Summary for non-specialists
Occasional Papers No. 119/2012
Occasional Papers index

# Possible reforms of real estate taxation: Criteria for successful policies

By Åsa Johannesson Lindén and Christian Gayer

Taxation on housing is relevant both due to Member States' consolidation needs and the overall functioning of housing markets. Tax on residential properties, i.e. housing, has been found to be less harmful to economic growth than other taxes. It can be designed as a tax on capital investment or as a tax on the consumption service of the house. Alternatively, it can be regarded as a charge for local public service.

In most cases, residential property is regarded as an investment which should be taxed as other capital investments. The theoretical best policy implies taxation of imputed rents (the return) and allows for the deduction of the costs including mortgage interest payments. However, tax systems that allow mortgage interest deductibility risk to turn into a strong tax subsidy over time, which can lead to over-investment in housing and debt accumulation by households. A second-best policy would be to remove mortgage interest deductibility and introduce a recurrent tax on property. Such a tax can be regarded as a proxy for taxing the return on or the consumption service of the house.

It is important to regularly update the tax base according to price developments on the housing market for the recurrent tax to function properly. Distributional considerations are also important when designing the tax. The paper finally looks at the current state of play of housing taxation in the EU.