

# 8% Residential Tax for Renters and Homeowners

## Rental Value 2.0 - Eigenmietwert 2.0

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### International foreword

The present taxation for homeowners in Switzerland is referred to as “Eigenmietwertbesteuerung”, in English rental value taxation. Because of the many disadvantages, this tax model is discussed repeatedly. However, one advantage is the solidarity between renters and homeowners. Under similar conditions a rented and an owned apartment generate similar tax revenues. The homeowners pay a higher income tax and the renters pay a higher rent. With this higher rent, the landlord pays the tax.

The Economic Commission of the Council of States (Ständerat) launched in February 2017 an initiative to repeal the rental value taxation. The more conservative leaning Parliament aims at a tax exemption for homeowners. Such a decision would result in a disparity as rental housing would then continue to generate taxes while residential property would be exempt. In addition to this tax privilege, the group of homeowners would profit from subsidies (Swiss Constitution, Art. 127-2, promotion of home ownership).

The 8% residential tax is a new approach. Instead of taxing the income side, the residential consumption would be taxed. The tax model aims for an equal treatment of renters and homeowners, as well as for an equal treatment of all kinds of landlords (natural persons or companies). 8% corresponds to one monthly rent per year. This tax rate can be considered as modest. When this tax is paid by everyone, cantons and municipalities can count on an important and steady revenue stream.

For me, several points are motivating for this political project: prevention of an increasing wealth divide, moderate tax rates, transparency against tax optimization, development of the municipalities and limiting private debt. Because of privileges for mortgages, Switzerland is world champion in private debt. And what about rental value 2.0? With this term I'd like to motivate the politicians in Switzerland to review the option of applying the unpopular rental value in an innovative way.

# 1 Introduction

Currently, the renovation of home ownership taxation in Switzerland is ongoing. This reform requires our creativity, because the new tax law should be equitable. For decades no majority decision could be found for a new tax model.

The Economic Commission of the Council of States as well as the Economic Commission of the National Council have adopted the initiative 17.400. (Council of States on 2 February 2017, National Council on 16 August 2017). The proposition requires among other items, the abolition of the rental value taxation on the principal residence and the avoidance of unequal treatment of renters and home owners. In addition, the tax reform must be household neutral, meaning the tax revenues of municipalities and cantons must remain roughly unchanged.

Economically speaking, three aspects of residential property may be taxed: assets, income and consumption. This applies to rental apartments as well as to homes.

Property tax on real estate is undisputed. On the other hand, rental value taxation is extremely unpopular. It leads to an additional tax burden on homeowners. In the case of rental value taxation, the rental value is added to the income, while residential consumption is tax exempt. The residential tax in the proposed concept would reverse this. The income side is tax exempt, but there is a flat tax of 8% for the residential consumption. In the future, instead of taxing the residential income, the residential consumption would be taxed.

The main objectives of the residential tax are:

- 1. Residential consumption is taxed at a similar rate as any other consumption;**
- 2. Comparable taxes for renters and home owners; and**
- 3. Unchanged and steady tax revenues for municipalities and cantons.**

In addition, the administrative burden is to be minimized and the number of tax loopholes reduced.

For many years, several parties are promising to abolish the rental value. They are very successful with this propaganda. But would such a tax exemption make sense for independent houses? Such houses cause high infrastructure costs for the local municipality. Homeowners should share proportionally in these costs corresponding to the principle of causality.

# 2 Definitions

Rental value taxation  For the history of the rental value taxation and its disadvantages see:	Present tax model in which the rental value is added to the taxable income. On the other hand, debt interest and maintenance costs may be deducted from the income.
Rental value (60%)	This estimated value corresponds to about 60% of a comparable rent. This is the basis for the taxation of homeowners in Switzerland.

Comparable rent (or imputed rent)	Amount to be paid annually for a comparable apartment or house. This includes type, size, equipment, location, energy consumption, etc.
principle of causality	Costs are distributed proportionally based on the principle of who causes more costs, must pay more.
Homeowner	A person who lives in his own apartment or in his own house.
promotion of home ownership	State support in accordance with the Federal Constitution, Article 108, paragraph 1. This is used primarily when high mortgage interest rates halt new construction.
residential consumption	At 36% this usually is the largest item in a household budget. It includes housing, energy and maintenance of the house.

### 3 Concept of residential tax

Rental incomes and rental values (at least 60% of the comparable rent) are taxed with 8% (=flat tax). One half of the taxes are paid to the canton and one half to the municipality. The municipality can cover part of the costs related to residential consumption. (Development, costs of infrastructure, general administrative expenses, etc.)

Rents and rental values remain on the present level. The residential tax does not affect the additional costs of renting. Companies and landlords do not pay any additional taxes on the profit of rental income. Companies have to run separate accounting for the rental of apartments.

Long term sub-letting of the primary residence, e.g. longer than three months, is tax exempt. In this case, the income from the sub-letting may not exceed 50% of the rent or the rental value.

The rental value can be declared or updated online. Example: an overestimation of an old property may be easily corrected.

A flat tax has the big advantage that entrepreneurial individuals and complex, tax-optimized companies tax their rental incomes in the same way!

### 4 Residential Consumption

Consumption has many characteristics. There are people who have to contend with minimal housing and are exposed to pollutants and noise. Others can afford to leave magnificent properties vacant. The proposed concept of residential tax doesn't criticize this situation nor does it contain a progression in the sense of a luxury tax.

Residential consumption is primarily taxable because it causes secondary costs for the municipality and for the canton. A tax on residential consumption also creates incentives to deal sparingly with the limited resources of land zoned for building.

Residential consumption largely reflects the wealth of a household. For this reason it is suitable as a basis for taxes, similar to VAT.

Residential consumption is difficult to measure. The two best indicators until now are the rent for rental apartments and the rental value for residential property. These indicators are applicable to the principal residence and the second home. A distinction is superfluous, which simplifies the tax system.

## **5 Declaration of Rental Value**

The homeowner declares his rental value online. He can also order this service from a specialist. The administration checks the plausibility of the updated rental value. When a property is sold, it may turn out that the rental value was based on wrong data. This has the consequence of additional taxes or even penalties.

When the rental value is declared, also the location is recorded. The corresponding estimation should roughly correspond to the assessments of rental and real estate offers at the same location. In the long term, it is also possible to classify all locations within a municipality.

Is the rental value suitable to detect exorbitant rents? This would be the case when a rent is more than 1.5 times the rental value (100%).

## **6 Reasoning and Considerations**

The flat tax on residential consumption is similar to the VAT: the larger the consumption, the higher the tax. Because residential consumption is in part proportional to the follow-up costs of the municipality, the residential tax corresponds to the principle of causality. Based on unchanged budgets in the canton and the municipalities, the residential tax helps to keep the level of income tax low. As a result, the residential tax ensures that this tax reform does not result in higher taxes on wages.

The uniform tax rate makes it possible to simplify and automate tax payments. The high transparency reduces tax loopholes to a minimum. This allows a considerable level of revenues with a moderate tax rate. Many homeowners with low mortgages would pay half of their current tax rate.

When there is a tax exemption for sub-letting of one's own primary residence this encourages better use of vacant rooms. An example would be when a pensioner rents a part of his property. There would be two winners: the pensioner due to the additional income, the sub-renter due to the affordable housing.

## **7 Poverty among the Elderly**

Poverty among the elderly can impact renters as well as homeowners. No tax model will prevent this; however, the residential tax increases the availability of funds for social assistance. About one-third of the residential tax will come from (non-tax exempted) homeowners.

Some retired homeowners lack the means to renovate their property. As a result, they are confronted with high costs for heating and repairs. With self-declaration, it would then be possible to reduce an overvalued estimation, in particular for older homes. A tax rate of 8% is for most pensioners acceptable or rather low.

## **8 Cantonal Sovereignty**

Residential Tax: levy and use of tax revenues are within the cantonal responsibility. The cantons determine the level of the rental value. As it was the case until now, this level should be within the limits of 60 and 100% of the comparable rent.

In order to be able to exchange tax data within and between the cantons, all cantons should adhere to a uniform data structure. This requirement is already in place today.

Additional computer applications are required for the levy and the self-declaration of the rental value. It would be most efficient if the cantons would procure this programming centrally in a coordinated manner.

## **9 Analogies between Renters and Homeowners**

In the current tax system (rental value taxation) the renters and homeowners are treated in a similar manner. Here are some examples:

- The construction and maintenance of rental apartments and houses create a similar number of jobs. In both cases VAT is paid.
- If a private landlord has two identical apartments and he lives in one and rents the other one, then similar tax rates would apply for both apartments.
- The residential consumption of renters and homeowners in comparable apartments has approximately the same secondary costs for the municipality.
- Both renters and homeowners are exposed to the same lever of immissions due to their residential consumption: noise, soot, tire wear, stench, etc.

Of course, there are also large differences: renters carry significantly fewer (financial) risks and can delegate many problems to the landlord, e.g. repairs.

## 10 Draft of an Initiative Text

Rental income and rental value (60 to 100% of the comparable rent) are subject to a flat tax which may not exceed the VAT. If a rental value is well below the comparable rent, the rental value is used for taxation. The Federal Council may determine exceptions, e.g. for pension funds.

The tax revenue is distributed 50% to the local municipality and 50% to the canton.

### **Two popular initiatives (referendum, initiated by the voters)**

An initiative could demand a residential tax for home ownership. Another initiative could be to promote a residential tax on rental apartments.

## 11 Challenges

The different taxation of rental apartments and leased commercial premises may be seen as a contradiction to the principle of equal treatment. However, it is questionable how much weight one wants to attribute to this perspective of some investors.

If housing and business premises are partially overlapping, taxation is challenging because different tax models are applied.

Companies operating in several sectors would need to differentiate the treatment of the rental income. Rental apartments would have their own annual report.

Rental income from abroad is not affected by the residential tax.

If mortgage rates increase to > 10%, Parliament may feel the need to reintroduce the tax deduction for mortgage rates. In this case, the residential tax is of minor importance. With a 50% mortgage debt, the residential tax is significantly less than 1% mortgage rate.

The impact of the residential consumption on the municipal budgets is not well known. The correlation is to be investigated.

For the collection of the residential tax by a service provider, it could be referred to as a residential fee, infrastructure fee or similar.

## 12 Application of Residential Tax

The residential tax is to apply to all self-owned residential property, that means houses and condominiums. A distinction between principal and second home residence is not necessary. The residential tax is also suitable for housing cooperatives.

When apartments are rented by companies, the residential tax is likely to be largely neutral for the public administration compared to current taxes. That means that companies already today pay about 8% of their rental income on average.

The residential tax could also be suitable for privately rental apartments. Whether or not the flat tax is neutral for the public administration it would need to be investigated. If the residential tax were to be applied here, the rent would be reduced in cases where the profit was disproportionately high.

In order to determine which areas the residential tax would apply, further clarification of today's tax revenues would be needed.