Housing in the tax system

*Draws heavily on Chapter 16 of Tax by Design: the Mirrlees Review (http://www.ifs.org.uk/mirrleesReview)*

- Neutrality is an important benchmark in tax design
  - Tends to be simpler, fairer and less distortionary
  - Not always – but should have a high hurdle to justify exceptions

- Housing is both a consumption good and an asset
  - Tax system should treat it appropriately from both perspectives

- Focus today on taxing housing consumption
  - Paper also discusses taxation of housing as an asset (see section 3)

- But first, an aside...
Stamp duty on housing

- ‘Slab’ structure absurd
  - £1 higher price can mean £40,000 higher tax bill

- More fundamentally, transactions should not be taxed at all
  - 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

- 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
Taxing consumption of housing services

• Housing should be taxed like other consumption
• Two ways this could be done
  1. VAT on new build
  2. Annual tax on the stream of consumption
• There are pros and cons of each
  – Or a combination could be used
  – Choice may depend on the starting point in a particular country
• From where the UK starts, taxing the annual flow makes more sense
  – New build not currently subject to VAT
  – There is an existing annual tax on property values: council tax

➢ Recommendation for the UK: transform council tax into a ‘housing services tax’
A ‘housing services tax’

• Tax the annual consumption value of housing, as a 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 regressive with wide bands)
A ‘housing services tax’

Note: rough guide only – see paper for details

Current property value

- Council tax bill
- Housing services tax bill
A ‘housing services tax’

- Tax the annual consumption value of housing, as a 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)

- Ideally based on rental values rather than capital values
  - But there may be a trade-off with practicality here

- And replace stamp duty on housing in the process
  - Initially on a revenue-neutral basis
Difficulty paying housing taxes

• Housing has important advantages as a tax base
  – Immobile, supply (and demand) unresponsive to price, ownership easily established

• But owner-occupied housing has one big disadvantage
  – The stream of services is not linked to a cash flow

• Distinguish between two different concerns:
  1. Well-off people who own a valuable asset but lack liquidity
     ➢ Allow deferral of tax payments as a form of loan?
  2. People who lack the underlying ability to pay
     ➢ The state benefits safety-net should incorporate an allowance for housing costs (including housing taxes)
Deferral of housing tax payments

- Would help some taxpayers; but should governments be wary?
- Deferral should always be with interest
  - Interest-free loans give preferential treatment to those who pay later – unfair, inefficient and potentially expensive
- Allow deferral only until sale of property or death
- Secured against housing equity
  - So restricted to home-owners
  - And perhaps restricted to those who lack the liquidity to pay the tax?
  - Those with no current income or net assets get outright support instead
- Long-term credibility of the policy matters
  - Government & taxpayers need to be sure the tax will ultimately be paid
  - Political consensus therefore especially valuable
  - Err on the restrictive side until well established?
Support for housing costs

• Housing taxes are one part of housing costs

• Benefit system provides a ‘safety net’ to guarantee minimum income
  – Housing is clearly an essential of life which should be included
  – No judgement on how generous it should be

• Best to include housing support in an integrated benefit
  – UK’s ‘universal credit’ is a (partial and imperfect) attempt to do this

• If means-testing on assets as well as income, don’t exclude housing
  – Housing is illiquid, but that’s what deferral is for
Support for actual or ‘reasonable’ housing costs?

- If level of housing costs is a choice, ‘reasonable’ is better
  - Taxpayer shouldn’t pay for me to choose somewhere expensive
- If level of housing costs is fixed, ‘actual’ is better
  - These costs are part of my basic needs
- Reality is somewhere in between
  - Short-run vs long-run
  - Social vs private housing
  - Rent + tax vs energy + water bills
  - Area vs specific property
- No simple ‘right answer’
  - UK has moved towards capping rent support as part of welfare cuts
  - Council tax support localised: the end of a national after-tax safety net
Conclusions: recommendations for the UK

• Replace council tax and stamp duty on housing with a ‘housing services tax’ to stand in place of VAT
  – Proportional to up-to-date values

• Reform the income tax & CGT treatment of (initially rental) housing
  – See section 3 of the paper

• There is a case for allowing some home-owners to defer payment
  – With interest, until sale of the property or death

• Benefits should include an allowance for (actual or ‘reasonable’) housing costs
  – Preferably as part of a single integrated benefit