Mortgage Interest Deduction Reform

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

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

In spring 2013, NLIHC launched the United for Homes (UFH) campaign. Composed of over 1,500 national, state, and local organizations and growing, 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.

ABOUT THE MORTGAGE INTEREST DEDUCTION

The mortgage interest deduction (MID) is a federal tax expenditure that provides some homeowners with reductions in the amount they owe on their federal income tax. It is a provision of the federal tax code that is very popular with Americans and long considered a "sacred cow" that policymakers tinker with at their peril.

However, 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. Each could achieve the same objective if it were structured as direct spending, and most analysts see them as spending by another name. However, others see them as government letting people keep their own money. Under any circumstances, the 175 tax expenditures reported by Office of Management and Budget (OMB) for 2015 amount to $1.25 trillion in uncollected federal taxes.

Because the MID is one of the largest and most regressive of all tax expenditures, it is under particular scrutiny now. 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. The challenge for low income housing advocates is to assure that any changes to the MID that result in savings direct those savings to ending the affordable housing shortage for extremely low income households and do not use the savings exclusively for other purposes, including deficit reduction or lowering tax rates.

OMB estimates the cost of the MID for 2015 to be $74 billion. This is lower than it has been in recent years, primarily due to the persistently slow recovery of the housing market since the housing crash of 2008. OMB projects the cost will again reach $100 billion a year by 2018. Nonetheless, the MID remains the second largest tax expenditure behind the exclusion for employee paid premiums for health insurance.

It is also important for housing advocates to know that the MID is not the only tax subsidy for homeowners. The tax code also allows for the deduction of state and local property taxes ($34 billion in 2015) and the exclusion of capital gains on home sales ($57 billion in 2014). 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 $76 billion in 2015.

Contrast these subsidies for homeowners with the cost of the Low Income Housing Tax Credit (LIHTC), projected to be $7.9 billion in 2015. 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. According the Congressional Joint Committee on Taxation, in 2011, 155,879,000 tax returns were filed, 30% of which were itemized. Just 22% of all tax returns claimed the MID. The top 55% of taxpayers who claimed the MID (those with incomes of $100,000 or more) received 77% of the total benefit.

Contrary to popular opinion, the MID was not created to incentivize homeownership. It began 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.

Moreover, there is no evidence that anyone makes the decision to move from being a renter to a mortgage holder in order to claim the MID. Other countries with similar or higher rates of homeownership do not have the MID. The MID does encourage people who are already have mortgages to buy bigger, more expensive homes through which they take on more debt and thus get bigger tax breaks.

THE UNITED FOR HOMES CAMPAIGN

The United for Homes (UFH) campaign proposes to modify 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 cap on the amount of mortgage for which interest can be deducted would be lowered from $1 million to $500,000. Mortgages for first and second homes and for home equity loans of up to $100,000 are eligible for the tax break as long the total amount of loans does not exceed $500,000.

Some people suggest that exceptions for the $500,000 cap should be made for high-cost areas. However, only 3.9% of all mortgages in the U.S. between 2009 and 2012 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. The median loan amount between 2009 and 2012 for mortgages of $500,000 or less was $171,000, while the median loan amount for all mortgages was $176,000. Clearly, the vast majority of people who are borrowing to buy a house would not be affected by the proposed new cap. National housing policy should not be based on a small number of loans to higher income people who live in a handful of high cost 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 2013 report for NLIHC, the Tax Policy Center projected that these changes to MID, phased in over five years, would generate $196.7 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 mortgage interest deduction. Seventy-six percent of Americans favor building more affordable housing in their states to help end homelessness.

The primary 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 of April 1, 2014, H.R. 1213 has attracted eleven cosponsors, all Democrats.

POTENTIAL FOR REFORM

While H.R. 1213 would never move as a stand-alone bill, it could be added to a larger tax bill. Going into the 113th Congress, momentum was developing for comprehensive tax reform. The chairmen of both the Senate Finance Committee and House Ways and Means Committee signaled that their respective committees would take up comprehensive tax reform. Each committee held numerous hearings and convenings. They solicited ideas on ways to improve the federal tax code from a wide range of stakeholders. Both indicated a strong willingness to challenge many of the tax expenditures.

In addition to earlier recommendations to modify the MID from deficit reduction advocates, the Bipartisan Housing Commission issued its report in February 2013, in which it called for MID reform in order to pay for housing assistance for extremely low income households. The recommendation from the Bipartisan Housing Commission is particularly important, because it reflected the consensus of many housing industry leaders, including some of the most vocal defenders of the MID.

Despite their efforts, neither chairman was able to advance comprehensive tax reform legislation in 2013, unable to reach bipartisan consensus on the basic purpose of tax reform. Senate Finance Committee Chairman Max Baucus (D-MT) was interested in both reducing the deficit and raising revenue for new spending, while House Ways and Means Committee Chairman Dave Camp (R-MI) wanted to reduce tax rates.

At the beginning of 2014, Senator Baucus resigned his Senate seat to become the new U.S. Ambassador to China. Senator Ron Wyden (D-OR) is the new Finance Committee Chairman. He has indicated that his goals for 2014 are to extend a collection of expired or expiring tax provisions that have typically been expended without controversy, but have languished in the last year due to partisan gridlock.

For his part, Chairman Camp released the draft of his bill in January 2014 over the objections of the House Republican leadership. To achieve significant rate reduction, he would eliminate or modify many tax expenditures including the MID. In fact, his bill includes one of two changes to the MID proposed by UFH; he would lower the cap from $1 million to $500,000. Mr. Camp will be replaced as chair of the Ways and Means Committee at the end of the 113th Congress because he has reached the end of his term limit as chair.

The Camp bill sends a strong message that the MID is ripening for reform. Indeed, it seems that many Members of Congress who heretofore have supported and defended the MID are having second thoughts. A resolution that declared the MID should not be changed in any way was introduced at the beginning of the 112th Congress at the behest of the Home Builders and Realtors®. By the close of the 112th Congress, it had attracted 198 cosponsors. Virtually the same resolution was introduced at the beginning of the 113th Congress; it only has 21 cosponsors.

There is broad consensus that comprehensive tax reform is long overdue. The question is not if it will happen, but when. In the meantime, housing advocates must build the case for MID reform and using the revenue raised to end homelessness and solve the housing problems of the very poor.

CURRENT LEGISLATION

Representative Keith Ellison (D-MN) introduced H.R. 1213, the "Common Sense Housing Investment Act of 2013," in the 113th Congress. Mr. Ellison's bill makes the changes to the mortgage interest deduction that NLIHC and the United for Homes campaign propose. Mr. Ellison would direct 60% of the savings to the NHTF, with the remainder split among the Low Income Housing Tax Credit program, Section 8, and the Public Housing Capital Fund. As of April 1, 2014, H.R. 1213 has eleven Democratic cosponsors.

FORECAST FOR 2014

It is imperative that all housing advocates speak in one voice demanding that any savings gained from MID reform be kept in housing and be used to address long neglected housing needs, specifically those of extremely low income renters. NLIHC will continue to commit significant resources in 2014 to the United for Homes campaign.

WHAT TO SAY TO LEGISLATORS & HOW TO TAKE ACTION

- Endorse the United for Homes campaign! Secure other endorsers in your community.
- Ask your representatives to co-sponsor H.R. 1213.
- Educate your elected officials on the benefits of mortgage interest deduction reform and the National Housing Trust Fund.
- Urge your local and state government to pass a resolution in support of the National Housing Trust Fund.

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