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Home Tax Allowance for Younger People

SUMMARY: With regard to home ownership and mortgage lending in Western Europe in general three models are referred to; the main criterion for classification of the types is who the home is owned by and how great a role mortgage lending plays. In Hungary the higher than 90 per cent rate of homes inhabited by owners represents one of the extremes of the resident-owner model. The problem of this model is that if the costs of home acquisition have not been incorporated into wages, then newcomers can be excluded. Borrowing, on the other hand, can burden residents for decades. It is difficult to move out of settlements characterised by lower home prices. The problems in Hungary would be alleviated if the proportion of social tenement flats and market rental homes were to increase by 5–10 percentage points each. The potential number of those seeking market tenement flats is up to 8–10 per cent of the population. A portion of the potential landlords are deterred by the taxation and uncertain regulatory environment. Housing subsidies must be concentrated on those younger than 38–39 years of age, as they were unable to partake in the previous allowances. Among them the proportion of people living in their own home is much lower, and only half of young people have received a family subsidy toward the purchase of a home. In personal taxation a tax refund should be given, for which only younger people (born after 1972) could be eligible. The amount thereof should be limited depending on how many children they have, whether they owned a home in 2010, and whether there was a lien on it. The (proposed) targeted use of the tax allowance: home purchase (construction), the repayment of housing loans, and home rental.

KEYWORDS: home ownership, mortgage lending, tax allowance

JEL CODE: H 24, R 31, R38

As the result of housing privatisation, a Hungarian housing model was wittingly-unwittingly created. In it owner-occupied housing receives an almost exclusive (higher than 90 per cent) role. Twelve to fourteen years after the mass housing privatisations – in addition to the undeniable benefits – the issue of what problems such a housing model is not capable of solving must be faced.

HOUSING MODELS

With regard to home ownership and mortgage lending in Western Europe in general three, and in some cases four, models are referred to. The main criterion for classification of the types is

who the home is owned by and how great a role mortgage lending plays. The liberal housing market model differs the most markedly from the others (e.g. Great Britain). The lending freedom of the banks here is less restricted, as a result of which it is relatively easy to get a mortgage; the amount of cash required for home purchase is low and the loan terms are long. The conservative or family-type model is characterised by a high proportion of resident owners (see Mediterranean countries and Ireland). The rate of both social and market-based home rental is low. In the case of mortgage loans the required down payment is relatively high and the maturity is shorter. Due to the above, the role of family assistance is important – both in raising the cash necessary

when purchasing a home and in the home construction work.

In the third, more balanced model the role of the state is higher. This, above all, is reflected in the higher proportion of social tenement flats; but the conditions of mortgage lending are also more strongly regulated by the state. Two subtypes of the model can be distinguished. In one of them the banks themselves provide credit in such a way that the credit remains with them later (e.g. Germany). In the other case the weight of mortgage loans is greater as the issuance of mortgage bonds is allowed (e.g. Denmark). By doing so the banks practically “are able to transfer” their loans to the purchasers of mortgage bonds and provide new loans from their funds freed up in this manner. There are some who consider the two subtypes two separate types ¹ (see *Tables 1 and 2*).

In many countries in the Eastern half of Europe the privatisation of the previous state tenement flats brought marked change in the 1990’s. Where it was widespread, today the proportion of resident owners (the Baltic countries, Slovakia, Slovenia, Romania, Bulgaria and Hungary) exceeds even that of

Southern Europe. Where the proportion of privatisation was smaller, the proportion of resident owners is only 50–60 per cent (Czech Republic and Poland). In my article I examine the problems of the resident-owner model characteristic of Hungary.

Practice shows that the resident-owner model is not without problems.

▶ Residents assisted by credit and subsidies are often burdened for decades by the new home acquisition. Therefore, not enough attention is paid to the fact that every 20–25 years every building would need to undergo a major renovation. In family homes and maximum 3–4 flat condominiums owners spend relatively significant amounts for this purpose. However, the greater the number of residents, the harder it is to persuade everyone to, on the one hand, to reach into their wallets, and, on the other hand, to undertake the inconveniences associated with block renovation. As a result, the houses prematurely deteriorate and the quarters turn into slums.

The property of the affected owners depreciates, which brings with it the market solution acclaimed

Table 1

HOUSING MODELS

	Rate of resident owners, %	Typical loan/home value, 2002, %	Typical length of home loans (year) 2002	Mortgage loans/GDP, 2004, %
Southern European model				
Italy	69	55	10–15	15
Spain	88	70	15–20	46
Anglo-Saxon model				
Great Britain	69	69	25	75
USA	68	78	30	65
Canada	64	75	25	42
Balanced model				
Germany	43	67	23	52
Austria	54	80 (maximum)	25	32 (2000)
Netherlands	54	90	30	79
Denmark	52	80	30	88

Source: Schwarz, pages 38 and 149

Table 2

DISTRIBUTION OF HOME OWNERSHIP AND USE IN EUROPE

per cent (total = 100%)

Country	Resident owner	Social housing	Private rental	other
Nordic countries (2004)				
Denmark	52	20	17	11
Finland	58	17	15	10
Norway	61	5	18	16
Sweden	39	24	19	19
<i>Nordic countries' average</i>	<i>60</i>	<i>13</i>	<i>16</i>	<i>13</i>
Other European countries (2001)				
Austria	42	20	19	20
Belgium	71	5	19	5
France	56	17	21	6
Germany	43	6	45	6
Ireland	78	9	9	4
Italy (2003)	67	6	8	19
Netherlands	54	34	10	2
Spain	82	2	9	7
Switzerland	35	14	43	8
Great Britain	69	21	10	0
<i>average</i>	<i>60</i>	<i>13</i>	<i>19</i>	<i>8</i>
Hungary (2006)	93	4	3	1

Source: OECD-country study, Denmark (2006)

as beatific, the knocking down of the buildings and the establishment of new quarters, according to the currently prevailing taste.

► If the costs of home acquisition have not been incorporated into wages (a large proportion of owners did not acquire the property by saving money from their salary), or if home prices are relatively high, then newcomers can be excluded from this home acquisition. As, even if they take on a large loan, they have little hope of acquiring a home without parental assistance. If support received from parents is given a big role, then those from families of more modest income can spend an entire phase of their lives struggling with housing problems.

► Prevents job change if those intending to move out of settlements which can be characterised by lower home prices cannot acquire their own home, or can only do so with difficulty.

In Hungary, the way out of the problems described, in my opinion, would be if the proportion of social tenement flats and market rental homes were to increase by 5–10 percentage points each (i.e. jointly from the current rate of nearly 10 percent to 20–30 percent). Due to scarce financial resources, an increase in the number of state tenement flats is only possible over the course of many years. Therefore, there is a need for temporary solutions that assist a significant proportion of the needy strata until the present number of state tenement flats increases by several fold. The other important objective is to undertake measures which help the rapid ascendance of the residential rental sector.

The tax allowance outlined in my article proposes a method for the above, which may affect relatively broad layers (and housing stock). On the one hand, it helps the evolution of a resi-

dential rental sector and, on the other hand, it remedies in part the problems of the age-group of younger people who have been left out of (or are being left out of) home acquisition.

PRIVATE RENTAL SECTOR: NEEDS AND SUPPLY

Resident-owner status does not represent a solution for those who at the time are not driven by stable (at least 4–6 year) motives to live in one place. At least 10–15 percent of a person’s path of life is comprised of such periods. Such is a significant fraction of youth (learning, career start, the period prior to settling down), but for many the period after divorce is the same.

Market home rental can offer an alternative for those moving to more developed (richer) areas. As in this case in 5–10 years they are capable of accumulating an amount to supplement the purchase price of their home sold in the other region, and are able to take out a loan with acceptable terms towards the purchase of a home. In specific cases, market home rental could be a temporary solution for low-wage earners. If the state pays a significant proportion of their rent for them.

On the other side, they are many who for a transitional period do not use their home (long-term absence, the time it takes for inheritance proceedings to be conducted, two resident-owners who are moving in together but do not want to give up their property), etc. A significant proportion of these persons are willing to offer their dwelling (in return for remuneration) to others for interim use.

If we were to try to quantify the potential number of those seeking tenement flats in Hungary, then for sure at least 8–10 per cent of the population would have to be listed here. In contrast, according to the assessments of the Central Statistical Office a mere 130,000 pri-

vate dwellings (3–3.5 percent of the entire stock) are rented out today in Hungary.

We can receive an overview of the potential level of the mobility housing demand if we take a look at the data of the well-oiled, (representing one-fifth of the housing stock) decades-old, French free-market residential rental sector. New tenants move into a quarter of the 4.8 million rented dwellings of this sector annually. Furthermore, only one-fifth of the tenants have been living in the dwelling rented by them for more than four years.²

If we view this in proportion to the Hungarian population, then in Hungary this would mean that annually 200,000 people would move into a stock amounting to one-fifth (one million) of dwellings. For mobility demand even just approximating those above, the system of buying and selling homes is cumbersome (see the time requirement for selling, duties, the taxes incurred on selling, furniture purchase, and moving). Renting is much better suited for this purpose

At the time of the 2001 census, there was a bit of a sensation when it turned out that 6 per cent of private dwellings are unoccupied. That is, in spite of the above-mentioned substantial potential demand, only a small fraction of owners rent out their dwellings.

It should be noted that a certain reserve capacity is a natural consequence of the market system – without this for example the swings in housing market prices would be too great – in both directions.

The high level of rent expected by landlords plays a role in the low number of private residential rentals in Hungary. (The former can be traced in part back to the high housing prices in Hungary, and in part to the high interest rates.)

A portion of the potential landlords are probably deterred by the unfavourable tax conditions, while others are discouraged from the idea of renting by the regulatory environment,

which after eighteen years can still be deemed uncertain. The potential tenants can sometimes also be held back from renting by the unreasonably strong desire for ownership.

The question is, from whom can the surge in the private rental market be expected?

From this standpoint, the French experience may be authoritative.

Ninety-four per cent of landlords are private persons and only four per cent are legal persons.³

The average rent is EUR 6/m²/month. This is 0.5 per cent of the average market home price (EUR 1,200/m²), i.e. 200 months' rent comprises the price of a similar size dwelling. This indicator does not differ significantly from the Hungarian value. However, the annual (net family) income/house price ratio is different. In Hungary it is six to seven, while in France it is less than five.

YOUNG PEOPLE: AT A DISADVANTAGE

Housing subsidies must be given primarily to those, who by virtue of their age, were unable to partake in the previous, substantial allowances, i.e. those younger than 38–39 years of age.

A significant portion of those currently over the age of 38–39 were able to avail of the allowances of 15–20 years ago. Before 1990 and 1994:

- *residents of council housing with nominal rent hardly had to pay anything; furthermore between 1993 and 1996 they were able to buy the previously rented dwelling for a very low price,*
- *for the others (until 1990) the opportunity was given to finance their home construction with low interest (2-3 per cent) credit, in addition to the availability of construction materials at a low (subsidised) price.*

The housing conditions of the younger age groups are appreciably worse than average. Only 60 per cent of younger households live in the given dwelling as owners. In contrast, this indicator for the elderly is above 90 percent (see Table 3). And we still have not taken into account the fact that many still live with their parents and do not have independent families because they cannot afford to purchase or rent a separate dwelling.

The younger generation's access to housing is less favourable than that of the elderly. Only a third of them consider their home comfortable (adequate or spacious), while the same

Table 3

DISTRIBUTION OF HOUSEHOLDS BY HOME USAGE LEGAL TITLE, 2005

(per cent)

Age of head of household, year	Home usage legal title			Total
	Owner	Rental	Other	
-29	60	24	16	100
30-39	81	11	8	100
40-49	91	6	3	100
50-59	94	4	2	100
60-64	93	3	4	100
65-69	94	2	4	100
70-74	91	3	6	100
75-	90	3	7	100
Összesen	89	6	5	100

Source: Central Statistical Office, Housing Statistics, 2006

ratio for the elderly is 75–80 percent (see Table 4). And we have not yet mentioned that the sufficiently spacious dwelling becomes cramped for them once the first or second child arrives.

The Central Statistical Office in the course of a targeted survey asked what proportion of young people receive parental support.⁴ For home acquisitions between 1999 and 2004 young people (maximum 34 years of age) on average received HUF 2 million of family support, which amounts to less than a quarter of total expenditure. Half of those belonging to the age group received family support (on average HUF 4.3 million); the other half, however, did not.

It should be mentioned that subsequent to the first home acquisition, later due to the rise in the number of children the current dwelling generally becomes cramped; therefore a new housing investment is required. (See Table 5)

If someone wanted to express the generational differences in terms of Hungarian

Forints, then the comparison of a couple with a home and without one does a good job of illustrating the situation.

One of the couples is older and as a result was able in the 1990s to purchase for a nominal amount the council dwelling they had rented until then. The other couple is younger (both under the age of 35); therefore they had no such opportunity. Therefore, they would now like to purchase their own home. This, even if it is small, will cost HUF 6–7 million. If they get credit for the portion of the purchase price above the required down payment, then they have to assume a monthly debt burden of around HUF 50 thousand for 20–25 years. The consumption level of the two married couples would be the same if the younger couple (together) earned HUF 100 thousand more (say the husband and wife earn HUF 50 thousand more each – because they receive net HUF 50 thousand from the HUF 100 thousand gross earning surplus toward paying the burden of the loan). But there are few employers who give such an earning surplus to younger people in order for them to be able to

Table 4

ADEQUACY OF DWELLING SIZE, 2005
(per cent)

Age of head of household, year	The dwelling for the household is				total
	cramped	acceptable	adequate	spacious	
until age 24	31	36	25	8	100
25–29	16	35	36	12	100
30–34	17	38	32	12	100
35–39	16	38	31	11	100
40–44	14	37	33	16	100
45–49	11	33	36	20	100
50–54	8	30	39	23	100
55–59	6	25	42	37	100
60–64	4	21	45	30	100
65–69	3	19	48	29	100
70–	3	21	52	31	100
Total	10	29	40	21	100

Source: Central Statistical Office, Housing Statistics

Table 5

**HOUSING SITUATION AND AGE,
2005**

Age of head of household, year	Persons per hundred rooms	Dwelling size, m ²	Number of household (thousands)
–29	120	61	191
30–39	128	77	589
40–49	118	84	681
50–59	95	86	914
60–64	75	78	428
65–69	72	77	298
70–74	69	76	284
75–	64	68	449
Total	97	79	3 837

Central Statistical Office: Housing conditions at the millennium, Budapest, 2006

Table 6

**THE PROPOSED TAX BRACKETS AND TAX RATES FOR YOUNGER PEOPLE WITH
THE YEAR 2010 PIT RATES**

Annual income (thousand HUF)	General tax rate (with employee allowance), %	Tax rate for younger people, %	Difference, %
0–839.28	0	0	0
839.28–2229	21.59	0	21.59
above 2229	21.59	21.59	0

live somewhere. And we have not even discussed the fact that any child(ren) taken on by them not only represent(s) additional expenditure, but in this case a larger dwelling is also necessary.

Today, according to earnings statistics, the earnings of 30–35 year olds fall short of that of 40–45 or 50 year olds. It's fortunate that the difference is only 5–10 per cent. It is in this way that the labour market assesses the performance of each age group. That would be fine, except for the fact that with regard to housing the gap resulting from the above-mentioned competitive disadvantage can never be closed. Because to this end, a difference exactly opposite in nature would be necessary.

To mitigate the young people's "competitive

disadvantage", I think an allowance should be given in personal taxation which only younger people could receive. A portion of personal income tax payments should be refunded to young people. Those born after 1972 could be eligible for the allowance.

The amount of the tax refund should be limited to, say, HUF 300 thousand per year.

It could be proposed that young people be given a housing tax refund from their very first tax payments, in such a way that they can get back as much as their entire tax payment. In the current tax system, it would mean that (due to the employee allowance) the tax allowance would come into play for the portion above annual gross earnings of HUF 839 thousand. (See Table 6)

Table 7

THE PROPOSED MAXIMUM (CUMULATIVE) AMOUNT OF THE TAX ALLOWANCE
(HUF million)

Number of children	No children	One child	Two or more children
Home ownership (31 December 2010)			
Yes, without a lien	1.5	2	3
Yes, with a lien	2	3	4
No	3	4	5

If after 2010 the flat rate PIT is introduced parallel to the elimination of the employee allowance with a tax rate of around 16 percent, then the HUF 300 thousand p.a. tax allowance could be granted. A young person would reach this limit around annual earnings of HUF 1.8 million if (s)he does not yet have children, and at HUF 3.1–3.3 million/year if (s)he claims the child allowance after two children (say HUF 80–100 p.a./child).

I devised the specific rates of the tax allowance with the consideration that

- there should be an upper limit for the tax allowance. After all, the aim is not to increase the given person’s net income, but to facilitate the young person’s access to acceptable housing over a longer time horizon. To this end HUF 30 thousand monthly seems sufficient. Therefore, the amount of the allowance should be limited to HUF 25 (300 p.a.) thousand monthly. In addition, it is expedient to set a total limit of HUF 1.5–5 million per person. The limit could depend on whether the given person has children, is the owner of a residential property and, if so, whether it is encumbered by credit (see Table 7).
- the allowance should reach the widest possible scope of beneficiaries. Therefore, in the lowest income bracket it is expedient to return the entire tax.

A quarter of the concerned age groups would probably end up in that bracket where (for those without children assuming the current

PIT 2 monthly earnings of HUF 200 thousand, and after 2010 probably above HUF 160 thousand) an increase of income would no longer increase the amount of the available tax allowance (due to the maximisation thereof at the level of HUF 300 thousand/year).

SPECIFIED USE OF THE TAX ALLOWANCE

It helps the housing of the affected groups if those concerned in fact use the tax allowance for the specified purpose. This can entail three types of expenditure: the purchase of housing (including construction), the financing of loans financing home purchase and home rental. The categories can be fairly well documented and are therefore verifiable; thus the administrative burden can be relatively modest.

It is expedient to include home rental, because this offers a solution to those who would not be able to afford the purchase of their own home. After all, they too must live somewhere. Not to mention the fact that according to statistics there are 200 thousand empty dwellings, which in the capital alone means 60 thousand dwellings. Home rental is only a realistic alternative if the government and the municipalities take effective steps to establish the legal and economic security of rental. Here primarily it is the protection of the landlord’s interests which must be thought of (e.g. guarantee of the expedited eviction of tenants breaching contractual terms, some sort of

insurance in case of vandalism, etc.). The level of the tax allowance itself “offers on a platter” one of the elements of effective protection. It is expedient to exclude any young person from the opportunity of receiving the tax allowance for a few years who is not willing to vacate the dwelling by the specified time, who vandalises the dwelling, or does not settle his/her debts.

If the young person has not availed of the allowance opportunity, then in the years following the introduction of the allowance (s)he could use his/her paid taxes (up to a maximum of HUF 300 thousand p.a.) at any time prior to the age of 39 for home purchase or loan repayment.

In the interest of a sufficient supply of rental housing the currently high burdens of rental would have to be mitigated:

- a dictated amortisation amount should be deducted from (residential) rental income on a m² basis, as well as amounts separated (preferably managed as a fund) for maintenance. Only the portion above this should be considered income,
- the tax rate should be reduced. It would be expedient to apply a tax rate of around 10 per cent. Rental housing could be a typical case of a reduction of the tax rate paradoxically leading to a significant increase in revenues.

It is worth considering stipulating for what kinds of loans the allowance can be claimed upon repayment – thereby encouraging banks to apply low interest margins (e.g. HUF loans, APR maximum 8–9 per cent). This can be effectively achieved if the risk of lending were to decrease with the provision of state guarantees.

EFFECTS OF THE OUTLINED SYSTEM

❶ For those under the age of 37–38, it would not only offer an alternative to the solution of housing problems (both in the shorter and

longer term), but for the majority of them there would be a strong incentive to take on work in the legal labour market, acquire a suitable profession and qualifications, and gain experience thereof.

❷ The appeal of the German and Austrian labour markets opening up in a year and half can be reduced – thus the adverse macroeconomic effects of masses of Hungarians working abroad can be mitigated.

The goal of taking on work in developed countries often is precisely for the individual involved to be able to buy a flat or house for himself/herself or his/her family.

❸ “Enabling” a significant proportion of potential buyers and tenants could act as a significant stimulant in today’s sluggish housing market. Increasing housing related expenditures may lead to additional demand. With its help, a further decline of housing prices and, with this, the generation of a serious housing crisis can be prevented.

❹ It would contribute to the development of a much bigger and real private residential rental market in Hungary.

FINANCIAL EFFECTS

When mapping the effects we can proceed from the assumption that the age group of up to 37 years of age represents some 50,000 of the annual 130,000–150,000 dwelling purchases and constructions and on account of the new system (in a couple of years) the number of dwellings rented by them will increase by 100,000. In case of these assumptions the value of the tax allowance would reach HUF 90 billion sometime around the fifth year. (In the third year for example the budget would suffer a loss in the amount of only about HUF 40 billion). The amount of revenue loss would reach

HUF 170–190 billion only in the 12–13th year, and probably would not increase afterwards.

effects after 2010 can only be ventured in view of the new tax conditions.

Those under the age of 37 comprise one-third of taxpayers, and the tax paid is estimated to represent a proportion smaller than this – an estimated HUF 500–550 billion of the entire HUF 2,000 billion. However, less than half of this HUF 500–550 billion tax revenue may originate from the proportion of income below HUF 2.2 million p.a. (and the part greater than half from the proportion of income above HUF 2.2 million) in case of the current PIT. An estimate of the systemic

At least one-third of lost revenues may be recovered. Namely, a significant proportion of the allowance is likely to be spent on home construction, which may bring significant revenue for the state. If the number of homes built increases by 10,000 annually, that results in HUF 50–60 billion of surplus revenue for the state. In addition, the tax mass after 100,000 rental homes may reach HUF 4–6 billion annually.

NOTES

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| 1 Source : Schwarz (ed.): <i>The politics of Housing Booms and Busts</i> | 3 Les conditions de logement des ménages en 2002, Paris, 2003 |
| 2 Les conditions de logement des ménages en 2002, Paris, 2003 | 4 Central Statistical Office: <i>Housing conditions at the millennium</i> , Budapest, 2006 |

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