Chapter 10

HOUSING TAXATION AND HOUSING POLICY

BY

RICHARD NETZER
Graduate School of Public Administration, New York University

I. INTRODUCTORY

In much of the world, the supply of housing is largely determined by private investment decisions; in some other countries, housing investment decisions are public ones in large part, but housing is offered at close to economic prices, and consumer decisions as to the disposition of consumption expenditures have a bearing on the level and composition of the housing stock. In either situation — wherever private investment and/or consumption decisions heavily influence the resolution of a country's housing 'problem' — governmental housing policy measures include not only the familiar positive financial inducements in the form of subsidies and favourable credit terms but also the negative instrument of taxes on housing.

In some Western countries, there is awareness that existing fiscal systems tax housing consumption at high rates and therefore offer a policy variable with much leverage. This is indicated by the use of tax abatement and tax exemption schemes to foster particular kinds of housing construction. However, systematic analysis of overall tax effects on housing decisions for an entire economy is infrequent. The purpose of this paper is to classify the types of tax impacts on private housing decisions to be found in developed Western countries; to present some quantification for a few cases, notably for the United States; and to make some non-quantitative judgments as to the overall effect of tax systems in various countries.

A considerable portion of the research underlying this paper was done in connection with a study of the economics of the property tax in the United States, sponsored by the Brookings Institution Programme of Studies in Government Finance.
The Economic Problems of Housing

II. NEUTRALITY AND UNNEUTRALITY OF TAXATION

Private housing decisions are, of course, affected, as are all private consumption and investment decisions, by aggregate fiscal policies. For example, under the 'balanced-budget multiplier' hypothesis, total private expenditure, including that for housing, might very well be greater if the budget is balanced at a high rather than at a low level of public expenditure. In this analysis, however, the concern is with differential tax effects on housing as such. The overall tax level may be high or low, and taxes on income, expenditure and/or wealth may be high or low without necessarily having differentially favourable or adverse effects on housing decisions.

What we seek, therefore, is evidence of lack of tax neutrality with respect to forms of private consumption and types of private investment. Since tax systems are complex and have evolved over many years, typically without real effort to secure this kind of neutrality, we should expect to find numerous unneutralities, some favouring housing and some discouraging it. The question for housing policy is the net effect of these offsetting unneutralities in taxation (other policies affecting housing provide a variety of unneutralities, but are beyond the scope of this paper).

(i) Income Tax Provisions

Among the major theoretical advantages of income taxation is its neutrality among specific types of investment and consumption decisions. Income taxes do, of course, affect the choice between income and leisure and perhaps have a bearing on willingness to accept risks, especially with graduated rates and inadequate income-averaging provisions; with graduated rates, they are likely to have some overall impact on the consumption function (consumption relative to before-tax income) as well. But in concept the income tax might be expected to be neutral with regard to housing decisions.

However, there are at least three aspects of income taxation which may produce significant unneutralities with respect to housing: the treatment of capital gains; provisions for depreciation and investment allowances; and the treatment of income and expenses connected with owner-occupied housing.

The tax treatment of capital gains is relevant here because the nature of real estate markets and the real estate investment process is

1 A major source for the information on tax provisions in Western Europe which underlies this and subsequent sections of this paper is Federation of British Industries, Taxation in Western Europe, 1964 (London, 1964).