NAR Committee:

Federal Taxation Committee

What is the fundamental issue?

Over the past five or six years, the growing federal debt, weak economic recovery, and continued growth of tax complexity have kept tax reform near the top of the national agenda. Members of Congress from both Houses and both parties have expressed a high level of interest in reforming the tax system. However, former President Obama expressed only limited support, and only for corporate or business tax reform. Moreover, the two parties have been quite far apart in their visions for what tax reform should accomplish. This resulted in many congressional hearings and much talk about tax reform, but little real action.

In late 2013, Former Senate Finance Committee Chairman Max Baucus (D-MT) released a series of staff discussion drafts on tax reform. Each draft covered a different topic of tax reform, and included some specific proposals to repeal certain tax benefits available under the current tax code. Important to commercial and rental real estate were proposals to increase the depreciable lives of real property used in business or held for investment to 43 years (from the current periods of 39, 27.5, and 15 years), to raise the tax rate on gain from depreciation recapture from the current 25% to the ordinary income tax rate (now as high as 39.6%), and to repeal the tax rules that allow taxpayers to exchange like-kind real estate on a tax-deferred basis. In February 2014, Former House Ways and Means Chairman Dave Camp (R-MI) released a comprehensive draft tax reform plan that included many of the same provisions as the Baucus plan that would be negative to commercial and investment real estate, as well as some different ones that would be devastating to residential real estate.

Many stakeholders in the real estate community, including NAR, viewed these proposals as a significant threat, even though there was little chance of the bills advancing in the near-term. NAR, together with other groups, sent a detailed letter to the Finance Committee in January 2014, which outlined the many reasons why adoption of the Baucus proposals would be a major step in the wrong direction for the nation’s economy, for job growth, and for tax reform. NAR also expressed grave concern with the Camp plan.

Both Senator Baucus and Representative Camp have now retired, but their tax reform ideas are still considered by many current policymakers to be viable ideas from which to draw for future tax reform plans. This is especially true when tax reform is considered in a revenue-neutral environment, such as still the case now. This means that revenues lost from tax rate reduction would have to be made up or offset by the removal or dilution of tax benefit provisions in the tax code.

The new leaders of the tax-writing committees, Ways and Means Chairman Kevin Brady (R-TX) and Finance Chairman Senator Orrin Hatch (R-UT), have each expressed a strong desire to accomplish tax reform. And now that President Trump has taken office and has made it clear that he shares the goal of modernizing the tax code, we are facing an environment that is more friendly to the possibility of big changes being enacted to the tax law than we have seen in a long time.

Until the last election put control of both Houses of Congress and the White House in the hands of the
Republicans, there was a significant divide between the parties, who shared power, as to what tax reform should look like. Generally speaking, Democrats were in favor of increasing the perceived level of fairness of the tax burden in our society. Republicans, on the other hand, were more concerned about economic growth and job creation. It is this divide that effectively prevented tax reform from moving toward enactment over these past few years.

While the two sides of the political aisle still have major differences in their general views of what tax reform should look like, it now appears much more possible that Republican preferences could prevail, especially if a handful of moderate Democrats can be persuaded to join in.

The path forward to tax reform is still quite cloudy, both as to timing and what might be successfully brought to the finish line.

However, with policymakers of all stripes expressing a willingness to simplify the tax law and to broaden the base and lower the tax rate, a very real possibility exists that common ground on tax reform can be found. Along with this possibility is the danger that the tax incentives for owning a home could be diminished for the majority of Americans, and that vital provisions for commercial real estate could be repealed or limited in order to “pay for” lowering the tax rates.

**I am a real estate professional. What does this mean for my business?**

Tax reform carries high stakes for real estate professionals and those who own real estate. The current system is very efficient and generally favorable for real estate. Alterations to that system would change -- likely to the detriment -- the economics of homeownership and of real estate investment. Any modification of real estate-related tax benefits in the current fragile economy could do serious damage and would create uncertainty for prospective purchasers.

Also, tax reform based on a goal of lowering the tax rates as much as possible could mean that policymakers ignore the societal and economic benefits of important and long-standing deductions, such as the mortgage interest deduction, in favor of reaching the ultimate low tax rate. While lower rates could help take some of the sting out of lost tax benefits, and generally be positive for the economy, the trade-offs would create many winners and losers among individuals, businesses, and entire industries. There is no assurance that tax reform would result in a net positive for real estate or for the economy. Indeed, the real estate sector could take a big hit, as it did in 1986, the last time tax reform was successfully undertaken.

**NAR Policy:**

NAR embraces no single tax reform model such as a flat tax or a retail sales tax. Similarly, NAR does not adhere to any specific schedule of tax rates as a primary goal. Rather, NAR policy acknowledges the complexity of the current tax system and seeks tax reforms that support the goals of homeownership and freedom to buy, maintain and sell real estate.

The current real estate tax provisions are among the most widely used and most readily understood tax provisions. Homeownership is not a special interest, nor a loophole. Nearly two-thirds of Americans own
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their homes, and a high percentage of tax benefits go to households with less than $200,000 of income. Many real estate investment decisions have been made with the current tax law factored in. Changing the rules on existing investments could harm the economic recovery and future job creation. Moreover, homeowners already pay 80 to 90 percent of all federal income taxes, and it would be unfair to increase the tax burden on this segment of the population.

Opposition Arguments:

Opponents of NAR policy argue that the current tax system is riddled with loopholes that benefit mostly high-income Americans. In the case of mortgage interest and property tax deductions, only about one-third of taxpayers itemize and are thus able to take advantage of these deductions, so the benefits should be spread out to more Americans. Further, some claim that the huge amounts spent through the tax code in subsidizing housing does little to increase the homeownership rate and largely rewards those who already have a home.

Legislative/Regulatory Status/Outlook

Over the past five or six years, both of Congress’s tax-writing committees (House Ways and Means Committee and Senate Finance Committee) have been active in holding hearings and developing draft tax reform plans. However, most of these draft plans have not moved beyond the discussion draft stage.

Until late 2013, most of the tax reform discussion was mostly focused on rate reduction, but no details were provided that would suggest which deductions and tax credits would be reduced or eliminated in order to "pay for" deep rate cuts. However, this changed with the release of the Camp plan in 2014 and a more recent tax reform “Blueprint” released by the House Republican leadership in the summer of 2014. NAR is particularly concerned about the mortgage interest deduction (MID) and the deduction for state and local taxes (including property taxes), as well as its commercial real estate provisions.

The reason for this concern is that a central feature of both the Camp and Blueprint plans is the elimination of all itemized deductions, except the mortgage interest deduction and the deduction for charitable contributions. Along with these changes, the standard deduction would be nearly doubled under these plans. While at first glance, it may seem that retaining the MID would hold homeownership tax incentives harmless, this would be far from the case.

In reality, a plan that eliminates most itemized deductions while doubling the standard deduction would mean that only about 5 percent of taxpayers would claim itemized deductions, down from about a third under the current law. In essence, this would mean that for the great majority of Americans, there would no longer be a tax difference between owning a home and renting one.

The Blueprint tax reform plan also presents some challenges on the commercial real estate side, as well as some potential opportunities. For example, under the plan, interest expense would no longer be deductible, to the extent that it exceeds interest income. This is particularly troubling for an industry as highly leveraged as is real estate. On the other hand, the Blueprint provides that most productive assets, including buildings, would be eligible for immediate expensing, or being written off fully in the first year. This could effectively do away with the need for depreciation schedules. However, there are many unanswered question about how such a plan would work, and whether all real estate investors would be
able to take advantage of these potential benefits.

On the Senate side of the Capitol, it is unclear what direction the Finance Committee might take in developing tax reform in 2017. Last year, the Committee’s chairman, Senator Orrin Hatch (R-UT), developed a complex and somewhat controversial tax reform plan designed to change the current-law requirement that corporations be subject to two layers of taxation. It is unclear how much support this plan might garner even among Committee Republicans, or if Chairman Hatch will pursue this plan in 2017 or develop something closer to the House Republican Blueprint plan.

President Trump has endorsed tax reform as a major goal of his new Administration. And having a Republican-controlled House and Senate in place, many are convinced that 2017 could be the year when some version of tax reform might finally get enacted. However, much work remains to be done before any tax reform plan comes up for any votes.

Real estate has much at stake with tax reform. While there is potential for simplicity and economic growth from a plan such as the Blueprint, there is also potentially much to lose, and the basic tax benefits of owning a home, which have been in place for over a century, are at risk.

NAR has already expressed major concerns through letters and high-level meetings with congressional leaders about the Blueprint and its possible effects on the tax incentives for owning a home. Further, NAR has commissioned economic studies by PwC (PricewaterhouseCoopers) to help assess the impact of this kind of tax reform plan on both the housing market and the commercial real estate sector as a part of its advocacy efforts.

**Current Legislation/Regulation (bill number or regulation)**

None at this time.

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