Trying to make sense of a mansion tax

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The 2015 election campaign will not be the first in which all parties will be promising to outstrip their rivals in their support for the NHS. At the Labour Party Conference last year Ed Miliband announced that a next Labour Government would introduce a tax– a so-called mansion tax - on high value homes worth more than £2million. In an article in the *Hampstead and Highgate Express* (October 23 2014), designed to calm jittery voters where Labour's majority is the smallest in the country, Ed Balls stated that the tax will be charged at £250 a month on properties worth between £2 and £3 million, but above £3 million it is apparently to be charged at 1% of capital value. The revenue from the tax, it is said, will contribute to a Time to Care Fund to help the NHS. He estimates that the mansion tax alone will put £1.2 billion into the Fund.

The picture of apparently rich property owners who live in "mansions" making hefty contributions to the NHS will appeal to many voters – far more than those who will actually have to pay the tax, many of whom do not vote Labour anyway. (Is that why £2million is the chosen threshold?) The threat of the tax has already caused panic among wealthy property-owners. Faced with a 1% tax on his £7 million home in Fitzroy Square in London the entertainer Griff Rhys Jones has said he will emigrate and live in a palace in another country. Setting aside for the moment all questions of equity, fairness and affordability, is it a tax which is actually workable in practical terms? It seems to be bedevilled with problems which will undermine any claim that it could support the funding of the NHS.

First, the government will have to identify these valuable homes. Getting householders to fill in self-assessment forms appears to be the chosen method. Other methods would be hard to implement. The Land Registry can provide a list of all sales where the price last paid was £2 million or more. But there will be many more where, historically, it was much less than £2 million, and the current value has inflated above that figure. An elaborate and expensive indexation exercise would not catch all homes above the £2million limit. Physical changes to the property or its environs, increasing its value, after the property had been bought do not show up on the register. The purchaser who bought a wreck at a cut-price and spent a fortune restoring it would not be detected. Griff Rhys Jones claims to fall in this category. Council tax bands are decades out of date and are no guide to current capital values. If then it is self assessment, who gets the form? Everyone? A carefully sifted group? As Alistair Darling recently said in the *Sunday Times,* self-assessment will throw up a lot of properties worth £1.9 million, especially if they have been in the same hands for many years.

It looks as if bands of value will be applied, rather than individual valuations. Even so, there will have to be some dispute resolution procedure, if value cannot be agreed. On Ed Balls' figures an annual liability of £3,000 will turn on whether a property falls below or above £2 million. If it jumps into the next band, a 1% levy will start at £30,000 a year, and continue upwards. Whether the value is £10 or £11 million will certainly be worth a fight. Money spent on resolving disputes about value will not be available for the NHS; and the process will not be over in one fiscal year.

Secondly, the concept of "value" itself is more complex than it might seem. Presumably it is the price which the property could be expected to fetch if offered for sale in the open market. The value of a freehold house occupied by the owner is ultimately a straightforward question. If it is subject to a mortgage the value of the owner's equity may be a lot less than the open market value; but that does not seem to be a ground for reducing the tax. But what happens if the property is let? That raises the fundamental question: is this a tax on ownership or occupation? Where property is let, who pays the tax?

Property taxes since the Poor Law Act 1601 have always been a tax on occupation. That is true of business rates and the council tax today. The underlying legal title to the property, possibly stratified down from the freehold through a series of leases and sub-leases, is irrelevant. (Unoccupied property is treated differently). But where the tax is based on the capital value of the prospective taxpayer's interest in the property there may be no taxpayer at all.

In London and elsewhere there are flats held on long leases at ground rents worth more than £2 million. In those cases the value of the freehold reversion is nominal, and therefore outside the tax zone; but the leasehold interest will qualify. By contrast it is unclear as to what happens when the freehold or leasehold owner lets to a tenant at a market rent. Such tenancies are unlikely to have any capital value, whatever the house or flat might be worth with vacant possession. There are blocks where some flats are owned on long leases at low rents by the occupiers, and therefore potentially subject to the tax, with neighbouring identical flats let out by their owners at market rents. Owner-occupiers will think it odd if no-one pays tax on a flat or house, exactly comparable to theirs, which is let.

To meet this objection Ed Balls said that investors will also pay the tax. That makes it look much more like a tax on ownership rather than occupation; but it opens up another large issue - the prospect of valuing every interest in a house or flat held on any type of tenancy or lease. Moreover the concept of the "investor" needs some thought. Does it mean "landlord"? Landlords of residential property lie across a spectrum, from the absentee home-owner who lets the property while working abroad to property companies with a portfolio of flats and houses letting them out in the course of their regular business. Lettings also lie across a wide spectrum, from assured tenancies at market rents to reversions to longer leases of varying durations at a range of rents.

Administering self-assessments on properties in which there is more than one legal interest will create a significant workload for HMRC and possibly the Valuation Tribunals. And how are the interests of non-occupying owners to be valued? Will they be based on vacant possession, or subject to the existing lease or tenancy? Anomalies between the tax imposed on comparable properties owned and occupied on different terms will somehow have to be avoided. But then, if property investors, great or small, who carry on the legitimate business of letting houses or flats to tenants at market rents, and pay corporation or income tax like other investors, have to pay a mansion tax on top, it will be hard to justify exempting investors in commercial property from the same tax. Residential landlords are unlikely to be able to pass the tax on to tenants who are already paying a market rent. The impact on the property investment market will be hard to predict.

According to Ed Balls the tax will respond to changes in property values, but not in a way that you might expect. As market values go up he says that the threshold will also rise, so that the number of taxable properties will not increase. Those who are exempt from the tax on the day it comes into force will always be safe. Their wealth may increase, but they will not be asked to share the burden of funding the NHS with taxpayers who are already subject to the tax. They will have the comfort of owning a property which, although valuable, will be tax-free, and thereby no doubt attract a premium price. This threatens to create a two-tier market of taxable and non-taxable homes, at least at the £2million margin. It does not take much imagination to see how the relative values might go into reverse. The more one thinks about this tax the greater the puzzle.

Mixed-use properties raise other questions. Commercial property will not be taxed, only homes. The capital value of the traditional shop or office with flats above will have to be apportioned. People who work from home will have to be thought about. So too will working farmers who own their land and live in farmhouses in desirable parts of the country like the Cotswolds. The NFU will be watching.

Technical problems apart, it is not clear why Labour is intent on taxing this particular element of personal wealth. Nothing is said about luxury yachts, valuable works of art, other investments, or owners of two homes worth less than £2 million each. For owner-occupiers their home is a capital asset - possibly their only asset – which does not produce income. But the tax has to be paid annually out of income, net after tax and all other outgoings. The unspoken assumption seems to be that there is a correlation between the capital value of a person's home and his or her disposable income, available for paying an annual levy on the asset. This is a category error. It is manifestly wrong. Capital taxes should be paid when capital value is realised. In the case of homes that should be on sale or death; and can we still justify the exemption from Capital Gains Tax on the sale of homes, of any value?

Nor has any comparison been made between disposable incomes in different parts of the country, in some of which house values are high, and others where they are relatively lower. Do people who live in 4-bedroomed houses in Wandsworth have more disposable income than those living in similar houses in Bristol or the Midlands? Those who have homes, bought long ago, where the current value exceeds the £2 million ceiling simply because of price inflation will find it difficult to accept that they must now pay an annual levy for the privilege of staying there, even if they can afford it. And there will be many who cannot afford it. People paying off mortgages, or retired people on fixed incomes, are unlikely to have £3,000 a year, much less £30,000 or more, as free money after tax to meet this liability.

Ed Balls says that a special concession will be made to those who earn less than £42,000 and do not therefore pay the higher or top rate of tax. In those cases liability will be rolled up, interest free, until sale or death. There may not be many home-owners with an income at that level living in £2 million mansions. More will be in the bracket of £60,000 – £100,000. In London some of those will have to find £30,000 a year, after tax, to stay in their present home. Whatever concessions finally have to be made, rolling up debt will not help. The NHS will lose the benefit of cash flow. If property is mortgaged there may be negative equity when the time for sale arrives.

Resourceful owners who sell up, buy a house for less than £2 million and invest the balance of the proceeds in other assets will be as wealthy as before but free from the levy. Others will take advantage of the rich complexities of our leasehold system, stratifying their title so that at no level is there an interest in the property worth £2 million.

We do not know what effect this tax will have on the market. Economic modelling is needed. If the market for expensive homes takes a hit, that will affect stamp duty, estate duty, capital gains tax where it is payable, and revenue from the mansion tax itself. Activity in carrying out improvements will slow down, where money spent on improvements will add to value. Restoring wrecks will be a hazardous enterprise.

The distribution of tax burdens between householders nationally is nevertheless notoriously unfair. The out-of-date basis on which council tax is charged works very much in favour of the rich. Labour would be better off commissioning the long-overdue review of the council tax, taking account of the wide spectrum of values which exists today between all homes, and re-distributing liability on a more equitable basis across the nation as a whole, rather than fastening on one particular group which may turn out to be less able to support the NHS than Ed Balls believes. Although this traditional tax on occupation works its way through the economy differently from a centrally imposed capital levy, it carries fewer technical and political problems and is likely to be more acceptable to a public which has grown up with it.