The taxation of high value property is again in the spotlight. We consider its impact on the prime property market.

The taxation of high value property has been under scrutiny since the March budget increased rates of stamp duty on properties over £2 million. The debate has been refuelled recently by renewed discussion of the merits of a mansion tax or other ‘wealth tax’.

Although increasing the tax on high value property is an ‘easy sell’ politically the economics may be more difficult to justify. Contrary to common perception, high value homes already make a disproportionately large contribution to the tax take from residential property.

To avoid unintended consequences, such as declining taxable activity, it is essential to understand both the effectiveness of further taxation and the impact it may have on the prime housing market and those active in it.

The Council Tax Debate
Understanding local government taxation

Council tax is arguably the one area of taxation where high value property makes a disproportionately low contribution to the tax take, and then only in some locations. As a result it has been suggested new council tax bands be introduced, replicating measures already undertaken in Wales. Properties in the top two council tax bands (G and H) account for 4.1% of the housing stock and £2.1 billion in council tax receipts.

Council tax valuations and the corresponding bands are undoubtedly outdated. But if council tax is a locally based tax designed to contribute to local authority budgets, then a council tax revaluation could redistribute the existing liability but would be tax revenue neutral.

The costs of administering a wholesale revaluation would be difficult to justify in these times of austerity, but a partial revaluation designed to bring in a new band for super prime property would be a more cost-effective option.

Targeting only properties in the highest council tax band would still require a revaluation of 130,000 properties, while targeting the top two council tax bands (G and H) would require a revaluation of some 940,000 properties.

More pertinently, it is questionable whether it is the council tax bands that are at issue or the charging structure of the tax.

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Lucian Cook, Savills Research

Band H properties account for just 0.6% of the housing stock in England. Even in the central London boroughs of Westminster and Kensington and Chelsea they account for 14% of all housing. These band H properties currently contribute approximately £320 million in council tax receipts with an average council tax bill twice the national average.

Each local authority currently sets council tax charges with regard to their specific financial needs. It then distributes the total requirement by reference to the make up of the housing stock within that local authority.

This means the amount of council tax payable for properties in the same band varies across the country and in higher value boroughs, where band H properties are most common, the council tax charges for band H properties are the lowest.

It is this difference between charges for properties in the highest council tax band that causes the inequalities that are so frequently referred to, even though the charge for a band H property is universally set at twice that of a band D property in each distinct charging area. If there is a desire to distinguish more between taxation levels of high and low value properties, it is these universal proportions that need to be changed.

To put this in context, in the 10% of local authorities charging the most for a band H property the annual council tax charge for such a property was £3,223 in 2010. By contrast, in the lowest 10% it was £2,465. Only in Wandsworth (£1,374), Westminster (£1,376) and the City of London (£1,878) are they below £2,000 per annum.
Central Government Taxation

The contribution of high value property

If the real issue is the contribution made by owners of high value property to central (rather than local) government taxation, then it is important to understand the current situation.

Our analysis shows high value property already makes a disproportionate contribution to receipts from both stamp duty land tax (the primary transactional tax) and inheritance tax (the primary wealth tax).

It is therefore important that any further changes don’t damage the value of this ‘rich seam’ of tax take. Market impacts have to be carefully considered.

Stamp Duty Land Tax

In 2010 properties worth over £1 million accounted for just 1.6% of recorded sales but 26% of residential stamp duty land tax receipts – some £1.2 billion.

Since then a new 5% rate for properties sold for in excess of £1 million and 7% for those for over £2 million have been introduced. Applied to the deals recorded in 2010 this new level of taxation would have accounted for 34% of the Stamp Duty Land Tax (SDLT) take, or £1.85 billion.

Increased rates of tax inevitably give rise to greater incentive to avoid that tax, which in turn requires the introduction of targeted avoidance measures, though the nature of recent SDLT avoidance measures has caused concern among both the property industry and wealth managers.

The SDLT charging structure has paid dividends for the Treasury in the post credit crunch environment.

The top end of the housing market has been much more buoyant than the mainstream, given an influx of overseas wealth and a much lower reliance on mortgage finance amongst domestic buyers. That has prevented a significant drop off in stamp duty receipts, despite the fact that transaction levels across the market continue to run at about 55% of the pre crunch norm.

For this reason, calls for a flat rate of stamp duty are unlikely to be considered expedient. However, the debate over a move away from a slab structure to a banded structure is likely to rumble on, given that it is less likely to create artificial thresholds in the market.

Inheritance Tax

Inheritance tax receipts from high value property are far lower than those from stamp duty. HMRC figures suggest that 1,456 estates with total assets exceeding £2 million were subject to inheritance tax in 2008/09. Of these, 1,173 (81%) comprised residential property with an average value of £1.13 million, generating, we estimate, a tax take of £381 million.

This means just 0.7% of the housing stock held at death generated 36% of the inheritance tax receipts from residential property. In most circumstances taxpayers’ nil rate bands cover the value of residential property held at death and no inheritance is applicable.

Consultation on the taxation of property held by ‘non natural persons’ suggests that inheritance tax receipts from high value properties will rise in the future, as more property currently held within offshore corporate structures is brought into personal ownership and therefore within the inheritance tax net.

Future Tax Policy

Our analysis suggests that, taken as a whole, high value property makes a disproportionate contribution to the tax take from residential property.

There are inequalities that result from the way council tax is charged, but these are offset by the distribution of central government taxes in the form of stamp duty and inheritance tax.

If the inequalities of council tax are to be removed, then it would be necessary to have a geographically uniform charge for each council tax band. But this would fly in the face of local accountability for the cost of local government. In the case of central government taxation, put simply there are three ways to increase the tax take from high end property: 1. minimising tax avoidance 2 increasing tax rates 3. introducing new taxes.

Tax Avoidance

In addition to increased anti-avoidance provisions that are specific to the tax in question, new taxes have (in some cases) been introduced to plug the gaps left by tax legislation. These have generally been retro-active in their effect i.e. by introducing new tax liabilities on those who have previously undertaken tax planning measures.

For example, the pre-owned assets tax introduced in 2005, created an annual levy on those who had used certain schemes to avoid inheritance tax on their death. There are parallels with the latest proposals for an annual levy where an individual has previously established a company “to envelope a property owned for the personal use of that individual or their family… where tax avoidance is a significant factor”.

As has been highlighted by commentators during the ongoing consultation, the wisdom and fairness of such retro-active legislation needs to be carefully considered. In the words of the Institute of Chartered Accountants of England and Wales the fiscal impact of such measures needs to be balanced against the potential that they are considered to “damage to the perceptions of the UK tax systems as fair, proportionate and stable”.

It is clear where such anti-avoidance measures are introduced account needs to be taken of the consequences in the context of the broader tax regime.

For example, the recent annual charge consultation has highlighted that...
the adoption of offshore corporate ownership vehicles by non doms has had more to do with inheritance tax planning than stamp duty avoidance.

Where property is forced out of the so-called ‘corporate envelope and into personal ownership by non doms it becomes liable to inheritance tax. Whatever the political desirability of achieving this, it will undoubtedly impact the relative attractiveness of owning prime properties in the UK to overseas buyers, even those resident here. We are already seeing buyers and owners delaying their transactions until they know the outcome of the ongoing consultation.

This suggests that further changes to the tax burden borne by high value housing could adversely impact on the market, with consequences not just for prices but also the central London development sector, which is one of the few buoyant parts of the UK house building industry. Most importantly, our analysis suggests that tax avoidance is not nearly as widespread as is believed and that most corporate structures are bona fide and set up for business purposes.

Tax Increases: the impact

Increased taxation at the point of transaction alters buyer behaviour. Since the 2012 budget we have seen sales in the £2.0 to £2.2 million price bracket fall by 29%, whilst those between £1.8 and £2.0 million have risen by 37%.

But at what point does taxation become such an issue that it affects wider market demand. Without doubt, raising transactional taxes has less impact in a strong market when prices are rising. In these circumstances, price growth may be temporarily reduced but prices will not be undermined.

The increase in the rate of SDLT for £2 million+ property to 7% has made the prime residential market look more uncertain. The rate of price growth in prime central London has slowed dramatically in the past six months, with average price rises of just 1.2% over that period masking the fact that the majority of properties in the Savills prime central London index have seen no price growth at all.

Further taxation could have a much greater impact on the market in the current environment than would be the case in stronger market conditions.

New Taxes

Entirely new taxes, such as a mansion tax, would add a further potentially damaging burden, unless part of wider tax reform.

While ideologically straightforward, new taxes on residential property risk being complex to administer not least given a range of valuation issues that will result in additional costs to both the taxpayer and HMRC. There is also little doubt that concessions would be sought from asset rich/cash poor owners and other groups such as owners of large listed properties that carry substantial costs of upkeep.

Proposals for future taxation of high value property should take account of the cumulative effect of increases on the total tax burden on owners of that property, whether than be full UK taxpayers or non doms (who for example are affected by the newly imposed non doms tax levy).

Conclusions

The taxation of high value property is likely to remain under the microscope in the short term. But this requires an informed debate that distinguishes between local and central government taxation, acknowledges the fact that high value property already makes a disproportionately large contribution to the tax take and takes account of the impact on the prime property markets and the wider economy.

There is a point where too much taxation stifles the market. We could be approaching a tipping point where further tax rises or the introduction of new taxes risk killing the goose that laid the golden egg.