Tax By Design: The Mirrlees Review

Land and property taxation

Stuart Adam, IFS
The Mirrlees Review

• Major review of the tax system from first principles
  – Set up by IFS under chairmanship of Nobel laureate Sir James Mirrlees

• Take as given total revenue and degree of redistribution
  – Ask how these can be achieved most efficiently

• Published by OUP in two volumes
  – *Dimensions of Tax Design*: collection of commissioned studies
  – *Tax by Design*: integrated overall vision by the editorial team
    - Focus today on Chapter 16 of *Tax by Design*

• [www.ifso.org.uk/mirrleesReview](http://www.ifso.org.uk/mirrleesReview)
A progressive, neutral system

• Consider the system as a whole
  – Use the right tools for the right objectives

• Achieve progressivity as efficiently as possible
  – Personal taxes and benefits are the best tools for redistribution
  – Target incentives where they matter most
  – Take a lifetime perspective, considering income and expenditure

• Neutrality as an important benchmark
  – Tends to be simpler, fairer and less distortionary
  – Not always – but should have a high hurdle to justify exceptions
Stamp duty land tax

- Basic principle that transactions should not be taxed
  - Why impose heavier tax on properties that change hands more often?
  - Assets should be held by the people who value them most
  - Reduced labour mobility one symptom of this more fundamental problem

- ‘Slab’ structure particularly absurd
  - £1 increase in price can trigger £10,000 increase in tax liability

- Stamp duties should not be part of the tax system
  - But don’t want to give up revenue / give windfall gains to current owners
  - So look to replace with better taxes rather than simply abolish
Conceptually, must distinguish:

- Business land
- Business property
- Domestic land
- Domestic property

William Vickrey:

The property tax is, economically speaking, a combination of one of the worst taxes – the part that is assessed on real estate improvements…and one of the best taxes – the tax on land or site value
Land value taxation is economically efficient

- Land is in fixed supply

- Gains in value accrue through no effort of the owner

- Taxing land value does not discourage any desirable activity
  - Windfall loss to land-owner on day tax is announced
  - But no disincentive to buy, develop or use land
Is land value taxation fair?

• Gains in value accrue through no effort (or merit) of the owner
  – Seems fair that these should be taxed as fully as possible

• But at given value, land is an asset like any other
  – Current owner may have acquired it at a fair price – not necessarily benefited from any rents
  – Why impose a windfall tax on (just) that asset?
Business rates are economically inefficient

- Business property is an intermediate input to production
- Basic principle that intermediate inputs should not be taxed
  - Economy inefficiently skewed away from property-intensive production
- Business rates also have other distortionary features in practice
  - Exemptions for certain sectors e.g. agriculture
  - Zero/reduced rates for empty buildings or unused land
Some headlines from 2009

Empty property rate tax creating a ‘bombsite Britain’ as owners demolish rather than pay new levy

Asda to demolish building to avoid empty property tax

A business has demolished office property comprising 52,000 square ft solely due to the impact of empty rates costs of £12,000 per calendar month
Replace business rates with a land value tax?

- And replace SDLT on business properties in the process

- On a revenue-neutral basis
  - No windfall gains/losses on average
  - Redistributes from owners of undeveloped land to owners of highly developed (and/or frequently traded) properties

- Do gradually, with transitional arrangements like UBR revaluation
Can LVT be implemented in practice?

- Key difficulty: valuing land separately from buildings
- Thinness of market makes this a real problem
  - Most market transactions are for land/property packages
- But some other countries seem to manage it
- And note that efficiency gains do not depend on accuracy
  - though fairness and scale of appeals might

- Merits a thorough official investigation
Taxing domestic property

• Case for land value taxation applies equally to business and domestic land

• But while there is no case for taxing business buildings, there is a good case for taxing domestic buildings

• In principle, could levy separate taxes on domestic land and domestic buildings

• But since want to tax both, a tax on combined value avoids need to value them separately
Taxing goods and services

• Only final consumption should be taxed
  – Not transactions (stamp duties) or produced inputs (business rates)
• Presumption to tax all consumption equally
  – Not least for reasons of simplicity
• There are exceptions to this
  – Where consumption is damaging (sin taxes, green taxes)
  – Where consumption is associated with work (childcare)
• But tax breaks for necessities on distributional grounds is NOT one of them
  – More efficient to redistribute based on total income/expenditure, without distorting people’s choices between goods
  – So we propose to broaden the VAT base, with a compensation package
Taxing consumption of housing services

• Housing should be taxed like other consumption
  – But not currently subject to VAT
• Could either tax new build, or stream of consumption
• From where the UK starts, the latter makes more sense
• Tax the annual consumption value of housing: substitute for VAT
• Looks like a sensibly reformed council tax
  – Based on up-to-date valuations (rather than 1991 values)
  – Proportional to values (rather than pointlessly regressive and banded)
  – No discounts for single occupancy (rather than 25% discount)
• And replace stamp duty on housing in the process
  – Initially on a revenue-neutral basis
A ‘housing services tax’
Note: rough guide only – see Chapter 16 for details

Current property value

Council tax bill
Housing services tax bill
## Land and property taxation: summary so far

**Current, ideal and proposed treatments**

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Taxing property as an asset

- Property is an investment as well as a consumption good
  - Returns are (actual or imputed) rent and capital gains
  - Should be part of coherent income tax / NI / CGT regime for savings
- Rental property currently subject to income tax and CGT
  - Like ordinary shares, bank accounts, etc
  - Investment discouraged; inflation and capital gains particularly problematic
- Owner-occupied housing currently exempt from income tax (on imputed rent) and CGT
  - Like ISAs (and NICs in general)
  - Enormous returns can go untaxed – rents, luck, disguised labour income
- Distinction creates a major bias in favour of owner-occupation
  - And between each of them and many other assets
- We propose reforms to move towards neutrality
  - Focus today on property, but part of a wider picture
A ‘rate-of-return allowance’ for rental property

• Continue to tax both income and capital gains
• But with an allowance for a ‘normal’ return on the investment
  – EITHER deduct (say) 5% of purchase price from rental income each year; tax capital gains at full marginal income tax rate
  – OR tax rental income in full, but charge CGT only on gains relative to a purchase price stepped up by (say) 5% per year
• ‘Excess’ returns should be taxed at full labour income tax rates
  – Including full NICs rates; on capital gains as well as income

• A rate-of-return allowance for owner-occupied property?
  – Desirable, but harder for both practical and political reasons
  – Pragmatically, keep current treatment in the medium term
Summary of recommendations

• Replace business rates (and SDLT on business property) with a land value tax
  – If land valuation proves feasible

• Replace council tax (and SDLT on domestic property) with a ‘housing services tax’
  – Proportional to up-to-date values

• Introduce a ‘rate-of-return allowance’ for rental property
  – And perhaps owner-occupied housing in the (even) longer term
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