Chapter 6

Help with housing costs

The main focus in this chapter is the *Review's* unique regular analysis of the continuing net tax advantages for existing homeowners, which place them at an advantage relative to both investors in private renting, and also would-be first-time buyers. The chapter also looks ahead to the demise of the regime of annual bricks and mortar subsidies for council housing, and how this, and the proposals in the new English housing strategy,[1] will impact on the balance between structural and personal subsidies to provide support for low-income tenant households.

For a discussion of the reforms to the housing benefit regime that are now in the process of being introduced, and the housing dimension of the wider welfare benefit reforms associated with the proposed introduction of the universal credit regime from 2013, readers are referred to the Contemporary Issues chapters in the 2010/2011 edition of the *Review*. This year the specifics of reforming the welfare safety net for homeowner households are discussed in Contemporary Issues Chapter 2.

The net tax position of homeowners

Despite the abolition of mortgage interest tax relief (MITR) for homeowners in 2000 the tax regime still provides substantial net advantages for existing homeowners. The abolition of MITR significantly reduced the long-standing fiscal bias in favour of existing homeowners, but did not remove it. The current extent of the net favourable tax position for homeowners is set out in Table 2.6.1; showing a net support for homeowners of some £12 billion in 2010/11.

The table shows the annual yield from the two taxes that bear on homeowners – stamp duty and inheritance tax. Both these taxes go rather wider than just homeowners. The stamp duty figures relate to all residential property transactions, while the estimates of the yield from inheritance tax (IHT) are based on the proportion of wealth in residential property held by all individuals subject to IHT, including non-corporate private landlords.

Table 2.6.1 **Private owner taxes and tax reliefs**

£ million

	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
Taxes																
Inheritance tax	**429**	**440**	**480**	**496**	**611**	**684**	**769**	**870**	**999**	**1,166**	**1,300**	**1,409**	**1,486**	**1,053**	**885**	**1,009**
Stamp duty	**465**	**675**	**830**	**1,065**	**1,825**	**2,145**	**2,690**	**3,525**	**3,710**	**4,620**	**4,585**	**6,375**	**6,680**	**2,950**	**3,290**	**4,040**
Gross Tax	**894**	**1,115**	**1,310**	**1,561**	**2,436**	**2,829**	**3,459**	**4,395**	**4,709**	**5,786**	**5,885**	**7,784**	**8,166**	**4,003**	**4,175**	**5,049**
Tax Reliefs																
Imputed rental return tax relief (net)	**- 7,500**	**- 8,300**	**- 7,500**	**- 9,800**	**- 12,800**	**- 14,000**	**- 14,600**	**- 16,800**	**- 17,200**	**- 15,600**	**- 14,700**	**- 13,900**	**- 11,500**	**- 8,100**	**- 8,700**	**- 11,400**
Capital gains tax relief (gross)	**- 500**	**- 600**	**- 800**	**- 1,400**	**- 3,000**	**- 3,300**	**- 6,000**	**- 10,000**	**- 10,500**	**- 13,000**	**- 12,500**	**- 15,800**	**- 14,500**	**- 4,900**	**- 3,700**	**- 8,800**
Capital gains tax relief (net)	**- 330**	**- 396**	**- 528**	**- 601**	**- 1,287**	**- 1,416**	**- 2,574**	**- 4,290**	**- 4,505**	**- 5,577**	**- 5,363**	**- 6,778**	**- 6,221**	**- 3,234**	**- 2,442**	**- 5,808**
Total Net Tax Reliefs	**- 7,830**	**- 8,696**	**- 8,028**	**- 10,401**	**- 14,087**	**- 15,416**	**- 17,174**	**- 21,090**	**- 21,705**	**- 21,177**	**- 20,063**	**- 20,678**	**- 17,721**	**- 11,334**	**- 11,142**	**- 17,208**
Net tax position	**- 6,936**	**- 7,581**	**- 6,718**	**- 8,840**	**- 11,651**	**- 12,587**	**- 13,715**	**- 16,695**	**- 16,996**	**- 15,391**	**- 14,178**	**- 12,894**	**- 9,555**	**- 7,331**	**- 6,967**	**- 12,159**

Source: Inland Revenue Statistics (various years).

Notes: Estimates of capital gains tax relief are based on two-thirds of HMRC estimates to provide for roll-over relief. A further 35% deduction has been applied for the years from 1998/99 to 2007/08 to allow for the CGT taper relief that applied in those years. It should also be noted that the stamp duty and inheritance tax yields are for all residential dwellings, and not just those occupied by homeowners. The imputed rental return tax relief is based on the asset values and mortgage debt figures from Table 45, average mortgage interest rates, net residential yield frigures from the IPD Index and standard rates of income tax.

The figures thus tend to overstate the yield that relates exclusively to homeowners. Council tax is not included as this is a tax that applies to households in all tenures, and is thus tenure neutral. The table also shows estimates of the two primary continuing forms of tax relief enjoyed by homeowners – capital gains tax (CGT) relief and tax relief on the imputed rental value of the home which the owner occupies. This imputed value was taxed until 1963 (albeit at a very low value), and was the logical counterpart to mortgage interest relief as an offset. This was a parallel to the arrangements for private landlords as the rental value of owners' homes is an income 'in kind' equivalent to the cash income a landlord receives from tenants.

It would have been logical for mortgage interest tax relief for homeowners to be abolished at the same time as Schedule A tax, but in fact it was another 37 years before that occurred. Even then, the fiscal advantages of homeownership were only reduced – not removed – since the absence of Schedule A tax (based on realistic values) has a very substantial net value even after full allowance is made for mortgage interest against the gross imputed rental values.

The estimates of the net value of Schedule A tax relief show it rising to over £17 billion in 2003/04, before falling back to below £9 billion in 2008/09 and 2009/10. Its value rose again to over £11 billion in 2010/11, as lower interest rates reduced the value of the estimated provisions of MITR against the gross level of tax calculated on the imputed rental values of homeowner dwellings in that year.

Table 2.6.1 also includes figures for the value of capital gains tax relief. The gross figures are those provided by HM Revenue and Customs. However, those figures assume that the tax is levied at the full rate, without any provisions for 'taper relief' that applied between 1998/99 and 2007/08, or the 'roll-over relief' which defers the application of CGT when the proceeds from the sale of a home are fully re-invested in another home, which is typically a feature of the tax in those countries, such as Sweden, where capital gains tax is applied to homeowners.

The estimated net values for CGT relief for homeowners shown in Table 2.6.1 take into account the 'taper relief' provisions of the UK's CGT regime, and also make provision for roll-over relief based on the Swedish experience showing that this reduced the gross yield by about one third.

The estimated *net* value of CGT for homeowner households fell from over £6 billion in the immediate pre-credit crunch years to just £2.4 billion in 2009/10. The rise to £5.8 billion in 2010/11 reflects not just the degree of recovery in house prices, but also the increase in the standard rate for CGT from 18 per cent to 28 per cent in that year.

While the methodology for these estimates could be refined, it is robust enough to give a ball park indication of the very substantial scale of the rental value and CGT reliefs. However, it should be noted that if either tax was ever levied it would reduce house prices; and this would in turn reduce the net income from the taxes.

Against that, Table 2.6.1 tends to underestimate the net advantages to homeowners as the tax yields shown relate to all privately owned residential property, while the estimates of tax reliefs relate solely to owner-occupied dwellings.

Disadvantages for would-be first-time buyers

There are no immediate prospects of any UK government fundamentally reducing the very substantial net tax advantages that these reliefs provide for existing homeowners. This is partly politics, and partly their low visibility – particularly in respect of the tax relief on the 'in kind' benefit of rental values which is an unfamiliar idea outside economic and taxation theory and history.

It should also be noted that these substantial net tax advantages accrue to existing homeowner households, and as already indicated this in turn is reflected in the prevailing levels of house prices. This higher entry cost to homeownership compounds the affordability barrier restricting access by low- to moderate-income households aspiring to become first-time buyers.

Also important is that those benefiting from the absence of any tax on the imputed rental value of owner-occupied dwellings are primarily those established owners having either no mortgage, or only a very small mortgage in relation to the value of their home. Recent first-time buyers with more substantial mortgages would be liable to little or no net tax, as their gross liability would be substantially or entirely offset by the MITR that is a logical part of such a tax.

This fiscal bias favouring existing homeowners should also be seen in the context of the regulatory and mortgage market advantages favouring investors in private rented housing outlined in Commentary Chapter 3.

While the tax provisions for private renting are generally logical and consistent with the overall UK tax regime, private landlords nonetheless have a competitive advantage relative to first-time buyers in that they have regular access to interest-only mortgages which have repayments some 40 per cent lower than for a conventional 25-year repayment mortgage (see Table 2.3.3).

Moreover, the generation of households that have been homeowners over the last thirty years has benefited from very substantial untaxed capital gains, and in many cases this has provided them with the funding to cover a deposit to purchase an additional property for the private rented market. And as seen in Contemporary Issues Chapter 1, landlords owning just one or two properties predominate in the sector.

Taken together, the compound fiscal, regulatory and mortgage-market bias is most favourable to established homeowners without a mortgage, and least favourable to would-be first-time buyers. Most disadvantaged of all are those would-be first-time buyers unable to call on any form of parental assistance with a deposit. Private landlords sit in the middle without the tax advantages provided to existing homeowners, but with a favourable regulatory and mortgage-market regime compared to that available to first-time buyers.

There is little sentiment for a return to policies that aim above all to maximise the extent of homeownership. The benefits of the flexibility offered by an active private rented sector are also widely supported. However, that is little comfort to the aspirant first-time buyers now disadvantaged in the housing market, both in relation to private investors and even more so to established homeowners.

End game for social sector subsidies

The planned reforms to the current financial regime for council housing in England will bring to an end a century of government subsidies to the sector; albeit that in the last few years more councils have been generating a surplus, and only a minority have been receiving a positive subsidy. But from 2012 onwards the council housing subsidy row in Compendium Table 109 will move to zero, and it is quite likely that Wales will follow suit shortly thereafter.

The subsidies, in the form of capital grants, to housing associations for new build housing are also being reduced in England with the move towards ‘affordable rents’ that are typically some 80 per cent of market levels, although somewhat lower in London (see Commentary Chapter 4).

The contrasting approaches to council housing finances, and social sector rents, in England, Scotland and Wales are discussed in more detail in Contemporary Issues Chapter 3.

If these policies mark a further shift away from bricks and mortar to personal means-tested benefits for low-income households, that shift has been exaggerated in the past and will still be far from complete even when the council housing finance subsidy regimes are terminated.

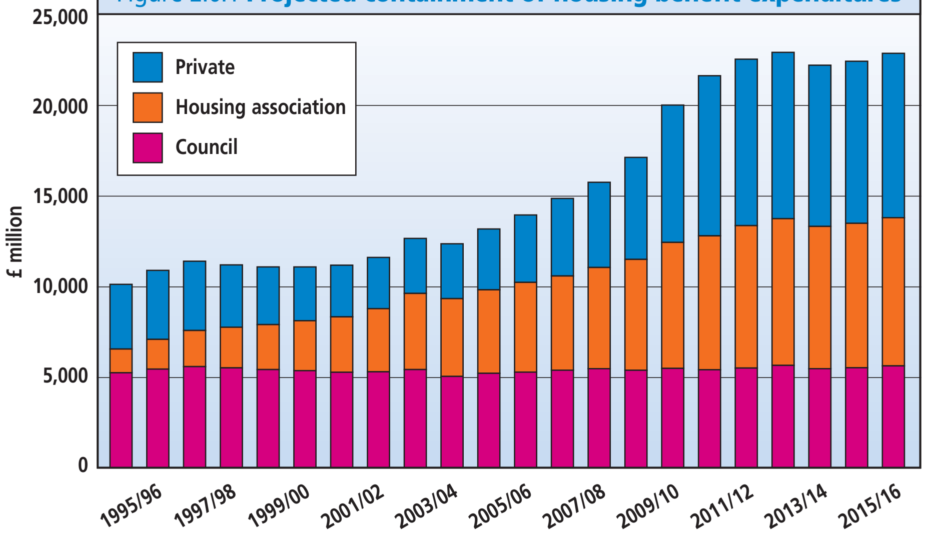
The 2005/06 edition of the *Review*[2] set out the continuing economic subsidies implicit in the provision of social housing with rents well below market values. If these economic subsidies do not enter explicitly into public sector accounts, they nonetheless represent a substantial opportunity cost in terms of rental income foregone, albeit offset to a large degree by the lower levels of housing benefit costs linked to those lower rents.

This chapter in the 2009/10 edition of the *Review* showed that in 2007/08 the value of those economic subsidies for social rented housing in England was close to £7 billion, with social sector rents averaging some 60 per cent of market values.

The future extent of those economic subsidies is set to decline as 'affordable rents' based on 80 per cent of market value become a larger part of the mix in the social rented sector relative to social sector rents of, on average, around 60 per cent of market value. This will, however, only be a gradual trend if the switch to 'affordable rents' remains targeted on supporting the development of new housing, without any moves to generally increase rents for existing social sector dwellings (beyond their current link to RPI).

There are inherent tensions here between any philosophical desire to reduce economic subsidies, and the continuing concerns about limiting the costs of housing benefit. Current DWP projections anticipate costs being contained in all tenures in the years to 2015/16 (see Figure 2.6.1). Those concerns suggest an underlying government assumption that a narrowly targeted approach to social sector rent increases will continue, where the higher housing benefit costs can be clearly shown to be more than offset by achieved savings in DCLG budgets.

Figure 2.6.1 **Projected containment of housing benefit expenditures**



Source: DWP Expenditure Tables.

But if that proves to be the case then this will see the continuing growth of an 'affordable rent' sector alongside a declining 'social rent' sector, with no equitable or logically justifiable rationale for providing one set of tenants with more substantial economic subsidies as compared to other tenants with similar incomes. It remains to be seen whether in time this will lead to renewed calls for a more consistent approach to rent-setting policy for all social sector landlords. Does this sound familiar?

References

1 HM Government (2011) *Laying the Foundations: A housing strategy for England*. (www.communities.gov.uk/publications/housing/housingstrategy2011).

2 Wilcox, S. (2006) 'More apparent than real? The decline of bricks and mortar subsidies', in S. Wilcox (Ed.) *UK Housing Review 2005/06*. Coventry: Chartered Institute of Housing.

Key Reading

Department for Work and Pensions (2011) Annual Report and Accounts 2010/11 (www.official-documents.gov.uk/document/hc1012/hc10/1010/1010.asp).

Department of Work and Pensions Statistics (http://research.dwp.gov.uk/asd/).

Housing benefit and council tax benefit: summary statistics, quarterly series

Department for Work and Pensions (http://research.dwp.gov.uk/asd/index.php?page=hbctb).

HMRC statistics (www.hmrc.gov.uk/thelibrary/national-statistics.htm).