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Taxing Luxury Real Estate and Regulating Vacant Properties

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A growing number of municipalities and states are exploring passage of luxury real estate taxes and anti-speculation provisions. Several jurisdictions have implemented or are exploring luxury real estate transfer taxes aimed at accomplishing two goals: 1) to calm the disruptive impact of surging luxury markets and, 2) to generate revenue for improvement of city services.[1]

Thirty-five states have luxury real estate transfer taxes, according to the Center on Budget and Policy Priorities. Seven states — Connecticut, the District of Columbia, Hawaii, New Jersey, New York, Vermont, and now Washington state— levy a surcharge on the highest-value homes or have a progressive bracket structure through their real estate transfer tax system.[2]

A recent report by the Urban Institute, "Exploring the Viability of Mansion Tax Approaches," suggests that a state such as Massachusetts could raise over $88 million a year by implementing a luxury real estate transfer tax.[3]

San Francisco. In 2016, San Francisco passed a ballot initiative in order to increase real estate transfer taxes on properties sold for over $5 million. For properties between $5 million and $10 million, the transfer tax is $11.25 for every $500, a drastic difference from properties worth between $1 million and $5 million that are taxed at $3.75 per $500 of value.[4] Through an unofficial agreement, the city agreed to spend revenue from the new tax on providing free city college tuition and expenses to San Francisco residents. The revenue is expected to exceed $44 million over the first year.[5] In addition, approximately $19 million has been allocated towards street-tree maintenance, an effort that had previously been abandoned due to a lack of allotted funding.[6]

Progress Report. The San Francisco Assessor's office reported that in their 2016-2017 fiscal year, they saw the highest level of transfer tax collections in the city's history at $411 million. This includes revenue from both the basic transfer tax on all properties and the revenue from Prop W, the luxury transfer tax, which was responsible for an additional $22 million in revenue. Commercial transactions represented 14 percent of total transfers but 57 percent of transfer tax revenue.[7] One commercial property sold for $335.5 million, generating $10 million in total transfer tax revenue.[8]

Oakland and Berkeley Follow San Francisco. Voters in the cities of Oakland and Berkeley both voted to approve progressive real estate transfer taxes in the recent November 2018 election. Oakland previously had a flat real estate transfer tax of 1.5 percent. The new rate system lowered the tax rate to 1 percent on home value up to $300,000, 1.5 percent on value between $300,000 and $2 million, 1.75 percent between $2 million and $5 million and 2.5 percent on real estate value over $5 million.[9] New revenue goes to the city's general fund.[10]

Berkeley's has a two-tier tax rate replacing its previous 1.5 percent flat transfer tax. Under the new system, the rate is 1.5 percent for property sales under $1.5 million and 2.5 percent for sales over $1.5 million.[11] Revenue is directed to homeless services such as shelters, rental subsidies, and staffing.[12]

Vermont and Connecticut. The states of Vermont and Connecticut both have progressive transfer taxes on real estate transactions. Vermont's transfer tax generates revenue for the Housing & Conservation Board which invests in permanently affordable housing and farmland conservation efforts.[13] In Connecticut both the state and municipalities have tax authority. In FY16, CT collected $186.6 million in state conveyance tax revenue. Municipalities collected an additional $52.4 million.[14]

New York City –Mansion Tax. In 1989, New York State implemented a 1 percent real estate transfer tax on properties sold for more that $1 million. This tax is paid by the buyer, unless that buyer is exempt, in which case it will be paid by the seller.[15] In 2019, New York State adopted a new "progressive mansion tax." Starting in July 2019, the tax begins with a 1 percent levy on sales between $1-2 million, but then increases across 8 tiers to a 3.9 percent rate on transactions over $25 million.[16] The new tax is expected to raise $365 million in FY2019-2020. The revenues will secure $5 billion in bonds for mass transit. If the levy had been in place in 2018, it would have affected 26 percent of Manhattan's residential market.[17]

New York City Luxury Second-Home Tax (the "pied-a-terre" tax). The 2019 "progressive mansion tax" is a transfer tax was passed as a compromise as real estate industry groups mobilized to oppose an annual "pied-a-terre" tax aimed at luxury second homes. Proposed in 2014 by the Fiscal Policy Institute, the movement was given a push by the decision of Citidal investment founder, billionaire Ken Griffin, to purchase a four-story 24,000 square foot penthouse for $238 million. The proposal is worth examining for the future.

New York City has an income tax, which out of state residents don't have to pay. So one justification for a luxury second home tax is that wealthy visitors should contribute more toward bearing the cost of services that makes New York City so attractive to international and out-of-staters buyers. Under the proposal that did not pass in 2019, properties over $5 million would be subject to the tax surcharge, starting at 0.5 percent of the home value to a maximum rate of 4 percent on homes above $25 million. A part-time owner of a $10 million unit, for example, would have to pay an extra $45,000 a year.

There are estimated only 5,400 units in New York above $5 million that are owned by non-residents. But it's unclear how many absentee buyers and sellers are trading homes in that range, which represents the top 8 percent of sales. The tax would generate an estimated $665 million a year.[18]

Had the legislation passed, New York would have joined Vancouver, Hong Kong, Paris and London in levying luxury second home taxes. New York City Residents already pay a 1 percent "mansion tax" on units over $1 million.

According to Moses Gates, vice president of the Regional Plan Association, such a tax may have slowed sales at the upper end of New York's housing market, but it could also have brought benefits that go beyond fixing the subway, including encouraging developers to focus on units that are more affordable to permanent residents. In the long run, according to Gates, everyone's property values benefit from safety, security and cultural amenities funded by full-time residents.[19]

British Columbia Foreign Buyers Tax. In 2016, British Columbia introduced legislation that applies a 15 percent tax to property transfers for foreign buyers. The 15 percent is added to the existing transfer tax, which varies from 1-3 percent based on property value. This legislation was inspired by an estimated rise in housing prices of 32 percent between 2015 and 2016.[20] This rise was attributed to a massive influx of foreign buyers, using the homes as a means of storing their wealth. This tax, along with Vancouver's vacancy tax, will discourage foreign investors and open up housing opportunities for Vancouver's population that were previously unaffordable.

New Jersey. The state of New Jersey has two additional transfer taxes, aside from those based solely on the sales price. The first applies to non-residents of New Jersey: If a non-resident is selling a house in New Jersey, they will be subjected to a 2 percent tax on the sales price of the home. This is in addition to the transfer tax that they pay which is also based on the sales price. The second additional tax is called the "Millionaire's Tax," homes selling for over $1 million will be subject to a 1 percent tax on the sales price, paid by the buyer.[21] There are small tax breaks for senior citizens on the base transfer tax, but none apply to the two additional taxes mentioned previously.

Hawaii. In November 2018, voters in Hawaii will vote on a new amendment pertaining to luxury real estate. The measure, "Hawaii Surcharge on Investment Properties to Fund Public Education,"[22] gives the state legislature of Hawaii the power to enact a surcharge on investment properties (previously defined as investments valued above $1,000,000). An amended version of the measure was approved for the ballot and would also give the state legislature the power to determine the size of the surcharge and which properties would be affected. The revenue from the surcharge has been earmarked for public education spending.

Washington State. Beginning January 1, 2020, Washington State will implement a progressive graduated transfer tax. Under this statewide system, the first $500,000 of a sale are taxed at 1.1 percent, after which higher sale values are taxed at progressively higher rates. The top tier levies a 3 percent transfer tax on sales valued over $3 million.[23]

The revenue from the tax is allocated as follows: "1.3% of the state tax collected by counties is retained to cover administration costs. Of the net proceeds to the state, 2% goes into the public works assistance account, 4.1% to the education legacy account with remaining amounts going the general fund."

Cities and counties have great flexibility to add-on to the state transfer tax to fund capital projects for homeless services and affordable housing.[24] Revenues will vary by locality, but the municipal add-on tax will generate an estimated $15-20 million per year in Seattle for affordable housing and homeless services.[25]

Taxation of Vacant Properties

A number of jurisdictions have tried to address the problem of vacant properties and create incentives to use a city's housing stock to house people, not wealth.

In most jurisdictions, the definition of vacancy is a property that is not occupied for over six months of the calendar year. Currently, Washington D.C. is one of the few cities to have experience implementing a tax on vacant properties that has been in place longer than five years. Political leaders in high-rent cities like New York, San Francisco, and Oakland have indicated an interest in following suit.

Washington, D.C. In 2010, D.C. City Council passed the Budget Support Act that applied an additional tax on properties, commercial and residential, left vacant for over half of the year. Vacant properties are taxed at a rate of $5 per $100 of assessed value. If the property is blighted, it is taxed at a higher rate of $10 per $100 of assessed value.[26] Operating under the Department of Consumer and Regulatory Affairs, the Vacant Building Enforcement Unit determines the category of each parcel: occupied, vacant, or blighted. Exempt properties are limited to those that are currently under construction, have had a change in ownership in the past calendar year, and/or are the subject of a probate proceeding or active litigation.[27]

To learn something about regulating vacancies, one must look outside of the United States at the experience of multiple cities including Vancouver, Paris, and Melbourne. These cities have enacted laws that tax or fine owners of properties left vacant.

Vancouver, Canada. In July 2017, Vancouver legislated a new property tax on vacant properties called the Empty Homes Tax. This new tax targets residential property in order to combat the recent housing crisis caused by landlords' lack of willingness to enter into rental agreements. Under the Empty Homes Tax, also referred to as the Vacancy Tax, vacant residential properties are taxed at a rate of 1 percent of their assessed values. Similar to D.C., homeowners can apply for exemption if their properties are under construction, have been recently sold, or are located in an area with rental strata restrictions.[28]

Melbourne, Australia. In 2017, the Victorian state government introduced a Vacant Residential Property Tax under the State Taxation Acts Amendment Bill, a law that will levy a tax on homes that remain unoccupied for over half of the calendar year. Almost identical to Vancouver's legislation, the imposed tax will be 1 percent of the properties' assessed value and will apply only to residential properties, leaving commercial properties exempt. Exemptions can also be obtained if the property in question is a vacation home for an Australian resident or a unit used for work. The tax will be applied based on self-reporting of homeowners.[29]

Paris, France. In Paris, a trend of extreme vacancy led to the 2015 introduction of a tax on vacant homes equal to 20 percent of the properties' market rent values. In 2017, the city decided to triple this tax to 60 percent in order to increase the legislation's efficacy. As of late 2017, approximately 7.5 percent of homes remain unoccupied. Due to the city's compact nature, new housing development is difficult, making lowering vacancy rates imperative.[30]

New York, NY. New York's vacancy struggle is mainly rooted in empty commercial properties. Mayor Bill de Blasio has proposed a vacancy tax that would levy a fee on property owners who refuse to lease their spaces. Landlords are skeptical of entering into leases that are often long term and price fixed, opting instead to wait until market rent increases to a more profitable level. This strategy has led to empty storefronts and barren neighborhoods.[31]

San Francisco, CA. San Francisco currently has an annual flat fee of $711 that homeowners pay for properties that remain unoccupied for six months or more in a calendar year. However, this fee is imposed based on self-reporting. A meager 38 residential and 47 commercial properties registered this year, leaving much to be desired.[32] Unfortunately, introducing a vacancy tax could be constrained due to California's Prop 13 property tax cap.

London, UK. In the United Kingdom, the government granted local governments the ability to impose a vacancy tax of 100 percent on properties left unoccupied with in their municipalities. Previous to this legislation, local authorities had the ability to tax vacant properties at a rate of 50 percent. However, many find it dubious that local authorities will do so. Imposing a large vacancy tax could potentially deter prospective homeowners from buying secondary residences.[33]

For further information, contact Chuck Collins: chuck@ips-dc.org. See our full study, Towering Excess: The Perils of the Luxury Housing Boom for Bostonians (Sept. 2018)

Source Notes

[1] See the Institute for Policy Studies report, Chuck Collins and Emma DeGoede, "Towering Excess: The Perils of the Luxury Real Estate Boom for Bostonians, September 2018. https://ips-dc.org/report-towering-excess/

[2] www.cbpp.org/research/state-budget-and-tax/state-mansion-taxes-on-very-expensive-homes.

[3] Jung Choi, Bhargavi Ganesh, Sarah Strochak, Bing Bai, "Exploring the Viability of Mansion Tax Approaches," Urban Institute, May 2018. https://www.urban.org/research/publication/exploring-viability-mansion-tax-approaches

[4] "City & County of San Francisco Office of the Assessor-Recorder." *Real Property Assessments | CCSF Office of Assessor-Recorder*, www.sfassessor.org/recorder-information/recording-document/transfer-tax.

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[6] Ibid.

[7] https://www.sfassessor.org/sites/default/files/uploaded/FY%202016-17_SF%20Assessor_AnnualReport_Website_Final.pdf

[8] https://www.sfchronicle.com/business/article/SF-office-building-sold-for-335-5-million-in-13591985.php

[9] https://berkhills.com/bay-area-living/what-you-need-to-know-about-the-new-property-taxes-and-laws-going-into-effect-in-the-east-bay

[10] https://www.eastbaytimes.com/2018/06/29/oakland-berkeley-consider-real-estate-tax-ballot-measures/

[11] https://berkhills.com/bay-area-living/what-you-need-to-know-about-the-new-property-taxes-and-laws-going-into-effect-in-the-east-bay

[12] https://www.eastbaytimes.com/2018/06/29/oakland-berkeley-consider-real-estate-tax-ballot-measures/

[13] http://www.vhfa.org/news/blog/what-know-about-vermonts-property-transfer-tax

[14] https://www.cga.ct.gov/2017/rpt/pdf/2017-R-0107.pdf. See page 3.

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[16] Update on New York State Budget Agreement, Real Estate Board of New York, April 1, 2019. https://rebny.com/content/rebny/en/newsroom/in-the-news/2019/Update_New_York_State_Budget_Agreement.html

[17] https://www.bloomberg.com/news/articles/2019-04-01/nyc-brokers-relieved-as-mansion-tax-replaces-a-pied-a-terre-levy

[18] http://fiscalpolicy.org/fpi-proposes-tax-on-most-expensive-nyc-pied-a-terre-residential-units

[19] https://www.bloomberg.com/news/articles/2019-03-15/nyc-brokers-see-new-threat-to-luxury-market-in-pied-a-terre-tax

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[23] Washington State Department of Revenue https://dor.wa.gov/find-taxes-rates/other-taxes/real-estate-excise-tax

[24] As prescribed in the legislation: Certification of Enrollment, Engrossed House Bill 1219, "Real Estate Excise Taxes -- Affordable Housing and Homelessness Projects", approved by the governor April 19th, 2019.

[25] The Housing Consortium, "Real Estate Excise Tax for Affordable Housing" https://www.housingconsortium.org/wp-content/uploads/2016/11/Real-Estate-Excise-Tax-Fact-Sheet.pdf

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