

Large Gap in Tax Subsidies Eases Slightly in Current Budget

By Michael J. Novogradac, CPA

Given the current economic environment, with foreclosures at historic levels and unprecedented turmoil in the housing market, it is more important than ever for the government to provide adequate funding for efforts to make housing affordable to all Americans, not just those fortunate enough to be capable of owning their homes. Estimates of federal tax expenditures for the five years of 2009-2013 reveal that homeownership tax subsidies will outstrip rental tax subsidies by more than 10 to 1.

As is the case every year, and required by the Congressional Budget Act of 1974, the president released in February his estimates of the loss in federal tax revenue that is attributable to provisions in the tax law that allow a special exclusion, exemption or deduction from gross income, or that provide a special credit, a preferential tax rate or a deferral of liability.

Some homeownership vs. rental housing background

While a majority of Americans are homeowners (estimates place homeownership levels at approximately 65 percent), it is increasingly apparent that those who rent due to their economic status or through personal choice receive short shrift from the federal tax code and other federal subsidies.

In a break from the past, the president's fiscal year-end 2009 budget released February 2008 included a 2.9 percent increase in budget for the Department of Housing and Urban Development (HUD), from \$37.4 billion in 2008 to \$38.5 billion in 2008. Compared to the 15 percent to 20 percent increases for several departments such as Commerce, Legislative, and the Small Business Administration, the 2.9 percent increase for HUD is shockingly small, especially given the current dire need for financing to allevi-

Rental housing tax expenditures	(\$ in billions)
Low-income housing tax credits	32.4
Passive loss exception (\$25,000)	47.9
Interest exclusion on rental housing bonds	4.8
Total	85.1

Homeowner tax expenditures	(\$ in billions)
Mortgage interest	576.7
Capital gains exclusion	191.8
Property tax deductibility	131.7
Interest exclusion on homeowner bonds	5.2
Non-recognition of discharge of mortgage indebtedness income	0.4
Total	905.8

ate the current housing crisis. Although HUD's programs support both the homeownership and rental housing programs, this modest increase undermines significantly the ability of the department to expand its programs to increase the affordability of rental housing, and continues to fund the department at levels that are significantly below the 2004 levels of \$45 billion.

The government's expenditure estimates

For the five-year period 2009-2013, federal tax expenditures for homeownership subsidies measured on a cash basis include \$576.7 billion for homeowners' interest deductions, \$191.8 billion in capital gains exclusion, \$131.7 billion in property tax deductibility, \$5.2 billion in exclusion of interest on homeowner bonds, and \$0.4 billion for non-recognition of discharge of mortgage indebtedness income, resulting in a total of \$905.8 billion in subsidies for homeowners. The president also calculated a federal tax expenditure of \$80.8 billion for the cost in federal tax revenue attributed to the ability of homeowners to omit recognizing imputed taxable income on the imputed

(continued on page 2)

Large Gap in Tax Subsidies

(continued from page 1)

value of occupying their owned home. As this expenditure represents a theoretical concept, it was omitted for purposes of our calculations. It is noteworthy that other than a modest decrease for the exclusion of interest on housing bonds, every element has seen a significant increase over the previous budget, except for the outlay for capital gains exclusion, which shrank from \$214.9 billion last year to \$191.7 billion this year, reflecting continued modest expectations for future home appreciation.

By comparison, for the same period and using the cash basis measure, the federal tax expenditures that subsidize rental housing include \$32.4 billion for low-income housing tax credits, \$47.9 billion in passive loss exceptions, and \$4.8 billion in interest exclusion on rental housing bonds, generating a relatively paltry total of \$85.1 billion in rental housing subsidies. The president also calculated a federal tax expenditure of \$72.7 billion from accelerated rental housing depreciation deductions compared to the actual economic depreciation of the property. As this expenditure represents a theoretical concept, it was omitted for the purposes of our analysis.

The Joint Committee on Taxation (JCT) finds a similar bias for homeownership in its 2008-2012 estimates. It shows homeowner subsidies of \$667.8 billion and rental subsidies of \$60.3 billion, a ratio of more than 11 to 1.

Although we welcome the slightly smaller gap between homeowner subsidies and rental housing subsidies represented in this year's budget, a result of market forces and not any specific action on the part of government, we hope that Congress and the president through strong and immediate action will take steps to shrink the gap even further. As Congress and the incoming Obama Administration plan for an economic stimulus bill to be passed in early 2009 to help stimulate the American economy, with planned expenditures estimated at anywhere from \$500 billion to \$1 trillion, we call upon the Congress and the new Administration to include more balanced subsidies for rental housing as part of the package, and ultimately to narrow the gap in the amount of governmental support given to encourage homeownership and the tax dollars provided for rental housing. Since about one of every three Americans is a renter, balanced housing tax

(continued on page 3)

Journal of Tax Credit Housing Editorial Board

Publisher ♦ Michael J. Novogradac, CPA

Editor ♦ Jane Bowar Zastrow

Managing Editor ♦ Alex Ruiz

Staff Writer ♦ Jennifer Dockery

Technical Editor ♦ Robert S. Thesman, CPA

Contributing Writers ♦ Brian Carnahan, Brandi Day,
Arthur Krauer, Buzz Roberts, Linda Yee

Production ♦ Jesse Barredo

Journal of Tax Credit Housing Advisory Board

Frank Baldasare ♦ CW Capital

Bud Clarke, MAI ♦ MMA Financial

Jana Cohen Barbe ♦ Sonnenschein Nath & Rosenthal LLP

Tom Dixon ♦ Boston Capital

Wendy Dolber ♦ Standard & Poor's Corporation

Rick Edson ♦ Housing Capital Advisors Inc.

Anthony Freedman ♦ Holland & Knight

Richard Gerwitz ♦ Citi Community Capital

John Lisella ♦ SunAmerica Affordable Housing Partners Inc.

Philip Melton ♦ Grandbridge Real Estate Capital

Stephen Ryan ♦ Cox, Castle & Nicholson LLP

Sheldon Schreiber ♦ Pepper Hamilton LLP

Arnold Schuster ♦ Sonnenschein Nath & Rosenthal LLP

Rob Wasserman ♦ U.S. Bancorp Community Development Corp.

Journal of Tax Credit Housing Information

Novogradac & Company LLP
246 First Street, 5th Floor
San Francisco, CA 94105
E-mail: cpas@novoco.com

Address all correspondence and editorial submissions to:
Jane Bowar Zastrow
Telephone: 415.356.8034

Address inquiries regarding advertising opportunities to:
Connor Beckley
Telephone: 415.356.8037

Editorial material in this publication is for informational purposes only and should not be construed otherwise. Advice and interpretation regarding the low-income housing tax credit or any other material covered in this publication can only be obtained from your tax advisor.

© Novogradac & Company LLP, 2009 All rights reserved.

ISSN 1940-4980

The Journal is printed using non-toxic soy-based ink.
Novogradac & Company LLP encourages readers to recycle.

Large Gap in Tax Subsidies

(continued from page 2)

policy would suggest that one of every three dollars in tax expenditures should support rental housing.

Comparison to prior years

The home ownership to rental tax subsidy ratio dropped dramatically from the 2007-2011 budgeted ratio of 15 to 1. However, the primary reason for the change was due to the \$121 billion swing in the estimate of the cost of gain exclusion on home residences, which is triggered by market forces, and not due to any change in policy.

Consumption tax

On page 325 of the Analytical Perspectives released with the president's proposed budget in February, the Office of Management and Budget (OMB) assesses which of the top 30 federal tax expenditures (including the LIHTC) would still be considered federal tax expenditures under a consumption tax. The top 30 federal tax expenditures are segregated into four categories:

1. is a tax expenditure,
2. probably is a tax expenditure,
3. uncertain as to whether it is a tax expenditure, and
4. is not a tax expenditure.

It is noteworthy that only one expenditure was classified in Category 1 this year, whereas six expenditures were included in Category 2, eight expenditures were included in Category 3, and 15 expenditures were included in

Category 4. Category 1, "is a tax expenditure," means that under a consumption tax the item being subsidized by the tax expenditure would be taxed, so the subsidy would still be needed if public policy was to subsidize it. The fourth category, "is not a tax expenditure," means that under a consumption tax the item being subsidized by the tax expenditure would not be taxed, so the subsidy would not be needed.

The LIHTC is classified as uncertain, in contrast to the 2007-2011 budget that classified the LIHTC as a tax expenditure under a consumption tax. This is particularly noteworthy because in the 2006-2010 budget the LIHTC was classified as uncertain. In its analysis of the consumption tax classification of the LIHTC, the Office of Management and Budget (OMB) reasoned that the LIHTC would not qualify as a tax expenditure because it acts to lower the tax burden due to qualified investments, but also reasoned that the LIHTC could be considered a tax expenditure as the LIHTC is narrowly targeted, and is too generous in some cases, resulting in a negative tax on income rather than the zero tax called for under consumption tax principles. It is unclear what events triggered the move by the OMB to revisit its analysis and move the LIHTC back to the uncertain category just one year after moving the LIHTC from the uncertain category to the "is a tax expenditure" category. The industry's goal should be to ensure that the LIHTC remains a tax expenditure in the event a consumption tax is ever adopted. ♦

This article first appeared in the January 2009 issue of the Novogradac Journal of Tax Credit Housing.

© Novogradac & Company LLP 2009 - All Rights Reserved

Notice pursuant to IRS regulations: Any U.S. federal tax advice contained in this article is not intended to be used, and cannot be used, by any taxpayer for the purpose of avoiding penalties under the Internal Revenue Code; nor is any such advice intended to be used to support the promotion or marketing of a transaction. Any advice expressed in this article is limited to the federal tax issues addressed in it. Additional issues may exist outside the limited scope of any advice provided – any such advice does not consider or provide a conclusion with respect to any additional issues. Taxpayers contemplating undertaking a transaction should seek advice based on their particular circumstances.

This editorial material is for informational purposes only and should not be construed otherwise. Advice and interpretation regarding property compliance or any other material covered in this article can only be obtained from your tax advisor. For further information visit www.taxcredithousing.com.