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Will President Bush Reform the Mansion Subsidy?

The President's Advisory Panel on Federal Tax Reform recommended scaling back one of the largest subsidies for the rich. But will he do it?

By Peter Dreier

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For years, progressives have been denouncing "welfare for the rich" – government subsidies to big business, pork-barrel Pentagon contracts to weapons makers, huge tax breaks for wealthy individuals and, most recently, colossal no-bid contracts for post-Katrina reconstruction to politically connected companies like Halliburton. No one was shocked when Republicans proposed cutting funds for Medicaid and Section 8 housing vouchers, while preserving – even expanding – subsidies for the affluent.

So it came as a surprise to some observers in November when President George W. Bush's Advisory Panel on Federal Tax Reform recommended scaling back one of the largest subsidies for the rich – tax breaks for wealthy homeowners.

The tax reform panel catalyzed a public debate over homeowner tax breaks that housing activists, including the National Housing Institute and the late Cushing Dolbeare of the National Low-Income Housing Coalition, have been advocating for decades. Since the 1980s, NHI has produced reports, op-ed columns in major newspapers and articles in *Shelterforce* focusing attention on what we call the "mansion subsidy," because most of the tax breaks benefit the very wealthy with expensive homes.

The news leaked out on October 7, following a meeting of the task force, and for the next few weeks the issue of homeowner tax breaks was a major news story. Reporters, columnists and editorial writers spilled a lot of ink reporting on the task force's deliberations and its potential recommendation to revise the tax break for homeowners. The proposal to scale back the mortgage interest deduction was just one of many possible recommendations the task force had under review, but it was the one that generated the most headlines.

Real estate industry lobby groups – like the National Association of Homebuilders, the National Association of Realtors and the Mortgage Bankers Association – complained that wiping out or scaling back the deduction would hurt existing homeowners, reduce the overall homeownership rate and damage the economy. Economists and tax experts argued that reforming the mortgage interest deduction would have no disastrous consequences for homeownership rates or housing costs and would mainly reduce tax breaks for the very rich. Others said that the homeowner tax breaks not only distort the housing market, but divert capital away from other economic sectors. A few major newspapers endorsed the idea of scaling back the deduction. For example, *USA Today* editorialized: "It mostly benefits people who don't need it."

[Graphic: Who Benefits from the Mortgage Interest Deduction]

[Graphic: Who Benefits from the Property Tax Deduction]

The President's panel reviewed several ideas before delivering its final report to the Bush Administration on November 1. One suggestion was to scrap the mortgage interest deduction – which allows write-offs on first and second loan amounts up to $1.1 million – and replace it with a 15 percent credit. The richest homeowners can now deduct 35 percent.

Another idea was to reduce the ceiling on mortgages eligible for tax breaks to $300,000 to $350,000. They also floated the idea of varying the ceiling to account for varying housing costs in different parts of the country. Panel member James Poterba, an economics professor at the Massachusetts Institute of Technology, suggested capping mortgage interest rate deductions at current Federal Housing Administration mortgage limits, which range from around $190,000 to about $310,000, depending on the locality. When politicians and housing industry lobbyists from high-cost states complained, they revised the proposal to range from $227,000 to $412,000. (The nation's median home price is now $268,000).

In exchange for these losses of tax benefits, the advisory panel suggested eliminating the alternative minimum tax, adding $100,000 to the $500,000 tax-free exclusion on home sale profit, lowering capital gains tax rates, cutting the number of tax brackets and providing a variety of other simplifications to the federal tax code.

Bush created the task force in January 2005 to suggest changes in the tax code. The goals were to make the code simpler and fairer, although there was considerable disagreement over what these terms mean. Bush insisted that the panel's proposal be "revenue neutral," meaning that any losses in government revenues would have to be offset by other tax code changes. The nine-member panel, co-chaired by former Senators Connie Mack (R-FL) and John Breaux (D-LA), did not include any representatives of housing advocacy or progressive tax reform groups.

One member of the group – Charles Rossotti, the IRS commissioner from 1997 to 2002 – said that, "everything's on the table." But when Bush announced the task force in January, he specifically mentioned that the panel should take account of the "importance of homeownership" in its recommendations. Some viewed this as a signal to the powerful real estate industry that Bush wouldn't challenge tax breaks for wealthy homeowners.

In fact, many of the media reports on the task force's recommendations focused on the political realities of challenging what the real estate industry views as a "sacred cow." *The Washington Post*, the *Los Angeles Times*, conservative columnist Robert Novak and liberal columnist (and Secretary of Labor under Clinton) Robert Reich declared that, whatever the merits of the task force proposals, any effort to tinker with the homeowner deductions were "dead on arrival" because of the political influence of the real estate industry. Most of the news reports got the basic facts right about who benefits from the mortgage deduction, but, with some notable exceptions, the press tended to accept the real estate industry's view that the current mortgage interest deduction promotes homeownership.

In a nation that values homeownership, no one wants to make it harder for families to buy a home, so by framing the debate in these terms, the real estate industry made it appear that the proposed reforms would undermine the "American Dream" of homeownership.

The real estate industry claims that the tax break was initially put into the tax code to promote homeownership. But there is no evidence to support this. According to political scientist Christopher Howard, author of *The Hidden Welfare State: Tax Expenditures and Social Policy in the United States* (Princeton University Press, 1997), the 1913 individual income tax bill allowed taxpayers to deduct from their total income "specific sources of incomes (such as gifts, inheritances and interest on state and local bonds) and specific expenses in order to generate a lower level of taxable income." And when Congress added mortgage interest payments as a deductible expense in 1939, it was because so many Americans during that time were engaged in farming, and it was simpler to allow them to include their housing expenses with their deductible farm expenses. Over the years many advocates for the deduction have revised history, translating the action as a conscious push for homeownership, when it really was born out of a much simpler agenda.

Of the hundreds of tax breaks (what economists call "tax expenditures") for corporations and individuals in the nation's tax code, the largest are the subsidies for homeowners. The two major homeowner tax breaks cost the federal government almost $90 billion last year – $70.1 billion for the mortgage interest deduction and $19.3 billion for the property tax deduction – according to a report by the Congressional Joint Committee on Taxation. That would be ok if most of it helped middle- and working-class people. But it doesn't. Those with the highest incomes and the most expensive homes (including second homes) get the largest subsidy.

Most Americans think that federal housing assistance is a poor people's program. In fact, less than one-fourth of all low-income Americans (those who have Section 8 rental vouchers or who live in government-assisted developments) receive federal housing subsidies. In contrast, almost two-thirds of wealthy Americans – many living in mansions – get housing aid from Washington.

More than half (53.7 percent) of last year's $89.5 billion homeowner subsidies went to the 11.8 percent of taxpayers with incomes over $100,000. More than one-fifth (20.6 percent) went to the wealthiest 2.3 percent of taxpayers with incomes over $200,000.

Wealthy households are most likely to own homes and to itemize deductions. Half of all homeowners do not claim deductions at all. Tenants, of course, don't even qualify. As a result, 62 percent of households with incomes above $200,000 receive a mortgage interest tax break, averaging $7,219. In contrast, only 3.5 percent of households with incomes between $10,000 and $20,000 receive any subsidy, averaging $317. If anything, these tax deductions help push up housing prices artificially, especially at the upper end, because homebuyers include the value of the tax subsidy in their purchase decision. This leads wealthy homeowners to buy bigger houses than they would without the tax breaks.

In recent years, many middle-class families have found it more and more difficult to buy a home. Contrary to the rhetoric of the real estate industry, these deductions aren't the salvation of the middle class. Only one-third of the 52 million households with incomes between $30,000 and $75,000 receive any homeowner subsidy.

As a result, a wealthy corporate executive is more likely to receive a much bigger homeowner tax break than a garment worker, a construction worker or a school teacher. The current system subsidizes the rich to buy huge homes without helping most working families buy even a small bungalow.

The real estate industry – homebuilders, realtors and mortgage bankers – argues that the homeowner tax break is the linchpin of the American Dream. This is nonsense. Neither Australia nor Canada has a homeowner deduction, and their homeownership rate (about two-thirds of all households) is about the same as ours.

Indeed, a report by the Congressional Research Service released in August 2005 noted that, "other homeownership subsidies, like down-payment assistance programs, are proven to be more effective at increasing homeownership among lower-income families and are less expensive than the mortgage interest deduction."

Housing subsidies for the rich are virtually an entitlement, but for the poor it is a lottery. While the tax code provides $48.1 billion in homeowner subsidies for families with incomes above $100,000, the entire U.S. Department of Housing and Urban Development budget is only $32 billion, which provides housing assistance for less than one-quarter of the nation's poor. And while the number of poor people has increased, the Bush Administration is cutting housing subsidies for low-income families. The gap between housing subsidies for the rich and the poor has been widening.

No one wants to eliminate existing homeowner subsidies for middle-class families. But the current system – which subsidizes the rich to purchase huge homes without helping most working families become homeowners – is in desperate need of reform.

For years, the Congressional Budget Office, in its annual report on budget options, has examined the impact of reducing tax breaks on expensive homes. In its February 2005 report, it noted that lowering the ceiling on the amount of principal eligible for the mortgage interest deduction from the current $1 million to $500,000 would affect only 700,000 homeowners (less than 1 percent of all homeowners) and raise $2.7 billion next year and more in subsequent years.

Despite these realities, the real estate industry has been successful in protecting the mortgage interest deduction from reform. When the tax break has been vulnerable, it is typically from conservative forces that want to scale it back to reduce the federal budget deficit or impose a regressive flat tax. A progressive reform of the mansion subsidy would require a broad grassroots coalition of housing activists, labor unions, community groups and others, who see it as part of a comprehensive challenge to government give-aways to big business and the wealthy.

In the unlikely event that President Bush supports his panel's proposals to scale back the mansion subsidy, and Congress adopts it, how would those savings be used? No doubt Bush and his fellow Republicans would want to use the funds to reduce the deficit, now bloated due to tax breaks for the rich and the war in Iraq. But why not use the money to expand the number of families who receive Section 8 housing vouchers? Or to help more working families become homeowners by providing them with downpayment assistance? Or to add a housing component to the popular Earned Income Tax Credit, which would be tied to local housing prices?

The current way we distribute housing subsidy funds is wasteful and unfair. As a nation, we have the resources to assist the millions of poor and working-class families who cannot afford market-rate rents or home prices. Let's stop subsidizing the rich to live in mansions and help working families achieve the right to decent affordable housing.

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Resources
President's Advisory Panel on Federal Tax Reform
www.taxreformpanel.gov/final-report

"National Association of Home Builders Concedes-Mansion Subsidy is Unfair!"
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www.nhi.org/policy/mansion1.html

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