

Revenue Options – Homeownership

Congressional Budget Office, August 2009



National Association of REALTORS® Government Affairs Division
500 New Jersey Avenue, NW, Washington DC, 20001

Every year, the Congressional Budget Office (CBO) is required by statute to recommend ways that Congress can cut spending and bolster revenues. The report for FY 2010 was issued in August 2009. It includes proposals that would have an impact on housing-related tax provisions.

These recommendations are NOT in bill form and should NOT be viewed as being part of the current legislative mix. Rather, CBO provides them for discussion and review.

Reduce the MID by Reducing the \$1.1 Million Cap to \$500,000.

Under current law, interest paid on up to \$1 million of mortgage debt, plus interest paid on home equity loans or lines of credit of up to \$100,000 may be deducted. These caps apply to the combined indebtedness on a principal residence and one additional residence. The caps were implemented in 1987 and have not been indexed for inflation.

CBO proposes a gradual reduction to the cap of \$100,000 a year, beginning in 2013 and ending when the cap would reach \$500,000 in 2018.

Revenue Impact: This proposal would increase federal revenues by \$41.4 billion over 10 years.

Change the MID to a Tax Credit

The value of a deduction to any particular taxpayer is directly related to that person's income tax bracket. The higher the bracket, the more value the deduction. By contrast, a tax credit has a stated dollar value and is worth the same amount, not matter what the tax bracket. For example, if an individual qualified for a credit of \$5,000 and had a tax liability of \$8,000, the credit would reduce the liability to \$3,000. If an individual qualified for that same \$5000 credit and had a tax liability of \$45,000, the \$5,000 credit would reduce tax liability to \$40,000. Thus, individuals with lower incomes/lower tax liabilities receive a greater proportional benefit than upper income individuals.

CBO proposes that the deduction be changed to a tax credit so that anyone who pays mortgage interest would be allowed to take a credit of 15% of the amount paid. Thus, if an individual paid mortgage interest of \$10,000, the credit would be \$1,500. Such a proposal would no doubt reduce the value of homeownership.

Note: A similar proposal was included in the recommendation of President Bush's Tax Reform Panel in 2005.

Revenue Impact: This proposal, coupled with the reduction in the caps above, would increase federal revenues by \$387.6 billion over 10 years.

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Reduce or Eliminate the Deduction for State and Local Taxes

Individuals who itemize deductions are permitted to deduct the cost of state and local income taxes, personal property taxes and real property taxes. Individuals who live in states with no income tax may elect to deduct sales taxes, as well as real and personal property taxes.

CBO proposes two different limitations on this deduction. The first would simply repeal the current itemized deduction. The second would be to allow the deduction, but to put a cap on it. The cap would be 2% of Adjusted Gross Income (AGI). Thus, if an individual had AGI of \$100,000, their deduction for all their combined state and local taxes would be \$2000.

Revenue Impact: Repealing the deduction would increase federal revenues by \$862 billion over 10 years. A 2% cap on the deduction would increase federal revenues by \$626 billion over 10 years.

Limit the Tax Benefit of All Itemized Deductions to 15%

Itemized deductions include not only deductions for mortgage interest, but also for state and local property taxes (including real property taxes), charitable contributions, some medical expenses and some casualty losses. The value of deductions increases as taxpayers move to higher brackets.

CBO has proposed limited the tax benefit of *all* itemized deductions to 15%. Mechanically, this is essentially the same as converting all deductions to a 15% tax credit.

Revenue Impact: This proposal would increase federal revenues by \$1.32 Trillion over 10 years.

Simplify Capital Gains Taxation

Under current law, a variety of tax rates apply to capital gains. The general rule is that capital gains are taxed at 15%. Special rates apply to lower income taxpayers (some are not taxed at all on capital gains), on collectibles (28%) and depreciation recapture (25%). The capital gains computations are among the most complex of current law for individuals.

CBO proposes restoring pre-1986 tax treatment to capital gains. This would be a significant simplification of current law. This change would also make the capital gains system more fair across tax brackets. Under the proposal, 45% of a capital gain would be excluded from taxation. The remaining 55% would be taxed at ordinary income tax rates. Before 1986, capital gains taxes were computed in



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the same manner. Depending on which year the gain was realized, the excluded amount varied from 50% to 60%.

Revenue Impact: This proposal would reduce federal revenues by \$48 billion over 10 years.

Like-kind Exchanges and \$250,000/\$500,000 Exclusion on Sale of Principal Residence

CBO makes no recommendation that would affect these provisions.

