Walbrook Economics

Stamp Duty- a counterproductive tax

A Proposal for Reform by the TaxPayers' Alliance

Stamp Duty Land Tax is one of Britain's most iniquitous and arbitrary taxes. It is a drag on economic activity; an obstacle to economic activity and mobility; and is less helpful to the Treasury, as a source of revenue, than it might initially appear.

The Tax Payers' Alliance believes that in the long term Stamp Duty Land Tax should be abolished. However reforms are also possible that would ease the burden on families with a limited, or even positive, impact on overall tax receipts. We present three proposals, all of which are designed to simplify and reduce the burden of the tax while helping promote Government objectives of mobility, fairness and growth.

In new research based on the relationship between the tax rate and transaction volumes, estimated by Best and Kleven, we show that cutting the rate of tax of Stamp Duty Land Tax can not only enhance economic growth and aid mobility but actually be fiscally neutral overall. With transaction volumes close to a historic low this is the time to act.

Proposal One – Move to a marginal tax. All purchasers would benefit from this proposal but, in percentage terms, the greatest benefit would be felt on average and lower than average priced properties. This proposal would be, at worst, fiscally neutral in our view, as the Stamp Duty Land Tax shortfall would be offset by higher VAT and employment tax receipts.

Proposal Two – Double the thresholds would exempt 77% of all transactions from paying any stamp duty and mean many fewer people paid Stamp Duty at the higher rates. We believe this proposal would also be fiscally neutral overall.

Proposal Three – Halve the rates is the largest tax cut of the three proposals and would send a very clear message to householders that the Government was determined to encourage homeownership and mobility. While there would probably be a net cost to the Treasury it would be a relatively small price for such a beneficial reform.

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Executive Summary

Stamp Duty Land Tax is one of Britain's most iniquitous and arbitrary taxes. It is a drag on economic activity; an obstacle to economic activity and mobility; and is less helpful to the Treasury, as a source of revenue, than it might initially appear.

The TaxPayers' Alliance believes that in the long term Stamp Duty Land Tax should be abolished. However reforms are also possible that would ease the burden on families with a limited, or even positive, impact on overall tax receipts. We present three proposals, all of which are designed to simplify and reduce the burden of the tax while helping promote Government objectives of mobility, fairness and growth.

- Prior to 1997 Stamp Duty Land Tax was a relatively simple tax set simply a zero and 1%. Since 1997 there have been nine substantive changes in the rates and thresholds that apply to this tax, significantly increasing the rates and complexity.

- Stamp Duty Land Tax raised £6.1bn in 2011/12 with residential property accounting for £4.2bn of that total. This represents 0.8% of the £549bn of taxes raised in that year.

- The scale of Stamp Duty Land Tax has become much more significant in recent years. Since 1992/93 it has increased 15 fold. The RPI has increased by 69%, over the same period. While this tax only makes a small contribution to overall tax revenues it falls very heavily on those individuals affected.

- Stamp Duty Land Tax receipts are highly cyclical and dependent primarily on transaction volumes and house prices. The Government needs to be particularly careful in setting the tax rates appropriately, or an increase in the rates could prove counterproductive.

- Ground-breaking work by London School of Economics economists Best and Kleven in their recent paper, '*Housing market Responses to Transaction Taxes; Evidence From Notches and Stimulus in the UK (June 2013),* clearly demonstrates a link between stamp duty transaction tax rates and valuations and activity levels. Their research examined data from every property transaction in the UK, from 2004 to 2012 and drew some important conclusions about the relationship between the level of Stamp Duty Land Tax and house price valuations and transaction levels. They argue that their *'bunching estimates imply that house prices respond by a factor of 2-5 times the size of the tax increase at a notch with larger effects at the bottom than at the top of the price distribution.'*

  They went on to demonstrate that a '*1%-point cut in transaction taxes increases market activity by about 20% during the holiday'.*

  Critically however, the positive effects, while diminishing over time, remain positive in the long term. In this regard Best and Kleven go on to say '*the total reversal effect, due to re-timing is only 30-40% implying that the stimulus had a sizable permanent effect.'*

- **Transaction volumes are currently close to a 20 year low at 920,000 per annum in 2012 against over 1.6m per annum in 2007.** Given a housing stock of approximately 25m units, this implies a current average moving cycle of once every 27 years, compared with every 15.6 years in 2007. There are a number of factors behind this decline but the work of Best and Kleven clearly shows that reducing the rate of stamp duty by 1% has increased volumes by 20% over a 16 month time frame in the past, with a permanent positive effect longer term.

- Stamp Duty Land Tax is only the tip of the housing tax iceberg. When a property is purchased a whole army of employees benefit: from the estate agent, to the solicitor, to the removal man, to the likely associated renovation and homeware trades.

- We estimate that that **around 1.1m jobs are dependent directly and indirectly on the housing market and that the fall in housing activity has cost 80,000 construction jobs and 80,000 to 100,000 associated positions in other trades**. This decline has cost the Treasury in excess of £1.3bn pa in lost income tax and national insurance. VAT receipts will also be affected by the reduction in economic activity and our estimate is that the decline in transactions has reduced VAT receipts by £1.75bn pa.

- We estimate that Stamp Duty Land Tax accounts for less than 30% of the total taxes associated with housing transactions. Therefore – if higher tax rates reduce transaction volumes – cutting stamp duty can increase the overall tax take.

- Stamp Duty Land Tax is a significant cost for people who are moving. While the severity of the tax, as a percentage of after tax income, generally rises with higher property values and levels of income, the '. For example a family earning an income of £50,000 would pay the equivalent of 25% of their after tax annual salary in Stamp Duty Land Tax when purchasing a £300,000 property.

- The TaxPayers' Alliance believes that in the long term Stamp Duty Land Tax should be abolished. However reforms are also possible that would ease the burden on families with a limited impact on tax receipts. We present three proposals, all of which are designed to simplify and reduce the burden of the tax while helping promote Government objectives of mobility, fairness and growth.

- **Proposal One – Move to a marginal tax**. Under the current system, the tax is levied on the entire value of the property at the highest rate where it crosses the threshold, rather than only taxing the value above each threshold at the higher rate. That means a house that sells for £250,000 will result in a Stamp Duty bill of £2,500 while a house that sells for £260,000 will result in a Stamp Duty bill of £7,800. Introducing marginal rates, like with Income Tax, avoids these inefficient and unjust anomalies and would therefore make the tax fairer. This proposal is simple: maintain the current bands and rates but apply it as a marginal tax.

  All purchasers would benefit but, in percentage terms, the greatest benefit would be felt on average and lower than average valued property. A marginal rate structure, with the same rates and bands, would have yielded £2.9bn in 2011-12 against the £4.2bn yield from the current slab rate structure, a £1.3bn reduction in revenue. However we believe **such a reduction would only need to generate a further 210,000 transactions pa to be fiscally neutral**. We believe that the increase in the volume of transactions would be enough that the proposal would be fiscally neutral, at worst.

- **Proposal Two – Double the thresholds.** If the thresholds were doubled, 77% of all transactions in 2011/12 would have been exempt from any Stamp Duty Land Tax. And the tax due on a transaction at the average price level, in the £250,000 to £500,000 bracket, would fall from £10,497 to £3,499.

  This proposal would benefit purchasers at most levels, but particularly those at the lower and medium end of the market. Under this proposal, Stamp Duty Land Tax would have yielded £2.7bn in 2011-12, which implies a raw cost of to the Treasury of £1.48bn before any multipliers. **The breakeven point for the Treasury would be 245,000 additional transactions pa**. We believe that this proposal would prove to be fiscally neutral as well.

- **Proposal Three – Halve the rates across the board.** Halving Stamp Duty Land Tax rates would send a clear signal to householders that the Government was determined to encourage home ownership and mobility. The raw cost to the Exchequer would be £2.1bn in 2011-12. The breakeven point would be an increase in transactions of 350,000 and, while this proposal would strengthen the economy and allow more people to move, there would be a cost to the Exchequer from implementing it,

Introduction

Stamp Duty Land Tax is one of Britain's most iniquitous and arbitrary taxes. It is a drag on economic activity; an obstacle to economic activity and mobility; and is less helpful to the Treasury, as a source of revenue, than it might initially appear.

This paper looks at the current system and makes recommendations that are designed to spur economic activity, stabilise revenues for the Government and restore an element of simplicity and fairness into the system. We believe it is urgent that the Government thinks again about the purpose, scope and fairness of this tax.

We believe that Stamp Duty Land Tax could easily be simplified and reduced to the benefit of the vast majority of home-buyers. Mindful of the current fiscal deficit we examine three proposals to ease the burden. Firstly we look at the implications of making this a marginal rate tax, rather than a slab rate tax; secondly we explore doubling the thresholds; and finally a halving of the rates. Each of these proposals would provide a substantial economic stimulus at little or no cost to the Exchequer. As the economy is finally showing some signs of recovery, this is an ideal time to act and cut Stamp Duty, which is a tax on mobility and prosperity.

The origins of Stamp Duty

Stamp Duty was a form of tax charged on instruments, or written documents, that historically required an official Government Stamp to be attached or embossed on the instrument in question. It can perhaps be seen as a British equivalent of the old 'Rhine Barons Tax'. They charged for boats to pass by their castles.

Stamp Duty was a charge for the effort of impressing the 'stamp' that legally and officially recognised and registered a contract. The tax was first introduced during the reign of William and Mary, in 1694 and was perhaps one of the less welcome imported ideas from William's native Holland.

Stamp Duty has had a rather chequered history. For example, the attempt to introduce 'The Stamp Act,' in 1765, in the British colonies of America understandably did not go down well and led to the cry 'no taxation without representation;' a cry that still has resonance today.

Today a stamp duty is still a levy on a contract, although the use of the physical stamp has long disappeared. The money is paid by an electronic transfer, straight from the lawyer to HMRC.

Currently, Stamp Duty is applied to two types of transaction in the UK with two separate taxes: the transfer of shares and the transfer of property, although historically it has been applied to all manner of transactions.

This paper will look exclusively at the impact of Stamp Duty on property, and in particular residential property.

The recent history of Stamp Duty Land Tax

Stamp Duty on residential property has become increasingly complex. The current tax rates for property transactions in the UK are outlined below. It should be noted that the highest tax rate is used for the entire value of the property, not just the marginal value above each threshold. In other words, a property worth £250,000 pays a tax of £2,500 while a property worth £250,001 pays £7,500 of tax. The tax therefore creates frictional points, with distortionary effects. This is an issue we will discuss in more detail later.

Current Rates of Stamp Duty Land Tax, announced March 2012

up to £125,000	zero
from £125,001 to £250,000	1%
from £250,001 to £500,000	3%
from £500,001 to £1,000,000	4%
from £1,000,001 to £2,000,000	5%
over £2,000,000	7%
(or 15% if bought by a corporation)	

Source HMG

Stamp Duty was not always so complex. Prior to 1984 it was quite simple; up to £30,000 zero-rated and 1% thereafter. Nigel Lawson made the system more generous in 1991 by raising the threshold before the tax was paid to £250,000, with a simple 1% rate above that. It should be noted that the average house price, according to the Nationwide House Price Index, was £54,000 in 1991 and therefore very few transactions paid any tax at all. Sadly this generosity lasted less than 12 months with thresholds reverting to the prior level of up to £30,000 zero-rated and 1% above that.

The 1993 Budget saw the threshold doubled to £60,000, with a simple rate of 1% above that. House prices averaged £52,000 by 1993 and therefore a typical property was still exempt from the tax.

It first became significantly more complex with changes introduced by the Blair Government in 1997. It was renamed Stamp Duty Land Tax with some technical changes in 2003. There were repeated increases in the rates which are outlined in the charts below. Initially the change was modest but successive Budgets saw a significant escalation of the tax rates.

Rates of Stamp Duty Land Tax, July 1997

Up to £60,000	zero
Over £60,000 and under £250,000	1%
Over £250,000 and under £500,000	1.5%
Over £500,000	2%

Source HMG

Rates of Stamp Duty Land Tax, March 1998

Up to £60,000	zero
Over £60,000 and under £250,000	1%
Over £250,000 and under £500,000	2%
Over £500,000	3%

Source HMG

Rates of Stamp Duty Land Tax, March 1999

Up to £60,000	zero
Over £60,000 and under £250,000	1%
Over £250,000 and under £500,000	2.5%
Over £500,000	3.5%

Source HMG

Rates of Stamp Duty Land Tax, March 2000

Up to £60,000	zero
Over £60,000 and under £250,000	1%
Over £250,000 and under £500,000	3%
Over £500,000	4%

Source HMG

Rates of Stamp Duty Land Tax, March 2005

Up to £120,000	zero
Over £120,000 and under £250,000	1%
Over £250,000 and under £500,000	3%
Over £500,000	4%

Source HMG

Rates of Stamp Duty Land Tax, March 2006

Up to £125,000	zero
Over £125,000 and under £250,000	1%
Over £250,000 and under £500,000	3%
Over £500,000	4%

Source HMG

Rates of Stamp Duty Land Tax, September 2008

Up to £175,000	zero
Over £175,000 and under £250,000	1%
Over £250,000 and under £500,000	3%
Over £500,000	4%

Source HMG

Then in 2010 Alastair Darling introduced the following arrangements when a pre-election inducement for first-time buyers was announced.

Rates of Property Stamp Duty March 2010

Up to £250,000 (first-time buyers only)	zero
Up to £125,000	zero
Over £125,000 and under £250,000	1%
Over £250,000 and under £500,000	3%
Over £500,000	4%

Source HMG

George Osborne complicated the tax's structure further and introduced a new 'super rate' of 5% for property over £1m, effective from April 2011.

Rates of Property Stamp Duty April 2011

Up to £250,000 (first time buyers only)	zero
Up to £125,000	zero
Over £125,000 and under £250,000	1%
Over £250,000 and under £500,000	3%
Over £500,000 and under £1,000,000	4%
Over £1,000,000	5%

Source HMG

Not content with his 5% 'super rate' he topped it up again with a new 7% rate for property over £2m announced in March 2012. The only simplification he introduced in that budget was to abolish the separate first-time buyer rate, which had meant first-time buyers did not pay Stamp Duty on properties worth less than £250,000, and Disadvantaged Areas Relief.

Stamp Duty Land Tax has, over quite a short period of time, become much more onerous and complex.

How much does Stamp Duty Land Tax raise?

Stamp Duty Land Tax (residential and commercial) raised £6.9bn in fiscal year 2012/13. Stamp Duty therefore is a significant source of revenue but the income to the Exchequer needs to be put into the context of the total tax take, which in fiscal year 2012/13 was £553.7bn. In other words, Stamp Duty Land Tax accounted for 1.24% of all taxes collected. The significance of stamp duty, relative to other taxes, can be seen in the table below which uses the forecasts of the Office of Budgetary Responsibility for estimated tax receipts by category of tax. And, looking only at residential property, the take in 2011-12 (the last available confirmed figures) was £4.2bn, or 0.8% of that year's total tax receipts.

Estimated Receipts From Different Taxation Sources (£bn)

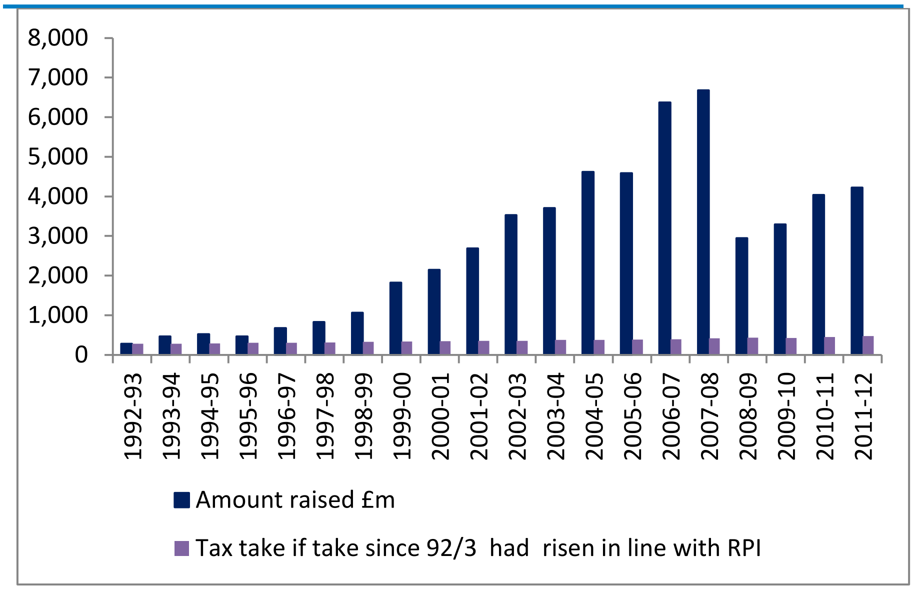
	2011-12	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2016-17**
Income tax	152.7	150.5	154.7	165.5	174.4	186.7
National insurance	101.6	103.8	106.7	108.6	113.9	125.5
Value added tax	98.1	100.7	103.3	107.2	111.2	115.2
Corporation tax	43.1	40.3	39.3	38.1	36.6	38.2
Fuel duties	26.8	26.6	26.1	26.3	27.1	28.3
Business rates	24.9	25.7	26.7	28.1	29.6	30.5
Council tax	26.0	26.3	27.4	28.3	29.1	30.0
VAT refunds	14.0	14.0	14.6	14.6	14.7	14.5
Capital gains tax	4.3	3.9	5.1	6.5	7.2	7.9
Inheritance tax	2.9	3.1	3.3	3.5	3.6	3.9
Stamp Duty Land Tax	**6.1**	**6.9**	**7.7**	**8.4**	**9.3**	**10.5**
Stamp taxes on shares	2.8	2.3	2.9	2.7	2.7	2.8
Tobacco and Alcohol taxes	20.0	19.7	19.8	20.8	21.4	22.1
Others	26.2	29.9	36.7	35.4	38.3	39.7
Total	**549**	**553**	**574**	**594**	**619**	**655**

Source OBR

Stamp Duty Land Tax has become a more important source of revenue over time. The chart below shows the residential property stamp duty tax take in each fiscal year from 1992/3 and the hypothetical sum that would have been raised if the tax had risen in line with the RPI index from fiscal year 1992/3.

Over that period the amount of residential stamp duty raised increased from £280m to £4.2bn, a 15 fold increase. As a point of reference the RPI increased by 69% over the same period. The scope and scale of the tax has therefore increased substantially in absolute and relative terms over the last 20 years.

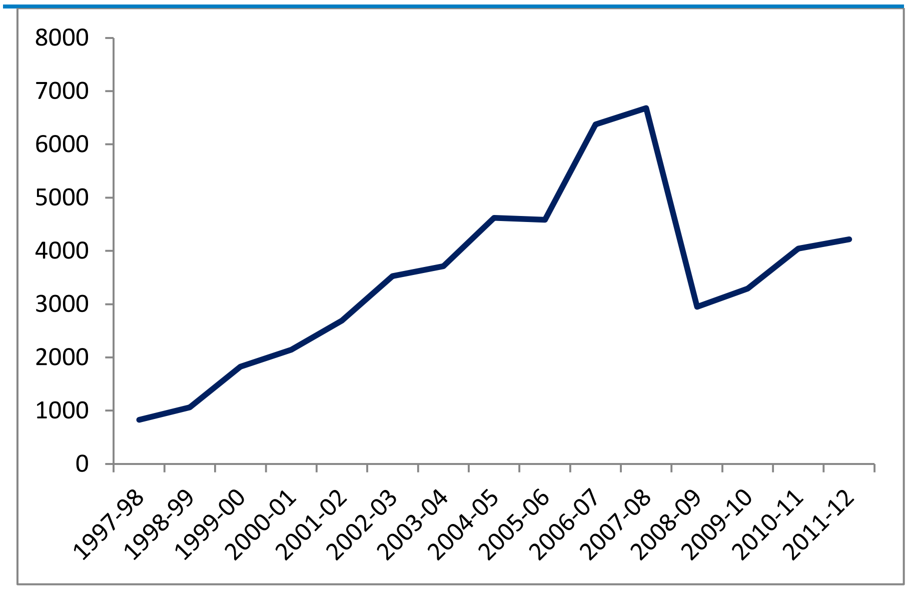
Residential Stamp Duty Collected and 1992/93 Revenues Indexed to RPI (£m)



Source HMRC and Walbrook Economics

While the scale of the tax has increased substantially, Stamp Duty Land Tax has proven to be a cyclical tax, highly dependent on both housing transaction volumes and house prices. This is illustrated in the chart below, which shows that receipts fell by more than half in the year after the onset of the credit crunch. Of all the significant tax categories raised by the Government, Stamp Duty Land Tax and Corporation Tax saw the greatest yield compression. Stamp Duty is clearly highly dependent upon housing transactions and values which in turn are often highly cyclical.

Receipts from Stamp Duty from Residential Property (£m)



Source ONS

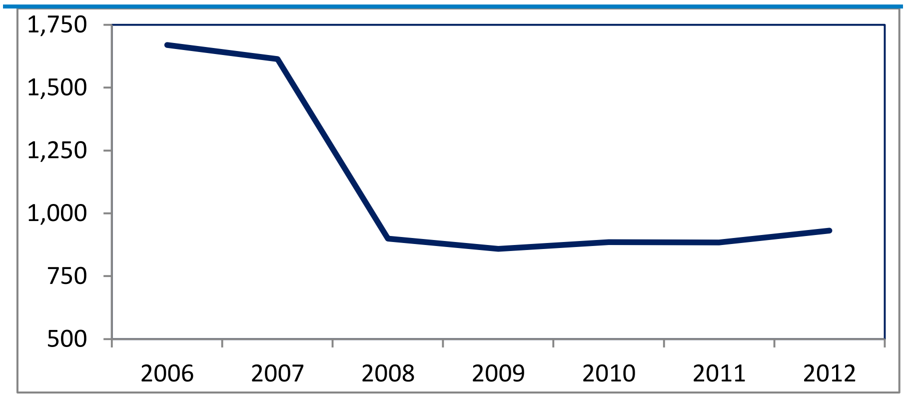
While it should be no great surprise that revenue from the tax is highly variable across the economic cycle, and responds to trends in the property market in particular, the Government needs to be particularly careful to provide a stable, predictable and appropriate environment with this tax, or it risks stifling activity and ultimately revenues.

It should be noted, according to the OBR's latest forecasts, they see stamp duty receipts, from all property, increasingly steadily so by 2016/17 it anticipates the Government will raise £10.5bn or 1.6% of the total tax take from Stamp Duty Land Tax in that year. Clearly this forecast remains highly dependent on the health of the housing market.

The impact of Stamp Duty Land Tax on the number of housing transactions

Currently residential transactions are close to a 20 year low at 930,000 a year. With an existing housing stock estimated at 25m homes in the UK this implies the average household is moving every 27 years. Prior to the credit crunch typically 1.6m transactions took place each year which equated to an average moving cycle of 15.6 years, which – given the natural rhythm of household events – appears to be a more sustainable long term level (although the values of the transactions were clearly inflated by a bubble in the housing market). The chart below highlights transaction levels since 2006.

Number of Transactions, 000s



Source HMRC

There are a number of factors behind the substantial fall in the number of housing transactions since 2008 and there are signs that the low cost of borrowing and initiatives like 'help to buy' are starting to stabilise the market (or reinflate the bubble). However these factors are beyond the scope of this note. What can be said, particularly in a more difficult housing market, is that high transaction costs will tend to reduce the propensity to move.

Almost certainly the impact of these frictional costs is at its greatest in a difficult market as the upfront stamp duty fee seems more real and onerous, relative to times when the market is more buoyant. If this is true it therefore follows that setting the most beneficial rate in the current sluggish environment is particularly important.

Ground breaking work by Best and Kleven in their recent paper '*Housing market Responses to Transaction Taxes; Evidence From Notches and Stimulus in the UK*' (June 2013) clearly demonstrates a link between stamp duty transaction tax rates and valuations and activity levels. Their research examined data from every property transaction in the UK, from 2004 to 2012. They draw some important conclusions about the relationship between the level of Stamp Duty Land Tax and house price valuations and transaction levels. They found that their *'bunching estimates imply that house prices respond by a factor of 2-5 times the size of the tax increase at a notch with larger effects at the bottom than at the top of the price distribution.'*

They also found that a *'1%-point cut in transaction taxes increases market activity by about 20% during the holiday'* and critically the positive effects, while diminishing over time, remain positive in the long term. In this regard Best and Kleven go on to say that '*the total reversal effect, due to re-timing is only 30-40% implying that the stimulus had a sizable permanent effect.'*

The Best and Kleven study clearly demonstrates that a 1% fall in stamp duty land tax increased transactions by 20% in the short term (16 months), with a permanent benefit of 60-70% of this increase. The impact on house prices was 2-5x the amount levied in tax.

Bell and Kleven's work may have exposed that Stamp Duty Land Tax is now on the right hand side of the Laffer Curve, with an increasing rate decreasing overall revenues. If the Government wants to maximise revenues, it needs to bear in mind that increasing frictional costs will reduce volumes. That will in turn reduce the amount raised in VAT and employment taxes and may well be counter-productive.

Other taxes on housing transactions

While Stamp Duty Land Tax was responsible for less than 1% of total revenue in 2011/12, it is only one of the ways in which the government benefits, in terms of tax receipts, from residential property transactions.

While the Government receives £4.2bn in residential stamp duty revenues, from around 900,000 property transactions, this is only the start. When a property is purchased a whole army of employees benefit: from the estate agent, to the solicitor, to the removal man, to the associated renovation and homeware trades.

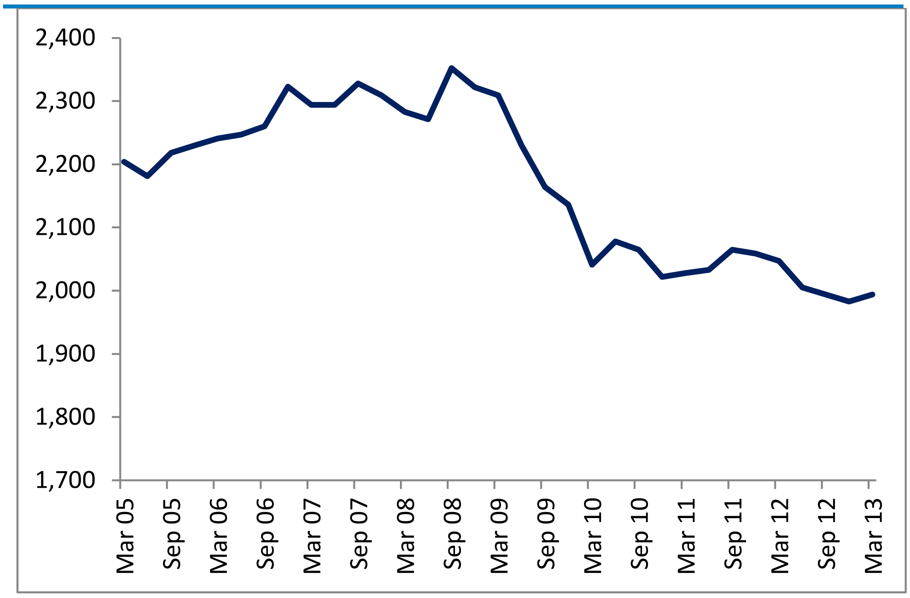
This section only deals with the direct impact of a transaction and not the other property taxes, like council tax.

Employment

According to the July ONS Labour Market Survey Report, nearly 2m people worked in the construction industry, or 6.1% of total employment. The construction market was worth £115.5bn in 2012, or around 8% of GDP. Private new build housing's output was £16.1bn and private RMI (repairs, maintenance and investment) was £15bn. Therefore private housing accounted for 26.9% of construction activity. Assuming an equal value weight for construction employees, this implies that around 540,000 construction jobs are in private residential housing activity.

The chart below demonstrates the cyclicality of this employment. Between Q3 2008 and March 2013 some 325,000 construction jobs were lost. Given that housing activity accounts for just over a quarter of all construction activity, this would equate to just over 80,000 housing related jobs being lost as a result of lower new build, with transactions falling from 1.6m pa in 2008 to 930,000 in 2013 and a subsequent lower RMI spend.

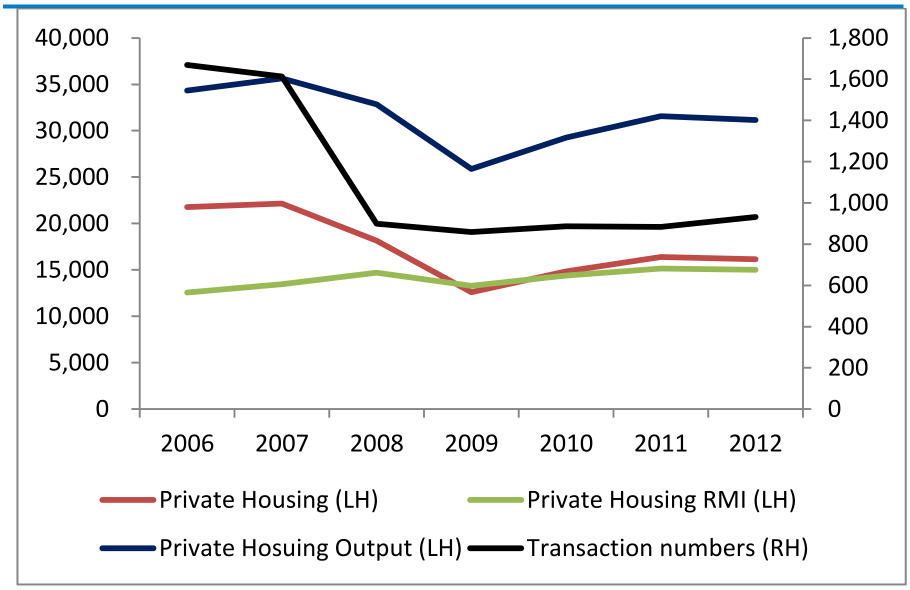
Employment in Construction Industry (,000)



Source   ONS

Further, over that period, the private housing element of the construction trade proved to be particularly cyclical with total output falling 12.6%, against 10.1% for the construction industry in total. This is demonstrated by the chart below which shows private new build housing, RMI and transactions from 2006.

Trends in New Private House building and Private RMI Spend 2006 to 2012 (£m) and Residential Transaction Volumes (,000)



Source ONS

We believe our assumption of 80,000 housing related construction jobs lost to be conservative, as this number is before any impact on the retail trades and professional services – including mortgage advisors, surveyors and conveyance solicitors – is considered. We estimate these non-construction job losses to be a further 80,000 to 100,000 positions.

For an employee earning a typical salary of £25,000 per annum their income tax contribution, at current rates, would be £3,112 with a further employee's national insurance contribution of £2,338 and an employer's NI bill of £2,689. Each job lost at an average salary therefore directly costs the Government just over £8,000 pa. This is before the payment of any welfare costs if they are unemployed and need to be retrained. We therefore estimate the cost to the Treasury of reduced residential housing related employment to been in excess of £1.3bn pa in lost Income Tax and National Insurance alone.

VAT

On each transaction there will be a typical estate agency fee of 1.5%. Using Nationwide Average House Price Data, which suggests that in Q2 2013 the average property was worth £167,200, typical estate agency fees would therefore average £2,508 + £502 in VAT. Then there are legal fees, removal costs and survey reports which would typically cost a further £2,500 + £500 in VAT.

On top of that there is substantial evidence that major additional RMI work on property is typically carried out within 2 years of purchase, be it a new kitchen, bathroom, decoration or home furnishing. We believe it is conservative to suggest an additional £7,500 is spent over and above what would be expected from not moving, over a two year period. This generates a further £1,500 of VAT.

Therefore we estimate that additional expenditure of £12,500 plus £2,500 in VAT is generated per additional transaction. On top of that there are the associated financial service products, which, although generally VAT exempt, clearly generate economic activity and tax receipts. Therefore we estimate that the 700,000 lost transactions pa, since 2007, costs the Exchequer around £1.75bn each year in lost VAT receipts alone

Tax Impact Model

As can be seen from the table below, before any multiplier is added we estimate that each additional residential sale brings in around £6,000 in tax receipts and, for an average priced house, Stamp Duty accounts for less than 30% of the revenue generated with each house sale. If higher Stamp Duty rates lead to fewer transactions, that will reduce total receipts by more than the reduction in Stamp Duty receipts alone would suggest.

Tax Model for Averagely Priced Property (£)

Purchase price	167,200	
Stamp Duty Land Tax	1,672	28%
VAT on Professional Services	1,000	17%
VAT on RMI	1,500	25%
Apportioned Income and NI per sale	1,857	30%
Total Tax Paid	6,029	

Source Walbrook Estimates

We believe our model underestimates the importance of residential property total tax receipts for two primary reasons. Firstly it excludes a multiplier effect. It is well understood that the impact of housing transactions is one of the quickest transmission mechanisms in the economy. Secondly the table above is based on mean house price transactions. Given the progressive nature of stamp duty and other taxes the median tax take is almost certainly higher

Secondly, we also believe that each additional 100,000 transactions of existing housing stock adds around £1.25bn (£12,500 additional sales per house) of additional economic output, or just under 0.1% of GDP, and £435m of VAT and employment related taxes. This is before any multiplier is applied and any additional activity in the financial services industry, which would provide mortgage, life insurance and investment products.

Based on that estimate, the fall in residential transactions, from 1.6m pa to 930,000, has cost society around 160,000 jobs, reduced mobility and hit the Exchequer, assuming both current house prices and the current sales distribution, by around £1.3bn in lost income tax receipts and £1.75bn in lost VAT receipts.

The frictional burden of Stamp Duty

Estimates from Best and Kleven described earlier provide clear evidence that housing transactions and valuations are affected by the tax rate.

Stamp Duty Land Tax is a substantial lump sum cost for purchasers. The illustrative table below, showing hypothetical examples of stamp duty payable at certain property sale points and after tax income, for selected income bands, demonstrates how material the stamp duty fee is as a percentage of after tax income.

Simple illustrative Model of Stamp Duty as % of After Tax Income (Various Bands £)

Property Cost	150,000	300,000	600,000	1,500,000	2,500,000
Stamp Duty Land Tax	1,500	9,000	24,000	75,000	175,000
Individual Earning	25,000	50,000	100,000	250,000	400,000
Income Tax	3,112	9,224	29,224	78,020	145,520
National Insurance	2,319	4,293	4,935	6,435	8,035
Approx. After Tax Earnings	19,569	36,483	65,841	165,545	246,445
Stamp Duty, % After Tax Income	8%	25%	36%	45%	71%

Source HMRC & Walbrook Economics

While the severity of the tax, as expressed as a percentage of after tax income, generally rises as property and income levels increase, the impact is almost certainly most acutely felt at the first-time and second-time buyer end of the market as buyers at that level are less likely to have significant property equity which the tax can be drawn down from.

For the first time buyer to stump up an additional £1,500, as in our example above, on top of an initial deposit and other transaction costs may well prevent them from going ahead with the transaction. Similarly for the family earning £50,000 to pay the equivalent of 25% of their after tax annual salary when purchasing a fairly modest (in many parts of the country) £300,000 property is very difficult.

There is little doubt that an increase in Stamp Duty Land Tax rates has the frictional cost of moving has led to a drag on overall transactions which has not only impacted mobility, but also diminished total tax receipts and suppressed GDP growth.

The economic impact of housing transactions

Making it less expensive to move will increase mobility. Mobility is desirable for a number of reasons. Firstly it enables people to choose, within their budget, the sort of property that suits them. Higher frictional costs will mean that some people, at the margin, will decide it is not worthwhile to move. Elderly people may become less willing to downsize, for example.

Mobility is also good for employment. Estimating how many people are dependent on housing transactions is clearly an imperfect science. Does it include, for example, the shop worker at Carpetright, or the jobbing builder who does RMI and fits a new bathroom?

There is a grey area but, as discussed earlier, the latest ONS Labour Market Statistical Bulletin for July 2013 showed that out of the 29.71m people in employment in the UK, 1.99 million worked in construction, 1.1m in financial services, 511,000 in real estate activities, and 4.9m in retail related activities. Those four categories account for 8.4 million jobs, or28% of all employment. While the ONS does not break down the data further it is not unreasonable to suggest that over 1,000,000 jobs are related, directly or indirectly, to residential property transactions. Our assumptions are outlined below.

UK Employment and Transaction Impact

	Total employment by sector	Our estimate of % transaction related	Impact
Construction	1,990,000	26%	540,000
Financial Services	1,100,000	6%	66,000
Real Estate	511,000	35%	178,000
Retail	8,400,000	4%	336,000
Total			1,120,000

Source ONS and Walbrook estimates

Making it easier for people to get on the property ladder by minimising frictional costs will also assist with family formation. While there are a number of factors behind the rising age of first-time buyers, clearly rising frictional costs are unhelpful. Getting on the property ladder is becoming increasingly difficult and that is likely to have implications for family size and the timing of such decisions.

Proposals

The TaxPayers' Alliance believes that in the long term Stamp Duty Land Tax should be abolished as it is an inefficient and unfair tax. However reforms are also possible that would ease the burden on families with a limited impact on tax receipts. The introduction of a separate Scottish regime, from April 2015, gives the Government an opportunity to iron out the anomalies in the system for the rest of the UK.

We present three proposals, all of which are designed to simplify and reduce the burden of the tax while helping promote Government objectives of mobility, fairness and growth.

Our assumptions are based on the Stamp Duty Land Tax yields from HMRC and Land Registry data in the tables below and we have applied these transaction levels and yields to our proposal models. Each model assumes that there is no uplift in valuations or transaction levels from the reduced Stamp Duty Land Tax rate applied in the proposal. We then apply the findings of Best and Kleven to estimate the net impact to the Treasury of each proposal.

It should be noted that 5% was the top rate applied in 2011/12 and there were approximately 3,000 transactions recorded above £2m. In that year first time buyers under £250,000 were exempt from the tax.

Property Transactions in 2012 and Estimated Stamp Duty Land Tax Yield 2011/12

Valuation	Transactions (,000)	Yield (£m)
0-£125,000	321	0
£125,001 -£250,000	397	545
£250,001- £500,000	162	1560
£500,001- £1,000,000	40	1005
over £1,000,000	12	1110
Total		4220

Source HMRC

Property Transactions 2011/12 – Average Transaction Size by Tax Band and Implied Average Stamp Duty Paid

Valuation	Ave Transaction Size	Implied Ave Stamp Duty Paid
0-£125,000	£87,900	0
£125,001 -£250,000	£184,200	£1,842
£250,001- £500,000	£349,900	£10,497
£500,001- £1,000,000	£691,900	£27,676
over £1,000,000	£2,418,900	£120,945

Source HMRC

Proposal One – Move to a marginal tax

Stamp Duty Land Tax is currently based on taxing the entire value of the property at the highest rate that it exceeds the threshold for, rather than charging the higher rate only on marginal value above each threshold. This creates pricing inefficiency and seems unfair. A house that sells for £250,000 will lead to a Stamp Duty bill of £2,500 while a property that sells for £260,000 will lead to a Stamp Duty bill for £7,800.

Introducing marginal rates for Stamp Duty – moving to a marginal rate system like Income Tax – would stop anomalies like that and would make the tax fairer. This proposal is simple: maintain the current bands and rates but apply it as a marginal tax.

The table below shows the impact of moving to a marginal structure. This table uses the assumptions described above for 2011/12. It is based on historic transaction levels and values and makes no assumptions about the likely increase in transaction levels and valuations as a result of reduced frictional costs. The average payment numbers are based on average transaction values in each band in 2011/12.

Introducing Marginal Rates

Valuation	Rate	Yield	Average Payment	Current Average
0-£125,000	0	0	0	0
£125,001 -£250,000	1%	£235m	£592	£1,842
£250,001- £500,000	3%	£688m	£4,247	£10,497
£500,001- £1,000,000	4%	£657m	£16,426	£27,676
£1,000,001- £2,000,000	5%	£420m	£46,750	£68,000
over £2,000,000	7%	£866m	£288,750	£385,000
Total		£2867m		

Source HMG

All purchasers would benefit from moving to a marginal rate but, in percentage terms, properties in lower bands would enjoy a larger tax cut. For example, an average priced property at the current 1% band sold for £184,200 in 2011/12. With a marginal structure, the average Stamp Duty bill would fall from £1,842 to £592, a reduction of 68%. An average priced property in the current 3% band sold for £349,900 in 2011/12. With a marginal structure the Stamp Duty bill would fall by 60% from £10,497 to £4,247. At the 5% rate, the saving on an average priced property would be £21,250, or 31% of the current Stamp Duty bill.

Moving to a marginal tax of the same rates and bands would have yielded £2.9bn against the £4.2bn achieved under the current slab rate structure, a shortfall of £1.3bn. However using our conservative assumptions of a £6,000 Treasury gain for each additional transaction (before multiplier) such a proposal would only need to generate a further 210,000 sales to be fiscally neutral.

Given the findings of Best and Kleven, this is less than the expected increase in transactions with a Stamp Duty cut on this scale. We believe that moving to a marginal tax, with the same current bands, would not only promote the Chancellor's growth objectives and aid mobility but it would be fiscally neutral, at worst.

Proposal Two – Double the thresholds

If the threshold had been doubled, 77% of all transactions in 2011/12 would have been exempt from any Stamp Duty. While most home-buyers would benefit, a typical home-buyer at an average price in the £250,000 to £500,000 bracket would see their bill reduced by two thirds from £10,497 to £3,499.

This proposal would reduce the tax bill for all those buying properties valued at less than £4 million. The table below highlights the yields to the Treasury and the impact on the tax level paid, at the average price within each band.

Double Thresholds

Valuation	Rate	Yield	Average Payment	Current Average
0-£250,000	0	0	0	£1,842*
£250,001 -£500,000	1%	£567m	£3,499	£10,497
£500,001- £1,00,000	3%	£830m	£20,741	£27,676
£1,000,001- £2,000,000	4%	£489m	£52,000	£68,000
over £2,000,000	5%	£825m	£275,000	£385,000
Total		£2713m		

*Average of payments on transactions over £125,000; Source HMG

This proposal would raise £2.7bn (in 2011/12 terms) with a raw cost of to the Exchequer of £1.48bn before any multipliers.

The breakeven point for the Exchequer would be 245,000 additional transactions pa. This again is within the level expected based on the Best and Klevin of the impact of changes in Stamp Duty rates on the market. We therefore believe that this proposal could also be revenue neutral.

Proposal Three – Halve the rates

Halving Stamp Duty Land Tax rates would send a clear signal to householders that the Government was determined to encourage home ownership and mobility. The impacts are shown in the table below.

The raw cost to The Exchequer would be £2.1bn. Alternatively, 350,000 extra transactions would be required for the Exchequer to breakeven. While this proposal would probably increase the volume of transactions significantly, we do not believe that it would prove revenue neutral using the Best and Kleven findings on the likely increase in transactions.

For example, if transactions increased by 200,000 as a result of this proposal, the increased revenue from in employment taxes, VAT, and Stamp Duty would raise around £1.2bn and the net cost would be £900m. That is a small price to pay for such a substantial easing of the burden on home-buyers though.

Halve Stamp Duty Rates (Yields Based on Estimates from 2011/12 data)

Valuation	Rate	Yield	Average Payment	Current Average
0-£125,000	0	0	0	0
£125,001 -£250,000	0.5%	£273m	£921	£1,842
£250,001- £500,000	1.5%	£780m	£5,249	£10,497
£500,001- £1,000,000	2%	£502m	£13,838	£27,676
£1,000,001- £2,000,000	2.5%	£292m	£34,000	£68,000
over £2,000,000	3.5%	£283m	£192,500	£385,000
Total		£2130m		

Source HMG

Conclusions

Stamp Duty Land Tax is not only one of Britain's most iniquitous and arbitrary taxes but it is also a poorly constructed tax in its current form. While the TaxPayers' Alliance would advocate its abolition, on the grounds that it is an impediment to economic activity, mobility and equity, we recognise that, in the short term and with a large public sector fiscal deficit, the Government may not feel that is practical.

Over the last fifteen years the tax has greatly increased in complexity from its origins of a clean 0% and 1% to a much a complex banded structure with increasing tinkering at each Budget which makes long-term decision making difficult.

A family purchasing a £300,000 house with an income of £50,000 would need to find 25% of their after tax income in Stamp Duty Land Tax to move. Little wonder transaction levels have plummeted. Despite that, residential Stamp Duty Land Tax only raised 0.8% of all tax receipts in 2011/12 and it is therefore of marginal importance to the public finances.

This paper has looked at how using a blunt implement, like Stamp Duty Land Tax, to raise revenue for the Treasury causes distortions and anomalies. The work of Best and Kleven, looking at each and every transaction from 2004 to 2012, clearly shows that reducing Stamp Duty Land Tax increases the amount of economic activity. Their findings show a 20% increase in transactions, over a 16 month period, with a permanent benefit of 60 to 70% of that total, with a 1% reduction in the tax.

Stamp Duty Land Tax is only a small part of the total amount of tax associated with housing transactions. We have shown the positive employment effects from increasing transactions. **We believe over 1 million employees make their livings directly, or indirectly, as a result of housing new builds, transactions or RMI.**

We have presented three proposals that we believe would materially reduce the burden on purchasers, aid mobility and enhance economic growth. Proposal One – move to a marginal tax with the same rates. This has the benefit of ironing out distortions and bottlenecks and reduces the iniquity of the current situation. It benefits all purchasers, those already established and those just starting out, but the benefits, in percentage terms, are greatest at the more modestly priced end of the market. Using the Best and Kleven estimates we believe this to be revenue neutral to small positive in the round.

Proposal Two – doubling the bands, has the great virtue of exempting 77% of all transactions, while again benefiting people at almost all levels of the market. This proposal we believe would at worst be revenue neutral for the Treasury, but it would not deal with the distortions created at the thresholds.

Proposal Three – halve the rates, is the most generous proposal. Implementing this proposal probably would reduce Government revenues but the net cost would be modest.

We are confident that two of our three proposals would be, at the minimum, revenue neutral for the Treasury while the cost of the third would be modest given the wider economic benefits. **We estimate that each 100,000 additional transactions generates 0.1% GDP growth and £435m of additional tax revenues through income tax, national insurance and VAT alone.**

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