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US lawmakers consider fate of mortgage interest tax break

By: James Politi - April 25, 2013

The biggest tax break supporting America's housing sector faced deep scrutiny at a congressional hearing on Thursday, as lawmakers weigh changes to one of the most politically sensitive provisions in the US tax code.

The ways and means committee in the House of Representatives is working on the most sweeping tax reform legislation since the 1980s, with a plan to lower rates for companies and individuals, and pay for the effort by limiting tax breaks.

One of the largest tax breaks that would have to be curbed is the deduction that some 37m US homeowners claim for their mortgage interest payments, estimated to cost the government $68bn in 2012.

Supporters of limiting or scrapping the mortgage tax break argue that this would remove big inefficiencies in the US economy that lead people to own rather than rent homes and to buy more expensive properties than they otherwise would.

Some have pointed to such tax preferences for housing as being as one of the roots of the sector's boom-and-bust that triggered the 2008 financial crisis.

"Our current tax code introduces significant, and costly, distortions into our housing and financial markets," Mark Calabria, director of financial regulation studies at the libertarian Cato Institute, told the committee on Thursday.

"These subsidies reflect the important role of housing in the US economy and in American society. And yet it is vital to consider the impacts of this policy and contemplate improvements," added Phillip Swagel, a former US Treasury official under George W. Bush now at the University of Maryland.

Opponents argued aggressively that such a move would damage the housing recovery just when it has finally started gaining traction after years in the doldrums. It would also crush the drive towards homeownership among young families, long associated with the American dream.

“Home ownership is a major path to wealth for the middle class. Any policy change that makes it harder to buy a home, or delays the purchase of a home to an older age, will have significant long-term impacts on household wealth accumulation,” said Robert Dietz of the National Association of Home Builders, a lobby group. He cited studies suggesting prices could drop by as much as 15 per cent if the deduction were curbed or scrapped.

“The housing market remains in a depression, and further weakening demand, or increasing user costs, will further restrict economic growth or risk a double-dip recession,” Mr Dietz said.

Lawmakers on the committee struck a cautious tone, given the backlash any modification could trigger. “This is an area that needs careful, thoughtful review,” said Dave Camp, Republican chairman of the committee from Michigan.

“There are many egregious loopholes in the tax code. But the main provisions incentivising home ownership are policies, not loopholes,” added Sandy Levin, the top Democrat on the panel, also from Michigan.

But any significant tax reform bill is unlikely to leave housing unscathed.

President Barack Obama’s 2014 budget includes a plan to cap tax deductions for the wealthy – including the mortgage interest deduction. Alan Simpson and Erskine Bowles, co-chairs of Mr Obama’s 2010 bipartisan fiscal commission, have also suggested big changes to the deduction, converting it to a 12 per cent tax credit that would be less expensive for the government and no longer apply it to second homes.

Nevertheless, Gary Thomas, president of the National Association of Realtors, pleaded: “Congress should avoid further raising taxes on homeowners in a quest for additional revenue while federal spending is at record highs. Congress must first look to reduce spending in order to get our nation’s fiscal house in order.”

Furthermore, the NAR president, who is also a real estate agent in California, warned that the last time Congress withdrew tax breaks for housing in the 1986 reform under president Ronald Reagan, a recession followed. “Congress must be mindful that eliminating widely used and simple tax provisions can have harsh and dangerous unintended consequences,” Mr Thomas says.