CONDITIONS FOR ECONOMIC EQUILIBRIUM
– a tax reform for rented properties
1. Government rules for subsidies and tax should be structured so that they do not affect a household’s choice of housing in terms of form of occupation. However, there are fundamental differences offered by the different forms of occupation – rented properties, owner-occupied homes and tenant-owner properties – that considerably limit the potential of these kinds of property being treated exactly the same. On the other hand, the conditions for taxation and subsidies regulated by the government should be structured so that they ultimately result in a fair balance.

Changes to taxation and subsidy systems over the past few years have resulted in an increased imbalance in the economic conditions imposed on housing by the government. We consider that rented properties are losing out in relation to owner-occupied homes and tenant-owner properties. This can primarily be explained by the following: changes to the property tax system, grants that have been abolished for new construction and the conversion of existing rented properties, and also the introduction of a household tax deduction (ROT-avdrag) for maintenance, repair and renovation (’MRR’) work for private individuals who own their homes, while at the same time, interest deduction rights for private individuals have remained the same.

In the public debate, opinions are divided on how to compare the different forms of occupation. We have assumed the perspective that we consider to be most correct, namely flows of payment. Comparing the revenues and costs of a property company with the income and expenditure of a small owner-occupied home, or a tenant-owner property, will result in a misleading analysis. This analysis, which includes both new properties and older housing stock, compares the rent paid by tenants with the housing expenses of owner occupiers and tenant-owners.

We found that the current tax and subsidy rules contribute towards pushing up the monthly cost of living in a newly built rented property by SEK 2,000, compared with living in a newly built, privately owned detached house or in a tenant-owner property. The single biggest explanation for the difference in the tax result is the right of private individuals to deduct interest charges from taxable income. When a corresponding comparison is made with older homes, the difference in the tax result is about the same; that is, SEK 2,000. Here, the major factors behind this difference include the right to make interest deductions and changes to the property tax system.

Our analysis shows a lack of equilibrium in the economic conditions when comparing between the forms of occupation, both for newly built properties and at the management phase. For this reason, measures to improve this balance should be targeted at both the construction of new properties and existing housing stock. As these imbalances are a result of the rules and regulations governing the area of taxation, they should also be rectified by correcting these rules and regulations. The aim of these changes is to achieve long-term sustainable rules so that landlords, builders and tenants can adapt to the conditions in the belief that they will remain stable.

We propose a tax reform, including the following measures, to help achieve equilibrium:

1) Imposing low-rate VAT on housing rents.

2) Abolishing property tax on rented properties.

3) Changing tax regulations to make it easier to maintain rented residential properties.

It may take many years to introduce low-rate VAT for housing rents. In the meantime, we propose a temporary tax subsidy for rented properties and that a framework of balanced conditions is introduced for the construction of new rental properties.

2. SUMMARY

Government rules for subsidies and tax should be structured so that they do not affect a household’s choice of housing in terms of form of occupation. However, there are fundamental differences offered by the different forms of occupation – rented properties, owner-occupied homes and tenant-owner properties – that considerably limit the potential of these kinds of property being treated exactly the same. On the other hand, the conditions for taxation and subsidies regulated by the government should be structured so that they ultimately result in a fair balance.

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1. LOW-RATE VAT ON HOUSING RENTS

Under the current rules, property owners must pay VAT on basically all goods and services that they purchase for their business operations. The VAT rate for this input VAT is 25 per cent. This expense is added to the price and helps drive up both the cost of new properties and rent levels in existing stock.

We propose that VAT is imposed on all housing rents, which is well in line with the fundamental principle that value added tax should be paid by end users in the form of a percentage share of the price of the goods or service. Output VAT should correspond to the lowest VAT rate, which is six per cent.

By imposing VAT on housing rents, property owners can make a deduction for input VAT. As input VAT is higher (25%) than output VAT (6%), there will be a considerable reduction in the property owners’ operating costs. Reducing the tax burden on rented properties in this way would make it profitable to build new properties and would create potential for lower rents for both newly built properties and for the existing stock. This also means a major step towards a fairer tax system for the different forms of occupation.

However, according to the Directive issued by the European Union on the common system of value added tax, Sweden cannot make a unilateral decision to amend the tax rate for housing rents. Sweden may nevertheless work to revise the Directive in respect of this item. In our assessment, there is good potential for achieving such a change. However, it is likely that this process will take several years.

MEASURES INTRODUCED TO HELP ACHIEVE EQUILIBRIUM PENDING LOW-RATE VAT ON HOUSING RENTS

The introduction of a low-rate VAT on housing rents may provide good opportunities to help achieve equilibrium between the different forms of occupation in the future. However, just working towards an EU decision in this respect is not sufficient. Pending an opportunity to introduce VAT on housing rents, it is important that measures are taken as soon as possible to achieve conditions for economic equilibrium. Consequently, this should involve rented properties also becoming eligible for maintenance, repair and renovation grants, and balanced conditions for new construction work. This is important, not least in light of the growing demand for rental housing, which is expected to increase in pace with the improving economy. These measures may require the approval of the European Commission under the Union’s State Aid Rules.

Rented properties also eligible for household tax deduction (ROT-avdrag)

The household tax rebate (ROT-avdrag) introduced last year enables home owners and tenant-owners to deduct half of the cost of repair, renovation and extension work carried out at their homes. The structure of this support disfavours those living in rented properties and there is a clear imbalance.

We propose that this form of support is extended to cover corresponding work at rented properties as well. A tax rebate of 50 per cent of the expenses for work relating to the residential parts of the property should be offered to the landlord, though no more than SEK 50,000 per residential unit and year. The support should be directed at both rented flats and houses, but only properties more than five years old.

In order to benefit everyone equally, it should be possible to provide the support even if a business does not pay any income tax or only pays a low property tax from which to deduct the support. In these cases, the support can be provided as a negative tax (disbursement) or saved to be used for tax assessments in later years. Indeed, it is often companies with poor results and proportionately low property tax that are in the greatest need of support to cover renovation needs.

Naturally, housing associations should also be entitled to the ROT-avdrag, not just tenant-owners.

Balanced conditions for the construction of new housing

A newly built rented property is currently SEK 2,000 more expensive to live in than an owner-occupied home, which is largely due to the tax subsidy available to those who own their own homes. This subsidy corresponds to 30 per cent of one’s interest expenses. This imbalance means that it is not feasible to build rental properties at the levels of rent in demand by broader groups. Consequently, far too few rental properties are currently being built. When constructing new housing, conditions for economic equilibrium are a prerequisite if new rental properties are to be built. Political decisions are required on measures to create this necessary equilibrium.
MEASURES MAKING IT EASIER TO MAINTAIN RENTED PROPERTIES

2. NO PROPERTY TAX ON RENTED PROPERTIES

Property tax (a municipal property charge) is currently imposed on properties that are rented out. These rented properties are consequently subject to double taxation. By this we mean that the landlord not only has to pay tax on any operating profits made, but also for actually owning the properties. It stands to reason that any profits should be taxed, but not that ‘means of production’ are also taxed. Nor is this found in other areas of business. The consequence of double taxation is that the economic conditions for rented properties are worse than compared with other forms of occupation.

Several government inquiries have drawn attention to this problem. The latest major parliamentary inquiry to deal with this matter (the Property Tax Committee) proposed that property tax should be replaced with a standard notional income for private dwellings (privately owned and tenant-owner properties) and that property tax on commercial properties (business tenancies) should be abolished, as commercial operations are already subject to conventional taxation. The National Budget also shows the property tax on commercial properties as a tax sanction; that is, an ‘excessive levy’ of tax.

We therefore propose that property tax is abolished for rented properties.

3. Tax-exempt maintenance reserve funds

Residential buildings are meant to be used for several generations and therefore require maintenance work and reinvestment a number of times during the life of the buildings. This means that costs vary greatly over the years, while rent levels should be kept relatively constant. Homeowners and tenant-owners’ associations can even out these costs by saving for future maintenance work without any tax consequences. However, all reserves for future maintenance work for rented properties are taxed at 26.3 per cent. This makes it difficult for landlords to distribute these costs in the rent over a period of time, which results in the cost of wear and tear being rolled over to future tenants.

One possible solution to this problem is to enable property undertakings to make annual provisions in a reserve fund for future maintenance work for properties in the same way provisions can currently be made; for example, to a tax allocation reserve. The maintenance reserve fund would then be subject to taxation when maintenance work is performed. In this way, costs and revenues are matched and the company’s savings for future maintenance work are not undermined, as the provision for savings is not taxed.

Deductions for depreciation adapted to reality

Another way of creating resources for future maintenance work is to adapt the possible fiscal deduction for depreciation to a building’s real economic life. The economic life for buildings and their components is currently considered to be between 25 and 40 years. However, the Swedish Tax Agency advocates in its General Advice a maximum deduction for depreciation of two per cent for rented properties, corresponding to depreciation over a period of 50 years. In other words, theory and practice do not correspond at all. As the deduction for depreciation is determined considering the economic life of a building (Chapter 19, Section 5 of the Income Tax Act), the General Advice provided by the Tax Agency should be amended accordingly.