



Tax Reform

Congress has begun discussing possible changes to the tax code to promote efficiency. In doing so, it is essential that Congress take the right approach to foster economic growth. Few industries have struggled in the past years as much as residential construction, and it is critical for future economic prosperity that Congress not harm job creation and recovery in the construction industry by increasing taxes on homeowners or homebuilders.

Mortgage Interest Deduction and Real Estate Tax Deduction

The mortgage interest deduction has been part of the tax code since its inception in 1913 and the cornerstone of American housing policy. Homeowners may deduct interest from up to \$1 million of acquisition mortgage debt and up to \$100,000 of home equity loan debt. These amounts were set in 1987 and have not been adjusted for inflation. The mortgage interest deduction is a counterpart to the business deduction for interest expense that investors in rental housing claim and creates parity between investors and owner-occupiers. The tax code also permits homeowners to deduct local real estate taxes paid.

There are many misperceptions regarding these deductions and who benefits. In reality, these deductions are middle-class tax breaks, and are particularly beneficial to younger households and larger families. Nearly 70 percent of the benefits of the mortgage interest deduction—and 77 percent of the real estate tax benefits—are claimed by those earning less than \$200,000. Yet these same taxpayers pay only 43 percent of all income taxes, meaning these deductions make the tax code more progressive and fair. IRS data indicates that as a share of household income, these deductions have the greatest benefit for those aged 18 to 35, as well as for larger families. Moreover, the vast majority of homeowners benefit from the mortgage interest deduction; since 2000, 86% of all the mortgage interest paid has been claimed on a tax return as an itemized deduction.

Changing the rules of the game would have an immediate, negative impact on housing prices and raise the after-cost debt burden for aspiring homeowners.

Capital Gains Exclusion

The tax code has long provided preferential tax treatment for certain capital gains (such as IRA and 401(k) retirement accounts), but also including gains earned

from the sale of a principal residence. In 1997, Congress passed the Taxpayer Relief Act (PL 105-34), which greatly simplified the housing capital gains rules. Under current law, homeowners, who live in their home for two of the past five years, are exempted from paying capital gains tax on up to \$250,000 (\$500,000 for couples) in profit from the sale of their principal residence.

The capital gains exclusion protects the homeowner's investment value. It is especially important for homeowners looking to downsize and draw out home equity for their retirement, as well as encouraging mobility by eliminating negative tax consequences for homeowners selling their residence in order to relocate. Eliminating or weakening the exclusion would act as a windfall tax on the approximately 75 million homeowners in the U.S.

Low Income Housing Tax Credit

The tax code also contains numerous provisions to support rental housing. One of the most unique—and effective—provisions is the Low Income Housing Tax Credit (LIHTC). Created as part of the Tax Reform Act of 1986, the LIHTC promotes public-private partnerships to produce affordable rental housing. Developers receive an allocation of LIHTCs from a state housing finance agency through a competitive application process. The tax credits are then sold to private investors to raise equity for the project. This allows private equity to be raised at a lower cost, which makes it possible to operate these projects successfully with below-market rents. In general, the LIHTC serves households earning 60% or less of the area median income. LIHTC properties must remain affordable for a minimum of 30 years. Because compliance is monitored by the state housing finance agencies as well as the investors, LIHTC projects have an exceptionally low foreclosure rate of less than one percent.

The LIHTC is currently producing approximately 75,000 new apartment homes annually, and since its inception, the LIHTC has produced more than 2 million affordable rental units. Despite its success, this is not sufficient to replace the number of affordable apartments lost each year.

Even in this tough economic climate, the LIHTC added approximately \$6.8 billion in income and created 90,000 new full time jobs per year across all U.S. industries—generating \$2 billion in federal tax revenue. No other workforce-housing program has been as successful as the LIHTC in producing safe, quality, affordable rental housing.

Solutions

Recently, several fiscal commissions have suggested reducing or eliminating the mortgage interest deduction; the capital gains exclusion; the Low Income Housing Tax Credit; and the deduction of property taxes, amongst others. These proposed tax increases would further depress home prices; put countless more

homeowners underwater; and trigger a new wave of foreclosures. Eliminating or scaling back these vital housing incentives will also shrink the local tax base of many communities, causing already cash-strapped state and local governments to further cut jobs and essential services. Given the extreme fragility of the housing market, with 21 percent of construction workers currently idled, raising taxes on homeowners and homebuilders is just not sound public policy.

Recommendations

- Oppose any changes to the tax code that would increase taxes on homeowners, renters, or homebuilders.
- Co-sponsor H. Res. 25, introduced by Representative Gary Miller, expressing the sense of Congress that the mortgage interest deduction should not be further restricted.