Taxing the Benefit of Homeownership. Distributional Effects of Including Net Imputed Rent in Taxable Income

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From a theoretical viewpoint, including non-cash income like imputed rent in the income concept for distributional analysis is preferred to looking at cash incomes only. From this perspective, it can be argued that there are circumstances when these non-cash incomes should also be included in the tax base. Undoubtedly, one of the most important private non-cash income components is imputed rent, i.e. the benefit one derives from homeownership. Even though (net) imputed rent can be regarded as a form of income, in most cases it is not counted as such in international comparisons and, by and large, is not taxed. Treating it differently from other types of income for tax purposes may be considered undesirable: according to the ability to contribute principle, it can be argued that by including net imputed rent in the taxable income as any other income source (i.e. considering the house as an investment good) would improve the fairness of the tax system. Moreover, again from a fairness point of view, it is not obvious why the state should offer tax relief to mortgage interests payments while excluding imputed rent from the tax base.

In this paper, we consider the case of including imputed rent for homeowners, net of mortgage interest and maintenance costs, in taxable income as any other income source for a selection of five European countries (Belgium, Germany, Greece, Italy, the United Kingdom). Three scenarios are studied using the multi-country tax-benefit model EUROMOD. The first scenario looks at the inclusion of net imputed rent in taxable income for the homeowners, while at the same time abolishing any existing mortgage interest tax relief schemes and taxation of cadastral incomes. When imputed rent is included in taxable income in this way, income tax revenues rise substantially in all countries under examination. Therefore, two revenue-neutral scenarios are analysed, in which the additional tax revenue raised through taxation of net imputed rent is redistributed to the tax payers, either through a proportional rebate (scenario 2) or a lump-sum tax credit (scenario 3). These scenarios are evaluated in terms of their distributive impact, using a range of inequality measures. Our results show how including net imputed rent in the tax base reduces inequality in each of the considered countries in scenarios 1 and 3, whereas inequality is increased according to scenario 2. Our simulations provide useful insights on the likely fiscal and distributional consequences of following this possible route towards a fairer tax base definition. Further, they show how, when considering the prospects for uniform fiscal policies across the EU, cross country variation in housing market characteristics, marginal tax rates and cash income distributions across tenure types play a paramount role in shaping their fiscal and distributional effects.