FAIRER SHARE

The Proportional Property Tax

FOREIGN HOMEOWNERSHIP SURCHARGE

THE CHALLENGES POSED TO THE RESIDENTIAL PROPERTY MARKET BY INTERNATIONAL INVESTORS & THE SOLUTION DEVISED BY FAIRER SHARE

JANUARY 2022

SUMMARY

In recent years, the high number of property purchases in the UK by overseas investors has helped to inflate house prices and increase inequality, while also facilitating economic crime. This is explained by the fact that property taxes in London are relatively low when compared to other major cities around the world. As a result, it is worth buying property in London - and in other UK cities - as part of a speculative portfolio even if you rarely visit.

Action is urgently needed to address the problems posed by international buyers in the UK property market and the fairest way of approaching the issue would be via a fundamental reform to the way we tax residential property.

By introducing a Proportional Property Tax (PPT), which is an annual levy on the prevailing value of the property, there would be surcharge for foreign-owned, empty and second homes.

It would raise an estimated £4.5 billion and would enable lower bills for most UK homeowners. It would mean that international buyers in London pay property taxes more aligned to what they might expect to see in New York or Paris.

A Proportional Property Tax would:

1. Act as a much-needed control on skyrocketing house prices
2. Limit the scope for property being used to facilitate economic crime
3. Ensure we have a fairer property tax system in all parts of the UK

THE PROBLEM

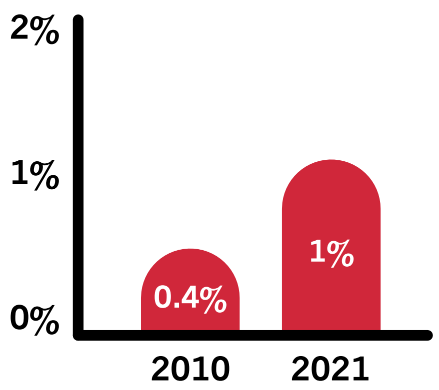
In recent years, the majority of property purchases in prime London have not been by locals living and working in the capital, but by foreign buyers. When Hamptons International began tracking the data in 2011, the figure stood at 52.3%, rising to a peak of 54.6% in 2018. Despite the shutdown of global travel in 2020, the figure still stood at 48.6 % [1].

While the figures have dropped since the pandemic started, it remains the case that a substantial number of London property purchases are by international buyers, most of whom are not UK residents. It is also the case that more such purchases are expected in the year ahead. "While the return of international buyers is still very much pinned to coronavirus, we expect buyer numbers will start to rise toward the end of the year and into 2022 as global travel opens up," Aneisha Beveridge, head of research for Hamptons, said in September 2021 [2].

While some of these foreign buyers are residents in the UK for tax purposes, many are not. In 2013, Knight Frank [3] found that of all £1m+ sales in prime central London that went to foreign buyers, some 28% of these buyers were not resident in the UK.

> **Foreign buyers are "largely composed of investors, looking to earn an income return by letting their properties to Londoners.''**
>
> Knight Frank
> *Independent real estate consultancy*
> *2013*

But the issue is not confined to London, with new research from The Centre for Public Data indicating that offshore buyers are buying up supply in other cities. The data shows that 247,016 titles across England & Wales are now registered to individuals with an overseas correspondence address, representing nearly 1% of all registered titles. This number has more than doubled since 2010, when such individuals owned around 0.4% of all titles in England & Wales [4].



Percentage of homes registered overseas

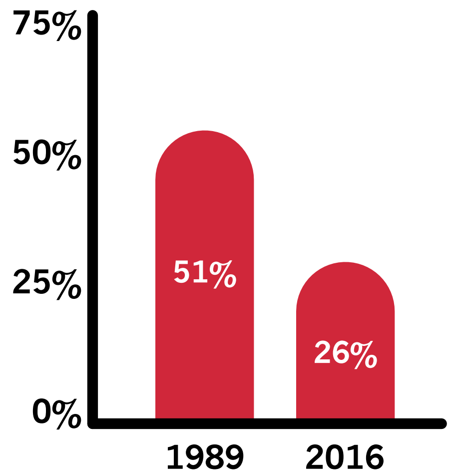
The owners of such titles are concentrated in London, yet northern cities make up an increasingly significant proportion of the total and have seen steep rises in recent years. Liverpool, Salford and Manchester have seen significant rises and the number of such titles in Liverpool is now at 7,925, four times the number in 2010. "Growth here may have been primarily driven by investment purchases rather than second homes," suggests the CIPD's report.

All too frequently, overseas property investments are used to facilitate economic crime by money launderers and fraudsters. As Conservative MP Kevin Hollinrake and Labour's Margaret Hodge wrote in a joint op-ed published in December 2021 [5]:

"Our property market allows criminals to hide and store their money. And our scores of enablers — lawyers, bankers, accountants, and more — promote financial structures or transactions that provide a veil of secrecy."

Kevin Hollinrake & Margaret Hodge
Conservative MP & Labour MP
December 2021

Furthermore, foreign buyers purchasing of property in the UK inflates house prices which has the effect of exacerbating issues of affordability and inequality. Since the turn of the millennium, house prices have risen significantly faster than wages, and a recent study estimates that house prices would be 19% lower without foreign investment [6]. It is also no secret that increasing numbers of young people have been unable to get onto the housing ladder. Youth home ownership (defined as those owned by 25-34 year olds), has fallen significantly since its 51 per cent peak in 1989, according to a Resolution Foundation briefing paper on the decline of youth ownership released in December 2021 [7]. This paper shows that youth home ownership halved to just 25 per cent in 2016, then rising slightly to 28 per cent in 2019 (there is no reliable data on how rates have changed over the pandemic period). The paper also notes that although the fall in young people's home ownership rates was most notable in regions such as Outer London and the South East before the financial crisis, all regions have been affected as the share of young people owning their home has 'levelled down' over time.



Percentage of 25-34 year olds who own their home

Instead of owning their home, young people are increasingly renting privately or staying in the family home, often with limited space of their own. More than one in five 16-24 years old live in overcrowded conditions, with this figure rising to 46% in London [8]. Increasing numbers of young people have also been forced to move out of the city where they work - or they have been unable to move to cities where there are greater employment opportunities. This is especially the case in London but is increasingly occurring in other cities as well. When exploring this issue in 2019, the Resolution Foundation established that the propensity of young private renters to move home has fallen by two-thirds between 1997 and 2018, partly reflecting the fact that private rents have risen consistently faster in higher-paying areas of England. "Our findings about the way that rising housing costs are determining the behaviour of younger renters in particular is a real cause for concern," they stated [9].

Finally, recent research has suggested that high housing costs in London are discouraging workers from moving to the capital in spite of rising pay premiums. The Resolution Foundation found that moving to London for work increased average pay by 18%in real terms in 2015-16, compared with 15% in 2007-08 [10]. However, they found workers are no more likely now to shift between the UK's regions for work than they were a decade ago.

> **"It says something about the scale of London's housing crisis that even 20% pay rises can't persuade more people to move to jobs in the capital,"**
>
> Stephen Clarke
> *Analyst at the Resolution Foundation*

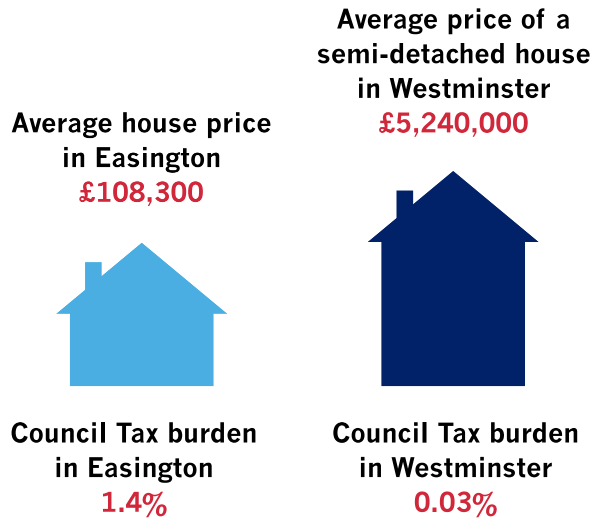
INTERNATIONAL COMPARISONS

The high number of property purchases by overseas investors is explained by the fact that the UK's property taxes are comparatively low.

The first property tax faced by all buyers in the UK is Stamp Duty. After a Stamp Duty holiday in 2020/21, home buyers must now pay Stamp Duty on all purchases above £125,000. On top of this, from 1st April 2021 a 2% Stamp Duty surcharge was introduced for overseas buyers on the purchase of residential property in England and Northern Ireland.

Yet with so many properties already owned by overseas buyers, in many senses the horse has bolted. Furthermore, any initial discomfort that wealthy foreign buyers might experience from Stamp Duty rates is surely offset by the extremely low property tax rates that follow. For example, in Westminster, semi-detached properties sold for an average £5.24m last year [11] - the maximum Council Tax for residents is just £1,655 per year.

Under current Council Tax rates, the owner of an average semi-detached home in Westminster pays only 0.03% of their property's value in Council Tax every year. Meanwhile the average household in the Durham constituency of Easington presently pays over 1.4% of their home's value in Council Tax every year [12] - making their "Council Tax burden" more than 44 times higher than that encountered by the owner of a £5m plus semi-detached home in Westminster.



In this way, the UK is a rather odd mix of a relatively high one-off tax in the form of Stamp Duty, followed by low recurrent taxes in the form of Council Tax. The recurrent tax cost is then wiped out by the yield received from rent or appreciation of the asset due to rising property prices. For wealthy international buyers, such relatively low property tax rates make it worth buying London property and holding it as part of a speculative portfolio even if they rarely visit. But the tax treatment is very different in other major cities.

PARIS

In France, there is an annual wealth tax on property called Impôt sur la Fortune Immobilière (IFI). This affects households with total taxable property assets worth over €1.3 million. There is a €800,000 tax-free allowance, then rates start at 0.5% and rise progressively to 1.25% for properties between €5m and €10m and 1.5% for properties above €10m [13].

Non-residents are liable to pay tax on their French real estate assets. Furthermore, companies or trusts (in fact all legal entities) that own French real estate, directly or indirectly, are subject to an annual tax of 3% of the market value of the property.

In New York, tax rates across the state are applied to the assessed value of home and rates are recalculated each year based on the total value of real estate in a tax district and the amount of revenue the tax authority needs. The New York state-wide average rate is 1.69% while in New York City, the average effective property tax rate is 0.88%. Brooklyn has the lowest effective tax rate in New York City at 0.66, while in Manhattan the rate goes up to 0.95% resulting in a typical homeowner in Downtown New York paying $8,980 every year [14].

In Canada's largest city, Toronto, residents also pay according to the value of their home. Property assessment values are determined by the Municipal Property Assessment Corporation and are updated every year. This value is then simply multiplied by the property tax rates to determine the yearly contribution. The city tax rate for residential properties is 0.45%. On top of this comes an Education Tax rate set at 0.153% for residential properties and a City Building Fund Levy of 0.006722%. Adding these three pieces together, results in a residential property tax rate of 0.61% in the city of Toronto [15].

THE SOLUTION

For some years, parliamentarians have been aware of the problems posed by international buyers in the London property market.

> **"Another crucial element in London's housing crisis is super-wealthy, non-domiciled international buyers who want to purchase property in central London. They are using London property as a status symbol and a safe deposit box, often keeping the properties empty for much of the year. Even in Hackney, large developments in Dalston had many units bought off-plan in Asia. The almost limitless supply of super-wealthy, non-domiciled buyers in the centre of London is causing a price ripple throughout zones 2 and 3, making it increasingly harder for ordinary families on average wages in previously affordable boroughs to meet their housing costs."**
>
> Diane Abbott
> *Labour MP*
> *2014*

In November 2021, a cross-party group of MPs called for legislation to stop the use of UK property for economic crime. In total, 40 MPs endorsed the initiative as a joint statement insisted that the Prime Minister "must now tackle the U.K.'s dodgy international reputation for facilitating economic crime across the globe in light of damaging Pandora Papers leaks [16]."

There have been some encouraging development around the prospect of using taxes to curb new buy-to-let and second home purchases. Neil O'Brien, Parliamentary Under Secretary of State at the Department for Levelling Up, Housing and Communities, used two articles for Conservative Home last year to set out his support for measures that favour "owning over renting". In February 2020, he highlighted the role of second and rental properties in the "relentless collapse" in home ownership, from 71% to 63%, between 2002 and 2015 [17].

> **"In 2015, we started phasing in limited changes to the tax treatment of buy-to-let and second homes. It worked. The collapse stopped...we must use the tax system to encourage new investments to flow into companies, not into inflating house prices."**
>
> Neil O'Brien
> *Parliamentary Under Secretary of State at the Department for Levelling Up, Housing and Communities*

More recently, Michael Gove, the Levelling Up Secretary, announced new rules that will mean From April 2023 second homeowners can only register for business rates if they can prove they let the properties for at least 70 days in a year [18].

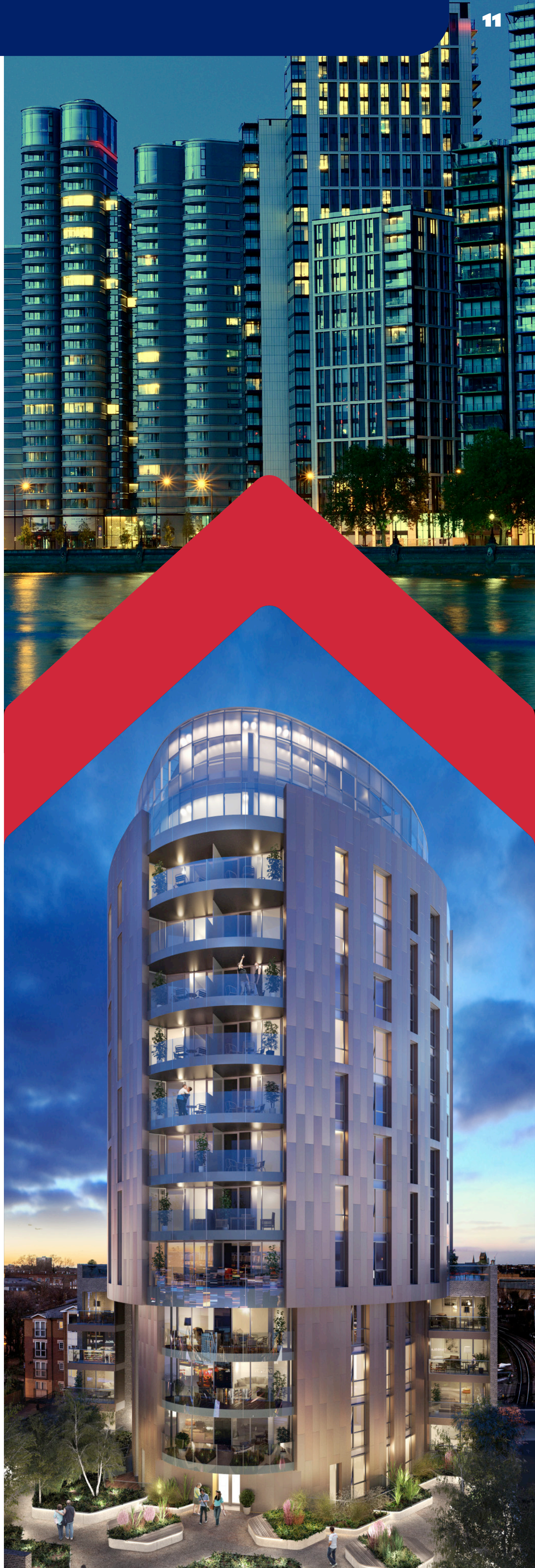
It's clear there is a desire to take action to create a fairer system and get a grip on a growing housing crisis. However, the simplest and more effective way of approaching the issue would be via a fundamental reform to the way we tax residential property. This could be achieved through a Proportional Property Tax that would serve as a replacement to our outdated and unjust Council Tax, based on property values from 30 years ago.

Under the system devised by the Fairer Share campaign, homeowners would pay an annual rate of 0.48% of their property value and 76% of homeowners up and down the country would see their bills go down. For local primary homeowners it would also replace Stamp Duty, a deeply unpopular tax imposed on property owners before they have even collected the keys to the front door.

On top of this, there would be a surcharge rate of 0.96% for foreign-owned, empty and second homes which would raise an estimated £4.5 billion. This would mean that an international buyer purchasing a £6.2m house in Westminster would pay out £59,520 every year, rather than the current £1,655. Foreign buyers would also continue to pay Stamp Duty.

International buyers in London would therefore pay property taxes more aligned to what they might expect to face in New York or Paris, putting a stop to the corrosive practice of wealthy individuals purchasing prime London property and then holding it as part of a speculative portfolio.

A Proportional Property Tax would mean lower bills for most households but increased rates for non-UK purchasers. Introducing such a reform is popular, even among Londoners. A 2018 poll found that 51% percent of Londoners would support an outright ban on non-residents buying property in London. And in 2017, a poll commissioned by the GLA asked Londoners which interventions they would support to increase housing supply and found restrictions on overseas buyers to be the most popular option [19].



THE RATIONALE

1. HOUSE PRICES

Successive Prime Ministers have pledged to fix the housing crisis and the incumbent is no exception. In his 2021 Conservative Party conference speech, Boris Johnson declared that “fixing the broken housing market” is key to “how we solve the national productivity puzzle”. And yet UK house prices grew at the fastest pace in 15 years in the quarter to the end of November 2021, according to data released by Halifax in December 2021 [20].

It is the same story in central London as the return of the international super-rich in 2021 amid the easing of coronavirus pandemic restrictions fuelled the highest annual growth in property prices since 2015 in the capital’s most expensive district. Rupert des Forges, Knight Frank’s head of prime central London developments, said members of the international jet-set elite were buying new-build properties as well as characterful older houses, West End developers having received over £250m of offers in the W1 postcode alone. “The pandemic has not altered London’s status as a global safe haven,” he said [21].

By fairly taxing the number of international buyers in London, the surcharge element of Proportional Property Tax would control house price inflation. Research by WPI Economics also shows that introducing a Proportional Property Tax has the potential to release hundreds of thousands of homes over five years to help tackle the housing crisis. In many cases these homes would be released because of increased transactions brought about by PPT. By increasing the number of transactions, PPT will increase the movement between homes that will allow those in under-occupied homes and those in overcrowded homes to find a better fit. Other homes would be released thanks to more second homes becoming available, empty homes becoming easier to sell and more homes being built sooner.

Around 600,000 homes would be released throughout England. This could mean up to a quarter of a million one- and two-bedroom homes freed up for young people who most need them, along with many more family homes. In London, up to 47,000 one and two bed starter homes could be released - more than any other part of the country [22].

2. ECONOMIC CRIME

The National Crime Agency estimates that the cost to our economy from money laundering alone is £100 billion. To put that into context, it is about the same as the budgets for the Department for Education and the Home Office combined. But as well as costing the Treasury billions, economic crime through the UK also harms our global reputation and endangers our national security [23].

As outlined above, to crack down on this, with the UK's property system enabling criminals to hide and store their money, ministers are now under pressure to create a public register of overseas UK property owners. That would mean requiring any overseas entity, when purchasing UK property, to register with Companies House and submit verified information. This would prevent owners hiding behind anonymity, preventing tax avoidance and money laundering.

This makes sense but it is not the only way to tackle the problem. By bringing in a Proportional Property Tax with an annual surcharge rate of 0.96% for foreign-owned, empty and second homes, there would be less incentive for criminals to hide and store their money in UK property in the first place.

3. A FAIRER SYSTEM FOR ALL

A Proportional Property Tax would mean higher rates for super-wealthy, non-domiciled international buyers who stand accused of using London property as a status symbol and a safe deposit box. HMRC estimate that there were 75,700 individuals claiming non-domiciled taxpayer status in the UK in the 2019/20 tax year [24]. A Proportional Property Tax would ensure that non-domiciles, who pay no UK tax on their offshore accounts, at least have to pay their fair share of property tax on their homes in the UK.

But while non-domiciles and other international buyers purchasing multiple mansions and luxury flats would pay considerably more, most households in the UK would pay less as the new system would be much fairer than the current regime which is based on valuations from back in 1991.

It is widely agreed that Council Tax a punitive, regressive tax. It may work as a modest service charge for millionaires, but it is more like a wealth tax for low and middle-income households. Council tax ensures that people who live in more modest houses end up paying a higher tax rate than those living in wealthier areas and more valuable properties. The absurdity of the current system is perhaps underlined by the fact that a household in Barnsley pays out 1% of their property value whereas a household in Battersea pays just 0.1%.

With a primary levy of 0.48%, a Proportional Property Tax would put an end to this deeply unfair system. As such it would mean lower bills for around 76% of households in England and for 99% of the households in the most deprived 10% of constituencies in England. On average, households would pay £435 less property tax each year.

CONCLUSION

Rising housing prices lead to resentment among the British public and there is an urgent need to tackle the housing crisis. This sentiment may not always be registered by politicians, or by newspapers with vested interests in maintaining the status quo. Yet it is clear from YouGov's monthly tracker, showing that only one five people want house prices to keep going up while close to 50 per cent of people believe it would be better for Britain if prices went down [25].

On top of this, unlike the rich who move to London, generating income tax, VAT and so on, non-resident, non-UK purchasers who buy property do not pay wider taxes or boost productivity. Rather, it could be argued that London's competitiveness suffers as high earners are discouraged from moving here by speculative price rises.

Proportional Property Tax has been backed by think tanks from across the political spectrum, while MPs on the Housing, Communities and Local Government committee recently called on ministers to "consider options for wider reform of Council Tax and business rates, including possibly replacing them with a Proportional Property Tax [26]." The reform has cross-party support, with backers including, Greater Manchester mayor Andy Burnham [27], former Liberal Democrat leader Vince Cable [28] and a host of Conservative MPs in seats from Barrow and Furness to Bishop Auckland [29].

Ministers should take note of this groundswell of support. By adopting a Proportional Property Tax, the Government could have its cake and eat it. For local primary homeowners, the policy would mean no more Stamp Duty and lower bills for the majority of households in the UK, under a fairer system for everyone. For the Treasury, the reform would be revenue-neutral with international buyers continuing to pay Stamp Duty and the surcharge on these purchases limiting the scope for property being used to facilitate economic crime and acting as a much-needed control on skyrocketing house prices.

ENDORSEMENTS

"The housing market has been a significant driver of wealth inequality in the UK over the past thirty to forty years. Ultimately, we conclude that 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 inequality, intergenerational inequality and regional inequality, and make our economy stronger.

Shreya Nanda
Economist at the Institute of Public Policy Research

"While the current system is regressive and distortive, an a proportional property tax would change this by rebalancing expected property tax liabilities and putting money in the pockets of those from modest backgrounds and areas.

Sam Robinson
Senior Researcher at Bright Blue

"I would encourage the chancellor to be a reforming chancellor and look at ways to improve the tax system through simplification, but also addressing areas of unfairness. These proposals around reforms to council tax and stamp duty are very welcome and ones which I would support.

John Stevenson
Conservative MP for Carlisle

"The cost of housing is holding back the younger generation. We need to get more housing onto the market for them. A Proportional Property Tax is key to this. It would replace Council Tax which has become increasingly regressive and is particularly hard on young people.

Rt Hon Lord Willetts
President of Resolution Foundation's Intergenerational Centre and author of The Pinch

FOOTNOTES

1. https://www.hamptons.co.uk/research/articles/foreign-buyer-numbers-fall-to-lowest-level-in-a-decade/#/
2. https://www.bloomberg.com/news/articles/2021-09-09/london-s-luxury-homes-lure-the-least-overseas-buyers-in-a-decade
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