The Taxing Wealth Report 2024

Every politician's guide to "How to pay for it"[1]

Capital gains tax reforms:

Charging capital gains tax on the final disposal of a person's main residence

Brief Summary

This note suggests that:

- A capital gains tax charge should be made on the final disposal of a former residential home by a person or their spouse or civil partner.
- This capital gains tax charge would usually arise on the death of a person or on the death of the last surviving member of the marriage or civil partnership of which they were a part, but it could also arise on the merger of households, on a sale before moving into a care home or on disposal of a property before emigrating. A partial charge could also arise on downsizing.
- Residential properties would be taken out of the scope of inheritance tax if this charge was made.
- This charge would be considerably more equitable and predictable than current inheritance tax charges, which create considerable regional tax injustice.
- The charge is fair: it only arises when a person ceases to have use of their main residence.

[1] This note forms a part of 'The Taxing Wealth Report 2024' published by Finance for the Future LLP, which is UK LLP number OC329502, registered at 33 Kingsley Walk, Ely, Cambridgeshire, CB6 3BZ. See https://www.financeforthefuture.com/taxing-wealth/. This note was written by Richard Murphy FAcSS FCA FAIA (Hon), Professor of Accounting Practice, Sheffield University Management School, who is a director of Finance for the Future LLP. © Finance for the Future LLP 2023

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- Without suggesting that the tax be hypothecated it is suggested that it is likely that it would be considerably more acceptable if a commitment was made to invest the proceeds in social housing.
- The proceeds that might arise from this suggestion are hard to estimate because the current level of gains of this sort arising on death are not known, not least because capital gains tax is not chargeable on death at present.
- It is known that the exemption of people's main residences from capital gains tax charge is thought by HM Revenue & Customs to cost £35.2 billion of tax foregone each year at present.
- Depending on the rates of capital gains tax chosen (and the Taxing Wealth Report 2024 generally suggests that those in use for capital gains tax are too low and should be subject to an investment income surcharge, which might be waived in this case) the amount of tax that might be raised could vary considerably. However, it would not be unreasonable to think that at least £10 billion of additional revenue could be raised a year, having taken into consideration the loss of inheritance tax on such properties.
- This proposal would require considerable consultation and great care in drafting to ensure that tax justice was delivered.

The proposal	To charge capital gains tax on the last occasion that a person, or a person connected to them, makes disposal of a residential property previously used as their main residence without reinvesting the proceeds in a new main residence. This is most likely to happen on death.
Reason for the proposal	1. To improve the horizontal equity of taxation, which is currently undermined by the exemption from capital gains tax of the main domestic residence of a UK taxpayer when no equivalent relief is available to a person who rents their main residence. 2. To increase the prospect of vertical equity of taxation in the UK which is heavily dependent upon the creation of improved horizontal tax equity. 3. To reduce the tax spillover effect that this exemption from capital gains tax creates in the UK housing market and in UK wealth profiles.

	4. To raise additional tax revenues.
Estimated tax that might be raised as a result of the recommendation made	The behavioural response to this charge is hard to predict. As a matter of fact, people will still dispose of properties that were previously their main residence, either during their life or on death. This charge will, then, be unavoidable. This fact will be assisted by the charge applying equally to those properties that are gifted (where the market value of the property gifted will be taxed) as well as to those that are sold. It is exceptionally unlikely that people will be dissuaded from owning their own main domestic residence as a result of this charge. Again, this suggests only a very limited scope for behavioural response to this charge. There may be minor behavioural issues to deal with on disposals taking place during life which do not result in the reinvestment of proceeds in another main residence. These are most likely when merging households, going abroad or selling in old age but before death. Careful drafting will be required in the first two cases, most especially if reinvestment does then subsequently occur within a reasonable time period of the earlier disposal, and in the last case to ensure no unforeseen interactions with inheritance tax arise within a reasonable time period of disposal. Likely proceeds from this charge should exceed £10 billion, therefore considerably exceeding the current inheritance tax charge on such properties whilst being considerably more equitable with regard to the basis of charge across the UK population as a whole. Since the largest gains likely to be subject to this charge will be those on the most valuable properties, which are by definition owned by the wealthy, this charge will inevitably reduce wealth inequality in the UK.

Ease of implementation	Not straightforward because of the sensitivity of the issues and because of issues referred to in the preceding paragraph.
Likely difficulties that might result from implementation	Technically few. Practically, a lot of taxpayer preparation might be required, as might also be the case with regard to systems required for reporting a potential tax liability, especially if it arises during life rather than on death.
Likely time required to implement the change	Several years for the reasons noted in the next section.
Consultation period required.	This is, in effect, a new tax on a tax base that has previously been considered sacrosanct from charge, and as such is bound to require an extensive consultation process to ensure that the tax is fair and charged appropriately. Implementation is, therefore, likely to take 2 to 3 years from the time proposal is made.

Background

By far the largest exemption by value for capital gains tax purposes is that provided to people on the gains arising from their use of a property as their main residential home. In 2022/23 it was estimated by HM Revenue & Customs[2] that this relief cost £35,200 million (£35.2 billion) having cost £31,700 (£31.7 billion) on average over the six preceding years.

This exemption, which has existed ever since the introduction of capital gains tax in 1965, has now contributed to a growing wealth divide within the UK economy as a whole. At one time, there was a joke that said that the UK could be divided between the haves and the have yachts, but that division is now much more commonly represented by the division between those who have secured ownership of their own domestic residence and paid for it over their lifetime, and those who have not been able to do so and have, instead, rented accommodation throughout their lives.

[2] https://www.gov.uk/government/statistics/main-tax-expenditures-and-structural-reliefs/non-structural-tax-relief-statistics-january-2023#:~:text=NICs%20(estimated%20at%20%C2%A324.7%20billion%20in%202021%20to%202022)

UK estate agents now suggest that the total value of the UK's housing stock amounts to £8,700 billion[3] before the offset of mortgage loans to produce the net wealth figure for such property included in data on UK wealth produced by the Office for National Statistics[4].

That gross figure apparently increased by 5.1% in 2022 or approximately £420 billion, which is a sum equivalent to about one sixth of UK gross domestic product (or national income) in the year in question. This makes it apparent that there is an issue that needs to be addressed concerning the resulting wealth inequality in the UK.

That is especially true when it is becoming increasingly difficult for young people to buy properties for use as their homes without considerable financial assistance from their parents, which fact perpetuates this problem. However well-motivated this tax exemption might have been when introduced there now appears to be good reason for reconsidering whether it should be retained in its existing form.

The purposes for this tax exemption have always been clear. There were three primary justifications for it:

1. There was no desire to charge tax on gains arising to a person if they were to move to secure employment. The obvious impediment to labour mobility that this would create was always considered a reason for not charging capital gains tax on the sale of domestic properties used as a person's main residence tax during their lifetime.

2. There was no desire to charge tax on inflationary gains arising when a person moved during the course of their lifetime when it was assumed that they would have a continuing need for a residential property after any sale giving rise to such a gain.

3. It was assumed that any desire to tax gains arising on residential properties of significant value at the time of death would be captured through the inheritance tax system.

The first of these assumptions remains entirely valid. It remains the case that the imposition of any tax that might reduce labour mobility might be harmful to the economy. For that reason, the gains arising on most lifetime sales of property should continue to fall outside the scope of a capital gains tax charge.

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[3] https://www.savills.co.uk/insight-and-opinion/savills-news/340229-0/uk-housing-value-hit-a-record-high-of-%C2%A38.68-trillion-in-2022-with-gains-favouring-owner-occupiers-rather-than-landlords#:~:text=The%20total%20value%20of%20all,year%2Don%2Dyear%20increase.

[4] https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/datasets/totalwealthwealthingreatbritain

However, the widespread expansion of home ownership and the considerable increase in the value of homes, even having taken inflation into consideration, suggests that some aspects of the second assumption do now require reappraisal.

That reappraisal has to, necessarily, be linked to the third assumption. That is because there can now be little doubt that the interaction between capital gains tax and inheritance tax with regard to main residences can produce unfair outcomes. In particular, because of the widespread variation in average house prices across the UK and in their increase over time there is considerable potential regional tax injustice that might arise because residences of apparently similar style in different parts of the country might be subject to considerable variation in the inheritance tax charge that might be payable upon them.

The recommendation made here takes all these factors into account.

Recommendation

It is proposed that lifetime gains on the ownership of residential property should become liable to capital gains taxation on the death of its owner, or of their spouse, civil partner, or other connected person to whom they might have transferred that ownership upon their ceasing to use it during their own life, which person, or their estate, should then be liable for the gain arising on that residential property at the time that they die or cease to use it as their main residence, which last provision shall also apply to any person making a disposal of a property without buying a replacement main residence during the course of their lifetime.

For example, suppose that Jo bought a property in 1972 for £10,000. They sold it for £22,000 in 1982, buying another property for £35,000 at that time. They then moved again in 1993, selling that second property for £89,000 and buying another for £115,000. They then remained resident in the property with their spouse until they died in 2022, their spouse having predeceased them having left their share in the property to Jo meaning that the entire gain on the properties owned during life is due by Jo's estate. Jo spent £12,000 on a new kitchen in 2003 and £19,000 on a conservatory in 2007. The property was valued at £485,000 at the time of death.

The total capital gain is:

	£	£
Sales proceeds or value of final property		485,000

Less: cost of final property	115,000	
Cost of new kitchen	12,000	
Cost of conservatory	19,000	
Total cost of final property		(146,000)
Gain on final property		339,000
Add: Gain on first property		
Sales proceeds	22,000	
Less: cost	10,000	
Gain on first property		12,000
Add: Gain on second property		
Sales proceeds	89,000	
Less: cost	35,000	
Gain on first property		54,000
Total lifetime gain on main residences:		£405,000

This can be rationalised as being the disposal value less the actual sum paid for the properties, which totals £80,000 in all. This is made up of £10,000 for the first property; £13,000 for the second property (being the cost less the proceeds on the first property); and £57,000 on the third property, being £115,000 spent less £89,000 from the proceeds of the previous property, making £26,000, plus £31,000 on improvements.

It is suggested that this sum should be subject to capital gains tax on death but that there be no inheritance tax charge on that gain as a result.

It is also suggested that this charge should arise during Jo's lifetime if they made a disposal of this value and then did not reinvest the proceeds for any reason, e.g. because they went abroad, or because they moved into a care home, or they merged their household with that of another person which other house then became their main residence for capital gains tax purposes.

The amount of capital gains tax due on this charge would depend on the rate chosen. This need not be at the same rate as other capital gains tax charges, at least during a transition period. It might also be exempt from the investment income surcharge proposed elsewhere amongst the Taxing Wealth Report 2024 propsals. It could also be subject to progressive

rates specific to this charge depending upon the amount of gain made. These variables clearly make it harder to estimate the likely revenues arising from this proposal.

Any estimate of the tax to be collected does also depend upon an estimate of the number of gains on the sale of properties that might fall within the scope of this charge. This does require that an estimate be made of the number of disposals that a person makes on average during their life. Whilst estimates that a person might live in ten or more properties during their adult life appear commonplace it also seems likely that a majority of these will be rental properties that they live in before acquiring their first own main residence. Three or four main owned residences seems to be a commonplace estimate.

Given that the tax exemption for capital gains arising on the disposal of domestic residences is now estimated by HM Revenue & Customs to cost £35.2 billion a year[5] what is clear is that there is considerable scope for raising revenue from this charge. This is most especially true because the proposal made is that the charge be on the lifetime gain made on a person's final disposal of a main domestic residence and not on the capital gain arising or disposal of the last such residence. As a consequence, a disproportionate part of the total cost of the £35.2 billion cost of this exemption might be brought within the scope of a charge to tax as a result of this recommendation.

That said, there will be a reduction in the amount of inheritance tax payable as a consequence of removing a person's principal private residence from the charge to that tax on death. Appropriate measures would also be required to allow for a reduction to an inheritance tax charge on disposal proceeds arising from the sale of a property in a reasonable time period before death.

It is suggested that the political feasibility of this charge would be considerably increased if the proceeds were to be used to build new social housing, even if not directly hypothecated for that purpose.

The proceeds to be raised would depend upon the rate of tax charged. If charged at a person's highest marginal rate of income tax rate in the year of death many such gains would be subject to tax at 40% or 45%. The former is the current inheritance tax rate, which does not take into consideration the cost of acquiring the property. As such these rates may be appropriate. However, to make this charge both progressive and fair it is likely that this gain might need to be subject to its own scale of charges. It might also need to be exempted from any investment income surcharge otherwise proposed in the Taxing Wealth

[5] https://www.gov.uk/government/statistics/main-tax-expenditures-and-structural-reliefs/non-structural-tax-relief-statistics-january-2023#:~:text=NICs%20(estimated%20at%20%C2%A324.7%20billion%20in%202021%20to%202022)

Report 2024.

Given all these variables, suggesting the annual yield from this tax is difficult, but a sum in excess of £10 billion per annum is entirely plausible even allowing for the loss of current inheritance tax charges on these properties.