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Mansion tax
The challenge of implementation

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Introduction

If elected in May, both the Labour and the Liberal Democrat parties have committed themselves to introducing an annual tax on high-value residential property. Their proposals for the so-called Mansion Tax are similar. It would be payable annually on properties worth over £2m. The Labour party have stated that the rate payable on a property worth between £2m and £3m would be £3,000 per year. However, aside from that, few further details have been provided.

Although the idea of a mansion tax seems very simple, there are many complex issues that would need to be ironed out before it could be implemented. These issues include the overall design, how properties would be valued, how it is collected, and when it might be introduced.

With Conservative-led and Labour-led Governments looking almost equally likely, the mansion tax is by no means a certainty, but it is worth considering the implications. In this report we do not debate the rights and wrongs of the tax, nor attempt to determine how much might be raised, or what constitutes a 'mansion', all of which has been exhaustively covered by other commentators. Rather, we concentrate on the practicalities of implementing such a tax.

We conclude that:

– although the concept sounds simple, introducing a mansion tax would be fraught with difficulties.

– designing and introducing an entirely new tax would be costly and time consuming. As a result, the Treasury is likely to modify an existing tax.

– council tax is a widely mooted mechanism for implementing mansion tax, but it is a local tax and setting a national rate may be tricky.

– although council tax is conceptually very similar to the mansion tax, reforming it to include a mansion tax would be complex and could trigger the need for a revaluation of 20 million homes in England.

– revaluing properties for council tax purposes is difficult. A complex full revaluation exercise could lead to unintended, and substantial, redistributional effects and could place more properties in higher bands than planned for.

– the most likely candidate to form the basis of the mansion tax is the Annual Tax on Enveloped Dwellings (ATED), even though its original purpose was quite different.

– the main additional features needed would be an extension of ATED to individuals as well as companies, and mechanisms to allow the 'deferral' of the mansion tax on lower earners.

– it would be unlikely the tax could be implemented for the 2015-2016 year. Realistically, we think it would be implemented in the following financial year.

What is the mansion tax?

Although the idea of a mansion tax seems very simple there are many complex issues that would need to be ironed out before it could be implemented. These include the design, how it is collected, and how its potential side effects might be managed.

How many people will pay mansion tax?

In 2013, the Government suggested that 55,000 properties would be liable, though other estimates produced since suggest it will be more. Last year around 3,400 properties were sold at over £2m; this amounts to around 0.4% of all sales. With 22 million owner occupied or rental properties across the UK, this suggests there are around 82,000 properties that would be liable for mansion tax. This compares with the 136,000 properties liable for the top band of council tax. The Labour party says that only 0.5% of the dwelling stock would be liable (so, around 110,000 homes).

How much would they pay?

The Labour party have stated that the rate payable on a property worth between £2m and £3m would be £3,000 per year. This is equivalent to a minimum rate of 0.1% of the value. But, aside from knowing there will be a sliding scale for higher value properties, we don't know the actual rate. Overseas owners of expensive second homes in the UK would be asked to pay more.

How much will it raise?

The Labour party has said it aims to raise £1.2bn per year from the tax. We estimate there are 82,000 properties which would pay it. Of those 82,000 properties, around 44% or 36,000 will pay £3,000, which will generate just under £110m of revenue, assuming no deferral. The remaining 46,000 properties will need to generate the remaining £1.1bn, about £23,775 per property.

Given how house prices rise, won't more and more properties be liable for mansion tax?

Labour have suggested that the £2 million threshold will rise in line with the average of 'high value' property prices.

Where are all the mansions located?

London has by far the highest share of £2m plus properties at around 80% (see Chart below); a further 16% are located in the south. The only region outside of the south to have any material share of properties over £2m is the North West.

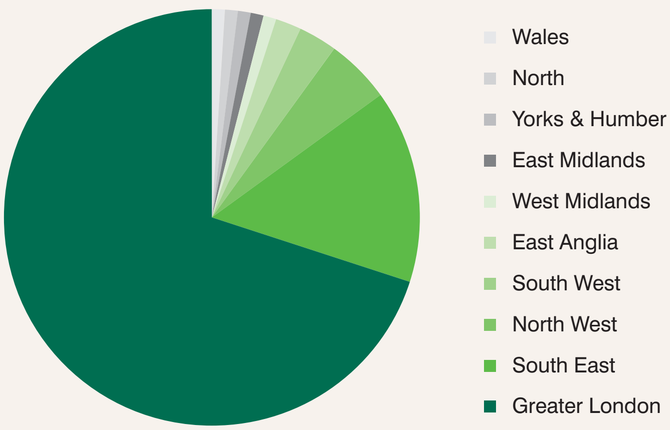
What about people who can't pay? Will they have to sell up?

Labour have suggested that homeowners can defer the tax until the property changes hands if they are not higher rate taxpayers. However, details of the deferral are not clear. For example, does it refer to household, single or joint incomes? Of course, deferral of the tax means that, at the point of sale, the homeowner would face a substantial lump sum tax liability; according to the ONS, the average length of owner occupation of a UK home is 11 years, which implies a substantial average rolled-up liability of at least £33,000.

Estimated average liability on sale for those deferring mansion tax payments.

33,000

Share of £2m plus properties by region



Won't wealthy homeowners try to avoid the tax?

Suggestions for likely avoidance tactics have included splitting a liable property into smaller properties (perhaps with a connecting door), splitting a property legally into two titles such as a freehold/leasehold arrangement, or simply converting the property into another use, such as B&B. Planning permission may well be needed to achieve this. In any case, these attempts at avoidance may well be more expensive than paying the tax. For example, the sub-division of a property into two properties means that one of them would be liable for Capital Gains Tax on any house price appreciation when sold. We think the potential for avoidance is overstated. However, HM Treasury's attempts to stop it might make the tax more difficult to understand and administer.

Are the Liberal Democrat proposals any different?

Liberal Democrat proposals are similar to those from the Labour party. There is no formal commitment to spend receipts on the NHS. That may explain the Deputy Prime Minister's preference for council tax being the collection mechanism.

Liberal Democrats appear to have a more relaxed policy on indexing the bands, saying that bands would be indexed to average house prices (not average high-value prices); and there is no commitment that the number of properties caught by the tax would not increase.

Liberal Democrats have only committed to allowing pensioners (not lower earners) to defer payment of the tax until the home is sold.

If the Labour and Liberal Democrat parties form a coalition, we can expect some negotiation over the details of the tax, which means that the preferences of the individual parties might not be implemented.

Households likely to be liable for mansion tax.

82,000

The implementation options

Should the mansion tax be a national flat rate tax, or a locally decided and collected tax? HM Treasury could introduce an entirely new tax, but modifying an existing tax looks easier. The obvious candidates would be either an amended Annual Tax on Enveloped Dwellings or council tax. We think that, on balance, a Labour Chancellor would opt for the former.

Annual Tax on Enveloped Dwellings

Previously, and revealingly, called the Annual Residential Property Tax, ATED is probably the leading candidate for implementing mansion tax. It is a relatively new UK-wide tax collected by HM Revenue & Customs, currently payable by companies that own high value residential property. It was designed to discourage the use of companies to hold residential property ('enveloping').

The table below sets out the existing bands and rates for ATED and shows how mansion tax bands above £2m might be constructed. The charge increases by (at least) CPI each year. The charge for £2m+ properties is substantially higher than is proposed for the mansion tax, but different charges could easily be applied to property held directly rather than corporately.

ATED is a fully worked up tax with a comprehensive system of exemptions and reliefs, a method of index-linking and a way of self-assessing liability through annual tax returns. As such we think it provides the best indication of how a self-standing mansion tax might actually be implemented by HMRC. Labour refer specifically to this tax as a model for the self-assessment system they propose for the mansion tax.

The three main changes needed to adapt ATED would be:

- extend to include individuals as well as companies, with a clear definition of overseas versus domestic owner;
- the introduction of a deferral system for low earners,
- link property value bands to an index of prime property price inflation (PPPI).

Labour's decision to index the property value bands to PPPI implies that regular revaluation of prime property would be needed. Unlike council tax, ATED already has this mechanism built in.

ATED is well developed and has an existing collection infrastructure. As a result, we think it unlikely that a Chancellor would elect to design an entirely new national tax from scratch.

Property value	ATED charge	Band introduced
£500,000 to £1m	£3,500	1 April 2016
£1m to £2m	£7,000	1 April 2015
£2m to £5m	£15,400	1 April 2013
£5m to £10m	£35,900	1 April 2013
£10m to £20m	£71,850	1 April 2013
£20m+	£143,750	1 April 2013

Council tax

Many commentators have argued that mansion tax could be integrated into council tax, perhaps by introducing new bands, splitting bands, or widening the band ratios. Deputy Prime Minister Nick Clegg has said he would prefer to use additional council tax bands as an implementation mechanism, although this does not yet appear to be Liberal Democrat party policy. And a recent British Property Federation (BPF) survey showed that, of the quarter of MPs surveyed, nearly 70% preferred this implementation route. The unfairness which many people see in council tax generally is also cited as a reason for mansion tax to be introduced in this way.

Yet despite its popularity and apparent neatness, this method is not without its pitfalls:

- the possibility of adding additional bands was exhaustively explored by Sir Michael Lyons in his 2007 independent review for the Government; he found the introduction of additional council tax bands may well need a (controversial) revaluation.
- council tax is retained locally, so the Government would need to repatriate the funds (probably by an offsetting cut in local government grants)
- council tax is payable at locally decided rates, whereas Labour has already said what the tax on £2m properties would be. It does not make sense to introduce a national rate into a local tax. Similarly local authorities could also decide on any discounts to offer. This adds complexity and a potential 'postcode lottery' of support schemes.
- it does little to improve the general unfairness of council tax unless a more radical reform of council tax is also undertaken – but that would be a much more difficult undertaking. The council tax tail should not wag the mansion tax dog.
- we think the need for regular revaluation of 'mansions' to decide which band they are in, or indeed whether they should pay the mansion tax at all, is one of the biggest objections to using council tax as the mechanism. As we show on the following pages, revaluing properties for council tax purposes is fraught with difficulties and we think these difficulties are sufficiently large that an incoming Labour Government would try hard to avoid them, even if that meant introducing an overlapping national tax like ATED on top of council tax.

Percentage of MPs surveyed that would prefer to use additional council tax bands to implement mansion tax.

70%

Valuation and revaluation

It will be challenging to determine accurate valuations and therefore who might be liable. If mansion tax is introduced via council tax, a complete revaluation might be needed to ensure wider fairness.

Being fair through accurate valuations

ATED requires that the value of property is self-assessed (and revalued every 5 years). In theory the same principle could be applied to mansion tax. Where there is large comparable evidence establishing valuations, an established Automated Valuation Model could be easily used to value a property. However, outside London and other metropolitan centres, it may be difficult, time consuming and costly to accurately value properties. This could in turn lead to abuse. However, HMRC has systems for risk-assessing such valuations and regularly challenges tax returns; the small number of taxpayers involved in paying a mansion tax may mean that the risk to tax revenue is manageable. But, the burden on taxpayers themselves will be unwelcome: many homeowners will have to get their property valued just to prove that they shouldn't pay the tax.

The problem of revaluation

In contrast, valuation of property for council tax purposes is carried out by the Valuation Office Agency (VOA). Because properties are assessed for council tax banding on the basis of their 1991 price, valuation is more complex. The relationship between council tax liability and home value is arguably now rather weak. Valuations are often challenged where individual properties are not thought to have held their 1991 value. This potential unfairness has led to repeated calls for council tax bands to be updated to current prices – known as 'revaluation'. Revaluation is a very large, complex and politically controversial exercise, which is why it has never been carried out in England (see box).

Labour have said that the mansion tax will be 'banded' like council tax in order to avoid individual valuations. However, if these bands were to be actually built into council tax (rather than floated on top of it using something like ATED) it remains unclear how this would work and what its relationship to existing council tax valuations might be. Sir Michael Lyons concluded in his 2007 review that new higher-value bands could be added to council tax without a complete revaluation. But we think that the potential unfairness of doing so could lead both council tax and mansion tax into disrepute. A complex full revaluation exercise would become necessary. This could lead to unintended, and substantial, redistributional effects and could place more properties in higher bands than planned for.

We conclude that the small number of taxpayers involved makes a revaluation of a bespoke high value national property tax rather easier than a revaluation for council tax purposes, and therefore that a bespoke tax will be preferred. While this is less tidy, it is also less likely to sacrifice votes.

The ill-fated history of council tax revaluation

During the 2001-2005 Parliament, Local Government Minister, Nick Raynsford, attempted a council tax revaluation of all 22 million homes in England. He said revenue from council tax would not increase overall (though when Wales revalued in 2005, revenues increased by 4%, so many people did not believe him). But the revaluation was cancelled by the Blair Government in September 2005 after Raysnford was reshuffled out of office. House prices in the South East had risen above the English average, and many properties in the south would have jumped up at least one council tax band as a result of revaluation. The political calculation was clear – if there were a large number of losers in the South East, and only a smaller number of winners in the North, the revaluation was effectively a significant redistribution of the local tax burden.

How long would it take to introduce a mansion tax?

Despite Labour suggesting as much, it is very unlikely that a mansion tax could be introduced as soon as a new government were formed. The timings would depend on the consultation period, the type of legislation necessary and the time taken to set up collection mechanisms.

Legislation

The introduction of an annual tax on high value properties is very likely to require primary legislation. The type of legislation depends on decisions made about its design – and, surprisingly the decision about what the proceeds are spent on. There are three broad options.

The Finance Bill

This is Treasury's main vehicle for introducing or amending tax legislation. As a high priority annual legislative vehicle, the Finance Bill would be the quickest and simplest way of introducing the mansion tax. The House of Lords has little influence in the Finance Bill, but it would require full confidence in the Government for it to proceed smoothly through Parliament. Were ATED to be adapted, a Finance Bill could be the vehicle. These Bills generally take around 4 months to be approved.

A Local Government Finance Bill

If Council Tax were selected as the mansion tax mechanism this would be the legislative vehicle. Parliamentary rules make it very difficult to use the Finance Bill to amend Council Tax legislation. This would be a slower route to implementation as it faces much more scrutiny in the Lords. These Bills typically take the whole of a Parliamentary session (6-9 months) to be approved.

A bespoke Mansion Tax Bill

The main reason for a bespoke Bill is to legislate not just for the way in which the tax is collected but also for the way the money is spent. Finance Bills can only be used to collect tax receipts for general purposes – they cannot be used for taxes which have specific spending objectives. Given that the Labour Party at least has said that it proposes to entirely spend mansion tax proceeds on the NHS, they may feel obliged to put this commitment into law (though HM Treasury is usually opposed to this because it ties their hands). If so, a bespoke Bill would be needed.

Bespoke Bills are also used when there is no immediate prospect of a Finance Bill. The recent changes to residential Stamp Duty Land Tax were implemented using a bespoke Bill which took 2 months to progress through Parliament.

The House of Lords would have only very limited say over such a highly targeted Bill, and it could be pushed through Parliament very quickly. These Bills typically take 4-9 months to be approved.

Retrospection

Shadow Chancellor Ed Balls has said that the mansion tax would be legislated for quickly and could even be applied to the tax year 2015-16. In other words, it would be retrospectively applied to property ownership even before the Bill became law. Retrospection could also involve mansion tax bills being issued to people for properties they no longer own. However, retrospective legislation is rare because it can be perceived as unfair. The general principle is that, if possible, people should be given time and fair warning to adapt their affairs to new rules once they are known. To breach this principle the Government's chief lawyer, the Attorney General, needs to agree.

Consultation

HM Treasury has typically published consultation documents prior to the introduction of new taxes. ATED, for example, was consulted upon in May 2012 as part of a package of residential property tax reforms. ATED was eventually legislated for in the 2013 Finance Bill and introduced in April 2013, so the period between consultation and implementation was around 12 months. We would expect roughly the same timetable for a mansion tax given the need to consult on technical issues such as deferral, definition of liable parties, and so on.

Overall timing

The earliest we think a mansion tax could come into effect is April 2016. This assumes, the tax has already been designed and is announced (with no consultation) at an early Labour Budget in July 2015. This would be followed by the immediate introduction of legislation, which receives Royal Assent perhaps by Christmas 2015.

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Sources

CBRE's information about what the parties have said about the mansion tax comes predominantly from their own official websites; where we use other sources we are clear in the report that this does not necessarily reflect the official position of the party concerned. Information about ATED comes from the Government's website, and we have sourced Sir Michael Lyons' views on council tax revaluation and additional bands from his original 2007 report. Information about the abandoned 2005 revaluation comes from reports produced by reputable media outlets at the time. Legislative practices, particularly relating to the Finance Bill, are sourced from briefings prepared by the House of Commons Library. Estimates of the numbers of properties affected by a mansion tax are our own; information about liability for council tax comes from the Valuation Office Agency.

Photography