Outline

• About the Mirrlees Review
• Transaction taxes and stamp duty land tax
• Input taxes, land value taxes and business rates
• Consumption taxation and council tax
• Savings taxation and the income tax treatment of property

Not covered:
• The local dimension
• Macroeconomic aspects (dealing with bubbles)
• Interaction with planning regime and other aspects of housing policy
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
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
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
### 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

- Key to effective savings taxation is neutrality across:
  - Consumption today vs tomorrow (don’t discourage saving)
  - Different assets (rental vs owner-occupied; property vs other assets)
  - Different income sources (labour earnings vs return to savings)
  - Different forms of return (income vs capital gains)
  - Different legal vehicles (direct investment vs incorporation)
  - Varying inflation rates

- Current system achieves none of these: can we do better?
Four options for savings taxation

1. Standard income tax (TTE)
   - Tax earnings and (nominal) capital income and gains
   - Like interest-bearing accounts, shares and rental housing

2. Earnings tax (TEE)
   - Tax earnings, but exempt (ignore) capital income and gains
   - Like ISAs and owner-occupied housing (and NICs in general)

3. Cash-flow expenditure tax (EET)
   - Tax relief for amounts saved; ignore returns within fund; tax withdrawals
   - Like pensions (and ‘human capital’ investments)

4. Rate-of-return allowance (TtE)
   - Tax earnings, but only tax capital income and gains above a ‘normal’ rate
   - Like Norwegian shareholder income tax
Reforming the taxation of property income

• Current regime for rental property distorts behaviour
  – Investing in property is discouraged
  – Inflation and capital gains cause particular problems

• Current regime for owner-occupiers seems too generous
  – Enormous returns (including disguised labour) go untaxed

• And distinction creates major bias in favour of owner-occupation
  – And between each of them and many other assets

• A rate-of-return allowance alleviates all these problems
A rate-of-return allowance for rental property

• Based on current system
  – Taxing both rental 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 (employee + employer) NICs
  – Applies to capital gains as well as income
A rate-of-return allowance for owner-occupiers?

• Similar, but using imputed rent instead of actual rent
  – Imputed rent is exactly what is assessed for the Housing Services Tax

• Same two implementation options now take on a different slant
  – EITHER deduct (say) 5% of purchase price from imputed rental income each year; tax capital gains at full marginal income tax rate
    ➢ *Would people just wait for the next government to repeal CGT?*
  – OR tax imputed rental income in full, but charge CGT only on gains relative to a purchase price stepped up by 5% per year
    ➢ *Is charging VAT + income tax + NICs rates on imputed rent each year politically realistic?*

• Retain current treatment of owner-occupied housing for now?
  – RRA for rental property alone would still be a major improvement
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