Chapter 6

Help with housing costs

It is a good time to be a property owner, it seems. Private owners continue to experience growing net tax benefits from their housing. In 2015/16 these rose by almost 40 per cent on the previous year to almost £22 billion (see Table 2.6.1). The largest contributor to this rise is the benefits from the non-taxation of imputed rental income. Owners benefit from the relative cost of consuming an owner-occupied house compared to an identical market rental property. Of the taxes that owners do pay, by far the largest is the stamp duty paid by purchasers of property. The buoyancy of this tax has recovered and, at £7.5 billion, now stands above pre-slump levels. However, it is also a tax which has undergone significant reforms, and it these that are the focus of this chapter.

This chapter of the *Review* typically deals with both taxation of housing expenditure and subsidy towards housing costs, given the considerable overlap between these issues. In this edition, however, personal housing subsidy is dealt with in Contemporary Issues Chapter 4, leaving this chapter to concentrate on taxation.

Taxes on property transactions

In December 2014, the UK government announced a major reform of stamp duty land tax (SDLT) throughout the UK. The Scottish Government introduced its own system (land and buildings transfer tax – LBTT) in April 2015, and the Welsh Government is also in the process of legislating to introduce its own system (land transaction tax) in 2018. The Northern Ireland Executive has included a review of its powers over SDLT in the delivery plan for its Programme for Government. The reformed UK and Scottish systems have now been in place for a full financial year, and here we review their operation.

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

£ million

	1995/96	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Taxes																	
Inheritance tax	429	684	769	870	999	1,166	1,300	1,409	1,490	1,057	918	1,072	983	1,089	1,244	1,392	1,701
Stamp duty	465	2,145	2,690	3,525	3,710	4,620	4,585	6,375	6,680	2,950	3,290	4,040	4,220	4,905	6,450	7,500	7,530
Gross tax	894	2,829	3,459	4,395	4,709	5,786	5,885	7,784	8,170	4,007	4,208	5,112	5,203	5,994	7,694	8,892	9,231
Tax Reliefs																	
Imputed rental return tax relief (net)	- 7,700	- 14,100	- 14,800	- 16,900	- 17,300	- 14,500	- 14,900	- 14,200	- 11,900	- 8,600	- 9,100	- 11,700	- 13,100	- 12,100	- 13,800	- 13,900	- 19,300
Capital gains tax relief (gross)	- 500	- 3,300	- 6,000	- 10,000	- 10,500	- 13,000	- 12,500	- 15,800	- 14,500	- 4,900	- 3,700	- 8,800	- 10,400	- 10,500	- 13,000	- 16,300	- 18,000
Capital gains tax relief (net)	- 330	- 1,416	- 2,574	- 4,290	- 4,505	- 5,577	- 5,363	- 6,778	- 6,221	- 3,234	- 2,442	- 5,808	- 6,864	- 6,930	- 8,580	- 10,758	- 11,880
Total net tax reliefs	- 8,030	- 15,516	- 17,374	- 21,190	- 21,805	- 20,077	- 20,263	- 20,978	- 18,121	- 11,834	- 11,542	- 17,508	- 19,964	- 19,030	- 22,380	- 24,658	- 31,180
Net tax position	- 7,136	- 12,687	- 13,915	- 16,795	- 17,096	- 14,291	- 14,378	- 13,194	- 9,951	- 7,827	- 7,334	- 12,396	- 14,761	- 13,036	- 14,686	- 15,766	- 21,949

Sources: Inland Revenue Statistics (various years), HM Revenue and Customs 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 figures from the IPD Index and standard rates of income tax. The stamp duty figures include the new Scottish transaction taxes.

SDLT and LBTT are taxes levied on the purchasers of property, and their antecedents date back to the 17th century when they were introduced seemingly because it was easy to do so. Most economists argue that transaction taxes are inefficient because they create a wedge between buyers and sellers, suppress market activity and lead to a sub-optimal allocation of properties.[1] However, governments are reluctant to abolish SDLT because it and its predecessor, stamp duty, became an increasingly lucrative source of revenue. UK receipts rose from £675 million in 1996/97 to a peak of £6.7 billion in 2007/08 on the eve of the global financial crisis (see Compendium Table 107). However, transaction taxes are also very unstable, reflecting volatility of prices and transactions in the housing market.

The impact of a transaction tax is difficult to assess because it is difficult to distinguish between its formal (who legally is liable) and actual (who pays for it in reality) incidence. In principle the price of housing is determined by the anticipated value of the services that flow from it (imputed rental income) if one is an owner-occupier or, if one is a landlord, from the rental income. Property taxes (whether transaction or recurrent) affect the owner's rate of return, which results in the price of housing changing. Although the purchaser formally pays the tax, over time we would expect it to be borne by sellers, i.e. reflected in the price. When domestic rates were abolished in favour of the community charge, there was an upward pressure on house prices (though this was outweighed by the recession). Similarly, when mortgage interest attracted tax relief, it undoubtedly inflated house prices. Moreover, when changes occur the market may take some time to adjust, so the 'capitalisation' effect may take some time to impact fully on prices.

Long-term experience of transaction taxes

Stamp duty was for many decades a very straightforward tax. It was levied at one per cent on property transactions over a certain threshold, which because it was rarely uprated, led to large-scale fiscal drag as rising house prices brought more properties over the threshold. In the 1980s, the generally low level of property transaction costs (including legal and surveying charges) were often cited as a reason for internationally high levels of homeownership in the UK. It was claimed that they facilitated entry into the homeownership market at a young age, and did not deter frequent moves necessitated as children were born and larger properties were needed.

The first attempt to use stamp duty to micro-manage the housing market occurred during the housing market recession in the 1990s. Stamp duty was effectively suspended for a fixed period in an attempt to entice buyers back into the market. The most notable effect of this concession was that there was an upswing in transactions only when the end of the 'holiday' was imminent.[2]

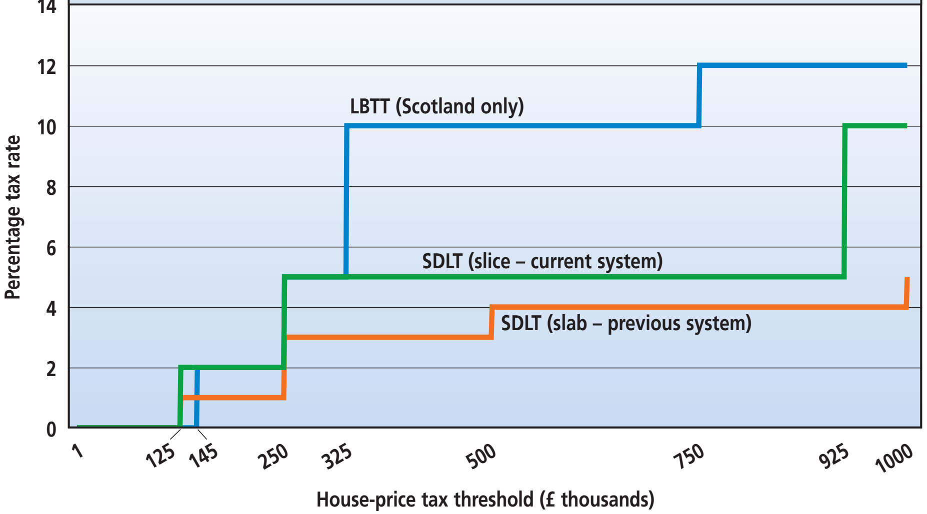
After 1997, the tax became more elaborate as the number of bands (and rates) grew, and were altered frequently. In addition, a variety of concessions were introduced for first-time buyers, purchasers in depressed areas and even 'to help kick-start the market in zero-carbon homes, encourage micro-generation technologies, and raise public awareness of the benefits of living in zero-carbon homes.'[3] These concessions eventually began to collide with one another (for example, a concessionary threshold for first-time buyers was greater than the general concession in depressed areas).

However, perhaps the most notable side-effect of the system was the clustering of transactions below the thresholds – an effect attributed to the 'slab' structure of the tax, whereby the rate of tax applies to the entire value of the transaction, rather than just to the element above the threshold. This effect was most pronounced just below the entry-level and the £250,000 thresholds.[4]

Structure of the tax

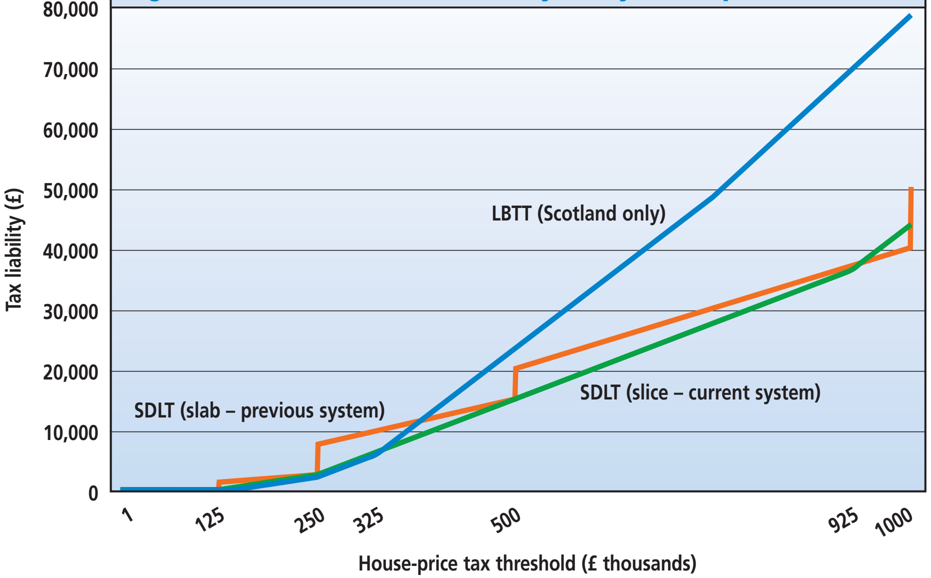
Figure 2.6.1 shows the thresholds on residential transaction taxes for properties worth up to £1 million. Under the old SDLT regime (which applied across the UK) the entry level threshold was set at £125,001 at which point a one per cent tax was levied on the entire value of the property. A three per cent rate applied from 250,001, four per cent at £500,001 and five per cent at over £1m and (not shown in the graph) seven per cent above £2 million. The reformed system, introduced across the UK in December 2014, moved to a 'slice' structure whereby the higher rates of tax were paid only on the portion of the value in excess of the threshold. The entry-level threshold was unchanged, and the rate is two per cent up to £250,000, at which point a five per cent rate applies. Properties in excess of £925,000 attract a ten per cent marginal rate, and those over £1.5 million 12 per cent.

Figure 2.6.1 **Thresholds and rates for SDLT and LBTT**



Source: Compendium Table 107.

Figure 2.6.2 **Transaction tax liability (£) by house price**



Source: Compendium Table 107.

This structure applied in Scotland for the four-month period before the introduction of its own system (LBTT) – so Scotland had three systems within six months. From April 2015, the entry point was set at £145,001, at the same two per cent rate, but some £20,000 higher than in the rest of the UK. As in the rest of the UK, the five per cent band begins at £250,001, but it then becomes more steeply progressive. The ten per cent band starts at £325,001, which is £600,000 lower than SDLT. The 12 per cent band begins at £750,001 – half the value that applies in the rest of the UK. (The Scottish Government initially announced that the system would move from two per cent to ten per cent at £250,001, and to 12 per cent on properties sold for more than £1 million, but changed this after the UK system was reformed in 2014.)

Figure 2.6.2 shows how the tax operates in the three systems. The reforms to SDLT remove the stepped rises in the old 'slab' system, but tax properties less heavily between thresholds. However, the Scottish system is clearly designed to shift liability onto more expensive properties. The entry point is higher and liability rises much more steeply on properties over £325,000. At a property price of £150,000 the purchaser would have paid £1,500 under the old 'slab' system, £500 under the current SDLT and £100 under LBTT. Purchasers in Scotland pay less than under the current SDLT up to £333,000 where the liability is £6,650 under both systems (and £3,340 less than under the old 'slab' system). LBTT becomes more onerous than the old 'slab' system at about £380,000. At £500,000 both the old 'slab' and new SDLT attract a tax of £15,000, but this is £23,350 in Scotland. At £1,000,100 the 'slab' system liability would have been £50,050, while the new SDLT is £43,850 and LBTT is £78,470.

Table 2.6.2 demonstrates that SDLT/LBTT thresholds vary greatly in relation to average house prices in the four nations of the UK (of course they vary within them, too.) This provides a better basis for comparing how the systems operate. The entry level of SDLT/LBTT occurs roughly at the average house price in Wales (91 per cent), Northern Ireland (110 per cent) and Scotland (108 per cent), but is considerably lower in England (61 per cent). The absolute threshold for the five per cent rate is the same across the UK. Again this represents a much smaller percentage of the average house price in England (121 per cent) compared to the rest of the UK (182-219 per cent). The Scottish ten per cent band begins both absolutely and relatively lower down the price range at about 2.5 times the average house price. In England it is 4.5

Table 2.6.2 **SDLT and LBTT thresholds as a percentage of average house prices**

Tax thresholds	England (SDLT)	Wales (SDLT)	Northern Ireland (SDLT)	Scotland (LBTT)
	Average house price (April 2015)			
	£206,000	£137,000	£114,000	£134,000
Two per cent (entry) £125,001	61%	91%	110%	–
Two per cent (entry) £145,001	–	–	–	108%
Five per cent £250,001	121%	182%	219%	187%
Ten per cent £325,001	–	–	–	243%
Ten per cent £925,001	449%	675%	811%	–
12 per cent £750,001	–	–	–	560%
12 per cent £1.5 million	728%	1,094%	1,316%	–

Source: Author calculation from Land Registry data.

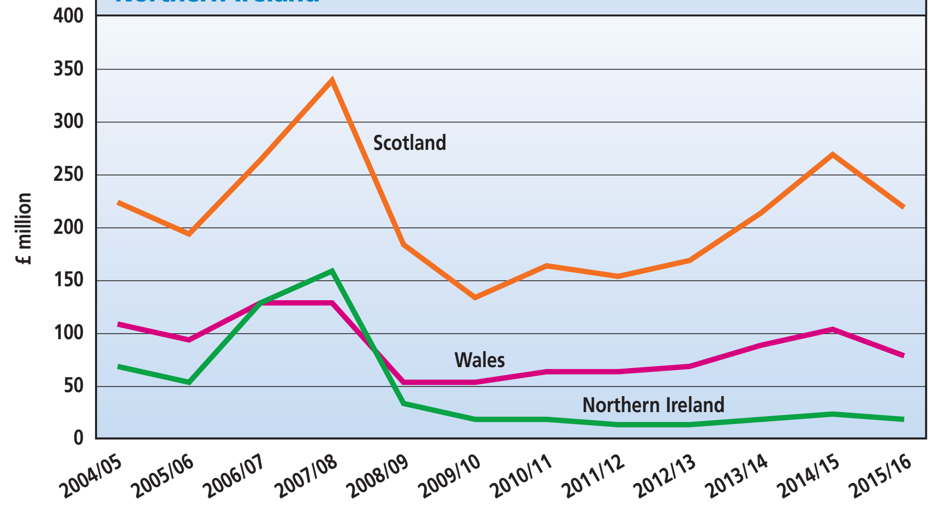
times higher and in Northern Ireland more than eight times the average. The top (12 per cent) band is set at 5.6 times the average price in Scotland, compared to 7.3 times in England and more than ten times in Wales and Northern Ireland.

The significance of these figures is that they imply that the tax is borne by transactions on a broader range of properties in England than in the rest of the UK, and that in Scotland the higher bands apply much lower down the price range than is the case elsewhere in the UK. The combination of the high entry threshold and the steeply progressive structure of the tax thereafter suggest that the revenue raised in Scotland is dependent on a smaller part of the market and that the revenues will be more volatile than elsewhere in the UK.

The first year of the new taxes

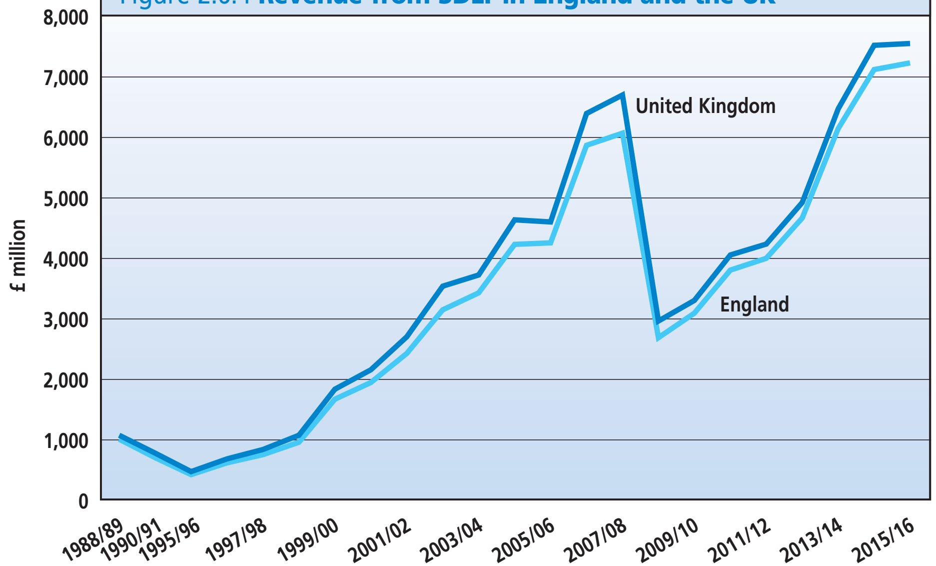
The reformed SDLT was introduced at midnight on the day the change was announced in December 2014, providing almost no opportunities for bringing forward or delaying transactions. However, there was time for would-be purchasers in Scotland to either bring forward or delay purchases according to whether they would benefit or not from the new system introduced in April 2015.

Figure 2.6.3 **Revenue from SDLT/LBTT in Scotland, Wales, Northern Ireland**



Source: Compendium Table 107.

Figure 2.6.4 **Revenue from SDLT in England and the UK**



Source: Compendium Table 107.

Figures 2.6.3 and 2.6.4 show trends in revenue from SDLT/LBTT and the old stamp duty. At the UK level revenues rose strongly in the decade up to the global financial crisis. Since 2008/09 they have recovered in England (and the UK as a whole) and now exceed the pre-recession peak (at least in nominal terms).

However, there was a dip in revenue in Wales, Northern Ireland and (especially) Scotland in 2015/16. In Scotland, the operation of the new tax has received much attention because it has been newly devolved and could be remodelled if the Scottish Government wishes. The first year of LBTT has been the subject of a report by the Scottish Parliament Finance Committee.[5] This notes that there were fewer transactions of properties in the £325,000-750,000 range than anticipated. Consequently, revenue was lower than forecast, £208 million against £235 million – although it should be noted that the £235 million figure relates to the anticipated revenue before forestalling (bringing forward or delaying sales) was taken into account. However, transactions of properties over £750,000 actually raised more revenue than expected.

The examination by the Scottish Fiscal Commission[6] attributes the difference in part to forestalling, but also suggests that the scale of house-price inflation taking more properties into the five per cent band (fiscal drag) was over-estimated. The SFC notes that it is possible that transactions in the £325,000-750,000 price range may be 'ongoing behavioural responses' to the tax. Such 'ongoing behavioural responses' may not be permanent and it may take some time for would-be sellers to lower their prices to a new level. The 'stickiness' of house prices in a downward direction is a feature of the housing market. When markets turn down, owners appear to be reluctant to accept that prices will fall. This in part explains the volatility of transactions. A submission by Aberdeen City Council to the Scottish Parliament's Finance Committee also suggests that it is difficult to disentangle the effect of LBTT on the market from that of the downturn in the oil and gas industry.

The committee concluded that it was too early to reach any definitive conclusion on the impact of LBTT, but urged the SFC to continue to monitor it. In the draft Budget in December 2016, the Scottish Government announced that it would make no changes to the thresholds or rates of LBTT.

Landlord surcharge

The UK government announced its intention to introduce a three per cent surcharge ('higher rates for additional properties') on SDLT for people purchasing properties that were not for use as their primary homes from April 2016. The Scottish Government followed suit and has introduced a similar measure ('additional dwelling supplement'). This measure is aimed primarily at tilting the playing field in favour of would-be homeowners, and first-time buyers in particular, at the expense of buy to let landlords. This adds more than £6,000 to a landlord's purchase of an average-priced property in England, about £3,400 in Wales and more than £4,000 in Scotland. Combined with the less favourable tax treatment of rental accommodation and the anticipated tightening of mortgage lending criteria, the measure will almost certainly have a depressing effect on the buy to let market (see Commentary Chapter 3).

When the scheme was announced in the UK, the government intended to exempt larger-scale landlords from the surcharge, because it wanted to encourage the build to rent market. However, it dropped this proposal. In contrast, in Scotland the exemption does apply when a transaction involves six or more properties. A bill has been introduced in the Welsh Assembly to facilitate the introduction of a new land transaction tax from April 2018. The bill is likely to receive Royal Assent in the Spring of 2017. It provides for the surcharge for secondary properties, but the rates will not be announced until closer to the date of introduction.

The future

Residential housing taxes have changed across the UK since the end of 2014, and further changes are likely in Wales and perhaps also in Northern Ireland. Their impact will doubtless be studied with interest, and may open up the possibility that their structure could be regionalised within England. The London Housing Commission[7] proposed that SDLT should be devolved to the capital, with an equivalent cut in central grant. However, as a source of revenue it is volatile, and the UK government is unlikely to be willing to devolve other tax powers such as income tax within England that could be used to balance-out receipts over the cycle. Nonetheless, such are the vast differences in house prices across the UK, there may well be a case for devolving the structure of SDLT.

References and notes

1 See for example, IFS (2010) *Tax by Design*, Chapter 16 (available at www.ifs.org.uk/uploads/mirrleesreview/design/ch16.pdf).

2 Stephens, M. (1996) 'Institutional responses to the UK housing market recession', in *Urban Studies*, 33(2), pp.337-351.

3 HM Treasury, quoted in Stephens, M. (2011) *Tackling Housing Market Volatility in the UK. Report of the Joseph Rowntree Foundation Housing Market Taskforce* (see www.jrf.org.uk/sites/default/files/jrf/migrated/files/housing-markets-volatility-full.pdf).

4 HM Treasury (2014) *Autumn Statement*, Cm8961, Chart 1.13. London: HMT.

5 Scottish Parliament Finance and Constitution Committee (2016) *Report on the First Year's Operation of the Land and Buildings Transaction Tax*, SP Paper 48. Edinburgh: Scottish Parliament.

6 Scottish Fiscal Commission (2016) *Outturn Report 2015-16*. Edinburgh: Scottish Fiscal Commission.

7 London Housing Commission (2016) *Building a new deal for London: Final report of the London Housing Commission*. London: IPPR.