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Federal Government Provides More Than $15 in Tax Subsidies for Homeownership to Each $1 for Rentals

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Estimates of loss in federal tax revenue for the five years of 2007-2011 reveal that homeownership subsidies will outstrip rental subsidies by more than 15 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.

While the annual value of total income tax expenditures for tax deferrals is reported on a cash basis and reflects the difference between taxes deferred in the current year and incoming revenues that are received due to deferrals of taxes from prior years, they frequently are not an accurate reflection of the true economic cost of these provisions.

Some homeownership vs. rental housing background

While a majority of Americans are homeowners (estimates place homeownership levels at approximately 70 percent), it is increasingly apparent that those who must rent because of their economic status or through personal choice are being squeezed out of tax subsidies.

For the first time in five years, President George W. Bush in his 2007 budget did not propose a single-family homeownership tax credit for developers of affordable for-sale housing. However, this year the U.S. Department of Housing and Urban Development (HUD) saw its budget decreased by 2 percent from the amount enacted for its 2006 budget. All of this leads to the question: isn't it time to level the playing field somewhat?

The government's expenditure estimates

For the five-year period 2007-2011, federal tax expenditures for homeownership subsidies, measured on a cash basis, include $471.4 billion for homeowners' interest deductions, $318.3 billion in capital gains exclusion, $74.2 billion in property tax deductibility and $5.9 billion in interest on exclusion on homeowner bonds, resulting in a total of $869.8 billion in subsidies for homeowners. (The president also calculated a federal tax expenditure of $204.8 for the cost in federal tax revenue attributed to the ability of homeowners to omit recognizing imputed taxable income on the imputed value of occupying their owned home. For purposes of our calculations, we omitted this additional federal tax expenditure for home ownership.)

By comparison, for the same period, the federal tax expenditures that subsidize rental housing using the cash basis measure include $23.6 billion for low-income housing tax credits; $29.4 billion in passive loss exceptions, and $2.6 billion in interest exclusion on rental housing bonds, generating a relatively paltry total of $55.6 billion in rental housing subsidies. (The president also calculated a federal tax expenditure of $68.6 billion from accelerated rental housing depreciation deductions. However, in the preceding year, the president estimated that this provision actually raised $15.4 billion, it was, in effect, a negative tax expenditure. Presumably, the reason it was a revenue raiser in prior estimates was that Congress had lengthened the depreciable life of residential rental property numerous times since 1986, and the net effect was a negative tax expenditure. The president made a different calculation this year. As this article went to press, we were attempting to better understand the change in interpretation. For purposes of our calculations, we ignore the $84 billion swing in reporting theory.)

The Joint Committee on Taxation (JCT) finds an even more extreme bias for homeownership its 2006-2010 estimates. It shows homeowner subsidies of $611.9 billion and rental subsidies of $31.1 billion, a ratio of nearly 20 to 1.

Again this year, it is time to call for the narrowing of the gap in the amount of government support given to encourage homeownership and the tax dollars provided for rental housing. It is time that rental housing gets the respect it deserves in the federal budget and the federal tax code.

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Federal Government

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	President's Budget 2007-2011 (Cash-basis, in billions)	Joint Committee On Taxation 2006-2010 (in billions)
Homeownership		
Homeowner Interest Deduction	471.4	402.7
Gain Exclusion on Home Residences	318.3	128.4
Property Taxes Deductibility	74.2	73.8
Interest Exclusion on Homeowner Bonds	5.9	7.0
Total	869.8	611.9
Rentals		
Low-Income Housing Tax Credits	23.6	27.4
Passive Loss Rules	29.4	Not included in JCT estimates
Interest Exclusion on Rental Housing Bonds	2.6	3.7
Total	55.6	31.1

Comparison to prior years

The home ownership to rental tax subsidy ratio dropped dramatically from the 2006-2010 budgeted ratio of 25 to 1. However, the primary reason for the change was due to the $84 billion swing in the estimate of the cost of accelerated depreciation for rental housing, as more fully explained above.

Outlay Expenditures

In the prior year's budget, the provisions subsidizing homeownership nearly doubled when applying the outlay equivalent measure, as compared to the cash basis. Under that budget, using the outlay equivalent measure, the numbers opened the gap even farther and are quite discouraging for the rental housing industry, as homeownership was favored over rental housing to the tune of an astonishing 49 to 1 ratio, compared to the 25 to 1 ratio estimated using the cash basis.

The outlay equivalent measure allows the cost of a tax expenditure to be compared with a direct federal outlay on a more even footing. Outlay equivalent is the amount of budget outlays that would be required to provide the taxpayer the same after-tax income as would be received through the tax provision. In the current year budget, the administration discontinued the estimate of the outlay equivalents, citing that: "[the outlay equivalents] were often the same as the normal tax expenditure estimates, and the criteria for applying the concepts as to when they should differ were often judgmental and hard to apply with consistency across time and across tax expenditure items." Due to the discontinuance of the outlay equivalent measure from the 2007-2011 budget, analysis of the true cost of each tax expenditure has become much more challenging.

More on tax expenditures

On page 317 of the Analytical Perspectives released with the president's proposed budget in February, the Office of Management and Budget assesses which of the top 30 federal tax expenditures (this includes 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 <u>not</u> a tax expenditure.

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 <u>not</u> be taxed, so the subsidy would <u>not</u> be needed.

The LIHTC is classified as a tax expenditure, in contrast to the 2006-2010 budget, which classified the LIHTC in the uncertain category. It is great news that the classification of the LIHTC has been revisited, with the more accurate conclusion that the LIHTC would remain a tax expenditure under a consumption tax. The industry's goal should be to ensure that the LIHTC remain a tax expenditure, should a consumption tax ever be adopted.