COMMENTS

"MAKING TAX INCENTIVES FOR HOMEOWNERSHIP MORE EQUITABLE AND EFFICIENT" BY ADAM CARASSO, C. EUGENE STEUERLE, AND ELIZABETH BELL

John E. Anderson, University of Nebraska-Lincoln

THIS PAPER MAKES THE PERFECTLY LOGICAL AND lucid case that the existing federal tax policies to encourage homeownership are not very rational, efficient or equitable. While the federal government spends billions of dollars each year on subsidizing owner-occupied housing, both housing and tax policy analysts question whether the current policy tools are appropriate. In fact, numerous alternatives have been suggested. In particular, The President's Advisory Panel on Federal Tax Reform (2005) suggested last year that the mortgage interest deduction be replaced with a refundable mortgage interest credit subject to regional house price caps. That proposal was not well received (an understatement to be sure!). The authors of this paper make the case yet again, with specific alternative policy proposals. Their analysis is thoughtful, relevant, and should be heeded by policy makers as they contemplate how to rationalize federal housing policy.

Table 1 illustrates federal tax expenditures for housing amounting to a total of $160 billion. The largest of the tax expenditures is the mortgage interest deduction (MID), $76 billion, or nearly half of the total. Beyond the MID, exclusions for capital gains tax and imputed rental income along with the deduction for state and local property taxes account for the other housing tax expenditures. In distributional terms, the authors show in their Table 2 that the MID and property tax deduction benefit primarily households in the upper two quintiles of the income distribution.

The authors of this paper use the Urban-Brookings tax policy micro-simulation model to calculate the revenue and distributional effects of four different policy reform options.

- A fixed percentage mortgage interest credit (MIC): repeals MID and replaces it with a refundable MIC of 16.7 percent.

- A flat MIC: repeals MID and replaces it with a refundable MIC of 1.03 percent of home value up to $100,000 cap (i.e., max credit of $1,030).

- A flat real estate tax credit: repeals real estate tax deduction and replaces it with a refundable credit equal to the lesser of $280 or 50 percent of the real estate tax.

- A flat tax credit in lieu of mortgage interest and real estate tax deductions: repeals the MID and the real estate tax deduction.

One of the policy options they do not present in the paper is a flat tax credit for first-time home buyers. If the policy objective is to maximize homeownership, this may be another mechanism to consider and may, in fact, be the most efficient mechanism.

Table 2 summarizes the advantages and disadvantages of potential policy changes.

There are several additional issues to consider. First, it is important to note that in the micro-simulation model homeownership is not endogenous (i.e., it is exogenously determined). This has important implications as the model does not allow for endogenous changes in tenure status, which we know would be a natural implication of these policy changes.

Second, it is also important to recognize that some estimates of the revenue potential from elimination of the MID is much smaller than the conventional estimates embodied in the tax expenditure report of the federal government. Follain and Melamed (1998) have modeled the endogenous financing decisions of households (portfolio reshuffling) and maintain that the static estimates embodied in the typical tax expenditure estimates overstate the revenue potential of policy changes.

Finally, it is important to note that recent tax policy changes were not in effect when the 2001 SOI public-use database used by the authors was constructed. Their micro-simulation model does take into account all the subsequent changes in tax, however. Since 2001 the following tax changes have been enacted: (1) reductions in tax rates in the higher tax brackets, (2) reduction in the

Table 1
Owner-Occupied Housing Tax Expenditures, 2006

Tax Preference	Tax Expenditure ($ billion)
Deduction for mortgage interest	76,060
Capital gains exclusion	39,750
Exclusion of net imputed rental income	29,720
Deduction for state and local property taxes	15,020
Total	160,550

Source: U.S. Office of Management and Budget, 2006, p. 288.

Table 2
Advantages and Disadvantages of Various Potential Policy Changes

Policy	Advantages	Disadvantages
Fixed percentage MIC: repeal MID and replace it with a refundable MIC of 16.7%	Redistribution of benefits from top quintile to 3rd and 4th quintiles	Introduces a new incentive to hold onto borrowing for lower-income households
		Interest rate subsidy lowers the cost of borrowing, which during periods of high inflation may encourage households to make investments that may not be economically sensible otherwise
Flat MIC: repeal MID and replace it with a refundable MIC of 1.03% of home value up to $100,000 cap (i.e., max credit of $1,030)	More redistribution, cutting in half the benefits to those in the top quintile and increasing benefits for those in bottom quintiles	
Flat real estate tax credit: repeal real estate tax deduction and replace it with a refundable credit equal to the lesser of $280 or 50% of the real estate tax	Smaller amount to redistribute, with benefits going to those in the bottom 4 quintiles	Relative disadvantage for local governments with high cost of providing public services
Flat tax credit in lieu of mortgage interest and real estate tax deductions: repeals the MID and the real estate tax deduction	Combination of options 2 and 3--	
First-time homebuyers credit	Marginal tenure choice incentive, not subsidizing infra-marginal purchase of housing	Administration and enforcement may be difficult
	Substantial redistribution	Substantial redistribution

capital gains tax rates, (3) reduction in the tax rates applied to dividends, (4) relaxation of limits on itemized deductions and personal exemptions for high-income filers, (5) increases in the child care credit, (6) increases in the dependent care credit, (7) marriage penalty relief, (8) 15 percent tax bracket for joint filers, (9) expanded ITIC, (10) AMT relief, and (11) increased depreciation deductions. These recent changes in tax policy have distributional implications for the *ex ante* distribution of housing benefits and after-tax income in the micro-simulation model, and thereby have implications for the *ex post* distribution and consequent implications for the differential benefits estimated. This is not to suggest any shortcoming in the authors' estimates, but rather to point out that in the wake of EGTRRA 2001, JCWAA 2002, and JGTRRA 2003, the *status quo* benchmark has changed substantially.

References

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