Perspectives

Fresh economic thinking for business

Stamp Duty Land Tax

The stamp duty land tax is under scrutiny in the UK for limiting mobility and making housing transactions harder and less efficient. We seek to briefly explore and analyse the possible impact of restructuring the SDLT based on the numbers and findings of the Adam Smith Institute.

Introduction

Stamp duty is a significant cost to home buyers and a significant source of government revenue. A leading economic think-tank has recently argued that stamp duty on properties should be abolished. In this article, we first set out what the think tank has argued and we then review this.

AnalysisThe stamp duty land tax is a tax on residential and commercial property over £125,000 and over £150,000, respectively.¹ Her Majesty's Treasury (HMT) suggests SDLT will bring in £12.9bn during the 2016-17 tax year.² In 2014, the SDLT was reformed since marginal tax rates on higher sale prices went far above 100% at several points, this caused bunching at certain price points.³ The rates were raised by 3pp on second homes and buy-to-let properties in 2016. The Adam Smith Institute (ASI) noted that any tax costs something to collect. The benefits of the tax

¹ Southwood, B. (2017), pg. 2. Beyond the Call of Duty: Why we should abolish Stamp Duty Land Tax. must outweigh the negatives to be effective in the market.

If a tax alters the payoff of production or behaviour it is "distortionary". There are two types of costs when assessing taxes, administrative and behavioural. Recent estimates put the total administrative cost of the UK tax system at £11 billion compared to £700 billion in receipts.⁴

There are three classes of taxes:

- A) Pigovian taxes are created to perfectly internalize the costs of an activity to correct behaviour. The polluter will pay what their pollution costs society while continuing to pollute if the costs are lower than the benefits they receive.
- B) Lump sum taxes are unavoidable; they are mostly used for widespread wealth distribution such as a poll tax. Lump sum

² Southwood, B. (2017), pg. 6. Beyond the Call of Duty: Why we should abolish Stamp Duty Land Tax.

³ Southwood, B. (2017), pg. 2. Beyond the Call of Duty: Why we should abolish Stamp Duty Land Tax.

⁴ Chittenden, F., Foster, H., & Sloan, B. (2010). Taxation and Red Tape: The cost to British business of complying with the UK tax system.

taxes have no effect on behaviour or have no distortionary cost because everyone pays the same since they are unavoidable.

C) Distortionary taxes stop the economically productive activity from occurring and destroy wealth. ASI notes that the SDLT discourages movement in the housing market by imposing a tax on moving from place to place.

The problem with stamp duty is the movement of assets between households and among firms. Liquidity problems arise when transaction taxes are in place. Under a VAT like tax system, you would only have to pay tax on the improvements you made on the purchase price, instead of the current system in which you pay tax on the whole amount.

Tax incidence is another is an important factor in any tax. Tax incidence not only describes the accounting reality but also the economic reality, such as who is worse off because of the tax. There are three main rules of tax incidence: the person or entity who pays the tax doesn't necessarily assume the tax burden, the distribution of the tax is irrelevant and parties with more inelastic demand bear more of the tax burden. For instance, the VAT is paid by the businesses which go to the government, but the customers actually pay the VAT on the goods they buy from the business. The burden is spilt in this case between the consumer, in the form of higher prices, and the business, in the form of lower sales because of the tax. A business doesn't care if it must pay a payroll tax or if its workers have to pay an income tax because economically it is the same for the company as both are predictable costs. The price of inelastic goods has very little effect on the demand for the goods.



Taxes shift the supply curve up and result in higher prices, not lower quantities supplied, such that the incidence falls on the consumer.

Evidence from the UK tax holiday suggests that the buyer only pays 2/3 of the stamp duty since in 2008 through 2009 the government cut the stamp duty and on average tax burden fell about £1500 while sales price increased £600 implying that the home buyers assumed 60% of the burden and homeowners held 40%.⁵

In 2008, the tax holiday decreased the SDLT by 1pp and increased the housing market by a fifth in the affected range, according to Michael Best & Henrik Kleven, with a database of all property transactions between 2004-2012.⁶ "This extremely high response indicates a high tax elasticity of housing transactions, suggesting a large efficiency cost to burdening them so heavily.⁷ Yet this study looked only at a 1% tax. The current UK system taxes the most expensive houses at approaching 10%, implying even larger deadweight losses at the top of the market" lan Davidoff and Andrew Leigh do a very similar study for Australia, with a data-base covering every housing sale for 13 years and find similar results; the stamp duty cuts housing turnover by 8% and the tax incidence is almost solely the seller's.⁸ Housing prices fell more than \$1 for each dollar of tax added.

 ⁵ Besley, T., Meads, N., & Surico, P. (2014). The incidence of transaction taxes: Evidence from a stamp duty holiday. Journal of Public Economics, 119, 61-70.
⁶ Best, M. C., & Kleven, H. J. (2013). Housing market responses to transaction taxes: evidence from notches and stimulus in the UK. London School of Economics

⁸ Shan, H. (2011). The effect of capital gains taxation on home sales: evidence from the Taxpayer Relief Act of

^{1997.} Journal of Public Economics, 95(1), 177-188. es

Paper	Drop in transaction volume from 1pp higher housing transactions tax at current margins
Best & Kleven (2013)	20%
Davidoff & Leigh (2013)	8%
van Ommeren & van Leuvensteijn (2005) ²²	8%
Dachis et al. (2012) ²³	14%
Hilber & Lyytikainen (2012) ²⁴	20%

ASI stated that these numbers could be conservative when quantifying the cost of the SDLT, Kopczuk & Munroe shows the negative effects of the New York City mansion tax such as reduced activity where it applied and across the market because the final housing price was unclear at a glance.⁹ An Australian Treasury analysis of various taxes found that their housing transactions tax was the most economically costly since stamp duties imposed a \$.80 welfare cost for every \$1.¹⁰ "Frictions" such as estate agency fees and the time and effort of moving reduce mobility and thereby reduce employment. A paper by David Blanchflower and Andrew Oswald finds a strong relationship between the developed world and homeownership rates and unemployment. They found that in the US 1% higher homeownership corresponds with 2.2% higher unemployment.¹¹ The paper cannot give a definitive conclusion on this topic because this inefficiency could be from a misallocating labour or housing. The UK is affected by extremely strict housing regulations so properties cannot change with the area; large transfer taxes make it difficult to shift properties from owner to owner to accommodate demand. When housing is inelastic it is paramount to have as few impediments as possible in the way of transferring ownership. Business lobbies argue for lower taxes because higher rates hamper business development. Evidence shows that the owner of the property bears the burden of the property. The occupants of the firm do not care about whose pockets their rent ends up in; they only worry about the final

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price. Property supply in the UK is inelastic because of the UK's strict planning regulations; firms can also find less ideal locations which makes the demand somewhat elastic. Households and firms use property for two different things, businesses use property as an inputs to production while households consume housing services provides by the property. Taxing outputs instead of inputs aligns with economic theory. If certain inputs are taxed, firm's production structures will move towards less efficient models.

Our assessment

Tax reforms bring up the question of fairness about two things: rights-based justice, and progressivity. Tax benefits in Western countries are highly progressive: those who pay the most tax benefit the least from paying it, while the group who pays the least tax gains the most for it. Any form of tax reform will lighten the burden of some households while increasing the burden of others. Property consumption tax in principle is highly progressive since those with higher incomes usually own more valuable property in a greater proportion than those that make less. An ONS statistic reports that the top decile owns on average £250,000 in property while the lowest three deciles own none.¹²



¹¹ Blanchflower, D. G., & Oswald, A. J. (2013). The Danger of High Home Ownership: Greater Unemployment. The Comparative Advantage in the Global Economy, Chatham House Series, 10.

¹² Chamberlain, E. (2015). Property wealth, Wealth in Great Britain, 2012 to 2014, Office for National Statistics.

⁹ Kopczuk, W., & Munroe, D. J. (2014). Mansion tax: the effect of transfer taxes on the residential real estate market (No. w20084). National Bureau of Economic Research.

¹⁰ O'Sullivan, A., Sexton, T. A., & Sheffrin, S. M. (1995). Property taxes, mobility, and home ownership. Journal of Urban Economics, 37(1), 107-129.

The SDLT is highly progressive, the 2% of properties sold for more than £1m accounted for 30% of total receipts.¹³ Removing SDLT and council tax while implementing VAT on imputed rent (the value of the property) will replace one regressive tax and one progressive tax with another progressive tax.¹⁴ When property is transferred it would accumulate the tax amount from the rental value at the time with nominal interest rates. This tax change would not affect frequent transitions as negatively like the SDLT. The SDLT was a perfect fit for the 17th century when the British government was smaller and less sophisticated. The SDLT is hugely biased against mobility, even while mobility in the UK is universally low. ASI insists that the government must remove the SDLT whether or not the government can replace its revenue. If the UK implements a 20% VAT based tax on rental yields on the UK's £7.5 trillion of property wealth it could generate £70bn.

¹³ Seely, A., & Keep, M. (2017). Stamp duty land tax on residential property, House of Commons Briefing Paper Number 07050

¹⁴ Sommer, K., & Sullivan, P. (2013). Implications of US Tax Policy for House Prices, Rents and Homeownership. Working Paper, Federal Reserve Board of Governors.