



HOME TRUTHS

Options for reforming residential
property taxes in England

Professor Paul Cheshire and Professor Christian Hilber

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About the authors

Professor Paul Cheshire

An economist by training, Paul Cheshire is Emeritus Professor of Economic Geography. He has been named one of the Planning industry's most influential people.

He is the author/co-author of more than 100 papers and was the 1989 winner of the Donald Robertson Memorial Prize and in 2004 won the Royal Economic Society's prize for the best paper in the Economic Journal. He won the European Regional Science Association/European Investment Bank's prize for lifetime contribution to regional science research in 2009.

He is an elected Fellow of the Academy of the Social Sciences and of the Weimer School. He held a Leverhulme Research Fellowship in 2000-01 and was a Visiting Fellow of the Lincoln Institute of Land Policy in 2002. He was awarded a CBE for services to Economics and Housing in 2017.

Apart from his academic work he has spent time as an advisor and as a consultant for the European Commission, the World Bank, the OECD, the UN and other international organisations as well as the UK government, including being a member of the Expert Panel for the Barker Review of the Planning System, and an Academic Friend of the Eddington Transport Study. Until its abolition in 2010 he was a board member of the National Housing and Planning Advice Unit

and a member of two of the Department of Communities and Local Government's Expert Panels.

Professor Christian Hilber

Christian A.L. Hilber is Professor of Economic Geography at the London School of Economics (LSE). He is an Associate of the Centre for Economic Performance (CEP) and a Member of the Academic Panel of the What Works Centre.

Prior to joining the LSE in 2003, he was a Postdoctoral Research Fellow at the Wharton School, University of Pennsylvania (1999-2002) and an Economist at Fannie Mae (2002-2003). Hilber's research concerns urban economics, real estate, housing, public finance, political economy and policy evaluation. He has published in journals such as *Review of Economics and Statistics*, *Economic Journal*, *Journal of Public Economics*, *Journal of Urban Economics* or *Journal of Economic Geography*.

He currently serves as an Associate Editor of *Regional Science and Urban Economics* (RSUE) and *Journal of Regional Science* (JRS) and as a member of the Editorial Boards of *Journal of Housing Economics* (JHE) and *Real Estate Economics* (REE). He is a Member of the Executive Committee of the Centre for Urban and Real Estate Management (CUREM) at the University of Zurich. He served as a Member of the Board of Directors of the American Real Estate and Urban Economics Association (AREUEA) between 2015 and 2017 and as the Director of LSE's MSc Real Estate Economics and Finance (REEF) between 2003 and 2018. He is a Fellow of the Weimer School of Advanced Studies in Real Estate and Land Economics. He has served as a consultant to the H.M.

Treasury. He won the 2019 Nick Tyrrell Prize for joint research on the economic impacts of Help To Buy.

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All remaining errors and all judgements are the authors' responsibility.

The views in this report are our own and do not necessarily reflect the views of Bright Blue.

Tax reform in the 2020s

This report has been commissioned by a high-profile cross-party, cross-sector commission established by Bright Blue to advise on reforms to the tax system in the years ahead to support the post-COVID economic recovery, the restoration of the public finances, and the achievement of better economic, social and environmental outcomes.

Bright Blue's project on tax reform aims to build and articulate a coherent vision, with clear principles and policies, for a tax reforming agenda in the 2020s, focussing in particular on four areas of tax policy: carbon taxation, property taxation, business taxation, and work and wealth taxation.

Bright Blue has commissioned independent experts to provide original analysis and policy recommendations in each of these four areas of tax policy, which the commission will consider before publishing a strategic vision for a tax-reforming, rather than just tax-cutting, agenda over the next decade.

The members of the commission include:

- **David Gauke**, Former Secretary of State for Justice
- **Sir Vince Cable**, Former Secretary of State for Business
- **The Rt Hon Lord David Willetts**, President of the Advisory Council and Intergenerational Centre at the Resolution Foundation
- **The Rt Hon Dame Margaret Hodge MP**, Former Chair of the Public Accounts Committee

- **The Rt Hon Andrew Mitchell MP**, Former Secretary of State for International Development
- **James Timpson OBE DL**, Chief Executive of the Timpson Group
- **Luke Johnson**, Entrepreneur and Chairman, Risk Capital Partners
- **Emma Jones MBE**, Entrepreneur and Founder, Enterprise Nation
- **Mike Cherry OBE**, National Chairman, Federation of Small Businesses
- **Mike Clancy**, General Secretary, Prospect trade union
- **Victoria Todd**, Head of the Low Incomes Tax Reform Group
- **Sam Fankhauser**, Director, Grantham Research Institute, LSE
- **Christina Marriott**, Chief Executive, Royal Society for Public Health
- **Helen Miller**, Deputy Director and Head of the Tax Sector, Institute for Fiscal Studies
- **Giles Wilkes**, Former Special Adviser, Number 10 Downing Street
- **Caron Bradshaw**, CEO, Charity Finance Group
- **Pesh Framjee**, Global Head of Non Profits, Crowe UK
- **Robert Palmer**, Director, Tax Justice UK
- **Lord Victor Adebowale CBE**, Chair, Social Enterprise UK

The views in this report on property taxation are those of the authors and do not necessarily reflect those of Bright Blue or members of our tax commission detailed above.

Foreword

I commend Bright Blue for producing a timely and compelling report that makes a powerful case for reforming the country's failing residential property taxes and proposes realistic ways of moving forward.

This Government has made the political choice to stand on a platform of levelling up. This policy position has garnered this Government an 80-seat majority with its core mandate about improving the lives of those who have been left behind in some of the most deprived areas of the country. We can only hope that the Government will feel empowered to take advantage of this extraordinary mandate for the benefit of the nation as a whole.

Yet, because of the pandemic, only a fraction of the work of levelling up has been achieved, leaving many areas in the same position that they have been for a generation.

In a bid to boost deprived areas of the country the Government has focused on investment in infrastructure, towns funds and freeports. While these measures are useful in the long run, people living in these areas are still having to pay for a tax that disadvantages them for living in lower value homes. To make a meaningful impact, tax reforms that translate to more money in the pockets of these communities are needed.

Bright Blue's excellent paper makes the critical point that it is politics, and not economics, that will determine the future of the UK's property taxes. These political choices have critical economic consequences which can either entrench or ameliorate rising levels of regional and

intergenerational inequality.

For the Government to truly achieve its mission, it must make political choices which have the desired impact of improving the lives of households that are most in need of levelling up on a timescale that resonates with voters.

Council Tax and Stamp Duty reform is one such area where the Government should seize the mantle of levelling up. Our view is that households are already paying sufficient property taxes – the problem is that the wrong households are paying the wrong taxes at the wrong times. Removing both taxes would have multiple benefits: it takes away the regressive banding system; it removes the arbitrary impact that house price growth over the last 30 years has had on people's tax burden; and lifts the economic handbrake that is stamp duty. It offers both a path to greater economic growth and a better distribution of the resulting income than our current system can provide.

Reform would improve living standards, and go some way towards ensuring that the whole UK can benefit from the same access to opportunities. It is exciting to see the authors advocating the introduction of a proportional property tax. Such a policy would be simpler, economically efficient and aligned with Government's goals. It would also provide greater fiscal flexibility and would benefit a large majority of households across the UK, helping to meet the Government's levelling up targets.

As the paper makes clear there is no technical reason for delay. Valuation of property is “an easy and cheap task so long as it does not rely on traditional valuation techniques but uses statistical methods” a revaluation with no additional structural change to property tax is rightly dismissed as failing insufficient to the scale of the challenge.

Bright Blue's paper also makes useful and noteworthy interventions around green deductions and tax-free thresholds which are useful additions to the debate and ones which we encourage the Government to consider fully.

Yet, where we stand currently, the first great hurdle is for the

Government to consider property tax reform at the highest levels. The political cost of inaction is simply too high now for the issue to be ignored.

If the Government really is serious about levelling-up, as the recent appointment of a Levelling Up Adviser suggests, then property tax reform is exactly the kind of “bold new policy intervention” that could really make “meaningful change” in people’s lives.¹

I very much hope that the Government gives this excellent paper the attention it deserves. Local government, economists, think tanks, tax reformers and third sector organisations are ready to support the principles of this initiative. Are ministers and Her Majesty’s Treasury willing to do the same?

Andrew Dixon
Founder & Chairman



1.GOV.UK, “Government to publish levelling up white paper” <https://www.gov.uk/government/news/government-to-publish-levelling-up-white-paper> (2021).

Executive summary

Property taxes are some of the oldest taxes in the world. They were, after all, the point of the Domesday Book. Their advantage has always been that property has a fixed location and taxes on it are simple to collect and difficult to avoid.

The main property taxes in England now, however, are a fudge: taxes both on houses and on people. This is the result of the Poll Tax fiasco and its aftermath in the late Thatcher period, requiring a quick fix which gave us Council Tax (CT) in 1993. To this was added a tax on transactions, the Stamp Duty Land Tax (SDLT).

There are also specific taxes on new construction: Section 106 (S106) Agreements, the result of one-off negotiations paid in kind for granting planning permission; and, the Community Infrastructure levy (CIL) raised as a tax per m² on built space but only charged by some Local Authorities (LA) with no policing of how proceeds are spent.

Since at least the 1950s, there has been a growing realisation that property taxes in England are in dire need of reform. All the current main property taxes have major defects rendering the system not fit for purpose. Assessments for CT are frozen at 1991 values and are highly regressive. Since the top value is still £320,000, the single occupant of a house worth £2.5 million in a London street may pay less than their married neighbours with a child in a one-bedroom flat next door. SDLT is a tax on moving, so means that people are less likely to downsize and it is more difficult to find houses to suit them as family circumstances change.

There are two further aspects of the system to take into account: first, the incentives it provides for local communities to permit new building – at present they must pay for service but get very little revenue which understandably fuels ‘NIMBYism’ and, second, the financial independence of local government. CT revenues provide only a small portion of LA revenues, most of which are in the form of central government grants. These result in a ‘claw-back’ of any additional revenues LAs might raise. The present system has converted local governments into little more than agencies of national government except in one respect: control of the planning system.

In this paper, we review, critically evaluate and make recommendations for the replacement of the current main taxes on residential property.

The focus is on the property taxation system for England, but the analysis and our ideas could be extended to Wales, Scotland and Northern Ireland.

We evaluate options for reform against a number of economic and political criteria. Economic criteria include: revenue raising; efficiency; equity; simplicity; incentives for building housing; and, automatic stabilisation. Political criteria include: public acceptability; ease of transition; and, alignment with key government objectives.

In coming to a final recommendation for replacing the main current property taxes, we were conscious that the best should not be the enemy of the good. There is widespread consensus that reform is badly needed: the problem is not so much thinking of better alternatives to the status quo but of agreeing which alternative. We have therefore given particular attention to the following criteria: simplicity, public acceptability and ease of transition.

The main replacements we consider are a proportionate tax on the value of houses or on the value of ‘unimproved land’ (the value of land assuming no obstacles to changing its use in the most profitable way): in both cases, with and without a tax exemption. We then include supplementary taxes or subsidies to these two principal options: a ‘green offset’, automatically adjusting how much tax was paid according

to the energy efficiency of the house; and, a ‘Development Levy’, paid at a standard rate to LAs with the revenues required to be spent on additional infrastructure and services to pay the costs generated by additional residents and on social housing.

In conclusion, the combination of policies we recommend as the main property taxes in England are:

- 1. An Annual Proportional Property Tax (APPT)** on the current capital value of houses to replace both CT and SDLT, which are phased out while the APPT is phased in.
- 2. The national government(s) and LAs to impose separate APPT tax rates.** The national tax rate(s) should be set to replace the shortfalls from phasing out SDLT. We estimate the rate required to achieve this would be 0.11% for primary homes and 0.14% for second homes (25% surcharge). LAs should be entirely free to set their own tax rates, with no claw back by the central government. LAs should be free to spend this revenue on the mix of local services their residents want. There should consequently be a clear distinction between those services for which there are nationally set standards (such as education, health care and social services) to be funded by national governments with LAs the agents for delivery; and those services which are locally determined (examples would be parks, local transport or cultural services).
- 3. A tax exemption on the APPT for houses worth less than £50,000.** This makes the option slightly more equitable but is set at a level where the impact on net tax revenue and neutrality is negligible.
- 4. Houses to be revalued annually** using statistical techniques but applying the tax to a three-year moving average of value with a clearly designed appeal process under the auspices of the existing government professional services (District Valuer Services). There should be provision for those faced with very large increases in tax liability (for example if the value of it doubles) to defer property tax payments until sale or inheritance.

5. **Green offsets** applied to the APPT to improve energy efficiency. The offsets can be designed in a revenue neutral fashion with a tax for energy inefficient buildings but a subsidy for energy efficient ones.
6. **A Development Levy** set at 20% of the realised market price of newly constructed houses. This is to replace the current Section 106 Agreements and CIL, and proposed Infrastructure Levy from the current Government.

Chapter 1: Taxes on property

Reviewing the literature on forms of taxation on residential property around the world suggests they can be broken down into four distinct types.

- i) **Taxes on the value of buildings.** Council Tax (CT), as explained in detail below, is the British example. Local property taxes are popular in numerous other countries, including the USA.
- ii) **Taxes on the value of land.** This is a tax long favoured by economists, going back to Adam Smith although most famously associated with the 19th century economist Henry George.² It has recently been advocated, or at least positively reviewed, by the New Zealand Productivity Commission³, the attorney and tax scholar Joan Youngman⁴, and the applied economist John Muellbauer.⁵
- iii) **Taxes on the value of transactions.** Stamp Duty Land Tax (SDLT), as explained in detail below, is the English example. Transaction taxes are widespread across Europe and the world.
- iv) **Taxes on increase in value.** This is capital gains, which is not

2. Henry George, *Progress and Poverty: An inquiry into the cause of industrial depressions and of increase of want with increase of wealth: the remedy* (New York: D. Appleton & Co, 1879).

3. New Zealand Productivity Commission, "Using land for housing", www.productivity.govt.nz/inquiries/using-land-for-housing/ (2015).

4. Joan Youngman, *A good tax*, (Cambs., MA: Lincoln Institute, 2016).

5. John Muellbauer, "Housing, debt and the economy: a tale of two countries", *N.I. Economic Review* (2018).

exclusive to property. In Britain, as in many countries such as New Zealand or Canada, housing receives special treatment: a person's primary residence is exempt from taxes on capital gains, favouring a life cycle approach to saving in the form of housing as an asset class. In the UK, Capital Gains Tax (CGT) is essentially paid only on second homes or buy-to-let properties. There are tax free thresholds but for houses that qualify, such as second homes, the rate charged on such properties is higher than on capital gains on other financial assets. The capital gains tax relief on first homes generates an incentive to divert assets into housing. It also favours owner-occupiers vis-à-vis landlords and renters.

There are, in addition, a range of other taxes (or subsidies) affecting residential property.

- i) **Levies on government induced land value uplift.** This is currently 'taxed' in two main ways in England: Section 106 Agreements (S106), which are essentially negotiated payments in kind, and the Community Infrastructure Levy (CIL), both of which are discussed in detail later. Both these, and their Scottish equivalents, are unique to Britain reflecting the particular discretionary form of British land use regulation and the scarcity value this generates for development land.
- ii) **Differential treatment of second homes.** In England, there is differential treatment of second homes for both SDLT and Council Tax. In some countries, such as the US (New York), Canada (Vancouver), France, Israel and Singapore, there is a specific tax on second homes or on foreign purchase of homes.⁶
- iii) **Taxes on or subsidies for energy inefficient buildings.** In the UK, there have been subsidies (negative taxes) for energy efficiency in buildings such as the 'Green Deal' or, more recently, the just

6. Christian Hilber and Olivier Schöni, "On the economic impacts of constraining second home investments", *Journal of Urban Economics* (2020).

abolished ‘Green Homes Grant’ for retrofitting homes. Systematic taxes on energy inefficiency have been proposed by, for example, Muellbauer because of a market failure with respect to energy use and its impact on climate.⁷

- iv) **Taxation on rental income.** If two people rent out houses they own to each other, both will pay tax on the rents they receive but if they live in their own houses, no tax is paid. Until 1963, owner-occupiers were liable to pay income tax on the value of the imputed rents they enjoyed. This is still the case in, for example, Switzerland.
- v) **Tax deductibility of mortgage interest.** Until April 2000, interest paid on mortgages in the UK up to a limit which varied over time was deductible for purposes of income tax. Such tax deductibility of mortgage interest still applies in many regions and countries although some, such as the regions of Flanders and Brussels in Belgium, The Netherlands and the USA, have been significantly reducing its scope.

There is a useful distinction between taxes affecting the stock of property, such as CT, and those on the margin. Examples of the latter are SDLT, paid only when property is transacted, or S106 or CIL, paid only on newly constructed houses.

This distinction is relevant for at least two reasons. First, the acceptability of a tax may increase if it is viewed as ‘voluntary’. One does not have to pay SDLT if one does not sell or buy a house, whereas CT is very difficult to avoid. In addition, a tax or levy on only new buildings – depending what group receives the revenues and how the revenues are spent – will affect the incentive for local communities to accept new development.

A 2014 OECD report by Richard Almy provides a useful survey of practice as it varies around the world in the taxation of ‘immovable

7. Muellbauer, “Housing, debt and the economy”

property’ (real property or real estate).⁸ Table 1.1 below is taken from this. It is immediately apparent that there is a wide range of international practice across OECD countries.

Table 1.1. Taxation of immovable property in OECD countries

A land tax only:	Estonia
A tax on land and buildings (a single immovable property tax):	Austria, Belgium, Canada, Chile, Czech Republic, Finland, Germany, Iceland, Israel, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, United States, India, Indonesia, South Africa
A land tax plus an immovable property tax:	Australia, New Zealand, Poland, Slovak Republic, Brazil
A building tax plus an immovable property tax:	Greece, Ireland, United Kingdom
A land tax, a building tax, and an immovable property tax:	Denmark, France, Slovenia, China, Russian Federation
A separate land tax and a separate building tax:	Hungary

The most common system seems to be a tax on the combined capital value of land and the current buildings on the land. Some countries – such as France – have separate taxes on buildings and on land. Then there are also countries like Denmark with separate taxes on land, residential buildings and commercial buildings.

8. Richard Almy, “Valuation and assessment of immovable property”, *Working Papers on Fiscal Federalism 19* (2014).

Box 1.1. The case of Denmark

The Danish experience illustrates the complex palimpsest of taxes and methods that have developed over time. There are three types of property taxes: a land tax on all types of land, a service tax on the value of buildings used for business or administration, and a property value tax on residential property.

The Danish land tax (*grundskyld*) is an annual tax on the assessed value of land and is part of the municipal property tax. The land tax rate was between 1.6% and 3.4% of the assessed land value in 2019.⁹ The service tax on the value of buildings used for business or administration cannot exceed 1% of the assessed value of the building. The annual rate of the property value tax on the owner-occupied dwellings in 2019 was 1% (3% above a threshold of about EUR 400K) of the assessed value of a dwelling.

The UK has separate taxes on residential buildings (plus the land on which they stand by implication) based on pseudo capital values¹⁰; and on rental values of commercial building space – which again, by implication, reflect some value of the land on which the building stands. In the next section, we explore the specific features of residential property taxation in England.

The current English system of residential property taxation

There are two main taxes on residential property in England: CT and SDLT. SDLT in England yielded some £11,250 million in 2019-20

9. Agricultural land is taxed as well, but at lower rates (below 0.7%).

10. 'Pseudo' because the values used to assess property for CT bear no relation to current capital values but to values assessed in 1991 or, for buildings constructed in the past 30 years, what their values might have been in 1991. This is discussed in more detail in the context of Table 1.2 below.

compared to £31,600 million from CT. In addition, there is the CIL and S106 Agreements.¹¹ A 2018 study for the Ministry of Housing, Communities and Local Government (MHCLG), claimed the total value of CIL receipts and Section 106 Agreements was some £6,000 million in 2016-17.¹²

We discuss all these ‘taxes’ (S106 agreements can be interpreted as a tax in kind) and their defects below.¹³

Council Tax (CT)

Box 1.2. The evolution of CT

‘Domestic Rates’, levied on property and originally introduced in 1601 to fund provisions of the Poor Law, were historically local governments’ prime source of revenue. But locally raised revenue, which was 75% of the total in 1930, fell to about 62% in 1970 and just over 50% in 1980 as central government grants along with central government control played a larger and larger part.¹⁴

A combination of rapidly increasing statutory obligations and rising wages created ever increasing pressures on local revenues.

11. There is also Capital Gains Tax, which is less important and more difficult to quantify than the main two. In fact, it is probably less important than S106 Agreements, although the total cost of those and the value they generate is impossible accurately to estimate and the hidden costs are likely high. See Paul Cheshire, “Broken market or broken policy? The unintended consequences of restrictive planning”, *National Institute Economic Review* (2018), R9-19.

12. MHCLG, “The incidence, value and delivery of planning obligations and community infrastructure levy in England in 2016-17”, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/685301/Section_106_and_CIL_research_report.pdf (2018).

13. There are other subsidiary and perhaps temporary taxes or subsidies on housing or specific categories of housing or buyers. An example is the Help to Buy equity loan scheme, a subsidy explicitly on purchases of new build homes and since 2021 exclusive to first time buyers. However, as research has shown this is a very dubious policy and at least where housing is in short supply – most areas where people are wanting to buy homes – more a subsidy on the developers who have specialised in building homes that attract first time buyers than on the first time buyers themselves (see Carozzi *et al.*, 2020).

14. Tony Travers and Lorena Esposito, “The decline and fall of local democracy: a history of local government finance”, <https://www.localis.org.uk/wp-content/uploads/2003/08/Travers-T-Esposito-L.-The-Divide-and-Fall-of-Local-Democracy.-A-History-of-Local-Government-Finance.pdf> (2003).

Despite rising grant income,¹⁵ following domestic rate revaluation in 1973 (postponed since 1968), in 1974 alone the average increase in domestic rates was 30%.¹⁶ Although this should be set against the then rate of inflation of 16% a year, still the outcry shows how sensitive public opinion is to changes in property taxes. This gave rise to serious political pressure for reform. A Royal Commission chaired by Sir Frank Layfield was set up as a response with a brief to review the whole system. This reported in 1976.

The Layfield Commission favoured a system of local government finance that remained decentralised but had new and substantially enlarged financial resources available to it. But no local tax reform ensued.¹⁷ As a holding measure, the post-1979 Conservative Government published a Green Paper in 1981. This looked at alternatives to the domestic rates, including a local income tax, a local sales tax and a poll tax. But once again, no reform occurred.

A second consultative paper, published in 1986, proposed the introduction of a poll tax as a replacement for domestic rates.¹⁸ This was euphemistically re-named the Community Charge and introduced in Scotland in 1989 and in England and Wales a year later.

Whether named the Community Charge or Poll Tax, the policy created serious opposition, the tip of the iceberg being the 'Poll Tax riots' of 1990. The new Conservative Government led by John Major abolished the Community Charge and cobbled together what was in essence a new variation of the Domestic Rates, the

15. In terms of revenues to finance services provided by LAs, grants from central government have grown very substantially since the Second World War. In some recent years these grants have provided 80 % of LA revenues. It is changes to these, designed in principle to ensure LAs have the necessary revenues to deliver a common quality of services such as education across the country, that means there tends to be a process of 'revenue equalisation': if an LA gets more revenue from local taxes on say property it is liable to lose government grants over the following period.

16. Parliament, "Select Committee on Office of the Deputy Prime Minister: housing, planning, local government and the regions- ninth report", <https://publications.parliament.uk/pa/cm200304/cmselect/cm0dpm/402/40202.htm> (2004).

17. For some further detail see Parliament, "housing, planning, local government and the regions"

18. Parliament, "Housing, planning, local government and the regions"

Council Tax (CT), introduced by the Local Government Finance Act in March 1992, coming into effect the following year.¹⁹

The CT was rushed through to resolve a political emergency. It combines a tax on domestic property (Business Rates are a separate and national tax) and a quasi-fixed tax on people: properties with only a single occupant pay only 75% of the tax and empty properties only 50%.²⁰ This was to reflect its ostensible function as a charge for services provided by local authorities.

Massive and differential house price inflation across property types and locations over the past 30 years, when CT was first introduced, means that CT liabilities now bear only a tenuous relationship to market values. The result is highly regressive as well as arbitrary.

CT is levied as a crudely estimated proportion of the value of houses with the liability to pay resting with the occupier. The rate paid is poorly correlated with the current value of houses and moreover is designed to reflect not just property prices but the number of people living in the houses so consuming services.

The bands for Council Tax are listed below in Table 1.2. These bands remain the same as when CT was established in 1991.

Table 1.2. Council Tax bands for 2020-21

Band	Property value range
A	Up to and Inc. £40,000
B	£40,001 – £52,000
C	£52,001 – £68,000

19. GOV.UK, “Local Government Finance Act 1992”, <https://www.legislation.gov.uk/ukpga/1992/14/section/93>.

20. GOV.UK, “Council Tax: Who has to pay”, <https://www.gov.uk/council-tax/who-has-to-pay>.

D	£68,001 – £88,000
E	£88,001 – £120,000
F	£120,001 – £160,000
G	£160,001 – £320,000
H	Over £320,000

Using a complex formula, centred on the yield from Band D properties, LAs apply a ‘rate’ – a fraction of the assessed value calculated to yield the total revenue required – to be paid in tax. LAs can set their own rates subject to the limits set from time to time by the central government. All resulting revenues are collected by the LA but, where legally provided for, a proportion is transferred as a ‘precept’ to a higher authority or an authority with specialised functions (such as drainage or flood prevention).

The CT has several serious deficiencies. The most recent valuation was done – in haste – in April 1991. Newly built houses are retrospectively assessed to the same date. A revaluation was planned for 2007, but this was postponed and then cancelled. For the purposes of CT, properties are still valued on a 1991 basis.

Since 1991 not only have house prices – abstracting from inflation – more than doubled, but the rate of increase has varied sharply by regions, even neighbourhoods. In a number of London boroughs, the median price of a detached house increased more than eightfold between 1995 and 2020; in some southern English towns, such as Brighton, by more than six times. But in towns in the North West, such as Burnley or Blackpool, the comparable increase was around 2.7 times.²¹

In 1995, the median price of a detached house in Camden already exceeded the cut-off of £320,000. The implication is that although by

21. ONS, “Median house prices for administrative geographies: HPSSA dataset 9”, <https://www.ons.gov.uk/peoplepopulationandcommunity/housing/datasets/medianhousepriceforationalandsubnationalgeographiesquarterlyrollingyearhpssadataset09> (2021).

June 2020, that house cost £3,650,000, for the purposes of CT, it cost the same. This illustrates why CT is so regressive: the more valuable your house, the less likely it is that your CT will have increased since 1991. The highest rates of tax are paid on the cheapest houses. There are even discounts of 50% for second homes.

Although it is generally accepted that CT is regressive across individuals, it is still surprising that per capita receipts from CT were highest not in London but the South East (£643) and in fact lowest in London (£481) followed by the West Midlands (£483), thus reinforcing rather than alleviating regional disparities. This is because London's boroughs impose lower rates for given tax bands compared to councils in other regions.

While there are discounts for second homes and for people in single occupation (generating an additional incentive for using available housing space inefficiently) there are no discounts for energy efficient houses. Several charges are levied on more polluting cars, for example higher costs of residents' parking permits, so the principle of taxing pollution is established, even for LAs. There is an elaborate system of energy efficiency certification for houses, through Energy Performance Certificates (EPCs). So it would be simple to scale taxes on houses to reflect their energy efficiency. CT does not do that.

A final feature of CT is that – since it was designed as a hurried replacement for the Community Charge – it retains an element of being a charge on residents for the provision of local public services. So it is levied on occupants not owners. One can debate whether this is a theoretical defect of the tax. In terms of distributional effects, it might appear to be adding to its regressiveness. But since Council Tax liability can be expected to be largely reflected in rents paid, the practical effect on income distribution is not likely to be great.

Stamp Duty Land Tax (SDLT)

The other main tax on housing in England is Stamp Duty Land Tax (SDLT), first introduced in 1694, which is paid by the buyers

when a transaction occurs. There are comparable taxes on property transactions in Wales and Scotland.

The rules and rates of the SDLT have changed over time. Particularly since 2010, the rates have increased and a range of complex exemptions (for first time buyers, for example) and higher rates for second homes have been introduced.

A reform in 2014 eliminated ‘bunching’ of transactions at the various tax rate thresholds. This has been achieved by making tax rates only payable on the portion of the property value which falls within each band.

This also affected how multiple dwellings relief (MDR) is calculated. In a similar vein, an annual tax on enveloped dwellings (ATED) and a 15% higher rate applied to corporate and ‘non-natural’ purchasers were introduced to deter the practice of buying and owning residential property within a corporate wrapper (referred to as ‘enveloping’).

In 2016 a higher rate for additional dwellings (HRAD) was introduced. This is an additional surcharge of 3% above the standard SDLT for purchases of residential property, when the buyer owns more than one property.

From November 2017, there were lower effective rates for first time buyers – for them the exemption threshold was £300,000 – and higher rates on the purchase of additional homes.

Because of the COVID-19 pandemic a tax holiday for SDLT was introduced in July 2020.²² The original holiday raised the exemption limit from £125,000 to £500,000. The holiday was set to expire on 31 March 2021 but was extended to 30th June in the 2021 Budget, and will be gradually phased out by lowering the exemption limit to £250,000 until the end of September 2021. First-time buyers will continue to be

22. The SDLT has been subjected to numerous tax ‘holidays’. Tax holidays are used to stimulate the economy during downturns. Recent examples include the Great Financial Crisis (holiday period: 9/2008-12/2009) or COVID-19 (7/2020-3/2021). While such stimuli have the potential to stabilise the economy, getting the timing right is problematic as the ongoing crisis illustrates: there is a real risk that the end of the holiday may coincide with the end of the furlough scheme, potentially triggering a rise in unemployment and a downward shock to the housing market.

exempt up to the threshold of £300,000 and a reduced rate will apply for dwellings valued between £300,000 and £500,000.

The rates in Table 1.3 below are those that applied prior to the tax ‘holiday’.

Table 1.3. Stamp Duty rates for all buyers other than first-time buyers, pre-8th July 2020

Property value	SDLT rate
Up to £125,000	Zero
The next £125,000 (the portion from £125,001 to £250,000)	2%
The next £675,000 (the portion from £250,001 to £925,000)	5%
The next £575,000 (the portion from £925,001 to £1.5 million)	10%
The remaining amount (the portion above £1.5 million)	12%

Note: Since 22 November 2017, first time buyers paying £300,000 or less for a residential property pay no SDLT. After the SDLT holiday ends, first time buyers will be exempt again up to a value of £300,000 and a reduced rate will apply for dwellings valued up to £500,000.

SDLT is progressive: although it reduces sales, when they occur rates rise with sales prices, at least, to £1.5 million. Consistent with this, at regional level – using data for 2018-19 – per capita revenue from SDLT was highest in London (£512) and lowest in the North East (£62).

While the reform of 2014 has been a step in the right direction, it neither eliminated nor materially altered the much more fundamental flaw of the tax – the fact that it “creates a disincentive for people to move house”, causing a mismatch in the housing market and inflexibilities in the labour market.²³

Evidence for the SDLT, and taxes on the value of transactions in numerous other countries, strongly confirm the adverse effects on

23. James Mirrlees, Stuart Adam, Tim Besley, Richard Blundell, Stephen Bond, Robert Chote, Malcolm Gammie, Paul Johnson, Gareth Myles and James M. Poterba, “Tax by design”, <https://www.ifs.org.uk/docs/taxbydesign.pdf> (2011), p.403.

household mobility. The economists Michael Best and Henrik Kleven estimate that a temporary elimination of a 1% SDLT increased housing market activity by 20%.²⁴ Estimates from a 2017 study by Christian Hilber and Teemu Lyytikäinen imply that a two percentage-point increase in the SDLT reduces mobility by 37%.²⁵ The same authors also show that the main adverse effects of the SDLT is on housing-related mobility and short-distance moves. Put differently, the SDLT discourages older residents from downsizing and prevents growing families from moving to bigger houses or more child-friendly neighbourhoods or areas with better schools, thus creating mismatch in the housing market and inefficient use of living space.

The estimated welfare loss to society is massive. Hilber and Lyytikäinen estimate it to be 84% of the additional revenue generated by the tax.²⁶ This strongly suggests that abolishing or phasing out SDLT and replacing it with another tax that is associated with less 'deadweight loss' has the potential not only to increase efficiency in the housing market but also to significantly improve economic output and public finances in the longer run.

Community Infrastructure Levy (CIL) and Section 106 (S106) Agreements

There are two other taxes, or effective taxes, specific to property that, like SDLT, also apply only on the 'margin', but in these cases on the value uplift conferred on land when planning permission is granted. Most of this value uplift is itself generated by the restrictiveness of the UK planning system and the constriction this imposes on the supply of

24. Michael Carlos Best and Henrik Jacobsen Kleven, "Housing market responses to transaction taxes: evidence from notches and stimulus in the U.K.," *Review of Economic Studies* (2018), 157-193.

25. Christian Hilber and Teemu Lyytikäinen, "Transfer taxes and household mobility: distortion on the housing or labor market?" *Journal of Urban Economics* (2017), 57-73.

26. Ibid.

development land.²⁷

In the UK, they go back to a legal case of 1427, when the Crown demanded compensation from property owners, whose land had become more valuable because of flood prevention and drainage works.²⁸ This led to a legal concept of ‘Betterment’ and attempts to tax it.²⁹ Originally seen as a result of physical improvements paid for by public authorities, since 1947 the focus has shifted to increases in the price of land as a result of development permission being granted.

The first of these is the Community Infrastructure Levy (CIL). LAs can choose whether to charge this or not. At the end of 2016-17, only 133 out of a possible 339 LAs (39%) were charging CIL. It is, therefore, an inefficient tax in terms of revenue raising.

LAs set their own rates and many have multiple rates determined by the location of the proposed development or its purpose, even form. In these cases, CIL is being de facto used as an additional instrument of development control as when, for example, rates are deliberately set so high on student housing as to eliminate it from the LA. CIL is a charge per square metre on the new development so is non-neutral: it penalises more spacious structures on a given site. Like other taxes on property, it is largely – probably entirely – capitalised into the price paid for development land. The proceeds from CIL are supposed – as its name implies – to be spent on infrastructure needed to support new development. However, this is not enforced so the revenues from CIL may largely disappear into LA general funds.

Next, Section 106 (S106) Agreements³⁰ are the outcome of negotiations between local planning authorities and developers whereby a condition

27. Paul Cheshire and Stephen Sheppard, “Welfare economics of land use regulation”, *Journal of Urban Economics* (2002), 242-69; Paul Cheshire and Stephen Sheppard, “The introduction of price signals into land use planning decision-making: a proposal”, *Urban Studies* (2005), 647-63; Christian Hilber and Wouter Vermeulen, “The impact of supply constraints on house prices in England”, *Economic Journal* (2016), 358-405.

28. Keith Davies, *Law of compulsory purchase and compensation* (London: Butterworths, 1984).

29. Paul Cheshire, Max Nathan and Henry G. Overman, *Urban economics and urban policy: challenging conventional policy wisdom* (Cheltenham: Edward Elgar, 2014), ch. 6.

30. So called because they were provided for under Section 106 of the Town and Country Planning Act 1990.

of granting planning permission is that the developer provides some community assets, usually in the form of ‘affordable housing’. S106 Agreements are sometimes called ‘planning obligations’. They are a form of tax, but a tax-in-kind.

A substantial proportion of LAs – more than half in 2010 – had never negotiated S106 Agreements and for roughly half of the 326 LAs for which there are data, the number of S106 properties built per annum between 2015 and 2018 was less than 20 units.

As mentioned above, a study for MHCLG claimed the total value of CIL receipts and Section 106 Agreements was some £6,000 million in 2016-17, but there were significant sampling problems likely to have generated an upward bias to this estimate.³¹ Since the LAs which answered the survey were self-selected, they were likely to have been biased in favour of those LAs who were active in pursuit of S106 agreements.

Furthermore, no ‘negative value’ was included for the transaction costs involved in the elaborate negotiation of S106 Agreements, the additional risk injected into the development process, or the resulting foregone construction, which in turn adversely affects the affordability of non-subsidised housing via limiting supply. In fact, S106 Agreements seem like an extremely inefficient and counterproductive way to provide local public goods.

The Government’s recent White Paper *Planning for the future* therefore proposes abolishing S106 Agreements and CIL with a new Infrastructure Levy, as explained later.³²

31. MHCLG, “The incidence, value and delivery of planning obligations”.

32. MHCLG, “Planning for the future”, <https://www.gov.uk/government/consultations/planning-for-the-future> (2020).

Chapter 2: **Criteria for changing the English residential property tax system**

That a pair of taxes introduced in recognisably their current form in 1601 (Rates, or CT), and 1694 (SDLT), should be in desperate need of reform is hardly controversial. Nor is it novel. The problem is not so much analysing why these main two property taxes are seriously flawed but in agreeing more efficient, equitable and politically acceptable replacements. More precisely, since many alternatives combining these features have been proposed, the problem is narrowing down options to focus the basis of real reform while acknowledging the implications any reform has for the independence of local government from central control.

Structural reform is vital, but unfortunately never quite urgent enough to get full-on attention. Furthermore, as the neglected Layfield Committee's report acknowledged, taxes on housing do not exist in a separate policy or fiscal compartment. The Layfield Committee was focused on the questions of centralised government control of local decisions as in say Greece or Ireland compared to very decentralised systems such as in the USA or Switzerland. Devolved power requires devolved sources of revenue. Taxes on property historically have provided that, since they are place-specific and paid by residents. They are, in addition, very difficult to avoid: CT is more effectively collected than any other tax in the UK.

Recent analysis has shown how important the degree to which revenues revert to LAs (which have responsibility for both planning decisions and providing services to residents, including the new residents who come with new houses), is as an influence on how restrictive LAs are with respect to development control.³³ In turn, that degree of restrictiveness applied to development control largely determines the long run supply of housing in a community.

Another issue is the overall impact property taxes may have on the distribution of disposable incomes and, since property is so tightly tied to place, the spatial distribution of incomes. But in the wider policy context, ensuring a particular tax is or is not progressive, is not very relevant: what matters is the impact of the tax and welfare systems overall on the post-tax distribution of incomes. Income tax may be a more suitable instrument to achieve any desired redistribution than are property taxes.

The quest by social scientists, in particular economists, for an optimally designed tax system dates back to at least Adam Smith.³⁴ It was formalised in the so called ‘theory of optimal taxation’ during the last century, with seminal contributions by Frank Ramsey³⁵ and Nobel laureate James Mirrlees³⁶, among others. Mirrlees was also the lead author of the most comprehensive review of the UK tax system to date: the Mirrlees Review that was published exactly a decade ago.³⁷

Existing tax systems, however, are not the design of a ‘benevolent planner’ but rather the product of an evolutionary process over centuries and are path dependent. Taxation systems are ultimately the outcome of a (murky) political process and any tax reform will in

33. Paul Cheshire and Christian Hilber, “Office space supply restrictions in Britain: the political economy of market revenge”, *Economic Journal* (2008), F185-F221.

34. Adam Smith, in *The Wealth of Nations*, discussed major criteria that “good taxes” should meet: taxes should be proportionate to incomes or ability to pay, certain rather than arbitrary, payable at times and in ways convenient to taxpayers and cheap to administer and collect.

35. Frank Ramsey, “A contribution to the theory of taxation”, *Economic Journal* (1927), 47-61.

36. James Mirrlees, “An exploration in the theory of optimal income taxation”, *Review of Economic Studies* (1971), 175-208.

37. Mirrlees et al, “Tax by design”.

practice have winners and losers. Thus, a tax design that is optimal in the eyes of economists is not necessarily politically feasible. In fact, taxes that fare well from an efficiency point of view often fare poorly from a political point of view.³⁸

While we believe that tax reform should be first and foremost dictated by economic considerations, political factors are real constraints that should not be ignored. Put differently, a ‘second best’ option for tax reform that not only generates a substantial improvement over the existing system but also has a realistic chance of political success, is arguably better than the ‘first best’ solution that is bound to lead to political failure.

We now propose and detail the economic and political criteria to judge an alternative residential property taxation system in England.

Economic criteria

Revenue raising

Essentially, this considers the difficulty of avoiding the tax, the cost of collection and the amount of revenue raised. The latter is particularly fundamental considering the rising budget deficit caused by the measures introduced by the Government to combat COVID-19.

Revenue raising will depend on the nature and total value of the tax base and how the tax base responds to rising tax rates. The tax base is greater for taxes on the transaction value of property compared to taxes on the increase in property value.

One significant advantage of all property taxes, in terms of their revenue raising capacity, is that property is visible and immobile. There is, however, an important distinction between annual property or land value taxes and transaction taxes. The latter appear to be avoidable, in contrast to the former. Especially if transaction tax

38. Margaret Thatcher’s poll tax was one of the most unpopular taxes in recent history.

rates rise beyond a certain level, the incentives not to sell and, for example, rent out or keep the property vacant for periods of time increase³⁹. In the case of the former, property or land value taxes, owners or occupants cannot avoid the tax, although with rising tax rates, property and land values fall as higher tax rates are negatively capitalised into property and land values.⁴⁰

Efficiency

A system of taxation or a tax is generally considered to be efficient if it allows governments to raise a certain amount of revenue with the lowest deadweight loss to society.

Tax systems tend to be more efficient the more neutral are the underlying taxes. The more neutral a tax, the less distorted are the decisions of the economic agents, and the lower, consequently, the deadweight losses associated with the revenue generation.

The concept of tax neutrality dates back to Ramsey, who argued that the ‘social planner’ should impose taxes in inverse proportion to the representative consumer’s elasticity of demand – in other words, the responsiveness of demand to prices – for that good.⁴¹ This would minimise social welfare losses. For example, independent of the public health arguments, cigarettes or alcohol should be taxed more heavily as the demand for these types of goods is unlikely to be very responsive to price increases.

Seen purely through this lens of neutrality, the optimal tax would be a lump-sum tax.⁴² A lump-sum tax is neutral in that it does not create incentives for individuals to change their behaviour, which could be

39. Or give incentives to evade by, for example, declaring false values. The same can apply to taxes on capital gains.

40. Christian Hilber, “The economic implications of house price capitalization: a synthesis”, *Real Estate Economics* (2017), 301-339.

41. Ramsey, “A contribution to the theory of taxation”.

42. A tax on the value of land is associated with fewer distortions than a tax on the value of properties. This is because the supply of structures and improvements is not fixed and imposing a tax on the value of properties, therefore penalises investment in buildings and so distorts land use decisions. However, even a land value tax is not completely neutral.

associated with welfare losses. However, lump-sum taxes fare very poorly in terms of equity and public acceptability, other criteria we outline below.⁴³

Non-neutral taxes distort consumer and producer choices. They also lead consumers and firms to devote socially wasteful efforts to try to avoid these taxes, for example hiring lawyers and accountants who help to restructure financial activities in a manner that minimises tax liability. Such distortions are greater when there are tax-free schedules, as affected individuals will try hard to stay below the relevant thresholds. More neutral taxes, therefore, contribute to efficiency by ensuring that something closer to an optimal allocation of the means of production is achieved.

In some instances, imposing a tax or subsidy may actually lead to a social welfare gain, even if we ignore what the tax revenue is used for. This is the case when a tax is implemented to correct so-called market failures, such as negative externalities. Textbook examples are the congestion charge or a tax on polluting behaviour. More relevant to this report, a discount on tax paid determined by the energy efficiency of buildings or land uses, or, on improvements to their energy efficiency could increase social welfare. These taxes and subsidies fare particularly well on efficiency grounds.

Taxes are also more efficient to the extent they have low collection and administration costs. These costs tend to be lower for national compared to local taxes because of the economies of scale in collecting taxes. Property taxes may be to an extent an exception here: they require a valuation of individual buildings which, with traditional methods of valuation, implies visits and a local administrative structure to organise the process. The tax base is easier to assess for transfer taxes vis-à-vis annual taxes on property or land values.

43. Lump sum taxes like Margaret Thatcher's poll tax are therefore arguably not a sensible option to pursue. This is, in principle, in contrast to a land value tax. The latter is efficient and it tends to reduce inequality.

Equity

This is essentially about whether reforms are likely to increase the equality in the post-tax income and/or wealth distribution. In other words, whether the distributional impacts of reforms are ‘progressive’.

It is worth noting, however, that one can distinguish between two forms of fairness, the guiding principle for equity. The ability-to-pay principle states that individuals with higher income and wealth should pay more taxes (vertical equity) and that individuals with higher necessary expenses, all else equal, should pay less (horizontal equity). The benefits principle, in contrast, stipulates that individuals should pay taxes based on the benefits they receive from public services.

While vertical equity justifies imposing progressive taxes, horizontal equity rationalises deductions and tax credits. In any society where equality is valued, progressive taxation will be an important policy instrument. Mirrlees pointed out, however, that with progressive income taxation there is a point of diminishing return, when higher tax rates reduce the motivation of productive workers.⁴⁴ In his theoretical work Mirrlees tried to find a balance between equity and efficiency: a point where taxation provides a shared benefit to society in the form of achieving equity goals without creating an onerous burden on individuals.

Simplicity

A good tax is simple: it is easy to understand and administer. Simplicity tends to help improve the willingness to comply with a tax, reduces socially wasteful efforts to avoid taxes, and reduces administration and collection costs. An example of a tax that fares well on simplicity grounds is a transaction tax with a single tax rate on the value of the transaction.

Incentives for housing supply

Considering the restricted supply of housing in England and the impact this has had on housing affordability, a replacement property tax

44. Mirrlees, “An exploration in the theory of optimal income taxation”.

system should seek to increase incentives for housing supply. Increasing supply would, in the long run, make housing more affordable.

One particular issue in England is the fact that Local (Planning) Authorities, under the current system of residential property taxation, have few fiscal incentives – indeed a net negative incentive – to permit residential development. Since planning decisions are almost the only sphere in which LAs have real control, local property tax revenues generate real incentives to which local communities and their political leadership react. Unless additional houses transparently generate more revenue for the communities which accommodate them, there is a strong disincentive for LAs to permit new development. This is because they (and their residents) largely face the costs associated with new residential developments (infrastructure related costs, more congested roads, more congested schools and changes to school catchment areas, higher spending on local state schools and higher expenditures on other local public services) but they reap very few of the benefits in the form of additional CT revenue. And since central government grants to LAs are needs-based any increase in CT revenue the LA may get is liable to be clawed back. Likewise, local residents, especially if they are homeowners, have strong incentives to oppose new developments.

Over the years the cumulative restrictiveness of local planning committees has greatly reduced housing supply and seriously damaged affordability as well as having other distorting effects, including on residential vacancy rates and commuting distances.⁴⁵

Taxes that create revenue locally – if the revenue is not redistributed away in the longer-term via the central government grants system – provide stronger incentives to LAs to permit residential development, thus addressing in the longer run the housing affordability crisis.

There are lessons to be learned from how we tax commercial buildings. Commercial buildings are still subject to the Uniform Business Rates

45. Paul Cheshire, Christian Hilber and Hans R.A. Koster, “Empty homes, longer commutes: the unintended consequences of more restrictive local planning”, *Journal of Public Economics* (2018), 126-151.

(UBR), introduced at almost the same time as the Poll Tax in the late Thatcher period. Unlike the CT it is still levied on the assessed rental value (not capital value) of buildings. Owners, not occupiers, are those ultimately responsible for its payment, although owners can structure agreements in a way to make occupiers pay. Far more importantly, while the old business rates were a local tax (although still ultimately subject to revenue equalisation – or claw back), the main point of the reform that established the UBR was to transform it into a national tax. This reflected the distrust the then Conservative Government had for the suspected militant socialist tendencies of swathes of local government thought to be stifling enterprise with punitive business rates.

The irony is that introducing the UBR caused business costs to increase in the long term by a larger amount than any feasible business rate would have done.⁴⁶ Revenues from business rates prior to the introduction of the UBR already largely flowed to HM Treasury because of the central government grant system of local government finance, but the change to the UBR made this confiscation of revenues transparent. This had such a disincentive effect on the willingness of LAs to give permission for new commercial development that over ten years the reduction in the supply of business premises caused rents of commercial space to rise by more than any feasible business rate. This strongly underlines the importance of property taxes in the structure of incentives faced by LAs which in the long run determine the supply of all types of property via the planning system, which LAs largely control.

Automatic stabilisation

A good replacement system for residential property taxation should ensure revenues would offset for the economic cycle. Taxes that help counter swings in the economic cycle provide automatic stabilisation. Given that residential property cycles tend to be pro-cyclical, taxes on the value of land or property, or on property transactions, tend to

46. Cheshire and Hilber, “Office space supply restrictions in Britain”.

all be automatic stabilisers. The one exception is the CT, which, given no revaluation for 30 years, has failed to provide any stabilisation. Conversely, because land values tend to be much more cyclical than construction cost, a tax based on land value has the strongest potential to automatically stabilise economic cycles.

Political criteria

Public acceptability

The reality is that every tax reform generates winners and losers. Generally, a tax reform can be expected to be more likely to succeed if it appeals to the ‘pivotal voter’. This suggests that tax reforms that benefit and are supported by a majority of the public are more likely to succeed.

Tax reforms that make future tax burdens more predictable are more likely to succeed than those that create greater uncertainty. One way of increasing the public acceptability of any reform may thus be to try to minimise uncertainty (for example, via smoothing annual tax adjustments over a number of years), especially during any transition phase.

Related to this are more recent insights from behavioural economics suggesting that salient taxes – such as an annual tax on land or property values⁴⁷ – while faring well on welfare economics and even equity grounds – tend to be much less popular than less salient and, in theory, avoidable taxes, such as the SDLT. The suggestion made by Muellbauer that there should be provisions for deferring liability to pay property taxes under defined circumstance until death when the tax debt would be settled out of the estate may be an attractive way of making changes more acceptable.⁴⁸ It would avoid the problem of large payments having

47. Marika Cabral and Caroline Hoxby, “The hated property tax: salience, tax rates, and tax revolts” *NBER Working Paper No. 18514* (2012) explores the link between salience and popularity of taxes, by means of analyzing local property taxes. Their starting point is the observation that the property tax is the most salient major tax in the U.S. but also the least popular tax. They show empirically that tax escrow, which makes taxpayers less informed about the taxes they pay, via reducing the salience of property taxes increases property tax rates.

48. Muellbauer, “Housing, debt and the economy”.

to be made by asset rich and income poor individuals, soften the blow of a revaluation making big increases to the (perceived) liability of some individuals and imbue the tax with a degree of being to some extent ‘voluntary’.

Ease of transition to reformed system

Perhaps the single most important obstacle to meaningful tax reform is the issue of transitioning from one system to another. While it is argued that proposed property tax reforms are associated with large welfare gains or equity improvements, the alleged or real difficulties of making the change and uncertainty created during the transition phase are often sufficient to persuade policy makers against action.

The likelihood of success of a tax reform is crucially determined by lobbying. The economist and political scientist Mancur Olson has shown that what stimulates people to act in groups are strong incentives and an ability to organise.⁴⁹ Applied to tax reform, small groups that are strongly adversely affected by a tax reform are more likely to act on shared objectives, as members are strongly motivated and smaller groups are easier to organise to act (lobby) on these shared objectives.⁵⁰ Large groups that experience smaller benefits are unlikely to act in accordance with common interest.

It is therefore strongly preferable to phase tax reforms over longer time periods to avoid substantial redistribution between winners and losers over short time periods. Evidence in support of this proposition is the successful phasing out of the Mortgage Interest Relief at Source (MIRAS) during the 1990s.

49. Mancur Olson, *The logic of collective action: public goods and the theory of groups* (Cambridge, MA: Harvard University Press, 1965); Mancur Olson, *The rise and decline of nations: economic growth, stagflation, and social rigidities* (New Haven: Yale University Press, 1982).

50. This argument also significantly explains the power of the NIMBY lobby. New development causes significant and very local costs and losses. However, the gains – in the form of lower house prices and more housing choices are very thinly spread over a wide area and large numbers. Since the planning system is controlled locally, losers not only have a greater incentive to lobby, they also control decision-making.

Alignment with Government objectives

At least in the short term, policies that are in broad alignment with the sitting Government's key priorities are more likely to gain traction and ultimately be implemented. Since the focus of this report's political analysis is on public acceptability and ease of transition, the government's policy priorities are, therefore, important elements in the political context in which reforms are being proposed. The current Conservative Government has two central policy objectives that seem particularly relevant when considering proposals for property taxation. The first is 'levelling up', which can be described as addressing regional disparities. The second is making progress towards the legal target of net zero emissions by 2050. It seems reasonable to assume, therefore, that policy ideas which advance these objectives are more likely to be adopted and implemented by this current Government.

Chapter 3: Options for reforming the English residential property tax system

Although we have stressed the importance of viewing property taxes in the context of the whole system of taxation and the incentives it generates with respect to housing supply, our main focus is on how we should tax residential property in England in a way that is different to the inefficient and inequitable way we do at the moment.

Although it could be seen as administratively easiest to update valuations and extend CT bands, we dismiss this outright. First, any such reform would not resolve the fatal flaw in the design of CT – that, in trying to tax both property and people, it is an imprecise fudge. Put another way, CT is not a pure or equitable tax on property values, but nor does it relate to or pay for the cost of local services. It tries to be both a property tax and a services tax, but is effective at neither.

Second, a common argument in favour of CT is that it is established, simple, and easy to understand. But the arcane process which backdates values to a hypothetical 1991 value for new houses is not understood by ordinary people; nor are the arbitrary ‘bands’. A straightforward system attaching the tax people pay to the current value of their homes would not only make the system fairer but more transparent and so, probably, more acceptable.

Finally, a stop-gap reform of CT would really be no easier than a more systematic and thought through reform. In order to mitigate the

deficiencies of CT – and avoid a return to the inequities in the effective property tax rates we see today and discussed above – regular revaluations are essential, just as they would be under alternative proposals. It would be preferable, therefore, to accompany regular revaluations with a more transparent and coherently designed system and devise a system for cheaply and fairly keeping assessed property values up to date.

There are attractive alternative options for property taxation that would score much more highly on the economic and political criteria we have identified than the current system of CT, SDLT, S106 Agreements and the CIL.

In our judgement any residential property tax reform should be required to have an annual revaluation. In principle, this is an easy and cheap task so long as it does not rely on traditional valuation techniques but uses statistical methods. Price data are now readily available, as are basic house characteristics and exact locations. The current price of all houses could be modelled, with transactions prices replacing estimated prices as sales took place. To avoid large fluctuations, while prices should be estimated annually, taxes should be levied on a three to five year moving average.

While to make the idea more acceptable there should be carefully defined grounds for appeal, it would be vital to tightly define those grounds and ensure only a small number of cases were worth appealing – an outcome of good modelling and stringent appeal criteria. If not, the costs of proper reform would rise substantially.

This modelling-based approach has been extensively applied elsewhere. Advances in data availability (Land Registry price paid data only became available some 20 years ago), modelling methods and computing power mean that modelling house prices is now a perfectly practical and cheap method. The use of statistical methods of property appraisal for tax purposes is widespread: “At least 15 countries have implemented statistical mass appraisal systems for the use in property taxation”.⁵¹

51. Jens Kolbe, Rainer Schulz, Martin Wersing and Axel Werwatz, “Land value appraisal using statistical methods”, *FORLand-Working Paper 07* <https://abdn.pure.elsevier.com/en/publications/land-value-appraisal-using-statistical-methods-2>. (2019).

There are two main policy options for residential property taxation we consider.

- An annual tax on the value of property: commonly referred to as an Annual Proportional Property Tax (APPT)
- An annual tax on the value of land: commonly referred to as a Land Value Tax (LVT)

Either of these two main options could replace the two main forms of property tax we have in England: CT and SDLT.

Annual Proportional Property Tax on current capital value of housing (or APPT)

The idea of the APPT is simple: impose a proportional tax on the value of residential properties.

In this scenario, land with buildings on it is taxed by an APPT since the value of the land which is legally attached to the buildings is fully reflected in the price of the whole property.

A question which arises is whether to tax undeveloped (brownfield or greenfield, including agricultural land) land separately: just as there is a case for taxing second or additional homes so there is an argument for taxing land that could have buildings on it. Otherwise landowners have an implicit incentive not to build. Or, put differently, taxing land without buildings on it generates an incentive to develop the land or to sell it to a developer who will. The other reforms we detail below would tax empty land but the problem here is how to identify land that could be built on.

Another important question is how much of the revenue from the APPT should go to national and how much to local governments. This is a crucial consideration, not only because each layer of government (central and local) has its roles and respective services to fund, but also because allowing LAs to derive substantive revenue from local development (new and existing) via the APPT that compensates for the local services and

the local infrastructure it has to fund, provides important incentives for LAs to permit residential development in the first place.

We propose to allow separate ‘national’ and ‘local’ tax rates. The national tax rate would be set such as to offset the loss of revenue to central government from phasing out the SDLT. LAs can then set their own tax rates, independently of the central government, with the local revenues used to provide local services the residents want, with no central government claw back mechanism.

A number of previous proposals for an APPT have demonstrated that, properly designed, an APPT would be considerably more progressive than the current system of CT and SDLT. Our simulations of possible outcomes – see Table 5.1 later – is broadly consistent with this, although the replacement of only the SDLT with an APPT would increase inequality, as the former is even more progressive (although otherwise deeply flawed) than the latter.

First, Fairer Share have proposed a national APPT set at 0.48% for primary residences and 0.96% for second homes, levied on property owners, with a national component that would go to central government for redistribution and an initial floating local component to go to LAs. The tax would replace CT and SDLT.⁵²

Fairer Share estimate that 76% of households would pay less in property tax under this proposal, with an average saving of £435 a year.⁵³ Their constituency-level analysis illustrated the potential spatial impact of an APPT along these lines. In large areas of the North their modelling suggested the majority of households – in some constituencies, 100% – would gain. The main losers from the reform would be in London and the South-East, where both house prices and incomes are higher. In these areas, they estimated there would be fewer winners.⁵⁴

52. Fairer Share, “What are we proposing?”, <https://fairershare.org.uk/proportional-property-tax/> (2021).

53. Fairer Share, “Our response to Financial Secretary to HM Treasury, the Rt Hon. Jesse Norman”, <https://fairershare.org.uk/our-response-to-jesse-norman-mp-hm-treasury/> (2021).

54. Fairer Share, “Constituency data”, <https://fairershare.org.uk/constituency-data/> (2021).

In order to smooth the transition to an APPT, Fairer Share further propose that the new system be phased in over a three year period, with increases in property taxes are capped at £1,200 and individuals able to defer payment of the tax to alleviate the ‘property rich, cash poor’ issue.⁵⁵

Second, the Resolution Foundation, as part of the work of its Intergenerational Commission, published an exhaustive report modelling a range of reforms including adjustments of CT rates within existing valuation structures and a version of an APPT on current property values (annually revalued) at rates of 0.5 and 0.7%, with tax free thresholds of £100,000 or regional variations of that to make the tax more progressive. These simulations are carefully done and show both the seriously regressive nature of the current CT and how proportional taxes with tax-free thresholds can at the same time generate larger revenues and be substantially more progressive, both across income groups and regions. Given their focus they also estimated the distributional impact by age group of the various options for reform. Younger age groups, especially households in their twenties and thirties, are the most likely to gain from the APPT plus tax-free threshold reform.⁵⁶

Annual proportional tax on current capital value of ‘unimproved’ land (LVT)

The idea of a tax on unimproved land value is again simple: as with the APPT, impose a proportional tax on the value of land independent of whether or not the land has buildings on it. Like with the APPT, we would propose national and local tax rates.

Taxes on ‘unimproved’ land value, that is on the underlying value of land, not on the value of the buildings on that land, have long been

55. Fairer Share, “Frequently asked questions”, <https://fairershare.org.uk/faq/> (2021).

56. Adam Corlett and Laura Gardiner, “Home affairs: options for reforming property taxation”, <https://www.resolutionfoundation.org/publications/home-affairs-options-for-reforming-property-taxation/> (2018).

regarded by economists as perhaps the most efficient type of tax. Its attraction is that it is largely neutral with respect to the impact on the incentives faced by economic agents and it generates incentives to use land for the most productive use permitted. This is because the tax – usually advocated as an annual payment of a fraction of the current capital value of land – would be levied on the most productive use to which any parcel of land is currently permitted to be put: not on the use it happens to be in at the present time. It would thus generate incentives to use land (and by implication the buildings on them) more efficiently. Not only does it not penalise the owners' investment, but such a tax potentially captures increases in value resulting from public investment in flood prevention or infrastructure. This has the merit of increasing the tax base to pay for public goods.

Indeed, in principle, a LVT would be desirable not just for housing but for all land, whether used for commercial buildings, golf courses, agriculture or land that is simply empty. It would be as near to a neutral tax as one could find and would generate systematic incentives to use land for the purpose most valuable to the economy and society.

Box 3.1. Augmented Land Value Taxes

While primarily designed as an efficient way to tax land, LVTs can be designed in such a way as to complement other policy goals, such as net zero, and mitigate implementation issues around distributional impacts and payment of the tax.

Muellbauer argues strongly for a modified LVT. This would replace all existing property taxes, but be augmented to reflect external effects. So the taxes paid would be reduced in proportion to the energy efficiency of buildings on it. Recognising a possible political objection to such taxes – that they fall heavily on the asset rich but income poor such as pensioners – he also argued that payment of his land value tax should, if desired, be able to be

deferred indefinitely with payment recovered out of the owners' estate on death. Thus the payment of the land tax is ingeniously made to appear to the land owner almost as voluntary: they could if they choose, not pay it at all but leave payment to their heirs. Such a feature should largely overcome the 'asset rich, cash poor' objection often raised against reform.⁵⁷

A general consideration with land taxes is of making reliable and acceptable valuations of the value of underlying land. When the land is built on – has a house on it – there will be many transactions of the 'house plus land' bundles. Put another way, we know the price of 'houses', including the value of the land they stand on, but the value of the land itself is hidden within the total – not identifiable separately. As has been widely demonstrated, information on house prices (including land) can be used to power efficient and robust statistical models for easily valuing houses and land together and to provide frequent, cheap re-valuations. But the specific price of underlying land – separate from buildings – remains opaque.

Even the concept of 'unimproved land value' is a complex one. It does not correspond to the observed market price of empty plots of land for building, since such prices will embody expectations about the probability, cost and time required to obtain planning permission and the cost of any S106 Agreements or CIL that may be imposed. Later, where we explore the implications of our two main options in more detail, the 'land values' used to estimate the total value of land by LA are those of the Valuations Office Agency (VOA). These are assessed by professional valuers and exclude the costs of steering a development through the planning system. They may reflect expert judgement rather than scientific data, but they do appear to conform to the intended

57. Muellbauer, "Housing, debt and the economy".

concept: to reflect the price of ‘unimproved land’. Since all values are estimated on more or less the same methods and assumptions, they should also be appropriate for comparative purposes: to address, for example, the question of how much the total area of land used for housing in Barnett is worth in comparison to that in Redcar. Equally, comparisons over time should be valid, subject to the inevitable variation between individual valuers.

Nevertheless, the practical difficulties of generating reliable and publicly acceptable values for ‘unimproved land’ which could then be used as a tax base on which to levy a proportionate tax remain a significant problem associated with applying the theoretically appealing idea of charging all taxes on property on the basis of the underlying land. While VOA valuations would arguably be the closest workable approximation to a measure of unimproved land value, they necessarily involve a degree of judgement and interpretation. Given that all such values reflect the professional but personal judgements of individual valuers and there are next to no observed transactions against which to verify those judgements, the scope for appeal and litigation would seem extreme.

Both the two main options we have identified – an APPT and a LVT – can be considered with important modifications:

- Tax exemptions, to support those with more modest means
- Green offsets, to support energy efficiency improvements and help achieve the important Government objective of net zero by 2050

Tax exemptions

Introducing tax exemptions within the APPT or LVT is associated with an obvious potential trade-off: the exemption helps achieve the equity goal, but it may hurt tax efficiency. This is because a tax exemption threshold will tend to trigger tax avoidance in the form of manipulation of the tax base. Indeed, a tax exemption may be more

problematic for a LVT than APPT. This is because land (in contrast to housing) can more easily be subdivided and allocated amongst family members in such a way as to take advantage of the tax exemption.

However, so long as reforms are robustly designed, tax avoidance is unlikely to constitute a major problem for an APPT or LVT. In contrast to income or wealth, real property is impossible to hide. So as long as there are no other exemptions from the APPT (such as for empty homes), the owner will not be able to avoid or evade the tax payment.

Another issue is that tax exemptions have an opportunity cost in the form of foregone net tax revenue. The exception is up to the point where an individual tax payment is less than the costs of collecting it. This provides a good reason for setting the exemption threshold low.

We suggest setting it initially at £50,000. Houses or land worth less than that would pay no tax: above that threshold, tax would be paid on the whole value. Since a tax rate of 0.5 % on £50,000 would yield only £250 of revenue but would cost a significant amount to collect, the revenue effects of such a threshold are negligible as too, therefore, will be the costs in terms of efficiency.

Although redistribution is an important consideration for property taxes, there are other tax instruments – crucially, progressive income taxes – that can be used more effectively for redistributive purposes. That said, there is an argument in favour of a redistributive element in APPT in particular.

As Mirrlees, for example, highlighted, there comes a point where raising income tax rates generates disincentives to work: so income taxes that are too high become sufficiently non-neutral to cause deadweight losses.⁵⁸ While high tax rates on APPT might have the effect that wealthy individuals invest in assets other than real property, this would actually have the positive side effect of more affordable land and housing space. This is because wealthy investors would have fewer incentives to hoard their wealth in land or second homes, thereby

58. Mirrlees, “An exploration in the theory of optimal income taxation”.

reducing investment driven demand and resulting higher prices and rents. Thus, although tax exemptions are not unproblematic, there are good grounds to opt for them. Moreover, there are at present no progressive wealth taxes – only progressive taxes on income – and as housing has over many decades become a more and more important component of individual wealth holdings, the case for a progressive tax on property seems to have become stronger.

Green offsets

These would be a reduction in the tax rate calibrated to reflect the energy efficiency of the building(s), or conversely an increase in the tax rate for energy inefficient buildings. While green offsets would be most readily applied to the APPT, they could also be incorporated into a LVT as Muellbauer has outlined.⁵⁹ Hitting net zero by 2050 is an important Government objective and, while progress has been made in other economic sectors, the contribution of the residential sector to CO₂ emissions has risen steadily. Thus, an effective policy to reduce residential CO₂ emissions is vital.

The green offsets could aim to be revenue neutral: a tax for energy inefficient buildings below a certain rating and a subsidy for energy efficient buildings above a certain rating.

While green offsets are a subsidy, or negative tax, their purpose is to internalise market failure in the form of greenhouse gas emissions and other negative externalities associated with energy inefficient buildings. In this sense – that they shift consumption choices distorted by a failure to pay for the social costs back to a neutral position – green offsets would score highly for efficiency.

Subsidies to incentivise energy efficient buildings are not new in public policy: the Green Deal and Green Homes Grant are two recent examples of public policy that sought to help homeowners to meet the cost of domestic energy improvements. However, the popularity of such

59. Muellbauer, “Housing, debt and the economy”.

schemes has been undermined by a complicated application process, such that the Green Homes Grant was phased out in March 2021.

It is clear that the public are supportive of more action on energy efficiency in the abstract: in a recent Bright Blue report, for example, 69% of the UK public reported that they support government subsidies for installing better home insulation. Moreover, the public marginally prefers policy approaches that use financial incentives (a ‘carrot’) rather than regulations that impose a ‘stick’ on behaviour (49% and 34% respectively).⁶⁰ This suggests that the problem is not the principle of policies to incentivise energy efficiency, but rather their design and implementation. Green offsets would address this concern, by circumventing the need for bureaucratic application processes and making salient the energy efficiency of homes while still providing a clear financial incentive to improve energy efficiency.

Green offsets do have two drawbacks. First, not only do they not generate any tax revenue (at least if they are designed as offsets rather than as a tax on energy inefficient buildings), but they represent an opportunity cost to the taxpayer in the form of foregone tax revenue.

Second, green offsets are likely to be regressive, as lower income households tend to be less likely to be able to afford investments in energy efficiency. However, green offsets fare extremely well from a welfare economics point of view as they correct a market failure and thus are associated with a welfare gain – a gain to society – in contrast to other taxes that distort consumer behaviour and thus induce a deadweight loss. There are thus strong welfare economic reasons to add this feature to any property tax. Relinquishing green offsets on equity grounds would also be foolish. This is because redistribution can be achieved with other tax instruments (such as a progressive income tax or an APPT with tax exemption) much more effectively. Thus, while green offsets are not a ‘free lunch’ they should, in our assessment, be

60. Anvar Sarygulov, “Going greener? Public attitudes to net zero”, <http://www.brightblue.org.uk/portfolio/going-greener-public-attitudes-to-net-zero/> (2020).

part of any reformed property tax system. Green offsets would also contribute to the Government objective of net zero emissions by 2050.

Development Levy

Finally, we consider an alternative option to another element of the English residential property taxation system: the Community Infrastructure Levy (CIL) and Section 106 (S106) Agreements, which the Government proposes to consolidate into a single Infrastructure Levy (IL). We consider an alternative to this IL: a Development Levy which would be a uniform proportionate levy on sales price with the rate set nationally.

This would effectively amount to a levy on land value uplift.⁶¹ As already discussed, the two current mechanisms for attempting to capture land value uplift, S106 Agreements and CIL, are highly imperfect. The costs and uncertainty involved with negotiating S106 Agreements in particular, depress housing supply by making otherwise viable developments too risky and expensive. Nevertheless, new building does impose costs on the local community which, if they were efficiently offset, would be likely to make development more acceptable to local residents (who control the planning decision process) and so improve housing supply and in the long run housing affordability.

Since these costs are associated only with new development the proposal is to charge a so-called Development Levy as a percentage of the realised price of all new houses built.

As currently proposed, the IL would act as a straightforward levy (payable at the point of occupation) on land value uplift above a minimum threshold. The intention behind this is to streamline development negotiations and make the process for capturing land value uplift more transparent.

The Development Levy we propose here goes further than the IL, by tying revenues to delivery of local infrastructure and public services

61. Paul Cheshire, "How to capture land value rises", *Planning* (2017), 16-18.

necessary to support the additional residents and to providing social or affordable housing. In other words, there should be an obligation, imposed by national government, to devote a fixed proportion of the proceeds of the Development Levy to procure affordable housing commissioned from suppliers such as Housing Associations. This would more than offset the loss of such housing consequent on the abolition of S106.

The reason why revenues should be spent on expanding local infrastructure and public services is obvious: additional residents add to the demand for these and under the current system of S106 and CIL, as well as the proposed IL in its current form, no funds are guaranteed to flow to local government to pay for them.

Additional affordable housing is also an appropriate object since currently most affordable housing is sourced via S106 Agreements, which are very inefficient.

A levy charged at 20% of market prices could yield very substantial revenues.⁶² If one takes £225,000 as an estimate of the average price of a new house in England and construction a modest 200,000 a year, that generates £9 billion a year (compared to the SDLT revenues of £11.5 billion for 2019-20). Although transition arrangements might be necessary because some developers would hold land bought at prices not including an expected 20% Development Levy paid on completed houses, the tax would in the long run be entirely capitalised into the price of land – so in that sense be neutral – and would increase developers' house building because there would be no negotiation costs or uncertainty associated with it. So long as the revenues it generated were exempt from claw back, so genuinely increased resources and public service provision for the local communities housing new development, they would reduce opposition to development and lead to a relaxation of NIMBYism.

62. Paul Cheshire and Boyana Buyuklieva, "Homes on the right tracks: greening the Green Belt to solve the housing crisis", <https://www.centreforcities.org/publication/homes-on-the-right-tracks/> (2019).

Conclusion

Ultimately, we believe that there are six specific options for property tax reform that should be rated against the economic and political criteria we have identified.

1. APPT on current value of housing
2. APPT on current value of housing plus a tax exemption
3. LVT on current value of unimproved land
4. LVT on current value of unimproved land plus a tax exemption
5. Green offsets on APPT or LVT
6. A Development Levy

In the next section, we assess and score each of these specific options against the economic and political criteria we identified earlier.

Chapter 4: **Assessment of options for reforming the English residential property tax system**

Now let us assess the six specific models for reform of residential property taxation against our economic and political criteria.

Revenue raising

Both the APPT and the LVT have the potential to raise large revenues, particularly as property and land are immobile. The capacity to raise revenue of the APPT exceeds that of the LVT, given that the potential tax base is larger; total property values in the UK exceed total unimproved land values. In particular, since it is easier to subdivide land and so manipulate values to get below the threshold and avoid tax, our judgement is that the LVT would be less efficient at raising revenue than the APPT.

Since the proposed tax exemption threshold of £50,000 is very low, our judgement is that the addition of such an exemption threshold to an APPT or LVT would have a negligible impact on the net tax revenue.

The impact on revenue of a green offset tax would not be great in any circumstances, but would vary according to whether it was an allowance to set against tax liability for more energy efficient houses;

a tax on less energy efficient ones; or, a revenue neutral combination of the two.⁶³

The capacity to raise revenue of our proposed Development Levy is somewhat lower as it only applies to new developments. However, the cost of collection should be very low.

Efficiency

The LVT is the most economically efficient form of tax.

Versions of either the APPT or LVT with a tax exemption, however, will be slightly less efficient from an economic viewpoint since they create an incentive for deadweight losses in activities designed to reduce liability.

The green offsets tax is highly efficient in that it corrects a market failure to restore efficiency.

The Development Levy fares least well here, as one issue of the levy is that it taxes capital investment rather than just the land value uplift, its main aim. That said, quantifying and taxing just the land value uplift is problematic in practice and the Development Levy still fares better than S106 Agreements and CIL when it comes to efficiency. Apart from its other inefficiencies, CIL taxes space that is constructed since it is charged per m².

Equity

Different property taxes do not directly redistribute income since they are raised on houses not people. Because there is no data on incomes by house it is impossible to estimate this except in broad terms but property taxes inevitably have a big influence on post tax income distribution since people of different incomes tend to live in houses of different

63. One drawback of a tax exemption, when combined with a subsidy (tax) on energy (in-)efficient housing is that very cheap excluded properties do not have any incentives to improve energy efficiency. The tax exemption would not preclude the government however from providing vouchers to those living in low-end housing to improve their energy efficiency. For practical purposes, however, so few houses would be involved that this possible effect could be ignored.

values. Rich people on average tend to live in more expensive houses.

Moreover, since property is locationally fixed, different systems of property tax will have different consequences for the spatial distribution of incomes, with significant implications for the 'levelling up' agenda.

Both the APPT and the LVT would improve equity since owners of more expensive houses or more valuable land would pay more, making both options considerably more equitable with respect to property value – and therefore, it is safe to assume, income – than CT. Adding a tax exemption makes it more equitable still.

The green offset is, depending on its design, probably regressive, if only very mildly so: poorer households live in slightly less energy efficient houses but the positive correlation between house prices and energy efficiency is only very weak.⁶⁴

The Development Levy, particularly after a transition period, would divert part of a windfall gain to a few to a wider public good, so improve equity, but compensate in kind poorer people by funding social housing.

Simplicity

The APPT scores highly because statistical valuation of houses is comparatively cheap and reliable. Running an acceptable appeals system would require some thought and administrative innovation, but CT bandings can already be appealed.

In contrast, the LVT would require significant administrative and strategic planning and serious, specialised expertise. It is not impossible, but if implemented as theoretically intended it would be highly innovative in modern times; the only country that currently implements a pure land tax, without any supporting taxes on buildings,

64. For housing units sold in England and Wales in 2019, the unconditional correlation between price paid and energy efficiency is 0.0145. Holding constant unobserved characteristics at postcode level, a 10% increase in price is associated with an increase in energy efficiency of 0.44% (own calculations, based on a merged dataset combining the Land Registry and the Energy Performance Certificates datasets). Energy efficiency is measured as the cost of energy required for space heating, water heating and lighting (in kWh/year) multiplied by fuel costs, so £/m²/year where the cost is derived from kWh.

is Estonia, as indicated in Table 1.1 earlier in this paper.

Both green offsets and the Development Levy would be simple to implement using existing systems.

Energy Performance Certificates (EPCs) already apply. One issue is that energy efficiency improvements do not currently improve a building's EPC. However, it would be easy to implement a reform which ensured owners were rewarded for investment in energy improvements.

Since the Development Levy would be applied to the market price of newly constructed houses, it would be simple to calculate. The only issue would be to ensure avoidance was minimised by for example selling completed houses at below market prices to intermediaries.

Incentives for housing supply

Except for the Development Levy and green offsets where there would be some incentive to build new houses since they are so much more energy efficient than old ones, the performance of the specific options is contingent on whether or not proceeds go to LAs or national government.

If LAs are to be persuaded to accommodate more houses – very strongly in the interests of the wider community and particularly younger people – new building needs to generate revenue.

This requires a major proportion of property tax revenue to go to local communities with no claw back in lost grants from central government. There has to be a transparent net revenue gain. So long as a substantial portion of the tax revenue is guaranteed to add to LA revenues, there will be an incentive effect via the planning system. The revenues from new residents would improve the fiscal position of the LA and help to improve local infrastructure and public services.

This report therefore advocates giving the power to LAs to set the rate at which they levy the property tax and the ability to retain those revenues. At the same time, any loss of revenue to central government our proposed changes produce should be compensated.

So, on the assumption that the equivalent of the revenue from the

SDLT would go to the central government as a national precept with LAs then free to choose their local tax rate for both APPT and LVT, and there is no clawback of locally raised revenue by central government, both do give strong incentives for increased housing supply.

The Development Levy would generate strong incentives for LAs to permit development on the grounds that substantial revenue could be raised from the new build sales.

Automatic stabilisation

All specific options, with the exception of green offsets, would tend to lift tax revenues in boom times and reduce them in recessions so would have some stabilising impact. As land prices are more pro-cyclical than house prices, the stabilising effect of the LVT is even greater than that of the APPT.

Public acceptability

We think an APPT with annual revaluation and a well-designed appeal process would be well received relative to CT and including a tax exemption for very low priced properties would improve its public acceptability. The basis of the valuation would be transparent (not hypothetical 1991 values) and relate to the observable prices of houses locally sold; it would also eliminate the grossly regressive nature of CT and introduce a movement towards greater equity.

A central element in our proposed reforms is that LAs should be free to set their own rates of tax on property. This means it is impossible to know in advance what the spatial and personal distributional impacts of them would be. But in Table 5.2 we report simulations of several plausible outcomes allowing for differing responses in richer compared to poorer LAs. These show that generally poorer communities and lower priced houses would tend to pay less, even allowing for the abolition of the highly progressive SDLT.

The LVT would suffer because it would be hard to verify valuations and the underlying concept is not so easy to grasp. This has the potential

to lead to significant barriers to implementation and a complicated appeals process.

The green offsets – especially if designed as a subsidy – would likely be popular. Their simplicity would give them a big advantage compared to previous green subsidies requiring the hassle of application and voluntary expenditures by the household. Since they would generate an incentive to improve energy efficiency for all households, they would also be far more effective.

The Development Levy would also be likely to be well received as it is paid by developers and the incidence is likely such that it reduces land prices (so input costs) and does not raise house prices relative to the status quo. Since the complexity and costs associated with the S106 Agreements system favour the largest developers, vested interests might lobby for the status quo.

Ease of transition

Changes inevitably generate losers as well as winners. Since losers tend to have strong political influence, there is a powerful argument for generous transition arrangements. Where significant gains and losses would result – such as with a movement to current house values taxed proportionately or the Development Levy on new house construction – the changes need to be smoothed over time.

Moreover, while the logic may be for an annual revaluation of properties, it would be better to smooth revaluations by using a moving average calculated over three years. Price changes in housing markets can be substantial, particularly in a country in which the supply of new houses is as unresponsive to demand shocks as in the UK.

Since both the APPT and the LVT would generate substantial change in individuals' tax obligations, there would also be a case for introducing provisions for deferring payment until sale of a property or inheritance subject to reasonable interest being paid. This would offset the possible impact on 'asset-rich, cash-poor' taxpayers.

The LVT option, however, would be worse since it would require

setting up a novel agency and process.

Green offsets could easily be implemented as they could build on the existing system of EPCs.

The Development Levy might require transitional arrangements to accommodate developers with land banks they had bought without the expectation of paying the levy on finished houses. That said, all developers would try to gain from any transition arrangements and would benefit from not having S106 Agreements or CIL. So the net effect on the development sector would in reality likely be minor.

Alignment with Government objectives

The current property tax system – comprising CT, SDLT, S106 and CIL – together with specific grants – has been evidently inadequate to address the net zero challenge, since emissions from the residential sector relative to total emissions have been rising steadily for 30 years. When it comes to another of the current Government’s central objectives – ‘levelling up’ – CT seems to be more of a hindrance than a help, considering its spatial impacts (see Panel A of Figure 5.1) and the effective tax rates on lower-value properties. The simulation results reported in Table 5.1 below are broadly consistent with this diagnosis. The set of reforms proposed, particularly the local APPT and the Developer Levy, would also incentivise LAs to accept development more readily thus supporting the objective of building 300,000 homes a year. Overall, therefore, the reform package proposed would support three of the government’s central objectives.

Conclusion

To compare the six specific reforms to residential property tax in England more exactly, we have scored them against each economic and political criterion on a scale of 1 to 10, drawing on our analysis above. The results are shown in the Table 4.1 below.

Table 4.1. Residential property taxes: evaluating options for reform

Option	Criteria Score: 1 = worst, 10 = best									
	Major Welfare Economic Criteria		Minor Welfare Economic Criteria			Political Criteria				
	Revenue Raising ¹⁾	Efficiency ²⁾	Equity ³⁾	Simplicity ⁴⁾	Incentives for housing supply ⁵⁾	Automatic stabilisation ⁶⁾	Public acceptability	Ease of Transition	Alignment with Government objectives	
Main tax:										
APPT (% tax on current capital values)	9	7	7	8	6*	7	7	6	5	5
APPT + £50k exemption	5	6	8	8	6*	7	8	6	6	6
LVT (% tax on 'unimproved' land value)	7	8	7	5	6*	8	4	4	6	6
LVT+ £50k exemption	7	7	8	5	6*	8	5	4	7	7
Adjustments	5-3 ⁸⁾	9	4	8	8	5	6-8 ⁷⁾	8	9	9
Green offsets										
Other Taxes	7	5	7	9	8*	7	7	5	6	6
Development Levy on sales prices										

Notes: ¹⁾ Difficulty of avoiding, cost of collection and revenue raised. ²⁾ Extent to which it would distort spending patterns away from an economic/social optimum. ³⁾ Extent to which it would be likely to increase equity with respect to income and/or wealth distribution. ⁴⁾ Ease of understanding and administering. ⁵⁾ Incentive effects on housing supply in all cases except green offsets dependent on split of revenues between national and individual Local Authorities. ⁶⁾ Assumption here is: equivalent revenue from SDLT goes to central government; LAs are free to choose their local tax rates (and there is no clawback mechanism). ⁷⁾ Extent to which the tax revenues would offset for the economic cycle. ⁸⁾ Dependent on whether designed as tax, revenue neutral (both tax and subsidy) or subsidy.

Chapter 5: A new system for taxing residential property in England

In theory, an LVT would be the most economically efficient way of taxing property. However, this must be weighed against the considerable implementation challenges and the political feasibility of such a reform. Therefore, based on the analysis of all the economic and political criteria, we believe that the current taxation system for residential property reform in England should be replaced with the following elements:

- An Annual Proportional Property Tax (APPT) on the current capital value of houses with a tax exemption of initially £50,000 and a 25% surcharge for second home owners.
- The national government(s) and LAs to impose separate APPT tax rates with LAs retaining the APPT revenues they raise.
- Green offsets applied to the APPT to improve energy efficiency.
- A Development Levy set at 20% of the realised market price of newly constructed houses with revenues spent only on identified purposes.

Recommendation one: An Annual Proportional Property Tax (APPT) on the current capital value of houses, with a tax exemption of initially £50,000 and a surcharge for second home owners.

Being guided by the principle that the best should not be the enemy of the good, we propose an APPT with a tax exemption for houses valued

£50,000 or less.

There are arguments for and against a tax exemption. On balance, we suggest introducing one single low threshold of initially £50,000, set to rise with house prices over time. This should be low enough to eliminate attempts to manipulate values for tax avoidance.

This would be transparently a property tax so liability to pay would be with owners. All houses, unless abandoned, would be liable to the tax with no discounts for second homes or fewer occupants.

In fact, higher APPT rates on second homes would be likely to be politically popular, and much more efficient compared to the higher SDLT rates on second homes that are currently in place. The latter provides incentives to wealthy second home owners to keep their underused or empty properties as capital investments for longer without trading them, because this allows them to benefit from any capital gains without having to face the transaction tax. Based on this rationale, we propose to introduce a 25% tax rate surcharge on second homes, so if the APPT rate were 0.5% on primary homes it would be 0.625% on second homes. This will provide incentives to use living space more efficiently and discourages underuse of space or holding of property for purely for the prospect of capital gains. The latter is a real concern in Britain as the planning system makes housing supply extremely unresponsive to price increases so increases in demand over time leading to strong price increases as housing supply cannot expand.⁶⁵

The APPT should have annual revaluation using statistical modelling, but with a three-or five-year rolling window to smooth annual changes. There should also be an appeals process so house owners could appeal against their valuations. This appeals process should be run under the auspices of the District Valuer Services (the existing government body responsible for providing expert valuation and other property advice

65. Hilber and Vermeulen, "The impact of supply constraints"; Christian Hilber and Andreas Mense, "Why have house prices risen so much more than rents in superstar cities?", *CEP Discussion Paper No. 1743* (2021).

to government and the public sector) with clearly defined rules and stringent requirements. Valuations from the national modelling system should only be revised on appeal if the appeal tribunal judged there was a discrepancy between the assessed value for the period and conditions on which it was based departed from an equivalent market value by 10% or more.

To avoid sudden and massive one-off redistribution we recommend a transition period of, for example, five years, in which there is a gradual phasing out of CT and SDLT and a phasing in of the APPT. Or, alternatively, a phasing out of the SDLT only and replacing the CT with an APPT in one go. Then the rates are adjusted over time, with the aim of keeping overall revenues neutral at national level, until the SDLT is completely phased out.

There should be a provision, subject to paying interest, to defer tax payments for 'asset rich and cash poor' individuals until the point at which properties are sold or an inheritance takes place. The conditions permitting this choice should be clearly defined.

Recommendation two: The national government and LAs to impose separate APPT rates

A share of the revenue of the APPT should go towards the national government and a share should go towards LAs. The share going to national government should be determined so that it offsets for the loss to national revenues of the abolition of SDLT.

Local authorities should be free to set their local tax rates as a proportion of the assessed local property value tax base independently of national government. Local authorities would be allowed to fully retain this revenue and use it on local public services, such as local refuse collection, recycling, local parking, environmental improvements, local transport infrastructure and services, maintenance of local beauty sites or parks, local libraries, and local museums. There should be no claw back in the long-term via changes in central government grants designed to fund services such as education, which may be locally

provided but to national standards.⁶⁶

This will generate tax incentives at the local level to permit new residential development and variety in the range of local services communities can offer: put differently, it should generate competition amongst local authorities to provide a mix of local services attractive to their existing and potential new residents.

Services such as education, health or social services, where nationally determined policy attempts to ensure uniform standards across the country, should remain subject to national funding, even if delivery is by LAs acting as agents of national government via central government grants. But funding services where there is a deliberate national decision to set national standards needs to be strictly separated from other local services.

Recommendation three: Green offsets applied to the APPT to improve energy efficiency.

One solution might be to offer allowances against the house owners' liability for APPT for the more energy efficient houses and an additional weighting on the liability for the least energy efficient houses. This could be calculated so the net effect of the green offsets was broadly revenue neutral.

The existing system of Energy Performance Certificates (EPCs) could be extended to calculate appropriate offsets. A great advantage of this scheme as opposed to previous schemes designed to incentivise more energy efficient housing (such as the Green Deal and Green Homes Grant) is that there would be no application process, it would provide systematic incentives to all house owners, and rates could easily be adjusted in the light of progress made towards reducing CO₂ emissions

66. The overarching idea is that the benefits derived from local services and from permitting new residential development should be congruent to the costs associated with providing these services and permitting the development. See Christian Hilber, Olivier Schöni and Maximilian von Ehrlich, "Land use, land use policy and local taxation", *OECD Consultant Report* (2016).

LAs should no longer, in effect, be confronted with a revenue penalty if they permit residential development. Under the current system this is a very perverse incentive.

from the residential sector. Since these emissions have been consistently rising as a proportion of national CO₂ emissions for 30 years, effective policy instruments are essential if net zero is to be achieved.

Recommendation four: A Development Levy set at 20% of the realised market price of newly constructed houses.

The Development Levy should be charged on the market price of new developments. This proposal has similarities with the Infrastructure Levy set out in the recent White Paper⁶⁷ but with both rates and the way they are spent required to be uniform across the country and determined by national legislation. This would focus the Development Levy as proposed here on generating incentives for LAs to accept development and ensure the construction social housing now achieved via S106 Agreements was more than compensated for and such social housing was provided where housing was most expensive.

Revenues would accrue to LAs but be required to be spent only on: infrastructure necessary to support the additional housing while maintain service levels; enhanced or additional provision of those public services which were the funding responsibility of local government; or in each LA a proportion determined by national government of total revenues should be spent on additional social or ‘affordable’ housing (presently generated via S106 Agreements).

We recognise such a Development Levy is a second best instrument since it is not entirely neutral from the perspective of developers. Even though the incidence of the tax would likely ultimately be on the price of land, since tax liability would increase with the value of the building put on any land, there would be some perverse incentive to build more cheaply (to use less capital). It would create winners and losers in the development industry, so transition arrangements would be necessary.

But in a situation in which planning policies have so restricted the supply of land that gaining planning permission for a site on the

67. MHCLG, “Planning for the future”.

northern edge of London can, for example, increase the value of the land from £20,000 per ha to £35,000,000 per ha these defects are all but trivial. Since it would be predictable and transparent, it would not increase risk or uncertainty, it would eliminate the current substantial negotiation costs falling on both LAs and developers and it would redress the current imbalance between large developers and smaller ones. S106 Agreements represent a substantial fixed cost and are one of the factors which have accelerated the monopolisation of the development industry. The costs of S106 or CIL are already capitalised into land prices meaning that in a range of locations building land has a negative price: that is the land is not viable for development.

While imposing a Development Levy at 20% might just possibly mean development in some housing market conditions was not viable, this would almost certainly be less than is the case with the present system and, since in more prosperous market conditions local communities would be transparently compensated for accepting new development, the current binding constraint on building or the power of NIMBYism would be reduced.

Exploring the distributional implications of our reforms by LA and house price

Our main reform is to replace both the CT and SDLT in England with an APPT, after an exemption for properties worth less than £50,000 is applied. The APPT has two components: a national rate, and a locally determined rate. The national rate is designed to replace the revenue lost from abolishing SDLT. The local rate will, in practice, be set by LAs.

So far, we have provided an assessment of the APPT against various economic and political criteria. However, we have not yet discussed what the tax rates might look like and simulated the potential distributional impacts – either as revenue per capita or as tax liabilities associated with differently priced houses.

We can conduct a simple before and after analysis at LA-level to simulate the potential distributional impacts of our main reform proposal in two

ways. First, by showing the proportion of English LAs where a typical resident would pay less overall in property tax, and the proportion where a typical resident would pay more overall. Second, we can simulate the impact on property tax payments before and after our proposed reform for a range of representative houses in specific LAs across England.

Since it is central to our proposed reform that LAs should control their own revenues to fund those services that are local responsibilities rather than those of national government, it follows that one cannot be certain what rate will be applied to the *local* portion of the APPT. In fact, since CT revenues in total are some five times those from SDLT, this local tax rate is more important in determining who wins and who loses from the reform.

We have chosen a set of five scenarios that cover a plausible range of outcomes from the transition to this new system of property taxation. In all cases we apply the same rate of national tax in all LAs such as to make up for national government the revenue lost from abolishing the SDLT. This means all scenarios have a uniform *national* element but also a *local* element of revenue which, except in scenario 1), varies by LA.

The five scenarios are:

- 1) National APPT to replace SDLT + local APPT set at a **uniform rate** across all LAs and yielding in total the same revenue as CT does at present.
- 2) National APPT to replace SDLT + local APPT set at a rate in each LA so that the local APPT yields the **same revenue for each LA** as CT does at present.
- 3) National APPT to replace SDLT + local APPT set at a rate in each LA so that in those LAs where the median house price is greater than the overall national median ('property richer LAs') the APPT is set to yield 10% **more** revenue than the CT does at present and in those in which the median house price is less than the English median ('property poorer LAs') is set to yield 10% **less** revenue than at present.

- 4) National APPT to replace SDLT + local APPT set at a rate in property richer LAs to yield 20% **more** revenue and in property poorer LAs 20% **less** revenue than at present.
- 5) National APPT to replace SDLT + local APPT set at a rate in property richer LAs to yield 10% **less** revenue and in property poorer LAs 10% **more** revenue than at present.

The first two of these scenarios aim for overall fiscal neutrality; in other words, achieving the same level of revenue from an APPT as from SDLT and CT.

Scenarios 3) and 4) assume that local public goods are normal – in other words, richer households, given the choice, consume more of them than poorer ones do. This suggests that property richer LAs decide to raise their local APPT at a level that raises more revenue than under CT, while the converse applies to property poorer LAs. Finally, scenario 5) assumes richer households, when they get the chance, choose to consume less publicly provided services and instead buy more services from the private sector while poorer households desire more public services. This reflects the possibility that property richer LAs may choose to set local rates at a low level, while property poorer LAs set higher local rates.

Unlike the first two scenarios which are designed to be fiscally neutral, it is not possible to estimate the ultimate impact on net tax revenues of scenarios 3), 4) and 5) since by intention in these scenarios LAs are each charging their own rate of local APPT.

Impact on average property tax liability by local authority

Tax revenue per person essentially illustrates the tax liability of a typical resident.⁶⁸ Calculating the pre-reform annual tax revenues per capita at LA-level is fairly straightforward. We have precise data on CT

68. Since this is the total value of all taxes paid divided by the population in the LA, it is, statistically, the mean tax paid.

revenue by LA from the Office for National Statistics (ONS) and we can estimate SDLT revenues by LA from the Land Registry. We can then calculate separate and combined annual revenues *per capita* by using population estimates from the ONS. We conduct this calculation using data for 2019.

The resulting annual tax revenue per capita by LA are illustrated in maps in Figure 5.1 (CT only), Figure 5.2 (SDLT only) and Figure 5.3 (CT+SDLT) below.

Figure 5.1. Annual revenue per capita from current CT, by Local Authority

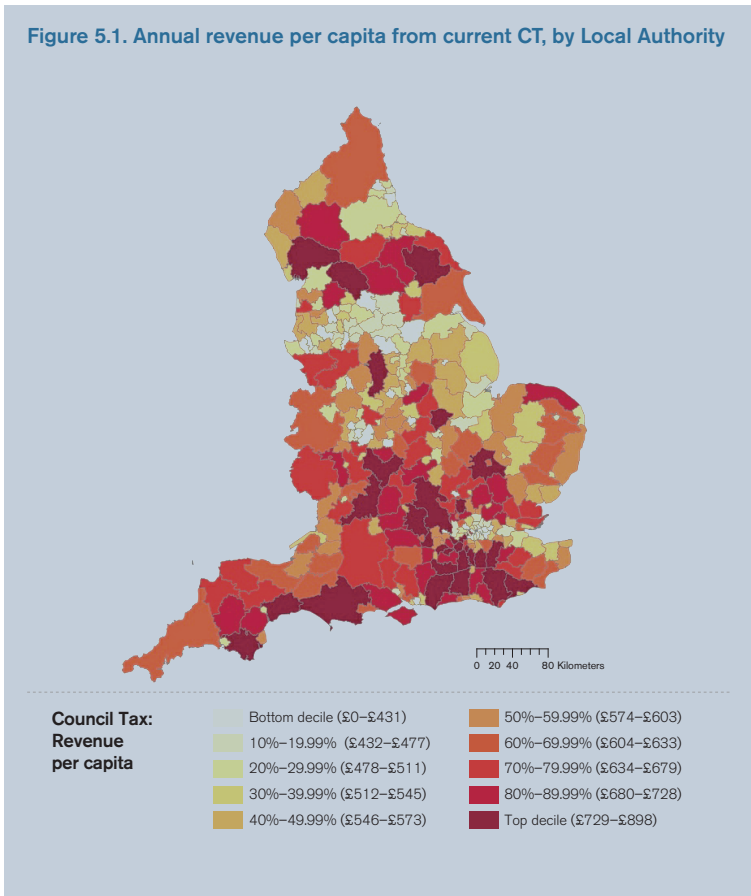
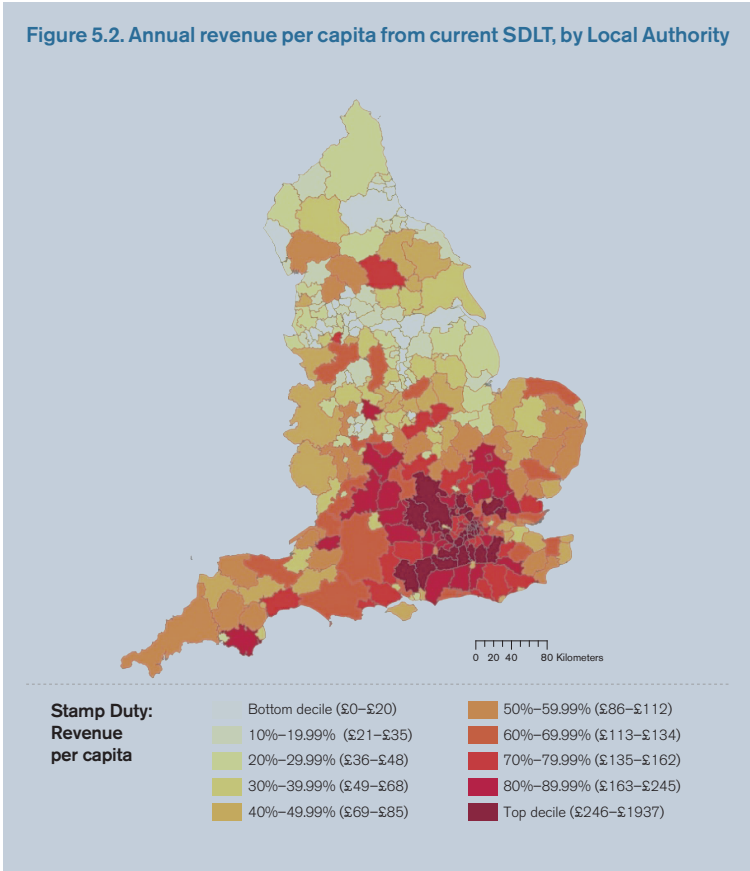
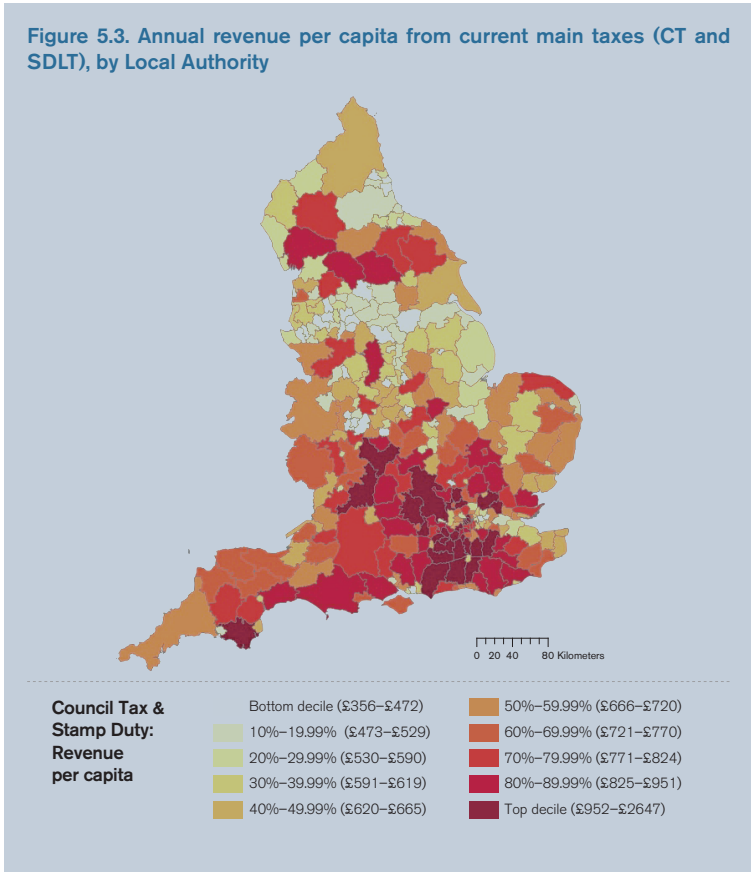


Figure 5.2. Annual revenue per capita from current SDLT, by Local Authority



A visual inspection of the map in Figure 5.1 reveals what for most will be a very unexpected fact: the lowest annual per capita revenue from the CT tend to be in more central boroughs of Greater London and, to a less obvious extent, in the bigger cities. The reverse is true for annual SDLT revenue (Figure 5.2 above), of course, since not only are house prices more expensive in London and the south east of England, but the rate of SDLT rises more than proportionately with price. The result is that SDLT – despite its manifold defects – is a highly progressive tax,

Figure 5.3. Annual revenue per capita from current main taxes (CT and SDLT), by Local Authority



both across houses and regions. But because the SDLT only contributes about 18% to the combined revenue of both taxes, the total annual revenue by LA is relatively low in the central London boroughs, and substantially higher in some LAs in the North East of England.

We can now show the results of scenario 1) – a national APPT to replace SDLT revenues and a local APPT to replace CT revenues, set at a uniform rate across LAs – in map form to make a visual comparison with the pre-reform status quo shown in Figure 5.3 above. This is done

in Figure 5.4 further below.

To calculate both the *national* and *local* rate of APPT that would be equivalent to the revenue from SDLT and CT in total, we can use information on the housing stock by LA from the MHCLG and on average house prices by LA from the ONS, both for 2019. Moreover, we can use Census data for 2011 to estimate the share of the total housing stock that is second homes.

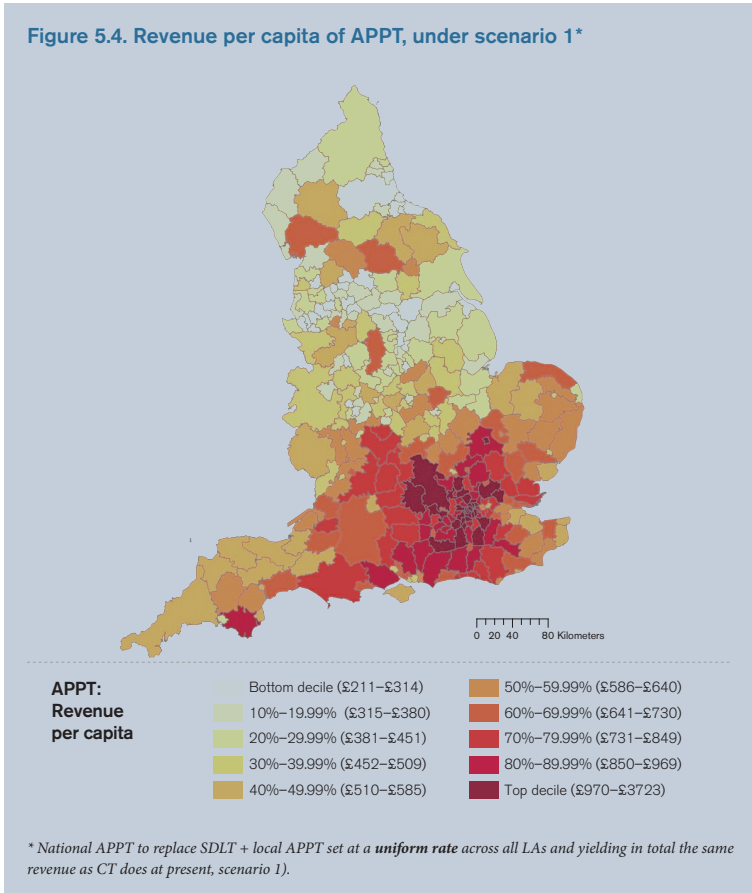
Again, our scenario 1) stipulates that the *national* APPT tax rate should be set such as to fully replace the SDLT. Our calculations suggest that, on average, in England and in 2019 the SDLT revenue per capita is £124 per annum. We can then use the housing stock data for 2019, the share of the stock that is second homes and the house price data (average between 2016 and 2018) to derive the *national* APPT tax rate that generates the equivalent annual revenue to the SDLT. This revenue neutral *national* annual tax rate is 0.11% for primary homes and 0.14% for second homes (if a 25% surcharge is applied, as suggested earlier in the paper). This *national* APPT rate would apply under all scenarios we simulate.

Now we can add the local element of APPT on the assumption that all LAs set the same *local* tax rate and this uniform local tax rate generates exactly the same revenue nationally as the CT did in 2019. This, again revenue neutral, uniform *local* tax rate is 0.51% for primary homes and 0.63% for second homes (if the 25% surcharge on second homes we propose is adopted).

Combining both the *national* and *local* tax rates to achieve scenario 1), the total, revenue neutral, APPT tax rate is thus 0.62% for primary homes (a 0.11% national rate and 0.51% local rate) and 0.77% for second homes (a 0.14% national rate and a 0.63% local rate).

Assuming these tax rates and knowing the value of the housing stock in each LA, we can now calculate the implied tax revenue per capita of the APPT by LA. This is illustrated in Figure 5.4 below, which reveals that, under the admittedly somewhat unrealistic assumptions of scenario 1) – that local tax rates are uniform across LAs – tax revenue per capita would be highest in the Greater London Authority and the South East of the country.

Figure 5.4. Revenue per capita of APPT, under scenario 1*



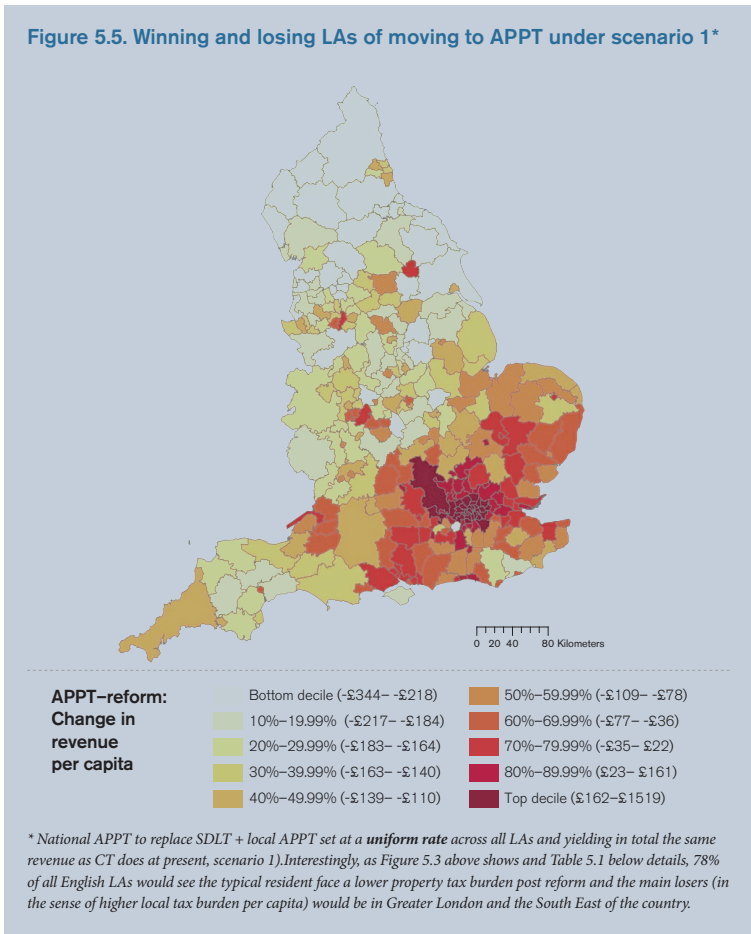
We can now identify winning LAs and losing LAs of our main reform under scenario 1). Winning LAs would be those where the typical resident sees a lower expected property tax liability overall. Losing LAs, in contrast, would be those where the typical resident sees a higher expected property tax liability overall.

It is worth noting, however, that the labels ‘winning LAs’ and ‘losing LAs’ have to be interpreted with some caution since more local tax revenue also implies more spending on local public services at local

level, benefiting local residents.

To illustrate these winning and losing LAs, we compare the total revenue per capita by LA under the current CT and SDLT tax system to that which we estimate would be the situation post reform. Since, at present, SDLT is only paid when houses are sold, to make this comparison we have converted it into an expected annual payment for the mean resident in the way defined in Box 5.1. These winning and losing LAs are shown in Figure 5.5 below.

Figure 5.5. Winning and losing LAs of moving to APPT under scenario 1*



However, it is worth reemphasising that, in practice, it is unlikely that all LAs would set a uniform APPT local rate as assumed in scenario 1). Hence, we also consider scenarios 2) to 5) that allow a range of alternative local APPT rates.

There are two ways to illustrate the differential impacts of each scenario: we can estimate the proportion of LAs that are winners or losers either in absolute terms or weighting each LA by its population. The outcomes on this basis are shown in Table 5.1 below.

Table 5.1. Proportion of English LAs where the typical resident has a higher (Winning LA) or lower tax burden (Losing LA)

Scenario		% 'Winning' LAs	% 'Losing' LAs
1): National APPT* + homogeneous local APPT**	Unweighted	78.0	22.0
	Weighted by population	74.6	25.4
2): National APPT + local CT revenue fixed***	Unweighted	31.6	68.4
	Weighted by population	29.4	70.6
3): National APPT + property richer LAs +10% & property poorer -10% revenue than CT***	Unweighted	68.4	31.6
	Weighted by population	68.4	31.6
4): National APPT + property richer LAs +20% & property poorer LAs – 20% revenue than CT***	Unweighted	64.2	35.8
	Weighted by population	65.9	34.1
5): National APPT + property richer LAs – 10% & property poorer LAs +10% revenue than CT***	Unweighted	39.3	60.7
	Weighted by population	37.5	62.5

Note: * The **national** APPT rate is 0.11% for primary homes and 0.14% for second homes. ** The local APPT rate is 0.51% for primary homes and 0.63% for second homes. *** The **national** APPT rate is 0.11% for primary homes and 0.14% for second homes. The local APPT rates vary across LAs such as to generate the local CT revenue, +/-10% of the local CT revenue, +/-20% of the local CT revenue and -/+10% of the local CT revenue.

Table 5.1 above shows that different assumptions about local tax rates lead to very different outcomes. We see three things.

First, since the (otherwise heavily flawed) SDLT is even more progressive

than the APPT, the *national component* of the reform is regressive. Thus, if we additionally hold local tax revenue constant (so there is no redistribution at local level), as in scenario 2), or we assume that poorer (richer) LAs opt to set a tax rate that yields more (less) revenue than under CT, as in scenario 5), the effect of the national component of the reform will dominate and thus ultimately yield more losers than winners.

Second, the ratio of winning to losing LAs can switch quite significantly with apparently small changes in *local* APPT rates.

Third, whether results are weighted by LA populations or not makes little difference to the balance of these LA distributional outcomes.

Overall, however, it is clear that a majority of English LAs would see the typical resident have a lower tax liability under our proposed system of property taxation relative to the current one in the scenarios in which property richer LAs raise more local tax revenue via the APPT than under CT and property poorer LAs raise less.

Impact on property tax liability by property price

There is a second and perhaps more revealing way of exploring the distributional outcomes of these five scenarios for the proposed main reform to English property taxation. This analysis focuses on individual houses across representative LAs rather than LA revenue per capita, so a different method is used to estimate house-specific CT and SDLT liabilities, as described in Box 5.1 below.

All English LAs can be ranked from the most expensive to the cheapest in terms of median house price: Kensington and Chelsea is the most expensive, and Burnley the least. These two LAs were selected, therefore, and then one LA from each decile in the distribution was selected to represent the whole range of the English housing market geography. This yielded the ten LAs – from most expensive to least expensive: Chelsea and Kensington; Guildford; West Berkshire; Basildon; Bedford; Cheshire East; Redditch; Leeds; Newcastle upon Tyne; and, Burnley.

We show the simulated impact on tax liability of our proposed reform for three different types of property across these ten LAs in

England. The three different type of property chosen in these ten LAs are: a property valued at the median price in an LA as of December 2019; 50% more than the median; and, 25% less than the median. Median prices for each LA relate to December 2019.⁶⁹ The distribution of house prices is not normal: there are relatively few expensive or very expensive ones but many less expensive ones. This means that the mean of the distribution is higher than the median but that the median is more representative of all houses. This is why we have chosen price points that are not symmetric with respect to the median.

Box 5.1. Methodology to ascertain current property-specific CT and SDLT liabilities

To enable the comparison of property tax liability between the existing and our proposed system by property prices in ten LAs, you have to first estimate the property-specific tax liabilities for both CT and SDLT in the current system.

On CT, you have to allocate realistic Bands for each of the 30 representative houses in the ten LAs chosen. This was done searching Rightmove and selecting a sample of houses in each LA with asking prices at or very close to the given price point. This process was not entirely random since outlier-type houses, for example those in very poor condition or with a sitting tenant, were discarded. CT Bands were then retrieved for some 90 houses. This was done by locating the full street address (if not on Rightmove's details, by inspecting photographs which often show street numbers or using Google Street View to locate the exact house) and then using the official VOA look-up website to identify the CT Band.⁷⁰

Having established CT Bands for each representative house, the

69. Median prices for each LA relate to December 2019 as reported in ONS, "Median house prices for administrative geographies".

70. Valuation Office Agency, "Search for your council tax band", <http://cti.voa.gov.uk/cti/Inits.asp?lcn=0>.

issue then arises as to how best to estimate the local rate that would be charged if the APPT were in force that would yield the same revenue given the wide variation in observed house prices relative to CT Bands. For example, in Bedford, houses with asking prices of £420,000 and £280,000 – the median + 50% and the median price for that LA – are in the same CT Band, C. The solution adopted is to smooth the effective CT rates in terms of current property prices across Bands to estimate what APPT rate would have been necessary to have yielded the same revenue to the LA as the CT. We know the yield of CT because we know the CT Bands and the rate charged by band in Bedford. So we apportion that total revenue by current house price so that a given rate of tax would yield the currently observed revenue.

This is done for all price bands for each LA. The estimated rate can then be adjusted pro rata to give the values needed to produce estimates for our other scenarios, for example 10% (or 20%) more or less revenue overall from CT.

Separately, the SDLT payment associated with each of the 30 representative houses is calculated using the rates applicable during 2019 for primary homes.⁷¹ We then multiply the SDLT tax burden for a given transaction in 2019 with the transaction propensity for each house to get a predicted annualised value of SDLT tax payments associated with each house. We estimate the turnover propensity using data on the housing stock in England⁷² and sales numbers⁷³ during 2018-19.

71. GOV.UK, “Stamp duty land tax”, <https://www.gov.uk/stamp-duty-land-tax/residential-property-rates>.

72. GOV.UK, “Live tables on dwelling stock (including vacants)”, <https://www.gov.uk/government/statistical-data-sets/live-tables-on-dwelling-stock-including-vacants> (2021).

73. GOV.UK, “Monthly property transactions completed in the UK with value of £40,000 or above”, <https://www.gov.uk/government/statistics/monthly-property-transactions-completed-in-the-uk-with-value-40000-or-above> (2021).

The actual outcome in terms of expected annual tax liability for any given property of course depends on what *local* APPT rate the LA actually decided to impose. The five scenarios we have chosen enable us to show a range of plausible tax liability outcomes of the proposed main reform.

Table 5.2 below shows, for a house at the three key price points in each LA, the change in total annual property tax liability that would result from the proposed reform, under the five scenarios chosen for differing *local* APPT rates.

A negative sign, also in a green background, indicates that less overall property tax would be paid after the reform: in essence, that type of property in that LA would be a ‘winner’. Conversely, a number in a red background shows that this property would be a ‘loser’, in the sense they would have a higher tax liability.

Table 5.2. Simulations for different English Local Authorities and house values

	Median price + 50%	Median price	Median price – 25%
Kensington and Chelsea (top decile)			
House value in thousand £ (Council tax band)	1879 (G)	1253 (F)	939 (F)
Pre-reform tax (SDLT+CT, in £)	7622	4476	3189
Post-reform (win/loss):			
Nat. APPT + local APPT w. uniform tax rate (in £)	3987	3264	2616
Nat. APPT + keep local CT revenue constant (in £)	-3127	-1479	-942
Nat. APPT + CT rev. +/- 10% (in £)	-2888	-1320	-822
Nat. APPT + CT rev. +/- 20% (in £)	-2649	-1160	-703
Nat. APPT + CT rev. – /+ 10% (in £)	-3367	-1639	-1062
Guildford (2nd decile)			
House value in thousand £ (Council tax band)	651 (F)	434 (C)	326 (C)
Pre-reform tax (SDLT+CT, in £)	3581	2121	1898
Post-reform (win/loss):			
Nat. APPT + local APPT w. uniform tax rate (in £)	442	561	113
Nat. APPT + keep local CT revenue constant (in £)	-113	191	-164
Nat. APPT + CT rev. +/- 10% (in £)	161	373	-28
Nat. APPT + CT rev. +/- 20% (in £)	435	556	109
Nat. APPT + CT rev. – /+ 10% (in £)	-387	8	-301
West Berkshire (3rd decile)			
House value in thousand £ (Council tax band)	518 (E)	345 (C)	259 (C)
Pre-reform tax (SDLT+CT, in £)	2815	1876	1698
Post-reform (win/loss):			
Nat. APPT + local APPT w. uniform tax rate (in £)	383	256	-99
Nat. APPT + keep local CT revenue constant (in £)	218	147	-182
Nat. APPT + CT rev. +/- 10% (in £)	464	310	-59
Nat. APPT + CT rev. +/- 20% (in £)	709	474	64
Nat. APPT + CT rev. – /+ 10% (in £)	-27	-17	-304
Basildon (4th decile)			
House value in thousand £ (Council tax band)	450 (E)	300 (C)	225 (B)
Pre-reform tax (SDLT+CT, in £)	2635	1753	1439
Post-reform (win/loss):			
Nat. APPT + local APPT w. uniform tax rate (in £)	146	101	-48
Nat. APPT + keep local CT revenue constant (in £)	188	129	-27
Nat. APPT + CT rev. +/- 10% (in £)	420	283	89
Nat. APPT + CT rev. +/- 20% (in £)	652	438	205
Nat. APPT + CT rev. – /+ 10% (in £)	-44	-26	-143
Bedford (5th decile)			
House value in thousand £ (Council tax band)	420 (C)	280 (C)	210 (B)
Pre-reform tax (SDLT+CT, in £)	2030	1742	1453
Post-reform (win/loss):			
Nat. APPT + local APPT w. uniform tax rate (in £)	566	-12	-155
Nat. APPT + keep local CT revenue constant (in £)	744	107	-66
Nat. APPT + CT rev. +/- 10% (in £)	954	247	39
Nat. APPT + CT rev. +/- 20% (in £)	325	-172	-275
Nat. APPT + CT rev. – /+ 10% (in £)	-140	-9	27

Table 5.2. – Continued (Bottom 5 deciles)

	Median price + 50%	Median price	Median price – 25%
Cheshire East (6th decile)			
House value in thousand £ Sterling (Council tax band)	360 (E)	240 (C)	180 (B)
Pre-reform tax (SDLT+CT, in £)	2410	1613	1376
Post-reform (win/loss):			
Nat. APPT + local APPT w. uniform tax rate (in £)	-186	-130	-264
Nat. APPT + keep local CT revenue constant (in £)	268	173	-37
Nat. APPT + CT rev. +/- 10% (in £)	41	21	-151
Nat. APPT + CT rev. +/- 20% (in £)	-187	-131	-264
Nat. APPT + CT rev. -/+ 10% (in £)	496	324	77
Redditch (7th decile)			
House value in thousand £ Sterling (Council tax band)	326 (D)	218 (C)	163 (A)
Pre-reform tax (SDLT+CT, in £)	1891	1612	1188
Post-reform (win/loss):			
Nat. APPT + local APPT w. uniform tax rate (in £)	125	-268	-180
Nat. APPT + keep local CT revenue constant (in £)	513	-9	14
Nat. APPT + CT rev. +/- 10% (in £)	309	-145	-88
Nat. APPT + CT rev. +/- 20% (in £)	105	-281	-189
Nat. APPT + CT rev. -/+ 10% (in £)	717	127	116
Leeds (8th decile)			
House value in thousand £ Sterling (Council tax band)	277 (D)	185 (B)	139 (A)
Pre-reform tax (SDLT+CT, in £)	1699	1277	1066
Post-reform (win/loss):			
Nat. APPT + local APPT w. uniform tax rate (in £)	15	-134	-209
Nat. APPT + keep local CT revenue constant (in £)	391	116	-21
Nat. APPT + CT rev. +/- 10% (in £)	213	-2	-110
Nat. APPT + CT rev. +/- 20% (in £)	35	-121	-199
Nat. APPT + CT rev. -/+ 10% (in £)	569	235	68
Newcastle upon Tyne (9th decile)			
House value in thousand £ Sterling (Council tax band)	247 (C)	165 (B)	124 (A)
Pre-reform tax (SDLT+CT, in £)	1678	1415	1187
Post-reform (win/loss):			
Nat. APPT + local APPT w. uniform tax rate (in £)	-149	-396	-423
Nat. APPT + keep local CT revenue constant (in £)	513	45	-92
Nat. APPT + CT rev. +/- 10% (in £)	322	-82	-188
Nat. APPT + CT rev. +/- 20% (in £)	130	-210	-283
Nat. APPT + CT rev. -/+ 10% (in £)	704	173	4
Burnley (bottom decile)			
House value in thousand £ Sterling (Council tax band)	141 (B)	94 (A)	71 (A)
Pre-reform tax (SDLT+CT, in £)	1445	1230	1230
Post-reform (win/loss):			
Nat. APPT + local APPT w. uniform tax rate (in £)	-574	-649	-795
Nat. APPT + keep local CT revenue constant (in £)	509	73	-253
Nat. APPT + CT rev. +/- 10% (in £)	329	-47	-343
Nat. APPT + CT rev. +/- 20% (in £)	150	-167	-433
Nat. APPT + CT rev. -/+ 10% (in £)	689	192	-163

Thus, as can be seen in Table 5.2 above, in the lowest priced housing market, Burnley, the cheapest houses are winners in all scenarios and houses with a price at the market median also gain in all scenarios, except those in which LA revenue is kept constant (scenario 2) or where we assume property rich LAs reduce their taxation by 10% and property poor LAs increase it by 10% (scenario 5).

Overall, there is a pattern of more winners in poorer LAs and for less expensive houses. Combining the results of all the different scenarios, of the lowest priced houses in the ten representative LAs, 76% are winners; for the median priced houses, 48% are winners; and, for the most expensive houses only 24% are winners. When interpreting these results, it is worth bearing in mind that there tends to be relatively few expensive (50% more than the median price) homes in a given LA, and many less expensive (25% less than the median price) ones.

As should be expected, the property poor LAs only tend to be losers in scenario 5) in which they are assumed to increase their local APPT rates while they are reduced in the property rich LAs. In the general pattern of property poorer and cheaper houses tending to be winners, the stand-out exception is Kensington and Chelsea. Here house prices are so high that almost none of the assumed local APPT rates under the different scenarios offsets the abolition of the highly progressive SDLT. The only scenario in which all house price points lose in Kensington and Chelsea is when the local APPT is set at a uniform rate across the country: expensive in an LA where the median house price was £1,253,000.

As we have stressed, the distributional effects of a single tax are only one factor in assessing its benefits. From a distributional viewpoint what matters is the overall effect of the tax system as a whole and also of the welfare system. Here we focus just on the distributional impacts of our proposed reforms to the main elements of English property taxation. And even just in this narrow focus they bear up quite promisingly.

Looking at the combined effect of our reforms, our simulations show that in any scenario in which property richer LAs increase their tax

rates relative to property poorer ones, then there are more residents who on average pay less in property tax than they do now, as Table 5.1 further above illustrates. Perhaps more telling, however, are the results of Table 5.2, which suggest that a move to APPT tends to favour lower-value properties, which will pay less property tax than the current system, particularly in property poor English LAs such as Burnley, Newcastle-upon-Tyne or Leeds. An APPT has a clear potential role, therefore, both in delivering the Government's 'levelling up' agenda and in ending the unfairness of the property tax system.

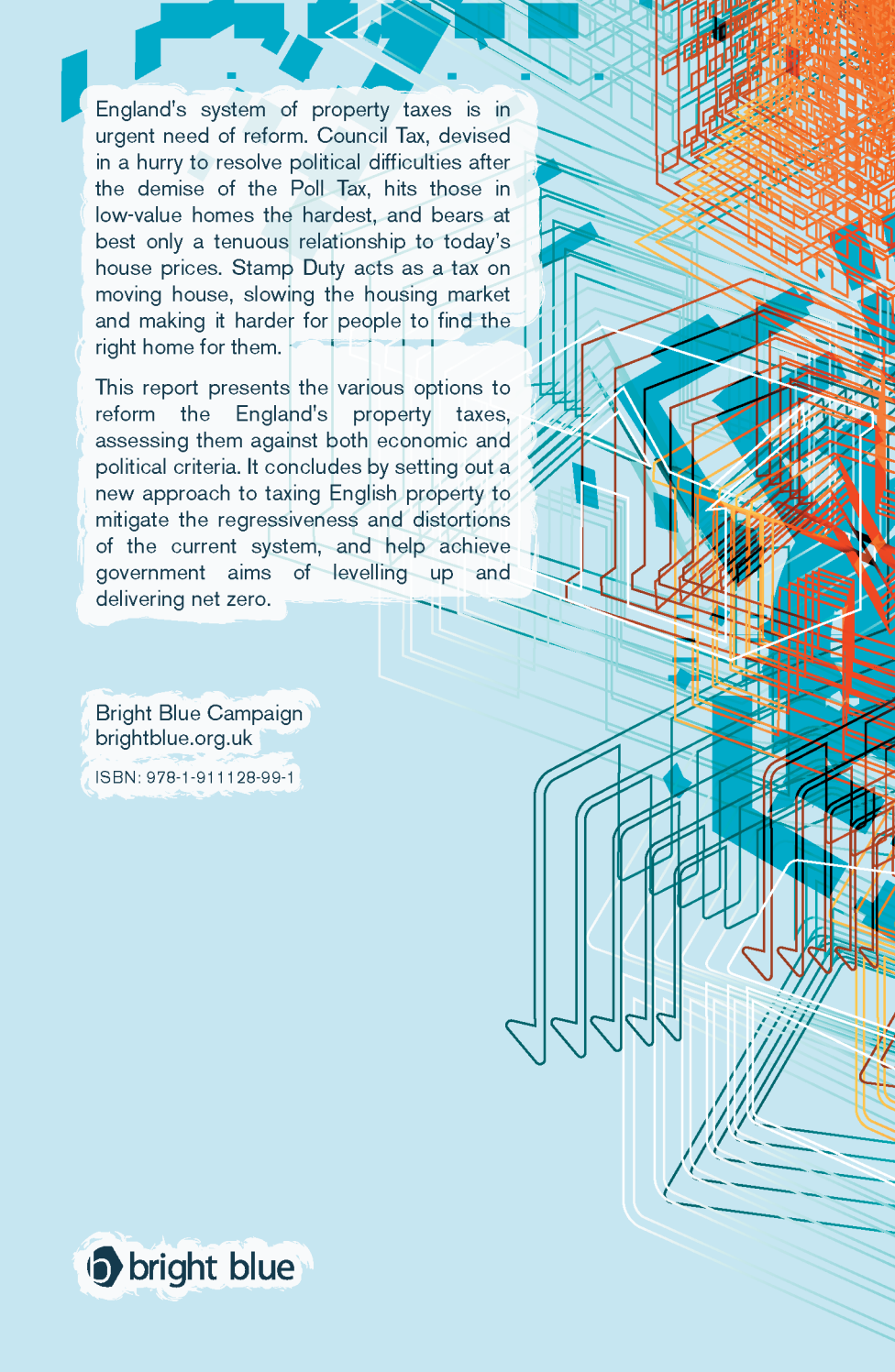
Conclusion

When starting the work for this report the authors were well aware of how problematic the main forms of taxation were: CT; SDLT; S106 Agreements and the CIL. But as the work progressed it became apparent the problems were even more serious than anticipated because the flaws in each element of the system reinforce those in others.

The existing system of property taxation in England is seriously flawed. But these taxes exist in an institutional environment which is itself dysfunctional. Local government finance is a complex tangle of user charges, property tax revenues and central government grants. There is a fuzzy division of responsibilities between central and subnational government (and there are a tangle of different layers): sometimes subnational governments act as agents of national government with almost no discretion; sometimes the responsibility is primarily that of local government. And, unfortunately, one of the areas over which local governments have most control is our highly dysfunctional planning system which in turn determines the supply of housing. This creates a vicious circle in which a dysfunctional fiscal system combined with a failing system of property taxation work in tandem to generate harmful unintended incentives, even more damaging than the individual components would be in isolation. In turn these unintended incentives interact with a dysfunctional system of land use regulation to fuel NIMBYism.

Thus, any reform proposed for English property taxation has to accept it will be applied in at least a third best world and, on their own, better property taxes cannot solve all problems. We have to accept second best solutions. We also have to confront existing fudges to decide whether it is property taxes that are being reformed, local government finances or the division of powers between tiers of government, because they are all interdependent. Here, we have taken the view that there can be no serious degree of autonomy unless local government has some control over its revenues independently of national government. With no resources, there can be no autonomy.

We have embedded this in the simplest, admittedly imperfect, set of reforms that seem feasible. With these reforms, we have aimed to strike a balance between what is economically efficient yet also politically feasible. Moving to an APPT fulfils both of these criteria, as well as having a role to play in addressing regional inequalities. With the addition of green offsets and a Developer Levy, these reforms will result in a system of property taxation that is fairer, greener, helps deliver more new homes and is simpler and more transparent than the one we have now.



England's system of property taxes is in urgent need of reform. Council Tax, devised in a hurry to resolve political difficulties after the demise of the Poll Tax, hits those in low-value homes the hardest, and bears at best only a tenuous relationship to today's house prices. Stamp Duty acts as a tax on moving house, slowing the housing market and making it harder for people to find the right home for them.

This report presents the various options to reform the England's property taxes, assessing them against both economic and political criteria. It concludes by setting out a new approach to taxing English property to mitigate the regressiveness and distortions of the current system, and help achieve government aims of levelling up and delivering net zero.

Bright Blue Campaign
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