Moving beyond Mansion Tax: a fair and efficient property tax regime

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with Tom Frostick and Nikki Stickland
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Executive summary

This paper considers recent proposals to introduce a new central government tax on high value property – dubbed “Mansion Tax” by advocates. The idea was introduced by the Liberal Democrats and later adopted by Labour, and its life so far has been illuminating. The proposal was originally for a 0.5% tax on properties worth over £1 million; it later became a 1% tax on properties over £2 million; eventually both parties settled for a lump-sum tax on properties over £2 million. Originally intended to fund tax cuts at the bottom of the Income Tax distribution, it is now intended to reduce the deficit (Lib Dem) or fund the NHS (Labour). Its shifting thresholds and purpose leads to the unavoidable conclusion that this is an ill thought out policy that is being pursued for electoral gain.

How the policy would work is far from clear. Labour have a target to raise £1.2 billion from the tax but they have not said how much it will cost or what thresholds will apply; all they have said is that homes worth £2-3 million will pay £3,000 a year. That leaves almost £1.1 billion to be raised from fewer than 57,000 properties (an average of nearly £20,000 each). Neither party have considered whether the tax will be passed down to leaseholders and tenants, or what will happen if property ownership is split. Plans for increasing the rates allow plenty of room for fiscal drag. Self-assessment under Labour would be difficult due to the thinly traded nature of high value property.

Of more concern is the fact that the tax fails to mulct those whom advocates claim they seek to target. Rather than taxing those with the “broadest shoulders”, it penalises single property owners over those with a property portfolio, singles out one (very common) asset class while exempting all others (including those that are demonstrably the preserve of the rich), fails to distinguish between owning outright and being saddled with a mortgage and totally ignores the taxpayer’s ability to pay.
Furthermore, by treating similar properties differently based on their location, and by treating the UK regions differently from one another, it is likely to create genuine feelings of grievance.

It is not even a good way to raise money. The sums involved are trifling and hardly warrant a new and complex addition to the tax system. Such additional complexity is likely to create perverse incentives that will (further) upset the smooth functioning of the property market. The existing Labour proposal for deferral makes the revenue stream highly unpredictable. The cost of implementation is prohibitive. And the impact on other taxes is such that some if not all of the additional revenue will be lost due to reduced tax receipts elsewhere.

These criticisms probably go a long way to explaining why there are few examples of such a tax elsewhere. “Mansion Tax” in Hong Kong, Singapore and some US states is more like higher rate Stamp Duty. High value property taxes in Greece changed more times over the past decade than proposals for the British Mansion Tax. The Irish RPT produced nugatory sums and created a sense of grievance in Dublin, where most taxpayers lived; the replacement LPT has similar problems. Denmark, alone among our case studies, appears to have a successful property tax regime. It is notable that the tax structure is very flat, the base is broad and the beneficiary is local government. Even so, the Danes have faced the same political pressure to avoid revaluation that afflicts Britain’s Council Tax.

The Danish example lends support to our own findings. We argue that a good system of property taxes should be local, simple, transparent, fair and efficient. Singling out property as an asset class is unjustified, problematic and unfair, so it can only really be supported where it has a long pedigree – in local government funding. It should be easy to understand the tax system and that system should work smoothly and effectively. Taxpayers should be clear about how much they are to pay and that amount should never be regressive. The fairness of the system should be balanced with its economic efficiency.

In conclusion, therefore, we recommend that proposals for a Mansion Tax be dropped. Instead, the Government should establish a Royal Commission with the task of considering the appropriate balance of taxes on property, and the merits of moving partly or wholly to the taxation of economic rent on land.
In the meantime, rather than introduce a new property tax that fits uncomfortably alongside existing taxes, we recommend that, instead of introducing Mansion Tax, the government reform Council Tax to make it a flat rate tax on the value of domestic properties.

- Local authorities should be free to set their own rate.
- All revenue on property values below £2 million would be retained locally.
- All revenue on property values above £2 million should be pooled by all local authorities and redistributed among them.
- Central government funding to local authorities should be reduced in line with the additional revenue raised locally.

Finally, we recommend that residents be permitted to defer payment of their tax until their property changes hands through sale or transfer. This should be guaranteed by local authorities placing a “charge on the land” to cover both the deferred tax and any interest. Local authorities should be free to borrow against this asset to smooth revenue.
Introduction

The purpose of this paper is to examine proposals for a new tax on high value properties, dubbed by advocates “The Mansion Tax”, and to suggest alternative means by which government could raise revenue from high value property owners.

Section I describes the proposed Mansion Tax – what it is and how it would work.

In Chapter 1 we examine the emergence of the Mansion Tax idea in the UK. We begin by describing Council Tax, another tax on property values. Council Tax and Mansion Tax share characteristics and interact with each other in a way that means that the latter cannot be properly understood without reference to, and understanding of, the former. Despite this, Mansion Tax advocates have only belatedly attempted to connect the two. We then go on to review how the Labour and Lib Dem proposals have evolved.

In Chapter 2 we look at how the Labour and Lib Dem Mansion Tax proposals would work. We consider how many properties would be affected, what the fee structure would be, who pays, whether it would be uprated, and how properties would be valued.

Section II provides a critique of Mansion Tax.

Chapter 3 investigates the suggestion among advocates that Mansion Tax would act as a tax on the wealthiest people in the UK – those with the “broadest shoulders”. In fact, Mansion Tax kicks in at an arbitrary threshold that bears no relation to acknowledged definitions of richness. It takes no account of ability to pay. It singles out owners of one asset class (domestic buildings) while ignoring those who may have larger stocks of assets more closely associated with being rich. It ignores the distinction both between gross and net worth and between single and multiple properties.
Chapter 4 moves away from purely economic considerations to discuss other interpretations of fairness. We note that what counts as a “mansion” bears no relation to the size and scale of a property, and that similar properties in different locations will be taxed differently. We also note that the tax is highly unevenly distributed geographically. While these may not fit into neat economic understandings of equity or fairness, there is a risk that individuals and whole communities will feel aggrieved by the unfairness of the system.

Chapter 5 examines whether Mansion Tax is a good way to raise money. We observe that the sums raised are nugatory and that Labour’s proposed system of deferral is likely to reduce this further. We also note that the cost of implementation is high. Mansion Tax is also likely to distort the market and to impact upon other taxes, reducing (if not outweighing) the gains from the tax itself.

Chapter 6 sets Mansion Tax in an international context by examining examples of levies on high value properties in the United States, Hong Kong, Singapore, Greece, Ireland, Denmark and Thailand.

Section III draws lessons from the above and offers both guidelines for reform and an alternative reform of the tax system that would obviate the need for a Mansion Tax while still raising additional revenue in a fairer and more efficient manner.

Chapter 7 argues that any reform, or addition, to property taxes should aim to be simple, transparent, fair, efficient and local. It begins, however, by questioning what we mean by property and calling upon the government to set up a Royal Commission with the task of considering the appropriate balance of taxes on property, and the merits of moving partly or wholly to the taxation of economic rent on land.

Having established broad principles for property tax reform, in Chapter 8 we map out how such a reform might look. The aim of this chapter is not to settle the question but to begin the debate. Furthermore, for the sake of argument we incorporate in our model four aims of Mansion Tax. We argue for the reform of Council Tax so that it becomes a flat tax based on property values. The rate would be set locally and revenues on property values below £2 million would be retained locally. Revenue on property values above £2 million should be pooled among local authorities to ensure redistribution. Government should reduce its grant to local authorities by a sum equivalent to this additional revenue.
We conclude Chapter 8 by proposing a mechanism for dealing with asset rich, income poor property owners. This mechanism would not only solve the problem in respect of our proposed flat rate property tax, but would also be superior to the deferral mechanism that has been floated as part of the Labour Mansion Tax proposal.
SECTION 1

1 - Evolution of Mansion Tax

In this chapter we discuss how the Liberal Democrat and the Labour Mansion Tax proposals have evolved over the last decade. However, before looking at Mansion Tax, it is important to understand the property tax system already in place in the UK. We thus begin with an overview of current residential property taxes, focusing especially on Council Tax since it has the greatest overlap with Mansion Tax.

Residential property taxation in the UK

The proposed Mansion Tax is a charge levied on a particular asset class: high value residential property. There are currently at least three taxes levied on residential property in the UK: Stamp Duty Land Tax, Inheritance Tax¹ and Council Tax. The first two are transfer taxes levied on the buyer, in the case of a sale, or the estate, in the case of death. Council Tax, and the proposed Mansion Tax, are lump sum taxes issued annually based upon the value of the property. They most closely resemble wealth taxes, though in some respects they can be seen as a “hybrid property and consumption tax”.² Due to the substantial overlap between Council Tax and the proposed Mansion Taxes, it is important to understand how the former works before we can understand the latter.

The current Council Tax system

Council Tax is a domestic property tax collected by local authorities in England, Wales and Scotland to fund local services. Northern Ireland continues to use a version of the “domestic rates” that applied across the UK until 1989. Council Tax is set by allocating dwellings to a series of

¹ Inheritance Tax is strictly speaking a wealth tax rather than a property tax, in that it does not distinguish between asset classes. However, for most inheritances the family home will be by far the largest part of the estate, so it is not unreasonable to consider it alongside other property taxes.
bands based on the (putative\(^3\)) value of the property in 1991.\(^4\) Subsequent improvements (e.g. extensions) only trigger a revaluation (re-banding) if the Valuation Office Agency (VOA) is asked to revalue the property; this would only be at the owners request or – if planning permission were sought – at the local authority’s request (in which case the revaluation is not applied until the property changes hands).

Table 1.1 (overleaf) sets out the structure of the bands in each of England, Wales and Scotland. The highest band is Band H (Band I in Wales). Local authorities are free to set their own Band D Council Tax, with the tax for other bands being determined by a billing ratio (e.g. a Band A property pays \(6/9\)th of a Band D rate; Band H pays twice the Band D rate). These ratios are set by central government, though they have not changed since 1993.\(^5\)

There are a number of very strong objections to the current system. Firstly, in terms of the amount of tax homeowners pay relative to the value of their property, Council Tax is highly regressive. Within bands, the lowest value property is charged the same amount of tax as the highest value property. Between bands the ratio of the cost of the tax to the value of the property falls as the value of the property rises. The cheapest (English) house in Band H is worth six times the most expensive house in Band A, yet Council Tax is levied at only three times as much.

This regressiveness is most pronounced in the top band. Within Band H (I in Wales), the ratio of the amount of Council Tax paid compared to the value of the property decreases to vanishing point. The owner of “the most expensive house in Britain”, 18 Carlton House Terrace in Westminster, pays £1,345.48 a year on a property worth around £250 million.\(^6\) The current, regressive system of property taxation has been levied by all three major political parties: by the Conservatives for four years, by Labour for 13 years, and then by the Conservative/Liberal Democrat coalition for five years.

While the regressive nature of Council Tax suggests that additional taxes on prime properties may be justified, proposals for Mansion Tax have not

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\(^3\) For properties in existence in 1991 this is based on the actual valuation in that year. Properties built after 1991 are assigned a nominal 1991 value as though they had existed at that time.

\(^4\) A revaluation of properties took place in Wales in 2003. Properties in England and Scotland have not been revalued since 1991.


\(^6\) Assuming that they do not receive a single-occupancy discount or claim Council Tax Benefit. “Yours for £250m: Inside the world’s most expensive house”, The Week, 13 December 2014, [www.the-week.co.uk/uk-news/52652/britains-most-expensive-house-five-facts-about-%C2%A3250m-mansion](http://www.the-week.co.uk/uk-news/52652/britains-most-expensive-house-five-facts-about-%C2%A3250m-mansion), accessed: 05/05/2015.
Moving beyond Mansion Tax

Generally been couched it terms of improving the existing system, Mansion Tax is not an efficient way of doing so, the two taxes do not fit neatly together, and the revenue from Mansion Tax does not go to the same place as revenue from Council Tax.

The second major objection is that most of the valuations on which Council Tax is based are almost a quarter of a century out of date. As Mirrlees notes, “Any property tax requires regular revaluations, and this process should begin as soon as possible”. However, successive

Table 1.1: Council Tax band by nominal value of property in England and Wales† and Scotland‡

<table>
<thead>
<tr>
<th>Band</th>
<th>England7</th>
<th>Wales8</th>
<th>Scotland</th>
<th>Billing ratio9</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Values not exceeding £40,000</td>
<td>Values not exceeding £44,000</td>
<td>Up to £27,000</td>
<td>6/9</td>
</tr>
<tr>
<td>B</td>
<td>Values exceeding £40,000 but not exceeding £52,000</td>
<td>Values exceeding £44,000 but not exceeding £65,000</td>
<td>£27,001 to £35,000</td>
<td>7/9</td>
</tr>
<tr>
<td>C</td>
<td>Values exceeding £52,000 but not exceeding £68,000</td>
<td>Values exceeding £65,000 but not exceeding £91,000</td>
<td>£35,001 to £45,000</td>
<td>8/9</td>
</tr>
<tr>
<td>D</td>
<td>Values exceeding £68,000 but not exceeding £88,000</td>
<td>Values exceeding £91,000 but not exceeding £123,000</td>
<td>£45,001 to £58,000</td>
<td>9/9</td>
</tr>
<tr>
<td>E</td>
<td>Values exceeding £88,000 but not exceeding £120,000</td>
<td>Values exceeding £123,000 but not exceeding £162,000</td>
<td>£58,001 to £80,000</td>
<td>11/9</td>
</tr>
<tr>
<td>F</td>
<td>Values exceeding £120,000 but not exceeding £160,000</td>
<td>Values exceeding £162,000 but not exceeding £223,000</td>
<td>£80,001 to £106,000</td>
<td>13/9</td>
</tr>
<tr>
<td>G</td>
<td>Values exceeding £160,000 but not exceeding £320,000</td>
<td>Values exceeding £223,000 but not exceeding £324,000</td>
<td>£106,001 to £212,000</td>
<td>15/9</td>
</tr>
<tr>
<td>H</td>
<td>Values exceeding £320,000</td>
<td>Values exceeding £324,000 but not exceeding £424,000</td>
<td>£212,001 and over</td>
<td>18/9</td>
</tr>
<tr>
<td>I</td>
<td>N/A</td>
<td>Values exceeding £424,000</td>
<td>N/A</td>
<td>21/9</td>
</tr>
</tbody>
</table>

† Local Government Finance Act 1992, S.5(2) and (3).

7 Based on the value in 1991.
8 Based on the value in 2003.
governments have resisted the need to revalue (with the notable exception being the Welsh Assembly, which revalued Welsh properties in 2003). This is because the political realities are difficult even if the economics are straight-forward. There is no reason why a revaluation should not be revenue neutral in aggregate. But there would clearly be winners and losers; identifying whom is the point of a revaluation. Nonetheless, revaluation is long overdue and should be conducted on a regular basis.

**Liberal Democrats, Labour and Mansion Tax**

In 2004, the Liberal Democrats proposed to abolish Council Tax and replace it with a local income tax. This new levy would have been set by local authorities – but collected centrally.\(^\text{11}\) Local income tax was justified by the party on the grounds of efficiency and fairness. It was estimated that the policy would save “over £300 million a year on bureaucracy”, while the lower 70% of households would “pay less or be unaffected” by the change.\(^\text{12}\) The policy was designed to make local taxation more progressive and to reflect people’s incomes (i.e. their ability to pay).

In 2008 it was reported that the party was shifting away from its local income tax plan, instead considering the case for extra Council Tax bands on higher value properties.\(^\text{13}\) This may have been a reflection of the difficulties that the Scottish National Party encountered promoting a local income tax in Scotland.\(^\text{14}\)

The original Mansion Tax announcement came in September 2009 when the Lib Dems needed a source of revenue to fund their election pledge to increase the Income Tax personal allowance to £10,000 a year.\(^\text{15}\) This was intended to help “low paid workers and pensioners” during the impending period of fiscal consolidation. The party’s Treasury spokesman Vince Cable argued that “In the current environment of big budget deficits, no government can afford to make such an offer unless the money can be raised somewhere else”\(^\text{16}\) and that the target should be high value homes – dubbed “mansions” for effect.

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11 Local Government Chronicle, ‘Kennedy unveils new alternative to Council Tax’, 12 January 2004. At the time the higher rate of Income Tax was 40p.
12 Ibid.
14 See eg The Scotsman, ‘Scrapping Council Tax has a £400m price tag - Browne’, 20 August 2007.
15 Which the party subsequently achieved in coalition government by raising the Income Tax personal allowance from £6,475 in 2010 to £10,500 in 2015. This was done without the introduction of Mansion Tax.
Under the initial proposal, a levy would apply to properties valued at more than £1 million using data from the Valuation Office Agency (VOA).

Above the £1 million threshold, homeowners would be required to pay tax at a rate of 0.5%, meaning those with a property valued at £2 million would pay £10,000 a year on top of their existing Council Tax demand. To protect “asset rich; income poor” homeowners, the levy could be deferred until the property was eventually sold. In the revised version of the proposal outlined in the Lib Dems’ 2010 manifesto, Mansion Tax would apply to properties valued at more than £2 million but be levied at a rate of 1%, rather than 0.5%.

The Lib Dems attempted but failed to get their proposals into the Coalition Agreement, or implement it during the 2010-15 coalition. In October 2012, Prime Minister David Cameron said “I don’t think the Mansion Tax is the right idea because I tell you before the election it’ll be sold to you as a Mansion Tax then after the election a lot of the people in Britain are going to wake up and find their more modest homes have been reclassified as a mansion.” George Osborne later reaffirmed the Conservatives’ opposition to the idea. He described it as a “tax con” that threatened ordinary homeowners. He also appeared to rule out a fresh round of valuations (implied by the introduction of Mansion Tax), arguing “It’s very costly to implement”. Previously the Conservative Communities Secretary Eric Pickles was said to have ordered the deletion of VOA data which would have been used to determine who paid Mansion Tax.

**Labour adopt Mansion Tax, Lib Dems alter their position**

In February 2013, Labour adopted the Lib Dem proposal for a tax on homes worth more than £2 million. The party remained vague about how the policy would work, indicating it was open to a new upper-rate Council Tax band instead of an entirely new tax. The move – described as a “political trap” – prompted a Commons debate the following month on the scheme’s introduction. The motion read:

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18 Cable V, ‘I stirred up a hornets’ nest’, but my Mansion Tax is fair’, Daily Mail, 29th September 2009.
22 Ibid.
23 Chapman J, ‘Mansion Tax plan is foiled by Pickles: Communities Secretary deletes data’, Daily Mail, 12th March 2012.
25 Ibid.
“This House believes that a Mansion Tax on properties worth over £2 million, to fund a tax cut for millions of people on middle and low incomes, should be part of a fair tax system; and calls on the government to bring forward proposals for such a tax at the earliest opportunity.”

During the debate Labour MP Karen Buck, said it was important to secure protection for “the small minority of people who have lived for a long time in areas with escalating property values and who are asset-rich but income poor”. Conservative Treasury Minister David Gauke agreed “that a Mansion Tax could hit asset-rich but potentially income-poor households”, stressing that “a third of the properties in London worth more than £2 million have been in the same ownership for over 10 years”. Labour’s Shadow Treasury Minister Chris Leslie said “there is a need to flesh out the details of how the Mansion Tax arrangement would be designed”, adding that “[we] need to commission the Treasury and the OBR to work on those particular details”. In the end, the Lib Dems voted against Labour’s motion, which they said was designed to split the coalition, but indicated that they remained committed to the principle of introducing an annual levy.

The full version of Labour’s Mansion Tax proposal was announced in November 2014. Under Labour’s plans, the levy would apply to homes above the £2 million threshold and would be expected to raise £1.2 billion. This figure had previously been cited by the former Lib Dem Chief Secretary to the Treasury, Danny Alexander, following Treasury analysis. Rather than proposing to use the revenue raised to “fund a tax cut for millions of people on middle and low incomes”, Labour shifted its focus towards investing in the NHS. The party promised to protect the “asset rich; income poor” by allowing those earning less than £42,000 a year – roughly the higher rate Income Tax threshold – to defer payment of

27 Ibid, Column 167
28 Ibid, Column 177
29 Ibid, Column 169
32 Groves J, ‘Our Mansion Tax will raise £1.2bn, say Lib Dems: Danny Alexander unveils party’s plans for bands to take in properties worth more than £2million’, Daily Mail, 10th April 2014.
Mansion Tax until their property is sold.\(^{33}\) It also described the tax as “progressive”, arguing:

> “Those owning properties worth £2-3 million will only pay an extra £250 a month through this new tax – the same as the average top band of Council Tax. We think that owners and investors in properties worth tens of millions of pounds should make a much bigger contribution. And we will look at asking overseas owners of second homes in the UK to make a larger contribution than people living in their only home.”\(^{34}\)

In April 2014, the Lib Dems decided to drop their plan for a 1% tax on high value properties in favour of a “modest additional banded levy on top of Council Tax”.\(^{35}\) Danny Alexander explained:

> “By building on the Council Tax system, there will be no need for a detailed valuation of the small proportion of properties affected. Crucially this means that this policy could be implemented quickly after the election. And people in homes valued at below £2 million would continue to pay just Council Tax.”\(^{36}\)

The plan was detailed more fully in April 2015, with the party proposing at least five Mansion Tax bands starting at £2 million.\(^{37}\) This brought the Lib Dem position closer to Labour, which also proposes bands rather than a fixed percentage rate above a threshold. The known details of the two parties’ proposals are compared in Figure 1.2. The proposals are similar: the tax would be levied on properties worth £2 million or more and qualifying properties would be placed in a series of bands, with higher charges applying to properties in higher value bands.

Differences in the proposals include the thresholds for and number of bands, as well as the respective charges. A notable difference is also the amount of revenue that the policies are intended to raise – Labour wants

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33 ‘Labour’s Mansion Tax: Six things you need to know’, 18\(^{th}\) November 2014.
34 Ibid.
36 Ibid.
to raise £1.2bn to the Lib Dems’ £1bn – and how the revenue would be used. In the current iterations of the proposals, Labour intends to use the revenue raised to support investment in the NHS.

Table 1.2: Comparing the Liberal Democrat and Labour Mansion Tax proposals

<table>
<thead>
<tr>
<th>Liberal Democrat proposal</th>
<th>Labour proposal</th>
</tr>
</thead>
<tbody>
<tr>
<td>An annual levy will apply to homes valued at £2 million or more on top of existing Council Tax liability. The £2 million threshold will rise in line with average house price inflation. The Lib Dems intend to raise £1 billion a year from the policy. This revenue has been earmarked for deficit reduction. There will be at least five Mansion Tax bands. Properties valued at between £2 million and £2.5 million will pay £2,000 a year. Those worth between £2.5 million and £3 million will pay £3,500. Those between £3 million and £4 million will pay £5,000. Between £4 million and £5 million, it will be £9,000. A decision on how much to charge owners of properties worth more than £5 million will be taken in a post-election budget.</td>
<td>An annual levy will apply to homes valued at £2 million or more on top of existing Council Tax liability. The £2 million threshold will rise in line with high value house price inflation. Labour wants to raise £1.2 billion a year from the policy. This revenue has been earmarked for investment in the NHS. There will be at least two Mansion Tax bands. Properties valued at between £2 million and £3 million will be required to pay £3,000 a year. Properties valued at more than £3 million will be required to pay more (details yet to be confirmed). Individuals earning less than £42,000 a year will have the right to defer the Mansion Tax until their property changes hands.</td>
</tr>
</tbody>
</table>

38 Ibid.
2 - How would Mansion Tax work?

Having discussed how the Labour and Liberal Democrat Mansion Tax proposals came about, in this chapter we look at how the proposals might work in practice, including: how many households would be affected; what each party’s charges may be; who would be liable to pay Mansion Tax; whether thresholds would be increased over time; and how properties would be valued.

How many households would be affected?

Both the Labour and Liberal Democrat Mansion Tax proposals would be levied on homes worth over £2 million. Data on the exact number of residential properties that would be affected are not readily available, even to government. As noted in Chapter 1, the last time UK properties were systematically valued was 1991 (2003 in Wales), and house prices have changed significantly since then.39

Various estimates of how many properties would be affected have been made. In 2013, government released estimates (based on earlier data) which put the figure at 55,000.40 However, given rapid house price growth, especially at the top end of the market, the current figure is likely to be much higher. Housing market analyst Hometrack estimates that around 58,500 properties are worth in excess of £2 million.41 Knight Frank’s 2013 figure was 50,000 but this has since more than doubled to around 110,000.42 Estate agents Savills estimates that around 97,000 properties are worth over £2 million in the UK.43 Property website Zoopla puts the figure at 108,000.44

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Prospective charges

Despite not knowing the size of the tax base, both Labour and the Lib Dems have set revenue targets for their Mansion Taxes – £1.2 billion and £1 billion respectively. This allows us to roughly calculate and compare the charges that could be expected under each proposal.

Labour’s Mansion Tax

Under the Labour proposal, a charge of £3,000 would be levied on properties worth between £2 million and £3 million (£3,000 a year), and homes worth in excess of £3 million would be charged considerably more. The implication is that the taxes for properties valued at over £3 million would be set at whatever level(s) were necessary to raise the remainder of the £1.2 billion target. Labour has not specified what the higher rate would be, or whether there would be a single levy on properties over £3 million or several bands.

Labour has, however, drawn parallels with the Annual Tax on Envelope Dwellings (ATED). The ATED is payable by “non-natural persons” (e.g. companies, unit trusts) that own residential properties in the UK worth over a certain threshold (£1 million from April 2015; £500,000 from April 2016). ATED is based on a banded system, whereby properties are charged different rates based on the value-band the property falls in to. For example, from April 2015, properties worth between £2 million and £5 million must pay £23,350, and properties worth between £5 million and £10 million are charged £54,450 a year.

Savills has used HMRC and Land Registry data to estimate the price distribution of £2 million plus homes, and used this to estimate prospective charges that properties in (putative) bands might face (see Table 2.1). The bands follow roughly the same structure as those for the ATED. According to Savills, around 40,300 properties are worth £2-3 million. A £3,000 tax levied on these properties would raise around £121 million, leaving over £1 billion to be raised from properties worth £3 million or more.

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45 See e.g. ‘Labour’s Mansion Tax: Six things you need to know’, Labour, 18th November 2014, where Labour refer to the “government’s new tax on properties bought through companies”.
47 Savills have used the bands currently in place under the Annual Tax on Enveloped Dwellings (ATED), though under ATED there is only one £2m - £5m band.
Table 2.1 Savills estimates of annual charges for Labour Mansion Tax\(^48\)

<table>
<thead>
<tr>
<th>Value Band</th>
<th>Number of properties</th>
<th>Prospective charge</th>
<th>Tax raised</th>
</tr>
</thead>
<tbody>
<tr>
<td>£2m - £3m</td>
<td>40,300</td>
<td>£3,000</td>
<td>£121m</td>
</tr>
<tr>
<td>£3m - £5m</td>
<td>30,600</td>
<td>£7,000</td>
<td>£214m</td>
</tr>
<tr>
<td>£5m - £10m</td>
<td>17,300</td>
<td>£18,000</td>
<td>£311m</td>
</tr>
<tr>
<td>£10m - £15m</td>
<td>5,200</td>
<td>£41,000</td>
<td>£213m</td>
</tr>
<tr>
<td>£15m - £20m</td>
<td>2,100</td>
<td>£71,000</td>
<td>£149m</td>
</tr>
<tr>
<td>£20m+</td>
<td>1,500</td>
<td>£125,000</td>
<td>£188m</td>
</tr>
<tr>
<td>Total</td>
<td>97,000</td>
<td>N/A</td>
<td>£1.2bn</td>
</tr>
</tbody>
</table>

The prospective charges in Table 2.1 are only a rough indication of what homeowners might expect to pay under Labour’s Mansion Tax. In reality, the calculations are complicated by the possibility of allowing deferral of payments (see Chapters 3 and 5), as well as Labour’s commitment to “look at asking overseas owners of second homes in the UK to make a larger contribution than people living in their only home”.\(^49\) Overseas owners of second homes could make up as much as 17% of the prime Central London market and 6% of the prime London market as a whole. Consequently, the (currently unspecified) higher rate levied on this group could reduce the charges levied on other property owners.

**Liberal Democrats’ Mansion Tax**

The Liberal Democrats estimate that their proposal would raise around £1 billion. Unlike Labour, the Lib Dems have provided detail about the bands and prospective charges that properties worth £2m - £5m would face (see Table 2.2). They have not specified the charge that would be levied on homes worth over £5 million, but we can assume that the rate would be set at the level required to reach the Lib Dems’ revenue target. Using Savills estimates of the number of homes that would fall in to each of the Lib Dems value bands, we estimate that properties worth over £5 million would need to be charged £26,750 to ensure the revenue target was met.


Moving beyond Mansion Tax

Table 2.2 Estimates of annual charges for Liberal Democrat Mansion Tax

<table>
<thead>
<tr>
<th>Value Band</th>
<th>Number of properties</th>
<th>Prospective charge</th>
<th>Tax raised</th>
</tr>
</thead>
<tbody>
<tr>
<td>£2m - £2.5m</td>
<td>22,316</td>
<td>£2,000</td>
<td>£44.6m</td>
</tr>
<tr>
<td>£2.5m - £3m</td>
<td>17,985</td>
<td>£3,500</td>
<td>£62.9m</td>
</tr>
<tr>
<td>£3 - £4m</td>
<td>20,204</td>
<td>£5,000</td>
<td>£101.0m</td>
</tr>
<tr>
<td>£4m - £5m</td>
<td>10,415</td>
<td>£9,000</td>
<td>£93.7m</td>
</tr>
<tr>
<td>£5m+</td>
<td>26,080</td>
<td>£26,750</td>
<td>£697.7m</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>97,000</strong></td>
<td><strong>N/A</strong></td>
<td><strong>£1bn</strong></td>
</tr>
</tbody>
</table>

Who pays Mansion Tax?

An issue which Labour and the Liberal Democrats are yet to address is who would be liable to pay Mansion Tax. Would it be the occupier or the owners? And how would it divide between freeholders and leaseholders? While this is clear in the case of owner occupiers, for those who let or rent property the difference may be – at least in the short term – materially important.

The owner pays

Labour have indicated (though not explicitly) that Mansion Tax would fall on the owner of a £2 million plus property. This is in line with the Annual Tax on Envelope Dwellings (ATED), which is payable by a “non-natural person” who owns a high value residential property in the UK. Since ATED is payable on ownership structure, it is open to tax planning activities, and consequently a number of anti-avoidance provisions have been put in place. For instance, HMRC provides that “Where companies and individuals connected to the company own multiple interests in a dwelling, these will be added together for ATED purposes.” This is to ensure that homeowners do not attempt to minimise their tax liability by splitting interest in the property (e.g. between a company with a freehold interest and an employee with a leasehold interest).

---

50 Figures for number of properties in each value band from Savills. Tax raised figures may not total due to rounding.
51 In the long term, we would expect the burden of the tax to be shared by the owner of the property and the resident. Who bears the brunt of the tax depends on the elasticities of property supply and demand.
52 For example, Labour states “Those owning properties worth £2-3 million will only pay…” Labour’s Mansion Tax: Six things you need to know’, Labour, 18th November 2014. Emphasis added.
Currently it is unclear how a Mansion Tax payable by owners would be structured. For example, we do not know whether individuals with short leases would be liable to pay all of the charge, some of the charge, or whether it would be payable by the freeholder of the property. We also do not know how Mansion Tax would interact with other property taxes such as the ATED. James Hender, head of private wealth at accountants Saffery Champness contends that a Mansion Tax would raise the question of double taxation for properties held in corporate structures.\textsuperscript{54}

\textit{The occupier pays}

Alternatively, Mansion Tax could be charged to a resident of the property, as in the case of Council Tax. Under the Council Tax system, there is a strict hierarchy of who is responsible for paying the charge, beginning with a resident with a freehold interest in the property, followed by a resident with a leasehold interest in the property, and so on. If the property is unoccupied then the owner is liable to pay Council Tax. The Liberal Democrats have framed their proposal in the context of Council Tax, which is perhaps an indication that they would make residents liable to pay the charge.

\textbf{Would the Mansion Tax threshold be raised in line with prices?}

In order to avoid house price inflation causing more homes to be classified as mansions, both parties have proposed that Mansion Tax threshold be scaled up over time. However, the proposals differ in terms of the index that would be used to increase the threshold.

The Liberal Democrats have hinted that their £2 million threshold would rise in line with average increases in UK house prices,\textsuperscript{55} and indicated that this up-rating would be carried out on an annual basis.\textsuperscript{56} In contrast, the Labour party have proposed that their threshold would increase in line with the average rise in high value property prices.\textsuperscript{57} Both parties have stated that, should there be a substantial increase in house prices before the policy is introduced, the initial threshold may start at a higher level, in order to avoid pre-implementation fiscal drag.

\begin{thebibliography}{9}
\bibitem{54} Palin A, ‘Chart that tells a story – Mansion Tax’, The Financial Times, 26\textsuperscript{th} September 2014, available: \url{www.ft.com/cms/s/0/37c2c350-448b-11e4-ab0c-00144feabdc0.html#axzz3YtWQLQDF} accessed: 05/05/2015.
\bibitem{55} ‘Mansion Tax: get the facts’, Liberal Democrats, available: \url{www.libdems.org.uk/get_the_facts_mansion_tax} accessed: 05/05/2015.
\bibitem{56} Speech by Danny Alexander MP, 9\textsuperscript{th} April 2014, available: \url{www.libdems.org.uk/danny alexander_renews_push_for_a_mansion_tax} accessed: 05/05/2015.
\bibitem{57} ‘Labour’s Mansion Tax: Six things you need to know’, Labour, 18\textsuperscript{th} November 2014.
\end{thebibliography}
It is by no means certain that linking threshold increases to average house price rises would avoid fiscal drag. In particular, properties in areas with higher house price growth could find themselves categorised as mansions.\textsuperscript{58} However, increasing the Mansion Tax threshold in line with high value property prices could also be problematic, if price growth at the high end of the market were sluggish compared to changes in the UK average. This was the case in the period September 2012-September 2013, when the average prices of high value properties decreased by 2.5\% compared to a 3.8\% increase in the UK average house price.

How would properties be valued?

Self-assessment

Under the Labour proposal, valuations would be carried out by self-assessment, with homeowners required to submit a self-valuation to HMRC.\textsuperscript{59} Homeowners would have the option either to hire a professional valuer or to undertake a self-valuation, and would bear the cost (in addition to Mansion Tax) of ensuring up-to-date valuations. Labour have indicated that the self-assessment system would be similar to the ATED.\textsuperscript{60}

If property valuations under Labour were to use the same value basis as the ATED, they would be on an “open-market willing buyer, willing seller basis.”\textsuperscript{61} Prices would have to be a specific figure – “in the range of” is not acceptable under the ATED – and these prices would then fall into one of several tax bands.\textsuperscript{62} HMRC would be able to challenge a valuation they thought was incorrect and impose penalties. Revaluations would take place on a regular basis to keep band thresholds in line with house prices. For the ATED these are currently set at 5 year intervals, if requested by the VOA.

A major concern is the lack of comparable data on high end transactions available for self-assessment purposes. In the 2013-2014 tax year sales of properties valued at over £2 million represented a mere 0.4\% of overall residential property transactions.\textsuperscript{63} Former Exchequer Secretary David Gauke has raised concerns about the feasibility of the ATED model being

\textsuperscript{58} Houlder V, ‘Soaring prices push more homes into ‘Mansion Tax’ bracket, Financial Times, 25 June 2014.
\textsuperscript{59} ‘Labour’s Mansion Tax: Six things you need to know’, Labour, 18\textsuperscript{th} November 2014.
\textsuperscript{60} Ibid.
\textsuperscript{62} HMRC, ‘Annual Tax on Enveloped Dwellings: the basics’, 21\textsuperscript{st} April 2015.
\textsuperscript{63} Skero N, ‘The Mansion Tax: Impact of the proposed Mansion Tax on family homes in the UK’, CEBR, September 2014.
replicated for Mansion Tax, given the differences in scale:

“The ATED takes a self-assessment approach. We believe that is the appropriate approach given the number of properties involved. HMRC can then take a risk-based approach to checking those. If all properties over £2 million were included, there would be a much stronger need for a formal valuation process by the Valuation Office Agency.”

**The Valuation Office Agency**

The Liberal Democrats have proposed that their tax be collected via the existing Council Tax system, through the creation of higher Council Tax bands. The party has not recently specified details of how the valuation process would work. However, the *Daily Mail* reported in 2012 that the party intended to use information from the Valuation Office Agency (VOA) – the body tasked with carrying out property valuations to support the Council Tax System – to implement the charge.

The VOA is responsible for assigning Council Tax bands to newly built properties (i.e. those built after the 1991 valuations) and revaluing properties where the initial Council Tax band has been challenged. The VOA’s remit could be expanded to include valuations for the Mansion Tax. The VOA would have responsibility for surveying properties that might fall into the new higher tax bands – looking at features including age of property, size, location and physical features (taking into account local sales data for similar properties) – and then assigning properties one of these bands.

The VOA already maintains a database of property band values for 24.7 million homes in England and Wales. However, there is some doubt about the sufficiency of the data held. In 2012 the *Daily Mail* reported that a VOA database containing property values and features was “effectively deleted” on the orders of Secretary of State for Communities

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64 Speech by David Gauke, former Exchequer Secretary, Public Bill Committee (Finance Bill), 16th sitting, 13 June 2013 cc495-6, cc499-500.


and Local Government Eric Pickles. As a consequence, a compilation of relevant data on property values for implementation of a Mansion Tax could take much longer than originally planned.68

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68 Chapman J, 'Mansion Tax plan is foiled by Pickles: Communities Secretary ‘deletes’ property data', Daily Mail, 11th March 2012.
SECTION 2

3 - The broadest shoulders

The three main residential property taxes in the UK are Stamp Duty Land Tax, Inheritance Tax (both taxes on the transfer of property) and Council Tax. As noted in Chapter 1, the Council Tax system is highly regressive: residents of low value property pay a higher percentage of their property value in tax than residents of high value property. It is also based on valuations made nearly a quarter of a century ago. Council Tax is in desperate need of reform.

Mansion Tax is an additional tax on property, which would be charged on top of Council Tax. It is not an attempt to fix the Council Tax system. As the Institute for Fiscal Studies notes:

“there is a strong case for taxing high value properties more heavily than at present given that they currently attract lower Council Tax as a proportion of property value. But it is doubtful that adding a new tax on top of the existing system is the best way to achieve this.”

Instead, Mansion Tax is an entirely discrete tax aimed at raising revenue for central government. Proponents justify its introduction by asserting that it is a “fair” way to raise revenue, since it will fall on the richest people in society – or as politicians have frequently put it, those with the “broadest shoulders”.

Former Labour Shadow Chancellor Ed Balls argued on BBC Radio 4’s World at One:

70 Where possible we use the term “rich” to deliberately conflate both high net wealth and high net income. It is far from clear whether the parties are concerned with income or wealth, though a Mansion Tax is surely more a wealth tax than an income tax.
“We think that when you have properties over £2m, where they are undertaxed compared to most people’s property, it’s fair to ask people with the broadest shoulders to pay some more”71

Similarly, former Labour Shadow Justice Secretary, Sadiq Khan, has argued:

“Those with the broadest shoulders must bear the biggest burden and the Mansion Tax will ensure they do so. This comes down to a basic issue of fairness”72

In 2014, Nick Clegg said that the Liberal Democrats would eliminate the structural deficit “in a way that is fair”, including asking:

“those with broadest shoulders to make some additional contributions, for instance through our Mansion Tax”73

While in their 2015 manifesto, the Liberal Democrats state:

“we will continue to tackle the deficit fairly by asking the wealthiest to pay their fair share. A Mansion Tax on the most expensive houses in the UK is a key part of how we will do this.”74

In so far as both Labour and the Liberal Democrats intend to introduce a Mansion Tax in order to raise revenue from the rich, it raises the question of whether owning a high value property is a good proxy for how rich someone is.75 In the remainder of this chapter we consider this question.

Table 3.1 provides abstract examples of who does, and who does not, pay Mansion Tax, based on the Labour and Lib Dem proposals (which are

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75 We noted earlier that neither Labour nor the Liberal Democrats have stated explicitly who their Mansion Tax will fall on: the owner or the resident of the property. In this chapter we assume that the owner of the property is also the occupier, making the distinction redundant.
identical from this perspective). As it shows, there is not only an arbitrary cut off at £2 million (such that a person with a £1.99m home pays nothing and a person with a £2m home pays a lot), but it also takes no account of income or ability to pay, ignores any other assets no matter how valuable, makes no distinction between owning a property outright or only having a small amount of mortgage equity, and bases an individual’s tax on the value of single properties not their full property portfolio.

Table 3.1: Examples of who does, and who does not, pay Mansion Tax

<table>
<thead>
<tr>
<th>Who will pay Mansion Tax?</th>
<th>Who will not pay Mansion Tax?</th>
</tr>
</thead>
<tbody>
<tr>
<td>i</td>
<td></td>
</tr>
<tr>
<td>ii</td>
<td></td>
</tr>
<tr>
<td>iii</td>
<td></td>
</tr>
<tr>
<td>iv</td>
<td></td>
</tr>
<tr>
<td>v</td>
<td></td>
</tr>
</tbody>
</table>

i: Arbitrary threshold

Labour and the Liberal Democrats label homes worth over £2 million “mansions”, while properties worth marginally less than £2 million are not. From this we can infer that Labour and the Liberal Democrats assume that the owners of £2 million homes are rich, whereas those owning a home worth less than £2 million are not. Two things are immediately apparent.

Firstly, there is no reason why £2 million should be the cut-off. No party has articulated how this threshold was derived. It is not, for instance, linked to average or median property values. Based on a UK housing stock of 27.8 million, of which 97,000 are subject to the Mansion Tax, this represents approximately 0.34% of homes. Being in “the richest third of the top percentile” is not a common measure of whether or not one is rich. It is hard to avoid the conclusion that the only reason for picking this figure was base politics – a conjecture that is supported by the Liberal Democrat’s otherwise-inexplicable shift from a £1 million to a £2 million threshold and by Labour’s alighting on the same figure as the Lib Dems.

Secondly, there is no reason why a person owning a £2 million home should pay £2,000 or £3,000 while a person owning a £1.99 million home should pay nothing. Indeed, at each threshold, the Mansion Tax on the least valuable home above the threshold may be greater than the difference in value between that property and the most valuable home below the threshold. It is notable that the Government moved away from a similar system in respect of Stamp Duty Land Tax in 2015 – a reform that the Liberal Democrats supported.78

ii: Asset rich, income poor homeowners

One of the main objections to any asset tax is that many assets do not yield an income and therefore some individuals are “asset rich but income poor” – i.e. they own substantial assets but have very low income. This is particularly acute if the asset is of fixed quantity and value. For example, while the owner of an equity portfolio could, in principle, be required to sell a small portion of it each time the tax became due, this is not possible in the case of a monolithic asset such as a house.79 Thus, the homeowner faces a potential tax bill that they cannot meet without selling their home.

It is worth noting that this “asset rich; income poor” objection is not unique to Mansion Tax. It is also levelled at Council Tax and was one of the main arguments against the Rates – the system of local government taxation that existed prior to 1990. Indeed, the subsequent Community Charge was originally proposed by the Conservative government primarily to address this “asset rich; income poor” problem, with Conservative councillors throughout the UK concerned about individuals who were unable to pay the Rates because the value of their home did not reflect their income.80 It is ironic that it was in attempting to solve this “asset rich; income poor” problem that the Thatcher ministry triggered the biggest crisis of legitimacy in the history of local government finance.

To illustrate our point an example may be useful. Anna is a seventy-year-old pensioner. In 1970 she and her husband bought a four bedroom house in Ealing, paying the mortgage off over 30 years and owning it outright.

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79 The same objection could be made about ownership of a company. Many of the world’s richest people are rich based on the assumed value of the companies they own. However, in so far as these firms are not traded, this value is at best assumed. Furthermore, if the value of the company is dependent upon the existing owners continued ownership, breaking the company up to satisfy the demands of a wealth tax could both reduce the wealth of the owner disproportionately and be overall wealth-destroying (i.e. it could be a move away from the Pareto-frontier).
from 2000. She retired in 2005 and her husband passed away in 2008. She currently has a total income (including private and state pensions) of £15,000 a year. Her house is now worth £2 million. Advocates of Mansion Tax may have little sympathy for Anna. Though she has a low income, she owns an asset worth £2 million. However, the fact remains that Anna would need to fund an additional tax bill of £2,000-£3,000 on top of existing taxes (including the £2709.86 that she already pays on her home in the form of Council Tax). It is difficult to see Anna as having society’s “broadest shoulders”.

Pensioners – especially those who own a property in London – are particularly likely to fall into this “asset rich; income poor” category. Currently 9% of all residents in inner London are over 65. The CEBR compared data from the 2011 census with their projections of the number of properties that will be subject to Mansion Tax in 2016 in three London postcode districts (see Table 3.2). They found that in all three areas pensioners accounted for an above average proportion of the population.

Table 3.2: Impact of Mansion Tax in 2016 by postcode

<table>
<thead>
<tr>
<th>Postcode District</th>
<th>Over 65s as a % of total population</th>
<th>Number of properties subject to Mansion Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>SW3 (Kensington and Chelsea)</td>
<td>17%</td>
<td>5,859</td>
</tr>
<tr>
<td>W8 (Kensington and Chelsea)</td>
<td>12%</td>
<td>5,033</td>
</tr>
<tr>
<td>NW3 (Camden)</td>
<td>14%</td>
<td>4,277</td>
</tr>
</tbody>
</table>

Deferral of payments

Allowing Mansion Tax payments to be deferred could avoid putting individuals on low incomes under financial pressure. Labour have proposed that:

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84 Ibid.
“People in high value homes who do not have high incomes – those who do not pay the higher or top rate of tax, and earn less than £42,000 a year – will have the right to defer the Mansion Tax until their property changes hands.”85

One problem with allowing payments to be deferred is that it will reduce the amount of revenue Mansion Tax raises in the short run. Since there is no way of knowing how many home owners may be entitled to payment deferrals, or in which value band their properties might fall (and thus what their payments would be), it is difficult to judge the revenue impact this proposal would have. However, we may conjecture (and the above observation about pensioners would support the idea) that a substantial number of people, at least in the lower Mansion Tax bands, might be eligible to defer.

Deferral would also have an effect on liquidity in the housing market. This could exacerbate inefficiencies in the allocation of housing stock (see Chapter 5), and negatively impact revenue raised from Stamp Duty Land Tax.

Finally, since the “asset rich; income poor” are particularly likely to be pensioners, many qualifying properties may only change hands on the owner’s death. Mansion Tax would be payable on top of Inheritance Tax, which could substantially increase the death tax rate.

iii: Singling out property

Fair taxes should not be arbitrary. An individual should not be taxed differently based on the economic choices that they make.86 There is no reason why a person who lives in a £1 million house but invests in £20 million of fine art should be taxed differently from somebody who lives in a £20 million house and has a “modest” £1 million art collection. However, by singling out property, Mansion Tax creates an arbitrary distinction between asset classes.

This could even lead to richer people paying less (or even no) tax. For example, a person with a £1 million house and a £20 million art collection would pay no Mansion Tax, while someone with a £2 million house and no art would be charged. We should make clear that we do

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85 ‘Labour’s Mansion Tax: Six things you need to know’, Labour, 18th November 2014.
86 The exception to this rule is the use of Pigouvian taxes to internalise externalities. For example, taxing somebody based on the economic choice to drive to work instead of taking the train at a level that internalises the cost of pollution is perfectly acceptable.
not argue that property taxes are inherently wrong. Our point is that property should not be singled out. Were a government to introduce a wealth tax it would be appropriate to include property wealth within the calculations.

Singling out property is also more likely to hit “ordinary” people than a tax on another asset class. This is because property is the asset class people are most heavily involved in for reasons other than accumulating wealth. That is, an individual’s decision to purchase a high value home is usually driven by their desire to live in the property, rather than because they see it as an investment opportunity. Thus Mansion Tax has the perverse effect of taxing the investments of “ordinary” people, while ignoring those asset classes that are largely the preserve of the rich, such as luxury yachts, jewellery, antiques etc. The most glaring distinction is with shares. While some of those caught by Mansion Tax might have had relatively modest incomes but been lucky in where they chose to live, it is highly unlikely that anybody would accrue a share portfolio worth over £2 million unless they were rich.87

iv: Gross verses net property wealth

Gross wealth is a meaningless measure. If you learn that your friend has £5,000 sitting in a current account you might consider them to be in a comfortable position, but if they also have £10,000 on their credit card they may in fact feel far from comfortable. One of the key flaws with Mansion Tax is that it is a measure of gross, rather than net, property wealth. A person who owns a £2.5 million home with a £2 million mortgage is clearly not as rich as a person who owns a £1 million property outright.

Mansion Tax is therefore a very poor proxy for what really matters, which is net worth. This also has perverse intergenerational effects as younger people, who will probably have bought their home more recently, are much more likely to have a large discrepancy between their gross and net property value than an older person who bought earlier.

87 The obvious exception is entrepreneurs, who have created their wealth.
v: Single verses multiple property ownership

Similarly, single property ownership is a worse measure of how rich an individual is than aggregate property ownership. If a person owns ten homes each worth £1 million then, *ceteris paribus*, they are clearly richer than someone who owns one property worth £2.5 million. Yet Mansion Tax does not take in to account the aggregate value of an individual’s property ownership.
4 - Falling short of “fair”

In the previous section we demonstrated that Mansion Tax does not necessarily increase the tax burden on those with the “broadest shoulders”. In this section, we examine two further issues with Mansion Tax that could undermine its alleged “fairness” as a means of raising revenue. The first is that the profile of £2 million properties varies significantly across the country. As a consequence, similar properties would not be treated equally under Mansion Tax. The second issue is that the burden of Mansion Tax would overwhelmingly be felt inside the M25. This has led to claims that the policy would be a “tax on London”.

What qualifies as a “mansion”?

Traditionally the term “mansion” has conjured images of sprawling stately homes, with the number of bedrooms in double figures. Yet, particularly in London, the homes in question do not fit this description. Using “nowcast” projections of UK property prices, the CEBR has estimated the number and type of homes that would be subject to Mansion Tax in London and the South East of England in 2016 (Table 4.1).

Four types of properties are considered: detached houses, semi-detached houses, terrace houses and flats. In London, of the 80,762 homes projected to qualify for the charge by 2016, 46% are terrace houses, while 21% are detached. In contrast, 97% of the properties forecast to be subject to the Mansion Tax in the South East are detached, while only 1% are terrace.
Moving beyond Mansion Tax

Table 4.1: Number of homes in London and the South East subject to the 2016 Mansion Tax, by type of home

<table>
<thead>
<tr>
<th></th>
<th>Detached house</th>
<th>Semi-detached house</th>
<th>Terrace house</th>
<th>Flat</th>
</tr>
</thead>
<tbody>
<tr>
<td>London</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2016</td>
<td>17,014</td>
<td>14,173</td>
<td>36,959</td>
<td>12,616</td>
</tr>
<tr>
<td>% of total</td>
<td>21%</td>
<td>18%</td>
<td>46%</td>
<td>16%</td>
</tr>
<tr>
<td>South East</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2016</td>
<td>10,906</td>
<td>220</td>
<td>101</td>
<td>17</td>
</tr>
<tr>
<td>% of total</td>
<td>97%</td>
<td>2%</td>
<td>1%</td>
<td>0%</td>
</tr>
</tbody>
</table>

According to property site Zoopla, as of April 2015, properties with a guide price of £2 million include:

- Two bedroom flat in Chelsea, SW3 – 1,053 sq ft, two bathrooms, on street parking;
- Four bedroom terrace townhouse in Wandsworth, London – 2,003 sq ft, three bathrooms (two en-suite), roof terrace;
- Six bedroom Grade II listed detached house near Birmingham – 12,101 sq ft, five bathrooms (four en-suite), cinema/games room, orangery, bar, office, indoor swimming pool, large gardens, additional one bedroom coach house;
- 14 bedroom farmhouse estate in South Yorkshire – private country estate with four cottages (two with five bedrooms and two with two bedrooms) arranged around a central courtyard. Also includes a Grade II listed barn, double garage with a first floor games room/office and 40 acres of arable land.

Clearly variation in the profile of £2 million properties is significant. As a consequence, many family homes that would not traditionally be thought of as mansions – though clearly valuable – could be charged Mansion Tax.

Defenders of Mansion Tax might argue that this is irrelevant. What matters is solely the value of the property. However, notions of “fairness” do not always correspond to economics, and this is particularly true with property taxes. Variations in relative prices between localities mean that identical properties could be taxed differently. Put differently, a four

89 Zoopla, accessed: 22/04/2015.
bedroom terrace house in Wandsworth would be classified as a mansion whereas an identical property in York would not. From an economic and a theoretical fiscal perspective, the size, shape and facilities of a property are irrelevant; the only thing that matters is its value. But in reality people compare homes not by price but by structure.

One obvious solution is to separate the taxation of land from the taxation of buildings. The value of a building is likely to be the same no matter where it is. What makes similar houses different in value is not their design but where they are – hence the “location, location, location” cliché – and the improvements that others make to the local area. Mansion Tax does not attempt to distinguish between land value (location) and improvements (buildings). It therefore taxes similar properties differently, which could create a sense of grievance among individual taxpayers. We discuss this in more detail in Chapter 7.

“Mansions” and the regions

As well as inconsistency in the tax treatment of similar homes, there would be significant regional variation in the number of properties that would qualify for Mansion Tax. According to Zoopla, over 90% of the homes currently worth in excess of £2 million are located in London and the South East of England (see Table 4.2). In addition, analysis shows that the average price of properties worth over £2 million differs significantly depending on the region in which they are located. In London, the average high value property price (£3,679,851) is over £1 million more than the average in Wales (£2,615,512) and a little under £1 million more than the average in the East of England (£2,722,831). Even within London the figures are highly divergent. The average price of a high value property in Kensington and Chelsea is £4,504,816. As a result, the average high value property in London could be charged considerably more than those in other regions, essentially penalising home-owners in the capital.
Table 4.2: Regional breakdown of properties worth £2 million plus

<table>
<thead>
<tr>
<th>Region</th>
<th>Number of homes worth &gt; £2 million</th>
<th>% of total</th>
<th>Average value of homes worth &gt; £2 million</th>
</tr>
</thead>
<tbody>
<tr>
<td>London</td>
<td>85,461</td>
<td>78.78%</td>
<td>£3,679,851</td>
</tr>
<tr>
<td>Kensington and Chelsea</td>
<td>22,454</td>
<td>20.70%</td>
<td>£4,504,816</td>
</tr>
<tr>
<td>South East England</td>
<td>14,261</td>
<td>13.15%</td>
<td>£2,876,355</td>
</tr>
<tr>
<td>East of England</td>
<td>3,718</td>
<td>3.43%</td>
<td>£2,722,831</td>
</tr>
<tr>
<td>South West England</td>
<td>2,079</td>
<td>1.92%</td>
<td>£2,815,471</td>
</tr>
<tr>
<td>North West England</td>
<td>881</td>
<td>0.81%</td>
<td>£2,751,724</td>
</tr>
<tr>
<td>Scotland</td>
<td>895</td>
<td>0.83%</td>
<td>£2,618,621</td>
</tr>
<tr>
<td>West Midlands</td>
<td>435</td>
<td>0.40%</td>
<td>£2,891,595</td>
</tr>
<tr>
<td>East Midlands</td>
<td>261</td>
<td>0.24%</td>
<td>£2,950,277</td>
</tr>
<tr>
<td>North East England</td>
<td>231</td>
<td>0.21%</td>
<td>£2,934,909</td>
</tr>
<tr>
<td>Yorkshire and The Humber</td>
<td>168</td>
<td>0.15%</td>
<td>£2,855,904</td>
</tr>
<tr>
<td>Wales</td>
<td>87</td>
<td>0.08%</td>
<td>£2,615,512</td>
</tr>
<tr>
<td>Total</td>
<td>108,477</td>
<td>100.00%</td>
<td>N/A</td>
</tr>
</tbody>
</table>

The picture painted by Zoopla’s figures is supported by sales data from the Land Registry. While Land Registry data is known to undercount transactions – it excludes, for example, all sales that have not been lodged with the Registry – it is useful for showing the geographical distribution of transactions. The data shows that sales of £2 million plus properties have been heavily skewed to London and the South East. Between 2010 and 2014, property sales in London accounted for four in five of the property sales in England and Wales worth over £2 million. This figure increases to around 94% when including sales in both London and the South East (see Table 4.3).

Table 4.3: Distribution of £2 million plus sales from 2010 to 2014

<table>
<thead>
<tr>
<th>Region</th>
<th>Over £2m</th>
</tr>
</thead>
<tbody>
<tr>
<td>London</td>
<td>80.28%</td>
</tr>
<tr>
<td>South East England</td>
<td>13.63%</td>
</tr>
<tr>
<td>East of England</td>
<td>2.72%</td>
</tr>
<tr>
<td>South West England</td>
<td>1.90%</td>
</tr>
<tr>
<td>North West England</td>
<td>0.82%</td>
</tr>
<tr>
<td>West Midlands</td>
<td>0.31%</td>
</tr>
<tr>
<td>East Midlands</td>
<td>0.13%</td>
</tr>
<tr>
<td>North East England</td>
<td>0.09%</td>
</tr>
<tr>
<td>Yorkshire and The Humber</td>
<td>0.12%</td>
</tr>
<tr>
<td>Wales</td>
<td>0.01%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100.00%</strong></td>
</tr>
</tbody>
</table>

Within London and the South East, the distribution of high value properties is concentrated in particular areas. Further analysis of Land Registry data shows that over half of the properties sold for more than £2 million in England and Wales between 2010 and 2014 were located in three London boroughs: Kensington and Chelsea, City of Westminster and Camden.  

Table 4.4 shows the ten London boroughs and South East counties with the highest number of £2 million plus sales, as a proportion of total sales in England and Wales (2010 to 2014). In total, these boroughs and counties accounted for roughly 80% of all high value property sales.
Table 4.4: 10 London boroughs and South East counties with the highest number of £2 million plus sales between 2010 and 2014 (as a percentage of £2 million plus sales in England and Wales, 2010 to 2014)93

<table>
<thead>
<tr>
<th>Rankings</th>
<th>London boroughs and SE counties</th>
<th>% of Total Sales (England and Wales) between 2010 and 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Kensington and Chelsea</td>
<td>25.71%</td>
</tr>
<tr>
<td>2</td>
<td>City of Westminster</td>
<td>19.42%</td>
</tr>
<tr>
<td>3</td>
<td>Camden</td>
<td>7.52%</td>
</tr>
<tr>
<td>4</td>
<td>Surrey</td>
<td>7.17%</td>
</tr>
<tr>
<td>5</td>
<td>Hammersmith and Fulham</td>
<td>4.95%</td>
</tr>
<tr>
<td>6</td>
<td>Richmond Upon Thames</td>
<td>4.15%</td>
</tr>
<tr>
<td>7</td>
<td>Wandsworth</td>
<td>3.59%</td>
</tr>
<tr>
<td>8</td>
<td>Barnet</td>
<td>2.79%</td>
</tr>
<tr>
<td>9</td>
<td>Merton</td>
<td>2.76%</td>
</tr>
<tr>
<td>10</td>
<td>Buckinghamshire</td>
<td>1.77%</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>79.83%</td>
</tr>
</tbody>
</table>

A “tax on London”

While the different treatment of similar houses may cause individuals to feel aggrieved, the different treatment of regions is likely to upset entire communities. In particular, if nearly 80% of the properties affected are in London, and over 90% are in London and the South East, then taxpayers in the south east of England may feel that they are being arbitrarily singled out by government. This was the case with the Residential Property Tax in Ireland; the tax fell disproportionately on Dublin, which led to charges of inequity, attempts to expand the base and its eventual abolition.

London and the South East have long been net fiscal contributors due to the higher average wealth and income of taxpayers in those regions. But there is a significant difference between taxing the rich across the UK, the distribution of whom is not even, and designing a tax that almost entirely falls on two regions. Controversially, the former leader of the Scottish Labour Party leader Jim Murphy has celebrated the fact that taxpayers in the south east of England could fund 1,000 extra nurses in...
Scotland. Mansion Tax has already been dubbed a “tax on London” by (among others) the city’s mayor, Boris Johnson, while even left-leaning Labour MP, Diane Abbot (who represents Hackney North and Stoke Newington), described Mr Murphy’s comments as “a cynical attempt to buy Scottish votes”.

Nevertheless, the principle of Mansion Tax appears, at present, to be popular; YouGov found that 60% of the public supported a levy on £2 million homes, with only 13% opposing the idea. What this section has highlighted, however, is that the impact of Mansion Tax would be highly inconsistent across regions and types of property.

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Moving beyond Mansion Tax

5 - Raising revenue?

In Chapters 3 and 4 we outlined why, contrary to the rhetoric of Labour and the Liberal Democrats, Mansion Tax would not be a fair way to raise revenue. In this chapter we turn to the other aspect of the policy – whether it would be an effective way of raising revenue. Not only is Mansion Tax intended to raise relatively little for the Exchequer and at a high cost (relative to intended receipts), it would likely create distortions in the property market – and elsewhere – which could lead to reductions in other tax revenues.

Revenue targets in context

Labour and the Liberal Democrats have both specified how much revenue they intend to raise from the introduction of Mansion Tax, and what they plan to spend the funds on. Labour says its policy will raise £1.2 billion, which would “help to fund our NHS for the future”.98 Meanwhile the Liberal Democrats’ proposal is intended to raise £1 billion, and they would “use this to help balance the books”.99

There are two issues with the parties’ respective revenue targets. The first is that setting a revenue goal is not a particularly sensible way of designing tax policy. As the Institute for Fiscal Studies notes:

“it is not clear that the appropriate tax rate on high value properties should be higher if there turn out to be fewer of them than expected, or vice versa.” 100

The second is that the amount of money that the parties intend to raise from Mansion Tax is relatively small. Total taxes are forecast to raise

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98 ‘Labour’s Mansion Tax: Six things you need to know’, 18th November 2014.
£622 billion in 2015–16. Figure 5.1 shows the forecast breakdown of these receipts by tax. The Labour Party’s proposal is equivalent to less than 0.2% of forecast tax receipts for 2015–16. The Lib Dems’ proposal is equivalent to 0.16%.

Figure 5.1: Public sector receipts, 2015–16 forecasts

Figure 5.2 shows estimates of public spending by main function in 2015–16. The revenue raised from Labour and the Lib Dem mansion taxes would account for 0.16% and 0.13% (respectively) of total managed expenditure for 2015–16.

Figure 5.2: Public sector spending, 2015–16 forecasts

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102 Ibid.
103 Ibid.
Deferred payments

Revenues would be reduced (in the short term at least) if individuals defer Mansion Tax payments. Labour has specified that anyone who “earns”\(^{104}\) less than £42,000 a year will have the right to defer the Mansion Tax until the property changes hands.

It is difficult to assess how much revenue would initially be foregone because we do not know how many households would be eligible to defer; the higher the number of eligible home-owners, the less revenue would be raised in the short term. Calculations are complicated by the fact that we do not know how much each eligible homeowner would have been charged, since we do not know which value band their property would fall in to (though it seems reasonable to assume that most of the eligible individuals would be facing lower charges, reducing the immediate cost to the Exchequer).

Both parties have indicated that their Mansion Tax charges would be adjusted in order to ensure that their respective revenue targets are met. As such, Labour’s deferral plans could increase the prospective charges outlined in Chapter 2 considerably. Besides the questionable economic rationale behind setting charges based on how many homes turn out to be exempt, higher chargers would exacerbate the downsides of the tax.

Cost of implementation

As well as raising little revenue, Mansion Tax would have high costs of implementation relative to intended receipts. The introduction of Mansion Tax would necessitate the valuation of thousands of properties. Currently, the cost of a professional valuation of a home worth between £2 million and £5 million is estimated at £1,800, rising to £4,800 for assessments of homes worth above £5 million.\(^{105}\) These costs fall on the taxpayer, increasing the cost of the tax, while raising no extra revenue for HM Treasury.

In 2013, former Exchequer Secretary David Gauke estimated that a general revaluation of high value properties by the VOA would cost around £10 million and take roughly 2 years, with additional annual costs of around £2 million.\(^{106}\) This figure would likely be much higher now

\(^{104}\) Presumably, Labour mean to refer to income rather than earnings.

\(^{105}\) Swinford S, ‘Ed Miliband’s mansion tax will force 120,000 to revalue their homes’ (quoting research by Savills), The Telegraph, 19th April 2015.

\(^{106}\) Speech by David Gauke, former Exchequer Secretary, Public Bill Committee (Finance Bill), 16th sitting, 13th June 2013 cc495-6, cc499-500.
owing to the increased number of properties captured by the tax. Furthermore, the heterogeneity of high value properties renders standardised valuations difficult, and as a consequence, it is likely that both individual valuations and assignments to bands would be contested. This would lead to uncertainty and administrative costs, borne both by homeowners and the government. Disputes over valuations could be time consuming and complex; Savills estimates that they could cost the Treasury £65 million (in addition to the cost of valuing properties).107

Finally, critics contend that there would be a shortage of professional surveyors to conduct “mansion” valuations, especially since the introduction of ATED valuations108 and given the backlog of appeals to the VOA over Business Rates.109

**Distortions in the market**

Mansion Tax would likely have a number of impacts on the high value property market. Firstly, the present value of expected Mansion Tax payments would be capitalised in current property prices, causing high end housing prices to fall. That is, buyers would be willing to pay less for a property now if they were faced with the prospect of paying a higher annual tax on the property in the future.

Secondly, the Mansion Tax threshold and “step” structure create a “notch” or “cliff” in tax liabilities, which could cause property values to “bunch” below the thresholds, having a further depreciative effect on high end property values.110 Commentators have argued that there are early signs of pre-emptive bunching in the high value market, resulting from speculation over the implementation of Mansion Tax.111 Figures from estate agents Strutt & Parker show that the overall value of transactions for properties above £2 million had fallen by 27% in the third quarter of 2014, compared to 21% for those below the mooted Mansion Tax threshold.112

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107 Swinford S, ‘Ed Miliband’s mansion tax will force 120,000 to revalue their homes’ (quoting research by Savills), The Telegraph, 19th April 2015.
111 Skero N, ‘The Mansion Tax: Impact of the proposed mansion tax on family homes in the UK’, CEBR, September 2014, quoting research by Savills and Frank Knight.
112 Somerset Webb M, ‘Higher property taxes will cool the housing market’, MoneyWeek, 27th October 2014.
To the extent that high value property prices fall and “bunch” below the £2 million threshold, Mansion Tax receipts would be reduced, which has implications either for the amount the tax will raise or for prospective charges. Allowing Mansion Tax payments to be deferred would also impact initial revenues, though it is difficult to judge by how much since we do not know how many individuals would qualify, or the size of the payments they would be able to defer.

Deferral would also have an effect on liquidity in the housing market, as people who had deferred payments might postpone moving in order to avoid paying the accumulated Mansion Tax payments. They may even postpone in the expectation that a future government would reverse the policy and “forgive” outstanding debts. This would exacerbate inefficiencies in the allocation of housing stock. Pensioners in particular may be deterred from downsizing and freeing up properties for larger families. Furthermore, a reduction in the number of property transactions could negatively impact revenue raised from Stamp Duty Land Tax.

**Impact on other tax receipts**

Mansion Tax would undoubtedly impact upon the revenue from other taxes, such as Inheritance Tax and Stamp Duty Land Tax.

CEBR forecasts the impact Mansion Tax could have on Stamp Duty revenues (from high value residential properties) between 2015 and 2020. Its projections suggest that cumulative lost Stamp Duty revenue – due to falling prime property prices and buyers being deterred from the high value property market – could reach around £2 billion by 2020.\(^{113}\) It contends that this estimate is conservative since it does not take in to account the knock on effect that a disturbance in prices and transactions at the high end of the market could have on lower value properties. CEBR argues that:

> “Considering the many unknowns surrounding estimation of revenues received from the proposed mansion tax e.g. property value bands, cost of implementation, number of homeowners qualifying for an exemption etc. it is conceivable that stamp duty losses will be equal to or even greater than mansion tax proceeds in later years.”\(^{114}\)

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\(^{114}\) Ibid.
Savills estimates that the tax could lead to forgone Stamp Duty revenue in the order of at least £160 million a year.\textsuperscript{115} On top of this, Savills calculates that £35 million could be forgone in Inheritance Tax revenue each year. Consequently, they estimate that for every £6 raised by Mansion Tax, at least £1 would be lost in Stamp Duty and Inheritance Tax revenue.\textsuperscript{116}

In addition to lost receipts from property taxes, other sources of revenue may be affected by Mansion Tax. For example, increased taxes impact upon consumption, reducing VAT and other consumption taxes and marginally reducing economic activity across the board. Mansion Tax could deter migration of high net-worth individuals, reducing Income Tax receipts. If Labour’s Mansion Tax proposal were adopted, these effects could be compounded by their commitment to “asking overseas owners of second homes in the UK to make a larger contribution than people living in their only home”.\textsuperscript{117}

\textsuperscript{116} Ibid.
\textsuperscript{117} ‘Labour’s Mansion Tax: Six things you need to know’, Labour, 18\textsuperscript{th} November 2014.
A Mansion Tax in the form mooted in the UK does not currently exist anywhere else in the world, which substantially limits how much can be predicted about the impacts of such a tax. However, a few countries do have higher rate taxes on high value properties and so this chapter will discuss how these have worked in practice and what the effects have been, where these are relevant to the Mansion Tax proposals in the UK.

United States, Hong Kong and Singapore

What has been labelled a “Mansion Tax” in Hong Kong, Singapore and certain US states and cities (New York, New Jersey and San Francisco) is in reality a transfer tax on property sales over a certain value, more akin to UK Stamp Duty than the annual levy currently proposed by Labour and the Liberal Democrats. For instance, the so-called “Mansion Tax” that has existed in New York since 1989 and New Jersey since 2004 applies at a rate of 1% to residential transactions above a threshold of $1 million.

The effects of these taxes on the housing market have been a “bunching” of house prices below the $1 million threshold and “missing transactions” above the threshold indicating a disincentive for property deals. For example, an increase in a transfer tax for expensive residential property introduced in Hong Kong in 2013 (8.5% on properties over $20 million) has resulted in a sizeable fall in home sales from more than 12,000 per month in 2011 to roughly 8,000 by December 2014. House prices initially fell by about 5%, but have since recovered and are now at a record high. This should be a cautionary note for UK policy makers who hope that Mansion Tax would help to stabilise London’s house prices.

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119 Ibid.
120 Ibid.
Greece

In recent years, Greece has experimented with taxes on high end properties which are similar in design to the UK Mansion Tax proposals. The picture of effects is complicated, however, by instability in the property tax regime. Until 2007, Greece imposed a special tax – the Large Property Tax – on real estate worth above a certain value. This took the form of a flat rate levy of 0.1% on “large immovable property” with a value of over EUR 300,000. This was then replaced by an annual scalable tax – the Single Property Tax or ETAK – based on a percentage of the portfolio property tax value, levied at 0.1-0.9% in 2008-2009 (with primary residences up to EUR 300,000 exempt). This tax proved difficult to collect however, and the Large Property Tax was reintroduced in 2010. Further, a temporary special tax for residential properties – the Haratsi – collected through electricity invoices was levied in 2011.

These taxes were replaced in December 2013 by a unified possession tax (ENFIA) levied on all properties at a rate of EUR 2-13 per m². Where the value of the property exceeds EUR 3 million an additional tax ranging from 0.1-1% of the value is also levied. In practice ENFIA required about 1.2 million Greeks to pay fees of up to EUR 100. One in four paid EUR 100-250 in 2014 and one in three amounts of EUR 250-500. 1.66 million paid sums exceeding EUR 500 (of which 78,000 paid more than EUR 3,000). Roughly 30 individuals holding very large estates paid in the region of EUR 200,000 to 600,000.

It is hard to disentangle the effects of these tax hikes on higher value properties in Greece from the wider fallout of the financial crisis. But uncertainty in property tax laws has been viewed as having a detrimental effect on market confidence. Figures from the Bank of Greece show that the number of real estate transactions more than halved between 2009 and 2012. It is also estimated that a number of individuals have sold or divided property to avoid the higher tax rates. Questions of fairness arise given that the assessed value of properties has remained constant while market values have fallen on average by

124 c. 1.5 million property owners.
127 Ibid.
Moving beyond Mansion Tax

roughly 40% between 2008 and 2013.\textsuperscript{129}

Despite this, the outrage of Greek taxpayers has been directed more at the universal ENFIA tax than the high end levy, and the newly elected Syriza party has announced that it will abolish ENFIA and restore the high value levy for properties above EUR 300,000.\textsuperscript{130} This is estimated to cut the number of individuals paying property tax by up to 90%,\textsuperscript{131} but it remains to be seen whether this will soothe voters and buoy the market.

**Ireland**

Ireland previously had a Residential Property Tax (RPT), charged at a rate of 1.5\% on the amount of a property over a market value threshold (this would have been EUR 1,389,000 in 2006 in accordance with indexation provisions contained in the legislation).\textsuperscript{132} The RPT was in place from 1983 to the end of 1996, and no more than 21,500 households were ever affected. It generated only about EUR 16.5 million in the last 2 years of its operation: “The tax base was narrow and revenue yields were insignificant”.\textsuperscript{133}

Up to three-quarters of the revenue from the RPT was raised from Dublin; Dublin contributed a significantly higher proportion of revenue compared to its share of Income Tax revenue and local authority expenditure.\textsuperscript{134} This led to charges of inequity, the attempt to expand the base in 1994 and its eventual abolition. All of these issues could well be replicated given the fact that a UK Mansion Tax would fall heavily on London.

Currently Ireland uses a Local Property Tax (LPT) instead, which came into force in late 2013. LPT is set at 0.18\% of the property value and applies to all residential properties. However, those owning residential properties with a market value of over EUR 1 million are charged 0.25\% on the value above EUR 1 million. Ireland’s Finance Department is currently undertaking a review of the LPT to determine its overall tax yield, administrative issues and the relationship with property prices.

\textsuperscript{130} Hope K, ‘Property tax backlash underpins Syriza’s poll prospects’, The Financial Times, 19th January 2015.
The review will present its findings in summer 2015. Initial opinions however, have suggested that the main issue with the RPT – that of urban home owners (especially those in Dublin) subsidising rural property owners – has not gone away. There are also fears that increasing numbers of middle class individuals will be dragged into the higher 0.25% bracket as house prices rise steeply.

**Denmark**

Denmark has an annual property tax set by the central government under which citizens pay 1% of the value of their property up to DKK 3.04m (£343,000), and 3% of any value above that. This is in addition to a municipal tax based on land values. The revenue from the property value tax goes to local government and represents 1.4% of total local government receipts. There are numerous exemptions to this tax in place (e.g. for pensioners). It has been argued that these property taxes, and the progressive element involved, played some role in helping Denmark avoid some of the macroeconomic instability that plagued the UK in the years post-1996 (e.g. overvalued exchange rate, excess house price inflation and consumption growth), though the role of Denmark’s mostly fixed rate mortgage market and local land value tax also played a key role. Some have argued that “the empirical evidence from the Danish Central Bank’s own model, suggests an important stabilising role for domestic property taxes.”

Nevertheless, it has been emphasised that the anticyclical stabilisation effect of such taxes is lost where values are not updated regularly. In 2001 Denmark’s property value tax was frozen. The effective tax rate has declined as house prices have risen, which has “amplified fluctuations in house prices by approximately one-fourth”.

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137 Somerset Webb M, ‘How a levy based on location values could be the perfect tax’, The Financial Times, 27th September 2013, available: [www.ft.com/cms/s/2/392c33a6-211f-11e3-8aff-00144fe-ab7de.html](http://www.ft.com/cms/s/2/392c33a6-211f-11e3-8aff-00144fe-ab7de.html) accessed: 05/05/2015.


Thailand

Thailand is currently considering a draft bill introducing new property taxes, which includes a levy of 0.1-0.5% on residential property valued at over 1.5 million baht. This is in response to declining tax revenues, and is already generating a great deal of controversy and public unease.142

Lessons from abroad

It should be stressed that none of the taxes discussed above are directly equivalent to the proposed UK Mansion Tax. In addition, lessons from abroad are limited for three reasons. Firstly, it is difficult to divorce the economic effects of high value levies from the effects of other fiscal and monetary policies. Secondly, unique national economic situations, taxation frameworks and political cultures substantially affect the workings and impacts of such property taxes, and the UK would be no different in this respect. Finally, a number of high value levies have either been discontinued (Ireland), reformed, changed or recently introduced (Greece, Ireland, Hong Kong, Singapore) or are still under proposal (Thailand). This limits the data available for studying their effects, in particular in the medium and long term.

Nevertheless, this short review has suggested some common outcomes. These include:

- A tendency for house prices to “bunch” at just below the level of the tax threshold;
- Where this levy is payable on property transfer, as with Labour plans for the option of Mansion Tax deferral, there is potential for disincentivising high end property transactions;
- Usually only a small amount of revenue is collected from such taxes;
- Destabilisation and pro-cyclical effects can occur where the value thresholds are not updated in line with changes in house prices;
- These taxes tend to penalise urban dwellers.

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More disputed – though also possible – effects are:

- Disincentivising capital savings and investment;
- Helping to stabilise volatile housing markets and prick housing bubbles, where thresholds are indexed or kept closely in line with market values;
- Encouraging tax avoidance strategies including the splitting of assets, alternative investment routes and tax planning.
SECTION 3

7 - Some basic principles of property tax reform

In Chapter 1 we noted that Mansion Tax represents a fourth tax on property and that it needs to be considered along with other property taxes. In Chapters 3 to 5 we demonstrated that Mansion Tax was not a good way of increasing taxes on the richest people in society, was not fair and was not efficient. In this chapter we consider what features a good property tax should display.

A good tax system should be efficient, fair and transparent.\textsuperscript{143} Mirrlees observes that “simple, neutral, and stable tax systems” are more likely to satisfy the criteria of a good tax system than “complex, non-neutral, and frequently changing systems”.\textsuperscript{144} Stability is a moot point, as any paper that both proposes fiscal reform and calls for fiscal stability can be accused of taking an Augustinian approach to the tax system.\textsuperscript{145} Our own list of criteria for a good system of property taxation is one that is:

- Local
- Simple
- Transparent
- Fair
- Efficient

Mansion Tax is none of these. Before we can consider these more general principles, however, we need to clarify what we mean by property.

What do we mean by property?

All property taxes in the UK conflate two things under the heading “property”: the value of the land and the value of the improvements.

\textsuperscript{144} Ibid.
\textsuperscript{145} “Lord, make the tax system stable, but not yet.”
Moving beyond Mansion Tax

However, it is far from clear that these two should be treated the same way, let alone combined within one tax.

A good principle of fiscal policy is that government should seek to tax economic rent rather than productive activity. Economic rent is the difference between the amount paid to the owner of a factor of production and the minimum amount necessary to keep that factor in its current use. It arises solely because of scarcity or exclusivity, and as such is a form of monopoly pricing.146

While improvements qua improvements are fungible (two identical buildings would be of equal value), the location of the buildings makes an enormous difference to the value of the property. Location is largely a function of the improvements that others have made to surrounding land. As Liberal MP and cabinet minister Winston Churchill told the House of Commons in 1909:

“Roads are made, streets are made, services are improved, electric light turns night into day, water is brought from reservoirs a hundred miles off in the mountains—and all the while the landlord sits still. Every one of those improvements is effected by the labour and cost of other people and the taxpayers. To not one of those improvements does the land monopolist, as a land monopolist, contribute, and yet by every one of them the value of his land is enhanced.”147

For example, Crossrail is expected to add 50% to the value of some properties along its route, to which the owners of that property contributed no more than taxpayers who did not benefit from Crossrail.148 For this reason, income from land is entirely economic rent, whereas income from improvements are reasonable entrepreneurial profits.149

146 Economic rent is not only a feature of land and property markets; other factors of production (i.e. labour or capital) can extract rent, and one of the most common sources of rent is government restraint of trade – for example, “closed shop” rules that allow unionised labour to extract rent in the form of elevated wages owing to legal barriers to competition, or trade barriers that enable owners of capital to extract monopoly prices from domestic consumers.


149 In neoclassical theory, while some entrepreneurial profit in the short term may represent economic rent, the proportion that is rent will be competed away over time as others enter the market to capture these rents – e.g. absent restrictive planning laws, any rent accruing to you from building a house would act as an incentive to your neighbour to do the same.
Taxing rent is also efficient because “Reducing rent does not change production decisions... economic rent can be taxed without any adverse impact on the real economy....”

In the current political environment the taxation of land values tends to be associated with the political fringes, but outside current UK politics it received major support. Henry George’s 1879 classic “Progress and Poverty” sold more copies than Karl Marx’s “Das Kapital”. The Liberal Government legislated for Land Value Tax in the 1909 “people’s budget”, though it was never implemented. In Denmark, a land value tax based on the market price of land has been levied since 1924. As the British winner of the 1996 Nobel Memorial Prize for Economic Science, James Mirrlees, wrote “The economic case for taxing land itself is very strong and there is a long history of arguments in favour of it.”

A shift to the taxation of economic rent on land rather than improvements of property is beyond the scope of this paper. However, any substantial reform of property taxes ought at least to consider the merits of a land value tax. We recommend that the government establish a Royal Commission with the task of considering the appropriate balance of taxes on property, and the merits of moving partly or wholly to the taxation of economic rent on land.

Central versus local

In Chapter 3 (iii) we noted that taxing property differently from other asset classes creates economic distortions. Ideally, therefore we would avoid taxing property differently altogether. However, we feel that a distinction needs to be made between property taxes that fund local government, and those that fund central government.

Property taxes to fund local government are not new – in fact, they have a long pedigree. As such they enjoy what Max Weber called “traditional authority”, one of his three sources of political legitimacy. This is certainly one reason why local government continues to raise revenue through property rather than income or consumption taxes. Traditional authority lends support to the case for improving the existing Council Tax system, but does not extend to new taxes that are unconnected to local government funding.

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Nonetheless, we acknowledge that a motivation behind the introduction of Mansion Tax is to make additional revenue available to central government. What is more, since high value properties are unevenly distributed, if revenues were retained locally, Mansion Tax would represent a windfall gain to wealthy areas; it would be of little or no benefit to those in less wealthy areas, while allowing the median level of taxation in wealthy areas to fall. A fair system should avoid such windfall gains.

**Simplicity and transparency**

Simple taxes minimise compliance costs. Compliance costs are in effect an additional tax, and an inefficient one at that. Filling in a tax return adds to the opportunity cost of paying one’s taxes without adding to government revenue; individuals or firms using professional tax accountants or lawyers similarly face an obvious cost. Both the time spent complying and the use of tax professionals are functions of the complexity of the system.

Legitimacy and democratic accountability require that citizens are aware of how much tax they are paying, on what, and how it is derived. Obscure taxes enable government to mulct taxpayers stealthily. This makes it harder for citizens to hold elected officials to account, and prevents citizens making informed judgements about the appropriateness of either general levels of taxation or specified taxes. If Colbert is right that good taxes minimise the amount of “hissing”, it should be because they are relatively painless, not because the “geese” are distracted.

Simplicity and transparency are important for economic planning. Taxation drives a wedge between what one earns (gross return) and what one keeps (net return); this changes the payoff from an action. If individuals cannot predict how the tax system will affect outcomes, it is harder to make economic plans.

Mansion Tax is superficially simple and transparent: property below a certain value are not taxed; those above are banded and pay a flat rate based on that band. The reality, however, is far more complicated: the value of properties that have not recently changed hands are speculative and so not transparent, and the interaction with other taxes is far from

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154 While taxation are usually understood narrowly to refer to compulsory contributions to government revenue, economists understand taxation as any cost imposed upon private actors by the state. Inflation is a tax on holders of currency, tariffs are a tax on consumers, regulation is a tax on business, etc. In the same way, the cost of complying with tax law is itself a cost on taxpayers.

simple. The vagueness with which some of the plans have been laid out (e.g. Labour’s failure to clarify the full structure of bands and rates) is an extreme example of how opaque the proposals are.

As a general principle, any tax reform should seek to minimise additional complexity and, if possible, simplify existing taxes. Creating a new property tax, based on a different set of valuations and with different mechanisms for exempting people, unnecessarily complicates the system and could leave individuals unclear as to their forthcoming tax bill. By comparison, a reform of existing property taxes creates an opportunity to simplify and clarify the existing system.

As we noted in Chapter 1, there are currently three property taxes in Britain with Mansion Tax proposed as a fourth. Mansion Tax is an ill-fitting adjunct to the Council Tax that further complicates the system. At the very least the two need to be rationalised, but there is a strong case for rationalising all taxes on property to create a single, economically efficient property tax.

It is worth noting in the context of our discussion of land value taxes, above, that the most enthusiastic advocates of land value tax refer to it as the Single Tax and suggest that it should replace all other taxes. These include John Locke, Baruch Spinoza and Henry George. This is beyond the scope of this paper, though we recommend that the Royal Commission considering taxes on property should consider the merits of replacing all property taxes with land value taxes.

Irrespective of that question, however, it is clear that a new property tax should aim to rationalise and replace existing property taxes to create a single, fair, efficient tax on property.

**Fairness**

How “progressive” a tax system should be is a normative question and is beyond the scope of this paper. It suffices here to say that there is no consensus on progressivity and not even the semblance of a consensus on how progressive. However, there is a broad agreement that taxes should not be regressive – they should not fall more heavily on those less able to pay. Overall, a tax system should be either flat (individuals pay in direct proportion to how wealthy they are) or progressive (the burden should increase as resources rise).

Irrespective of how progressive the overall tax system is, however, it is mistaken to assume that all taxes should be equally progressive. What
matters is the fairness of the system as a whole; individual taxes should be designed with that whole in mind. Council Tax is clearly regressive and should be reformed. Mansion Tax does nothing to fix the Council Tax system, and while it is progressive between bands, it is regressive within bands.

**Efficiency versus fairness**

A good tax system will be efficient, both in terms of the cost of collection compared with the amount raised, and the economic efficiency resulting from the effect taxes have on incentives. One clear fault line in property taxes is between the inefficiency (in terms of economic incentives) of a series of bands and the inefficiency (in terms of cost) of valuing every property individually for a flat rate tax. Unlike taxes on income and consumption, which are easy to quantify exactly, property values are only crystallised at the point of sale. At any other time, values are at best estimates, whether conducted by self-assessment or by fiscal authority assessors. As there is a substantial opportunity cost to estimating values, banding may be quicker and less expensive.

Another fault line also exists between efficiency and fairness – the most efficient taxes are not always the most equitable; the most progressive are rarely the most efficient. While a series of bands may be more efficient than a flat rate tax, it would be less equitable since within the bands the tax is regressive. A trade off therefore results between two extreme ideal types: a tax on the precise value of each property, equivalent to an infinite number of bands, is fair and equitable but expensive; a single band is very cheap but infinitely regressive, being in effect a poll tax. The challenge for those designing a new tax is to determine the point at which the cost of valuing property (in efficiency) outweighs the benefits (in fairness).

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157 E.g. may cause “bunching” in the property market.
158 We ignore the question of equity in respect of the distribution of the tax burden. Our focus is purely on the fact that any banding will suffer from intra-band regressiveness.
8 - Proposals for reform

In Chapter 7 we set out some general features for a good property tax system. In this final chapter we sketch out a model for what a good system of property taxes might look like. In doing so we stress that our aim is not to provide a definitive answer to the question of how property – and particularly high value property – should be taxed. Rather, our aim is to explore how some of our general principles might manifest themselves in practice and so start a conversation about how best to design a fair and efficient property tax system. In light of recent proposals for a Mansion Tax, we feel such a debate is long overdue.

From the outset we acknowledge that Mansion Tax aims to:

1. Raise more money from owners of high value property;
2. Raise more money overall;
3. Redistribute the extra revenue away from the area where it was levied;
4. Use the additional revenue to meet central government spending shortfalls.¹⁵⁹

This exercise seeks to show how these ends could be achieved without many of the failings of Mansion Tax. However, it is worth noting that our proposals would work equally well if some of the above aims were abandoned.

More broadly, our aim is to suggest reforms that make the tax system more simple, transparent, fair, efficient and local. We noted in Chapter 7 that there was a strong case for looking at the question of taxing the economic rents on land and recommended the establishment of a Royal Commission to that end. Our proposals below do not take this further; they sketch out a reform of existing property taxes that neither advances, nor impedes future progress towards taxing the economic rent from land.

¹⁵⁹ In general in the case of the Lib Dems; specifically for the NHS in the case of Labour.
A model reform – creating a flat rate property tax

The simplest, clearest and fairest way to reform property taxes would be to replace or reform Council Tax so that it becomes a flat tax on the current value of individual properties. Properties should be frequently and regularly revalued to ensure that the valuation remain up-to-date, as is currently the case with Business Rates. As with the current Council Tax, a single tax rate would be set locally, but how that would be distributed between properties of different values would be set centrally. However, instead of a Band D figure in pounds and a complicated schedule of bands and ratios, local government would set a percentage and government would mandate that that percentage is applied in direct proportion to property values.

This would be highly redistributive, shifting taxes from owners of lower value property to owners of higher value property.\textsuperscript{160} The Council Tax requirement (excluding precepts) in England and Wales in 2014-15 was £25.7 billion.\textsuperscript{161} The total value of property in England and Wales in 2014 is estimated at £5,349 billion.\textsuperscript{162} Thus an average tax of 0.48\% on the value of UK domestic properties would yield approximately the same amount as the current Council Tax system.

By contrast, the average property price in England and Wales in February 2015 was £178,007.\textsuperscript{163} The average Council Tax bill was £1,045 in England\textsuperscript{164} and £1,088 in Wales.\textsuperscript{165} Using Land Registry data we can determine that the average Council Tax bill was 0.56\% of the average house price in England and 0.92\% in Wales.

Raising a further £1.2 billion, as Labour suggest, would require an additional 0.02\%. Thus a flat rate that averaged 0.5\% across local authority areas could replace both Council Tax and the proposed Mansion Tax.

\begin{footnotesize}
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  \item As a general point, house prices are right skewed – there are fewer high value properties than low value properties – so most households would see a reduction in their Council Tax.
  \item Department for Communities and Local Government, ‘Council tax levels set by local authorities in England 2015-16’, 26\textsuperscript{th} March 2015. To this we have added an average Welsh Council Tax bill of £1,088 multiplied by a 2011 Welsh census figure of marginally over 1.3 million households.
  \item Savills, ‘UK homes now worth a total of over £5.7 trillion, up 10\% year on year’, 12\textsuperscript{th} January 2015, available: \url{www.savills.co.uk/_news/article/0/185344-0/1/2015/uk-homes-now-worth-a-total-of-over-%C2%A35.7-trillion--up-10--year-on-year}, accessed 05/05/2015. Note that we have subtracted the value of properties in Northern Ireland, Scotland and Wales.
  \item Land Registry, ‘House Price Index – March 2015’, April 2015.
  \item Keep M, ‘Council Tax 2013/14’, Standard Note: SN/SF/6599, House of Commons Library, 3\textsuperscript{rd} April 2013.
\end{itemize}
\end{footnotesize}
All of these figures are averages across the UK. In practice, we recommend that rates be set locally to retain the connection between property taxation and local government, and to avoid the Mansion Tax problem that people who live in areas where property values have appreciated rapidly are taxed punitively irrespective of their ability to pay. For example, in Ealing, where the average property price is approximately two and a half times the England and Wales average, the local authority could set the tax rate at 0.18%. Under such a system, a person in a £2 million Band G house would pay £3,600 in flat-rate property tax. This would be an increase of £1,341.78 a year, substantially more than under the current system, but less than the additional £2,000 under the Lib Dem plans or £3,000 under Labour. Meanwhile, residents in an average Band E property worth £450,000 would pay £810 a year instead of £1,656.03 under the current Council Tax system.

The major losers from this system would be the owners of properties that are substantially more valuable than other properties in the area. The owner of a £2 million house in London might see their total tax bill rise, but the owner of a £2 million house in the North of England would see a dramatic increase in their tax bill. As a general point, ownership of property that is more valuable relative to the local mean is likely to be a better proxy for total wealth and for ability to pay than the value of a property relative to the national mean, but even so we recognise that this will not be a perfect measure.

We believe that the above system would satisfy most of our criteria for a good tax reform. The system is simple in that it avoids the creation of an additional property tax, and improves the functioning of the existing one. It is transparent in that the amount of tax is a simple percentage of the value of the property. It is fair in that it is no longer regressive. It is local in that rates are set locally.

**Redistribution and the flat rate property tax**

At the beginning of this chapter we agreed to incorporate four aims of Mansion Tax into our proposal. The above has addressed the first two. We now turn to consider the latter two.

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167 We would expect this for two reasons. Firstly, they are less likely to have become wealthy simply because of large increases in property values over time, as these would have affected average prices as well. Secondly, a property of any set value will be far further up the distribution of house values in a low value area than in a high value area.
Redistribute the extra revenue away from the area where it was levied

To retain the link between property taxes and local government, we recommend that local authorities pool the additional revenue accruing from properties worth over £2 million. Revenue on values below that would be retained locally; revenues on values above that would be pooled. For example, a £2.5 million house in an area with a 0.2% Council Tax would face a bill of £5,000, of which £4,000 would be retained locally and £1,000 would be pooled. We recommend that local authorities pool this resource themselves, perhaps through the auspices of the Local Government Association.\footnote{We note that the LGA’s membership involves almost all top tier local authorities. There are a couple of hold-outs, but these authorities should not be allowed to avoid pooling simply because they do not wish to be LGA members. Rather, like Norway’s relationship with the European Union, they would have to accept rules they could not influence.}

Use the additional revenue to meet central government spending shortfalls

If the additional revenue is retained and pooled by local government, it would appear at face value that it is not available to meet central government spending shortfalls. However, this can easily be rectified by reducing central government grants to local government by a corresponding sum. In effect, instead of government collecting and retaining £1.2 billion in extra taxes, it reduces expenditure by £1.2 billion and allows local government to collect and retain a corresponding sum. The £1.2 billion saving to central government can be used (for example) to reduce the deficit or fund the NHS.

Efficiency of the flat rate tax

The main concern with our ideal-type proposal is efficiency, specifically regarding the cost of revaluing individual properties. Fortunately, there is good evidence on which to base an estimate of that cost. Firstly, in 2005-6 the Office of the Deputy Prime Minister produced an estimate for a blanket revaluation of properties for Council Tax purposes of £200 million; approximately £267 million in 2015 prices.\footnote{House of Commons Library, ‘The Council Tax (New Valuation Lists for England) Bill’, Bill 57 of 2005-06, Research Paper 05/73, 1 November 2005, p12. Figure uprated to 2014 using the Bank of England’s Inflation Calculator; there has been zero inflation in 2015.} Secondly, the Welsh Assembly Government estimate the cost of the Council Tax revaluation in
Wales in 2003, including appeals, at £8 million.\textsuperscript{170} This equated to around £6.15 per property.\textsuperscript{171} Up-rated to 2015 prices and multiplied by over 27 million properties across Great Britain, this leads to a figure of £237 million.\textsuperscript{172} Based on these two calculations we estimate that a UK-wide revaluation would cost around £250 million.

While this might appear a substantial sum of money, it represents less than 1\% of the amount that would be raised by the new flat rate tax in the first year. Assuming revaluations were then conducted on a 5 yearly cycle, the cost of valuing properties would be just 0.2\% of the amount raised. This is a relatively trifling sum. By way of comparison, in 2013-4 HMRC spent £3.6 billion collecting £505.6 billion in taxes, meaning that the average cost of tax collection was 0.71\%.\textsuperscript{173} Though the revaluation would not be the only cost of collection, it places the cost in proportion.

Moving from cost-efficiency to economic efficiency, we note that a flat tax avoids the economic distortions resulting from the “stepped” structure of the Mansion Tax and the Council Tax (e.g. “bunching”) as discussed in Chapters 5 and 7.

\section*{Dealing with the “asset rich, income poor” dilemma}

Mansion Tax, Council Tax and our flat rate property tax all face the “asset rich; income poor” dilemma, as property taxes do not address taxpayers’ ability to pay. Below we set out a proposed system of deferral. This reform is entirely independent of the above recommendations and could apply whether or not policy makers accept our other recommendations.

To properly understand the asset rich, income poor challenge, it is important to acknowledge two things. Firstly, having a low income does not mean that one should not contribute; it means that one cannot contribute. Secondly, those that have substantial assets can afford to pay, just not yet. The obvious solution is to allow them to defer payment until such time as they are able to pay, either when they finally realise

\begin{footnotesize}
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\item \textsuperscript{171} In 2002-03 the Welsh property stock was estimated at 1,296,111. Welsh Government, ‘Dwelling stock estimates by year and tenure’ in ‘Stats Wales’, available: https://statswales.wales.gov.uk/Catalogue/Housing/Dwelling-Stock-Estimates/DwellingStockEstimates-by-Year-Tenure accessed: 05/05/2015.
\item \textsuperscript{172} Beckett D, ‘Trends in the United Kingdom Housing Market, 2014’, Office for National Statistics, 22\textsuperscript{nd} September 2014.
\end{itemize}
\end{footnotesize}
the value of their asset or when their estate is liquidated following their death.

The Liberal Democrats’ Mansion Tax proposal does not address the asset rich, income poor challenge. Labour propose to allow property owners earning less than £42,000 a year to defer, but do not explain how this affects their calculation of the amount that the tax would bring in.

We recommend that the system be designed to guarantee that the deferred tax is eventually paid, and then create an asset based on that guaranteed future receipt that can be used to finance revenue today. The government (local or national) that levied the tax could borrow against the fixed asset, thus ensuring no short term impact upon revenue. The asset would be guaranteed by placing a “charge on the land”, ensuring that the owner of the asset was guaranteed to recover the value when the property finally changed hands (on sale or inheritance). Deferral would not be available to legal entities other than individuals (otherwise transfer could be deferred indefinitely). Owing to the relative size of the tax bill and the property value, the total charge on the land would always be worth less than the value of the property even if the tax was deferred repeatedly over a number of years. Interest on the deferral should be paid by the taxpayer, probably by adding the interest to the cost of deferral. Assuming that the interest rate was marginally above the local authority borrowing rate, this would be a very low price to pay for deferring one’s taxes and remaining in one’s home.

**Transitional arrangements**

A final point is worth considering. All tax changes have winners and losers. This is no reason to avoid changes that increase aggregate welfare and/or make the tax system fairer. However, there may be a case for smoothing the impact upon those affected. Tax changes also create an opportunity for tax authorities to mask overall tax increases (or decreases) in the tax take.

In reforming the tax system, government may therefore wish to consider two transitional arrangements. Firstly, it may wish to phase in changes over time. Secondly, it may wish to legislate for a period during which the overall effect of reform was revenue-neutral, so that people could see the effect of the reform before any changes in the overall level of taxation took effect.

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174 A universal tax cut (rise) could in principle be Pareto-improving. In reality it is highly unlikely that all those affected by both the tax cut (rise) and the corresponding spending cut (rise) would benefit.
Summary

In summary, we recommend that plans for a Mansion Tax be dropped, and that Council Tax be replaced with (or reformed to be) a flat rate tax on the value of domestic properties. Local authorities would be free to set their own rate. All revenue on property values below £2 million would be retained locally. All revenue on property values above £2 million should be pooled by all local authorities and redistributed among them. Central government funding to local authorities should be reduced in line with the additional revenue raised locally. Finally, we recommend that residents be permitted to defer payment of their tax until their property changes hands through sale or transfer. This should be guaranteed by local authorities placing a “charge on the land” to cover both the deferred tax and any interest. Local authorities should be free to borrow against this asset to smooth revenue.

As noted at the outset, we do not offer these proposals as a final say but as the beginning of the conversation. Many readers will have questions, concerns or improvements to offer. We believe that such comments will help inform the debate about a fairer and more efficient form of property tax. However, we maintain that the above is a significant improvement upon proposals to add a Mansion Tax on top of existing property taxes.
Conclusion

Mansion Tax looks remarkably like an idea that was dreamt up by the Campaigns Department rather than the Policy Department. While election strategists and speech writers may think that taxing big houses is the same as soaking the rich, policy analysts are well aware that the value of a person’s primary (even sole) residence is a poor proxy for net worth. Meanwhile, the policy has gone through so many revisions since it was first announced in September 2009 that it often looks like it was changed on the hoof to satisfy the shifting demands of conference seasons, manifesto writing and the media cycle.

Mansion Tax has two core problems. Firstly, it taxes the wrong people. The word “mansion” conjures images of Brideshead, Downton Abbey and Toad Hall, and taxing the owners of such palatial dwellings seems like a strike against centuries of class privilege and decades of rising inequality. But in reality, what politicians dub mansions many ordinary people see as their homes. Some of those people have lived in that (their only) home for decades; others have bought it so recently that they are already bowed down under huge mortgages.

Who is hit by Mansion Tax and who is not seems frankly perverse. Mansion Tax falls on those who own a single property even slightly above the margin, but not those who own several properties just below. It does not reflect the owner’s ability to pay – and existing proposals to allow those on less than £42,500/year defer payment will disrupt the flow of revenue to the Treasury. The tax treats the highly indebted the same as those who own outright and allows those who choose to invest in fine art, fine wine or foreign property to pay nothing. Instead, it falls almost exclusively on homeowners in the south east of England. Far from taxing those with the “broadest shoulders”, it is a tax on London and it runs the risk of being the new “granny tax”.

Secondly, the tax is badly designed. Estimates of the number of houses affected vary widely. Neither party has considered who would be
charged – owners or residents – whether this might be passed on or what happens if ownership is divided (say, by separating leasehold and freehold, or grounds from house). Existing proposals for increasing rates give huge latitude for fiscal drag; proposals for deferral make the stream of revenue unpredictable and unreliable. Labour has not even properly set out the thresholds and sums to be paid, and their proposals for self-assessment would be difficult due to the thinly traded nature of high value property.

Even its advocates do not expect much from the policy. They claim that it will raise between £1 billion and £1.2 billion. If true this is less than 0.2% of tax receipts and barely 0.15% of government spending. Yet even these targets may not be best if it has knock-on effects on other taxes. The tax could potentially be very expensive to collect, and could hit taxpayers with high implementation costs. There are already signs that it is affecting the UK’s fractured housing market.

It is for this reason that there are few parallels with the Mansion Tax abroad. Anything approaching Mansion Tax has failed to raise revenue, witnessed constant meddling, and has created substantial grievances. Only in Denmark, among our case studies, has property taxation been a success, and that is because it is a broad-based, fairly flat local government tax and is coupled with a Land Value Tax. That makes sense, because property taxes should be simple, transparent, fair, efficient and local.

To this end we offer an alternative – though we recognise (unlike Mansion Tax advocates) that this should be the start of a conversation on how best to tax property and wealth, not the end of one. We recommend that all parties drop their proposed Mansion Tax plans.

We propose instead that the government reform Council Tax to make it a flat rate tax on the value of domestic properties.

- Local authorities should be free to set their own rate.
- All revenue on property values below £2 million would be retained locally.
- All revenue on property values above £2 million should be pooled by all local authorities and redistributed among them.
- Central government funding to local authorities should be reduced in line with the additional revenue raised locally.
To deal with “income rich, asset poor” taxpayers, we recommend that residents be permitted to defer payment of their tax until their property changes hands through sale or transfer. This should be guaranteed by local authorities placing a “charge on the land” to cover both the deferred tax and any interest. Local authorities should be free to borrow against this asset to smooth revenue.

Finally, no serious debate about property tax can ignore the issue of unearned economic rents on land (as opposed to improvements). We recommend that the government establish a Royal Commission with the task of considering the appropriate balance of taxes on property, and the merits of moving partly or wholly to the taxation of economic rent on land.

Mansion Tax is bad policy disguised as good politics. We call instead for fiscal reform that is based on firm economic foundations. Our hope is that this can also be good politics. After all, a policy that is both effective and fair should appeal to all.
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