JOSEPH ROWNTREE FOUNDATION

INSPIRING SOCIAL CHANGE

AFTER THE COUNCIL TAX: IMPACTS OF PROPERTY TAX REFORM ON PEOPLE, PLACES AND HOUSE PRICES

The Council Tax is widely discredited. This study examines two key questions: would taxing property values be fairer than the Council Tax, and could such a tax help to reduce house price volatility?

Key points

- A progressive property value tax would reduce the size of median gross bills by £279 a year compared to the Council Tax.
- Gross bills would fall by more than 10 per cent for almost two-thirds (63 per cent) of households. Fewer than one-quarter (22.3 per cent) would experience increases of more than 10 per cent.
- A progressive property tax would reduce gross median bills for the poorest tenth of households by £202, and increase them for the top tenth by £184.
- However, London is a special case because of its high property prices, and needs to be handled differently, with its own scheme.
- A property tax could also have a supporting role in reducing house price volatility, along with other measures such as mortgage credit controls.
- Any national property value tax would need to be phased in gradually.
- A property tax should also take account of household income and a hybrid property and income tax should be investigated.

The research

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BACKGROUND

The Council Tax is decaying and lacks credibility. In England it operates on property values that are more than two decades out of date.

Property values have generally risen substantially since last assessed in 1991, but at different rates between different parts of the country and within the same areas. The Council Tax is designed to tax a higher proportion of the value of cheaper properties compared to expensive ones, so is widely regarded as being both unfair and inconsistent. The UK Government has provided grants to encourage local authorities to freeze Council Tax bills, but this is becoming increasingly expensive to fund and some local authorities are increasing the tax anyway.

This study investigates alternatives to the current Council Tax system, and assesses the costs and benefits of introducing a system of national property taxation. Four different systems are assessed: the existing Council Tax system, a revalued Council Tax system, a national property tax based on a fixed percentage of property values, and a progressive national property tax based on a higher percentage on the whole of property values over certain thresholds.

Tax reform has been examined on the basis of three criteria:

- to ensure fairness between places;
- to pursue fairness between people; and
- to reduce house price volatility.

Fairness between places

An increase in the tax burden in London (and to a lesser extent the South East) in favour of the rest of the country would be the main change in distribution between places if a revalued Council Tax shifted to a flat-rate property value tax (and a progressive property tax).

The apparent ‘undertaxing’ of London is removed by measuring the impact of property taxes in relation to Gross Value Added (GVA) and Gross Disposable Household Income (GDHI) property taxes. The outcomes appear more progressive on GVA, although on the basis of GDHI per capita the redistribution may go ‘too far’ to qualify as being fair between places. Some form of property value tax approach would be needed to create greater fairness between places. However, any reform would need to be phased in if this creates a large re-distribution of tax burden.

Fairness between people

Overall, the introduction of a flat rate or progressive property tax would bring about a more progressive distribution of tax burden.

There would be substantial reductions in gross liability for low-income households, which could significantly reduce the need for rebates. Reductions in liability would also benefit middle-income households. Increases in liability are distributed towards the top of the income distribution. However, although more people would gain than lose, there would be losers across the income spectrum. These households might be protected using some of the savings in rebates.

Such radical changes would have to be phased in over many years, and even then it is likely that some of the end results would still be unfair. The principal problem is the 'London effect.' The high levels of property prices in the capital mean that increases in gross liability would affect some households across the entire income spectrum. Special arrangements would be needed for the capital to ensure that an appropriate balance between property tax and other notions of fairness were maintained. Central London would certainly have to be treated in another way or excluded from a scheme covering the rest of the country.

A pure property tax would not be fair – it would need to be related to income through another mechanism. At first glance there is a strong case for embedding such a mechanism within the structure of the tax itself, so that it became a hybrid income and property tax.

House price volatility

Econometric results suggest that property taxation represents a small, but statistically significant component of house price change. The analysis may well underestimate the potential impacts of a property tax, as the results were obtained by analysing an inherently regressive system of taxation. The analysis also suggests that changes in the distribution of prices are an important aspect of volatility, and that the relatively lower rates of property tax on expensive properties may contribute to this.

These findings provide some support for a progressive national system of property tax. It is unlikely that such a system would have a sufficiently powerful effect on volatility by itself but it could operate alongside other policy instruments, such as mortgage credit controls.

Key implementation issues

To gain a fairer system of property taxation, it is necessary to move away from the Council Tax system of banded property values, towards one that is more closely related to property values.

This study shows that although a system of property taxation would be fairer between people and places, three principal problems emerge: the London effect, low-income households that would miss out, and how to phase in the new tax.

London effect

On some measures, property taxation appears to tax London too much due to its very high property prices. This is not only a question of transition – it is likely that an upper limit on a property tax would be required to prevent an undue burden on low- and middle-income households.

Low-income households losing out

Although a property tax would bring about a better match between incomes and gross tax liability compared to the Council Tax, there would be some on low incomes who would lose. The distribution of gainers and losers is such that low-income households in London would lose out, whereas well-off households in the north would gain. A tax based purely on property values without assessing the ability to pay would therefore be unfair.

Transition

Because some of the losses would be large, any system of property taxation would need to be phased in. The JRF Housing Market Taskforce proposed a scheme of moving from the Council Tax to a 'point value' system – whereby the tax would be based on property values within each local authority area and the revenue that the authority needed to raise – then gradually to a national system of property taxation by adjusting grants in response to house prices.

The Mansion Tax, now proposed by Labour as well as Liberal Democrats, might also be a way of introducing and gradually extending a national property tax. By itself, though, it does not tackle the decayed Council Tax and many of the problems that arise from this.

Conclusion

One key test of fairness is someone's ability to pay tax from their current income. Taking this as our starting point implies a shift away from property taxation and towards local income tax. There are, however, good social and economic reasons for ensuring that the tax base is diverse. In particular, property value taxes create desirable incentives when housing is scarce. They also tax a resource (housing wealth) that is often unearned. However, it is practically, politically and ultimately ethically important that a property tax must also have regard to current income.

The answer may lie in the design of a property tax, shifting emphasis away from the value of capital assets towards the income they may yield. Such a system existed in principle in the form of the old 'Schedule A' tax, which taxed the rental value of property. It was abolished in the early 1960s after it had been allowed to wither in much the same way as the current Council Tax system. Some form of hybrid property and income tax might be developed from this idea. For example, the weight attached to measured property-related income might depend on current income. The attraction of such a hybrid tax would be that the income element would be inherent to it, rather than a separate corrective mechanism, as has been the case with the rebate schemes operated alongside the rates and Council Tax. However, such a hybrid income and property tax would itself need to be carefully designed and tested. Efforts should now focus on the practicalities of design and implementation.

About the project

The project constructed a new database of property values based on the Census and records of 7 million housing transactions. This provides estimates of values for every property in England and is therefore the most comprehensive data set on property values to date. The English House Condition Survey was used to estimate the impact of tax changes on households.

FOR FURTHER INFORMATION

This summary is part of JRF's research and development programme. The views are those of the authors and not necessarily those of JRF.

The main report, **After the Council Tax: impacts of property tax reform on people, places and house prices** by Chris Leishman, Glen Bramley, Mark Stephens, David Watkins and Gillian Young, is available as a free download at www.jrf.org.uk

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