

TAXATION OF OWNER-OCCUPIED HOMES IN SWEDEN

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DANISH ECONOMIC COUNCIL, 17 AUGUST 2016



AGENDA

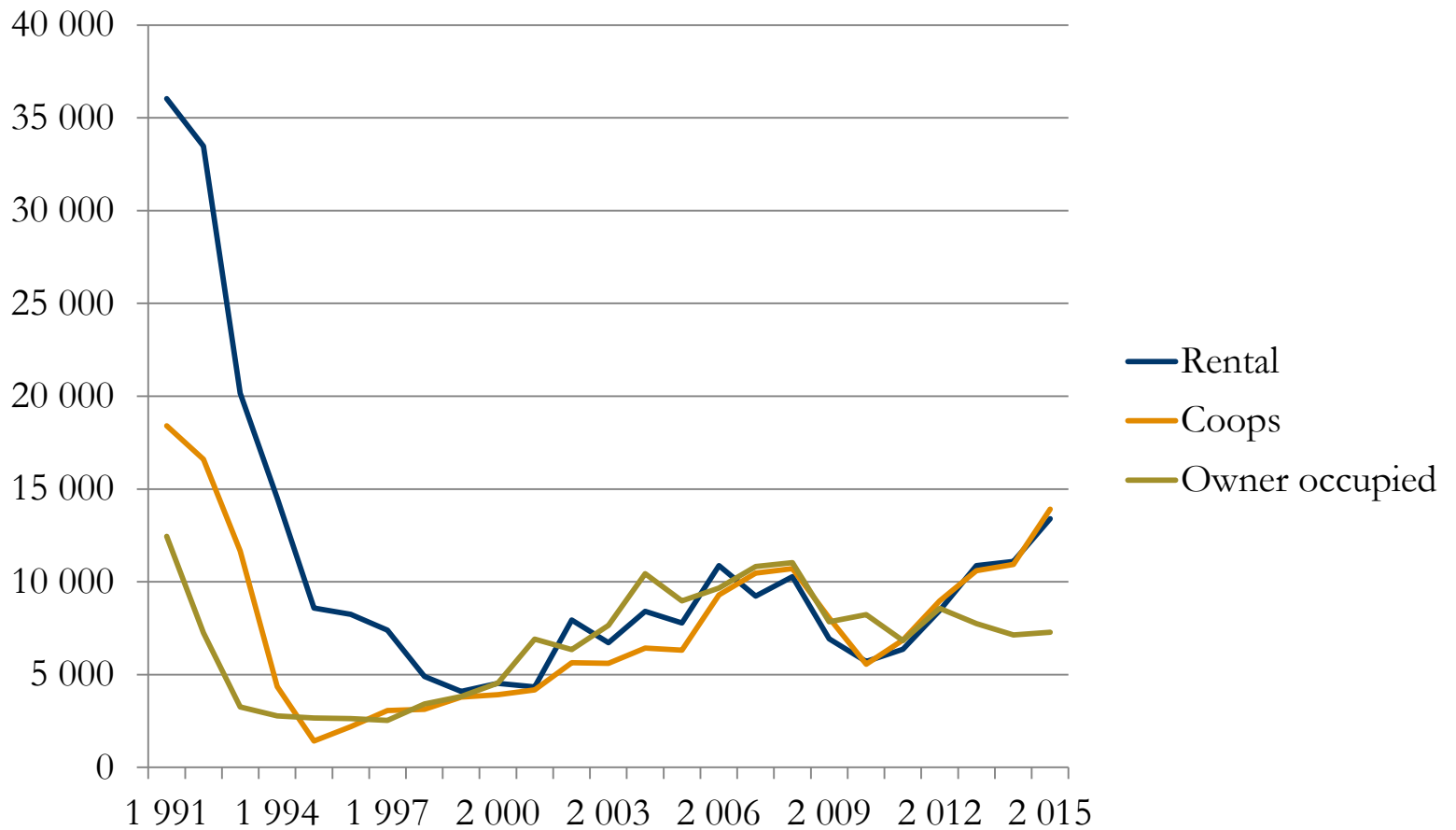
- Background
 - Swedish housing market
 - Broad features of tax system
- Impact on user cost of owner-occupied housing
- Neutrality across assets
- Issues
 - Uncertainty
 - Mobility
 - Income distribution
- Why is the property tax so impopular?



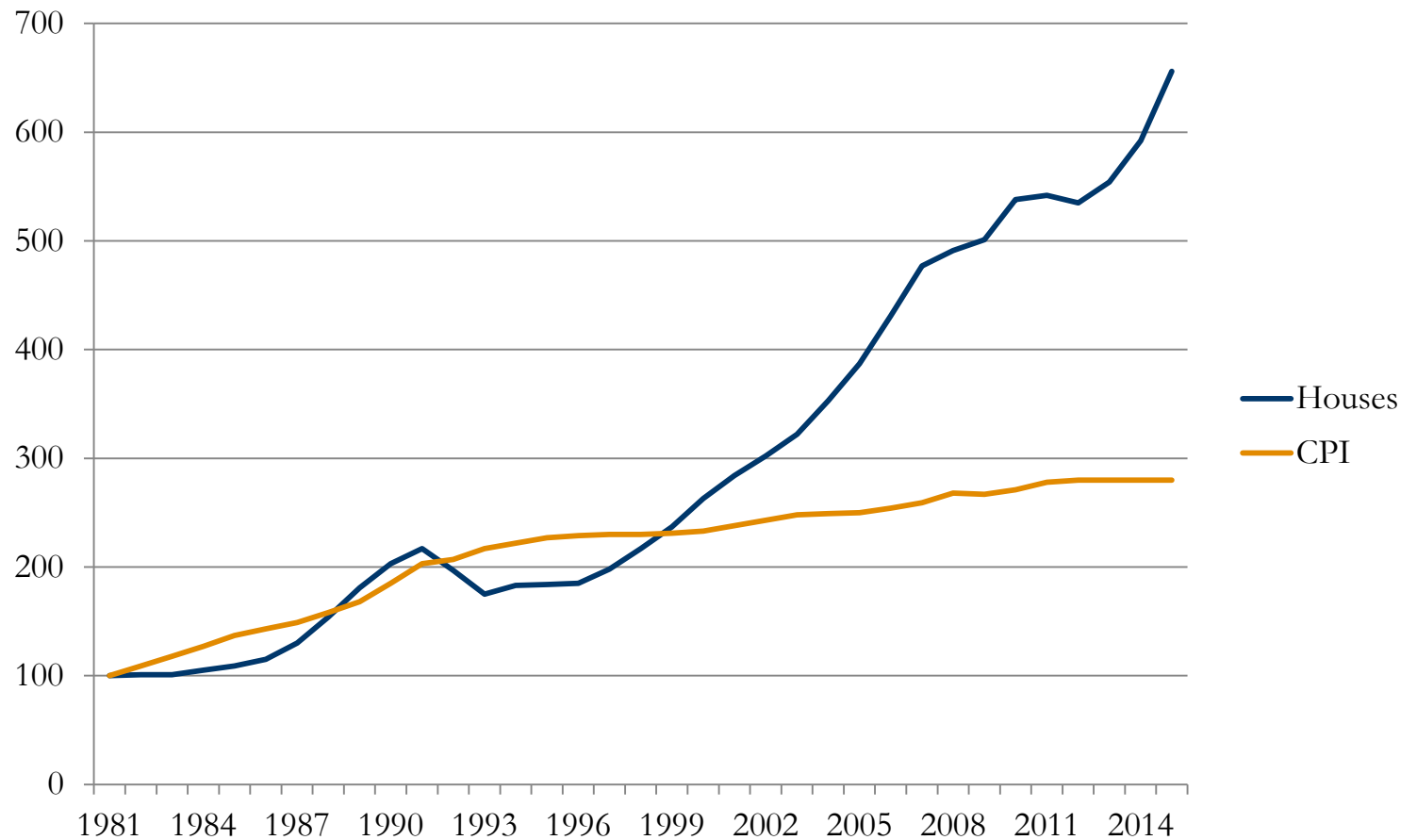
SWEDISH HOUSING MARKET

- Tenure modes, trend from renting towards owner-occupation
 - Rental apartments: 36 % of all households (41 % 1990)
 - Owner-occupied houses: 41% of all households in 2014 (42% 1990)
 - Coop shares (bostadsrätter): 23% of all (17% 1990).
- Housing shortage
 - Rent regulation – increasing queue lengths
 - Price boom
 - Insufficient new construction
 - Inefficient use of the housing stock.

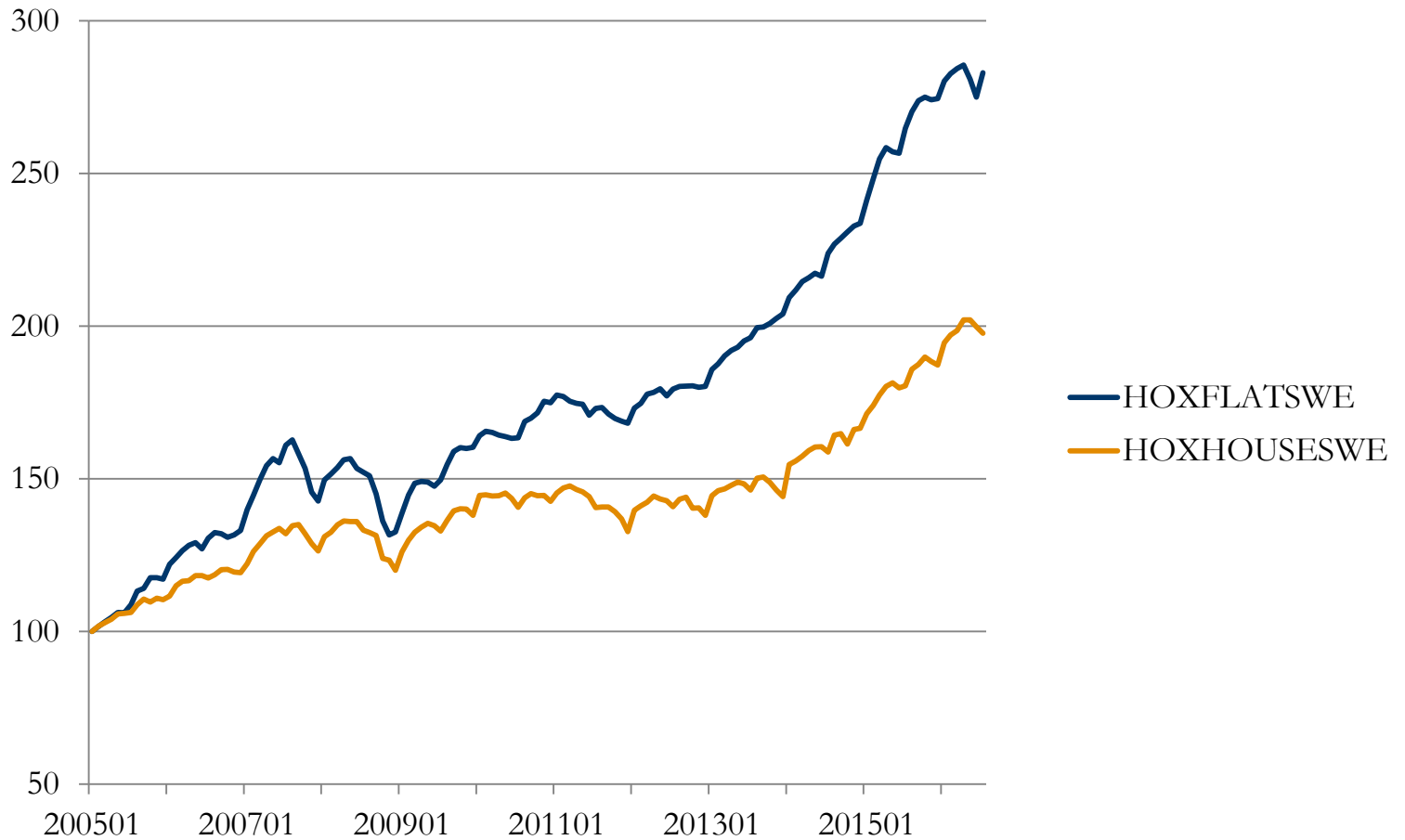
NUMBER OF NEW HOUSING UNITS, BY TENURE



PRICE INDEX, OWNER-OCCUPIED ONE-FAMILY HOUSES



PRICE INDEXES, HOUSES AND COOPS



BROAD FEATURES OF THE SWEDISH TAX SYSTEM

- Income tax
 - 1990: Comprehensive income tax. Progressive tax schedule.
 - 1991-: Dual system. Progressive scale for labor income. Flat rate on capital income with deficits deductible.
- Property tax
- VAT
- Abolished taxes
 - Wealth tax in 2007
 - Inheritance and gift tax in 2005.



REVENUE BY TAX BASE, 2013

	Billion SEK	% of revenue	% of GDP
Labor	991	60.8	26.3
Capital	173	10.6	4.6
Consumption	466	28.6	12.4
Total	1630	100	43.3

Source: Tax Statistical Yearbook of Sweden 2015

ITEMS OF CAPITAL TAXES (BILLION SEK)

	2004	2013
Property tax	24.0	31.3
Capital income	14.4	36.4
Pension fund returns	11.3	6.7
Stamp duties	7.1	8.9
Wealth tax	5.3	0
Inheritance and gift taxes	2.5	-0.2
Corporate taxes	71.5	89.0
Total	136.2	172.6

ITEMS OF CAPITAL INCOME, BILLION SEK, 2013

Interest and dividend income	+ 94.0
Interest expenses	- 98.7
Capital gains	+ 117.9
Capital losses	- 6.0
Net income	+ 106.7
<i>Net tax</i>	<i>32.9</i>
<i>Total deferred housing capital-gains</i>	<i>261.3</i>

IMPACT ON USER COST

User cost = the cost of consuming owner-occupied housing services

$$P[\theta + r(1-T) - \pi(1-\tau) + m]$$

P = price per housing unit

θ = taxes related to property value (wealth tax, property tax, stamp duties)

r = cost of capital

T = tax on capital income (interest deductions)

π = expected capital-gains

τ = effective capital-gains tax

m = maintenance and operation costs (VAT, tax concessions)

TAXES RELATED TO PROPERTY VALUE (H)

- Based on assessed values, aimed at 75% of market value.
- Property tax (reabeled property fee in 2008)
 - 1991-2007: A fixed proportion of assessed value (1-1.5%)
 - 2008-: 0.75% of assessed value up to a cap at SEK 7262, corresponding to close to median house value. Some concessions for new construction and for retired people.
- Stamp duties
 - 1.5% of transaction price, 2% of mortgage value.
- Older taxes
 - Imputed-income tax
 - 1954-66: a fixed proportion (2-3%) of assessed value added to labor income at a progressive scale.
 - 1966-90: a progressive function (2-10% at the margin) of assessed value added to labor income at a progressive scale.
 - Wealth tax
 - Until 2006: 1.5 % of net wealth above a basic deduction (3 mSEK in 2005).

CAPITAL-INCOME TAXES (T)

- – 1990: Net capital income (after full deduction of interest payments) added to labor income and taxed at a progressive rate, up to 85% until 1982 and 50% until 1990.
- 1991-: Net capital income taxed at a flat 30% rate. Interest payments fully deductible. Deficits above SEK 100,000 deductible at 21% rate.
 - From 2012 the return on financial assets held on a special account (*investeringssparkonto*) is calculated as market value times a return index (currently 1.4%).
 - Capital gains taxes (τ)
 - -1991: inflation-adjusted capital gains added to taxable income. Could be postponed if reinvested.
 - 1991-93: nominal gains taxed at 30%. No postponement
 - 1993-2007: nominal gains taxed at 15 (20)%. Could be postponed.
 - 2007-: nominal gains taxed at 22%. Can be postponed (at an interest) if reinvested in a new property.

A SIMPLE CALCULATION

$$\text{User cost} = \theta + r(1-T) - \pi(1-\tau) + m$$

θ = effective property tax rate plus wealth tax, plus effective stamp duty.

r = 10-year mortgage rate

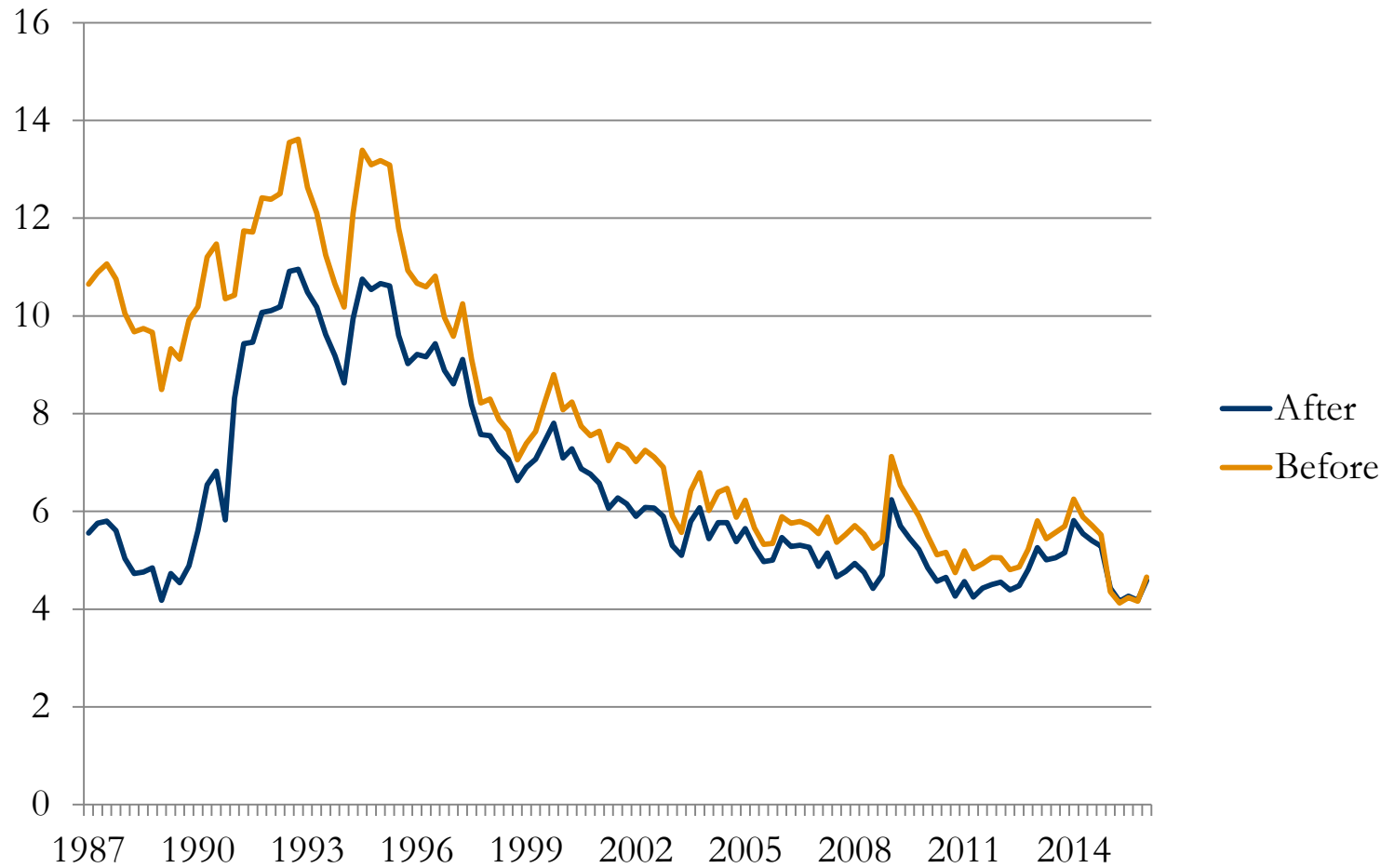
t = median marginal tax rate for the first krona of interest deduction

π = expected CPI-inflation

τ = effective capital-gains rate based on 20-year holding period

m = 3 percent.

USER COST BEFORE AND AFTER TAXES



ANOTHER PERSPECTIVE – NEUTRALITY ACROSS ASSETS

- Financial assets (investeringssparkonto)
 - Tax base = reference rate (statslåneränta) + 0,75 = 1,40 (nov 2015).
 - Tax = **0,42 % of value.**
- Owner-occupied homes
 - Property tax = max 0,75 % of assessed value = 0 - 0,5% of market value.
 - Capital-gains tax = 22 % = 0,4 % of value per year (20-year holding period, 3 % value growth, 5% discount rate)
 - Total tax = **0,4 – 0,9 % of value.**
- Debt and bank accounts
 - 30 % of actual interest
 - Current mortgage rates 1,5 – 3,5 %
 - Tax = **0,45 – 1,05 % of value.**

WHAT TAX BASE?

- The Swedish tax system mixes at least three principles
 - Taxing actual realized return (debt and bank accounts, some capital gains)
 - Taxing imputed income based on assessed asset values
 - Imputation rate fixed over time (houses)
 - Imputation rate varies with market conditions (financial assets on investeringssparkonto).
- Should expected or actual returns be taxed?
 - Should the state carry part of risk?
- Should risk premia be taxed?
- Should normal long-term return or currently expected return be taxed?

OTHER ASPECTS

- Property tax as an automatic stabilizer of house prices.
 - Should limit equity withdrawal and dampen both macro and financial instability.
- Taxing land versus buildings
 - Inelastic versus elastic supply
- Lock-in effects and mobility.
 - Realized versus accrued capital gains.
 - Add interest to implicit tax liability
- Income distribution
 - Owners versus renters, rich versus poor, young versus old..

LOCK-IN EFFECTS, A SIMPLE EXAMPLE

- Compare two 40-year housing careers
 1. Buy today. Sell after 40 years.
 2. Buy today. Sell after 20 years and buy a new house at the same price. Sell after 40 years.

Total discounted tax payments for a house that costs 1mSEK today and grows in value at 3% per year with a 5% discount rate.

1. SEK 71,000
2. SEK 112,000

REFORM DISCUSSION

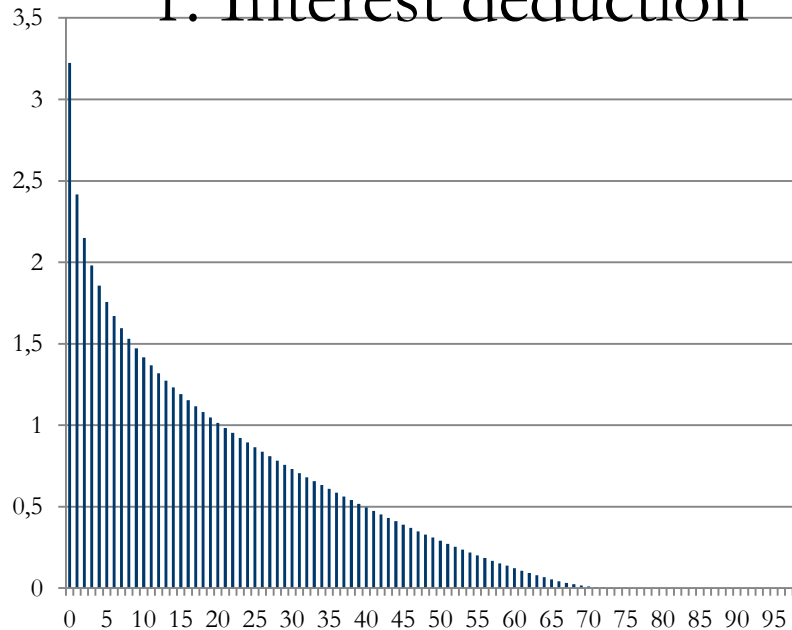
- Reasonable neutrality at today's low interest rates.
But at more normal rates?
- Lack of neutrality across houses
- Raise (neutralize) the property tax?
- Limit deductibility of interest rates?
- An integrated wealth tax?
 - The Dutch Box model.

DISTRIBUTIONAL PROFILE

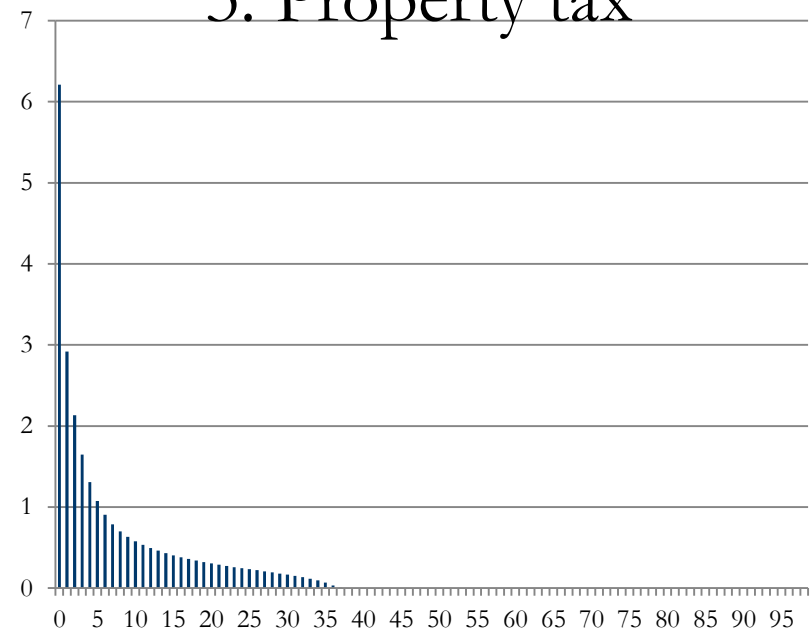
- Finanspolitiska Rådet (2016) reports simulations of impact effects of changes to interest deductions and property taxes. Three hypothetical reforms
 1. Allow only 70% of interest payments to be deducted
 2. Limit the deductibility of capital-income deficits
 3. Make property tax strictly proportional (remove cap)

PERCENTILES OF HOUSEHOLDS SORTED ACCORDING TO IMPACT ON DISPOSABLE INCOME

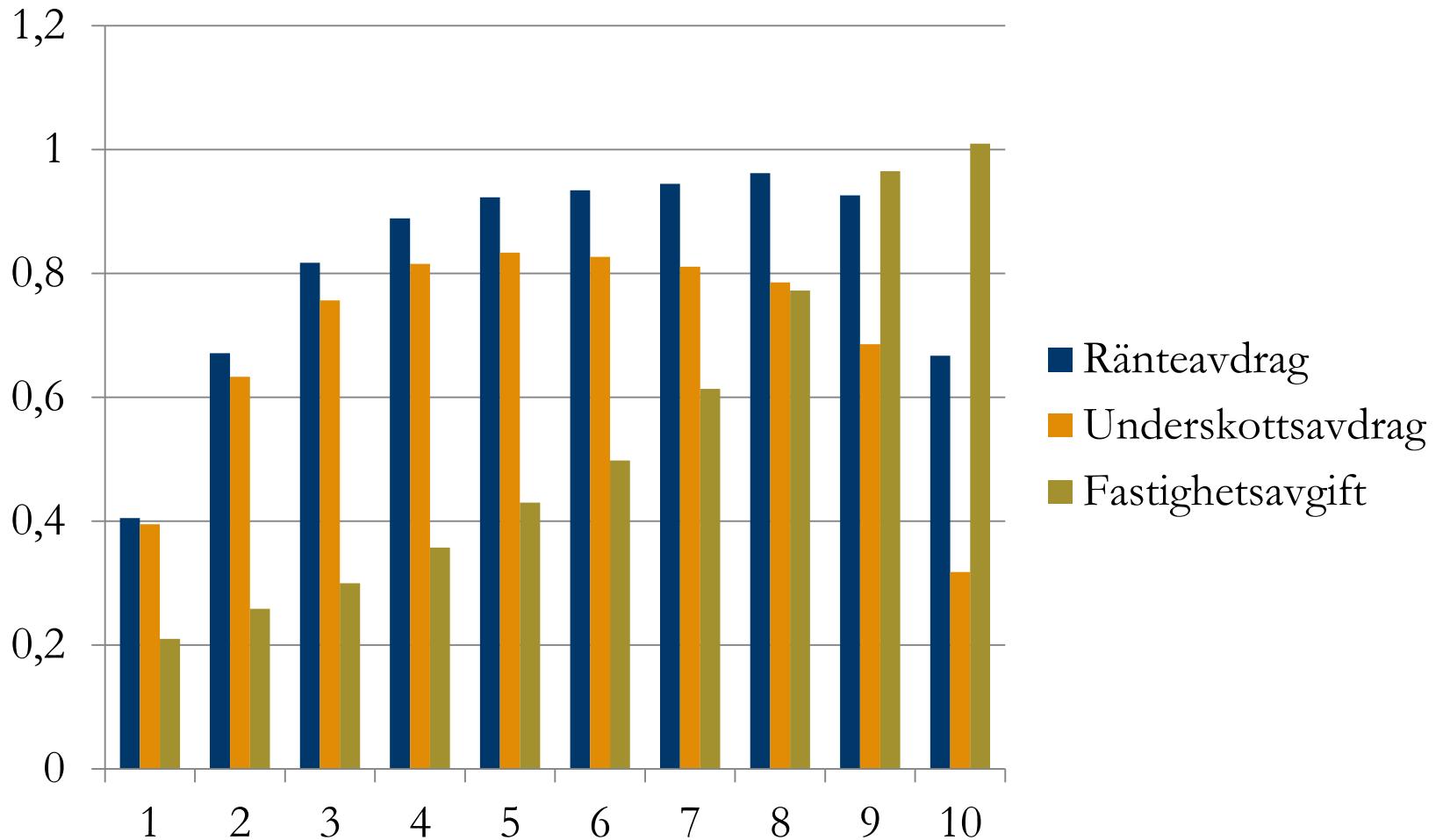
1. Interest deduction



3. Property tax



EFFECTS ACCORDING TO INCOME DECILE, FAMILIES WITH CHILDREN



CAPITALIZATION EFFECTS

- Have been documented for previous reforms
 - Elinder and Persson (2014), Mavropoulos (2016) for the 2008 property tax reform.
- The simulated reforms (Finanspolitiska Rådet) would raise user cost by at most 10%.
 - House prices should fall by max 10% depending on supply elasticity.
- A 10% capital loss corresponds to 30-40 % of yearly disposable income for an average homeowner.
 - The real impact depends on phase in the life cycle and housing career.

"Ekonomkåren älskar fastighetsskatten, men svenska folket gillar inte fastighetsskatt. Så det blir ingen fastighetsskatt”.

(Finance minister Magdalena Andersson, social democrat, January 2015).

WHY WAS (IS) THE PROPERTY TAX SO IMPOPULAR?

- "The archipelago problem"
 - Accuracy of value assessments.
 - Sensitivity to individual transaction prices when few comparable transactions.
 - Around 90 percent of all transaction prices deviate more than 30 percent from assessed value (times 1 1/3).
 - Liquidity problems.
 - Dual nature of housing as an investment and a consumption good. Higher house asset price \Leftrightarrow higher housing consumption price ("housing wealth isn't real wealth").
 - Transaction costs of substituting out of housing consumption.