Swiss, US rental taxes highest in OECD

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Switzerland imposes the highest taxes on rental income of non-resident landlords, according to a study on the tax situation in more than 90 countries around the world. The study has been conducted by Global Property Guide with contributions from leading accounting firms in each country.

The effective income tax rate in Geneva, Switzerland can be as high as 48.6% on a rental income of €1,500/month and 54.5% on income of €12,000/month.

Other OECD member countries that impose high effective tax rates, above 20%, include the US, Norway, Spain and Finland.

In Norway, the flat 28% rental income tax is combined with a progressive capital tax. Although deductions for operating costs and income-generating expenses are allowed, effective tax rates are still high, ranging from 27% to 31%.

Spain charges 24% withholding tax on the gross rental income of non-resident foreigners, no deductions are allowed. Finland, on the other hand, charges a flat 28% tax but all direct income-generating expenses are deductible. This leads to an effective rate of around 24% in Finland.

The importance of deductions is also highlighted in the case of France. The nominal income tax rate for non-residents is high at 25%. However, if the gross rental income on a furnished flat is less that €76,300 per annum, deductions of up to 72% can be made. Only the remaining 28% of gross income is taxed, amounting to an effective tax rate of only 7%.

In the UK, personal deductions combined with depreciation and costs are higher than the assumed gross income of €1,500 per

month (€18,000 per year), leading to zero taxable income.

Effective rental income tax rates are generally below 10% in Luxembourg, France, Japan, South Korea, Mexico, New Zealand and the UK.

Gross or net taxation

In Canada and the US, non-resident landlords are given the option to choose between two options: 'gross' or 'net' income taxation. The gross income tax rate is high but the process is very simple; no deductions, no allowances, no accountants involved.

In the US, the gross rental income of non-resident aliens (NRA) that are "not effectively connected" is taxed at 30%, withheld by the tenant. In Canada, gross income is subject to a fixed 25% tax, also withheld by the tenant.

Landlords can alternatively opt to pay net income after allowed deductions, potentially lowering tax rates, but the rules are complicated. Maintenance, local taxes and depreciation are deductible subject to certain rules.

In Canada, by "electing under section 216" the net income is taxed at rates ranging from 15.5% to 29%. After deductions and allowance, the final effective tax rates range from 8.14% to 14.87%, much lower than the 25% gross rate.

Rental income tax assumptions

Global Property Guide's estimate of the "effective" tax rate includes adjustments for depreciation, and any other typical costs which a landlord pays such as management charges, buildings insurance, real estate agency fees, real estate taxes, etc. However, mortgage expense tax relief is not included.

To make the income tax situation easy to understand, the study adopts a standard case:

1. Gross rental income is US$1,500/month, or US$18,000 per year (€1,500 or €18,000 for Europe).

2. The property is directly jointly owned by husband and wife, who are both foreigners and non-residents. Many countries impose higher taxes on foreigners and/or non-residents, or allow them lower deductions.

3. The owners have no other local income aside from rent.

4. There is no mortgage, i.e., no loan was taken to buy the rental unit.

The result is an "effective income tax rate", which is typically different from the nominal tax rate. These effective rates represent what taxes are really payable, after all allowances and deductions. They provide a clearer and more realistic picture of a country's tax situation for potential investors.

Social effects

Higher marginal taxes on rental properties are argued to be pro-poor because of the perception that landlords and property owners are typically rich, thus should be taxed more. The perception is amplified when taxing non-resident foreigners.

However, excessive taxation of rental property affects the availability of affordable housing, as shown by much research. High taxes on rental income lead to low net rental yields, which discourage owners from renting out their properties.

And due to the filtering effect, any policy that makes it difficult or expensive to produce any type of housing restricts the available stock of low-cost housing. The filtering effect is a process by which poorer households move to occupy the void left by richer households as they move from renting to ownership or to better and newer housing.

Spain's high rental income tax rate of 24%, for instance, combined with restrictive tenancy laws, has led to the shrinking of the private rental market. Property owners prefer to keep their housing units empty rather than rent them out. In 2001, about 14% of the total housing stock was vacant, more than the entire rental stock (which was only 10% of the housing stock).

From an investor's point of view, the significant difference between nominal and effective tax rates in many countries

highlights the importance of tax planning. Knowing all the legally allowable deductions and allowances can spell the difference between profits and losses, and separate gainers from losers.

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