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# The Behavioral Response to Housing Transfer Taxes: Evidence from a Notched Change in D.C. Policy<sup>☆</sup>

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## Abstract

This paper estimates the behavioral response to residential real estate transfer taxes by studying notched tax rate changes in Washington D.C., exploiting both a price and time notch as identifying variation. We provide evidence that there is manipulation of the sales price to the lower-tax-rate region around the price notch, and use this manipulation to show that there was significant awareness of the tax changes and the incentives they created. We then construct difference-in-difference estimates to examine whether there is a lock-in effect in the volume of house sales away from the price and time notches; we find no evidence of a lock-in effect in this setting. Taken together, our results suggest that the welfare costs of a state introducing or eliminating a housing transaction tax are small.

*Keywords:* housing transfer taxes, lock-in, tax notches.

## 1. Introduction

As of 2012, 35 states and the District of Columbia had a transfer tax on residential real estate transactions.<sup>1</sup> Washington D.C. had one of the highest transfer tax rates of all, even before 2006 when it increased its effective tax rate from 2.2 to 2.9 percent of the sale price for home buyers with house sale prices above \$400,000. The mean state housing transaction tax rate in 2012 for states that had this tax was 0.58% in the U.S. (and the standard deviation was 0.54%).<sup>2</sup> Some counties and municipalities also impose transfer taxes. As with other transfer taxes such as capital gains levies, this type of tax makes selling a house more costly, and therefore may affect how often houses are bought and sold—the “lock-in” effect—as well as house value.

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<sup>1</sup>States with flat fees of \$5 or less are not included in this calculation.

<sup>2</sup>This calculation is based on the lowest possible tax rate in each state. Some states have higher tax rates for homes above a certain value. The calculation does not include any county or local tax rates.

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