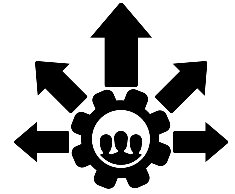
Mortgage Interest Deduction Reform



By Sheila Crowley, President and CEO, National Low Income Housing Coalition

NLIHC is calling for changes to the mortgage interest deduction in order to generate revenue to support more rental housing, specifically to fund the National Housing Trust Fund (NHTF).

NLIHC has long used the MID to illustrate the imbalance in federal housing subsidies between direct spending in low income rental housing assistance and tax-based support for higher income homeowners. Even before she founded NLIHC in 1974, Cushing Dolbeare had been a critic of the injustice and inefficiency of the MID as a federal housing subsidy to higher income homeowners when help for low income renters was so scarce. The imbalance of federal housing subsidies is a recurrent theme of NLIHC reports and Congressional testimony.

In spring 2013, NLIHC launched the United for Homes (UFH) campaign. Composed of nearly 2000 national, state, and local organizations located in every Congressional District, UFH seeks smart and fair 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. UFH proposes that the new revenue be directed to the NHTF.

This is not the first conception of a NHTF to be funded with revenue raised by changes to the MID. H.R. 5275, the Federal Housing Trust Fund Act of 1994, reflecting a proposal to do so advanced by NLIHC and others, was introduced by Representative Major Owens (D-NY). H.R. 5275 was the first legislative proposal to call for changes to the MID to fund affordable housing. Alas. the Owens bill never gained a single cosponsor nor was it considered in committee.

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. Mounting concern about the size of the federal deficit has brought attention to federal tax expenditures, also known as tax loopholes. These are tax breaks for corporations and individuals that have been enacted into law over the years to subsidize some activity that an interest group or politician has determined to be worthy of government support. The 169 tax expenditures reported by Office of Management and Budget (OMB) for 2016 amount to $1.31 trillion in uncollected federal taxes.[1]

Because the MID is one of the largest and most regressive of all tax expenditures, it is under particular scrutiny. 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. Former House Ways and Means Committee Chairman Dave Camp (R-M) included changes to the MID in his sweeping comprehensive tax reform bill introduced late in the 113th Congress.

The question is not if or when will the MID be reformed. The question for low income housing advocates is how to make sure that a significant share of the revenue raised from changes to the MID go to affordable rental housing.

The federal government produces two different estimates of the annual cost of the MID. The most recent estimate from OMB is in the President's FY16 budget proposal, in which the MID is projected to cost $75.26 billion in 2016 and $102 billion by 2019.[2] In its August 2014 report on federal tax expenditures, the Joint Committee on Taxation (JCT) of the Congress estimated the cost of the MID to be $81.6 billion in 2016.[3] Both OMB and JCT show the MID to be lower than in recent years. This is primarily because of the sluggish housing market. Nonetheless, MID remains the second largest federal tax expenditure, only behind the exclusion for premiums paid by employers for health insurance.

The MID is not the only tax subsidy that benefits

1 http://www.whitehouse.gov/omb/budget/Analytical_Perspectives (see Supplemental Materials, Tables 14-1 to 14-4)

2 Ibid.

3 https://www.jct.gov/publications.html?func=startdown&id=4663

homeowners. The tax code also allows for the deduction of state and local property taxes ($35.5 billion in 2016 using OMB numbers) and the exclusion of capital gains on home sales ($39.5 billion in 2016 per OMB). OMB also includes a tax expenditure called an 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 $82.4 billion in 2016. (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 2016 to be $233 billion, 18% of the cost of all tax expenditures. Contrast these subsidies for homeowners with the cost of the Low Income Housing Tax Credit (LIHTC), projected to be $7.9 billion in 2016 by OMB. Moreover, while the homeownership subsidies are tax benefits for individual taxpayers, LIHTC is a corporate tax benefit. The federal tax code provides no housing-related tax breaks for taxpayers who are renters, unlike several states that have renter tax credits.

CURRENT LAW

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 based on the size of the mortgage, not on the value of the house. The interest can be on mortgages 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 one's tax bracket. Thus, taxpayers in the 33% tax bracket will be able to reduce their taxes by 33% of the amount of interest paid. Someone in the 15% tax bracket will 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. JCT reports that 166 million tax returns were filed in 2014, but nly 29% of which were itemized. Just 21% 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 82% of the total benefit. The top 18% of taxpayers (incomes of $200,000 or more) received 42% of the benefit.

The MID was created in 1913, with the adoption of the 16th Amendment to the U.S. Constitution establishing the 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.

THE UNITED FOR HOMES CAMPAIGN

The United for Homes (UFH) campaign proposes smart, simple changes the current mortgage interest deduction (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.

There is concern that the $500,000 limit is too low. However, only 4.6% of all mortgages in the U.S. between 2011 and 2013 were over $500,000. In only 3% of all counties in the U.S. was the percent of mortgages over $500,000 5% or more. Most people who borrow money to buy a house would not be affected by the proposed new cap. National housing policy should be based on the size of loans taken out by the majority of people who live in a variety of neighborhoods throughout the country, not the needs of people who live in a handful of expensive metro areas.

UFH also proposes converting the tax deduction to a non-refundable tax credit of at least 15%. A tax deduction reduces one's taxable income on which one'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.

According to a February 2014 report for NLIHC, the Tax Policy Center projected that these changes to MID, phased in over five years, would generate $230 billion in revenue between 2014 and 2023. NLIHC proposes that this revenue be used to capitalize the National Housing Trust Fund (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.

According to a 2013 national poll, 60% of Americans favor the United for Homes proposal to reform the MID. Seventy-six percent of Americans favor building more affordable housing in their states to help end homelessness.

Important beneficiaries of the UFH proposal will be middle and low income homeowners who pay mortgage interest but who do not now claim the mortgage interest deduction. 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 39 million to 55 million, with 99% of 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.

Representative Keith Ellison (D-MN) introduced H.R. 1213, the "Common Sense Housing Investment Act of 2013," in March 2013. It contains the changes to MID as proposed by UFH 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. As the close of the 113th Congress, H.R. 1213 has attracted 16 cosponsors, all Democrats. Representative Barbara Lee (D-CA) introduced H.R. 5352, the "Out of Poverty Act of 2014," in July 2014. It is a sweeping anti-poverty bill that includes major initiatives on housing, education, nutrition, jobs, and tax credits. Mr. Ellison's bill was part of Ms. Lee's bill.

Mr. Ellison is expected to introduce his "Common Sense Housing Investment Act" early in the new Congress.

POTENTIAL FOR MID REFORM

Numerous observers think the mortgage interest deduction is ripe for reform, but only as part of comprehensive tax reform. In the 113th Congress, both the Senate Finance Committee and the House Ways and Means Committee worked toward achieving bipartisan comprehensive tax reform. In fact, the House reserved the bill number H.R. 1 for a comprehensive tax reform bill. In the end, neither committee succeeded.

However, late in the 113th Congress, House Ways and Means Committee Chair David Camp (R-MI) introduced the Tax Reform Act of 2014, designated as H.R. 1. His bill would amend the MID by capping the size of a mortgage for which a taxpayer can deduct the interest at $500,000. The new cap would be phased-in over four years and would only apply to new mortgage debt. Mr. Camp also would eliminate the deduction of interest paid on home equity loans.

H.R.1 was the comprehensive tax reform legislation that Mr. Camp has been working on throughout the 113th Congress. Mr. Camp retired at the end of the 113th Congress, and the new chair of Ways and Means, Representative Paul Ryan (R-WI), will craft his own approach to tax reform.

Nonetheless, Mr. Camp has left a marker that makes room for future changes to the MID. He rejected the position that MID reform is harmful to the housing market stating, "historical data show that the strength of the nation's housing market is tied more closely to the health of the overall economy than to any specific tax policies that may be in place."

An indicator that MID reform may be gaining traction is reflected in significantly reduced support for a Realtor backed House resolution to protect the MID, introduced by Representative Gary Miller (R-CA). In the 112th Congress, the resolution attracted 198 cosponsors. He reintroduced on the first day of the 113th Congress, but had only 22 cosponsors at the close of the Congress. Mr. Miller has also retired. After six weeks of the 114th Congress, no one has introduced a similar resolution. Members of Congress may no longer see it as the "sacred cow" of housing and tax policy.

FORECAST FOR 2015

It remains to be seen if the new Congress and the Obama Administration will be able to come to agreement on comprehensive tax reform. The Senate Finance and House Ways and Means Committees again have set their sights on reform, and President Obama has offered major changes to the tax code in his FY16 budget proposal.

But the partisan divide between Democrats and Republicans is deep and prospects for compromise are dim.

However, comprehensive tax reform is inevitable. When it does occur, the MID will change. It is imperative that all housing advocates speak in one voice to make sure that savings gained from MID reform be kept in housing and be used to address the long neglected housing needs of extremely low income renters. We cannot wait until reform is about to occur. The groundwork must be laid now.

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 National Housing Trust Fund.

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 United for Homes Campaign through social media. ■

FOR MORE INFORMATION

Learn more and join the United for Homes campaign at: www.unitedforhomes.org

Learn more about the National Housing Trust Fund at: www.nhtf.org