Mortgage Interest Deduction Reform

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The mortgage interest deduction (MID) is one of the largest federal housing subsidies in the United States. Compared to the HUD budget for discretionary programs ($38 billion requested by the administration for FY17), the MID is projected to cost more than $68 billion in 2017. A disproportionate share of the MID's benefit goes to wealthy homeowners: The top 18% of taxpayers who claimed the MID (those with incomes of $200,000 or more) receive 42% of the total benefit.

Because federal housing supports are skewed in favor of tax-based housing subsidies versus direct spending on low income rental housing programs, NLIHC asserts that the U.S. must realign federal resources to better match housing need. To do this, NLIHC advocates simple and smart modifications to the MID to generate more revenue to support rental housing programs, primarily for the National Housing Trust Fund (NHTF).

Even before establishing NLIHC in 1974, Cushing Dolbeare had been critical of the MID, pointing to the injustice and inefficiency of subsidizing homeownership for people with higher incomes when too few resources were available to help very poor families meet their housing needs. NLIHC continues to call attention to this issue through our research and advocacy efforts.

In 2013, NLIHC launched the United for Homes (UFH) campaign that has since grown to become a nationwide effort with more than 2,300 national, state, and local organizations, located in every congressional district. UFH seeks changes to the MID that will both help more low and moderate income homeowners, and generate new revenue to solve the housing problems of the very poor—including people who are homeless.

ABOUT THE MORTGAGE INTEREST DEDUCTION

The MID is a federal tax expenditure that provides some homeowners with reductions in the amount they owe on their federal income tax. When filing annual federal income tax returns, taxpayers can deduct the interest paid in that tax year on home mortgages of up to $1 million. The deduction is not based on the value of the home but rather on the size of the mortgage. Taxpayers can deduct mortgage interest on first and second homes. In addition, the interest on up to $100,000 in home equity loans can be deducted for a cap of $1,100,000 on the value of mortgages eligible for tax breaks.

The value of the deduction, or the degree to which it reduces one's taxable income, depends on a person's tax bracket. Thus, taxpayers in the 33% tax bracket are able to reduce their taxes by 33% of the amount of interest paid, while those in the 15% tax bracket can reduce their taxes by just 15% of the interest paid.

In order to benefit from the MID, a taxpayer must file an itemized tax return. The Joint Committee on Taxation of the U.S. Congress estimates that almost 169 million tax returns were filed in 2015, but only 27% were itemized. Only 20% of all tax returns claimed the MID. The top 61% of taxpayers who claimed the MID (those with incomes of $100,000 or more) received 81% of the total benefit. The top 18% of taxpayers (incomes of $200,000 or more) received 42% of the benefit.

The idea that the MID was created to spur homeownership is a myth. In reality, the MID was enacted in 1913, shortly after the ratification of the 16th Amendment to the U.S. Constitution, which allowed Congress to establish a federal income tax. When the income tax was implemented, certain business expenses were allowed to be deducted, including interest on all loans. Very few Americans had home mortgages at the time and most personal and business finances were intermingled. Eventually, federally-insured and 30-year mortgages multiplied after World War II and the MID became more important to the emerging middle class. Even so, the earliest estimate of the cost of the MID in 1977 was just $4.7 billion.

However, the cost of the MID exponentially increased in the 1990s and 2000s as the cost of home purchases accelerated, reaching estimates of $100 billion. Since the housing finance crisis of 2008, the value of the MID dropped along with home values, homeownership rates, and interest rates.

The federal government produces two different estimates of the annual cost of the MID. In the president's FY17 budget proposal, the Office of Management and Budget (OMB) projected that the MID will cost $68.61 billion in 2017 and $127.36 billion by 2025.[1] The Joint Committee on Taxation (JCT) estimated in December 2015 that MID will cost $84.3 billion in 2017.[2]

Homeowners also benefit from other tax subsidies in addition to the MID. When filing their federal income taxes, individuals can deduct state and local property taxes (estimated to cost $35.58 billion in 2017 using OMB numbers) and exclude capital gains on home sales ($43.46 billion in 2017 per OMB). OMB also includes a tax expenditure called exclusion of "net imputed rental income." Imputed rent accrues to homeowners because they do not pay taxes on the income they derive from not paying rent, even though they get to take tax breaks for the costs of owning a home (i.e., mortgage interest and property taxes). OMB projects the cost of the imputed rent exclusion to be $104.95 billion in 2017. (JCT does not provide an estimate of the cost of the imputed rent exclusion.)

Thus, OMB projects the total cost of tax expenditures that subsidize homeowners in 2017 to be $252.6 billion, 18% of the cost of all tax expenditures. In contrast, the federal tax code provides no housing-related tax breaks for taxpayers who are renters, unlike several states that have renter tax credits.

THE UNITED FOR HOMES CAMPAIGN

The UFH campaign proposes smart, simple changes to the MID by reducing the size of a mortgage eligible for a tax break to $500,000 and converting the deduction to a 15% non-refundable tax credit.

Under the UFH proposal, the first $500,000 of any mortgage would be eligible for the tax credit, a change from the current limit of $1,000,000. Mortgages for first and second homes and for home equity loans of up to $100,000 will be eligible for the tax break as long the total amount of loans does not exceed $500,000. Capping the amount of debt eligible for the MID would generate almost $95 billion dollars throughout a 10-year period.

Although some have raised the concern that the $500,000 mortgage cap is not large enough, the truth is there are very few mortgages exceeding that amount in the United States, and those that do are concentrated in very few places. In fact, only 5% of all mortgages between 2012 and 2014 exceeded $500,000.[3] In 94% of all counties, fewer than 3% of mortgages were larger than $500,000. The vast majority of people who have mortgages on their homes would not be affected by the proposed limit.

UFH also proposes converting the tax deduction to a 15% non-refundable tax credit. A tax deduction reduces one's taxable income on which a person's total tax bill is based. In contrast, a tax credit is a direct reduction of one's total tax bill. Taxpayers do not have to itemize their tax returns to benefit from a tax credit, which means tax credits are more accessible to lower income households. Moreover, a tax credit as proposed by the UFH campaign would be the same percentage for everyone, unlike a tax deduction whose value increases with income. Generally speaking, tax credits are flatter and fairer.

The Tax Policy Center has projected that these changes to MID, phased in over the course of five years, would generate almost $213 billion in revenue between 2016 and 2025.[4] NLIHC proposes that this revenue be used to capitalize the NHTF. Once funded, the NHTF would expand, preserve, rehabilitate, and maintain the supply of rental housing affordable to extremely low income and very low income individuals and families.

Middle and low income homeowners who pay mortgage interest but who do not now claim the mortgage interest deduction stand to gain from the UFH proposal. Based on calculations done by the Tax Policy Center, under a 15% non-refundable credit, the number of homeowners who will get a tax break will grow from 33 million to 48 million, with most the increase being households with incomes of less than $100,000 a year. Higher income households with mortgages, primarily those with incomes of $200,000 or more, will pay more taxes.

1 https://www.whitehouse.gov/sites/default/files/omb/budget/fy2017/assets/ap_14_expenditures.pdf

2 https://www.jct.gov/publications.html?func=startdown&id=4857

3 http://nlihc.org/sites/default/files/Rare-Occurrence_print.pdf

4 http://www.taxpolicycenter.org/UploadedPDF/2000542-options-to-reform-the-deduction-for-home-mortgage-interest.pdf

The UFH proposal to reform the MID has received considerable public support. According to a 2013 national poll, 60% of Americans favor the campaign's proposal. Seventy-six percent of Americans favor building more affordable housing in their states to help end homelessness.

Members of Congress have also taken note of the campaign and have introduced legislation incorporating the UFH proposal. In March 2015, Representative Keith Ellison (D-MN) introduced the Common Sense Housing Investment Act of 2015 (H.R. 1662), which contains the UFH proposal to modify the MID and directs 60% of the revenue raised to the NHTF, with the remainder going to other low income rental housing programs. UFH had endorsed Mr. Ellison's bill. So far in the 114th Congress, H.R. 1662 has attracted six cosponsors. Mr. Ellison introduced a similar bill in the 113th Congress. In June 2015, Representative Barbara Lee (D-CA) introduced the Pathways Out of Poverty Act of 2015 (H.R. 2721), a sweeping anti-poverty bill that includes major initiatives on housing, education, nutrition, jobs, and tax credits. Mr. Ellison's bill was included in Ms. Lee's bill.

POTENTIAL FOR MID REFORM

As concern has grown regarding the size of the national debt, there has been greater scrutiny on tax expenditures, which amount to more than a trillion dollars in uncollected federal taxes each year. These tax breaks, claimed by corporations and individuals, have been enacted into law throughout the years to subsidize some activity that an interest group or politicians have determined to be worthy of government support. OMB estimates that tax expenditures will cost the federal government $1,372,853 trillion in fiscal year 2017.[5]

Because the MID is one of the largest and most regressive of all tax expenditures, it has received increased attention by law and policy makers, and is thought to be ripe for reform but only as part of comprehensive tax reform. Numerous tax reform and deficit reduction panels and commissions have called for changes to the MID. Economists and tax policy experts across the political spectrum criticize the MID as inefficient and poorly targeted.

MID reform has also been gaining traction in Congress. Members of Congress may no longer see it as the "sacred cow" of housing and tax policy. Former House Ways and Means Committee Chairman Dave Camp (R-MI) included changes to the MID in his sweeping comprehensive tax reform bill introduced late in the 113th Congress. House Speaker Paul Ryan (R-WI), who started the 114th Congress as the chair of the Ways and Means Committee, has stated that he supports lowering the MID cap to $500,000. However, Mr. Ryan's successor to lead the Ways and Means Committee, Representative Kevin Brady (R-TX) has yet to voice his position on the MID.

Moreover, a realtor-backed House resolution to protect the MID has seen waning support. When Representative Gary Miller (R-CA) first introduced the resolution in the 112th Congress, it attracted 198 cosponsors. However, when Mr. Miller introduced the resolution again in the 113th Congress, only 22 representatives agreed to cosponsor it. Mr. Miller retired and so far, none of his former colleagues have introduced a similar resolution in the 114th Congress.

Low income housing advocates must make sure that when Congress does decide to modify MID through comprehensive tax reform, a significant share of the revenue raised from those changes goes to affordable rental housing.

FORECAST

It is highly unlikely that the 114th Congress and the Obama Administration will be able to come to agreement on comprehensive tax reform. The partisan divide between Democrats and Republicans runs deep, especially in an election year, and prospects for compromise appear bleak.

President Obama offered major changes to the tax code in his FY16 and FY17 budget proposals, and the Senate Finance and House Ways and Means Committees had at first set their sights on reform in the 114th Congress. However, those efforts have largely stalled. Even though the Senate Finance Committee established working groups early in 2015 to examine ways of overhauling the tax code, the resulting reports were far below the scope and detail originally expected. The reports were silent on reforming the MID.

After Mr. Ryan rose to become Speaker of the House, Representative Kevin Brady (R-TX) was elected to serve as the new chair of the committee

5 https://www.whitehouse.gov/sites/default/files/omb/budget/fy2017/assets/ap_14_expenditures.pdf

and has since stated he would "relentlessly pursue tax reform," but that "overall tax reform will wait for a Republican president in 2017." Senate Majority Leader Mitch McConnell (R-KY) also commented, "We're certainly not going to be able to be doing big comprehensive tax reform with this president."

However, comprehensive tax reform is something Congress can no longer afford to avoid. Some advocates believe that with Speaker Ryan, a longtime advocate for rewriting the tax code, now setting the House agenda, Congress might meaningfully take up comprehensive reform. When that happens, the MID will change. Housing advocates must work together to make sure that savings gained from MID reform be kept in housing and used to address the long neglected housing needs of extremely low income renters. Although tax reform is unlikely to move in 2016, we must lay the groundwork now to make this goal a reality.

WHAT TO SAY TO LEGISLATORS

- Ask your representative to co-sponsor the Ellison bill and any other legislation that is introduced that would change the MID and generate significant new revenue to fund the National Housing Trust Fund and other housing aid for extremely low income renters.
- Educate the members of your Congressional Delegation on the benefits of MID reform and the NHTF.

HOW TO TAKE ACTION

- Endorse the United for Homes campaign! Secure other endorsers in your community.
- Urge local and state government officials to pass resolutions in support of the United for Homes proposal.
- Promote the UFH Campaign through social media.

FOR MORE INFORMATION

Learn more and join the UFH campaign at: www.unitedforhomes.org

Learn more about the NHTF at: www.nhtf.org ■