

Large Gap in Tax Subsidies Narrows Somewhat in Current Budget

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Estimates of loss in federal tax revenue for the five years of 2008-2012 reveal that homeownership subsidies will outstrip rental subsidies by more than 24 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 70 percent), it is increasingly apparent that those who must rent due to their economic status or through personal choice receive short shrift from the federal tax code and other federal subsidies. Unlike last year, the president's budget includes a 1 percent increase in budget for the Department of Housing and Urban Development (HUD), from \$42.4 billion in 2006 to \$42.8 billion in 2007. Despite being small, the budgeted 1 percent increase actually exceeds the change for the last two years of no increase in 2006 and a 6 percent decrease in 2005. Although HUD's programs support both homeownership and rental housing programs, this modest increase significantly undermines the ability of the department to expand its programs to increase the affordability of rental housing, and continues to fund the department at levels significantly below its 2004 levels of \$45 billion.

The government's tax expenditure estimates

For the five-year period 2008-2012, federal tax expenditures for homeownership subsidies, measured on a cash basis, include \$520.3 billion for homeowners' interest deductions, \$214.9 billion in capital gains exclusion, \$88.0 billion in property tax deductibility and \$7.4 billion in interest on exclusion on homeowner bonds, resulting in a total of \$830.6 billion in subsidies for homeowners. (The president also calculated a federal tax expenditure of \$220.2 billion 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. As this expenditure represents what is substantially a theoretical concept, for purposes of our calculations, we omitted this additional federal tax expenditure for homeownership.) It is noteworthy that every element has increased significantly over the previous budget, except for the outlay for capital gains exclusion, which shrank from \$318.3 billion last year to \$214.9 billion this year, reflecting much more modest expectations for future home appreciation than experienced during the last several years of the frothy housing market.

By comparison, for the same period, the federal tax expenditures that subsidize rental housing using the cash basis measure include \$27.8 billion for low-income housing tax credits, and \$6.1 billion in interest exclusion on rental housing bonds, generating a relatively paltry total of \$73.7 billion in rental housing subsidies. (The president also calculated a federal tax expenditure of \$73.3 billion from accelerated rental housing depreciation deductions compared to the actual economic depreciation of the property and \$39.8 billion in passive loss exceptions for individuals. The accelerated rental housing depreciation expenditure represents what is substantially a theoretical concept; for purposes of our analysis, we omitted this additional federal tax expenditure for rental properties. We also omitted the passive loss exception for individuals for two reasons. First, this exception applies to all rental real estate, not just rental housing. Second, the passive loss rules, in general, serve to limit the ability of taxpayers to deduct losses from residential rental businesses. This limit on the deductibility of losses from residential rental businesses is a revenue raiser, not a tax expenditure.)

The Joint Committee on Taxation (JCT) finds a slightly lower bias for homeownership in its 2007-2011 estimates. It shows homeowner subsidies of \$678.2 billion and rental subsidies of \$32.7 billion, a ratio of more than 20 to 1.

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Large Gap in Tax Subsidies

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	President's Budget 2008-2012 (Cash-basis, in billions)	Joint Committee On Taxation 2006-2010 (in billions)	President's Budget 2007-2011 (Cash-basis, in billions)
Homeownership			
Homeowner Interest Deduction	520.3	430.2	471.4
Gain Exclusion on Home Residences	214.9	153.5	318.3
Property Taxes Deductibility	88.0	87.1	74.2
Interest Exclusion on Homeowner Bonds	7.4	7.4	5.9
Total	830.6	678.2	869.8
Rentals			
Low-Income Housing Tax Credits	27.8	28.7	23.6
Interest Exclusion on Rental Housing Bonds	6.1	4.0	2.6
Total	33.9	32.7	26.2
Ratio	24.5	20.7	33.2

Comparison to prior years

The home ownership to rental tax subsidy ratio is down from the 2007-2011 budgeted ratio of over 33 to 1. However, the primary reason for the change was due to the \$103 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.

Although we welcome the smaller gap between homeowner subsidies and rental housing subsidies represented in this year's budget, we hope that Congress and the president will act to shrink the gap through means other than the recent market shifts in housing prices. As such, again this year it is time to call for the narrowing of the gap between the tax dollars used to encourage homeownership and the tax dollars provided for rental housing.

Consumption tax

On page 316 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 fed-

eral 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, which 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 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 their 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 remain a tax expenditure in the event a consumption tax is ever adopted. ❖