



# Housing: tax pressure in the EU and its drivers

S. Fatica\*

*(with S. Barrios\*\*)*

*\*ECFIN - \*\*JRC*

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# Outline

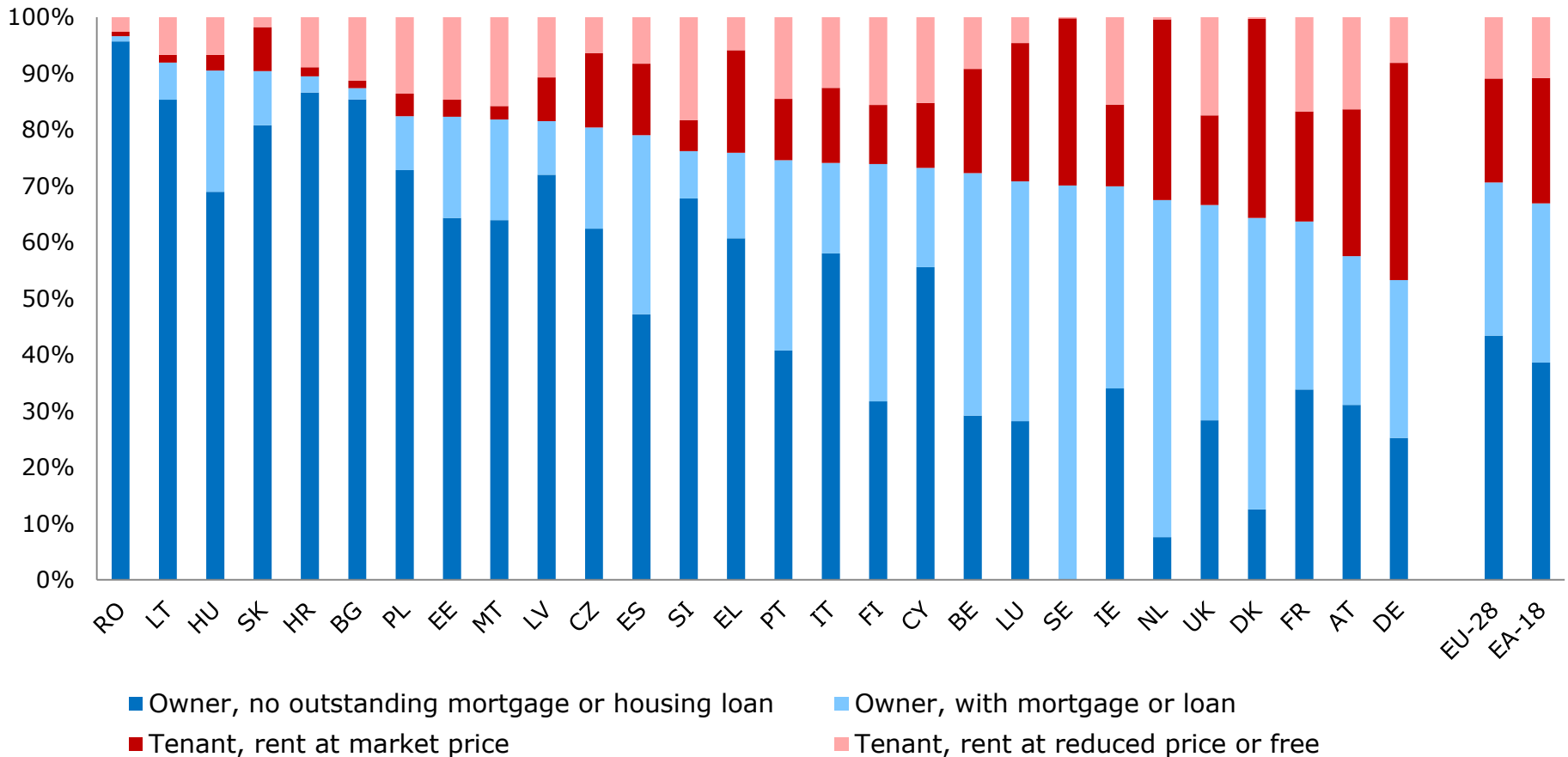
1. Introduction and motivation
2. How to tax housing?
3. Assessing the tax pressure on owner-occupied housing: a synthetic indicator
4. Additional results: focus on distributional impacts
5. Conclusion

# 1. Introduction and motivation

- Housing is usually the most important asset for households,...
  - ... at the extensive margin (= homeownership rates)...
  - ... and at the intensive margin (= value with respect to other real and financial assets in household portfolios)

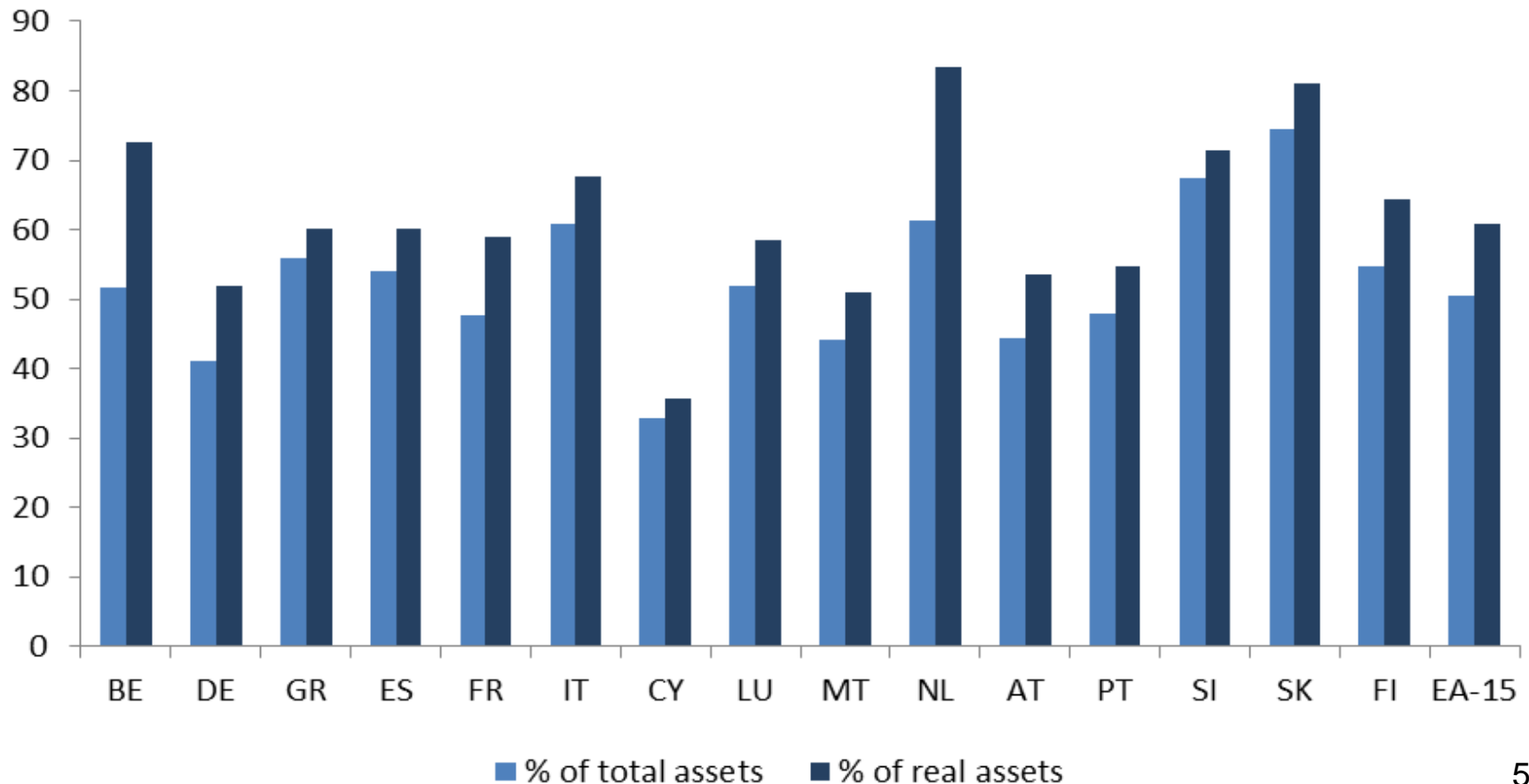
# Extensive margin

## Homeownership & rental rates in the EU



# Intensive margin

## Value of HMR as a % of asset holdings



## 2. How to tax housing?

### Lessons from the Mirrlees Review:

- **Housing is both a consumption good and an asset**
  - and should be taxed accordingly, in a consistent way with the design of the whole tax system
- **Neutrality benchmark:**
  - avoid tax-induced (mis)allocation of resources (inter-temporal, intra-temporal: among assets, income sources, types of return, ...)
  - avoid exemptions with no economic and/or social justification

## Taxation of housing as:

- **Consumption good**

- tax housing services consumed: VAT, tax on the flow of services

- **Asset**

- *tax the net income flows*: tax on net return (=rental income net of costs), capital gain tax

- *tax the sale and purchase of the asset*: transfer tax

- other: tax the stock value, the bequest/donation of the asset

**Owner-occupied housing: investor = consumer!**

- In practice, taxation of housing varies significantly across the EU, both in terms of institutional arrangements and budgetary outcomes (European Commission, Tax Reform Report, 2014)
- Some common features:
  - a) Fairly low level of recurrent taxes (also due to outdated cadastral values)
  - b) Tax exemption of imputed rent (= in-kind benefit to homeowners)
  - c) Tax relief for mortgage payments
  - d) Existence of distortive transfer taxes

Note that c) and taxation of imputed rent would not be at odds with tax neutrality



### 3. Tax pressure on owner-occupied housing

Owner-occupied housing (OOH) as investment in the neoclassical framework (Poterba, 1986) → utility maximisation → equilibrium condition:

$$R = \underbrace{(i + m - \pi)}_{user\ cost} P_H$$

$R$  : imputed rental income from housing capital

$P_H$  : price of housing capital

$i$  : interest rate, or foregone equity cost

$m$  : maintenance costs and economic depreciation

$\pi$  : nominal asset revaluation term (capital gain)

With taxes, the user cost becomes:

$$\frac{R}{P_H} = C = (1 + t_{tr}) * [t_p + m - \pi (1 - t_{CG}) + i(1 - \phi t_M)\lambda + i(1 - t_y)(1 - \lambda)]$$

$t_{tr}$ : transfer tax

$t_p$ : recurrent property tax

$t_{CG}$ : capital gain tax

$t_M$ : rate of relief for mortgage interest payments (with limit set to  $\phi$ ,  $0 \leq \phi \leq 1$ )

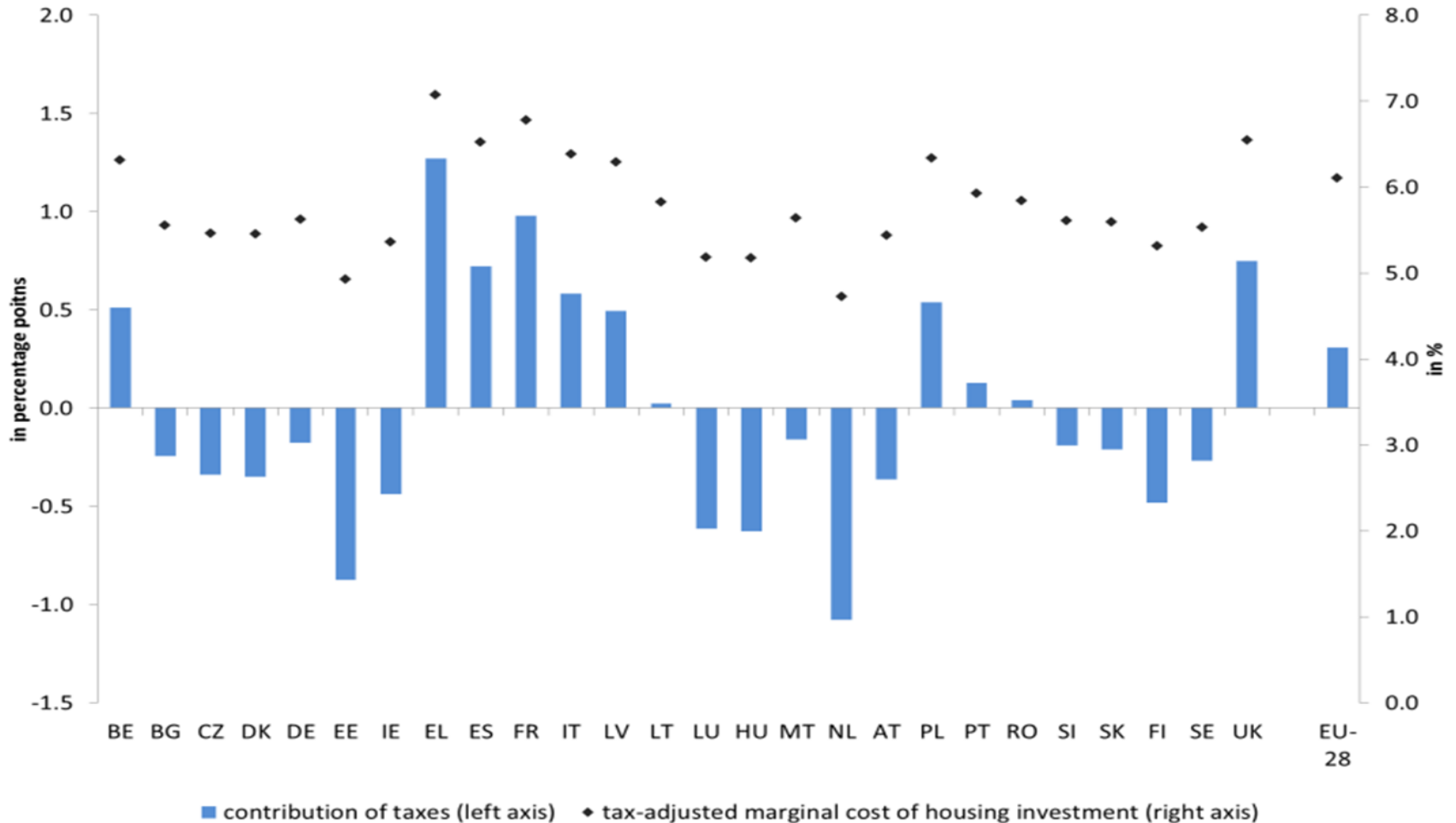
$t_y$ : tax on the return to alternative financial investment

$\lambda$ : loan-to-value

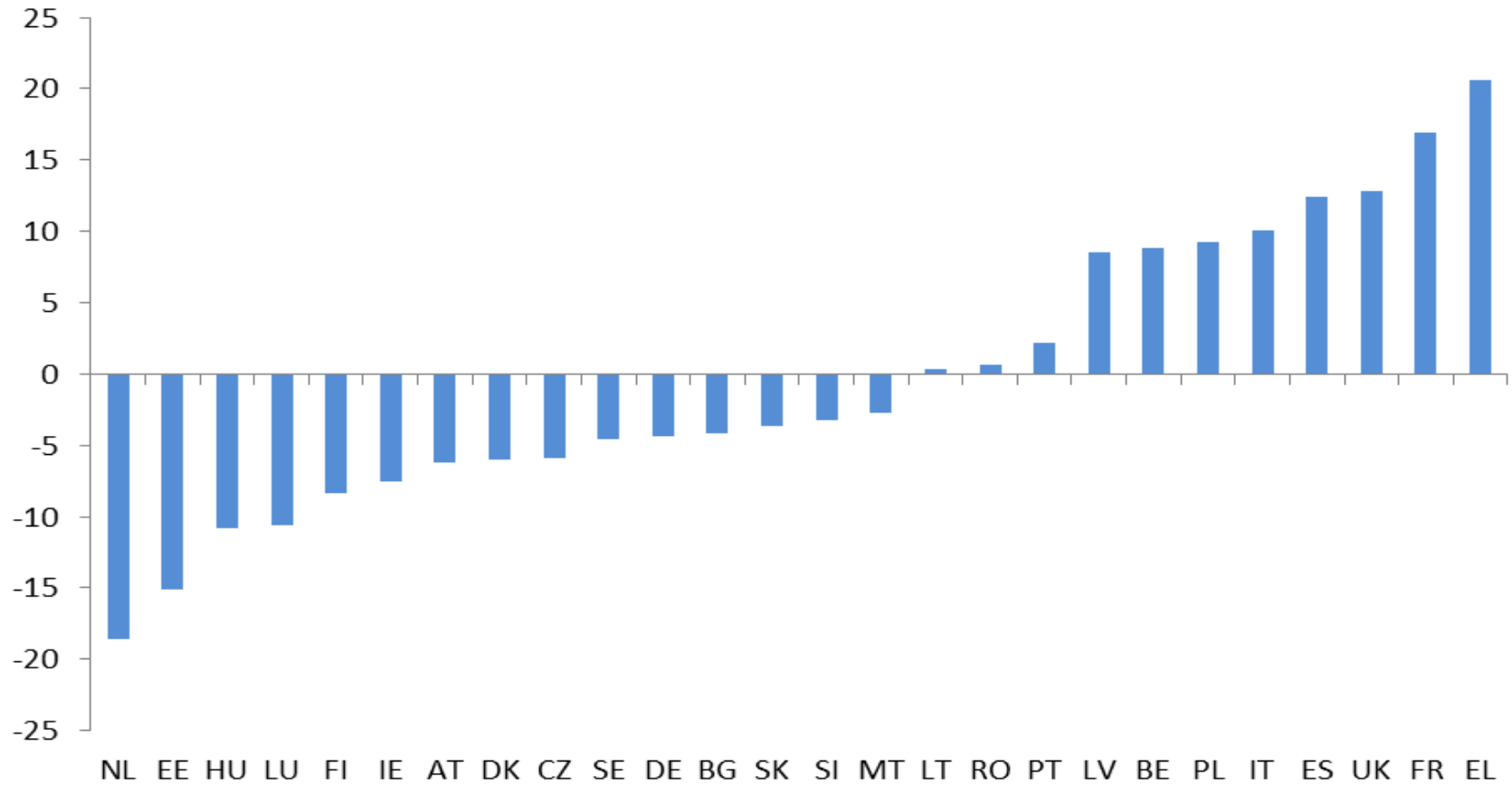


European Commission

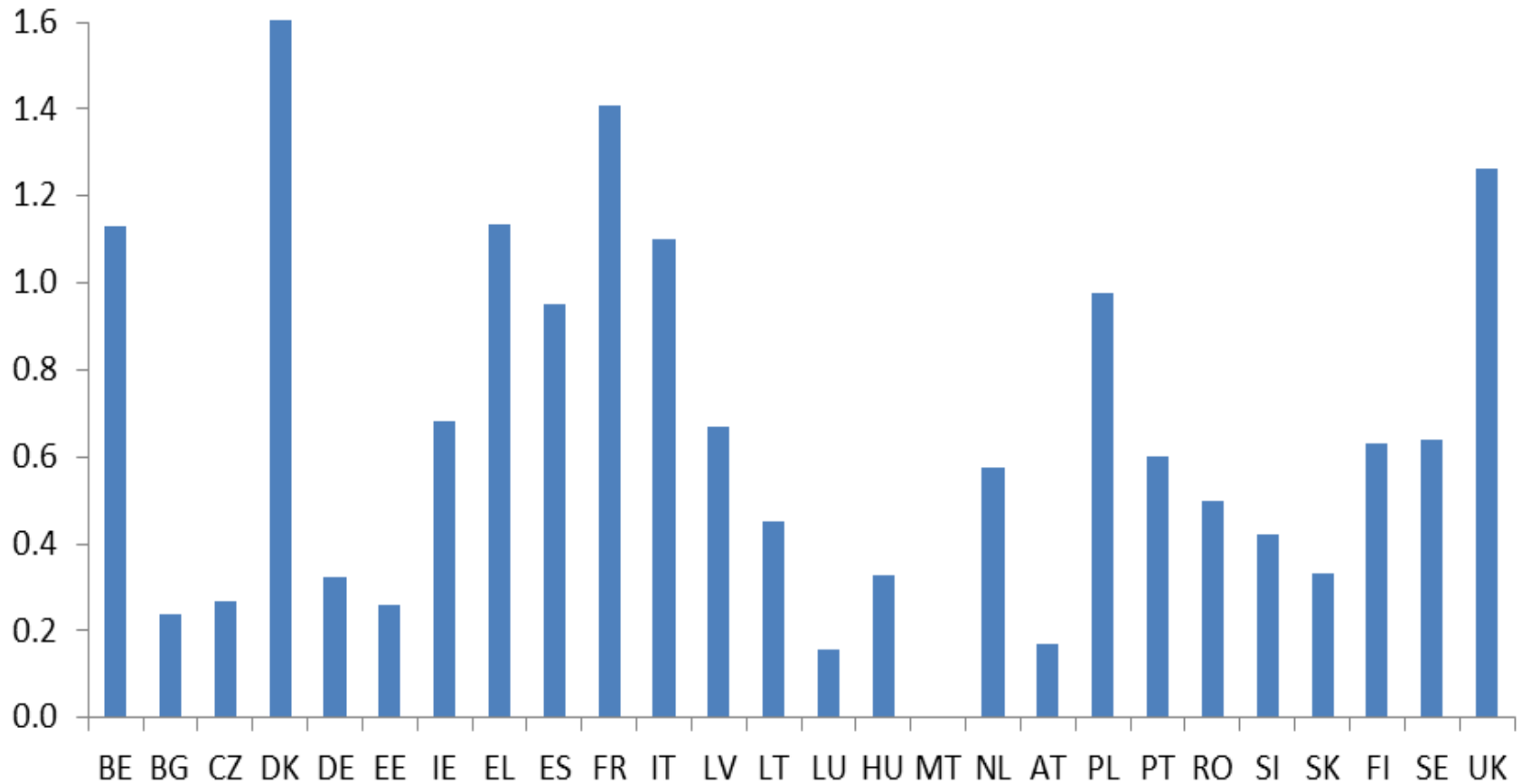
# User cost for OOH and contribution of taxes



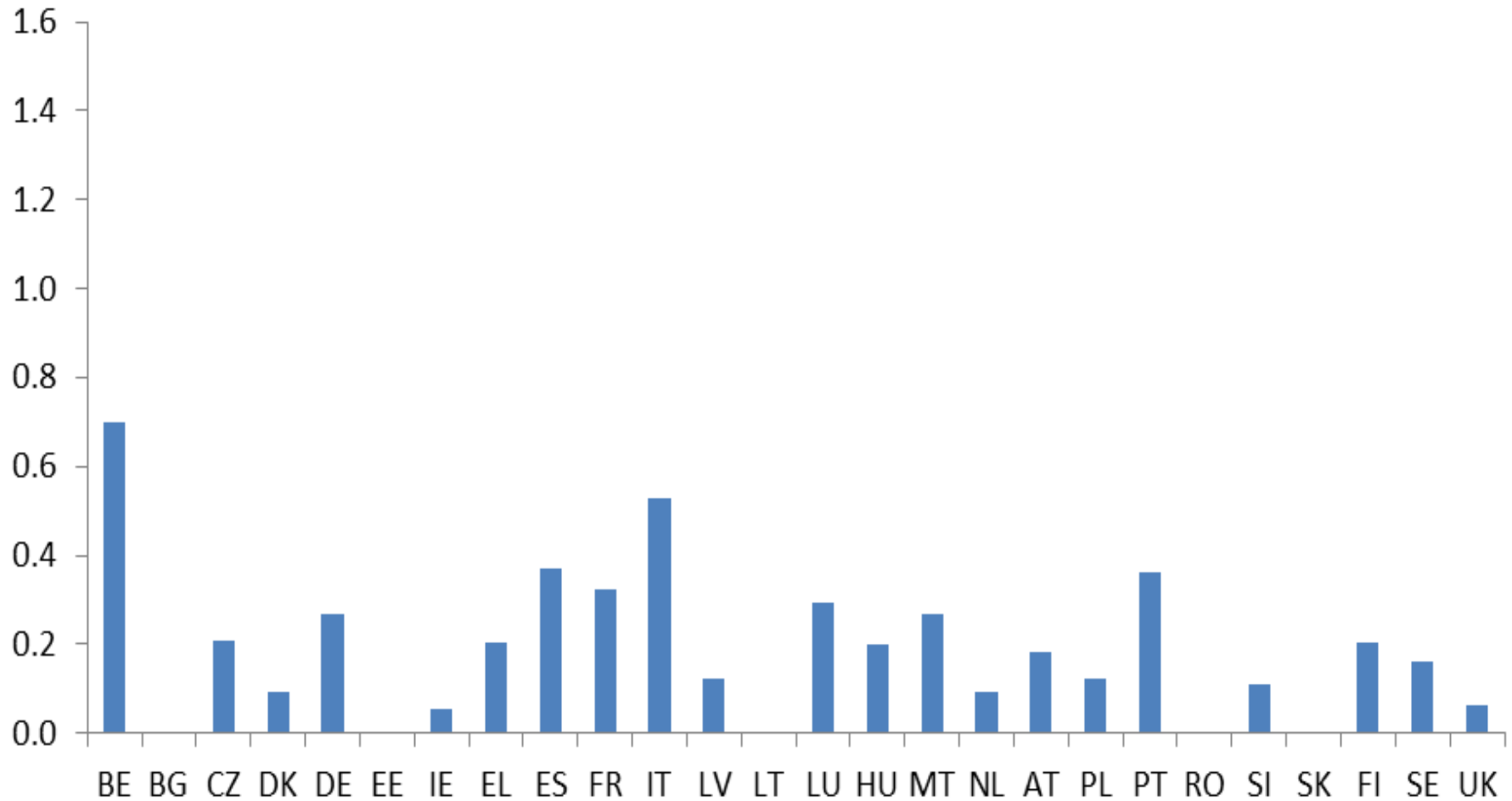
## Contribution of taxes to the user cost (in %)



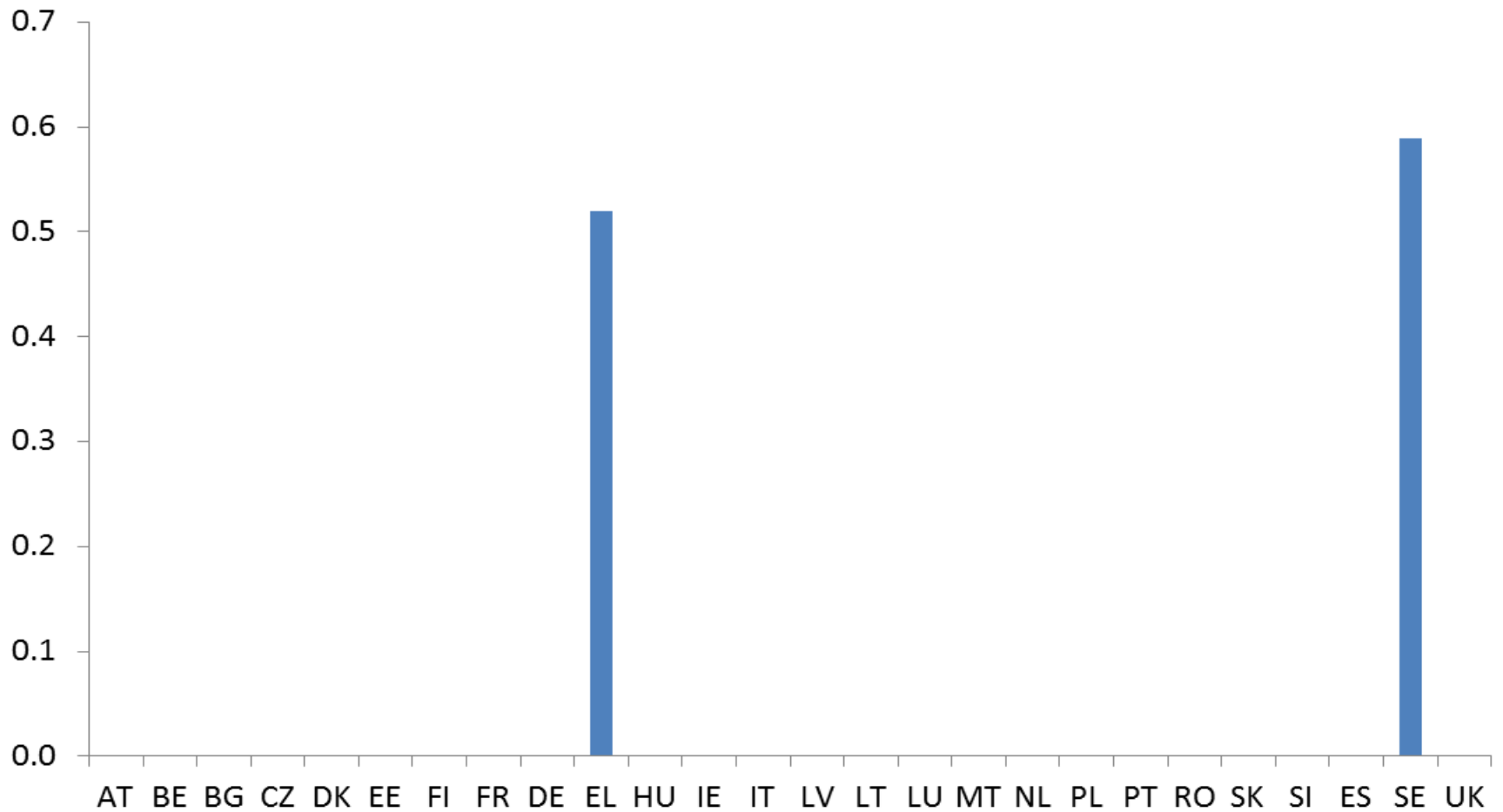
## User cost: contribution of recurrent taxes (pp)



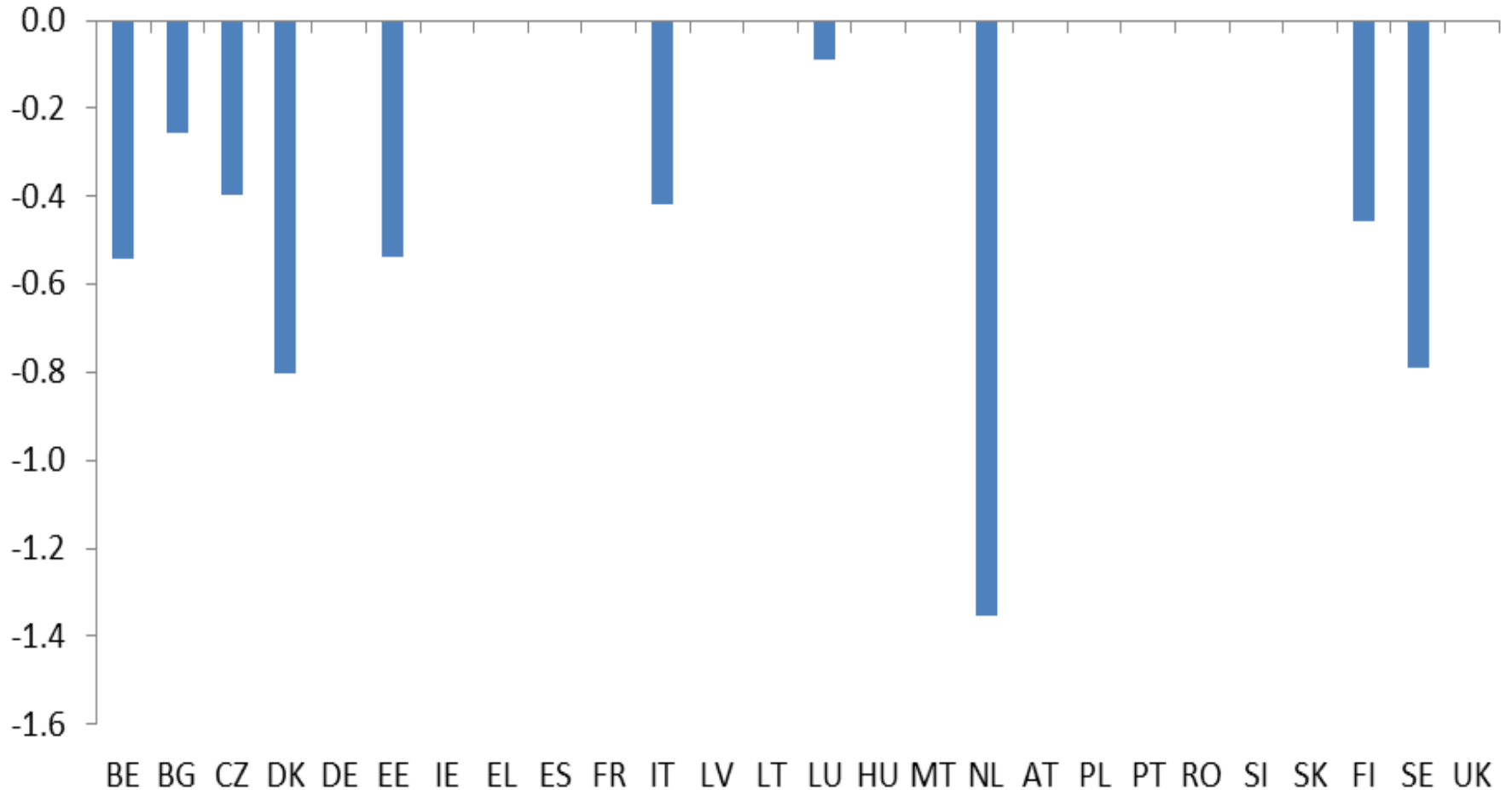
## User cost: contribution of transfer taxes (pp)



## User cost: contribution of capital gain tax (pp)



## User cost: contribution of mortgage interest tax relief (pp)



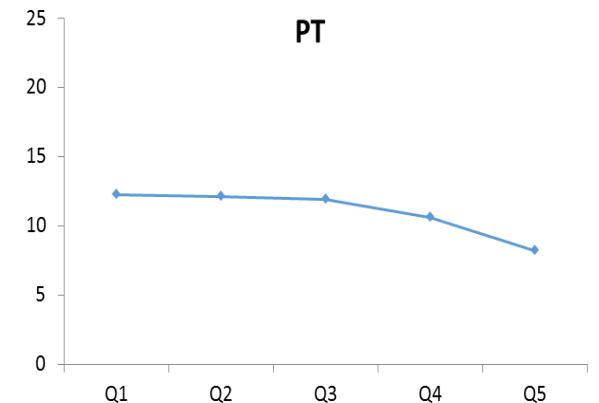
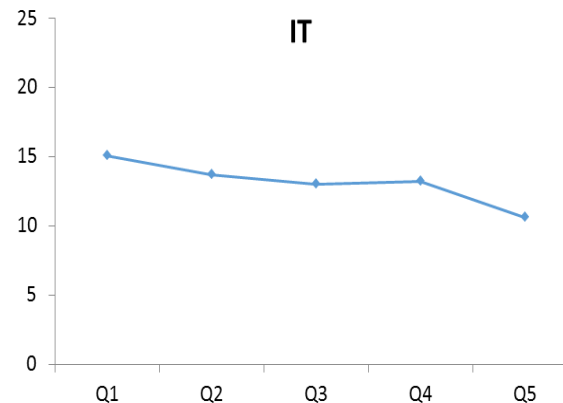
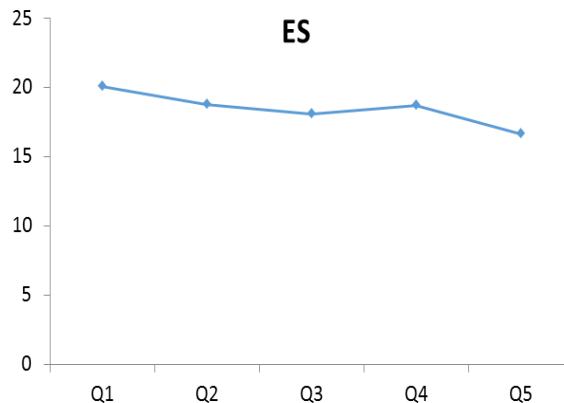
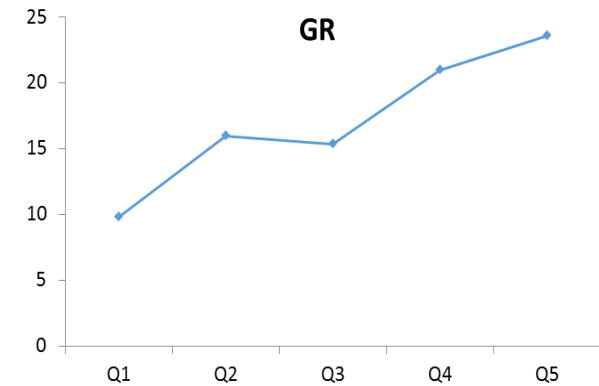
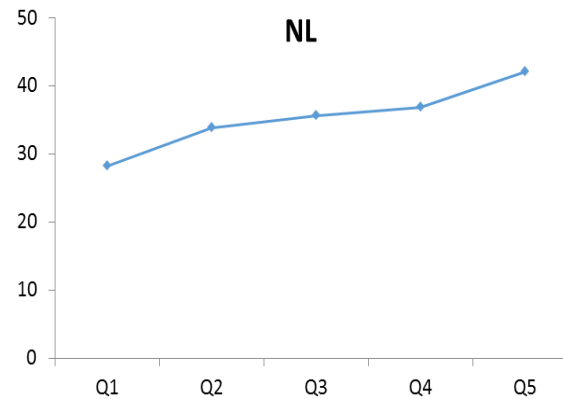
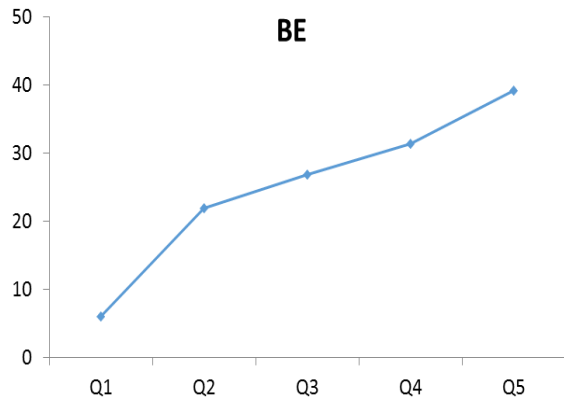
Rules on mortgage tax relief applicable to new loans as of 2014.

Source: Tax Reform Report.



## 4. Additional results: distributional impacts

### % reduction in interest rate on mortgage loans by equalised income quintiles



## Mortgage interest tax relief (% of disposable income)

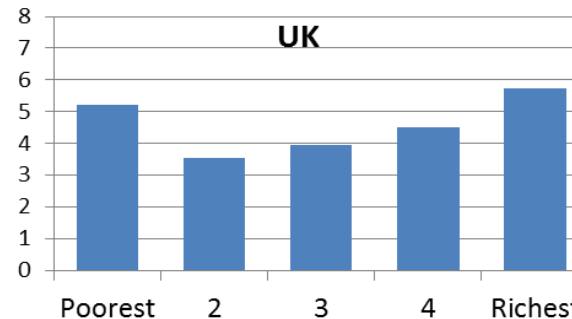
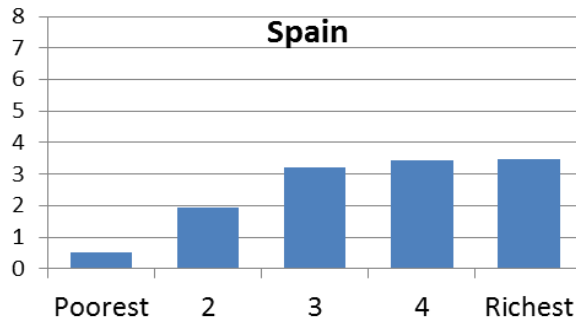
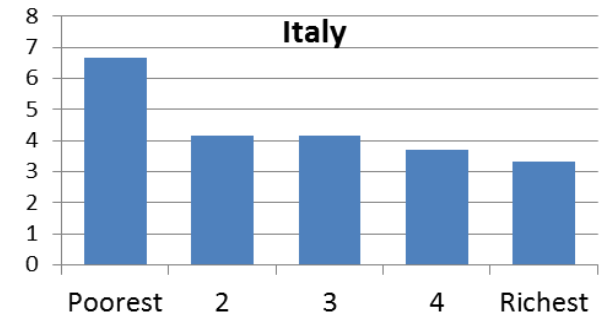
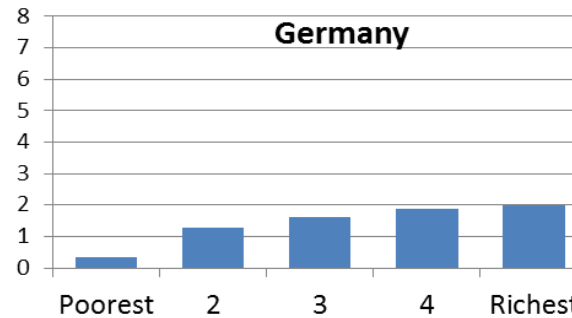
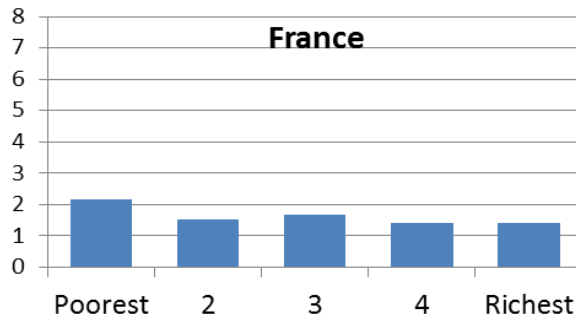
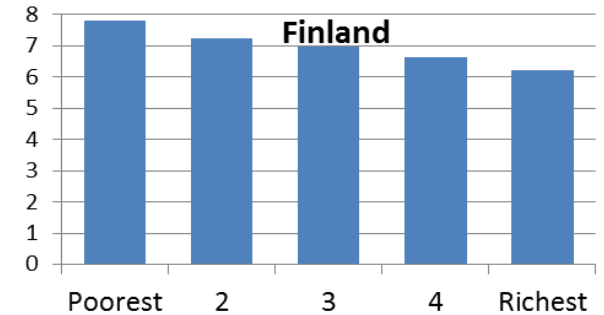
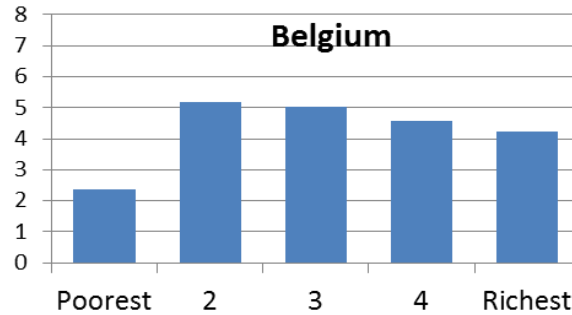
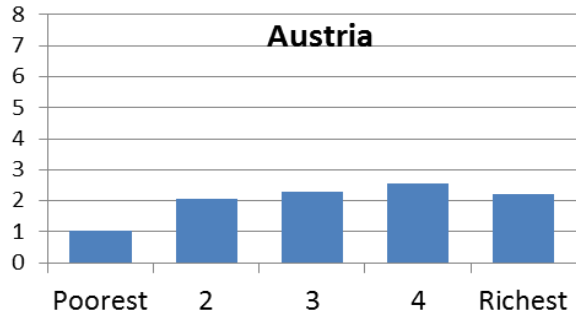
	quintile 1	quintile 2	quintile 3	quintile 4	quintile 5	Total
Belgium	0.2	0.8	1.7	2.3	2.0	1.3
Finland	0.1	0.2	0.4	0.4	0.4	0.3
France	0.0	0.1	0.1	0.3	0.3	0.2
Italy	0.1	0.2	0.2	0.3	0.2	0.2
Spain	0.0	0.2	0.6	0.9	0.9	0.5

## Recurrent tax (% of gross disposable income)

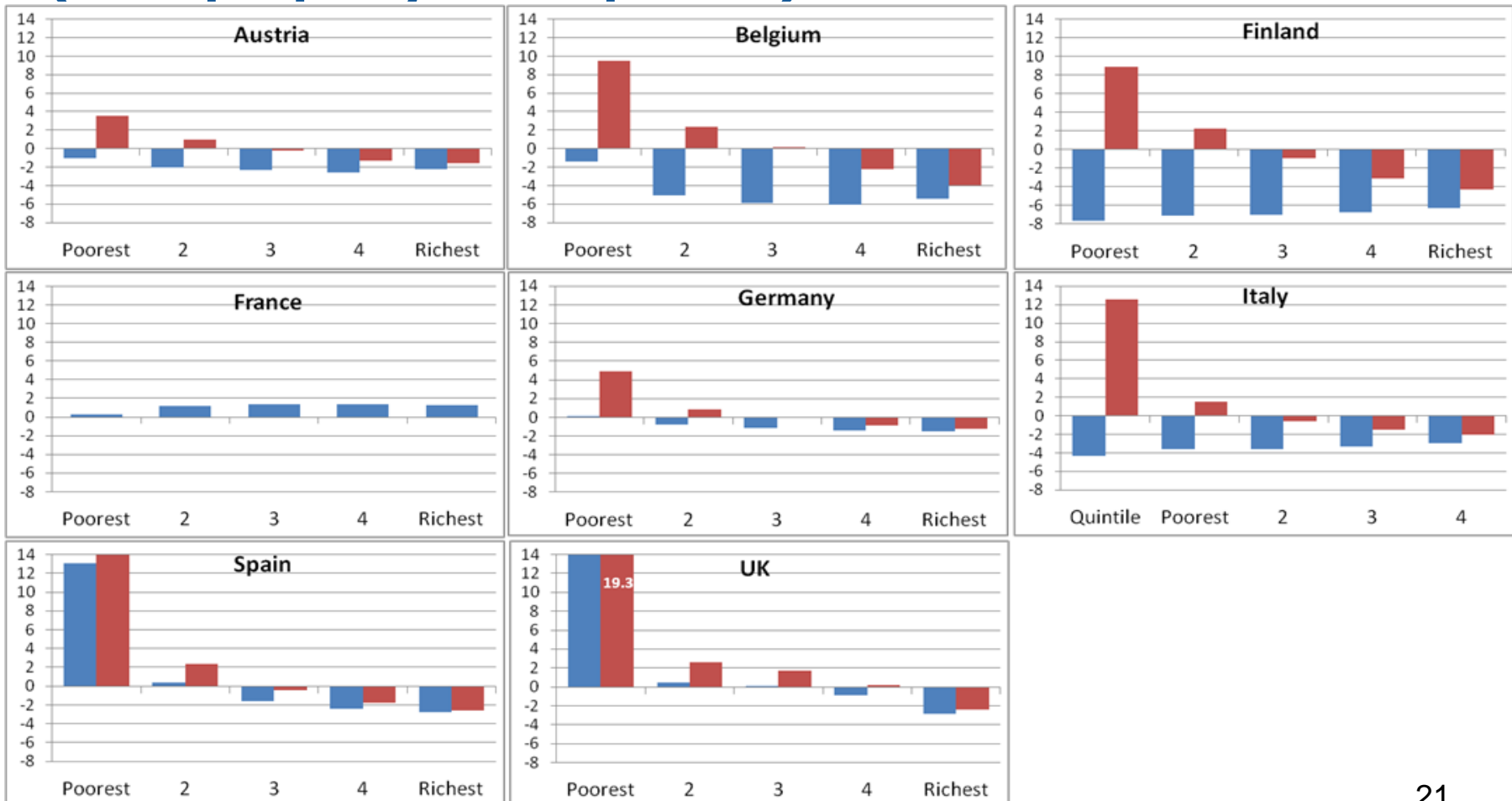
	quintile 1	quintile 2	quintile 3	quintile 4	quintile 5	Total
France	1.8	2.3	2.8	2.5	2.2	2.3
Spain	3.3	2.4	1.7	1.2	0.9	1.6
UK	6.6	3.1	2.6	1.8	1.0	2.9
Germany	0.3	0.3	0.3	0.3	0.3	0.3
Finland	0.3	0.2	0.2	0.2	0.2	0.2
Italy	1.0	0.6	0.4	0.4	0.3	0.8
Belgium	1.2	0.9	0.6	0.5	0.4	0.8

Source: Joint Research Centre of the European Commission, based on the EUROMOD model

# Imputed rent tax exemption (% of disposable income)



# Revenue-neutral counterfactual: tax net imputed rent (with property tax repealed) & income tax credit



## 5. Conclusions

- Housing taxation varies widely across the EU...
- ...but relatively low contribution to the cost of homeownership, due to tax exemption of imputed rent, relief for mortgage interest payments, low level of recurrent taxation
- All these aspects raise issues in terms of efficiency (tax neutrality) and equity (distributional impacts)
- Caveat: spillovers are important → broader economic and institutional context (housing market dynamics, macro-prudential policy, etc)