspirational, the successful and sometimes the fortunate. Rather, it needs lower, simpler taxes which encourage innovation and productivity and which simulate, not penalise, wealth creation.

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