EUROPEAN CENTRAL BANK

EUROSYSTEM

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Homeownership taxation after the Great Recession onset in Europe: do property taxes compensate for income tax exemptions?

Gerlinde Verbist (Herman Deleeck Centre for Social Policy, University of Antwerp, Belgium),

Francesco Figari (Department of Economics, University of Insubria, and Institute for Social and Economic Research, University of Essex, United Kingdom), and

Francesca Zantomio (Department of Economics, Ca' Foscari University of Venice, Italy)

Tjeerd Jellema, ECB

Tax Neutrality and Homeownership

- Owner Occupied Housing is captured by imputing a rental expense and a (non-cash) rental income (IR).
  - The imputed rent is not part of taxable income
  - In some countries, mortgage interest is tax-deductible
- Income taxation therefore treat Rental Housing and Owner Occupied Housing differently

Offset by property taxes

- House ownership is taxed under property taxation;
  - This could possibly compensate for homeowners income tax savings
- To what extent doe property taxes compensate for the income tax advantage
  - How far are we from tax neutrality?
  - What are the distributional aspects, e.g. I the case of asset rich income poor households.

Contribution of the paper

- EUROMOD – multi country tax benefit model to provide systemic view of the interplay of taxes
  - Measurement of homeownership bias from onset of Great Recession in terms of aggregate size and distribution
- The role of property taxation on the main residence in mitigating the homeownership bias, and the extent this substitutes for the loss of income tax revenues
  - Depends fully also on the distributional effects of the income tax housing related allowance and the property tax liability.

Current situation in countries

	Personal Income Tax		Property taxation		
	IR exempt	MI tax relief	Type	Revenues (as % of GDP)	Latest values assessment
Austria	YES	YES, Limited amount allowed for low incomes	Real Estate Tax: federal and municipal rate on standard value of property	0.2	1973
Belgium	YES	YES	Real Estate Tax: regional and municipal rate on Cadastral Income	1.22	1975
Finland	YES	YES, among most generous in EU, although being limited	Real Estate Tax: municipal tax on taxable value of the property	0.64	2011
France	YES	NO – abolished in 2010 (tax credit maintained for second properties)	Real Estate Tax: municipal rate on Cadastral Income	1.33	1978
Germany	YES	NO	Real estate tax: federal and municipal rate on standard value of property	0.45	1964
Italy	YES	YES	Real Estate Tax: municipal tax on Cadastral Income	1.51	1988
Spain	YES	Mortgage tax credit removed since 2012 (still compensation for house acquired before 2006)	Real Estate Tax: municipal rate on Cadastral Value. Net Wealth Tax	1.09	1994
United Kingdom	YES	NO (after lengthy phasing-out), maintained on other taxed properties.	NO	-	1991 (2005 in Wales)

Home ownership

Table 2: Homeownership rates in 8 EU countries, 2010.

	Owned on mortgage	Owned outright	Rented	Reduced, social or free rented	Owned/Rent Market Ratio
AT	25.40	32.10	17.20	25.30	3.34
BE	41.60	30.20	19.50	8.70	3.68
FI	42.00	32.30	10.10	15.60	7.36
ES	33.20	46.70	11.90	8.30	6.71
FR	28.90	33.30	20.10	17.70	3.09
DE	27.80	25.50	39.60	7.10	1.35
IT	15.40	56.50	14.00	14.10	5.14
UK	41.30	27.70	12.50	18.50	5.52

Source: Own calculations on the basis of EU-SILC/FRS.

Homeownership and IR Estimation

- Cross country comparability:
  - IR estimates are estimated based on the **rental equivalent method**, hedonic regressions on SILC data sets.
    - Covariates are type and size of the dwelling, quality of the dwelling and the neighbourhood, occupancy in years, geographical location, household income.
    - Heckman selection correction is used to allow for housing quality differences between rented and owned.
  - Net IR version deducts interest payments, for some households negative net imputed rent, set to 0.
  - Cross checking against observability of actual tenants rent

Methodology

- Fiscal microsimulation on estimated IR data using EUROMOD
- Different tax regimes exercised through everything else held constant

- Two options for benchmark tax neutral systems
  - Neutrality in taxation of returns from owner occupied housing with respect to other investment in housing or immobile property
  - Personal Income Tax rates vis a vis low risk financial investment

Result

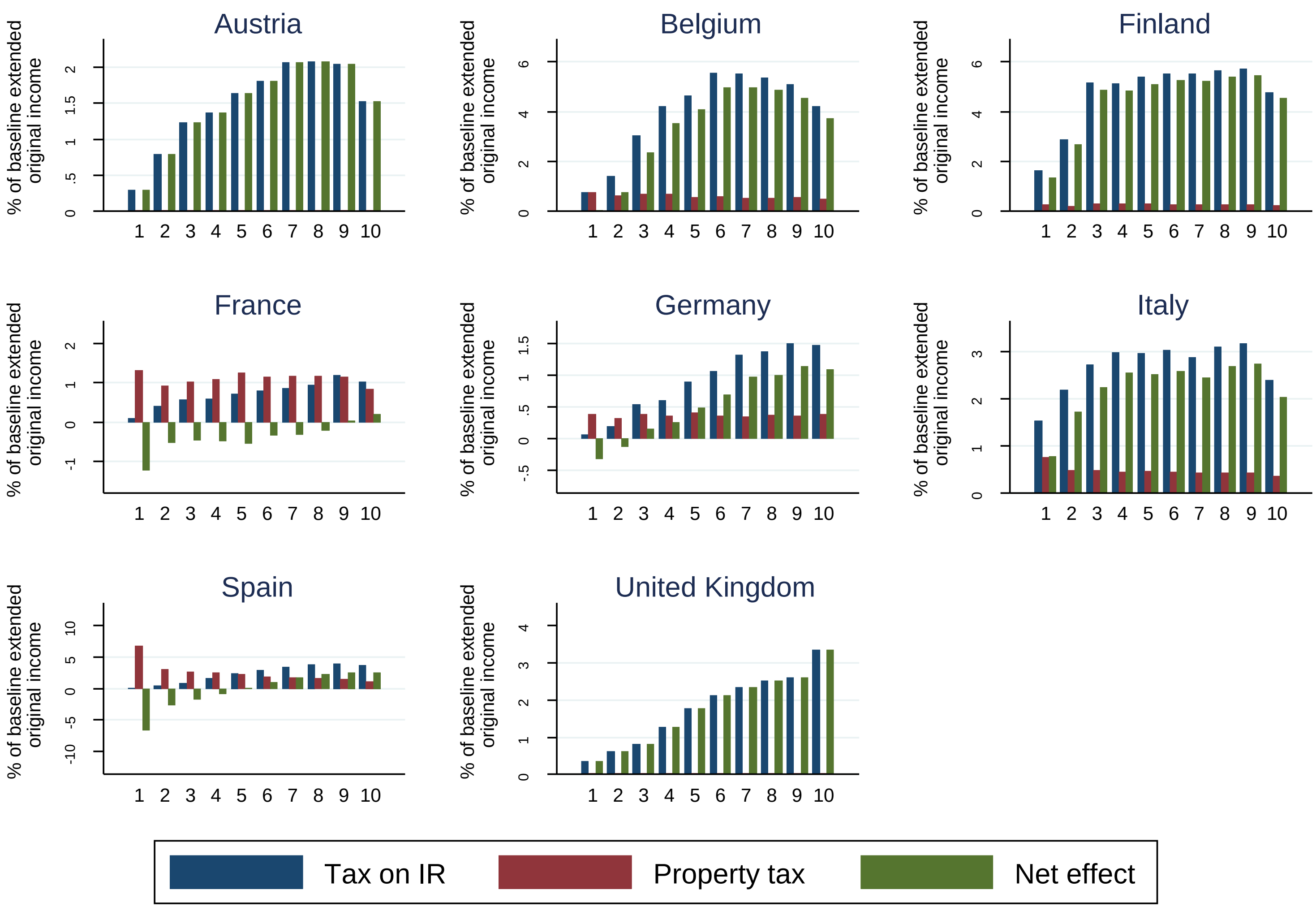
Budgetary impact

Table 5: Budgetary impact of different scenarios and compensation role of property tax (% of tax reve

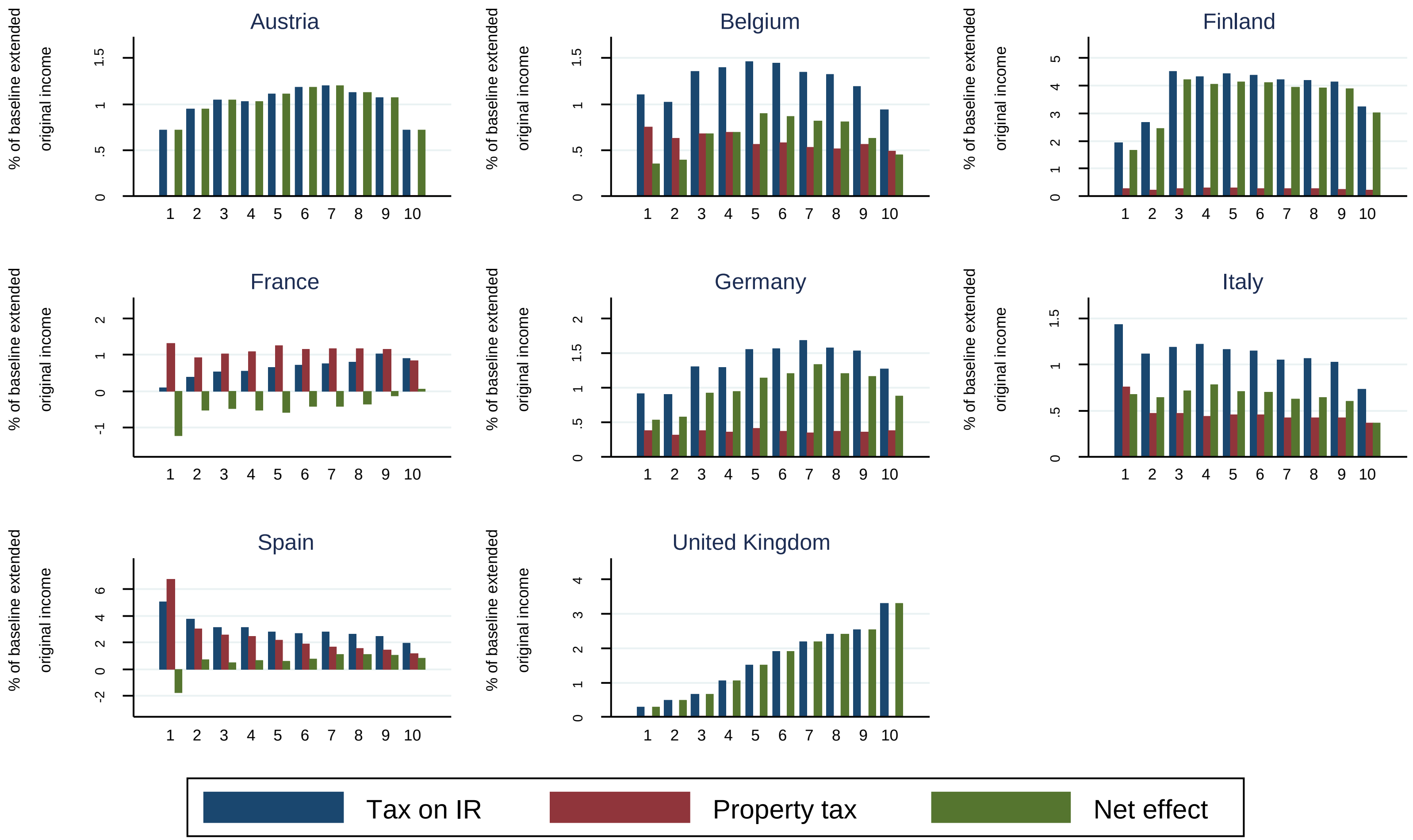
	Property Tax as % of tax revenue	Scen. 1: IR taxed as part of PIT		Scen 2: IR taxed as financial income	
		Change in tax revenue (a)	Property Tax as % of (a)	Change in tax revenue (b)	Property tax as % of (b)
AT	-	11.38	0%	6.78	0%
BE	3.06	24.31	12.60%	6.65	46.00%
FI	1.37	26.62	5.10%	20.39	6.70%
ES	15.27	25.96	58.80%	22.24	68.70%
FR	7.06	5.83	121.10%	5.13	137.60%
DE	2.59	8.25	31.40%	9.96	26.00%
IT	2.29	15.03	15.20%	5.46	41.90%
UK	-	17.85	0%	17.09	0%

Source: Own calculations on the basis of EU-SILC/FRS.

Results PIT


Austria
Belgium
Finland
France
Germany
Italy
Spain
United Kingdom
% of baseline extended original income
% of baseline extende original income
1 2 3 4 5 6 7 8 9 10
Tax on IR
Property tax
Net effect

Results FIT



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Conclusions

- No country in the sample taxes IR in PIT.
- Simulation provides estimates of tax revenue from IR as part of PIT or as part of financial income. It follows that property taxation of owner occupied housing only in part compensates for this.
- Sizable bias in favour of homeowners is found in the data, bias affects the income distribution. Property taxes are proportional to the value of the property, whereas income taxes are progressive.

Imputed rent calculation

CPA_TOTAL	Total	22 892	
P2PP	Total intermediate consumption/final use at purchasers' prices		2 836
D1	Compensation of employees [5]		
D11	Wages and salaries [4] [5]		
D29_M_D39	Other net taxes on production [5]		2 393
K1	Consumption of fixed capital [5]		9 343
B2N_B3N	Operating surplus, net [5]		8 320
B2G_B3G	Operating surplus, gross [5]		17 664

Source : Supply and Use Table Belgium, 2014, NACE68A, imputed rent from owner occupied dwellings

What would be the equivalent income tax base on imputed rents. (IR)

Homeowners do not just ‘receive’ imputed rents.
They also face ‘costs’ in maintaining the housing assets. (E.g. small maintenance and repairs + imputed bank service charges (FISIM) + consumption of fixed capital)

- The appropriate concept for equivalent income taxation would arguably be net operating surplus from owner occupied housing
- This would lower the estimate by 51%
- From which interest (D41) need to be deducted to arrive at the net IR

Questions

- How representative are the estimated IR’s, due to the narrow market rental segments, compared with the large owned segments? I would welcome seeing the descriptive statistics of the covariates comparing rental and owned segments.
- The net IR’s as part of taxable income are likely overestimated due to the omission of consumption of fixed capital and intermediate costs, hence the budgetary and distributional impact might be overestimated. I question therefore the conclusions comparing with property taxes.
- The paper identifies two methods of taxation for IR. However, as owner occupation is presumably an activity equivalent to renting out property as an unincorporated enterprise, the activity of renting might be considered to be taxed as a self employed activity, and taxed appropriately? Would VAT taxes apply in some of the countries?
- Negative incomes in progressive income tax systems lead to negative taxes, is it then justifiable to set negative net IR’s to 0?

Comments

- Nice paper, and nice illustration of exercising through tax alternative measures
- The paper in part emphasises the post financial crisis nature of the estimates. Would it have been beneficial to provide two sets of static simulations, namely before and after the financial crisis, for the same set of countries, as patterns of homeownership, rents and house values might have been affected.
- The paper emphasises the calculation of the IR’s using rental equivalence and the resulting impact on incorporating net IR as a tax base. It concludes on the lack of neutrality, however it does not exercise through the scenario of actually adjusting property tax systems to achieve neutrality.
- For this the authors may need to use the HFCS data set as regards housing wealth. This may provide a better assessment of the noted distributional effects.