

REPORT OF THE CHIEF LEGISLATIVE ANALYST

DATE: May 21, 2013

TO: Honorable Members Rules, Elections and
Intergovernmental Relations Committee

FROM: Gerry F. Miller 
Chief Legislative Analyst

Council File No.: 13-0002-S5
Assignment No.: 12-12-1002

SUBJECT: Resolution (Koretz-Cardenas) to Support legislation and administrative action which would ensure that the current Federal income tax deduction for interest paid on debt secured by a first or second home is not further restricted.

CLA RECOMMENDATION: Adopt Resolution (Koretz-Cardenas) to include in the City's 2013-2014 Federal Legislative Program SUPPORT for legislation and administrative action which would ensure that the current Federal income tax deduction for interest paid on debt secured by a first or second home is not further restricted.

SUMMARY

Resolution (Koretz-Cardenas), introduced December 14, 2012, notes that homeownership is a fundamental American ideal, which promotes social and economic benefits beyond the benefits that accrue to the occupant of the home and that it is an important factor in promoting security and stability for American families. The Resolution further notes that the provisions related to homeownership are among the simplest and most easily administered provisions of the Internal Revenue Code of 1986. According to the Resolution, the current Federal income tax deduction for interest paid on debt secured by a first home has been a valuable cornerstone of this Nation's housing policy for most of this century and may well be the most important component of housing-related tax policy in America today and that it is of crucial importance to the economy of Los Angeles. The Resolution therefore requests that that the City support legislation and administrative action which would ensure that the current Federal income tax deduction for interest paid on debt secure by a first or second home is not further restricted

BACKGROUND

On December 14, 2012, Resolution (Koretz-Cardenas) was introduced to support legislation and administrative action to ensure that the current Federal income tax deduction for interest paid on debt secured by a first or second home is not further restricted. Similarly, on January 3, 2013, the United States Congress introduced H. Con. Resolution 4, expressing that the current Federal income tax deduction for interest paid on debt secured by a first of second home should not be further restricted.

For many years, the mortgage interest deduction has been a topic of study and discussion by policymakers and researchers as they consider options to modify the existing deduction. Some of these options include eliminating the mortgage interest deduction altogether, limiting it to first homes, replacing the deduction with a tax credit, or capping itemized deductions as a whole. Some researchers have suggested that any changes to the deduction should be phased-in given that some homeowners have made investment decisions based on the current tax code.

Mortgage Interest Deduction

According to Internal Revenue Service (IRS) Publication 936, home mortgage interest is any interest a taxpayer pays on a loan secured by a first or second home. Home mortgage interest may be deducted if an individual files Form 1040, itemizes deductions on Schedule "A" and the home qualifies as a secured debt.

The mortgage interest deduction allows homeowners to deduct, from taxable income, the interest that they pay on the mortgage for their home when calculating the annual federal income tax. This federal policy has been in place since 1913. Currently, homeowners may deduct interest from up to \$1 Million of acquisition mortgage and up to \$100,000 of home equity loan debt.

Congressional Budget Office (CBO)

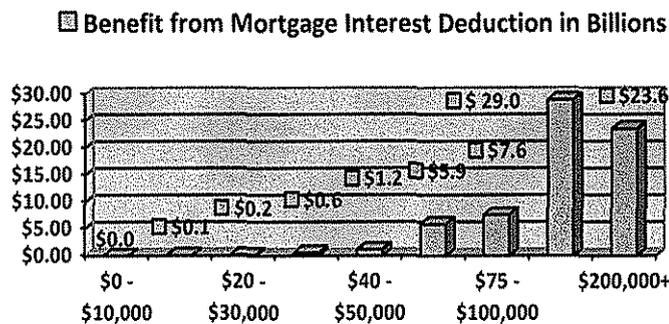
According to the Congressional Budget Office (CBO), federal tax expenditures include: 1) exclusions of certain types of income from income taxes; 2) deductions of certain items from taxable income; and, 3) preferential tax rates such as capital gains and dividends. The deduction for interest paid on mortgages for owner-occupied residences is the largest of the deductions and is projected to equal .8 percent of Gross Domestic Product between 2013 and 2022.

Center on Budget and Policy Priorities (CBPP)

According to the Center on Budget and Policy Priorities (CBPP), the mortgage interest deduction is part of a group of deductions known as "itemized deductions," which also include charitable giving and state and local taxes. Taxpayers have the option of itemizing their deductions or taking the standard deduction (\$6,100 for singles and \$12,200 for couples in 2013).

CBPP states that in 2012, 77 percent of the benefits associated with the mortgage interest deduction went to homeowners with incomes above \$100,000 and approximately 35 percent went to homeowners with incomes above \$200,000. Table 1 demonstrates the monetary benefit in billions of dollars per homeowner household income bracket. The table shows how those taxpayers in the higher income brackets benefit significantly while those with lower incomes benefit minimally.

Table 1- Benefit of Mortgage Interest Deduction



Source: Center on Budget and Policy Priorities – April 4, 2013

CBPP notes that the deduction is poorly suited to help struggling homeowners keep their homes. Homeowners whose incomes decline will receive a smaller subsidy if they fall into a lower marginal tax bracket. Homeowners whose incomes drop to the point where they owe no federal income tax in a given year would lose the full value of their deduction.

A July 2012 CBPP report, indicates that in 2009, approximately 50 percent of homeowners nationally claimed the mortgage interest deduction. According to this report, the Bowles-Simpson and Domenici-Rivlin deficit reduction commission and the Bush Administration's Advisory Panel on Federal Tax Reform each proposed to convert the mortgage interest deduction to a credit that would increase revenues and reach a broader share of low- and middle-income homeowners. The Domenici-Rivlin report proposed a refundable credit of 15 percent of the first \$25,000 of a mortgage interest paid which could be claimed by all homeowners.

California Legislative Analyst's Office (LAO)

According to the LAO, some of the concerns with the mortgage interest deduction are: 1) the deduction largely encourages people who were going to buy a house anyway to buy a more expensive house; 2) benefits go disproportionately to higher-income taxpayers who pay higher marginal rates and are more likely to itemize; and 3) the value of the deduction is often capitalized to some extent into the housing prices.

In the past, the LAO has proposed eliminating the mortgage interest deduction, reducing the deduction and changing the deduction to a credit. In a March 18, 2013 report, the LAO includes the following analysis relating to the benefits of the mortgage interest deduction:

Table 2

Mortgage Interest Deduction Distributed by Income Group					
2004 Income Year					
	Taxpayers Benefitting		Tax Reduction		
	Number (Thousands)	Share of Total	Amount (Millions)	Share of Total	Average Tax Deduction
Income Quintile					
Bottom	8	.2	\$1	-	\$108
Second	117	3.0	15	.4%	128
Third	442	11.2	132	3.5	298
Fourth	1,281	32.6	743	19.6	582
Top	2,080	52.9	2,907	76.5	1,398
TOTALS	3,9028	100.0%	\$3,798	100.0%	\$968

Source: California Legislative Analyst's Office

Table 2 demonstrates that the difference in the number of taxpayers benefitting from the mortgage interest deduction. In 2004, there were only 8,000 Californians in the bottom quintile who benefitted from the mortgage interest deduction and received an average deduction of \$108. However, there were over two million taxpayers in the top income quintile who benefitted and received an average deduction of \$1,398.

National Commission on Fiscal Responsibility and Reform

In 2010, the National Commission on Fiscal Responsibility and Reform (Commission) issued a report, *The Moment of Truth*, which contained recommendations, to bring the federal budget into balance by 2015 and to improve the long-run fiscal outlook. Among other things, the Commission recommended comprehensive tax reform which included a modification to mortgage interest deductions (MID). Specifically, the Commission recommends to offer the deduction only for principal residences (discontinue the deduction for second mortgages).

H.R. 505

Congressional Bill H.R. 505 was introduced by Representative Keith Ellison on February 5, 2013, to eliminate the mortgage interest tax deduction for second residences that are boats.

H.R. 1213- The Common Sense Housing Investment Act of 2013

H.R. 1213 was introduced by Representative Keith Ellison on March 15, 2013 and it would amend the Internal Revenue Code as follows:

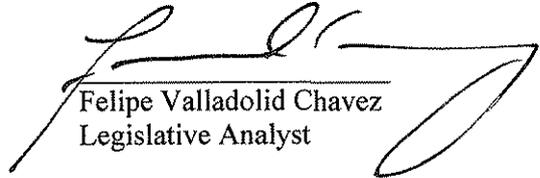
- 1) In lieu of a mortgage interest deduction, it would allow a tax credit for 15 percent of mortgage interest paid in a taxable year for the taxpayer's principal residence and on other residence;
- 2) Provide for a phase-out of the mortgage interest deduction between 2014 and 2018;
- 3) Allow a deduction for interest and taxes relating to land for dwelling purposes owned or leased by cooperative housing corporations; and,
- 4) Increase the state housing credit ceiling for the low-income housing tax credit.

H. Con. Res. 4

H. Con. Res. 4 was introduced by Representative Gary Miller on January 1, 2013 expressing the sense of Congress that the current federal income tax deduction for mortgage interest paid on a first or second home should not be further restricted.

CONCLUSION

The Los Angeles Housing Department reports that proposals to reform the mortgage interest deduction must be further evaluated to understand the benefits and impacts on the City where high housing prices and low median incomes make for a unique geographic area that may be overlooked by national figures. However, the City of Los Angeles supports the legislation that continues to provide tax incentives to homeowners. It is therefore recommended that the City support legislation and administrative action which would ensure that the current Federal income tax deduction for interest paid on debt secured by a first or second home is not further restricted


Felipe Valladolid Chavez
Legislative Analyst

Attachments: 1) Resolution (Koretz-Cardenas)
GFM:fvc

RESOLUTION

WHEREAS, any official position of the City of Los Angeles with respect to legislation, rules, regulations or policies proposed to or pending before a local, state or federal governmental body or agency must have first been adopted in the form of a Resolution by the City Council with the concurrence of the Mayor; and

WHEREAS, homeownership is a fundamental American ideal, which promotes social and economic benefits beyond the benefits that accrue to the occupant of the home; and

WHEREAS, homeownership is an important factor in promoting economic security and stability for American families; and

WHEREAS, it is proper that the policy of the Federal Government is and should continue to be to encourage homeownership; and

WHEREAS, the value of a home represents a valuable source of savings for a family; and

WHEREAS, the provisions related to homeownership are among the simplest and most easily administered provisions of the Internal Revenue Code of 1986; and

WHEREAS, the current Federal income tax deduction for interest paid on debt secured by a first home has been a valuable cornerstone of this Nation's housing policy for most of this century and may well be the most important component of housing-related tax policy in America today; and

WHEREAS, the current Federal income tax deduction for interest paid on debt secured by second homes is of crucial importance to the economy of Los Angeles;

NOW, THEREFORE, BE IT RESOLVED with the concurrence of the Mayor, that by the adoption of this Resolution, the City of Los Angeles hereby includes in its 2011-2012 and 2013-2014 Federal Legislative Program support for legislation and administrative action which would ensure that the current Federal income tax deduction for interest paid on debt secured by a first or second home is not further restricted.

PRESENTED BY:


PAUL KORETZ

Councilman, 5th District

SECONDED BY:

