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DLUHC seminar

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Taxing rented and owner-occupied housing



Economic
and Social
Research Council

Housing in the tax system

- Key idea: housing is both a consumption good and an asset
 - Occupier enjoys a flow of services from living in the property
 - Owner gets a return on his/her purchase
- Tax system should treat it appropriately from both perspectives
- Starting point is neutrality: treat similar activities similarly

Taxing housing consumption

- Housing should be taxed like other consumption
- Two ways this could be done:
 1. VAT on new build
 2. Annual tax on the stream of consumption
- From where the UK is starting, the latter makes more sense
- Tax the annual consumption value of housing: substitute for VAT
- Looks like a sensibly reformed council tax
 - Based on up-to-date values (rather than 1991 values)
 - Proportional to values (rather than regressive with wide bands)
 - No discounts for single occupancy (rather than 25% discount)
- Tax rental vs capital values – principle vs practicality?

Taxing housing as an asset

Private rental housing

Owner-occupied (main) home

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Income tax on rental income

CGT on capital gains

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No tax on imputed rental income

No CGT

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Income tax on rental income
– and mortgage interest deduction
restricted to basic rate

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Taxing housing as an asset

Private rental housing

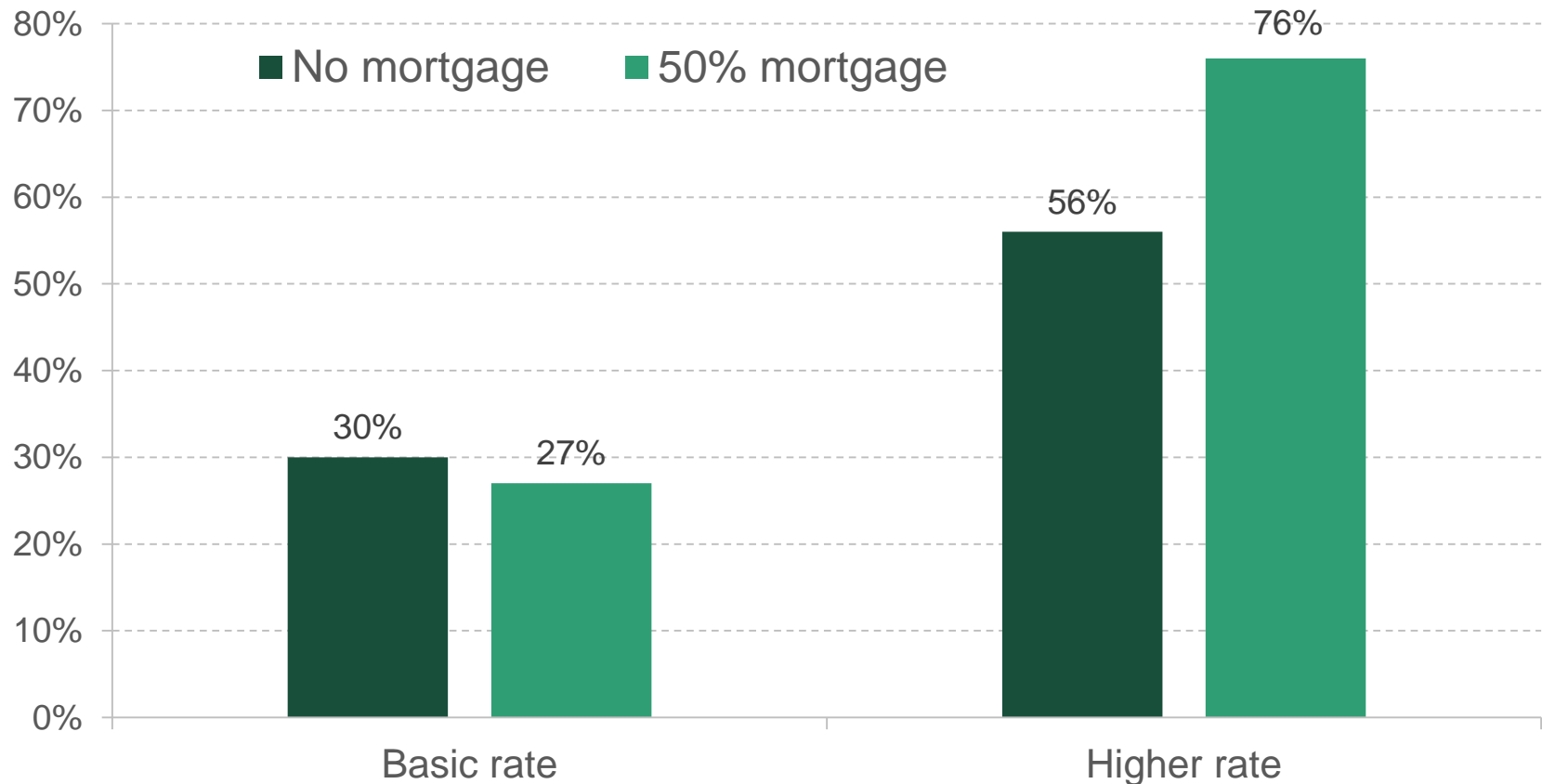
Owner-occupied (main) home

-
- Income tax on rental income
- and mortgage interest deduction restricted to basic rate
- CGT on capital gains
- higher rates than for other assets

No tax on imputed rental income

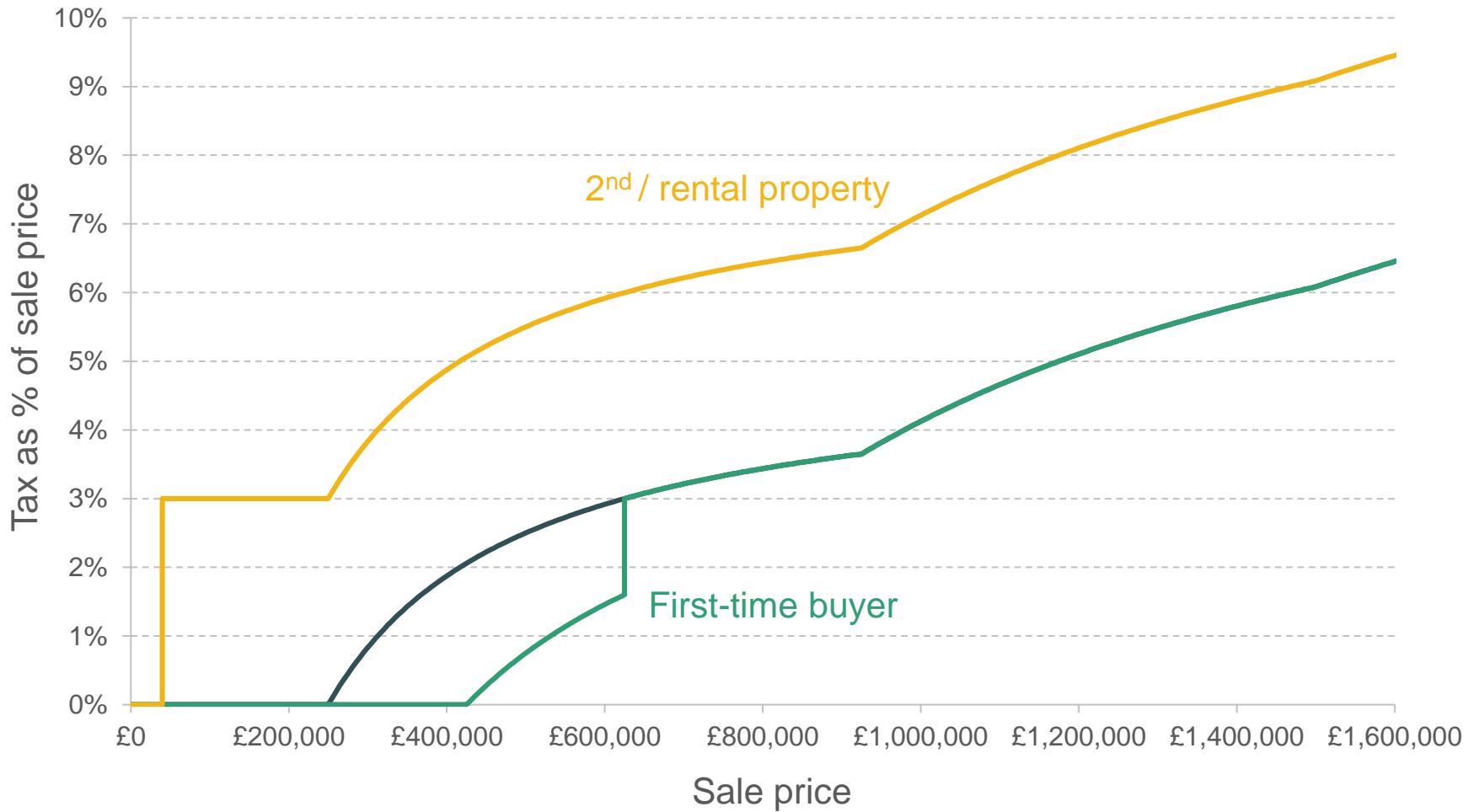
No CGT

Effective tax rates on 10-year buy-to-let investment



Source: Table 5.3 of Adam & Shaw (2016), *The effects of taxes and charges on saving incentives in the UK*. Full details and assumptions given there.

Stamp duty land tax



Taxing housing as an asset

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No CGT

Taxing housing as an asset

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<i>plus</i>	<i>plus</i>
Stamp duty with 3ppt supplement	Stamp duty with 1 st -time buyer's discount

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	Lifetime ISA, previously Help to Buy,...

Rental vs owner-occupied housing



- Subsidising owner-occupation largely ineffective in making housing more affordable overall
 - Supply constrained, so just bids up prices
- But does affect the allocation of housing
- Debatable whether any justification for favouring owner-occupation
 - But certainly not on this scale
 - And certainly not in this odd cocktail of ways

Reforming the taxation of property income

- Major bias in favour of owner-occupation vs rental
 - And between each housing investment and many other assets
- Current regime for owner-occupiers seems too generous
 - Enormous returns have gone untaxed
- Current regime for rental property distorts behaviour
 - Penalises buy-to-let investment and penalises renting
 - Inflation and capital gains cause particular problems
- A 'rate-of-return allowance' could alleviate all these problems

A rate-of-return allowance for rental property

- Based on current system
 - Taxing both rental income and capital gains
 - Ideally at full labour income tax rates
- But with an allowance for a (risk-free) rate of return on investment
 - EITHER deduct (say) 3% of purchase price from rental income each year; tax capital gains at full marginal income tax rates
 - OR tax rental income in full, but charge CGT only on gains relative to a purchase price stepped up by (say) 3% per year
 - Like old indexation for inflation, but for an interest rate instead
- Give tax relief for mortgage interest above the risk-free rate
- Ensure returns below the risk-free rate ('losses') relieved in full

A rate-of-return allowance for owner-occupiers?

- Similar, but tax *imputed* rent and capital gains above the RRA
 - Imputed rent is exactly what is assessed for reformed council tax
- Same two implementation options now take on a different slant:
 - EITHER deduct (say) 3% of purchase price from imputed rental income each year; tax capital gains at full marginal income tax rate
 - *Would people just wait for the next government to repeal CGT?*
 - OR tax imputed rental income in full, but charge CGT only on gains relative to a purchase price stepped up by (say) 3% per year
 - *Is charging VAT + income tax + NICs rates on imputed rent each year politically realistic?*
- Retain current treatment of owner-occupied housing for now?
 - RRA for rental property alone would still be a major improvement

Conclusion: recommendations

- Replace council tax and SDLT with flat % tax on up-to-date values

- Introduce a 'rate-of-return allowance' regime for rental property
 - And perhaps owner-occupied housing in the (even) longer term

- Reverse recent ad hoc policies that exacerbate bias:
 - Subsidies for owner-occupation: IHT, LISAs
 - Penalties for buy-to-let: mortgage interest restriction, extra SDLT