

A BREXIT OPPORTUNITY

INTRODUCTION

With Brexit finally done and Britain - in theory at least - now back in control what advantage has the government taken of its new found freedom to shape our future for the better? Specifically, what measures are planned to alleviate the cost of living crisis and make house prices affordable again? Nothing is in sight.

Yet two simple, easily implemented measures are available to a government willing to think outside the box.

The first is the abolition of VAT and its replacement with the old purchase tax. The second is the re-introduction of Schedule A income tax on property.

These two measures should have a marked beneficial effect on the economy. First, the abolition of VAT, the standard rate of which is 20%, will cut the cost of living significantly. As essential items loom larger in the budgets of the less well off, this measure should benefit them disproportionately. The consequent one-off reduction in the cost of living would ease inflationary pressures appreciably.



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Second, the re-introduction of Schedule A tax - this time based on the site and not the building - should improve housing supply as second homes come up for sale and empty properties are either sold or rented out. By directly targeting site values, which are the source of capital gains, it would signal an eventual end to the era of unfair and unearned tax-free profit from sitting on residential property. The need for the socially divisive "Bank of Mum and Dad" could eventually disappear, leaving demand a function of the basic need for suitable accommodation.

VAT was introduced in 1971 in preparation for our joining the Common Market: purchase tax was phased out shortly thereafter. VAT was highly controversial and entailed a massive increase in Revenue personnel and imposed considerable administrative costs on businesses. Its abolition now would lead to big savings in the costs of business as well as releasing an army of Revenue employees for other duties, e.g., chasing fraudsters and tax dodgers. Vastly more important, however, would be the effect on the purchasing power of the poor, needy and less well off - sections of the community where the cost of basic essentials looms very large.



As for purchase tax, this was levied on the wholesale value of luxury goods. Initially set at 33.3% it was increased to 66% for some items. Reinstating this tax would enable the government to discourage undesirable consumption, e.g., over-sized cars with high fuel consumption. Its yield is potentially considerable and it would help defray the loss of revenue from the abolition of VAT.

WHAT IS SCHEDULE A INCOME TAX?

Schedule A income tax is probably unknown to most people. Their experience is of Schedule E (wages, salaries and pensions) or Schedule D (self-employed earnings). Yet Schedule A income tax used to feature regularly on the tax returns of owner occupiers. They were treated as having an income equivalent to the rent their property would command. Various deductions were allowed, e.g., repairs, insurance etc., the net amount being regarded as taxable income. This form of Schedule A tax ceased to be applicable to individuals in the 1960s but Schedule A remains applicable to companies.

The Schedule A tax here proposed would differ from the former tax in important respects. First, it would not be confined to the owner occupier but would apply to all owners of residential property whether owner-occupied, rented or empty. Second, the tax would be payable only on that part of the annual rent attributable to the site; the building element would not be taxed. Thus improving one's property would not affect the Schedule A tax payable.

It is easy to assess the annual rent of a property; most people would have a good idea of it anyway. But it is not obvious how to assess that part of the rent attributable to the site. However, simple calculation can indicate a minimum figure. Assume a house worth £500,000 which is insured for £300,000, being the rebuild cost. That rebuild cost is the maximum value attributable to the building. Deducting this from the total property value gives the minimum value attributable to the site. Thus the minimum site value in this case would be £200,000.

If on the open market the property would rent for £20,000 a year; the amount attributable to the site, 40%, would be £8,000. The income tax payable on this notional income would depend on the taxpayer's other income. For a well-off person the applicable tax rate could well be 40%--even more. For some individuals it could be less, even nothing.

Schedule A tax would be payable by the owner not the renter. But would not the owner merely put up the rent to recoup the tax? Possibly, but the scope for this is very limited. The rent of a property is determined by the most people can pay. That won't change with the introduction of Schedule A tax. If the landlord (owner) decides to take the property off the market he still has to pay the tax. As he would thereby lose both his rent and the tax, he is not likely to do this.

How would Schedule A income tax alleviate the housing crisis? First, people would find it significantly more expensive to have second homes. In some parts of the country (Cornwall is a notable example) wealthy outsiders have driven up the cost of homes to a point where local people cannot afford a house. This tax would help bring these second homes onto the market. Second, there are many empty properties around the country - an estimated one million in fact. This tax would make it costly to keep such properties out of use. Third, people who occupy a property much bigger than they need could save tax by moving to a smaller property. So Schedule A tax would encourage people to downsize where appropriate.

House prices rise because the site value rises: the building itself deteriorates in value (in real terms) and is a maintenance liability. By taxing the site value a significant restraining influence is exercised over the rise in house prices. The attractiveness of residential property as an investment will take a knock. There will be less urgency to "get on the ladder." This will make residential property less attractive as an investment allowing basic demand, i.e., the need for suitable living accommodation, to come to the fore.

Schedule A tax would also help redress the North South divide. The government's Levelling Up programme is based on the mistaken belief that people in the South work harder and are more productive than in the North. But the real reason for the divide is that people in the South have the advantage of location, i.e., proximity to markets, the press of population, better infrastructure (roads, railways and airports). The newspaper vendor standing outside Bank Station in the heart of the City will sell vastly more newspapers than one positioned at, say, Maidenhead Station. Both bring the same skill and aptitude to the job but one earns vastly more. Why? Because of location. The Schedule A tax takes this into account. Realistically, the South will still look more attractive vis-a-vis the North but noticeably less so.



THE EFFECT ON THE TREASURY BALANCE

How would these proposals affect the public purse? In 2022/23 VAT amounted to £160bn - 16% of total taxes. Its abolition would leave a gaping hole in public finances. In the 1960s purchase tax accounted for around around 8% of total tax revenue. Assuming the same proportion, purchase tax could well yield some £80bn, i.e., half the shortfall. The likely yield of the new Schedule A tax is difficult to estimate. However, assuming an average house price of £250,000, the current total of 28.2 million households, and the same annual rental and site value coefficient as in the example the yield could well be in the region of £45bn.

This would still leave a significant shortfall of £35bn. It would then be for the authorities to decide what other taxes to raise. However, the spirit of these proposals would suggest funding the deficit by increasing inheritance tax and removing the capital gains tax exemption from any future rise in the value of owner occupied properties.

CONCLUSION

These two measures would entail a significant shift in the tax burden from the poor and needy to the well-off. Their effect on house prices, second homes and capital gains tax-exemption will not be welcome. So they will be politically difficult. It will require a lot of persuasion to gain acceptance for them. However, a decent standard of living and acceptable accommodation are fundamental requirements of a civilised society.

The continuing failure of society to meet these needs is a scandal and could eventually lead to social unrest. The time for tinkering with these problems is fast running out: radical solutions are called for. 🇬🇧