NAR Issue Summary
Federal Tax / Tax Reform

NAR Committee:

Federal Taxation Committee

What is the fundamental issue?

The last major tax reform legislation was passed in 1986. Continued concerns about a growing federal debt, weak economic recovery, and increasing 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, the two political 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 until now.

A "Blueprint" released by the House Republican leadership in the summer of 2016 has served as the guide for the House Ways and Means Committee as it drafted its recently released reform bill, H.R. 1, the Tax Cut and Jobs Act. NAR's longstanding concerns about risks to the mortgage interest deduction (MID) and the deduction for state and local taxes (including property taxes), as well as its limits of the capital gains exemption, have materialized in H.R. 1, and also in the Senate's just released tax reform bill.

H.R. 1 eliminates of all itemized deductions, except the mortgage interest deduction, the deduction for charitable contributions and a limited deduction of real property taxes up to a cap of $10,000. The Senate tax reform bill is similar, except it would eliminate the property tax deduction. Along with these changes, the standard deduction would be nearly doubled under both of these bills.

While at first glance, it may seem that retaining the MID would hold homeownership tax incentives harmless, this is far from the case. In reality, this plan would mean that far fewer than 10 percent of taxpayers could 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. President Trump has endorsed this kind of tax reform, and if the House and Senate can work out the differences between their two versions, he would likely sign the resulting bill.

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.

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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.

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 their homes, and a high percentage of the tax benefits of home ownership 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. Negatively changing the rules on existing investments is unfair and could harm economic growth and future job creation. Moreover, homeowners already pay 83 percent of all federal income taxes, and it would be unfair to increase the tax burden on this segment of the population.

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 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.

For the detailed economic analysis underlying NAR's policy, please go to the later section of this page entitled: "Economic Research Underpinning NAR's Advocacy Efforts."

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.

Mortgage Interest and Real Property Tax Deductions:

NAR supports the preservation of these deductions which have been part of the tax system since its inception over 100 years ago. The deductions are among the most popular and widely utilized in the tax code. The value of these tax benefits are both directly and indirectly embedded in home prices, and home prices will fall significantly if the deductions are eliminated or limited. Moreover, these deductions primarily benefit the middle class. Seventy-three percent of the value of the mortgage interest deduction and 70 percent of the value of the property tax deduction goes to taxpayers earning less than $200,000 per year.

Exclusion of Capital Gain on Sale of Principal Residence:

NAR supports the preservation of the exclusion of capital gain on the sale of a principal residence. Additionally, NAR supports indexing the current exemption, capped at $250,000 for a single filer and $500,000 for joint filers, to inflation to avoid its value eroding over time. Real estate is the most widely-held category of assets owned by American families. For the great majority, it is the family home that constitutes their real estate assets. Not only is the current-law exclusion a major simplification measure for millions of taxpayers, it also greatly enhances their saving toward retirement.

Deferral of Gain on Like-kind Exchanges:

NAR supports current tax law provisions which have long recognized that when an investor in real estate exchanges one property for another of like kind, economically, nothing has changed. Indeed, allowing capital to flow more freely among investments is critical to economic growth and job creation. Provisions that allow for the deferral of gain on the like-kind exchange of real property is vital to economic growth and should be maintained.

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

The “Blueprint” released by the House Republican leadership in the summer of 2016 has served as the guide for the House Ways and Means Committee as it drafted its reform bill, H.R. 1, the Tax Cut and Jobs Act. NAR’s concerns about the mortgage interest deduction (MID) and the deduction for state and local taxes (including property taxes), as well as its limits of the capital gains exemption, have materialized in H.R. 1, and also in the Senate’s tax reform bill.

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What H.R. 1 Would Do:

- Cap the mortgage interest deduction at $500K for new mortgages.
  - Cap applies to new mortgage debt (but not refinancing) incurred after November 2, 2017.
  - Limit is not indexed to inflation causing its value to even further diminish over time.

- Nearly double the standard deduction
  - The bill's combination of a much higher standard deduction and the repeal of most itemized deductions would place homeownership tax incentives beyond the reach of more than 90% of American families.

- Limit the exemption on Capital Gains Tax from the sale of a primary residence
  - New rules would require homeowners to live in their home for at least 5 of 8 years before a sale to qualify for the exemption, versus just 2 of previous 5 years today. This would create a hardship to homeowners who have to move inside that five-year window.
  - The exemption phases out for single filers with incomes over $250K ($500K for joint returns).

- Eliminate the deduction for state and local income or sales taxes.

- Eliminate the Mortgage Interest Deduction for second homes and for new home equity loans.

- Eliminate the deduction for moving expenses.Eliminate the deduction on interest on student loans.

- Eliminate the deduction for medical expenses, even for the elderly.

- Eliminate the deduction for personal casualty losses, such as from hurricanes or wildfires.

Senate Tax Reform Bill:

In addition, on November 9, 2017, the Senate Finance Committee released its version of a tax reform bill that will likely be considered by the committee and the full Senate by the end of November. While the Senate draft bill has some differences from the H.R. 1, they would both have very negative effects on the residential real estate market and the incentives for homeownership.

These results are very disappointing, especially when one considers that tax reform is supposed to improve our tax system. Not only is this legislation a clear and present danger to American homeownership, it will cost our children and grandchildren $1.5 trillion or more in new federal debt.

With political control of the House and United States Senate, the Republican majority can pass this sweeping reform proposal with no support from Democrats. Using the complex legislative tactic known as "Budget Reconciliation," a simple majority in the House and Senate is all that is required to move the bill. However, the path forward to this legislation becoming law is still somewhat rocky. The Senate version of tax reform is somewhat different from the House bill, and these differences will have to be worked out before a final bill can be presented to the President for his signature. Finding the necessary compromise necessary to work out these differences could be difficult and time consuming.

Real estate has much at stake with tax reform. The potential exists that the basic tax benefits of owning a home, which have been in place for over a century, are at risk. NAR has already expressed opposition to H.R. 1 as written through letters and high-level meetings with congressional leaders. NAR's Federal Political Coordinators will be flying into Washington, D.C. the week of November 13, 2017 for direct meetings with House and Senate members.

Economic Research Underpinning NAR's Advocacy Efforts

In the summer of 2016, Speaker of the House Paul Ryan introduced a series of tax reform concepts known as the "Blueprint." Many stakeholders in the real estate community, including NAR, viewed the concepts as a significant threat, even though there were few details available.

In the fall of 2016 as the national election focused on tax reform proposals, NAR engaged PwC (PricewaterhouseCoopers) to review the impact of a comprehensive tax reform proposal. The proposal utilized the basic outline offered in the "Blueprint" – a lowering of marginal tax rates, consolidation of the current tax brackets down to three, a near doubling of the standard deduction, an elimination of all itemized deductions other than charitable contributions and the mortgage interest deduction, and elimination of all personal exemptions.

- The analysis estimated that taxpayers (including both homeowners and non-homeowners) with adjusted gross incomes (AGI) between $75,000 and $250,000 would on average pay higher income taxes, while all other income categories would, on average, enjoy tax reductions
- Homeowners with AGI between $50,000 and $200,000 would see an average tax increase of $815
- Non-homeowners with AGI in the same range would see an average tax reduction of $516
- Taxpayers with AGI under $50,000 would see average tax reductions of under $100
- Taxpayers with AGI over $200,000 would see average tax decreases of over $15,000.

The analysis determined that home values in the short run would fall by an overall average of 10.2 percent because of the comprehensive tax reform.

Current Legislation/Regulation (bill number or regulation)

None at this time.

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