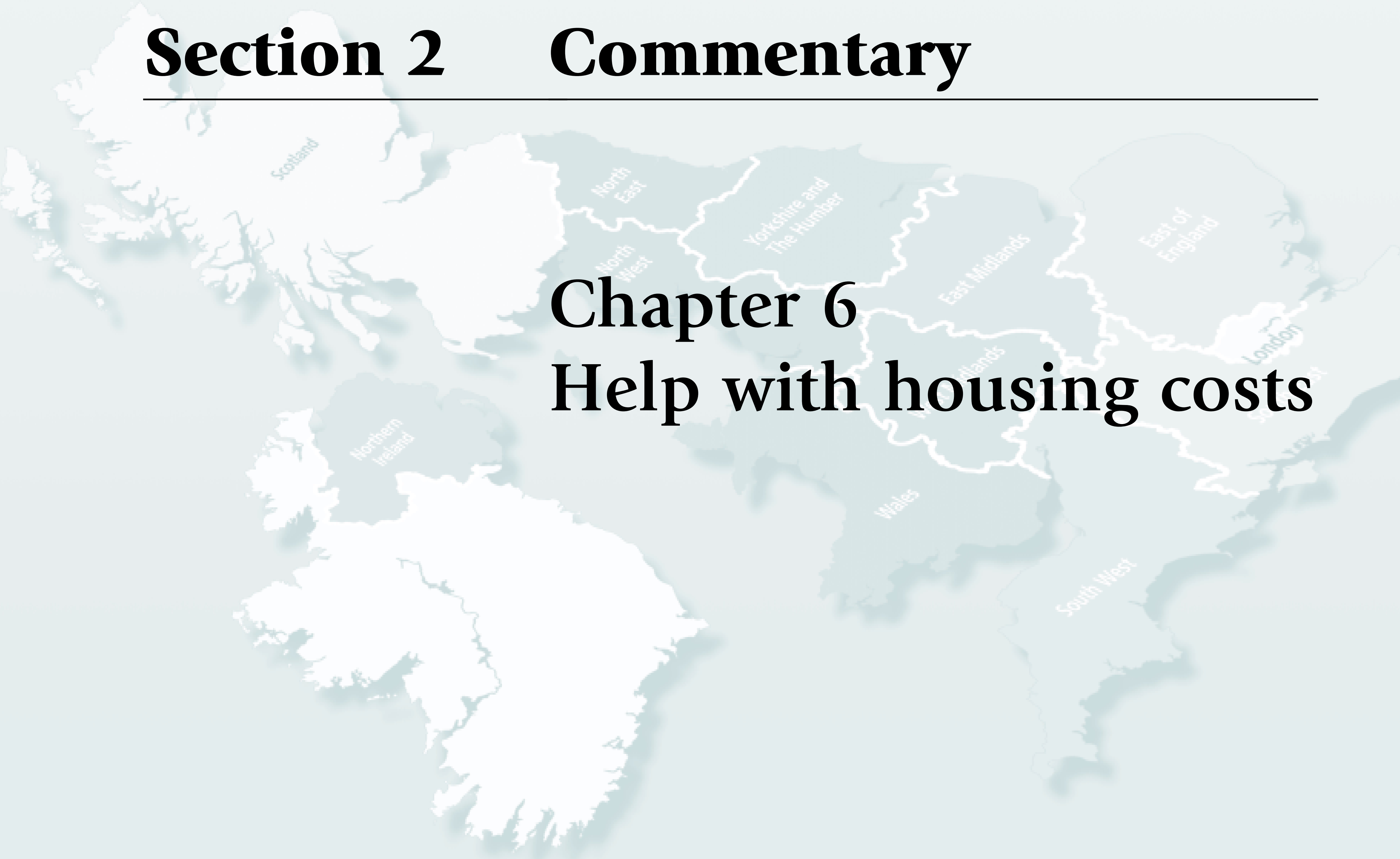
Section 2 Commentary

Chapter 6
Help with housing costs



Home-owner taxes and reliefs

The continuing sharp rises in house prices, together with the pressures on government budgets, has now led to increased discussion and speculation on ideas for reforming the tax regime for home-owners. Chris Holmes, for example, in an IPPR report published earlier this year called for a review of the current home-owner's exemption from capital gains tax (Holmes, 2003). From a different perspective there have been calls for the reform of the current structure of stamp duty (Andrews *et al*, 2003).

Table 2.6.1. summarises the key taxes, and tax reliefs that apply to home-owner housing in the UK, following the abolition of mortgage interest tax relief in April 2000. The table is not quite complete. It does not include figures for the estimated value of the 'Schedule A' tax on the use value of home-owner housing, that was abolished in the 1960s. While economically sound, the reintroduction of such a tax would logically require the reintroduction of an offsetting mortgage interest tax relief, and there is little appetite for this so soon after having eventually achieved its abolition. Nor does the table include council tax, because although this is crudely related to property values, it is paid by residents in all tenures, and not exclusively by home-owners.

Table 2.6.1 **Home-owner taxes and tax reliefs**

£ million

	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02
Capital gains tax relief	- 2,000	- 1,000	- 850	- 850	- 500	- 600	- 800	- 1,400	- 3,000	- 3,300	- 6,000
Inheritance tax	214	190	202	212	215	221	240	249	306	343	375
Stamp duty	630	280	465	520	465	675	830	1,065	1,825	2,145	2,705
Net tax position	- 1,156	- 530	- 183	- 118	180	296	270	- 86	- 869	- 812	- 2,920

Source: Inland Revenue Statistics (various years).

Capital gains tax

The table shows that as house prices have risen the estimated notional value of that relief rose to £6.0 billion in 2001/02. The estimate for 2002/03 is an even larger £11.0 billion. However, these estimates make no provision for 'roll over relief', where the proceeds of a house sale are wholly applied towards the purchase of another dwelling. Such 'rollover' relief is typically applied in countries, like Sweden, that do apply capital gains tax to home-owners. Moreover the Inland Revenue also acknowledges that the abolition of the relief would itself impact on the market, and in practice this would further reduce the yield from that abolition.

The potential yield from the introduction of a fully configured capital gains tax would thus be significantly lower than suggested by the headline Inland Revenue figures. That is not to say that the option should not be considered. There is a clear economic logic, especially when those capital gains can be described as 'windfall gains' arising from a sustained period of falling interest rates and economic growth.

However, it should also be noted that the estimated income from home-owner capital gains are highly cyclical, and the potential yield in the years ahead is likely to fall significantly, as we are now unlikely to see any further substantial falls in interest rates, whether or not the UK eventually joins the Euro. The case for capital gains tax on home-owner dwellings also needs to take account of the other taxes that impinge on home-owners' capital wealth.

Inheritance tax

Home-owners' residences are included in the assets that are subject to inheritance tax, although there is a relief covering the transfer of residences to surviving spouses. In the most recent year for which data is available (2000/01) the value of residential dwellings (£15.8 billion) represented 39 per cent of the total assets in the estates reported that year. Total receipts from inheritance (and capital transfer) tax in 2000/01 were estimated at £2.2 billion, and on the basis of the value of residential dwellings as a proportion of total assets the level of inheritance tax attributable to the value of housing wealth can be crudely assessed at some £340 million.

Table 2.6.1 shows the 'housing' yield from inheritance tax on the run of years from 1991/92 to 2001/02. The 2001/02 figure is based on the author's projection of the proportion of housing wealth relative to total assets, following the rising trend typical in periods of rapidly rising house prices.

Inheritance tax also clearly bears more strongly on higher income home-owners, and in particular those in the south of England, given the relatively high threshold for estate values before they become liable (£255,000 for 2003/04). For higher income home-owners inheritance tax thus serves to capture an element of the wealth held in residential dwellings that might otherwise be captured by capital gains tax.

The threshold value for estates subject to inheritance tax has typically in recent years been uprated in line with inflation. Over time it follows that if house prices continue to rise above the rate of inflation then the 'housing yield' from inheritance tax will continue to rise. That said, it must be acknowledged that it is relatively easy to set up trusts and other arrangements to avoid or diminish liability for inheritance tax, and the lawyers and financial advisers engaged in that business often refer to inheritance tax as a 'voluntary' tax.

Stamp duty

Home-owners also make a substantial contribution to the Exchequer by way of stamp duty. Stamp duty is a transaction tax, levied every time a dwelling is bought or sold, and does not have any underlying economic rationale. It is simply a well established and easily collected form of taxation. The recent rises in house prices, plus the successive hikes in the rates at which higher value dwellings are subject to the duty, have begun to see a sharp rise in the annual level of stamp duty collected by the Exchequer.

Table 2.6.1 shows how the yield had risen to £2.7 billion by 2001/02. Regional figures for the yield from stamp duty, over a longer run of years, can be found in Compendium Table 108. The recent rises in the yield from stamp duty reflect not just rising house prices, but the introduction of higher rates of duty for higher value properties, and the non-indexation of the lowest threshold value of £60,000 which has remained unchanged since 1993.

Table 2.6.2 shows the way in which the stamp duty rates applied to higher value properties were increased four times between 1997 and 2000, with the rates of 3 per cent now applying to properties valued at over £250,000, and 4 per cent for properties valued at over £500,000.

Rising house prices will continue to have a disproportionate impact on the yield from stamp duty. As dwellings increase in value a higher proportion of them become liable to the higher rate of duty, which is then payable on the whole value of the dwelling, not just the element of value above the higher level threshold. Similarly, at the other end of the housing market, more dwellings will become liable to pay the duty at the basic 1 per cent rate, as their values increasingly exceed £60,000.

Table 2.6.2 **Stamp duty rates and thresholds**

Rate applied as a percentage of property value

Price band	1997	1998	1999	2000
Under £60,000	**0.0%**	**0.0%**	**0.0%**	**0.0%**
£60,000 to £250,000	**1.0%**	**1.0%**	**1.0%**	**1.0%**
£250,000 to £500,000	**1.5%**	**2.0%**	**2.5%**	**3.0%**
Over £500,000	**2.0%**	**3.0%**	**3.5%**	**4.0%**

Source: Andrews *et al*, 2003.

There is a strong case for reforming stamp duty. The 'slab' structure of the duty rates, which are applied to the full value of the property, rather than to the marginal element of value above each threshold, leads to artificial bunching of prices just below each threshold level. It also encourages avoidance measures such as inflated payments for 'fixtures and fittings', so that the declared purchase price remains just below threshold levels.

It can also be argued to be a tax on mobility, as it is only paid by home-owners when they move. If you move twice in ten years you pay more than the household, in equivalent value property, that moves only once in that period. If, however, stamp duty was levied on the basis of capital gains, rather than total values, the tax raised would be the same for both households, regardless of how frequently they moved.

Reform options

There is a strong case in principle for the Chancellor to reform the taxes on home-owner wealth, but none are without problems. The case for capital gains tax is particularly strong, but the yield will be far less than suggested from the Inland Revenue headline figures due to the impact of 'roll over' relief. The yield is also likely to fall in the coming years as house price rises ease back.

Logically the introduction of capital gains tax should also see the abolition of stamp duty, or its return to a very mild form of transaction tax. Alternatively the Chancellor has the option of sitting on his hands and letting the non-indexation of stamp duty thresholds (and the inflation only indexation of the inheritance tax threshold) increase his yield from the existing taxes.

Introducing changes to these taxes will not be easy. There have already been a rash of middle income tabloid front page shock horror stories this year, as a taste of the frenzy the Chancellor would face were he to actually suggest the introduction of capital gains tax for home-owners. In this context he may find it easier to make progress by looking at ways to limit the extent of inheritance tax evasion, and reforming stamp duty so that it is based on capital gains rather than total values.

The new tax credits

This year has seen both the introduction of the new child and working tax credits, replacing the working families tax credit scheme, and the new pensioner credit. Both of these reforms are central to the government's policies and targets for reducing poverty. However, the introduction of the child and working tax credit schemes was poorly managed by the Inland Revenue with consequential long delays and backlogs.

Even with those teething problems overcome there are a number of problems with the new tax credit regime. It is based on annual gross earnings and, for households in receipt of both tax credits and housing benefit, this fits poorly with the weekly assessment of net incomes. On the plus side, the more generous tax credit regime has reduced the numbers of working tenant households that need to claim both tax credits and housing benefit, especially in high value areas.

A further difficulty for the child and working tax credits is that their predecessors have all suffered from relatively low take-up rates, especially among low-income home-owner households, as seen in Table 2.6.3. There are a number of reasons for the persistent low home-owner take-up rate for tax credits, and these have not been addressed by the Inland Revenue publicity for the new scheme, which made no reference to tenure. However, this is an area where the Inland Revenue has now agreed to work with the lending industry to try to get across the message to low-income working home-owners.

In the longer run, reforms to introduce a tenure neutral housing tax credit could serve both to tackle the problems of the poor interface between tax credits and housing benefit, and the poor level of home-owner take-up (Wilcox, 2003). While such reforms are not likely in the immediate future they do fit with proposed reforms of housing benefit policy, and in particular the introduction of local flat rate allowances, rather than benefit levels based directly on actual rents (albeit subject to complex limits).

Table 2.6.3 **Estimated take-up rates for tax credits by tenure**

Percentages of eligible households

Price band	1991	1998/99	1999	2000
Home owner	**47%**	**55%**	**60%**	**51%**
Private tenant	**69%**	**78%**	**87%**	**79%**
Social tenant	**77%**	**76%**	**80%**	**75%**
All tenures	**61%**	**68%**	**72%**	**62%**

Source: Wilcox, 2003.

Housing subsidy and housing benefit subsidy

This coming April will see the end of the direct link between housing subsidy and housing benefit subsidy for council housing in England and Wales. This has always been unpopular with tenants, although it can be argued that it merely served as a politically maladroit form of national rent pooling.

Indeed, while the housing benefit link will disappear in April 2004, in both England and Wales they will be replaced by new mechanisms to garner 'notional surpluses' from councils whose Housing Revenue Accounts are strongly placed. This will take different forms in England and Wales, and there is a particularly anomalous position for Wales. So the April 2004 change, while important, is more a change of form than a change of substance. The incentives for councils to consider stock transfer as a means of escaping the redistributive net of the housing subsidy system will remain in place.

References

A. Andrews, A. Evans, P, Koundouri and G. Meen, 'Residential stamp duty: time for a change', *Housing Finance*, Summer 2003, Council of Mortgage Lenders.

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S. Wilcox, *Giving credit where its due: Home-owners and tax credits*, Council of Mortgage Lenders, 2003.

Key Reading

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