# Our property tax system is in dire need of reform: we need radical solutions such as automatic Council Tax revaluation or a national property tax based on property values

Blog Admin

*With the recent news that first time buyers have little prospect of owning their own home in the next five years, it is clear that our housing system is in need of reform.* **Mark Stephens** *of the Joseph Rowntree Housing Market Taskforce argues that our current system of Council Tax is outdated and unequal, and proposes some radical reforms that may go some way to diminish the cyclical effect of the housing market.*

It's hard to think of a popular tax. Possibly ones that hit those seen as rich and underserving – bankers' bonuses spring to mind. But of all of the unpopular taxes, property taxes seem to be especially unpopular. In fact, it was the unpopularity of rating revaluation in Scotland that precipitated the Thatcher government's catastrophic experiment with the poll tax, which did at least show that it is possible to devise a tax that is even more unpopular than a property tax.

So when the Joseph Rowntree Foundation Housing Market Taskforce examined the role that property-related taxation might play in moderating house price volatility, it did so with some trepidation. We also considered whether taxes could be made fairer because we recognise the importance of taxes being seen to be legitimate and fair. The poll tax failed precisely because it lacked legitimacy and precipitated a substantial non-payment campaign.

Our view is that inadequate housing supply is an underlying cause of both the pricing out of younger households from home ownership and market volatility: once inflation is built into the system, expectations of higher prices can fuel an unsustainable boom. We also recognise that it is unrealistic to expect the supply deficit to be removed in near future. Moreover, even if higher levels of output are achieved, the housing system will always be vulnerable to demand-side shocks (for example, sudden changes in credit conditions) that can spark a house price boom. Both Ireland and Spain experienced simultaneous house price and building booms.

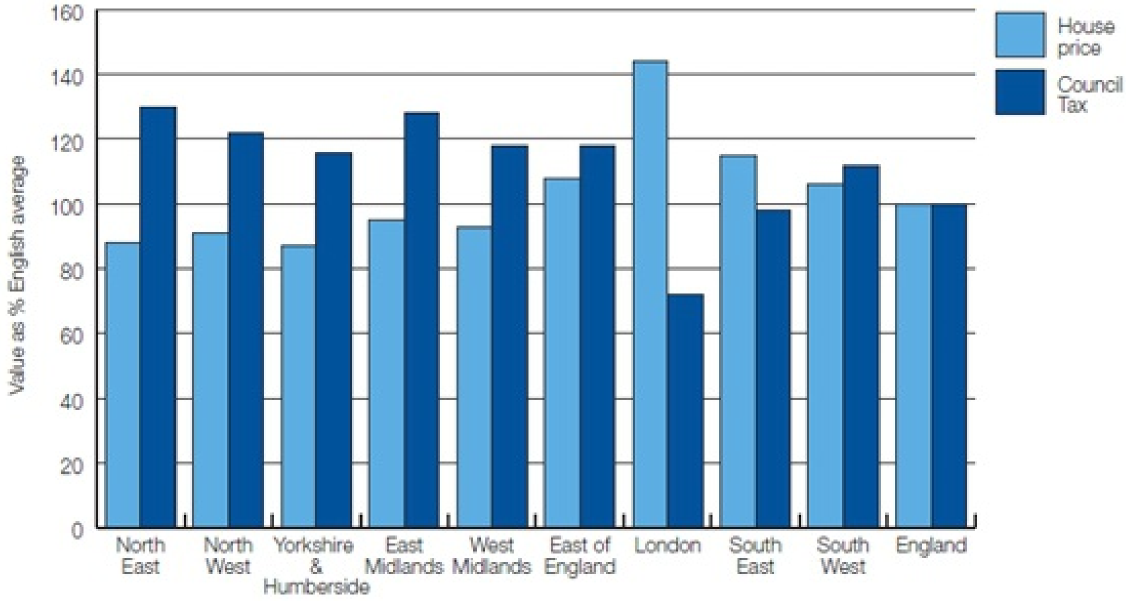
The introduction of Capital Gains Tax on principal homes should be ruled out (a conclusion that may be surprising to some). The current exemption is now the main tax advantage that home-ownership enjoys relative to renting (because private landlords pay capital gains) and there are good grounds for taxing it like any other asset. But there are huge practical problems with implementing such a tax on homes. If people were taxed each time they moved house, it would discourage them from moving. That would be both unfair and bad for the economy. This is why countries that do have a capital gains tax on homes allow for 'roll-over' relief by which capital gains that are re-invested in housing are exempted. This, of course, diminishes any counter-cyclical effect that the tax might have. Moreover, if the tax were imposed on final sales, it could have quite perverse consequences – discouraging older households from trading down into smaller properties, for example, so perpetuating under-occupation.

Economists tend to dislike Stamp Duty because it is a tax on mobility. While this is a strong argument, it is not an overwhelming one. The manipulation of this tax has had some impact as a counter-cyclical tool over the housing market cycle. But we also concluded that it could be both fairer and more effective if it were to be reformed. It could be made fairer if it were restructured from its current 'slab' form (whereby once the price of a property crosses a threshold the tax is paid on the entire price) to a slice one (whereby the tax is triggered at whatever rate only on the part of the price that exceeds the value). The current structure is widely perceived as being unfair, and is also widely manipulated.

Thresholds should be uprated automatically, according to an index such as the CPI. The history of the tax has been one whereby thresholds are left unchanged for long periods, and then are suddenly raised in destabilising and ad hoc way. Automatic uplifting with CPI would provide some 'fiscal drag' when real house prices are rising, and some moderation on taxation on the downturn. We do not suggest that this measure alone would cure the problem. Everything we recommend is part of a package, and we see Stamp Duty reform as a useful element to it.

Far more controversial would be any move to reform our current system of property tax, which takes the form of the Council Tax in Great Britain. Council Tax is not especially fair and does not do much to counter the house price cycle – though to be fair it was not intended to do so. Even with the rebate system it's slightly regressive. It also has the effect that properties in regions with relatively low property values are taxed at a much higher rate than properties in regions with relatively high property values (Figure 1).

**Figure 1: Regionally regressive effects of Council Tax (2009/10)**




*Note:* Regional house prices as percentage of English average; Council Tax rate (regional amount as percentage of regional house price) as percentage of English average.
*Source:* CLG (2009b) Live Table 512

Council Tax rose at a much slower rate, so reducing the effective rate of tax on property (as shown in Figure 2). Meanwhile there has been no revaluation since the tax was introduced in England and Scotland – it is based on property values two decades ago! Both the last Labour Government and the current Coalition Government ruled out revaluation, exploiting the widely held misconception that such a move would increase revenue from just about everyone rather than redistribute tax liability between properties within the same local authority area.

**Figure 2: Average house prices and Council Tax revenue (England, 1993–2009)**


*Source:* CLG Live Table 512 (simple average house price); CLG (2009b)

The Taskforce set out a way in which Council Tax could be reformed to make it fairer and enable it to moderate housing price fluctuations. The tax base could be revalued and the number of bands increased as has already been done in Wales. This would improve the relationship between the relative value of a property and the amount paid in tax. Moreover, revaluations should become automatic and more frequent to prevent anomalies accumulating over time. Still better, the tax could be transformed into a 'point value' system replacing the bands with a liability based on the capital value of the property as has already been done in Northern Ireland.

But neither of these measures alone would exert much countercyclical influence. This would require the transformation of the property tax into a national tax which rises and falls with property values as Oxford economist John Muellbauer has argued. It could be phased in through the adjustment of formula grant, but eventually the instability of revenues from property tax would necessitate a different tax base for local government. We also believe that fairness would be served only if such a tax were accompanied by a rebate system for low income households. We do not underestimate the significance of this proposal, and for this reason we state clearly that research on its impacts would need to establish that the gains clearly outweighed the costs before it was pursued.

Many will say it’s politically impossible to embark on such a reform – but that’s what was said about mortgage interest tax relief which was finally abolished without a murmur of protest a decade ago. The long term damage caused to society and the economy by the UK’s persistent boom/bust cycle means that that even contentious solutions need to be seriously considered.