



Institute for
Fiscal Studies

Tax By Design: The Mirrlees Review

Land and property taxation

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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.ifs.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

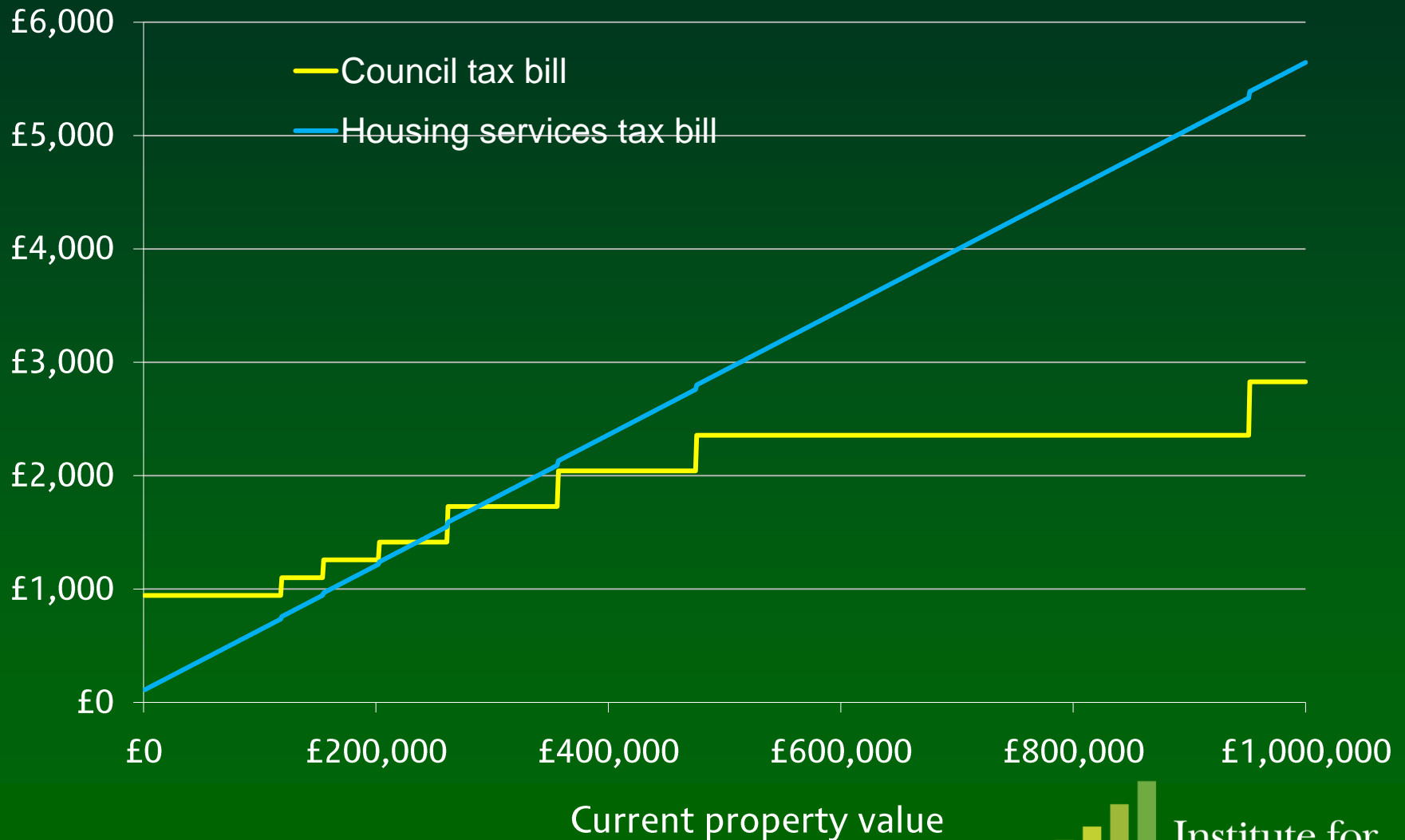
- Only final consumption should be taxed
 - Not transactions (stamp duties) or produced inputs (business rates)
- Presumption to tax all consumption equally
 - Not least for reasons of simplicity
- There are exceptions to this
 - Where consumption is damaging (sin taxes, green taxes)
 - Where consumption 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



Land and property taxation: summary so far

Current, ideal and proposed treatments

	Business	Domestic
Buildings	<p>Business rates</p> <p>Don't tax</p> <p>No tax</p>	<p>Council tax</p> <p>Tax like other consumption</p> <p>Housing services tax</p>
Land	<p>Business rates</p> <p>Tax arbitrarily high</p> <p>Land value tax</p>	<p>Council tax</p> <p>Tax arbitrarily high</p> <p>Housing services tax</p>

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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