Institute for Public Policy Research

PULLING DOWN THE LADDER

THE CASE FOR A PROPORTIONAL PROPERTY TAX

Shreya Nanda

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EXECUTIVE SUMMARY

The UK's current system of property taxation is unfair and outdated. Council tax is based on 30-year-old property valuations, varies widely around the country, and is capped at relatively low property values, meaning that a multi-million-pound property in the South-East of England can attract the same tax bill as a normal family home elsewhere. Stamp duty, the widely disliked tax levied on the sale of properties, acts to 'gum up' the housing market and to hinder the efficient use of housing. Neither has done enough to address the enormous increase in housing wealth over the past 40 to 50 years that has been primarily concentrated in London and the South East, and disproportionately benefitted the old and already wealthy. Reform is overdue.

In this report, we set out the case to scrap council tax and stamp duty and replace them with a tax proportional to the value of the property itself – a continuation of the argument we made in our 2018 Commission on Economic Justice (Roberts et al 2018). Such reform would be fairer and more progressive in three main ways.

Firstly, noting the political salience of 'levelling up' and addressing **regional inequality**, a proportional property tax would accurately reflect the variation in house prices within England, with the highest revenues being raised from those with the most property wealth. Areas with lower house prices would no longer pay higher property tax rates than areas with higher house prices, as they do under our current system of council tax.

Secondly, a proportional property tax would better and more fairly address **wealth inequality** in England. Our current system of council tax is regressive with respect to property values and with respect to incomes – households in less expensive properties pay substantially more in tax as a share of their property values. A proportional property tax would be progressive with respect to wealth and would represent a net redistribution from the highest earners towards low- and middle-income households.

Finally, it would lead to a **stronger economy**, helping to more efficiently use our existing housing stock, rebalancing property values across the country, and boosting spending among lower-income families.

Given our support for a proportional property tax, we set out important questions of policy design - the level of taxation; the treatment of different groups; levels of fiscal devolution and geographic redistribution; and transitional and ongoing protections. As with any structural reform, particularly of the tax system, moving from the current system will involve rebalancing and redistributive effects that must be considered and managed. We discuss the impact of these proposals on local government finances, but we do not assess the implications for this area in detail.

Finally, we turn our attention to a prominent proposal for the introduction of a proportional property tax from the campaign organisation *Fairer Share*, which proposes a tax rate that would be fiscally neutral compared to the current system, and which would result in 75 per cent of households seeing reduced tax bills. We map the changes in tax bills across England from these proposals, and the consequent changes to house prices. We find that the higher taxes levied on more expensive properties in the London and the South East could serve to reduce house prices in those areas, whilst the majority of local authorities would see reduced tax bills and potentially a consequent increase in house prices. There is potentially a trade-off here – on the one hand this could boost local economies and spur housebuilding, but on the other hand it could make affording a home more difficult on the margin for potential buyers. However, we find that the largest projected price rises are concentrated in the areas that are currently the most affordable.

And we find that the proposals would result in economic benefits in two main ways: firstly by removing stamp duty and facilitating more property sales, and secondly by putting more money in the pockets of low- and middle-income households, who are more likely to spend their disposable income than wealthier homeowners. This could see GDP increase by up to £3.27 billion per year and £0.04 billion a year respectively.

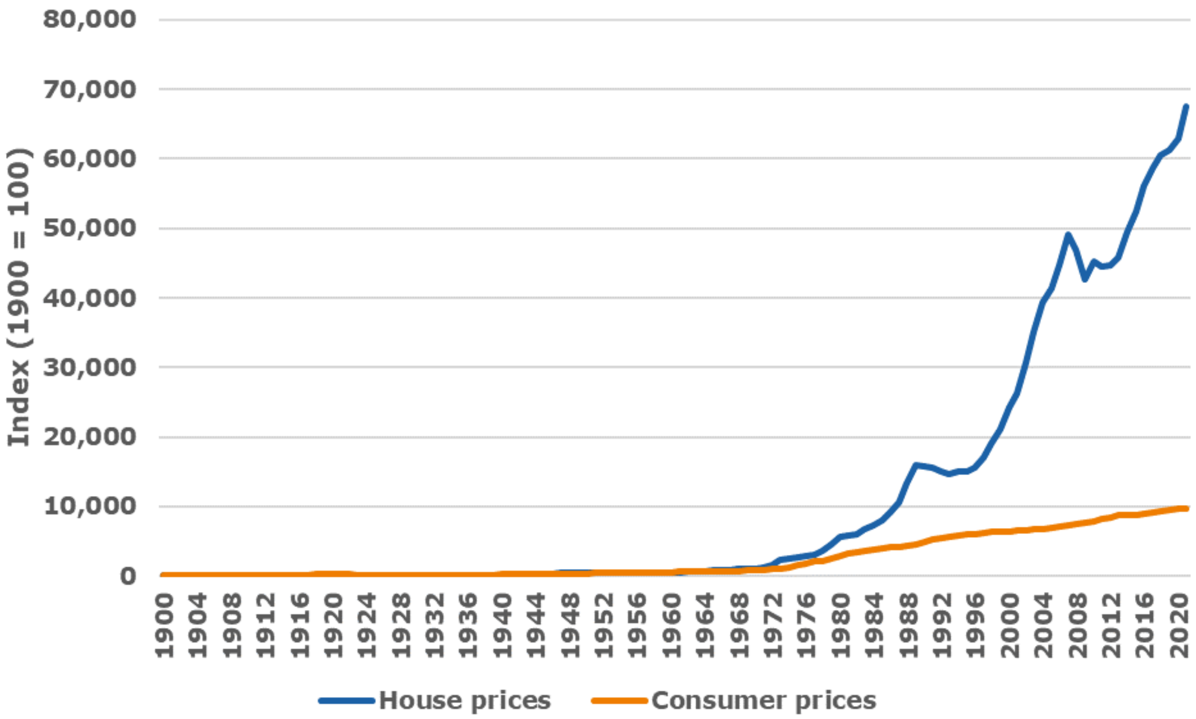
The housing market has been a significant driver of wealth inequality in the UK over the past 40 to 50 years. Ultimately, reform is needed to ensure a fair social contract. Moving from our current system of property taxation to a proportional property tax would help achieve this. It would help to address wealth inequality, intergenerational inequality and regional inequality, and make our economy stronger.

THE CASE FOR CHANGE

Any attempt to talk about economic justice in the UK must reckon with the state of the current housing market. Most obviously, there has been an enormous increase in housing wealth that has accrued to certain households over the last 40 to 50 years. These households have tended to be older (D'Arcy & Gardiner 2017), wealthier, and concentrated in London and the South East. Partly, this has been driven by structural shifts in the UK's economic geography, away from land-intensive industry distributed around the country, and towards dense knowledge-economy clusters in cities, and particularly in London. Our housing model – a dysfunctional planning system, a lack of redistributive property taxation and an inadequate supply of social housing – has meant that the gains from this shift have been captured by sitting homeowners in these prosperous cities and their surrounds, instead of being shared more widely.

FIGURE 1: House prices in the UK have risen faster than consumer prices since the 1970s

House price index and consumer price index, nominal, 1900 = 100, UK



Source: HM Land Registry (2021b), Bank of England (2017), ONS (2021e)
Notes: For 2021, values are only based on data for the first six to seven months of the year.

Those who have lost out are those who have been locked out from owning their own home, including the young and those without family wealth. This group has not only been shut out from the historic accumulation of housing wealth; too many face steep rents, cramped living spaces, precarious conditions, and (for those who can afford them) staggeringly high mortgages.

If we want a fair social contract, rather than one that allows one group to benefit at the expense of others, we need to change our housing model. Redistributive property taxation – to ensure that the current housing stock, and the rents from it, are more fairly shared – provides one way of doing this, as so many economists and other thinkers throughout history have pointed out (Ricardo 1817, George 1879, Smith 1776, Paine 1797, Mirrlees et al 2011).

The current system

Our current system of property tax includes four main taxes: council tax, stamp duty, capital gains tax and income tax (on rental income and imputed rental income).

Council tax

Council tax is a tax levied on tenants and homeowners and collected and retained by local authorities. Properties are divided into eight bands (A-H), based on their value in 1991. Local authorities set the tax payment for properties in Band D. Payments for properties in the other bands are then calculated relative to the Band D payment, according to the formula in table 1.

TABLE 1: Council tax payments increase less than proportionately with property values

Council tax band thresholds and payment ratios, England

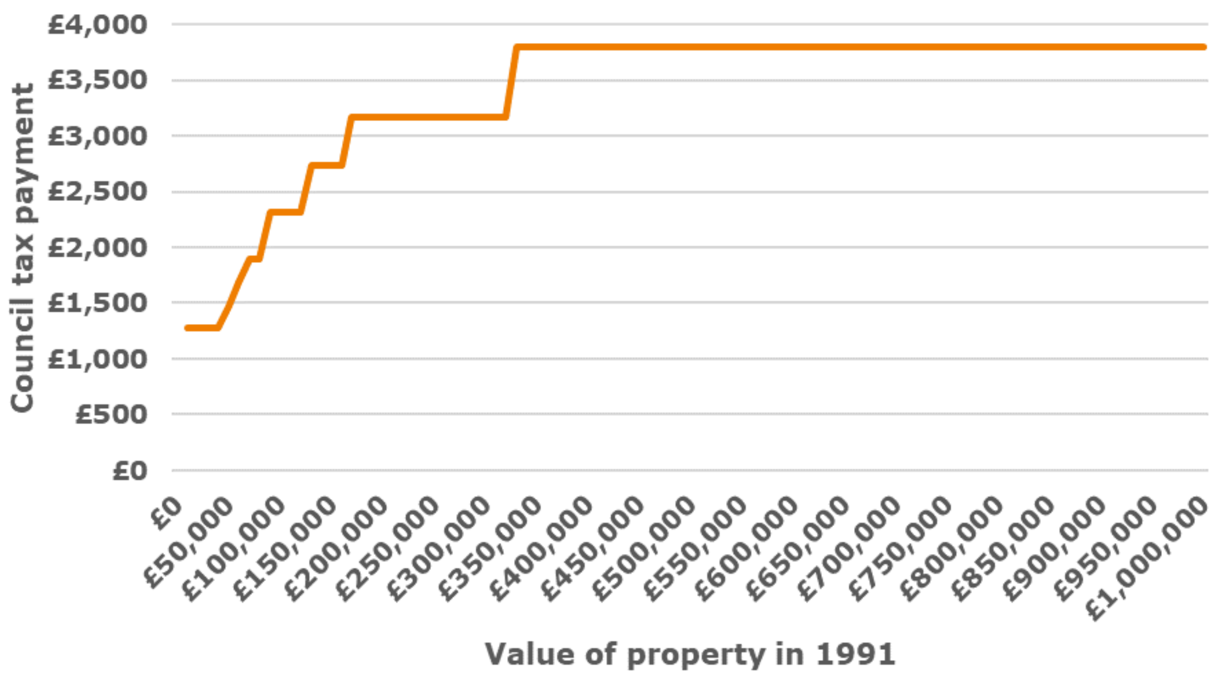
Band	Value	Ratio of Band [X] payment to Band D payment
A	Up to £40,000	6/9
B	£40,001 to £52,000	7/9
C	£52,001 to £68,000	8/9
D	£68,001 to £88,000	9/9
E	£88,001 to £120,000	11/9
F	£120,001 to £160,000	13/9
G	£160,001 to £320,000	15/9
H	£320,001 and above	18/9

Sources: VOA (2020), London Datastore (2021)

Instead of increasing in line with property values, payments are therefore designed to increase more slowly than property values. In effect, council tax is designed to act as a hybrid between a property tax[1] and a service charge.[2] Council tax is therefore regressive with respect to 1991 property values – as property values increase, council tax payments fall as a share of property values. Figures 2 and 3 illustrate this, using the average Band D payment in England (£1,898 in 2021-22) to construct an example council tax schedule.

FIGURE 2: Council tax payments rise more slowly than property values

Council tax payment schedule based on the average Band D payment, England

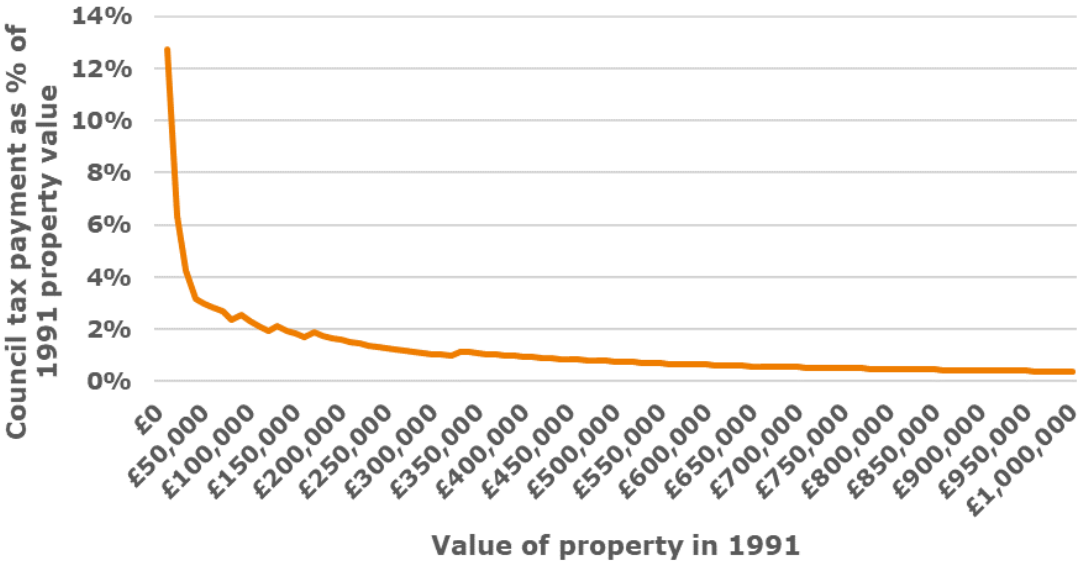


Sources: VOA (2020), London Datastore (2021), MHCLG (2021a)

[1] Used here to mean a tax relating to the value of a property.
[2] A charge relating to the value of services provided.

FIGURE 3: Council tax falls as a share of property values for higher-value properties

Council tax payment schedule, based on the average Band D payment, England



Sources: VOA (2020), London Datastore (2021), MHCLG (2021a)

This means that the capacity for council tax to redistribute the gains from property ownership from owners to non-owners is highly limited. Moreover, rates are fairly low as a share of property values – about 11 per cent of annual rental values, or 0.41 per cent of capital values (author's analysis of MHCLG 2021b, ONS 2019, ONS 2021a, ONS 2021c, MHCLG 2021c, MHCLG 2021d, MHCLG 2021e).[3] [4]

Stamp duty land tax

Stamp duty land tax (stamp duty) is a tax levied on the buyers of property at the point at which the property is bought. It is calculated based on the property price. The stamp duty tax schedule is progressive with respect to property price, rather than regressive as for council tax – properties in higher price bands pay a higher rate of stamp duty than properties in lower price bands.

While stamp duty does provide some redistribution, the level is very small – receipts work out at about 3 per cent of annual property rental values, or 0.11 per cent of capital values (author's analysis of HMRC 2020, ONS 2019, ONS 2021a, ONS 2021c, MHCLG 2021c, MHCLG 2021d, MHCLG 2021e);[5] and it does so at the expense of 'gumming up' the housing market (Mirrlees 2011, Hilber & Lyytikäinen 2017, Morton 2019, Southwood 2017). Downsizing is

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[3] In our estimate of capital values, we have assumed that capital values for properties in the private and social rented sector vary with rents in those sectors, i.e. that rental yields are uniform across sectors. A more in-depth assessment was beyond the scope of our analysis.
[4] We have taken total rental values to be equal to current rental values plus current taxes levied, and the equivalent for capital values, on the basis that current property taxes should in theory be capitalised into current market prices (Hilber 2015, Gaffney 2009, Mirrlees et al 2011).
[5] The same notes apply to this analysis.

disincentivised, and so part of the housing stock ends up being used less efficiently than it otherwise would (ie held vacant or underoccupied).

Capital gains tax

Capital gains tax is a tax levied on the owners of an asset at the point at which the asset is sold. It is levied on the difference between the purchase price of an asset and the sale price. A higher rate is charged for gains of a larger size. However, while the owners of second homes and rental properties are subject to capital gains tax, primary residences – the bulk of the housing stock – are exempt from the tax altogether. This considerably reduces the amount of redistribution performed by our current property tax system. Moreover, even where capital gains tax is paid by property owners, it is taxed more lightly than other forms of income, such as employment income (Nanda and Parkes 2019).

Income tax

Income tax is a tax paid by individuals on their income. The tax schedule is progressive with respect to income – those with higher incomes pay a higher tax rate than those with lower incomes in a given year. Income tax is paid by the owners of rental properties on their profits from renting out their property or properties – ie their rental income less any expenses or allowances.

Historically, income tax was also levied on owner-occupiers on the ‘imputed rental income’ they derived from their properties – i.e. the amount they would hypothetically have to pay in order to rent the property they are currently living in. However, this tax was scrapped in 1964/65 (Bentley 2018), and now owner-occupiers do not pay any tax on the imputed rental income from their properties.

Summary

While the share of total tax revenue derived from tax on property is higher than the OECD average (12.3 per cent in 2018, compared to 5.6 per cent for the OECD as a whole; OECD 2020), our current system of property taxation does not achieve substantive redistribution from winners to losers – it is not designed to do so. By contrast, a differently designed system of property tax has the potential to be far more redistributive.

THE CASE FOR A PROPORTIONAL PROPERTY TAX

A proportional property tax is a tax levied annually upon a property's value (Roberts et al 2018, Dixon et al 2020, Mirrlees et al 2011, Gardiner 2018, Cheshire & Hilber 2021). The tax would be levied upon the owner of the property, rather than the resident as in the current system of council tax. Instead of a property owner paying a council tax based upon its 'band', they would pay a simple percentage of the property value every year. For example, under a proportional property tax levied at 0.5 per cent, a property valued at £200,000 would pay £1,000 each year.

In this section, we make the case that a proportional property tax is an improvement on the current combined system of council tax and stamp duty. We then briefly compare proposals for a proportional property tax to other proposed property tax reforms.

Addressing wealth inequality

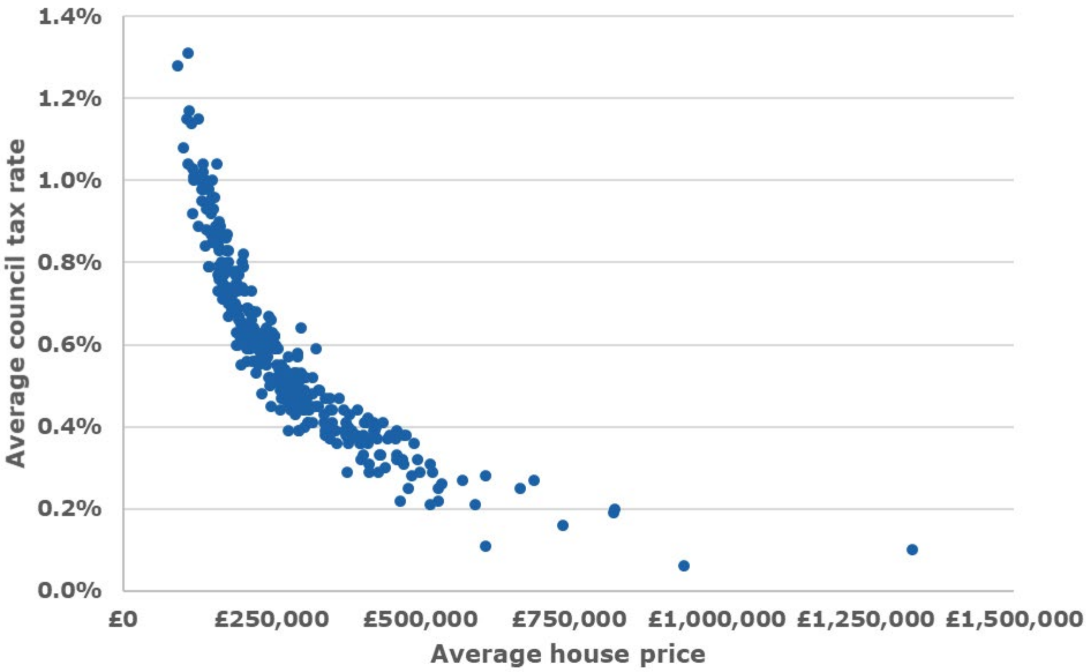
As above, those who have owned homes over the past 40 to 50 years have benefitted enormously from house price inflation, while those who did not have become locked out. Rognlie (2015) found that the housing market was almost entirely responsible for increases in wealth inequality in G7 countries since the 1970s. Depending on the design of the policy, a proportional property tax could help to redress this situation by redistributing from those who hold housing wealth to those who do not.

Council tax in a given local authority is regressive with respect to property price (see 'Council tax'). And rates vary around the country, with rates on average higher relative to property values in areas with lower house prices than in areas with higher house prices (see figure 4).

This means that replacing council tax with a proportional property tax would be far more progressive with respect to wealth. All homes would pay the same flat tax rate. Assuming that the change is fiscally neutral, this would mean higher tax bills on more expensive properties, and lower bills on less expensive properties, helping to address wealth inequality.

FIGURE 4: Areas with lower property prices pay higher rates of council tax

Average council tax payment as a share of property value and average (mean) house price, by local authority, England



Source: Fairer Share (2020), HM Land Registry (2021a)

And it would help to redress some of the inequalities we see today in housing standards – the median household in the social rented sector inhabits around just 62 sqm of floorspace, and around 70 sqm in the private rented sector. This compares to around 95 sqm for owner occupiers (MHCLG 2020). And over half (52 per cent) of owner-occupier households are living in underoccupied dwellings, according to the official occupancy definition,[6] compared to just 10 per cent for social renters and 15 per cent for private renters (ibid). A proportional property tax would impose an ongoing cost to property ownership, encouraging owners to use their property more efficiently. This would help to free up housing stock for others to use.

Addressing regional inequality

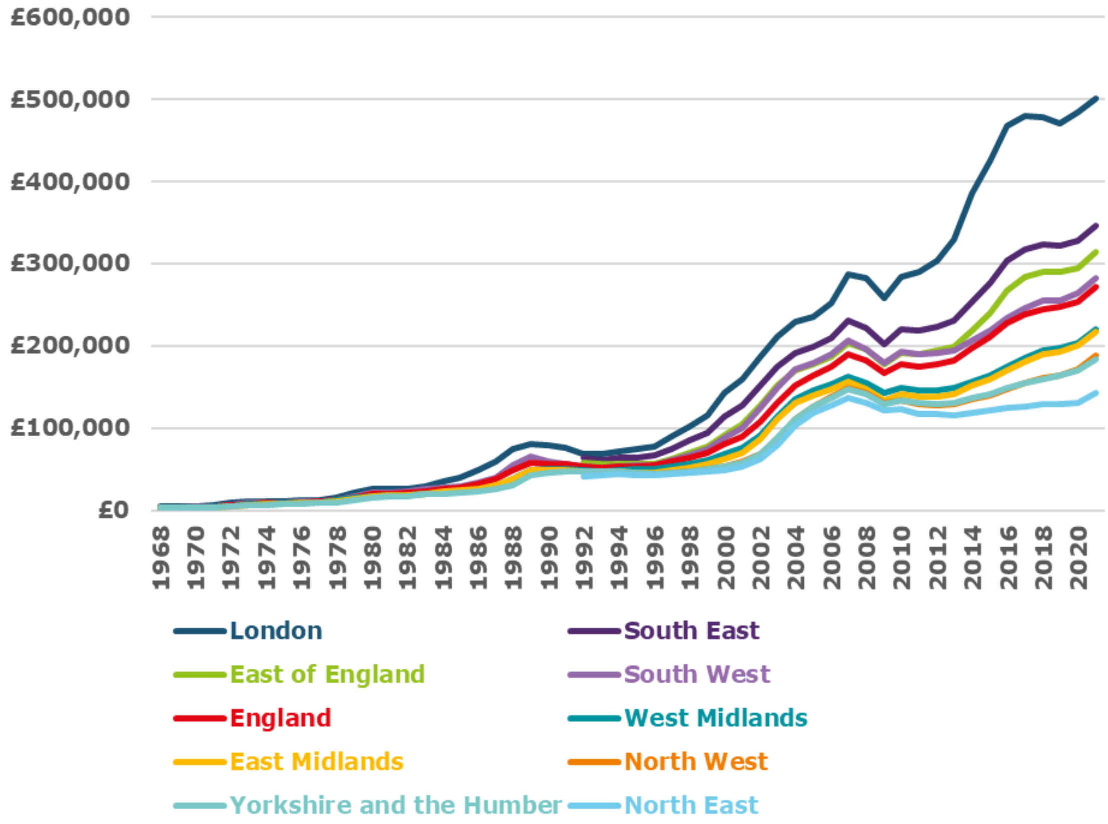
Homeowners in all parts of the UK have benefitted from house price appreciation, but some have done so more than others (see figures 5 and 6). This means that even the beneficiaries of house price inflation outside of the

[6] See: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/945013/2019-20_EHS_Headline_Report.pdf, "Bedroom standard" (p50).

country's most prosperous areas have become relatively more locked out of living and working in those areas, should they wish to do so.

FIGURE 5: House prices have risen in all regions, but particularly in London

Average (mean) house prices by region (nominal), England

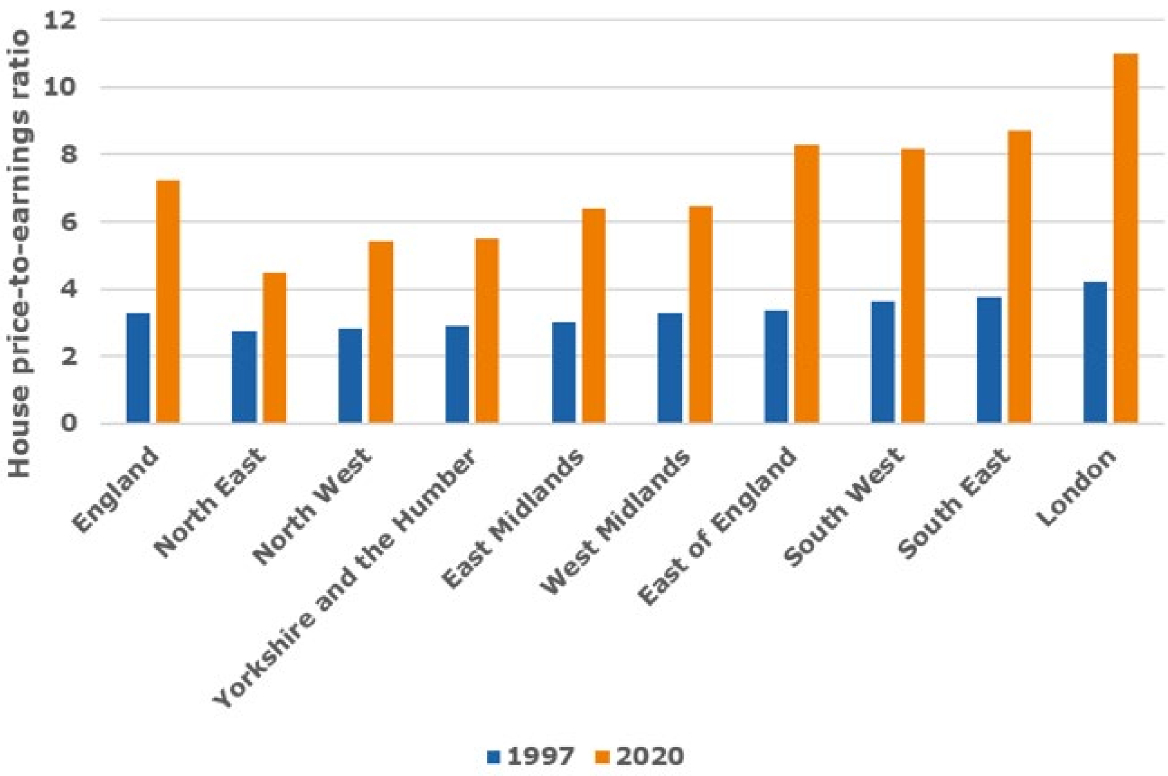


Source: HM Land Registry (2021b)
Notes: Data for some regions is not available for earlier periods, so these series start from a later point. For 2021, values are only based on data for the first six months.

Because council tax rates are higher in less expensive parts of the country, whereas a proportional property tax would apply the same tax rate across the country, under a fiscally-neutral switch to a proportional property tax, areas with higher house prices would see tax rises, while places with lower prices would see reduced tax bills.

FIGURE 6: Disparities between regions in terms of housing affordability have increased since 1997

Ratio of average (mean) house prices to average (mean) gross annual earnings of full-time employees by region, 1997 and 2020, England



Sources: HM Land Registry (2021b), ONS (2021f)
Notes: Earnings data is for full-time employees only.

On the face of it, this would help to reduce regional inequality. However, regional inequality cannot be addressed by property taxation alone. The overall impact of these changes on regional inequality would also depend on how these new tax revenues are distributed. At present, council tax revenues are fully retained by local authorities. So if the revenues from a proportional property tax were similarly retained by local authorities, this would imply a large redistribution in local authority revenues towards areas with higher house prices. Additional redistribution at the national level would be needed to ensure that this did not occur, and that the policy led to an overall reduction in regional inequality (Raikes 2020).

The benefits of fiscal devolution

IPPR and IPPR North (Raikes 2020) have long advocated for greater fiscal devolution, on the grounds that:

- fiscal devolution tends to mean more equal and better outcomes
- fiscal devolution may be associated with higher economic growth

- fiscal devolution can improve public services
- fiscal devolution can reduce regional inequality.

We have further argued that this should be accompanied by greater redistribution, both within regions and between them.

Moreover, in addition to the practical benefits, giving places greater powers and autonomy to improve their own economies is a necessary part of any levelling-up agenda. If the government is to truly live up to its own rhetoric on levelling up, we need a fair, transparent settlement where power is shared between local places and central government (Johns et al 2020). Giving local areas the power to set their own property taxes is part of this.

In particular, the UK has a chronic shortage of infrastructure funding. As Forth (2019) showed, a lack of funding for intracity public transport is holding back economic growth in the UK's cities (excluding London). Giving local areas or city regions autonomy over property taxation could help to fill this gap. Investments in new infrastructure – transport, schools, and hospitals – would raise local property values (Stiglitz 1977). A coherent system of property taxation would mean that some or all of this value would flow back to local treasuries, instead of being captured by local property owners, as it is now. This could help to meet the funding needs for this or future infrastructure.

A greater degree of fiscal autonomy could also help increase the incentives for local residents to vote for policies that would promote growth and increase local tax revenues (Niemietz 2014). For example, as The Economist (2021) notes, Switzerland's cantons retain a high share of taxation; and Switzerland builds three times as many homes per person as Britain. However, this would of course again depend on how those revenues were then retained or redistributed.

The economic case

More efficient use of the existing housing stock

Currently, the high cost of housing is at least to some extent driven by the constrained supply of housing in areas where people want or need to live. While building new housing represents a more direct way of addressing this, ensuring that the existing housing stock is used more efficiently would also help reduce the cost of housing for those who do not own property. For context, over half of owner-occupied households are currently under-occupying their properties, according to the official occupancy definition (MHCLG 2020).[7]

A (well designed) property tax attaches an ongoing cost to the holding of property. It would therefore incentivise owners to ensure that their property is used efficiently, rather than, for example, leaving rooms empty in high-demand areas. This would increase the amount of housing space available to rent or buy, benefitting those who are currently struggling to afford decent housing. Council

[7] See: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/945013/2019-20_EHS_Headline_Report.pdf, "Bedroom standard" (p50).

tax does a poor job of providing this incentive, because of its lack of proportionality with respect to house prices; it is further weakened by exemptions such as the single person discount, which allows single occupants to reduce their council tax bill.

Agglomeration effects

As above, a well-designed property tax would go some way towards increasing the supply of available housing stock in high-demand areas, allowing population density in those areas to increase. One strand of economic thought suggests that, as well as the direct benefits to people in need of housing, this also has the potential to raise the productivity of the wider area, through channels such as lowering transaction and transportation costs, allowing more complex supply chains, facilitating free exchange of ideas and information, enabling the development of specialised clusters, and allowing individuals to pursue greater career specialisation without sacrificing personal or household mobility (Glaeser 2010). Collectively, these effects are known as agglomeration effects.

This theory has been critiqued (e.g. Raikes 2020, Longlands and Cox 2016) – these authors question, for example, whether these benefits are really additional at the national level, or whether they simply benefit richer areas at the expense of poorer ones. The answer to this question is beyond the scope of this paper – we can only note that, whatever the wider economic impact of increasing population density in areas of high demand, this will likely be an additional consequence of a proportional property tax.

As above, a proportional property tax system could also help increase investment in transport and other infrastructure, increasing productivity across the country and particularly in cities outside London.

Inequality and redistribution

Our current system of council tax, as well as being regressive with respect to property values, is also at least semi-regressive with respect to incomes. Without council tax support, households with lower incomes pay considerably more, on average, as a share of their incomes – close to 10 per cent in the lowest decile, compared to below 2 per cent in the lowest decile (Adam et al 2020). With full take-up of council tax support, households in the lowest eight deciles would pay similar amounts as a share of income, with households in the top two deciles paying less as a share of income (those in the top decile would pay around half as a share of their income as those in the lowest decile). Non-take-up of council tax support is significant, so the true situation will lie between these two scenarios (Adam et al 2020).

A switch to a system of proportional property tax that is less regressive with respect to income would therefore represent a net redistribution towards lower-income households. As lower-income households, on average, spend a higher share of their incomes, this would increase the amount of consumption in the economy, providing a boost to demand. This would also help address intergenerational inequality – the lowest incomes tend to be found among younger workers (Francis-Devine 2020).

More broadly, a recent strand of economic thinking links high wealth inequality and high indebtedness among those who do not own property to low economic growth (Mian et al 2021, Stevenson 2015, Klein & Pettis 2020, Breach 2021). This means that we would expect a proportional property tax that redistributes to the less wealthy to increase growth.

Abolishing stamp duty

Stamp duty depresses property transactions, resulting in a less efficient use of our housing stock (see 'The current system'). For example, Hilber & Lyytikäinen (2017) find that a two percentage point increase in stamp duty reduces household mobility by almost 40 per cent. This leads to poorer housing outcomes for individuals. It also reduces the effective housing supply; means we potentially lose out from agglomeration effects; and depresses economic activity surrounding the housing market, such as demand for the services of estate agents, surveyors and solicitors. Abolishing stamp duty would thus bring economic benefits through all of these channels.

Housing affordability

A move from council tax to a proportional property tax would (assuming that the change is fiscally neutral) increase tax bills on average for expensive properties, and reduce them for cheaper properties. Prospective buyers would take account of these future tax bills, and would alter their buying decisions accordingly (as would their mortgage lenders, since future property tax bills would affect their ability to service a mortgage). These tax bills would therefore be partly or wholly reflected by (capitalised into) house prices (Hilber 2015) – house prices would fall in expensive areas, and rise in cheaper areas.

This would likely benefit buyers in expensive areas, such as London and the South East, who are currently struggling to afford to buy. Conversely, it could make housing less affordable for buyers in less expensive areas. However, as Hilber notes, in areas where supply is less restricted, lower tax bills may make housebuilding more profitable and so induce higher levels of housebuilding in response, instead of fully capitalising into higher house prices. Moreover, even where net tax bills fall, the switch from stamp duty to a proportional property tax, and the removal of council tax discounts and exemptions, will increase the incentives to use property efficiently, increasing the effective housing supply – this may also go some way towards offsetting any increase in house prices.

Higher house prices would, of course, also benefit the owners of those houses, and could see wealth inequality between regions fall.

CASE STUDY: FAIRER SHARE PROPOSAL

In 2018, IPPR called for the introduction of a proportional property tax (Roberts et al 2018). Since then, the *Fairer Share* campaign was founded. They have published a prominent and detailed proposal for the introduction of a proportional property tax. We will now take a closer look at their proposal. We will summarise the proposal and then look at some of the economic impacts of this proposal.

The proposal

The *Fairer Share* proposal is as follows (Dixon et al 2020).

- Abolish **council tax**, **stamp duty** and the **bedroom tax**.
- Replace them with a **proportional property tax** – a flat tax of **0.48 per cent** on the current value of residential property.

The policy design contains the following elements.

- Responsibility for payment would be shifted from tenants to landlords.
- Increases in tax bills would initially be **capped** at £100 per month, until the property is sold.
- Those who are unable to pay would be able to **defer** payments until their financial situation improves or the property is sold. A modest rate of interest would be charged on top of the deferred tax amount.
- A higher rate of 0.96 per cent would be charged for **second homes**, **empty homes**, and homes owned by **non-UK residents**.
- Valuations would take place annually.
- The proportional property tax would also apply to undeveloped land with residential planning permission.
- Revenues would be split between central and local government. (Details of the split are not specified.)
- The budget for council tax support would be retained, but its distribution could be altered to reflect the new distribution of tax.

Their analysis suggests the following.

- Their proposal would be fiscally neutral.
- 75 per cent of households would pay less tax.

Economic impacts

Because council tax is devolved in Scotland, Wales and Northern Ireland, the *Fairer Share* proposals relate to England only. All analysis here is therefore also for England only.

Impact on house prices

If taxes on a property rise, we would expect property prices to fall, and vice versa. Hilber (2015) surveys the literature on the topic and reports that "The vast majority of the earlier studies explore the capitalization of fiscal variables… into house prices and find substantial if not full capitalization". In other words, tax changes are substantially or fully captured by property prices.

For simplicity, we have assumed full capitalisation. However, as Hilber notes, in areas where supply is not constrained, we may expect to see lower or even no capitalisation of tax changes into house prices (see 'Housing affordability').

To estimate the impact of the *Fairer Share* proposal on property prices, we first compare average house prices (HM Land Registry 2021a) and average rents (ONS 2021b) for 2020/21 by local authority. We compare the two to estimate the average gross annual rental yield on homes in each local authority, as per PropStats (2019).[8]

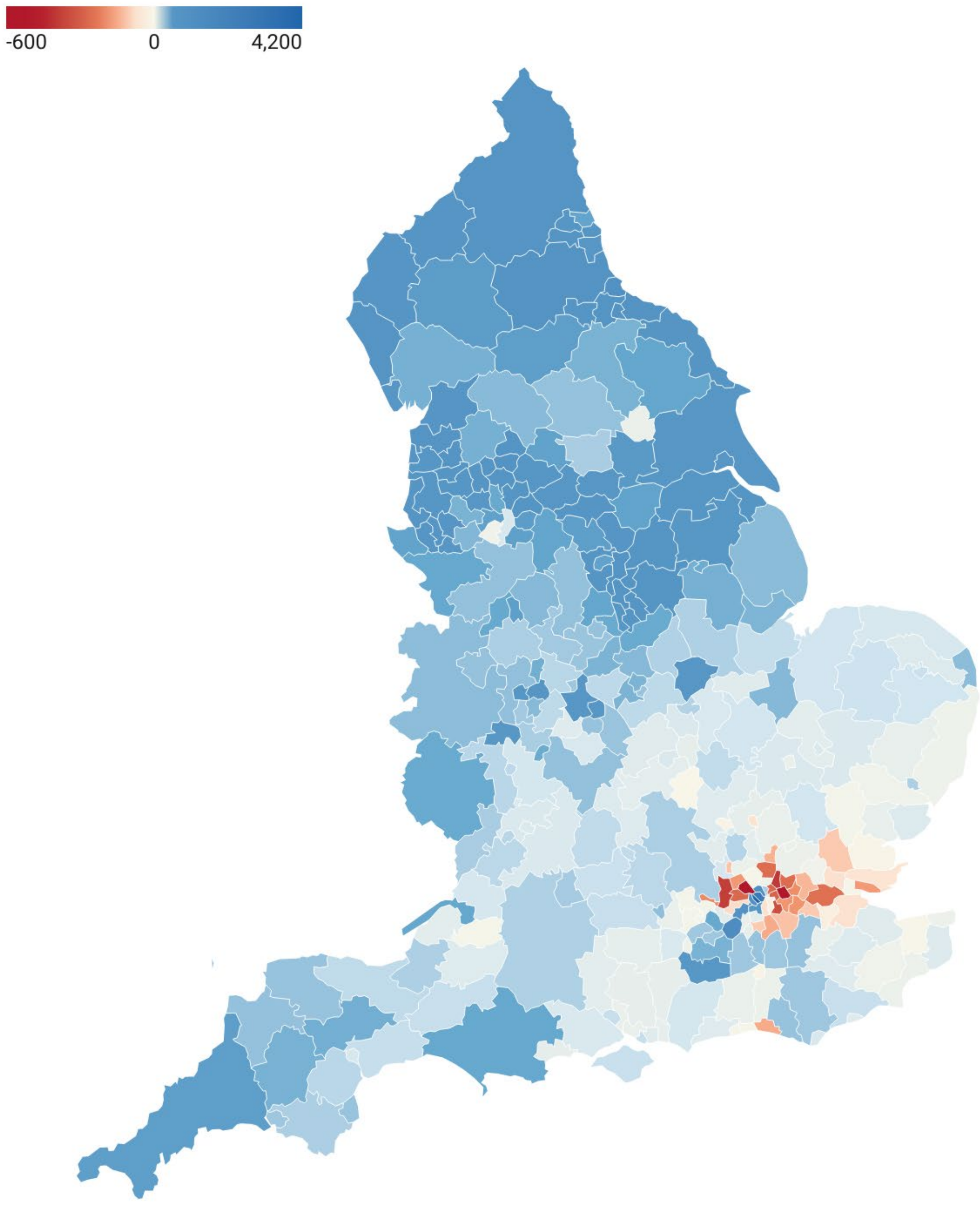
We then take estimates of the average change in tax bill for owner-occupiers in each local authority under the *Fairer Share* tax proposals. These estimates are calculated by WPI Economics, who model the impact of the *Fairer Share* proposals on households at the MSOA level. These estimates include the impact of changes to both council tax and stamp duty. They are presented in figure 7.

These estimates are then combined with our estimates of rents, house prices and rental yields to give estimates of the changes in owner-occupied house prices that would result from the *Fairer Share* tax proposals. In reality, these changes in property prices would then feed back into tax bills, as the tax is calculated as a proportion of the property value. However, these dynamic impacts are not captured in our analysis – we estimate the first-order impacts on house prices only.

[8] This assumes that rents for private rental properties in a local authority area are similar, on average, to imputed rents for owner-occupied properties. Our analysis of ONS (2019), ONS (2021a), ONS (2021c) and MHCLG (2021c) suggests that, for England as a whole, this is the case – we obtain an estimate of £10,500 for average annual imputed rents for owner-occupied properties in 2019, compared to £10,100 for average annual rents for private rental properties in 2019/20.

FIGURE 7: Among homeowners, households in London would largely pay more tax, while households in the rest of the country would pay less

Average annual impact of Fairer Share proposals on household budgets, owner-occupier households, by local authority district, £

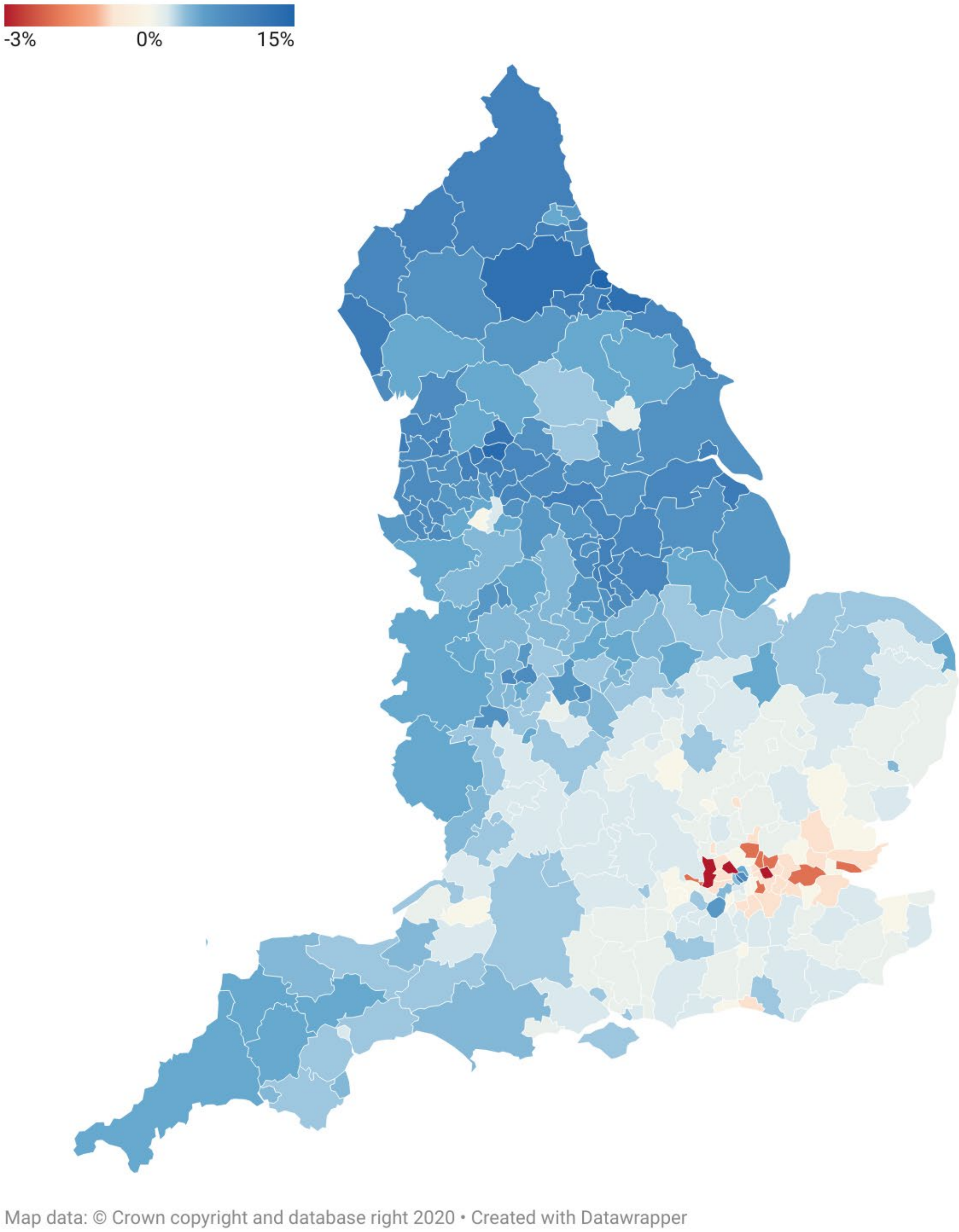


Map data: © Crown copyright and database right 2020 • Created with Datawrapper

Source: WPI Economics (2021)
Notes: For most local authorities, average annual tax changes for owner-occupier households are in the region of -£1,000 to +£1,000. There are two outliers: Westminster (+£2,600) and Kensington & Chelsea (+£4,200).

FIGURE 8: House prices falls are concentrated in London, while the biggest rises are seen in the North East and North West

Percentage change in owner-occupied house prices, by local authority district



Source: IPPR analysis of HM Land Registry (2021a), ONS (2021b), WPI Economics (2021)

TABLE 2: The biggest house prices falls are concentrated in London

Top 10 percentage falls in owner-occupied house prices, by local authority district

Local authority district	Region	Change in house prices, %	Change in house prices, £
Newham	London	-3%	-£12,410
Brent	London	-3%	-£13,224
Hillingdon	London	-3%	-£10,395
Waltham Forest	London	-2%	-£11,517
Lewisham	London	-2%	-£9,248
Thurrock	East of England	-2%	-£5,634
Southend-on-Sea	East of England	-2%	-£5,014
Slough	South East	-2%	-£5,015
Redbridge	London	-2%	-£6,913
Enfield	London	-2%	-£6,289

Source: IPPR analysis of HM Land Registry (2021a), ONS (2021b), WPI Economics (2021)
Notes: House price changes are in terms of 2020/21 house prices.

TABLE 3: The biggest house prices rises are concentrated in the North East and the North West

Top 10 percentage increases in owner-occupied house prices, by local authority district

Local authority district	Region	Change in house prices, %	Change in house prices, £
Hartlepool	North East	+15%	+£16,387
Burnley	North West	+14%	+£12,531
County Durham	North East	+13%	+£13,643
Middlesbrough	North East	+13%	+£14,579
Redcar and Cleveland	North East	+13%	+£16,146
Kensington and Chelsea	London	+12%	+£162,934
Pendle	North West	+12%	+£12,990
Hyndburn	North West	+11%	+£11,594
North East Lincolnshire	Yorkshire and the Humber	+11%	+£14,242
Copeland	North West	+11%	+£13,807

Source: Author's analysis of HM Land Registry (2021a), ONS (2021b), WPI Economics (2021)
Notes: House price changes are in terms of 2020/21 house prices.

Figure 8 shows the estimated impact of the *Fairer Share* proposals on house prices across the country. Tables 2 and 3 show the specific local authorities with the largest expected house price changes in either direction.

These results show that house prices are expected to rise in 88 per cent of local authorities, and fall in 12 per cent. The largest rises are concentrated in the North East and North West, while the largest falls are concentrated around London. However, as above, price rises may be lower than projected in areas where housing supply is not constrained – i.e. areas outside of large urban centres. And some of these rises may be offset by increases in effective housing supply – not captured in this analysis.

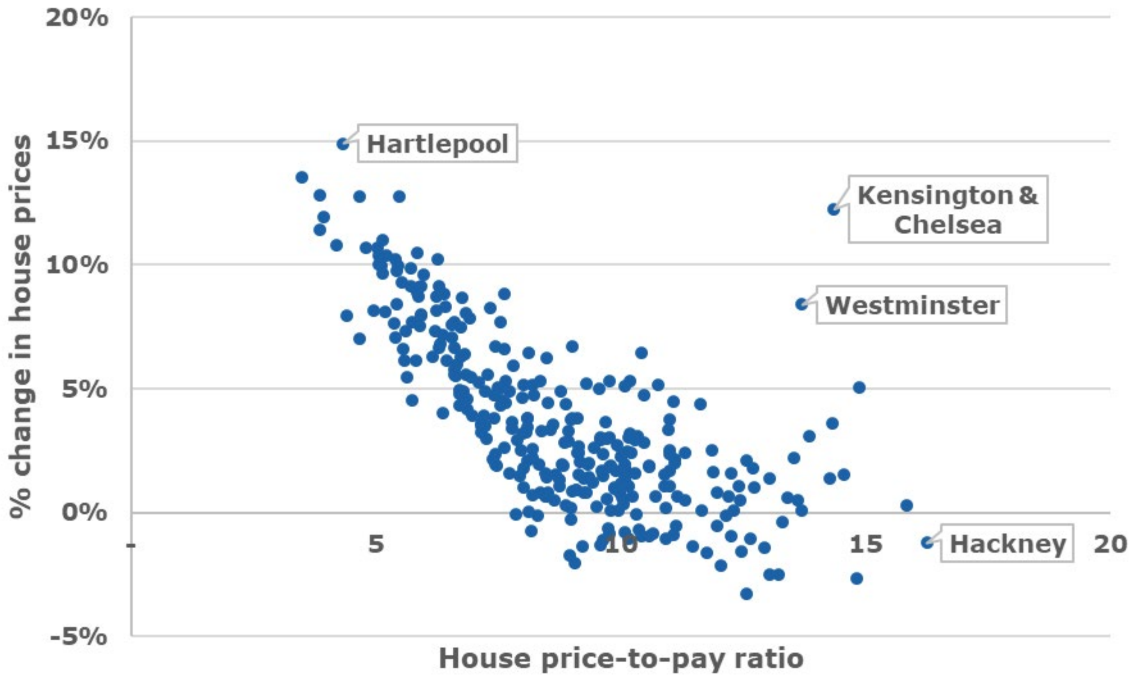
This analysis is restricted to the first-order impact on owner-occupied property prices. However, *Fairer Share* have also proposed the introduction of a surcharge for second homes, empty homes, and homes owned by non-UK residents. This will also affect property prices, and may offset some of these projected house price rises, particularly in areas with a high degree of second homeownership.

In general, we would expect to see the greatest price falls in the areas with the highest house prices. However, this is complicated by the fact that the *Fairer Share* proposals cap tax increases at £100 per month for existing residents. This means that for properties at the very highest end, we see a big fall in tax bills from the removal of stamp duty, but the corresponding rise in proportional property tax bills is capped. This means that the overall rise in bills is lessened, and for some in this group (for example, Kensington and Chelsea) we actually initially see a significant fall in tax bills. While this should be considered in the policy design, these falls will dissipate over time as these properties are sold and the cap disappears. Instead, the largest initial rises in tax bills are seen in places like Newham and Brent, where property prices are high, but not high enough to derive the full benefit from the £100 per month cap.

The house price rises we see in figure 8 and table 3 present a potential trade-off. On the one hand, these rises could boost local economies and spur housebuilding, but on the other hand, they could make affording a home more difficult on the margin for potential buyers. However, as figure 9 shows, in general, the highest house price rises from these proposals are concentrated in the areas which are currently the most affordable. In other words, we would expect them to help narrow gaps in housing affordability across England, rather than widen them further.

FIGURE 9: The biggest house price rises are seen in the areas where housing is most affordable currently

Percentage change in owner-occupied house prices from Fairer Share proposals, and ratio of average (mean) house price to average (mean) gross annual pay, by local authority district



Source: IPPR analysis of HM Land Registry (2021a), ONS (2021b), WPI Economics (2021), ONS (2020).

Impact of abolishing stamp duty

The *Fairer Share* proposals include abolishing stamp duty for owner-occupied properties. As above, one of the impacts of stamp duty is to disincentivise housing transactions, and thus reduce the level of transactions in the economy. Building on the methodology in Morton (2019), we estimate the impact of abolishing stamp duty on the level of residential property transactions.

We use data from HMRC (2020) on the total value of residential property transactions and the stamp duty revenue collected to estimate the average stamp duty tax rate, by house price band. We then combine this data on the number of transactions in each price band (ibid), and with the multiplier obtained by Morton from the literature on the impact of stamp duty on property transactions. According to Morton, transactions increase by an estimated 20 per cent, on average, for every 1 per cent decrease in stamp duty charged (as a proportion of the value of the house). We estimate that the total abolition of stamp duty would see an increase of 34 per cent, or 342,000, in annual residential property transactions in England.

We then combine this with an estimate from Knight Frank (2020) of the GDP impact per property transaction associated with peripheral housing market activity (e.g. estate agents, surveyors, solicitors). Knight Frank estimate this at £9,559 per transaction. Combining this with our estimate of 342,000 additional transactions gives an estimated GDP benefit for this channel of £3.27 billion per year. This increased economic activity will also translate into higher tax revenues for the Exchequer.

This may overestimate the net impact on GDP, as some of this activity may crowd out activity elsewhere. We can think of this as an upper-bound estimate of the GDP impact obtained through this channel. This increased economic activity will also translate into higher tax revenues for the Exchequer.

Impact of redistributing to lower-income households

Because house prices are correlated with income, the *Fairer Share* proposals would, on average, increase tax bills for high-income households and reduce them for low- and middle-income households – representing a net redistribution from the former to the latter (Landman Economics 2021). Because lower income households, on average, are more likely to spend any income, putting more money in the pockets of lower income households provides a boost to the economy, thus increasing economic activity and GDP.

To estimate the impact on the economy, we take estimates of the distributional impact of the *Fairer Share* proposals from Landman Economics. Here, the impact of these proposals on households by income is modelled using data from the Understanding Society household panel survey. This is used to produce estimates of the average overall change in tax bills – taking into account the introduction of the proportional property tax, the removal of council tax, and the removal of stamp duty – for households in each income decile.

However, this analysis does not include the impact of the £100 per month cap on tax bill increases proposed by *Fairer Share*. This means that the initial distributional impact may be less progressive than these estimates suggest. However, again, over time, the impact of the cap will dissipate.

In terms of the incidence of the tax, this analysis assumes that the full benefit of the reduction in council tax will be borne by tenants, and that a portion of the proportional property tax bill will be passed on to tenants - 66 per cent for private renters, and 25 per cent for social renters. In reality, in the long run we might expect the incidence of both of these changes to be largely borne by property owners, rather than by tenants (Mirrlees et al 2011; Murphy 2018; Corlett and Gardiner 2018). This would have implications for this distributional analysis, though the direction of the impact is not clear.

TABLE 4: Households in the middle income deciles would gain the most from the *Fairer Share* proposals

Impact of Fairer Share proposals on household budgets, by income decile

Decile	Impact on household budgets
1 (poorest)	+£28
2	+£188
3	+£227
4	+£297
5	+£244
6	+£268
7	+£264
8	+£56
9	-£93
10 (richest)	-£1,077
Overall average	**+£39**

Source: Landman Economics (2021)

The overall impact of these proposals is fiscally neutral, so there should be no positive aggregate impact on household budgets. However, this analysis was not able to fully account for the incidence of the tax changes on social housing providers. Therefore, this analysis shows a small positive aggregate impact on household budgets.

We then use these estimates to project the macroeconomic impact of this redistribution. This is done by building on the methodology in Parkes et al (2020), which uses Bank of England estimates of household spending responses to income shocks to model the macroeconomic impact of various fiscal policies. We compare the *Fairer Share* proposals to an intervention which has the same fiscal impact, but spread evenly across the income distribution. This allows us to isolate the impact of the redistributive element of the proposals, while stripping out any implied aggregate fiscal impact. We find that the fiscal multiplier associated with the *Fairer Share* proposals is 1.35, compared to a multiplier of 1.30 for the counterfactual scenario. This means that for every additional £1 that is retained by households, we would expect to see GDP increase by £1.35.

We also find that GDP would increase by an estimated £1.26 billion as a result of these policies, compared to £1.22 billion in the counterfactual scenario. There is not a large difference between the two scenarios, because the *Fairer Share* proposals are only moderately progressive with respect to income. Again, this increase in GDP would have additional positive implications for the Exchequer.

Summary

A summary of our estimates of the economic benefits from the *Fairer Share* proposals is contained in table 5. This is by no means a comprehensive list of all of the potential economic impacts of these proposals – the proposals would also affect the economy through other channels, such as more efficient use of housing (both from the removal of stamp duty and from the introduction of a proportional property tax), agglomeration effects, and facilitating greater infrastructure investment. However, estimating these impacts is beyond the scope of our analysis. Our analysis shows a total GDP impact of up to £3.33 billion per year from increased activity around the housing market, and redistribution towards lower-income households.

TABLE 5: The *Fairer Share* proposals would lead to a substantial increase in housing market activity

Impact of Fairer Share proposals on GDP

Economic benefit	Impact on GDP
Increased housing market activity from the removal of stamp duty	+£3.27bn
Redistribution towards low- and middle-income households	+£0.04bn
Total	**+£3.33bn**

Source: IPPR analysis of Morton (2019), HMRC (2020), Knight Frank (2020), Landman Economics (2021)

CONCLUSION

The housing market has been a significant driver of wealth inequality in the UK over the past 40 to 50 years. Our tax system has failed to keep up, and reform is needed to ensure a fair social contract. Moving from our current system of property taxation to a proportional property tax would help to achieve this. It would help to address wealth and income inequality, and make our economy stronger.

Across the political spectrum there is a renewed interest in addressing regional inequality within the UK and England – or "levelling up" - and we have shown how a proportional property tax could help address existing inequalities in the taxation of housing. The existing system of council tax and stamp duty is regressive. Replacing it with a proportional property tax would redistribute the burden of tax more fairly, with areas with higher house prices no longer paying lower rates of tax.

Important questions of policy design – the level of taxation; the treatment of different groups; levels of fiscal devolution and geographic redistribution; and transitional and ongoing protections – must be considered in order to ensure that the policy is fair, effective, and capable of winning support.

A recent proposal from the *Fairer Share* campaign suggests one way of addressing these questions. Their proposals would reduce property tax bills for most households; increase property transactions; and redistribute, on average, to low- and middle-income households. We could see GDP benefits of up to £3.27 billion per year from increased housing market activity, and £0.04 billion per year from redistributing income towards lower-income households.

Fairer Share's proposals are the most prominent and detailed set of proposals for a proportional property tax currently in the public debate. They have carried out work to consider the political aspects of policy design, as well as the technical aspects. Their proposals would not, alone, bring about a fair housing settlement, but they are a step in the direction needed, and an improvement over our current system of property taxation and housing wealth accumulation. As part of a fair fiscal settlement for all parts of England, these proposals could help address regional inequality across the country.

APPENDIX: QUESTIONS OF POLICY DESIGN

Here we explore some policy design questions for the introduction of a proportional property tax, and the trade-offs inherent in those decisions.

The tax rate

Council tax revenues in England in 2019-20 were £30.6 billion (MHCLG 2021b), and stamp duty revenues from residential property were £8.4 billion (HMRC 2020). A proportional property tax would need to raise the same amount in order to be fiscally neutral.

Of course, it could also be set at a higher or lower level. The choice of tax rate is primarily a political question. A higher rate would be more effective at tackling wealth inequality, incentivising efficient use of the housing stock, and recouping the benefits of public investment. However, it would expose individual households to a greater level of personal risk (their property tax bills going up due to factors outside of their control) and could reduce community stability if people are forced to move more frequently.

Who is taxed

Most proposals for a proportional property tax suggest transferring the responsibility for the tax from tenants (who under the current system are responsible for paying council tax for the properties they rent) to landlords. In the long run, changing who pays the tax is unlikely to have much of an effect on its actual economic incidence, which we would expect to be largely borne by property owners (Mirrlees et al 2011; Murphy 2018; Corlett & Gardiner 2018). However, it could benefit tenants in the short term; in general, would expose them to less volatility; and would shift the administrative burden of dealing with council tax to landlords (Dixon et al (2020) estimate that this would save local councils £400 million per annum in administrative costs).

More broadly, there is a question of whether specific groups should be treated differently. Under council tax currently, some councils offer discounts for second homes and short-term empty homes. However, there are also provisions to levy higher rates on homes that have been empty for long periods.

A new property tax system could levy differential rates on certain groups or types of property, such as second homes, landlords, non-resident foreign property owners, empty homes, or even those with an excessive number of spare bedrooms. Both the politics and the economics of taxation are different for these groups than for ordinary homeowners. It may be both possible and desirable to levy higher property taxes on these other groups than on ordinary homeowners. For example, Labour leader Keir Starmer recently floated proposals for a tax on the incomes of private landlords (Burn 2021).

Who sets the tax

Powers over setting property tax and collecting the revenue could be held at different levels of government, from central government to city-level to local. If the tax is used to fund infrastructure, then it could make most sense to have the tax be controlled at the level at which infrastructure decisions are made.

However, it is also necessary to consider the geographic distribution of revenues – fiscal autonomy for regional or local areas would need to be accompanied by redistribution between areas if it is not to lead to an increase in inequality between areas in terms of budgets. And the degree and means of redistribution between areas could also affect incentives to vote for revenue-increasing policies (see 'Addressing regional inequality').

Shifting tax-setting powers from local government (where council tax-setting powers sit at present) to central government would also leave local government budgets more exposed to shifts in national policy, as we saw with cuts to local authority budgets post-2010.

How the revenue is distributed

Revenues could be retained by local authorities, or redistributed between them. As above, a move from council tax to a proportional property tax would increase tax revenues in richer areas and reduce them in poorer ones. Without redistribution, this would imply a large redistribution in local authority revenues towards areas with higher house prices. Additional redistribution between local authorities would be needed to ensure that this did not become the case.

There is also the question of whether the revenues should be treated like any other local or central government revenue, and form part of the general budget, or whether they should be channelled towards a specific purpose. For example, Thomas Paine, writing in 1797, proposed that the revenues from a tax on land inheritance should be used to fund universal pensions and a universal 'inheritance' for all members of the population. Similarly, Farley (2017) and others have proposed that the revenues from a land value tax could be used to fund a citizen's dividend or a universal basic income.

How the transition is managed

The introduction of a proportional property tax has the potential to be disruptive, with some households potentially suddenly facing much higher tax bills, and/or sharp dips in the value of their property. Therefore, it is worth considering measures that could be used to smooth the transition to a proportional property tax.

One proposal (Myers 2016) suggests that an annual property tax should be phased in on new properties at the point of sale, replacing stamp duty. Another option would be to more directly compensate owners for losses in their property values as a result of the tax. This could be done universally, or it could be concentrated towards those facing the biggest losses relative to the price at which they purchased the property – i.e. recent buyers. A variant of this would be to provide protections for recent buyers against negative equity.

Finally, regarding the potential for sudden jumps in tax bills, one proposal (Dixon et al 2020) would impose a cap on tax increases for existing homeowners, which would disappear at the point of sale.

Mitigation

Another area to consider is that of providing support for low-income households. At the moment, we have a system of council tax reduction for low-income households, as well as separate discounts for single people and full-time students.

Under a proportional property tax, we might also wish to mitigate the impact of the tax on low-income owners and tenants. One way of doing this would be to retain our current system of council tax support, or a variant of it.

Another option would be to allow households on low incomes to defer payment of the tax. Tax bills would continue to accrue, potentially with interest, but would not need to be paid until the household's financial position has improved, or the house is sold. There are examples of such a deferral mechanism for property taxes in other countries, for example in Ireland and parts of Canada (Citizens Information 2021, City of Vancouver 2021, British Columbia 2020). And Muellbauer (2015) proposed a variant system, whereby low-income households would be offered the option of a tax deferral in exchange for giving the government an equity stake in their property.

However, there is a trade-off between addressing wealth inequality and income inequality. A system of support for the asset-rich, cash-poor could end up taxing those without wealth to support those with wealth, thus increasing wealth inequality.

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