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BRIEFING

Home county

Options for taxing main residence capital gains

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December 2021

Acknowledgements

The authors are grateful to the abrdn Financial Fairness Trust for supporting this work. This work is supported by a project advisory group, whose members are Brian Bell, Kate Bell, Emma Chamberlain, Rowena Crawford, Naomi Eisenstadt, Annie Gascoyne, Mubin Haq, Eleni Karagiannaki, Carla Kidd, Sebastian Koenigs, Sarah Luheshi, Brian Nolan, Gregg McClymont, Tim Pike, Andrew Summers, Gemma Tetlow, Martin Weale, Steve Webb and Chris Wilford and the work has benefitted from their comments. The authors would also like to thank Arun Advani; staff at HMRC; and colleagues James Smith and Torsten Bell at the Resolution Foundation. All errors remain the authors' own.

The Resolution Foundation joined the abrdn Financial Fairness Trust to embark on a major investigation into the role of wealth in 21st century Britain. This briefing note is part of a three-year programme the trust is supporting. abrdn Financial Fairness Trust's mission is to contribute towards strategic change which improves financial wellbeing in the UK. Its focus is on tackling financial problems and improving living standards for those on low-to-middle incomes. It is an independent charitable foundation.

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A Corlett & J Leslie, *Home county: Options for taxing main residence capital gains,* Resolution Foundation, December 2021

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Summary

Over the past 30 years, the total value of household wealth has risen from three times national income to well over seven times. The single biggest driver of this increase has been the capital gains that owner occupiers have seen on their main residences. Inflation-beating house price growth and high ownership rates have combined to add around £3 trillion to British households' wealth since 2000. This alone accounts for around a fifth of all British family wealth today. This trend has also been amplified by the pandemic: house prices rose by 19 per cent from the end of 2019 to mid-2021, making this the first post-war recession to be accompanied by rising house values.

The huge size and unequal nature of these gains mean that it is worth revisiting some of the long-established attitudes towards them; in particular. that they should be entirely untaxed. The context that makes such a reconsideration worthwhile is that the next few years will see a major package of tax rises, concentrated on wages and profits, rather than wealth, that will take tax as a share of the economy to its highest level since 1950. Further impetus might come from a recognition that, although greater housing wealth is welcome, the trends that have delivered it have also brought negative consequences that we have failed to address, in part because of resource constraints: from falling home ownership to greater wealth gaps. So, despite the evident political and administrative challenges involved, it is worth at least asking whether we can do better than we presently do in relation to these huge, unearned, unequal and untaxed capital gains.

Huge gains in housing wealth have been unequal and unearned

Increases in house prices have been large but unequal, flowing overwhelmingly to those already holding more wealth as home owners. The least-wealthy third of households have gained less than £1,000 per adult, on average, from rising house prices this century, and the wealthiest 10 per cent have seen an average gain of £174,000.

Gains are also very unequally distributed by age and geography. Older families are more likely to be home owners and to have purchased a property before the rapid house price growth of the late 1990s and early 2000s. On average, adults over the age of 60 today have benefitted from around £80,000 of gains on their current main residence since 2000, whereas those aged 40-44 have received around £34,000. The regional distribution of gains is also stark, with the south and east of England experiencing much larger gains since 2000 than other areas of the country (the average gain per adult was £76,000 in London, but just £21,000 in the North East of England).

Importantly, these gains, which have driven nearly all the increase in families' housing wealth since at least 2006, are also unearned: in aggregate, they have been

driven principally by the global decline in interest rates rather than representing active accumulation of wealth, such as through paying off of a mortgage or home improvements.

Windfall gains from house price rises are almost entirely untaxed, while significant taxes rises on earnings are due in the next few years

These large, unequal and unearned capital gains are also largely untaxed. This is because Capital Gains Tax (CGT) applies to most assets but main residences are explicitly excluded. Given that these gains are often passed on at death, rather than cashed out during life, it is also worth considering their tax treatment at death: at present, the vast majority of homes can be passed on tax-free irrespective of whether their value results from years of hard saving or unearned windfall gains.

Although this tax treatment has largely been a matter of political consensus in Britain over recent decades, the scale of gains enjoyed by home owners is far beyond anything envisaged by any policy maker. They also exist in the context of a coming structural increase in taxes, reflecting continued demographic change, demand for public services, and the expected loss of some existing revenue sources such as Fuel Duty. Recent tax increases have been focused on profits and earned income, with the new Health and Social Care Levy taking the basic marginal rate for employees to 33.25 per cent; and for graduates repaying loans, this can rise to 42.25 per cent, or even 50 per cent after accounting for the effect of employer National Insurance.

The wider context includes the undeniable failure to address some of the negative consequences of the same process that has delivered these housing wealth windfalls: the decline of youth home ownership, and rising wealth gaps that harm social mobility and raise the importance of parental wealth in defining life opportunities.

Against that backdrop, it is worth at least considering whether we can do better than the status quo of largely ignoring capital gains on main residences for tax purposes. There are obvious political and administrative challenges involved, but considering in detail how a different approach might be taken reveals that practical ways forward are available should we choose to take them.

Practical routes are available to tax these gains

The most obvious solution is to end the main residence exemption within Capital Gains Tax (CGT). While most assets can attract CGT, with rates ranging from 10 per cent to 28 per cent, main residences are entirely exempted. In contrast, some other developed countries, including Sweden, Portugal and the US, do tax these gains to some extent.

The UK could follow suit by introducing some CGT for main residences. Doing so would bring design challenges, but practical options exist to overcome them. We suggest that main residence CGT would best operate as follows:

- It should – on fairness grounds – apply to some past accruals as well as those made in future; but no attempt would be made to tax gains that have already been realised;
- For current home owners, gains made since that property was purchased or since April 2000 (whichever is later) should be taxable;
- There should be no CGT 'uplift' at death, or in other words CGT should not be forgiven at death (as currently happens), but transfers between spouses would not be taxed at that point;
- Through a rollover relief, tax should not be due when people move house, except where they downsize or leave the property market; and
- Improvement and transaction costs should be deductible (as is the case for other types of property in the existing CGT system).

For illustration, we look at three sets of possible choices about tax allowances and rates, and find that main residence CGT could raise between £4 and £11 billion a year (modelled in 2021):

- A flat tax of 28 per cent on these gains would raise an estimated £11 billion a year, though this would require almost all estates that include housing assets to pay CGT.
- A 28 per cent rate with a £75,000 tax-free allowance per person per property would ensure around 60 per cent of people are not affected while reducing the revenue raised to £4 billion.
- An alternative system in which only capital gains above inflation were taxed would, with a 40 per cent tax rate and a £12,300 annual allowance, raise £10 billion a year.

An additional revenue consideration is that it would be odd, if such a tax were implemented and applied at death, to continue the current forgiveness of capital gains on other assets at death. Ending this uplift at death (which would be sensible even in the absence of main residence tax reform) would raise an additional £2 billion a year.

The Inheritance Tax system provides an alternative route to taxing these huge gains

The fact that these options for applying CGT to people's main residence would primarily apply at death raises the question of whether the Inheritance Tax system could also achieve some of the same ends. One such route to taxing some primary residence capital gains would be to restrict the Residence Nil-Rate Band (which helps ensure that residences can be passed on tax free to direct descendants) so that it could only be used against 'earned' property wealth. This would, in effect, deliver a limited main residence CGT through the Inheritance Tax system, though relatively few estates would therefore be taxed – as it would still be possible to inherit over £650,000 tax-free – and this would raise perhaps £2 billion a year. Alternatively, a policy that would be simpler but less targeted on capital gains would be to simply abolish the Residence Nil-Rate Band altogether, which might raise £3 billion a year.

Like any tax rise, CGT reform would face criticisms – with real trade-offs in its design. But ignoring the big wealth changes of the past two decades also has costs. Not least, there are the opportunity costs, including higher taxes on wages. For example, around £6 billion a year would be sufficient to raise the personal National Insurance threshold to £12,500 in this parliament (as the last Conservative manifesto suggested). The revenue raised could alternatively be used to mark a step change in addressing the social and economic side-effects of rapidly rising house prices. That could include radical approaches to raising home ownership rates amongst younger generations, with £7 billion sufficient to give everyone a £10,000 grant at the age of 25 – transforming young people's wealth levels and home ownership prospects. Or we could provide a collective inheritance benefiting the larger part of younger generations who will not become home owners: £6 billion a year in tax revenues would be enough to build 60,000 new social homes each year.

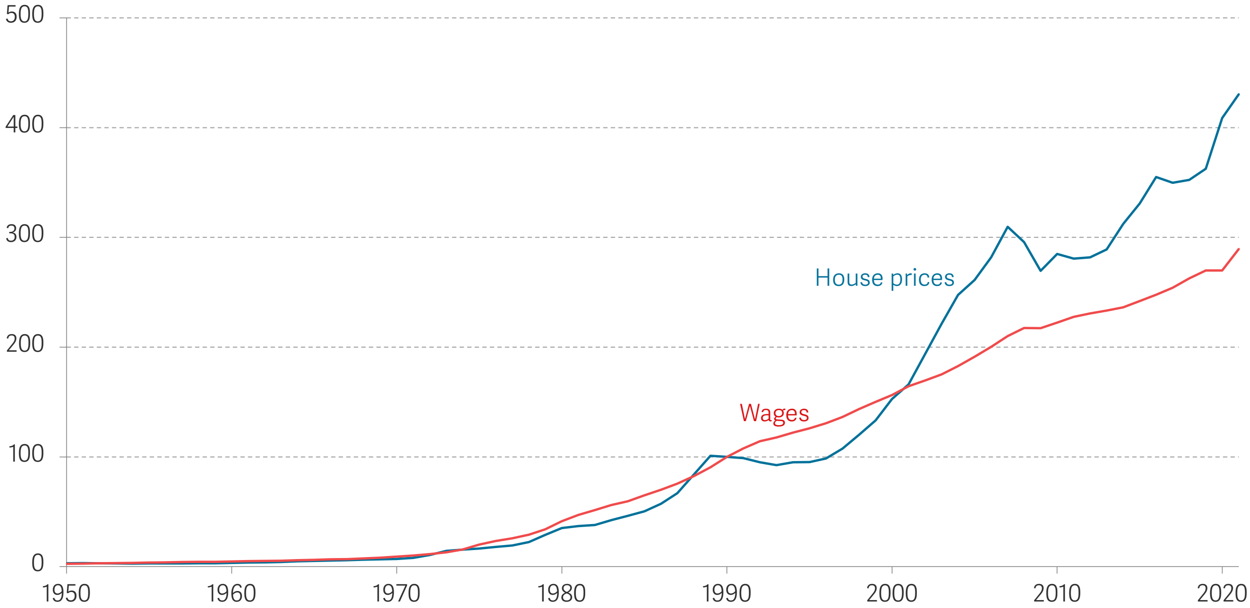
Reconsidering our current approach to these huge, unearned, unequal and untaxed capital gains is far from straightforward. Policy makers supportive of change should note that practical policy options are available should they choose to take a different path. And those who support the status quo should support an honest debate which recognises the costs that it brings with it, including higher taxes for working people and an undermining of the idea that the UK is a meritocracy where how wealthy you become is determined by the effort you put in. Even if the current approach was optimal in earlier eras, it's far from clear it's the best we can do today.

Huge unequal, unearned and untaxed house price rises over the past two decades have boosted household wealth

Huge increases in house prices over the past 20 years have driven a rapid increase in the value of UK household wealth – a major and underappreciated change to the UK economy. Such rises have been way in excess of wage increases (Figure 1): house prices have nearly tripled since 2000 (increasing by 182 per cent), while nominal wages have increased by only 85 per cent. And these gains have also far outstripped general increases in prices: real inflation-adjusted house prices have risen 86 per cent over that period.[1] These trends have been amplified by the pandemic during which a range of factors – including falls in the cost of borrowing and increasing demand for space – have meant that, uniquely for a recession, prices have risen (by 19 per cent between Q4 2019 and Q2 2021).[2] Recognising rising wealth levels is vital to understanding modern Britain, as it touches on questions of the relative roles of wealth and income in the economy, the fortunes of different generations, and the Government's fiscal decisions.

FIGURE 1: **House prices growth above wages is a relatively new phenomenon**

Index of nominal wages and house prices (1990 = 100): UK



SOURCE: RF analysis of Bank of England; ONS.

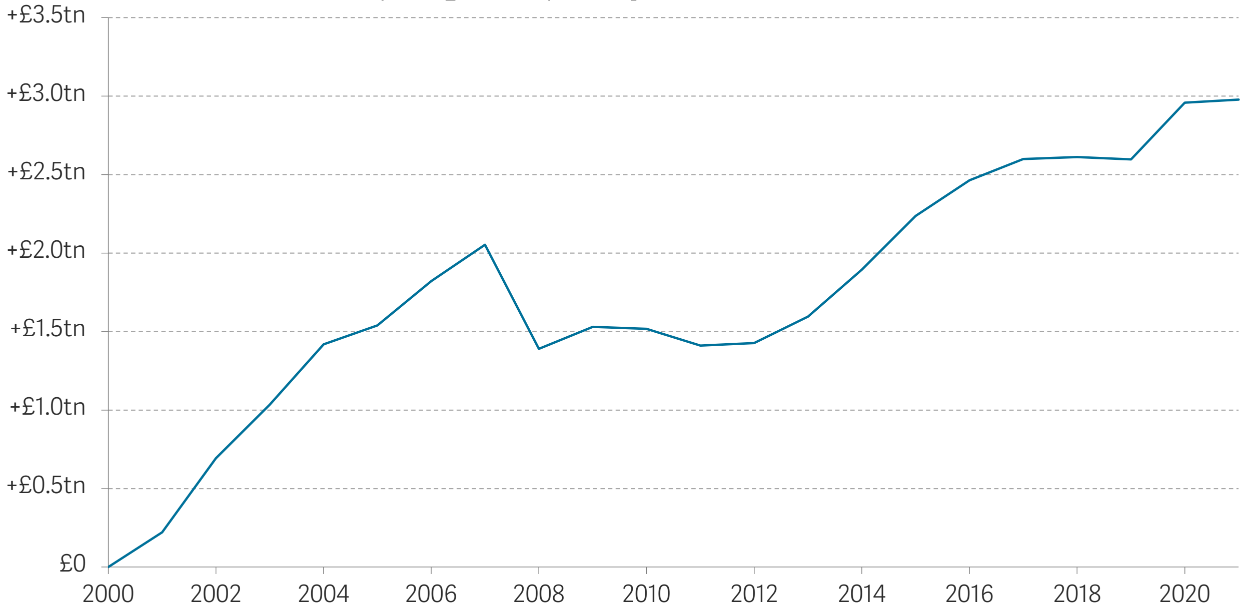
1 For a broader analysis of the makeup and development in UK household wealth, see: G Bangham & J Leslie, Rainy days: An audit of household wealth and the initial effects of the coronavirus crisis on saving and spending in Great Britain, Resolution Foundation, June 2020.

2 Rising house prices reflect falling interest rates, government support for incomes and direct housing market support (i.e. the reduction in stamp duty), and pandemic-driven shift in preferences for larger housing outside of dense urban areas. For more see: L Judge et al, Housing Outlook Q3 2021: The effect of transaction tax holidays on house prices, August 2021. For an estimate of the impact of the pandemic on UK household balance sheets see: J Leslie & K Shah, (Wealth) gap year: The impact of the coronavirus crisis on UK household wealth, Resolution Foundation, July 2021.

The long-run rise in UK housing wealth is the largest single driver of the rise in wealth in Britain, and has been driven by substantial increases in capital gains over the past 20 years on primary residences. Figure 2 shows the estimated cumulative real gain since 2000 for Great Britain – equating to a total £3 trillion increase. This represents almost a fifth of total household wealth, as estimated in mid-2021.[3]

FIGURE 2: **Since the turn of the century, gains on main homes have been huge**

Total real cumulative capital gain on primary residences since 2000: GB



NOTES: Gains are calculated using the stock of properties in round 6 of the Wealth and Assets Survey (i.e. 2016-18) and regional house-price indices. The stock of properties is adjusted using the rate of growth in the number of owner-occupier properties from the English Housing Survey. Gains are measured net of increases in line with CPIH since 2000.
SOURCE: RF analysis of ONS, Wealth and Assets Survey; ONS, Consumer Price Inflation; DLUHC & MHCLG, English Housing Survey.

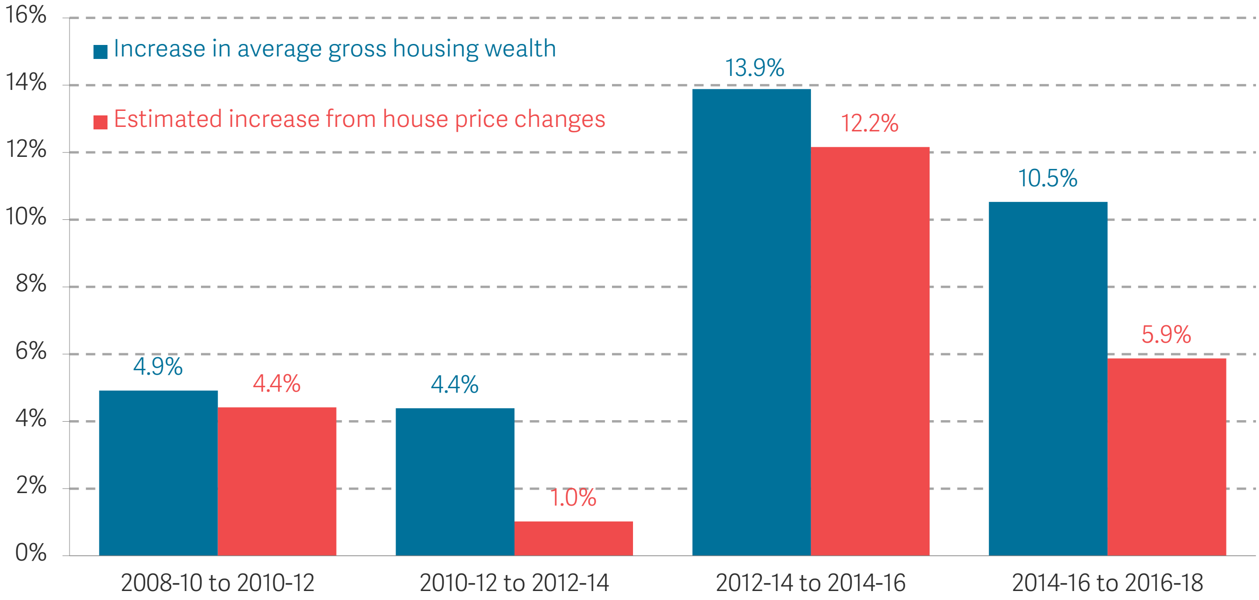
Rising house prices have driven the majority of the increase in families' housing wealth since at least 2006, rather than other factors that affect the level of housing wealth. Figure 3 compares the observed increase in average gross housing wealth for families in each round of the ONS's Wealth and Assets Survey (which covers two-year periods) with what would be expected from just changes in average house prices over those periods.[4] Rising house prices do not fully explain the growth in housing wealth – with other factors including the growth in the housing stock, home improvements and a shift in balance sheet composition towards housing and away from other asset types – but rising prices are clearly the primary driver of increasing wealth. This has important implications for

3 For estimates of wealth in 2021, see: J Leslie & K Shah, (Wealth) gap year: The impact of the coronavirus crisis on UK household wealth, Resolution Foundation, July 2021.
4 A version of this chart originally appeared in G Bangham & J Leslie, Rainy days: An audit of household wealth and the initial effects of the coronavirus crisis on saving and spending in Great Britain, Resolution Foundation, June 2020.

how this increase in wealth should be treated because it is largely 'unearned' and not all families have benefitted to the same extent.

FIGURE 3: **Rising house prices explain the vast majority of increasing housing wealth**

Average changes in gross property wealth and estimated changes based on changes in house prices: GB



NOTES: Estimated changes in property wealth are based on regional house price indexes. The definition of property wealth in the WAS extends beyond residential property and so the change in prices used in the estimate will be approximate.
SOURCE: RF analysis of ONS, Wealth and Assets Survey and Regulated Mortgage Survey.

These huge unearned property wealth gains are unequally distributed

The benefit of higher house prices has been unequally distributed across the wealth distribution, by age group, and by area.[5]

Increases in house prices have benefited those families with more wealth to begin with. Clearly, receiving capital gains on primary residences is only possible for those families who own their home. As discussed in our previous work, although housing wealth is more evenly distributed than other types of wealth – particularly financial wealth – large price rises still benefit those with existing high levels of wealth by more.[6] Figure 4 shows an estimate of the average capital gains that have been made on current primary residences

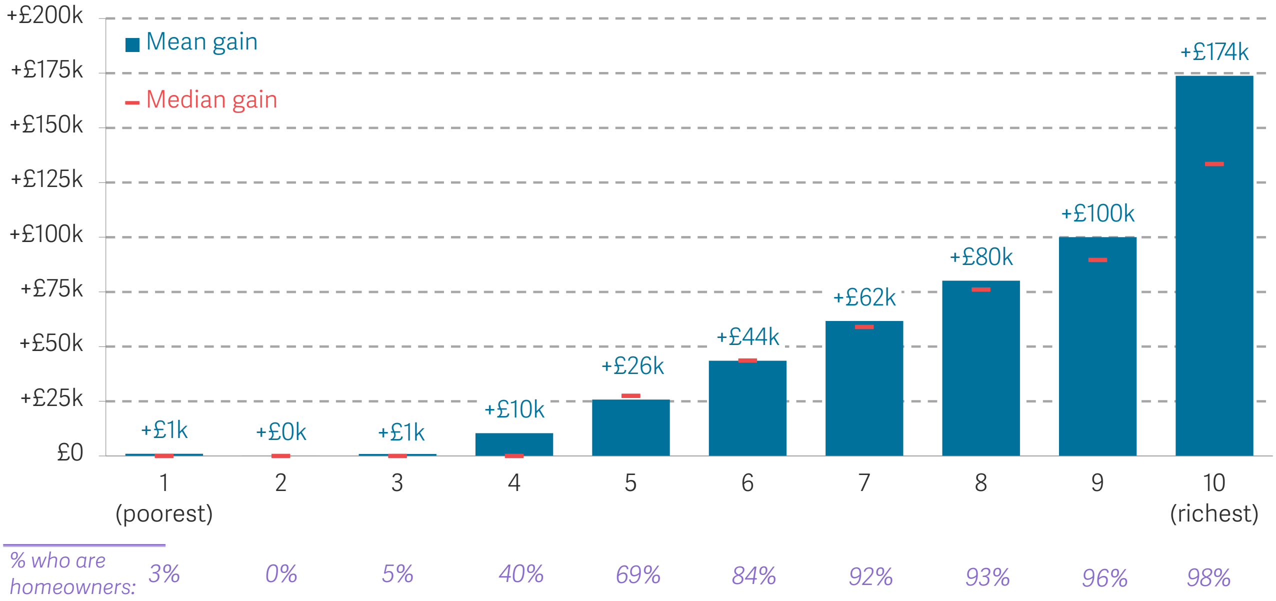
5 Gains will have been experienced differentially for other groups as well, particularly for different ethnic groups. Past research has highlighted the heterogeneity in typical asset composition for different ethnic groups which would have a material effect on average gains (see G Bangham, A gap that won't close: The distribution of wealth between ethnic groups in Great Britain, Resolution Foundation, December 2020). Unfortunately, given the nature of this analysis, the sample sizes of the Wealth and Assets Survey make analysis of gains across ethnic groups difficult.

6 See, for example: J Leslie & K Shah, (Wealth) gap year: The impact of the coronavirus crisis on UK household wealth, Resolution Foundation, July 2021.

since 2000 for each decile of the distribution of net wealth.[7] The least-wealthy third of households have gained less than £1,000 on average, compared to an average gain of £174,000 for the wealthiest ten per cent. As the net wealth decile is defined in 2016-18, part of this reflects the fact that people who were lucky enough to experience rising wealth in the past are likely to be richer today. But, crucially, it also reflects that capital gains on assets are only available to those who already own assets.[8] These gains amplify the gaps in wealth between families across the wealth distribution, which have risen substantially in recent years.[9]

FIGURE 4: **Unearned gains in property wealth have raised the wealth of the already wealthy**

Average estimated nominal capital gain, per adult, since 2000 on current primary residence, by net wealth decile in 2016-18: GB, 2021



NOTES: Net wealth deciles are measured using net financial wealth, net property wealth and net pension wealth. Gains are weighted using the average length of ownership of properties as measured in the Family Resources Survey, and are based on average regional house price growth since 2000.
SOURCE: RF analysis of ONS, Wealth and Assets Survey; ONS, Consumer Price Inflation; DLUHC & MHCLG, English Housing Survey; DWP, Family Resources Survey.

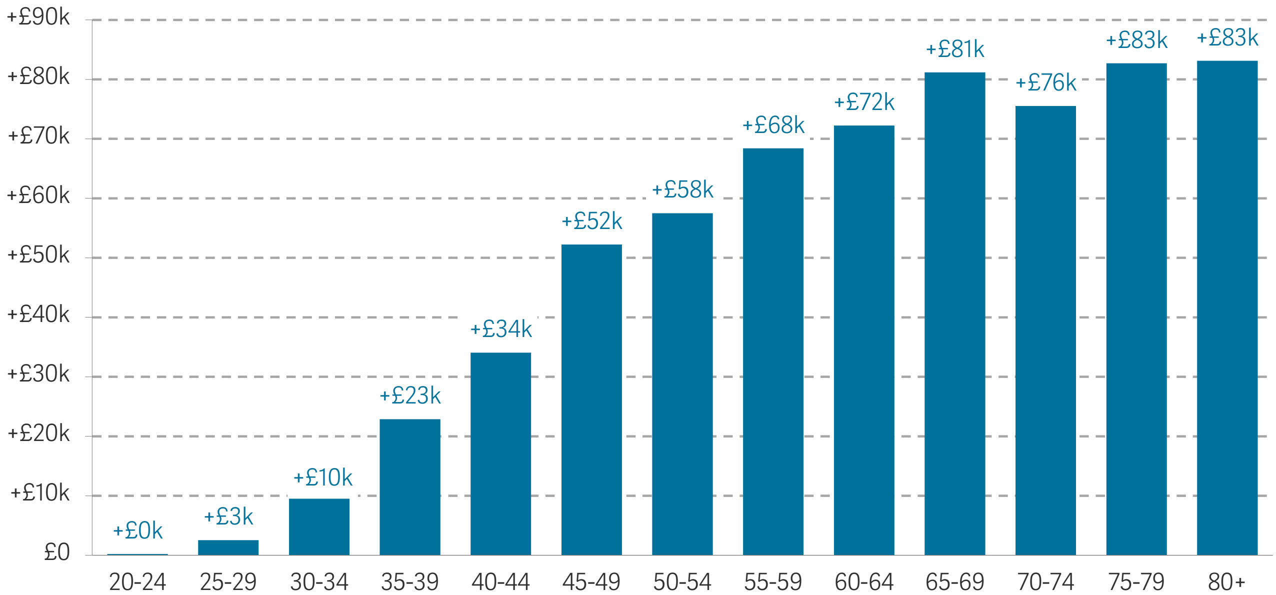
Older families have also benefited by more than younger ones. This is because older families are more likely to be home owners, and are more likely to have purchased their current main residence prior to 2000. Figure 5 shows the average gain for different age groups. Again, this makes clear the 'lottery' of receiving these gains – assuming that

7 Restricting to 'current' primary residences means that if someone moved in, for example, 2010, capital gains would only be counted from 2010, rather than from 2000.
8 For an in-depth discussion of the relationship between capital gains, wealth inequality and saving see: A Fagereng, et al., Saving Behavior Across the Wealth Distribution: The Importance of Capital Gains, NBER working paper 26588, December 2019.
9 J Leslie & K Shah, (Wealth) gap year: The impact of the coronavirus crisis on UK household wealth, Resolution Foundation, July 2021.

house price rises will not be as rapid in the future as they have been over the past 20 years. Effectively older families have typically benefitted from purchasing properties prior to the rapid rises in house prices in the late 1990s and early 2000s, while these gains look unlikely to be repeated (as discussed in the next section), creating a significant inequity between otherwise identical families.[10]

FIGURE 5: **Older people have, on average, benefitted more from house price rises**

Average estimated nominal capital gain, per adult, since 2000 on current primary residence, by age group: GB, 2021



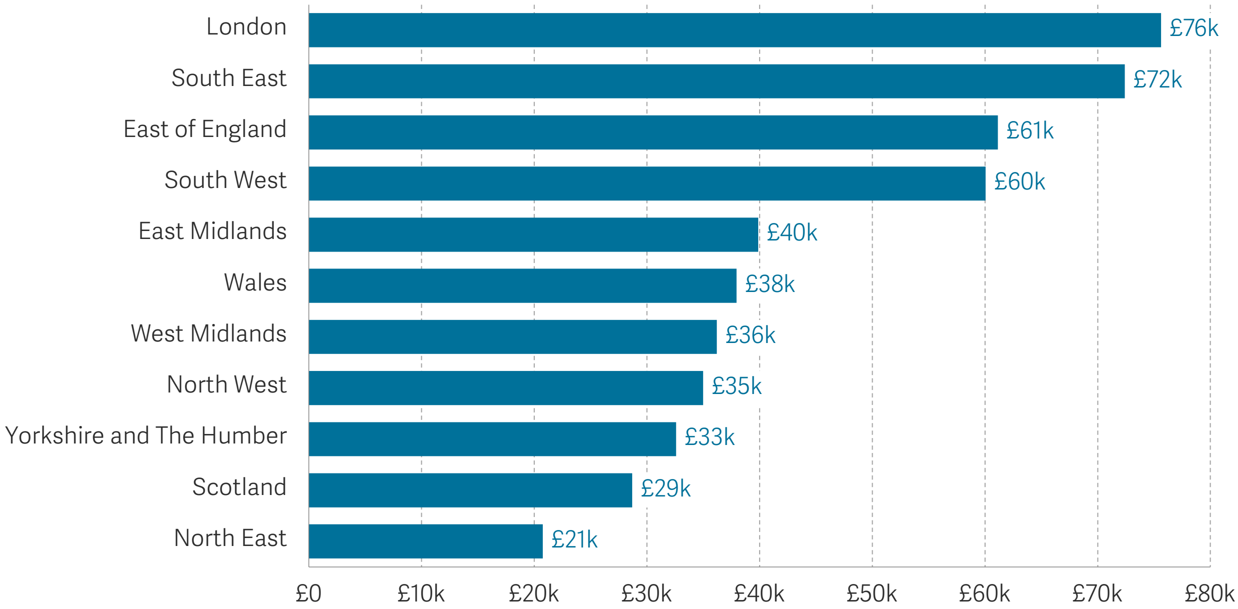
NOTES: Gains are weighted using the average length of ownership of properties as measured in the Family Resources Survey and are based on average regional house price growth since 2000.
SOURCE: RF analysis of ONS, Wealth and Assets Survey; ONS, Consumer Price Inflation; DLUHC & MHCLG, English Housing Survey; DWP, Family Resources Survey.

The regional distribution of gains is also stark, with the south and east of England experiencing much faster gains since 2000 than other areas of the UK. This has been driven by the higher pre-existing house price level and much swifter house price growth, and thus capital appreciation, in and around London. As shown in Figure 6, the region with the highest average gain per adult was London (at £76,000) while the lowest region was the North East of England (at just £21,000).

10 For more on the intergenerational differences in cost of purchasing a home, see: L Judge & J Leslie, Stakes and ladders: The costs and benefits of buying a first home over the generations, Resolution Foundation, June 2021.

FIGURE 6: **Housing wealth has risen much faster in southern & eastern England**

Average estimated nominal capital gain, per adult, since 2000 on current primary residence, by region: GB, 2021



NOTES: Gains are weighted using the average length of ownership of properties as measured in the Family Resources Survey and are based on average regional house price growth since 2000.
SOURCE: RF analysis of ONS, Wealth and Assets Survey; ONS, Consumer Price Inflation; ONS, Life expectancy at birth and selected older ages; DLUHC & MHCLG, English Housing Survey; DWP, Family Resources Survey.

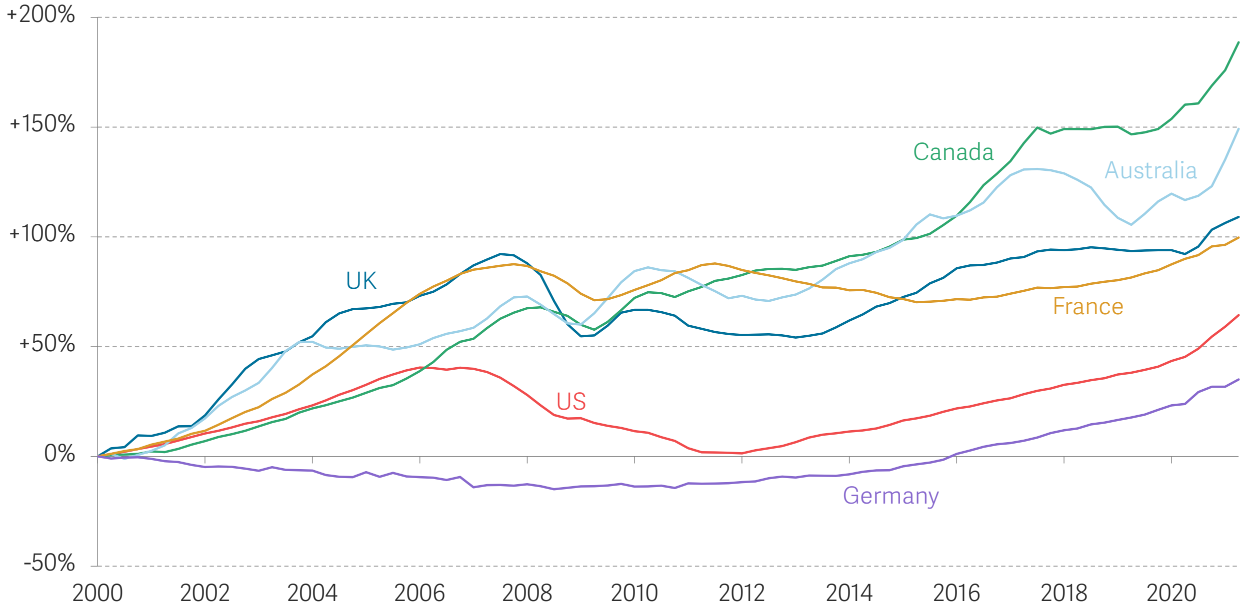
Rising housing wealth is unearned and likely to prove a ‘one off’

Rising house prices is not a phenomenon unique to the UK. Figure 7 compares average house price growth in the UK to similar countries. Here it is clear house prices have risen substantially in many other large advanced economies. This suggest a common driver is at play. Indeed, a wide range of studies suggest that these changes are part of a broader global trend, primarily driven by a secular fall in longer-term interest rates around the world.[11]

11 See, for example: D Miles & V Monro, UK house prices and three decades of decline in the risk-free real interest rate, Bank of England staff working paper 837, December 2019.

FIGURE 7: **House prices have grown across developed countries**

Change in average house prices since 2000: UK and comparator countries



SOURCE: RF analysis of OECD, Analytical house price indicators.

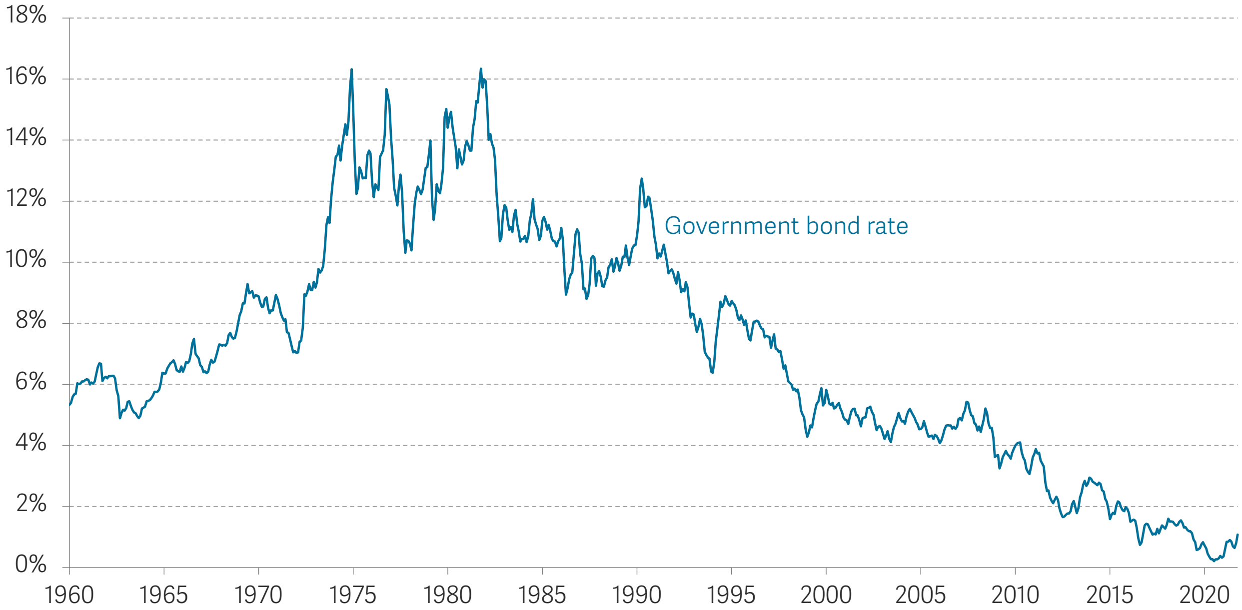
Interest rates are a key determinant of house prices – lower interest rates mean prices rise higher as it is cheaper to borrow.[12] Interest rates have been falling across developed countries (Figure 8 shows this for the UK) and are unlikely to fall materially further due to difficulties in reducing interest rates below zero.[13] Therefore, all other things equal, unearned gains on housing in the future should be smaller than the experience so far this century.

12 Quoted mortgage rates will be driven by the marginal cost of bank funding (which will be a function of broader market interest rates, bank risk/term premia, and regulation) and the expected loss on the loan. These quoted rates increased during the pandemic as lenders anticipated losses on mortgages due to the economic consequence of the pandemic. But these rates have since started to fall back towards pre-pandemic levels. It is possible that a further decline in mortgage spreads (i.e. the gap between mortgage rates and the broader risk-free interest rate in the economy) could reduce headline mortgage rates, but they are already at roughly half the level following the financial crisis regulatory reforms and it is difficult to see them falling substantially in the future, without a substantial weakening of regulatory standards.

13 This is an area of active economic debate, with some arguing that central banks can and should set negative interest rates, as indeed some already have. For more discussion of some of these topics from a UK perspective see: S Tenreyro, Let's talk about negative rates, Bank of England speech, January 2021.

FIGURE 8: **Low interest rates mean that large falls in mortgage rates in the future are unlikely**

10-year government bond rates: UK



NOTES: Nominal rates shown for bonds of 10-year maturity.
SOURCE: OECD.

These passive, one-off gains are currently untaxed, in stark contrast to earnings

The huge and unearned gains to housing wealth are effectively untaxed. This is partly because Capital Gains Tax (CGT) applies to most assets but main residences are explicitly excluded. In addition, even though main residences are often passed on at death and could attract Inheritance Tax, the capital gains will still largely be untaxed then because Inheritance Tax only affects around 6 per cent of estates, and – as we will also explore in more detail – main residences receive an extra tax-free allowance.[14] Indeed, a married couple can pass on £1 million of wealth tax-free, comfortably covering most properties (the average house price in 2021 is £270,000).[15]

CGT is a long-established part of the tax system because a gain is effectively a form of income[16] and there are few reasons to think that gains on primary residences are any different from a gain on any other form of asset.[17] There have been some good reasons for these gains to remain untaxed, not least because of the incentives on mobility (i.e. concerns about 'locking' people into homes). However, given that the scale of these gains has been larger than anyone can surely have anticipated, it is worth reconsidering policy in this area.

14 6 per cent is an estimate for 2022-23. Source: OBR, Economic and Fiscal Outlook, October 2021. As transfers between spouses are not taxed, the proportion of families affected will be higher.
15 ONS, UK House Price Index: September 2021, November 2021.
16 A Corlett, A Advani & A Summers, Who gains? The importance of accounting for capital gains, Resolution Foundation, May 2020.
17 Note that gains on other properties such as second homes and buy-to-let investments are taxed at rates of up to 28 per cent.

Failing to tax the large capital gains on primary residences has significant economic side effects

While policy makers may be understandably reticent to address these huge unequal, unearned and untaxed increases in wealth, this failure has consequences. As we explore below, taxes are currently rising on earnings, rather than sources such as capital gains, in order to deal with higher government spending pressures. The UK's balance of taxes is therefore a choice that is worth reconsidering, as well as whether more focus should be put on ameliorating the effects of higher wealth levels and gaps on society more broadly.

Failure to tax such gains puts pressure on other taxes at a time when revenues need to be increased

The Government's choice not to tax these gains has broader ramifications for public policy, in the face of public finance constraints. All things equal, choosing not to tax unearned passive capital gains requires the government to tax earned income more heavily: and indeed, the significant tax rises announced over recent fiscal events have focussed on increases in National Insurance and Corporation Tax.[18] Lower tax revenue also constrains public spending. Taxing housing wealth gains could facilitate investment in projects which would offset the broader implications of rising wealth gaps: for example, as we explore later, more direct support could be provided for home ownership or social house building, with the latter providing a collective inheritance for the parts of future generations who will not benefited from the rise in housing wealth.

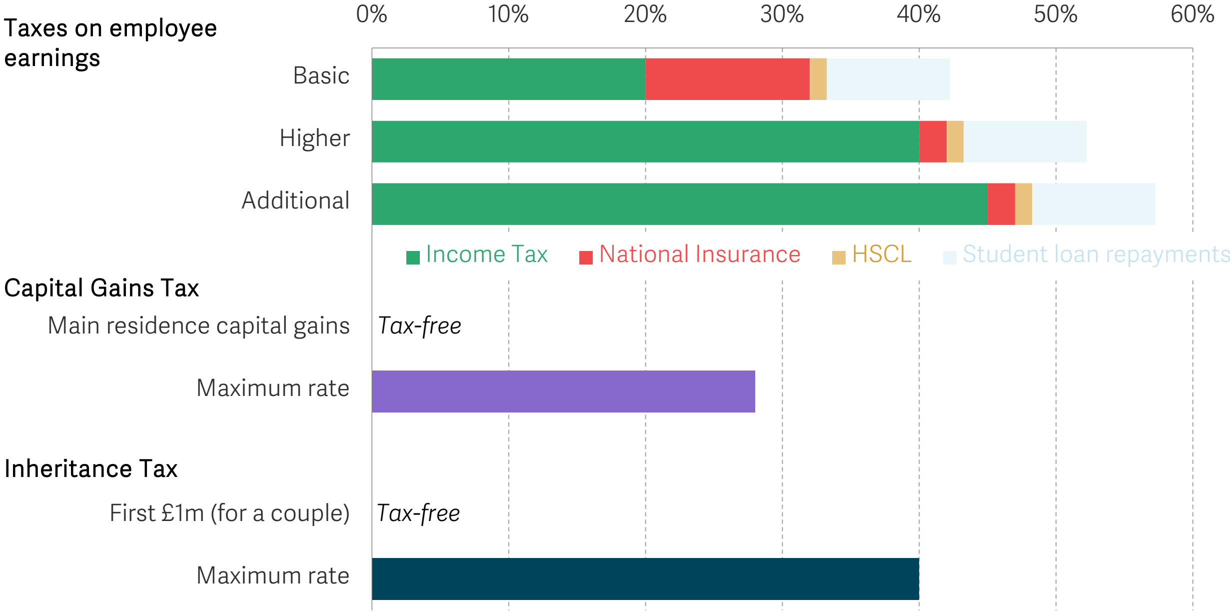
Taxes on 'earned' income are increasing at the moment, at least in part because others sources of revenue have not been explored. As we demonstrate in Figure 9, the typical marginal tax rate for an employee is now (from April 2022) 33.25 per cent. For graduates repaying loans, this can rise to 42.25 per cent, or over 50 per cent once the effect of employer National Insurance is accounted for.[19] (For higher and additional rate payers, marginal rates are even higher.) These figures include the effect of the new Health and Social Care Levy, which only affects earned income (although there was a parallel increase in dividend taxes) and which was in part implemented to ensure that "nobody needing care should be forced to sell their home to pay for it".

These marginal rates are not necessarily high by historical or international standards (and average tax rates are of course lower than marginal rates).[20] But they throw into stark relief the fact that tens, or even hundreds, of thousands of pounds can be made in the housing market – or inherited – without making any tax contribution at all.

18 For more on recent changes to fiscal policy see: T Bell, et al., The Boris Budget: Resolution Foundation analysis of Autumn Budget and Spending Review 2021, Resolution Foundation, October 2021.
19 Benefit tapering such as in Universal Credit and Child Benefit could raise these marginal rates still further.
20 A Corlett, The shifting shape of UK tax: Charting the changing size and shape of the UK tax system, Resolution Foundation, November 2019.

FIGURE 9: **In contrast to the zero taxation of main residence gains, even basic rate employees may face marginal tax rates of over 40 per cent**

Illustrative expected marginal tax rates on employee earnings, capital gains and bequests: 2023-24



NOTES: HSCL = Health & Social Care Levy. Student loan repayments are only payable above around £27,000 (for those on repayment Plan 2).
SOURCE: RF analysis.

The difference between how the UK taxes employment income versus various forms of 'unearned' income is particularly notable in the current fiscal context. Tax as a share of GDP is forecast to rise to historic highs over the 2020s,[21] and it is likely to remain there as the population ages and the country desires to spend a disproportionate share of economic growth on health and other public services.

It is important to answer the question of whether new or reformed taxes should be applied to 'unearned' income rather than increasing other taxes still further. Otherwise, the same policy levers are likely to be used again: National Insurance rate rises have become a common way of raising extra revenue (including in 2003, 2011 and now 2022), and there have also been the notable VAT rises of 1991 and 2011. There are also good economic reasons to favour property-related taxes to others. Real estate in general is a good basis for taxation, as the supply of land and homes is not very responsive to how heavily homes are taxed.[22] And taxes on the inheritance of wealth may even improve the supply of labour.[23]

21 Resolution Foundation, The Boris Budget: Resolution Foundation analysis of Autumn Budget and Spending Review 2021, October 2021.
22 See for example M Kumhof et al., Post-Corona Balanced-Budget Super-Stimulus: The Case for Shifting Taxes onto Land, CEPR Discussion Papers 2021, November 2021.
23 See for example D Cox, Inheritance, bequests, and labor supply, IZA articles, 2014; K Doorley & N Pestel, Labour Supply after Inheritances and the Role of Expectations, IZA, March 2016; and J Brown et al., The effect of inheritance receipt on retirement, Review of Economics and Statistics, May 2010.

The lack of debate over whether to tax capital gains on main residences is also mirrored by a failure to address the more challenging downsides created by those gains

- This rise in house prices has a real impact on the opportunities available to many people. Most obviously, high house prices have contributed to the sizeable fall in home ownership among younger age groups, creating long-term issues around housing costs (which tend to be higher in the private rented section) and saving accumulation for retirement.[24]

Rising wealth has been accompanied by rising gaps between families. The gap between average wealth for the richest 10 per cent and those in the middle of the wealth distribution has increased by half since 2006-08.[25] This has profound impacts for society and living standards. Indeed, higher housing wealth provides the ability to enjoy higher levels of consumption (e.g. by downsizing in the future or by borrowing against the value of the property) and provides some protection from negative financial shocks.

Larger absolute gaps between families mean it is increasingly difficult for someone to save their way up the wealth distribution – harming social mobility; between 2006-08 and 2016-18 the number of years a typical family would need to save to reach the average wealth of those in the top decile, assuming they saved 100 per cent of their income, grew from 60 to 96.[26] Evidence has also highlighted the importance of inheritances in reducing social mobility and increasing life-time living standards inequality – so this rise in housing wealth, in particular, will compound the problem.[27] And as higher house prices have led to falling home ownership for younger generations, the importance of parental wealth in providing the resources to get on the housing ladder has become more important.[28] Both of these factors have meant that the economic experience for younger generations now relies more on the luck of being born to wealthier parents than was the case in the past.

Taking all this together, then, there is a clear case for the Government to consider how to address the huge unequal, unearned and untaxed gains on main residence wealth directly. The potential revenue from reforming the tax system and the broader implications for society should not be ignored. In the rest of the paper, we focus primarily

24 For more on the trends and drivers of changing youth home ownership see: A Corlett & F Odamtten, Hope to buy: The decline of youth home ownership, Resolution Foundation, December 2021.
25 J Leslie & K Shah, (Wealth) gap year: The impact of the coronavirus crisis on UK household wealth, Resolution Foundation, July 2021.
26 See G Bangham & J Leslie, Who owns all the pie? The size and distribution of Britain's £14.6 trillion of wealth, Resolution Foundation, December 2019.
27 See: P Bourquin, et al, Inheritances and inequality over the life cycle: what will they mean for younger generations?, Institute for Fiscal Studies, April 2021; L Gardiner et al., An intergenerational audit for the UK: 2019, Resolution Foundation, June 2019; and J Blanden, A Eyles, S Machin, Trends in Intergenerational Home Ownership and Wealth Transmission, CEPEO Working Paper Series 21-05, UCL Centre for Education Policy and Equalising Opportunities, May 2021.
28 S Clarke & J Wood, House of the rising son (or daughter): the impact of parental wealth on their children's home ownership, Resolution Foundation, December 2018.

on the first issue and set out how the Government could practically go about requiring some extra tax contribution from those who have made these substantial gains.

The obvious way to tax these main residence gains is to treat them just like other asset price rises and use Capital Gains Tax

There are many ways in which passively-acquired housing wealth could be taxed. Council Tax and Stamp Duty are clearly major property taxes, but both are deeply flawed – as discussed in Box 1 – and their focus will never be on unearned income accruing from the happenstance of when a person bought a house (or when their parents did). We will return to the design of the Inheritance Tax system, but this has its own problems and only has an impact on relatively few estates. Clearly if we wish to tax main residence gains, the obvious tool would be to use the CGT system, and this policy option has had relatively little scrutiny.

BOX 1: **Council Tax and Stamp Duty Land Tax reform**

Homes in the UK are not completely untaxed, of course. Council Tax and Stamp Duty Land Tax (and its Scottish and Welsh equivalents) do raise significant sums. But the former has evolved into as much of a 'poll tax' as a property tax,[29] while the latter depresses mobility given that the number of transactions – unlike the stock of housing – is responsive to taxes.[30] Transaction taxes such as Stamp Duty may also reduce the number of transactions in the market, increasing volatility.

An overhaul of recurring property taxes and Stamp Duty is long overdue. The Resolution Foundation's Intergenerational Commission recommended replacing Council Tax with a progressive property tax paid by owners rather than renters; with the cheapest 10 per cent of properties in each region paying no tax; a proportional rate of 0.85 per cent of value above this; and a top marginal rate of 1.7 per cent for the most expensive properties. And it recommended halving Stamp Duty rates (except for additional properties).

Such reforms would make the tax system fairer relative to property values, improve mobility, reduce disposable income inequality, and potentially have inequality-reducing impacts on wealth by changing property values – levelling

29 A Corlett & L Gardiner, Home affairs: options for reforming property taxation, Resolution Foundation, March 2018.
30 K Scanlon, C Whitehead & F Blanc, A taxing question: Is Stamp Duty Land Tax suffocating the English housing market?, LSE, November 2017.

out some of the house price changes of recent decades.[31]

But reform of Council Tax in England has not been forthcoming, with valuations now over thirty years out of date. (Progress in Scotland and Wales has been more encouraging.) And major reform is more likely to happen if it is done on a revenue-neutral or tax-cutting basis, to limit the number of losers from reform or the scale of their losses.

Even if or when such property reform happens, it would not distinguish between passively and actively acquired property wealth – between the £500,000 property owner who paid £500,000 and the one who paid £100,000 and has since made those large capital gains. That is not a problem in itself, but it does mean that the argument for some tax on gains specifically would remain.

While most assets can attract CGT when they are sold or otherwise disposed of, with tax rates ranging from 10 per cent to 28 per cent, main residences are specifically exempted. HMRC estimates that this 'Private Residence Relief' was worth £25 billion in 2019-20 (though see later sections for our own, lower, costings of specific reform options).[32]

Removing this relief has been proposed before

Although it is a longstanding feature of the UK's tax system, the lack of CGT on main residences has not gone without comment during the house price rises of the last two decades. The 'Mirrlees Review' concluded that a system that treated owner-occupied housing like other investments "would be ideal: it was surely inappropriate that the enormous returns enjoyed by homeowners during the long property boom up to 2007 went untaxed. But we recognize that this would be much more difficult [than reforming the treatment of rental property] and may be politically impossible in practice."[33]

Kate Barker (former member of the Monetary Policy Committee), argued that "Charging CGT on gains on our main residences would bring the taxation of housing more into line with other assets, and it would tend to discourage over-investment in housing" and that "Changes in house prices often result from public policy: restrictions on neighbouring land, transport links, or the quality of a nearby school, for example. It is odd not to tax these gains, which the homeowner has done nothing to earn, but charge CGT on the profits from selling a business enterprise."[34]

31 S Adam et al., Revaluation and reform: bringing council tax in England into the 21st century, IFS, March 2020.
32 HMRC, Non-structural tax reliefs, October 2020.
33 J Mirrlees et al., Tax by design, IFS, September 2011.
34 The Guardian, Charge capital gains tax on main residences, says property expert, September 2014.

The National Institute of Economic and Social Research has also raised this suggestion, and argued that "If a capital gains tax were introduced, this would reduce the gains in an upturn and losses in a downturn so dampening cyclicality. Capital gains tax would also reduce the resistance to planning, reduce 'under occupancy' and even increase the flow of savings in productive investment."[35] Other work has set out some specific policies, such as a flat 10 per cent tax on all gains,[36] and in many cases it is suggested that Stamp Duty Land Tax could be scrapped at the same time.

A number of other countries already tax such gains

There are plenty of points of reference for removing or restricting the CGT exemption from main residences.

Even within the UK's existing tax system, there is CGT on other properties such as second homes and buy-to-let properties (as well as business premises). Some property disposals may lead to only partial relief where people have moved between multiple homes they own, and for homes with substantial grounds. And non-residents must also pay CGT on most property disposals (although Private Residence Relief can still be used in some circumstances).

What's more, a number of other countries (although only a minority) have some form of main residence CGT. For instance:

- The United States applies CGT on gains above $250,000 (or $500,000 for a married couple), although – as we will discuss in more detail – gains are written off at death.
- CGT is also due on main residences in Sweden. Payment of tax can be delayed if the proceeds of a sale are used to buy another property, although the government now charges interest.
- Tax can be charged on housing capital gains in Germany in some limited circumstances, where a property has been owned for under ten years and hasn't been the main residence for the past two years or longer.
- Portugal taxes main residence capital gains at standard tax rates, though with an allowance for inflation and (for residents) only half of the gain is taxable. Tax may not apply if the proceeds are reinvested in another residence.

It is generally the case, internationally, that improvement and transaction costs are deductible when calculating taxable gains.

35 A Armstrong, Written evidence to the House of Lords Select Committee on Economic Affairs, NIESR, December 2015.
36 M Johnson, Paying for the coronavirus, Social Market Foundation, July 2020.

All of these examples, together with the UK's existing CGT system and the earlier proposals above, provide hints of how applying CGT to main residences might best be implemented in the UK.

Proposals for how main residence CGT would best work

While the idea of main residence CGT (hereafter, MRCGT) flows naturally from the background considerations set out above, and there are the international and UK precedents to draw on, there a number of important decisions to take about the design of such a policy.[37] In order to come to a more detailed policy design that can be modelled, and its costs and benefits weighed up, we now briefly explore seven of the biggest sets of questions that the idea of MRCGT raises, and set out what we think would be the best possible solutions.[38]

1. Should the tax be limited to only future gains? No, the tax should be somewhat retroactive.

In theory, MRCGT might be introduced only for gains accruing in the future: i.e. ignoring all gains made before a particular implementation date. But, while this would in many ways be much simpler than the alternatives (and is the approach that was taken for non-residents' CGT), this would mean that none of the capital gains of the past twenty years or so would be covered. Given the enormous scale and unequal distribution of these, set out earlier, and the possibility that such gains will not often be repeated, we feel that only taxing future accrued gains would rightly be considered unfair. It would mean that tax revenue would be very slow to build up – on the scale of many decades – with the added political risk that the tax would be abolished before reaching substantial revenue-raising capacity.

In general, it is desirable that the tax system should not be retroactive, in order to provide greater certainty. However, it is a very frequent occurrence that someone who has built up an unrealised gain may be subject to previously-unexpected tax rates upon final disposal (e.g. any change in CGT rates would do this). Our answer, then, is that a MRCGT should not exclude gains that have already been accrued. The next two design considerations consider how this might work.

37 As we explore in this section, we do not think it would be appropriate to simply remove the existing Private Residence Relief without making any changes to how CGT would then be applied to main residences.

38 An additional question is how capital losses should be treated by a MRCGT. However, the relatively straightforward answer is that these could be treated like other losses in the CGT system: offsettable against present or future taxable gains, but not rebated outright or offsettable against other forms of taxable income.

2. Should it capture gains that have already been cashed out? No, gains that have already been realised would not be taxed.

While future realisations would therefore be covered by a MRCGT, should it also cover people who have already 'cashed out' their gains? An example would be someone who recently sold up and moved into a care home. It seems to us that it would not be reasonable or at all practical to try and tax these gains: beyond the administrative difficulties, there would be no guarantee that those who gained in the past now have the wealth or income to pay such a tax.

A MRCGT, then, would be focused on current and future home owners. In a sense this would be a source of unfairness: one person selling their home may be given a large tax bill while someone selling a few days earlier may be exempted. But this may be unavoidable and is a side effect of most tax changes (which begin at a particular point in time and cannot affect previous generations). It would also require careful implementation if ever effected: with such a tax taking effect immediately upon its announcement (as often happens with changes to Stamp Duty Land Tax), in order to avoid an incentive for people to hurriedly sell up and therefore bank their gains before the tax came into place (though this in turn would require HMRC and the private tax advice sector to be able to develop some new capacities very rapidly).

3. How far back would the tax look? For current home owners, gains made since that property was purchased or since April 2000 (whichever is later) would be chargeable.

For current home owners, there is also the question of what range and form of past gains would be included. We could include all gains made on their current home since purchasing it, though for some people this could cover only the past year while for others it could cover the past half century or more.

Alternatively, we could tax gains made since a particular year, and try to tax home owners' gains made not just on the current property but on all properties bought and sold over that period. This would be on the basis that we do not want to punish people for staying in the same property relative to those who have moved, and therefore both should be taxed. However, attempting to tax gains that have already been realised, even if they have been reinvested in other owner-occupied property, may cross a line in terms of retrospection and administrative burden.

The most pragmatic approach is therefore to tax only gains on the current properties of current home owners (as well as everyone's future gains). However, this tax should be limited in its time period, for three reasons. One, the further back in time this tax goes, the greater the potential inequities between those who would be taxed (current home owners) and those who wouldn't (those who've sold up) and between 'stayers' and 'movers' (though the latter would have paid more Stamp Duty). Second, administrative hurdles may grow if property values from many decades ago are required (see the discussion below about deducting expenses, for instance). And third, substantial house price rises were much less common in earlier decades (particularly above-inflation and above-wage-growth rises). For example, taxing nominal gains since 1989 might raise no more revenue than taxing gains since 1997, as house prices were flat over the intervening period.

Our suggestion for the best approach, therefore, is to tax only gains on the current homes of current home owners, but to also rebase historic purchase prices to a particular date, such as the start of the tax year in 2000.[39] (The Office of Tax Simplification has noted that 2000-based valuation might be simpler than assessing earlier values, in part due to an improved land registry.[40]) This does mean that a MRCGT would need to impute what many people's homes were worth in 2000, rather than use an actual transaction value. This might raise the potential for disagreements, but such rebasing has worked in practice: long-held assets are currently rebased to 31 March 1982 market values, for example, and non-residents are taxed on residential property gains since 6 April 2015.

4. How should CGT at death be applied? The tax would not be forgiven at death; transfers between married couples would not be taxed at that point; and payment would be required at death (reducing Inheritance Tax liabilities).

The UK's CGT system at present includes forgiveness at death (also known as 'step up in basis' or 'tax-free uplift on death'). This means that if an asset is sold a day before death, CGT is due, but if it is held until death then the slate is wiped clean on any gains made.

Continuing the current rule as part of a new MRCGT would create a very distortionary incentive not to sell main residences before death, and would mean that a huge proportion of revenue would be lost. Main residence gains should therefore not be written off at death. Indeed, there is a strong argument that the current forgiveness at death should be removed for other assets. And if a MRCGT were introduced without this forgiveness then this argument would be further strengthened.

There is a separate question about transfers between spouses (including civil partners). As with existing CGT (and Inheritance Tax), transfers between spouses (whether at death

39 Analysis of the Family Resources Survey suggests that around half of current pensioner home owners bought their current home prior to 2000, and would therefore be taxed on their imputed gain since that year, while the other half have bought since then and any MRCGT would be based on their actual purchase price.
40 Office of Tax Simplification, Capital Gains Tax review - first report, November 2020.

or before) should be untaxed – but without changing the base value that is later used for calculating CGT.[41]

Finally, there are a number of options for how exactly death should be treated by any MRCGT.

One option is that tax should only apply, relative to the original acquisition price, when the asset is later sold. This 'carryover' or 'no gain, no loss' approach has merit.[42] But it is possible that some gains may not be taxed for a very long time given that this could be repeated for multiple generations. This approach also raises a practical issue of how this future CGT liability would be reflected in people's Inheritance Tax bills.[43]

Alternatively, death could be treated as a realisation, with CGT due at that point. This would force some homes to be sold (to cover the tax bill) when they would not otherwise be, but on balance we believe that tax should be due at death and, in practice, inherited houses are generally sold rather than retained.

We propose that Inheritance Tax would continue to apply, following payment of any MRCGT due – which consequently reduces the value of the estate before Inheritance Tax is charged – but the comparative roles of the two taxes are discussed further later in this note.[44]

5. Should the tax apply when people move house? Only when downsizing or leaving home ownership.

Under what circumstances would MRCGT be due before death? Certainly, where people sell their property and do not buy a new home, tax would then be due on any capital gains. But where people do buy a new home, it is desirable that their capital gain can be 'rolled over' into the next property and any tax delayed.

If we imagine the case of a home owner moving to another property of the same value (neither upsizing nor downsizing), there are good reasons not to demand payment at this point. First, their gain is still locked up in the property and so they may face liquidity problems paying a large tax bill (though mortgages could help with this). And second, there would be an economic incentive for people to delay moving in order to delay paying the tax – as a pound today is worth more than a pound in the future (this is the 'lock-in' effect). The requirement to pay MRCGT at death is not so subject to this unwanted incentive (as the timing of death is far less in people's control). Fears/hopes that the rate

41 Further consideration should be given to those who are unmarried and living together, but we do not explore this question in this note.
42 Office of Tax Simplification, Inheritance Tax Review – second report: Simplifying the design of Inheritance Tax, July 2019.
43 Office of Tax Simplification, Inheritance Tax Review – second report: Simplifying the design of Inheritance Tax, July 2019.
44 As an example: an estate worth £2 million might include a main residence that had risen in value by £100,000. If we assume that this gain was fully taxable, and £28,000 of Capital Gains Tax therefore paid, then the value of the estate for Inheritance Tax purposes would be reduced to £1,972,000 (reducing any Inheritance Tax bill by £11,200).

of MRCGT would be increased/decreased in the future would further distort people's home-moving decisions. Given that geographic mobility in the UK is already reduced by Stamp Duty,[45] we do not want to exacerbate this.

So where people 'upsize' or 'move sideways', the full capital gain should be rolled over and no tax would be due. This would broadly match the functioning of the existing CGT rollover relief, that applies to certain business assets. As in that system, some flexibility about timing would be required: so that a new home could be bought 12 months before, or up to three years later than, the first home is sold.

Where people 'downsize', we suggest that some but not all MRCGT would become due – in proportion to the scale of the downsizing (so moving to a property worth only half as much would mean half the gain on the original home would be taxed at that point).[46]

6. What costs, if any, should be deductible? Investments in the property, as well as Stamp Duty and other transaction costs.

As shown earlier, the norm in those countries with some form of MRCGT, and the approach of the UK's broader CGT system, is to allow input costs to be deductible from capital gains. In the case of non-primary residences in the UK, this includes home improvements (but not maintenance costs), Stamp Duty Land Tax and other transaction fees. It would be seen as unfair to tax people on increases in value resulting from substantial home improvements, and policy should not disincentivise future home improvement – especially given that investing in home insulation improvements will be an important part of reducing the country's greenhouse gas emissions.[47] So, although not everyone will have kept adequate records (particularly going back to the year 2000),[48] it would be best if MRCGT followed the existing CGT system.

7. Would there be any tax-free allowances? We model three possible regimes.

Finally, we come on to the important question of what tax rates and tax-free allowances might be applied in a MRCGT.[49] At present, CGT for real estate applies at a basic rate of 18 per cent and a higher rate of 28 per cent, above an Annual Exempt Amount of £12,300. The exact parameters of the CGT system have changed often (and indeed we believe there should be more changes).[50] But, for illustration, in this note we will look at three potential systems with a wide range of allowances:

45 C Hilber & T Lyytikäinen, Transfer Taxes and Household Mobility: Distortion on the Housing or Labor Market?, Spatial Economics Research Centre discussion paper 216, June 2017.
46 One other complication is the existence of equity release products (lifetime mortgages and home reversion plans). Given that these allow people to stay in their homes but liquidate their values (including capital gains they've made), any MRCGT could become due at this point (again in proportion to the value extracted), or else only charged upon final realisation.
47 J Marshall & A Valero, The Carbon Crunch: Turning targets into delivery, The Economy 2030 Inquiry, September 2021.
48 Such cases are one argument for (also) having a large standard tax-free allowance, as we explore in the following section.
49 Note, again, that reform might equally be presented as a removal or capping of Private Residence Relief.
50 G Bangham, et al., Unhealthy finances: How to support the economy today and repair the public finances tomorrow, Resolution Foundation, November 2020.

- A flat rate of 28 per cent on all gains (net of costs).[51] This gives an indication of the maximum that might be raised in revenue, without raising any CGT rates. But it would mean that every home owning estate would potentially be taxed: creating a substantial increase in administration both for the public and the state.
- A 28 per cent rate with an (arbitrary) £75,000 per person, per property MRCGT allowance.[52] For couples this would therefore make £150,000 of main residence gains tax-free. As we will see, this considerably reduces the number of people who would pay anything.
- A system with an allowance for inflation. The current CGT system does not have such an allowance, but from 1982 until 2008 (for individuals) it did,[53] and there is a good theoretical case for not taxing 'paper gains' – particularly in the case of long-held assets like houses.[54] Excluding inflationary gains from taxation might slightly improve the political case for such a tax. It would also remove one argument for why CGT rates should be lower than Income Tax rates. Therefore, alongside an inflation allowance we also model a 40 per cent tax rate and (only) the Annual Exempt Amount. Such a system would be a more significant divergence from the existing CGT system, however.

Other design choices could be made, of course. But setting out a set of choices highlights the trade-offs that would have to be made, as well as enabling us to now look at the potential revenue and individual impacts of such a tax.

These forms of main residence CGT could raise £4-11 billion a year (plus another £2 billion from related reform)

We now turn to model how much the three options set out above would raise; how much individual taxpayers would have to pay; and what proportion of estates would pay. Further details of our approach can be found in the annex, and in every case we model all taxes as being paid at death (with rollover relief applying when people move).

The first option would tax all gains at 28 per cent, and would therefore affect most home owners except where improvement and transaction expenses exceed gains. We estimate that total net revenue raised under this system would have been around £11 billion

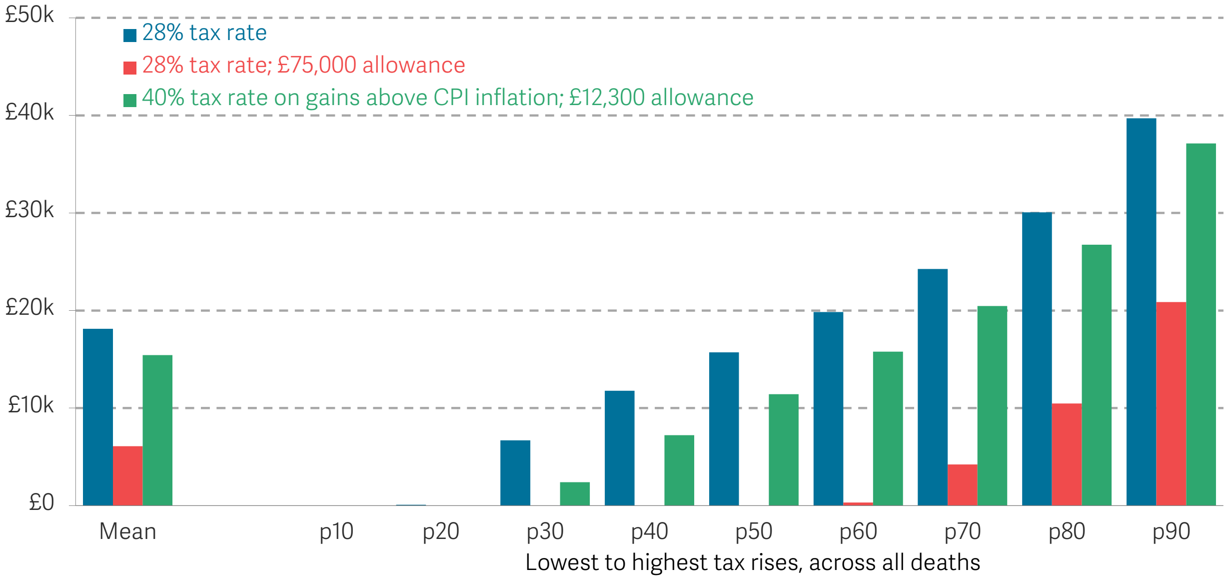
51 For simplicity (both of modelling and policy) we do not model a basic and higher CGT rate (e.g. 18 and 28 per cent).
52 While a lifetime allowance for gains would be fairer than a per property allowance in some ways, for administrative reasons it may be easiest to have a separate allowance for each property transaction. It should also be noted that a large allowance raises questions about uprating policy (which we do not grapple with here), as the expectation of future allowance increases may distort when people realise gains.
53 Only gains accrued up to 1998 could be adjusted for (RPI) inflation, and then this capacity was removed altogether in 2008.
54 A Advani, The taxation of capital gains: principles, practice, and directions for reform, CAGE, October 2021.

in 2021 (after accounting for a reduction in IHT due).[55] Among all deaths, the average adult would be expected to pay around £18,000, although around 10 per cent would pay £40,000 or more. These high figures reflect the fact that most adults modelled as dying in 2021 own their primary residence and typically have lived in that property for a significant period.[56]

Our second option adds in an allowance of £75,000 of tax-free gains per person (per property). As can be seen in Figure 10, this more than doubles the proportion of deaths that would not lead to a CGT bill, to around 60 per cent of the population.[57] It also results in substantially reduced tax payments for those over the payment threshold. The estimated net tax revenue for this option is substantially lower than that with no threshold, at £4 billion in 2021.

FIGURE 10: **Different main residence CGT options would produce a range of outcomes in terms of the proportion of people affected and the size of their tax bills**

Range of estimated tax payable on death under different main residence CGT options, among all people modelled as dying in 2021: GB



NOTES: See the report text for a more detailed description of these options. All options also include an approximated allowance of 3 per cent of the sale price of the property to allow for Stamp Duty, estate agent and conveyancing fees, and average home improvements. Results are shown net of reductions in Inheritance Tax payments as a result of CGT reducing the value of the estate. Results are points on the distribution calculated as the mean values across 1,000 simulations where individuals in the Wealth and Assets Survey are randomly selected based on their probability of death given their age and sex.
SOURCE: RF analysis of ONS, Wealth and Assets Survey; ONS, Consumer Price Inflation; ONS, Life expectancy at birth and selected older ages; DLUHC & MHCLG, English Housing Survey; DWP, Family Resources Survey.

55 There are a number of reasons why this differs from HMRC's estimate that the existing relief is worth £25 billion a year (HMRC, Non-structural tax reliefs, October 2020). These include the fact that we exclude gains accrued before 2000; and, because we assume that the tax would primarily be levied at death, we include the negative knock-on impact on Inheritance Tax revenues. In contrast, HMRC assume that tax would be paid when people move, but not at death (i.e. broadly the reverse of the approach we take) and so the calculations and data sources involved are very different.
56 For more detail on property moves, see the methodology annex.
57 For modelling purposes, we look at members of a couple separately. In reality, spouses would pay nothing if their partner is still alive (with the surviving partner then paying more upon their own death), and so these figures are an overestimate of how many deaths would lead to tax liabilities.

The final option we model in detail is one which explicitly allows for inflationary rises in the value of the property, but is combined with a higher 40 per cent rate and a £12,300 allowance (i.e. the existing CGT Annual Exempt Amount). In aggregate, this option results in very similar payment amounts and distributional profile as the first option (the flat 28 per cent tax), albeit with somewhat fewer people paying the tax. The net revenue raised would have been around £10 billion in 2021.

Other considerations

It is worth also considering the absolute numbers of people who might be affected. In the second option, with a £75,000 allowance, although a clear majority of deaths (including a majority of home owners) would not pay a bill, this would still in theory mean 240,000 deaths would be affected each year (although this is an overestimate as we do not account for the fact that transfers between married couples would at that point be tax-free). This is high compared to the 25,000 expected to pay Inheritance Tax in 2019-20,[58] but similar to the existing number of CGT payers per year (265,000), and we believe that greater use of automation could be made (and would have to be) if CGT were expanded to homes in this way.[59] There are administrative and political arguments for minimising the number of people who would pay – and so an even larger allowance could be chosen, for example – but this is, of course, a trade-off against how much revenue the tax could raise.

While our cost estimates are inevitably uncertain, there are good reasons to think revenues may increase over time. In particular, younger cohorts of pensioners are (for now) more likely to be home owners; and the number of deaths per year is expected to rise steadily for the next few decades (abstracting away from Covid-19, and unlike the number of births).[60] Overall, we have previously estimated that the total volume of bequests is expected to more than double between 2018 and 2035.[61]

Finally, as we noted in the previous section, applying CGT to main residences at death (as well as some home sales during life) would perhaps make the current forgiveness of CGT at death for other assets untenable. Indeed, even in the absence of MRCGT, this CGT uplift at death should be ended. As an example, imagine a landlord who has benefited from house price rises on multiple properties over the past two decades. If they sold their properties before death, they would be liable for CGT, however if they held on to their properties until death that liability would be erased. There is no good reason for this distortionary tax break, and from a housing market perspective it is particularly

58 OBR, Economic and Fiscal Outlook, October 2021.
59 HMRC, Capital Gains Tax statistics, August 2021.
60 ONS, National population projections, October 2019.
61 L Gardiner, The million dollar be-question: inheritances, gifts, and their implications for generational living standards, Resolution Foundation, December 2017.

undesirable for the tax system to create extra incentives to invest in, and hold on to, buy-to-let properties and second homes. Applying CGT at death for other assets would raise over £2 billion a year, on top of any main residence revenue.[62]

The Inheritance Tax system provides an alternative route to taxing these huge gains

Implementing CGT on the huge gains on main residences is likely to be politically challenging given the increase in taxes on home owners, who are, after all, more likely to vote. There are certainly those who will baulk at such a challenge. As we argue above, this risks storing up problems for the future – both in terms of putting pressure on other taxes and in terms of the side effects of high house prices. There are, however, alternatives that can be used to make progress in this area. We discuss these below.

Given that any MRCGT would – we suggest – primarily be collected at death, we can also look at related Inheritance Tax (IHT) reform options, in case these are administratively simpler.

So how might IHT be reformed to achieve similar ends as a MRCGT? The obvious answer is to look at IHT's Residence Nil-Rate Band (RNRB), which is another route by which main residences (and their associated capital gains) are protected and favoured by the tax system. The RNRB was introduced in 2017 (and was only fully phased-in by 2020), and now adds an extra £175,000 tax-free band (£350,000 for couples) where a residence is passed to a 'direct descendant'. On top of the general £650,000 nil-rate band (for a couple), this means that £1 million can be passed on free of tax. Our estimate of this relief's value in 2021 is around £3 billion, and while there are reasons to think this may be an overestimate in the short-term,[63] its value in future should be buoyed by demography, house price rises and rising cohort home ownership rates.

Using Inheritance Tax to tax capital gains

One option would be to make specific allowance for main residence capital gains in the IHT system. As in the CGT options above, gains on main residences (since last sale or 2000) would be calculated at death. Then, the RNRB could (for example) be restricted to covering only actively acquired housing wealth and not passive capital gains, and the latter would therefore potentially be taxed via IHT at a marginal rate of 40 per cent.[64]

62 G Bangham, et al., Unhealthy finances: How to support the economy today and repair the public finances tomorrow, Resolution Foundation, November 2020.

63 HMRC estimates that this tax relief was worth £1.3 billion in 2019-20 (HMRC, Non-structural tax reliefs, October 2020), though at this point the threshold was only £150,000 rather than its current £175,000. Note that we do not have data in the Wealth and Assets Survey on the intended recipients of inheritances, so we have assumed that all people dying in 2021, with appropriate asset values, would be able to make use of the RNRB. In practice, not all individuals will gain from this because it only applies when passing on a residence to direct descendants.

64 The RNRB does not apply solely to main residences in the same way as Private Residence Relief, and these definitional differences would need to be considered in greater detail.

Distributionally, this would mean that only large estates would pay anything, as the general Nil-Rate Band (of up to £650,000) would still apply. Administratively, it would mean the tax was dealt with through the existing IHT administration (rather than applying both CGT and IHT). Politically, it might be sold as the focusing of an existing relief, rather than the imposition of an entirely new tax. And, as discussed earlier, there may be greater acceptance of a tax on unearned rather than earned wealth, and the (flawed) argument that IHT represents 'double taxation' can clearly not be applied to the former, given the lack of main residence CGT.

This form of tax would raise an estimated £2 billion a year.[65] This would not cover realisations other than at death, and therefore there would be an increased incentive to downsize or sell up before death, but a separate main residence CGT could potentially be introduced for these cases.

Scrapping the Residence Nil-Rate Band entirely

The RNRB has been criticised for its complexity and unfairness.[66] Those who wish to pass property to their siblings, nieces, nephews or non-relatives, for example, feel aggrieved by the 'direct descendant' rule.[67] The existence of another specific tax relief for main residences discourages investment in other assets and may even add to house prices.[68] It is "too complex and people struggle to understand it", including downsizing provisions that are particularly "impossible for a lay taxpayer to understand",[69] and its complexity may even lead to incomplete take-up.

One might therefore want to go further than the proposal above and simply scrap the RNRB entirely (recall that this relief did not exist before 2017). This would not be targeted specifically on capital gains. But given that it would target the main residence wealth of wealthy families, at the point when it is passed to the next generation, it is also not so different in practice. As a sign of the overlap between the policy options, the average main residence capital gain made by those who would be affected by abolishing the RNRB is £140,000. As noted above, this would raise around £3 billion a year.

These options would affect fewer estates

As the RNRB now exempts up to £170,000 of value per person, and the IHT rate is 40 per cent, scrapping the tax relief entirely would result in tax rises of up to £70,000 (or £140,000 per couple) on larger estates. But, as shown in Figure 11, relatively few estates

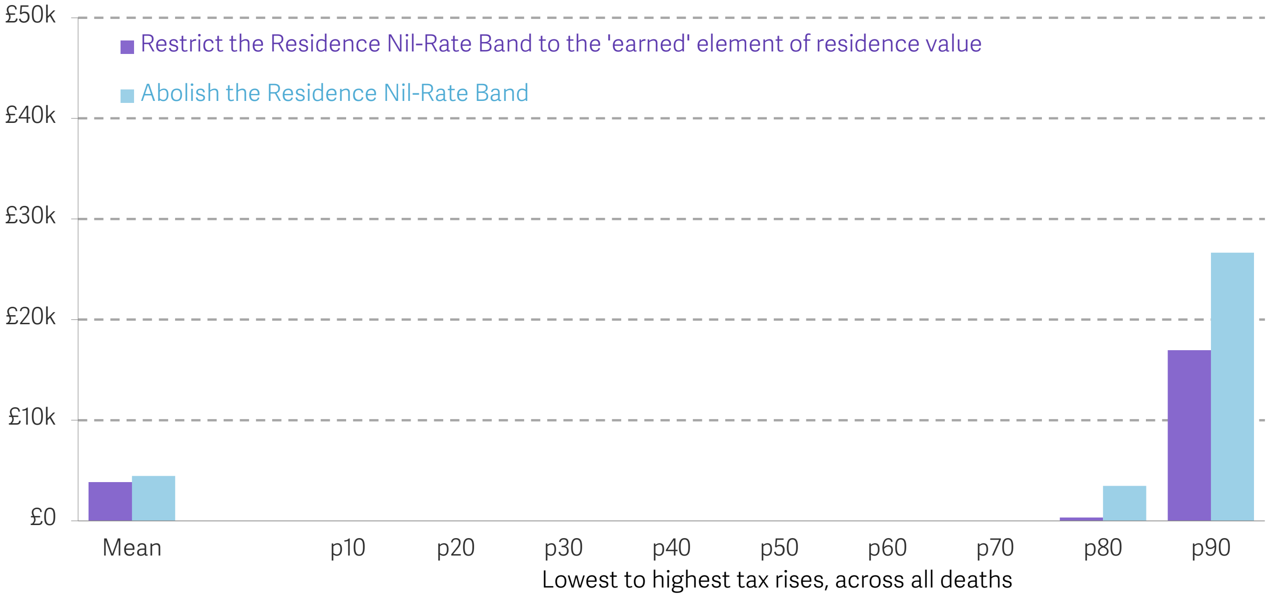
65 This assumes no allowance for inflation, nor any extra tax-free allowance beyond the existing IHT bands, though we do account for a deduction of input costs as in our earlier options.
66 Office of Tax Simplification, Inheritance Tax Review: second report, July 2019: "The residence nil rate band is one of the most complex areas of Inheritance Tax and generated a large proportion of the correspondence received by the OTS."
67 Office of Tax Simplification, Inheritance Tax Review: second report, July 2019.
68 Office for Budget Responsibility, Economic and fiscal outlook, July 2015.
69 Wedlake Bell LLP, as quoted in Office of Tax Simplification, Inheritance Tax Review: second report, July 2019.

(21 per cent) would be affected, as the Nil-Rate Band would continue to take estates worth under £650,000 out of tax, and it is only towards the top of the distribution that the scale of tax rises would rival the MRCGT options.

The option of effectively removing passively-gained housing wealth from the scope of the relief would, naturally, have a smaller impact than outright abolition.

FIGURE 11: **The impact of abolishing or restricting the RNRB would be concentrated on high value estates**

Range of estimated tax payable on death under two Inheritance Tax options, among all people modelled as dying in 2021: GB



NOTES: See the report text for a more detailed description of these options. Results are points on the distribution calculated as the mean values across 1,000 simulations where individuals in the Wealth and Assets Survey are randomly selected based on their probability of death given their age and sex.
SOURCE: RF analysis of ONS, Wealth and Assets Survey; and ONS, Life expectancy at birth and selected older ages.

One objection to removing or limiting the RNRB is that this would not affect the largest estates, as the band is already tapered away for estates worth over £2 million. In addition, those estates may also benefit from alternative IHT reliefs such as agricultural and business property reliefs, as well as the exemption of lifetime gifts given more than seven years before death.[70] Given that one reason for IHT's unpopularity is (arguably) the perception that the very wealthiest do not pay it,[71] any increase in IHT for main residences might best be coupled with other reforms that would affect that top group – as we explore in Box 2.

70 A Corlett, Passing on: options for reforming inheritance taxation, Resolution Foundation, May 2018.
71 A Corlett, Passing on: options for reforming inheritance taxation, Resolution Foundation, May 2018.

BOX 2: Other potential Inheritance Tax reforms, to ensure larger estates pay their share

In the current IHT system, the highest-value estates (e.g. those over £10 million) on average pay a lower effective tax rate than those worth £1-9 million.[72] To ensure that IHT is made more proportionate right across the wealth distribution, a cap could be introduced to agricultural and business property reliefs, which currently allow all qualifying property to be passed on untaxed. In 2015-16, a £2.5 million cap would have affected only 62 estates in the case of agricultural property and 93 estates for business property, yet could raise £600 million a year.[73] Scrapping the reliefs entirely might raise over £1 billion a year.[74]

Removing the gratuitous tax-free treatment of inherited pensions could also raise £500 million a year, or perhaps even £1.4 billion, and should be a priority for reform.[75]

More broadly, we believe there is a good case for entirely scrapping the current IHT system and replacing it with a tax based on recipients (a 'Lifetime Receipts Tax').[76] In this way, lifetime giving would no longer be a simple way to reduce tax for those with substantial wealth. While this could be designed in any number of ways, the allowances and rates we have suggested previously might lead to additional revenue of £7 billion a year.

There is no ducking the fact that under-taxing housing wealth means higher taxes elsewhere and unfair housing outcomes

Like any tax rise, implementing a tax on main residence capital gains would face criticisms. As well as the general opposition that any tax rise might encounter, there are trade-offs in its design, as we have shown. Raising more through the Inheritance Tax system also faces its own political challenges. But doing nothing to reflect the big structural changes that have happened over the last few decades regarding the importance of wealth comes with its own costs. Not least, under-taxing housing wealth of course requires higher taxes elsewhere and means a reduced capacity to ameliorate problems in the housing market.

72 Office of Tax Simplification, Inheritance Tax Review: first report, November 2018.
73 G Bangham, et al., Unhealthy finances: How to support the economy today and repair the public finances tomorrow, Resolution Foundation, November 2020.
74 HMRC, Estimated cost of non-structural tax reliefs, October 2020; and Advani, E Chamberlain & A Summers, A wealth tax for the UK, Wealth Tax Commission, December 2020.
75 See G Bangham, et al., Unhealthy finances: How to support the economy today and repair the public finances tomorrow, Resolution Foundation, November 2020 and A Advani, E Chamberlain & A Summers, A wealth tax for the UK, Wealth Tax Commission, December 2020.
76 A Corlett, Passing on: options for reforming inheritance taxation, Resolution Foundation, May 2018.

If we consider the trade-offs within the tax system, raising £6 billion a year (for example) in wealth-related taxes would be sufficient to raise the personal National Insurance (and personal Health and Social Care Levy) threshold to £12,500 by 2024-25 (from an expected level of around £10,500) – which is stated as an 'ambition' in the 2019 Conservative manifesto.[77] Alternatively, £5 billion is enough to halve Council Tax for everyone in the two lowest bands (A and B),[78] while £6 billion could halve Stamp Duty Land Tax for residential properties.[79] These are tax cuts that would benefit large fractions of the population.

Revenue raised could alternatively be used to mark a step change in addressing the social and economic side-effects of rapidly rising house prices. That could include more radical approaches to raising home ownership rates amongst younger generations. For example, £6 billion a year might allow 60,000 additional social homes to be built each year,[80] which compares to a current build rate of only 6,000 per year (and a total social housing stock of around 5 million units).[81] An extra 60,000 social homes per year would mean adding secure housing for around 1.4 million people each decade.[82]

The potential additional revenue is also large in comparison to other existing forms of home ownership support. The 'First Homes' scheme, for example, which delivers discounted new homes, is supported by a £150 million fund;[83] while £2.3 billion was granted in 2015 to support 'Starter Homes' (though actual spending may have been lower).[84]

Finally, as we have shown in previous work, an unconditional £10,000 'citizen's inheritance' for everyone when they reach the age of 25 would cost around £7 billion a year.[85] This would transform youth wealth levels,[86] and (all else equal) put young working people in a strong position to put down a deposit on a house.[87]

These are only examples of the policy trade-offs that are the bread and butter of politics. But they help emphasise that if we want the UK to be a country where one's wealth isn't primarily determined by the luck of historic house price changes and inheritances, then a shift in tax policy is needed.

77 RF analysis of DWP, Family Resources Survey, using the IPPR Tax Benefit Model.
78 RF analysis of DWP, Family Resources Survey, using the IPPR Tax Benefit Model. This Council Tax costing is purely for illustration: in practice, it would leave too large a jump in bills between Band B and Band C.
79 Based on projected revenue for 2022-23 from OBR, Economic and Fiscal Outlook, October 2021.
80 This assumes a cost of £100,000 per home. For a lower figure, see: R Hughes et al., Euston, we have a problem: Is Britain ready for an infrastructure revolution?, Resolution Foundation, March 2020.
81 Shelter, The story of social housing [accessed: December 2021]
82 ONS, Families and households in the UK: 2020, March 2021.
83 House of Commons Library, First Homes for first-time buyers (England), November 2021.
84 House of Commons Library, Starter Homes for First-Time Buyers (England), May 2018.
85 Such a scheme could also replace the (much less equitable) Lifetime ISA and Help to Buy ISA, which together cost around £1 billion a year. See G Bangham, The new wealth of our nation: the case for a citizen's inheritance, Resolution Foundation, May 2018; and OBR, Economic and Fiscal Outlook, October 2021.
86 G Bangham, The new wealth of our nation: the case for a citizen's inheritance, Resolution Foundation, May 2018.
87 A Corlett & F Odamtten, Hope to buy: the decline of youth home ownership, Resolution Foundation, December 2021.

Annex (methodology)

This annex details the methodology and key assumptions we have taken to produce the estimates of the tax revenue raised under the various policy options we have considered.

The primary source of data for our analysis is the ONS's Wealth and Assets Survey. This is the most comprehensive data on the asset holdings of households in Great Britain. However, the first survey wave was only conducted in 2006 to 2008, and the latest available published data covers the period from April 2016 to March 2018. Cleary, this is both a shorter time series than needed to estimate capital gains since 2000 and does not cover gains up until 2021. To construct a broader estimate of capital gains, we produce proxy main residence values each year using (annual) regional house price indices from the ONS.[88]

Another disadvantage of the Wealth and Assets Survey is we do not directly observe house moves in the dataset. In order to account for the length of time someone is likely to have owned their current property we use the Family Resources Survey from the DWP to estimate, for each five-year age group, the distribution of these lengths. In this way, we can roughly estimate capital gains accrued since the purchase date of currently occupied properties, as well as estimating gains since 2000 (for properties purchased earlier than that).

Our policy proposals are based on tax payment when leaving the residential property market (or downsizing). While this can happen at any time, we have simplified the estimated revenue by considering only capital gains at death.

We have abstracted from behavioural effects as a result of introducing the tax. In the real world, taxes are associated with avoidance (legal reductions in tax liability) and outright evasion (non-compliance with the rules), and house price growth could also be affected. It is difficult to estimate the impact of behavioural changes on revenue, not least because there would be a dynamic effect over time as it is difficult to immediately restructure asset holdings in order to reduce the tax liability. Finally, we do not include any estimate of (HMRC) administration costs.

For the specific calculation of our tax revenue estimates, we use ONS life expectancies by age and gender to model which individuals in our data are expected to die in 2021.[89] We run 1,000 simulations based on the probability of death to determine the distribution of tax payments and report the mean values across the simulations at the various points

88 We do not account for differential house price growth for different types of residential property within region. This is because that data can be noisy/volatile – however the trade-off is that we are not accounting for any drift in the relative value of different property types.

89 This abstracts from the effects of Covid-19 given data constraints and to make revenue estimates more consistent with future returns.

of the payment distribution. This is scaled up to reflect ONS projections of deaths in 2021 – as projected prior to the pandemic (i.e. our results are not affected by the increase in deaths during the pandemic).[90] As a result of this scaling, our revenue estimates are on a UK basis (even though the Wealth and Assets Survey does not include Northern Ireland). This scaling also roughly accounts for cases where people do not appear in the Wealth and Assets Survey because they live in a care home, for example, but may have realised a large capital gain.

We consider payments at the individual-level, rather than a family- or household-level; or, in other words, we assume – for modelling purposes only – that payment occurs at death even when a partner is still alive, and that both partners own equal shares of property wealth. Over the long run, this should not have a material effect on the revenue estimates, because the total amount of measured capital gains in-scope is unaffected, but it may affect the exact time-profile of tax payments as, in practice, married couples would only be taxed upon the death of the second partner.

For inheritance tax change estimates, we adjust our revenue results to reflect differences between the value of wealth, as measured in the Wealth and Assets Survey, and the value of estates at death implied by Inheritance Tax revenue.[91]

90 The overall ONS projections for deaths do not match the death probability weighted result from the Wealth and Assets Survey due to population coverage (e.g. the does not include people in care homes).

91 This is in line with the approach taken in A Advani, H Hughson & H Tarrant, Revenue and distributional modelling for a UK wealth tax, CAGE working paper no. 578, August 2021.

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