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IFS-CIOT debate

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# Reforming the taxation of housing: What changes should the Chancellor choose?

# Council tax & SDLT: problems & solutions



## Council tax:

- Still based on 1991 values (in England and Scotland)
- Regressive with respect to those values
- Discount for sole occupancy done in a way (25% discount) that distorts housing allocation

## Stamp duty land tax (and devolved equivalents):

- Discourages transactions (including upsizing/downsizing, moving for work or retirement,...)

**Solution:** reform council tax to be proportional to up-to-date values

- (With discount for sole occupancy, if kept, unrelated to property value)
- Set tax rate to replace revenue from council tax and SDLT, which would be abolished

# Budget: tax rises on high-value homes?



## Increase tax rates in higher bands

- e.g. copy Scotland's increases for bands E–H (£2bn); double for bands G & H (£4bn)
- Falls on those with high 1991 property values, not high current values

## Add more bands, or introduce a 'mansion tax' (perhaps replacing council tax and/or SDLT)

- Need updated valuations for affected properties
- If revalue only those in high bands, miss those with high current value but low 1991 value
- If update valuations for new tax, still levy council tax based on old bands?
- Why use updated valuations only for properties in high bands?
  - Little administrative advantage now that valuations would mostly be done statistically
- If avoid valuing by applying new tax only after next sale, distorts timing of next sale

# Income tax & CGT: problems & solutions



**Landlords' returns** (rental income + capital gains) are:

- Under-taxed: tax rates lower than on income from work
- Over-taxed: investment penalised; taxed even on purely inflationary returns

**Owner-occupiers' returns** (imputed rental income + capital gains) not taxed at all

- No disincentive, but huge windfalls have gone untaxed

**Disparity** massively favours owner-occupation, penalises landlords and tenants

**Solution:** tax landlords (at higher rates) only on returns in excess of risk-free return to investment

- Ideally owner-occupiers too, in long run – but more challenging

# Budget: tax rises on high-value homes?



## **NICs on landlords' rental income**

- Would reduce under-taxation of high returns relative to income from work
- Would also increase over-taxation of normal returns – discourage housing investment – unless let landlords deduct a risk-free return on their purchase cost
- Tenants would lose as well as landlords – already penalised relative to owner-occupation

## **CGT on main homes** (above a certain value)

- What principled reason to apply CGT to high-value but not low-value properties?
- Would cause distortions unless also tax imputed rent and deduct risk-free return
- Would gum up housing market if people delay transactions in hope of policy reversal

# Conclusions



- Higher annual property tax would do less economic damage than most other tax rises
  - Including SDLT or CGT on main homes
  - True whether applied broadly or just at the top
  - Whether it's fair for any extra tax burden to fall on home-owners is a different question
- Proper principles-based reform would be better than tinkering
  - Simply increasing tax based on 1991 values would exacerbate existing unfairness
  - Do we really want two separate taxes on property value operating in parallel?