NAR Issue Brief
Tax Reform 2017

Tax Reform is Important but Must Not Erase the Tax Benefits of Homeownership

Issue Background: Since its inception over a century ago, the U.S. income tax system has recognized the positive effects of homeownership for families, communities, and society by rewarding home buyers with tax benefits. The result has been a home-owning society that is, in many respects, the envy of the world. However, a kind of tax reform plan already being considered in Washington is inadvertently threatening to decimate or even wipe out the tax benefits of owning a home for 95 percent of American families. Ironically, the proponents of this type of tax reform pledge to protect the Mortgage Interest Deduction (MID) by retaining it as one of just two itemized deductions that would not be repealed.

The Downside of Tax Simplicity: In an effort to simplify the tax code, tax reform would eliminate the deduction for state and local taxes paid, including property taxes. Moreover, the standard deduction would also be doubled or tripled, which would greatly diminish the number of taxpayers claiming deductions for MID. Together, these changes could largely erase the tax benefits of owning a home for all but about 5 percent of tax filers. For everyone else, buying would offer little or no more tax benefit than renting.

How Might Tax Reform Eliminate the Tax Benefits of Homeownership? By greatly increasing the standard deduction, itemized deductions become less relevant and a lot fewer people would be able to claim them. This is because taxpayers claim the higher of the actual itemized deductions or the standard deduction. If most other itemized deductions were eliminated, such as the deduction for state and local taxes paid, the effect of the higher standard deduction would be greatly exacerbated. This is because homeowners would have a far lower amount of itemized deductions to claim, and only a small minority with the highest deductions would meet the higher threshold for itemizing.

Why are REALTORS® worried about a higher standard deduction? A small increase in the standard deduction might be justified and even a good idea. However, doubling or tripling the amount, while at the same time eliminating most itemized deductions, would have the consequence of hollowing out the incentive effect of the remaining deductions (namely, the mortgage interest and charitable contribution deductions). For the great majority, there would no longer be a strong tax incentive to purchase a home, rather than to rent one. This would upset 100-plus years of our tax system offering a meaningful incentive to become a homeowner, and could have all sorts of unintended negative consequences.

What negative consequences might result from this kind of tax reform? REALTORS® are worried about two possible effects above others. First, the tax incentive to buy a home has its first and largest effect on the first-time homebuyer. Moving from renting to purchasing home is often very difficult, and making the finances work is a major challenge for most. Having a strong and appropriate tax incentive to assist in this has been instrumental in getting millions of homeowners into their first house. Second, if the tax benefits of owning a home suddenly disappear for the majority of current homeowners, this will have a significant and negative effect on the price of homes. Most homeowners could lose equity and thus family savings. Millions of homes could go underwater, meaning the home is no longer worth as much as is owed on its mortgage.

But wouldn't the economic growth effect of lower tax rates offset these effects? Possibly yes, in the longer run. But over a shorter and mid-range period, there could be moderate to severe economic consequences to the housing sector and the entire economy, not to mention negative effects on communities and families everywhere. The U.S. is, in many ways, still reeling from the economic shock from falling home prices suffered in the Great Recession. Housing's contribution to GDP generally ranges from 15 to 18 percent (per the National Association of Home Builders), so a negative impact on housing could shake the entire economy.

Can you offer an example of the impact of a higher standard deduction on a first-time homebuyer? Yes. Let's consider the case of a hypothetical single woman living in Colorado. She currently rents an apartment, but wants to buy her first home – a condo. Having saved up for a 5 percent down payment on a $263,000 unit, she would find the monthly mortgage payment would be $1,193 with a 4 percent interest loan. Under the current law, this first-time purchaser would be eligible for tax incentives to buy the condo totaling over $3,300 for 2016. But under a tax reform plan that almost doubles the standard deduction, and repeals all itemized deduction except the MID and charitable contributions, her tax benefit would drop to almost nothing. Thus, the cost of buying would suddenly skyrocket by as much as $263 per month.

Under tax reform, tax rates are going down. Wouldn't the first-time buyer pay less tax? Not necessarily. Tax reform would produce winners and losers, but many homeowners would find themselves paying more tax dollars to Uncle Sam, while still losing the tax incentive to buy a home. The tax effect on individuals of tax reform is important, but so is the impact on society and families of our country moving from a one where homeownership is encouraged toward possibly becoming more of a nation of mostly renters.

Does this mean that REALTORS® will oppose tax reform? Not at all. Our tax system is too complex, and tax reform should simplify it. However, in doing so, we must be careful not to discard the features of the system that provide the bedrock for homeownership in America.