Reforming Housing Taxation

SUERF workshop on “Real estate markets – outlook, risks, scenarios, policies”
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The distribution of housing wealth
Housing is a key asset for households, in particular for the middle class.

Composition of household assets by wealth quintile, unweighted average
29 OECD countries, 2019 or latest available year

But overall housing wealth is heavily concentrated among wealthier households...

Share of owner-occupied housing and secondary real estate by wealth quintile
29 OECD countries, 2019 or latest available year

... and among older households

Mean value of owner-occupied and secondary housing assets and liabilities by age group of household head
26 OECD countries, 2019 or latest available year

Homeownership rates have declined over generations in a number of countries

Homeownership rates over the lifecycle for successive birth cohorts
Australia, Southern Europe, the United Kingdom and the United States

Housing taxes: current issues and options for reform
OECD countries levy a wide range of taxes on housing

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But housing, in particular owner-occupied housing, often benefits from preferential taxation

• Preferential tax treatment for owner-occupied housing is very common
  • e.g. capital gains tax exemptions, mortgage interest relief (and the non-taxation of imputed rents), and other tax incentives for homeownership (e.g. reduced transaction taxes for first-time buyers)

• In some countries, owner-occupied housing ends up being significantly undertaxed compared to other assets
  • Distorts the allocation of savings, tends to be regressive, and reduces revenue potential

• Highly preferential tax treatment of housing may have counter-productive effects
  • Fuelling house price growth where housing supply is relatively fixed
  • Measures to increase housing supply tend to be more effective to enhance housing affordability

• Preferential tax treatment for secondary housing is less widely available but still applies under different forms
The report identifies options to enhance the design and functioning of housing taxes:

- Reduce distortions
- Improve efficiency in the allocation of savings
- Support greater mobility
- Enhance the equity and progressivity of housing taxes
- Attenuate upward pressure on house prices
- Address tax avoidance and tax evasion
- Support energy efficiency and clean energy use
- Enhance revenue potential
Significant scope to improve the efficiency, equity and revenue potential of property taxes

**Current issues**

- Recurrent property taxes are one of the most economically efficient forms of taxation.
- Evidence suggests that property taxes tend to be regressive with respect to income, but distributional impacts will vary across countries and depending on tax design, and property taxes are likely to be more progressive relative to wealth.
- In many countries, the lack of regular property revaluations significantly reduces equity, efficiency and revenues.
- Property taxes raise potential liquidity concerns for income poor but asset-rich households.

**Reform options**

- Recurrent property taxes should be based on regularly updated market values (consider embedding the update of very outdated values in a comprehensive property tax reform).
- The use of value bands, caps and assessment limits should be avoided.
- Progressive tax rates may enhance equity, but progressivity is typically better achieved by higher levels of government.
- There is a strong case for tax deferral or payments in instalments to address liquidity issues.
Recurrent property tax revenues have not been keeping up with house price growth

Mean growth in real housing prices and mean growth in recurrent property tax revenues over time
15 OECD countries, 1995-2020

The design of transaction taxes should minimise welfare costs and not impede mobility

Current issues

- Distortions from transaction taxes will depend on direct effects on housing markets and indirect effects on labour markets.
- Transaction taxes may help curb house price growth/speculation, but empirical findings are mixed.
- There is limited evidence on the distributional effects of transaction taxes; these will depend in part on homeownership and mobility patterns, as well as tax design.
- Pro-cyclical tax revenues may create funding shortfalls in economic downturns.

Reform options

- Transaction tax rates should be reduced, particularly where they are high and as part of a package of reforms (to avoid windfall gains for current homeowners).
- Differentiated or progressive transaction taxes are options to enhance equity and reduce distortions in some segments of the housing market.
- To address significant and volatile price growth on housing markets, the use of transaction taxes should be carefully assessed against policy alternatives.
Countries could consider taxing capital gains on main residences above a threshold

Current issues

There is some justification for exempting a portion of capital gains on owner-occupied housing to encourage savings in the form of housing wealth, prevent lock-in, and simplify tax administration.

However, capital gains tax exemptions distort saving and investment decisions, represent significant foregone revenue, and may contribute to increases in house prices.

Capital gains tax exemptions for main residences disproportionately benefit higher income and wealthier households and raise geographical and intergenerational equity concerns.

Reform options

Taxing capital gains on main residences above a threshold would reduce distortions, enhance equity and raise revenues.

- Threshold can be set high to target the wealthiest households and continue exempting most homeowners.
- Reforms will need to carefully consider which gains will be subject to tax.

Taxing capital gains on secondary properties promotes neutrality among different asset classes.

Where capital gains are taxed, countries should consider taxing real rather than nominal capital gains.
Countries could limit or phase out mortgage interest relief on owner-occupied housing

Current issues

Mortgage interest relief (MIR) allows taxpayers to deduct the costs that they incur generating taxable income, but there is little justification for MIR in the absence of taxable income.

MIR is ineffective at raising homeownership, encourages household indebtedness, and represents a significant fiscal cost.

MIR provides greater benefits to high-income households, although lower-income and lower-wealth households may still benefit given high relative debt levels.

Reform options

Removing MIR for owner-occupied property would enhance efficiency, equity and revenues.

Alternatively, MIR could be scaled back in ways that reduces regressivity (e.g. restrict eligibility, cap deductions or credits).

A gradual phase-out may be needed to increase political support and prevent destabilising housing markets, and reforms should be carefully timed.

Strong case for MIR for rented properties, but limitations could be considered to reduce regressivity.
Additional recommendations

- **Tax policies encouraging homeownership** → may lead to increases in house prices when supply is inelastic

- **Tax incentives targeted at increasing affordable housing supply** → evaluate against non-tax measures

- **Tax incentives for energy efficient housing renovations** → could be better targeted to ensure that they reach low-income households

- **Recurrent taxes on vacant homes** → more research is needed to assess their effectiveness relative to alternative policies

- **Address housing tax avoidance and evasion** through a combination of measures
Contact details & further reading

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Further reading

Housing Taxation in OECD Countries (2022)
https://doi.org/10.1787/19900538

Inheritance Taxation in OECD Countries (2021)
https://doi.org/10.1787/e2879a7d-en

Taxation of Household Savings (2018)
https://doi.org/10.1787/9789264289536-en

The Role and Design of Net Wealth Taxes in the OECD (2018)
https://doi.org/10.1787/9789264290303-en