

Revised June 17, 2008

HOUSE-PASSED HOUSING TAX PACKAGE IMPROVES SIGNIFICANTLY ON SENATE VERSION But Addressing the Foreclosure Crisis Will Require Other Measures

By Aviva Aron-Dine, Barbara Sard, and Will Fischer

On April 10, the Senate passed a bill comprised largely of housing-related tax cuts.¹ Six weeks later, the House passed its own housing legislation including its own package of housing-related tax measures.

Some of the provisions in House-passed housing tax package have merit, and the House-passed tax package represents a significant improvement over the Senate's version. Unlike the Senate bill, the House package is revenue-neutral, and it omits both an ineffectual special-interest tax break and a seriously misguided provision that would limit the ability of local governments to raise revenue. The House package also includes a set of worthwhile reforms to the Low-Income Housing Tax Credit, as well as a provision (also included in the Senate bill) that would allow states to issue additional tax-exempt housing bonds and use the proceeds to refinance subprime mortgages to help some families remain in their homes. (For a detailed comparison

KEY FINDINGS

The House-passed housing tax package improves on the Senate's version in several important respects.

- It omits the Senate's net operating loss provision, an expensive business tax break that would neither help homeowners nor boost the economy.
- It temporarily expands the Low-Income Housing Tax Credit and includes a package of other changes that would enhance the credit's effectiveness.
- It does not include a provision of the Senate bill that would effectively prevent local governments from increasing property tax rates, seriously aggravating their fiscal problems.
- It complies with the Pay-As-You-Go (PAYGO) rule: the cost of the package is fully offset over 10 years.

However, the House-passed package does include two provisions – a credit for first-time homebuyers and a non-itemizer property tax deduction – that are not the best use of scarce resources.

While some provisions of the tax package have merit, by itself the package would do little to address the foreclosure crisis. Measures passed by the House and approved by the Senate Banking Committee to help families struggling to keep their homes are far more important in this respect. So are measures passed by the House and Senate to assist communities especially hard hit by foreclosures.

¹ See Aviva Aron-Dine, Barbara Sard, and Chad Stone, "Senate Housing Legislation Highly Disappointing," Center on Budget and Policy Priorities, April 8, 2008, <http://www.cbpp.org/4-8-08tax.htm>.

of the House-passed and Senate tax packages, see appendix table 1.)

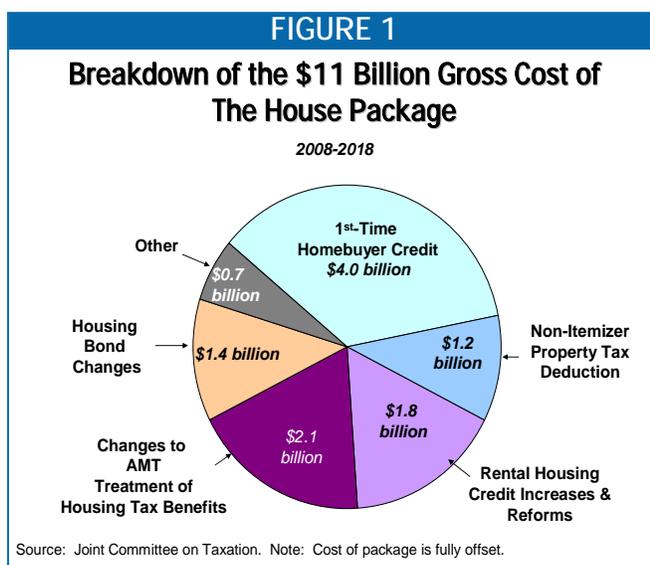
Still, the tax package in the House-passed housing bill would, as a whole, do little to address the foreclosure crisis. Far more important in this respect are several *non-tax* measures now before Congress. These include provisions in the House-passed housing legislation and approved by the Senate Banking Committee that would facilitate restructuring of mortgages and thus help families struggling to keep their homes, as well as measures passed by both the House and the Senate to help communities especially hard hit by foreclosures.

Major Components of the House-passed Package

Figure 1 shows the breakdown of the cost of the House-passed tax package. The single largest provision is a tax credit that provides a \$7,500 interest-free loan to first-time homebuyers who purchase homes within the next year. The combined cost of this provision and another tax break for homeowners — a non-itemizer property tax deduction that was also included in the Senate legislation — is \$5 billion, or about 46 percent of the package’s total gross cost. As explained below, these two provisions are not a good use of scarce resources, which would be better spent on measures targeted to addressing the foreclosure crisis.

The next major elements of the House-passed package are a set of reforms to the Low-Income Housing Tax Credit (LIHTC), a temporary expansion of that credit, changes to rental housing bond rules, and a set of changes in the treatment of housing tax incentives (including the LIHTC) under the Alternative Minimum Tax (AMT). These provisions, which account for more than one-third of the package’s cost, should enhance the effectiveness of the LIHTC and tax-exempt housing bonds at promoting the construction and rehabilitation of affordable rental housing. The final major provision in the package, which accounts for another 12 percent of its cost, increases temporarily the value of tax-exempt housing bonds that states and localities can issue and allows the proceeds from these bonds to be used to refinance loans for families in danger of losing their homes due to adjustable rate sub-prime mortgages.² This provision (also included in the Senate tax package) would provide state and local governments with the means to help some low-income homeowners remain in their homes.

The cost of the package is fully offset by two revenue-raising provisions: a measure that requires securities’ brokers to report additional information to taxpayers and the Internal Revenue Service



² The House-passed bill also includes various smaller provisions, such as changes to the rules governing Real Estate Investment Trusts (REITs); these other provisions together cost about \$725 million over ten years.

(IRS) and a measure that would delay an already-enacted corporate tax cut for one year. All of these provisions are discussed in more detail below.

The First-Time Homebuyer Credit

The first-time homebuyer credit provides an interest-free loan of up to \$7,500 to first-time homebuyers who purchase a home within the next year.³ This would work as follows. Suppose a first-time homebuyer purchases a home this coming January. She could claim a tax credit equal to 10 percent of the purchase price of the home or \$7,500, whichever is larger, on her 2009 tax return. She then would be required to pay \$500 (one-fifteenth of the credit) back on her 2011 tax return and on her return for each of the following 14 years.⁴

Suppose that, after six years, this individual decided to sell the home. She then would pay back the rest of the tax credit (the \$5,000 she had not yet paid back after six years) immediately, unless she sold the home at a loss, in which case she would not be required to pay back the rest of the loan.⁵ Because of this last provision, the tax credit effectively provides homebuyers with a modest amount of insurance against a continued decline in housing prices, as well as an interest-free loan: the federal government would essentially absorb up to \$7,500 of the loss on the sale of the home.⁶

The tax credit would be refundable, meaning that households with incomes too low to owe income taxes could benefit from it, and it would begin phasing out for couples with incomes above \$140,000 (singles with incomes above \$70,000).

Boosting the Demand for Homes Likely Not a Desirable Goal

One apparent goal of the provision is to encourage individuals to purchase homes within the next year, which would boost the demand for homes that are for sale. This goal is a desirable one *if* the housing bubble has deflated, homes are no longer overvalued, and housing demand is low simply because individuals are too nervous about further price declines to buy and lenders are too nervous about further defaults to lend. In that situation, an interest-free loan, combined with modest insurance against loss, could help “unstick” the housing market, initiating a positive cycle where more homebuyers would enter the market, stabilizing prices and reassuring other buyers, who then would also enter the market.

On the other hand, if the housing bubble has not yet fully deflated and homes are still overvalued, then short-term measures designed to boost housing demand are not desirable. Such measures might at most stabilize prices temporarily, at the cost of postponing further price declines. When those price declines subsequently materialized, homebuyers selling at a loss would be excused from paying back the remaining portions of their tax credits, meaning that other taxpayers would absorb

³ Purchasers who did not own a home at any point in the three years before the purchase would be assumed to be first-time homebuyers.

⁴ Repayment of the credit would begin in the second year after the purchase of the home.

⁵ More precisely, the amount of the credit recaptured at sale cannot exceed the gain from the sale (where the gain is determined after adjusting the purchase price downward by the amount of not-yet-repaid credit).

⁶ To claim the credit, the taxpayer would have to hold onto the home for at least the remainder of the taxable year in which it is purchased.

the cost despite the absence of a public benefit. Meanwhile, because losses would often exceed the value of the tax credit, the homebuyers themselves could be left significantly worse off. For example, a moderate-income family enticed by the tax incentive to invest its savings in a home could face the loss of those savings.

Experts are simply not sure whether home prices are likely to fall further. A recent Goldman Sachs analysis concludes that rising foreclosures indicate significant further price declines to come.⁷ Other analysts have reached different conclusions. Most likely, the situation varies by region. For example, a recent study by the Center for Economic and Policy Research found that, while there are some areas of the country where it could make sense for low- and moderate-income families to buy homes, in many markets it currently makes much more sense for them to rent.⁸

In light of the uncertainty, tax incentives that boost housing demand probably are not advisable at this time.⁹

Provision Probably Will Mostly Help Homebuyers Who Would Have Bought Homes Anyway

For better or for worse, however, the homebuyer credit in the House-passed tax package is unlikely to do much to increase housing demand, and hence is likely to have neither the significant positive effects its supporters hope for nor significant negative effects of the type just discussed. Since the credit simply provides a relatively modest interest-free loan and a relatively small amount of free insurance against loss, it is hard to believe that it would induce large numbers of people who would not otherwise have purchased homes over the next year to enter the housing market.¹⁰

Instead, most of the benefits are likely to go to those who would have purchased homes anyway, taking advantage of what they see as a good opportunity to enter the housing market for the first time. Thus, the credit is probably best thought of as a small subsidy to homebuyers who enter the market over the next year. This means that the credit will provide some assistance to middle- and low-income families that will certainly appreciate the help.

But it also means that the credit is probably not a good use of available resources. Insurance against declines in home prices may be sound policy, particularly for low- and moderate-income

⁷ Seamus Smyth, "Rising Foreclosures Mean House Prices Far From Bottom," Goldman Sachs Daily, April 8, 2008.

⁸ Dean Baker, Danilo Pelletiere, and Hye Jin Rho, "The Cost of Maintaining Ownership in the Current Crisis: Comparisons in 20 Cities," Center for Economic and Policy Research and National Low-Income Housing Coalition, April 2008, http://www.cepr.net/documents/publications/ownrent_2008_04.pdf.

⁹ There are additional reasons, not linked to current housing market conditions, that it probably does not make sense to add new tax incentives for homeownership. The tax code already provides more than \$100 billion in homeownership tax benefits. A better approach would be to permanently reform these existing benefits to provide more help to low- and moderate-income homeowners and less incentive for the purchase of very large homes by upper-middle- and high-income households. See for example, David Leonhardt, "Playing the Housing Blame Game," *New York Times*, April 2, 2008.

¹⁰ Taking into account the benefits of not having to pay interest and assuming a 6 percent interest rate, the \$7,500 loan provides a benefit worth about \$3,000. This is small relative to the purchase price of even a modest home.

families for whom a home is often their only source of wealth.¹¹ But like other insurance, families that want it should have to pay the premiums, rather than shifting the cost to other taxpayers. Proposals for somewhat different first-time homebuyer credits were praised by the Administration in its first few years in office and were introduced by various policymakers in recent Congresses during a period when rapidly rising home prices left many families priced out of the market. Today, in contrast, prices are declining, and the people most in need of help are families that have already bought homes and are struggling to keep them. In a world of limited resources, funds would be better devoted to measures helping those families.

The Non-Itemizer Property Tax Deduction

The House-passed tax package creates a new, temporary property tax deduction for non-itemizers (i.e. for taxpayers who claim the standard deduction rather than itemizing their deductions).¹² This provision is also included in the Senate-passed bill, but the House-passed version is smaller, providing a maximum deduction of \$700 per couple (\$350 for a single filer), as compared with \$1,000 per couple (\$500 for a single filer) under the Senate bill. More important, the House omitted a troubling feature of the Senate provision that would significantly harm local governments. (That issue is discussed on page 9 of this analysis, in the section comparing the House-passed tax package with the Senate's.)

Even with this improvement, however, the non-itemizer property tax deduction, like the first-time homebuyer credit, is not the best use of scarce resources. The idea of a non-itemizer property tax deduction appears to have arisen during the period when housing values were appreciating rapidly, and property taxes were perceived to be a major burden on moderate-income homeowners. In today's housing market, however, with property values falling, this issue is less important. (Of course, for some homeowners, assessed property values may not yet have caught up with the drop in home values. But where that has not yet happened, this "catch-up" is likely to occur soon.)

Meanwhile, the problem of families struggling to keep their homes has become much greater. Because these families are homeowners and pay property taxes, they would receive at least some assistance from a property tax deduction for non-itemizers, provided they do not itemize and their incomes are high enough to benefit from a tax deduction. But many homeowners who own their homes outright or are *not* struggling with their mortgage payments also would benefit. And because the benefits would be spread so widely, they would be too small to provide meaningful help. The \$700 per couple (\$350 per individual) deduction in the House-passed package, which would cost \$1.2 billion for one year, would provide a benefit worth only \$70 to a couple in the 10 percent tax bracket and only \$105 to a couple in the 15 percent bracket (and only \$35 and \$53, respectively, to singles in these brackets).

If Goal Is to Help Low- and Moderate-Income Seniors, Deduction Is Not a Good Means

¹¹ William N. Goetzmann and Matthew Spiegel, "Policy Implication of Portfolio Choice in Underserved Mortgage Markets," in Nicolas P. Retsinas and Eric S. Belsky, editors, *Low-Income Homeownership: Examining the Unexamined Goal* (Joint Center for Housing Studies and Brookings Institution Press, 2002), p. 257.

¹² This provision is also included in the House-passed tax "extenders" bill (H.R. 6049).

Typically, much of the concern around property taxes centers on seniors, for whom these payments are perceived to constitute an especially onerous burden. Yet low- and moderate-income seniors would receive little or no benefit from a property-tax deduction for non-itemizers. Because Social Security benefits are not taxable for low- and moderate-income beneficiaries, seniors generally need substantial *non*-Social Security income to have enough taxable income to owe income tax and thus to benefit from a deduction. As a result, Urban-Brookings Tax Policy Center estimates indicate that *61 percent of elderly households* would not be able to benefit from *any* new tax deduction, simply because they do not have income tax liability.¹³

The Low-Income Housing Tax Credit Reforms and Changes to the AMT Treatment of Housing Tax Credits

The House-passed tax package contains a series of provisions improving and temporarily expanding the Low-Income Housing Tax Credit (LIHTC), the largest source of federal funding for construction and rehabilitation of affordable rental housing. These provisions would do little to address the immediate foreclosure crisis.¹⁴ Over time, however, they would provide moderately-priced rental housing that would help meet the needs of some low-income families displaced from their homes by foreclosure or unable to purchase homes as a result of increasingly restrictive mortgage lending practices. More generally, by significantly strengthening the LIHTC, the provisions would help the state agencies that allocate and administer these tax credits to address a modest portion of longstanding affordable housing shortages, create new opportunities for some additional low-income families to live in low-poverty neighborhoods that currently lack moderately priced rental housing, and provide a boost to some distressed communities.

The package would significantly increase the resources available through the LIHTC, in part by expanding the amount of credits that states are permitted to allocate to developers in 2008 and 2009. Currently, in most states, the number of qualified projects applying for credits substantially outstrips the supply of tax credits.

In addition, the package would allow the LIHTC and two other tax incentives — a credit for rehabilitation of older buildings and a tax exemption for interest on bonds supporting moderately priced housing — to reduce an investor's tax liability under the Alternative Minimum Tax (AMT).¹⁵ In nearly all cases, developers who receive LIHTCs sell the credits to investors for a price somewhat below one dollar for each dollar of tax credit, because the developers either lack sufficient tax liability to fully use the tax credits or cannot derive the maximum benefit from the credits themselves for other reasons. Yet it is the proceeds from the sales of the credits that help fund the construction or rehabilitation of affordable housing. By allowing investors subject to the AMT to benefit from the LIHTC, the House-passed package would increase the pool of potential purchasers for the tax credits, which in turn would likely raise the price at which the credits are sold and consequently generate more funds to support affordable housing. In recent years, the price of the housing tax credits has dropped by more than 10 percent according to some reports, in part because

¹³ See Tax Policy Center Table T08-0012.

¹⁴ The LIHTC provisions could potentially prevent some foreclosures of rental properties, primarily among the large and mid-sized properties that receive most credits under the program.

¹⁵ The change would apply to both the corporate and the individual AMT.

some large investors have become subject to the AMT and have therefore been unable to claim the credits.¹⁶

The Housing Bond Increase

The House-passed tax package authorizes a one-time increase in tax-exempt housing bond authority. It also expands the allowable uses for these bonds. Currently, state and local governments can use tax-exempt housing bonds to help finance new mortgages for low- and moderate-income first-time homebuyers, as well as to finance multi-family rental housing. The provision would allow them also to use the bonds to assist with refinancings of adjustable rate subprime mortgages issued in 2002-2007. (A similar provision is included in the Senate bill.)

Increased housing bond authority and increased flexibility in the use of these bonds could allow state and local governments to provide significant help to some households hurt by the foreclosure crisis. Tax-exempt housing bonds have typically been used to help low- and moderate-income families. While they may be used to help families with incomes up to 115 percent of area or statewide median income¹⁷ — nationally, about \$71,000 for a family of three — in practice, the families assisted by these bonds have significantly lower incomes than the law allows.¹⁸ The provision allowing state and local governments to use these bonds to fund mortgage refinancings could thus be of significant help in preventing foreclosures for some low-income borrowers.¹⁹ Mortgages financed by tax-exempt housing bonds have lower interest rates than conventional loans, making them more affordable for lower-income borrowers.

¹⁶ Several other provisions in the House-passed package would improve the rules governing the allocation and use of LIHTCs and the rules for tax-exempt bonds used for rental housing. One particularly valuable change would give states broad discretion to allocate extra tax credits (referred to as a “basis boost”) to particular housing projects. Basis boosts can provide added resources to promote various state priorities, such as helping to subsidize rents at levels affordable to families that have incomes close to the poverty line. Such boosts currently are permitted only in a limited number of statutorily-defined areas. The flexibility that the House-passed package provides would make it easier for states to build housing affordable to the neediest families in areas where basis boosts are not currently permitted, including many low-poverty neighborhoods with low crime and strong schools.

The package also contains a flawed, but easily corrected, provision intended to protect against sharp swings in rent levels. In LIHTC-funded developments, these rent levels are generally capped at 30 percent of the monthly income of a household at 60 percent of the HUD-estimated median income for the local area. HUD’s income estimates are sometimes quite volatile, with particularly large fluctuations (sometimes exceeding 20 percent in a single year) when HUD alters the methodology or the sources of the income data it uses. If such fluctuations in income estimates are permitted to lead to large swings in rent limits, the result can be disruptive for both owners and low-income tenants. The House-passed package would permanently protect owners against rent limit declines and guarantee modest increases in some cases when rent limits would otherwise be stagnant. The package does not, however, provide protection against extreme rent increases for low-income tenants. Such a protection could be added with modest modifications to the bill’s language and at no added cost.

¹⁷ The income limit is increased to 140 percent of state or area median in lower income or distressed areas.

¹⁸ The average income of households assisted by these bonds in 2006 was \$45,000. Peter Lawrence, “Housing Bonds,” National Low Income Housing Coalition 2008 Advocates’ Guide to Housing & Community Development Policy, p. 77.

¹⁹ The provision would be even more effective if the additional bond authority were distributed according to a formula that took into account the prevalence of foreclosures and subprime loans, rather than according to the existing population-based formula.

The number of families helped is likely to be modest, however. Proponents have estimated that the \$10 billion increase in bond authority provided could fund mortgages for 80,000 households.²⁰

The Revenue-Raising Measures

The cost of the tax cuts in the House-passed tax package is fully offset with two revenue-raising measures.

New Basis Reporting Requirement

Currently, financial institutions are required to report dividends, interest payments, and the sale prices of financial assets to taxpayers and the IRS. Capital gains taxes, however, are based on the sales price *minus the purchase price* (or the “basis”). And financial institutions are *not* required to report the purchase price of financial assets. Partly as a result, overstatement of the purchase price of assets (which leads to understatement of capital gains) is believed to be widespread and to contribute significantly to the capital gains “tax gap.” The IRS estimates that the capital gains tax gap was \$6-\$9 billion in 2001.²¹

The provision in the House-passed tax package would require financial institutions to begin reporting the purchase price of financial assets. The provision raises \$8.0 billion (over the 2008-2018 period), and thereby covers most of the cost of the housing package’s provisions. A version of this proposal was included in the Administration’s fiscal year 2008 and 2009 budgets.

Delay Implementation of a Corporate Tax Cut Enacted in 2004

In 2004, Congress enacted a tax cut for multinational corporations. The 2004 provision (known as “worldwide interest allocation”) allows firms to use a more favorable formula for apportioning certain tax deductions between U.S. and foreign income.

The House-passed tax package would delay this tax break, now scheduled to take effect in 2009, until 2010. This would save \$3.1 billion, covering the rest of the cost of the housing tax cuts.²²

Comparing the House-passed Committee and Senate Tax Packages

As discussed above, the House-passed tax package spends about \$5 billion on provisions that are not a good use of resources. But it represents a very substantial improvement over the Senate’s tax package, because of four key differences. (For a detailed comparison of the House and Senate tax packages, see Appendix Table 1.)

- **The House-passed tax package does not include the Senate’s net operating loss**

²⁰ The \$1.4 billion cost of the provision pays for an additional \$10 billion in tax-exempt bond authority.

²¹ Internal Revenue Service, “Tax Gap Facts and Figures,” http://www.irs.gov/pub/irs-utl/tax_gap_facts-figures.pdf.

²² The House-passed tax “extenders” bill would delay the tax break until 2019, raising \$30 billion.

carryback provision.²³ With a ten-year price tag of \$6.1 billion, this provision is the largest in the Senate housing bill. Yet it would help neither homeowners nor the overall economy. Its main function would be to provide some businesses with large tax breaks, for which there is no strong policy justification.

A business experiences a “net operating loss” when its tax deductions exceed its income. Under current law, businesses may use their net operating losses to reduce their previous two years’ taxable income, in which case they receive refunds of taxes paid in those years. Businesses may also use these losses to reduce their taxable income in any of the next 20 years. The Senate housing legislation would extend the “carryback” period from two years to four years for net operating losses incurred in 2008 or 2009. Supporters claim that this would prevent layoffs and boost investment, especially in the homebuilding industry, and that it would prevent homebuilders from selling houses at “firesale” prices.

These claims do not bear up under scrutiny. Generally speaking homebuilders and other businesses will retain workers if they believe that the value of what the workers can produce exceeds their wages. They will invest in new construction if they anticipate adequate demand for new houses. And they will avoid selling houses at “firesale” prices if they expect to be able to sell them at higher values in the not-too-distant future.

None of these calculations is influenced significantly by a tax break like the NOL provision, which provides businesses with more cash *whether or not* they avoid layoffs and firesales or increase investment. Simply put, a no-strings-attached cash infusion will not prevent businesses from making profit-maximizing choices about hiring, investment, and sales. This explains why, in its recent report on economic stimulus options, the Congressional Budget Office gave an extended loss carryback period the *lowest* of its three cost effectiveness ratings.²⁴

- **The House-passed package includes a package of reforms to the Low-Income Housing Tax Credit.** As discussed above, these reforms will enhance the credit’s effectiveness at increasing the supply of affordable rental housing, and will increase the amount of credits available in the next two years to construct and rehabilitate rental housing. Over time these provisions will help meet the additional demand for rental housing that is resulting from the current crisis, as more families remain renters and an estimated several hundred thousand moderate-income households are displaced from their homes by foreclosures.
- **The House package does not include the provision from the Senate package that would harm local governments.** The House-passed package does, as discussed above, include the property tax deduction for non-itemizers that is also included in the Senate package. But the Senate version of the provision would *deny* the deduction to taxpayers who live in jurisdictions that increase property tax rates over the next year. By effectively preventing localities from raising tax rates to help compensate for shrinking property tax revenues caused by declining home values, the provision could force many localities to cut police, firefighting, schools, and

²³ For a more detailed discussion of the net operating loss provision, see Aviva Aron-Dine, Barbara Sard, and Chad Stone, “Senate Housing Legislation Highly Disappointing.”

²⁴ Congressional Budget Office, “Options for Responding to Short-Term Economic Weakness,” January 2008, http://cbo.gov/ftpdocs/89xx/doc8916/01-15-Econ_Stimulus.pdf.

other vital public services. It also would improperly pre-empt local taxing powers and pressure states to make up the lost local revenue even as many of them struggle with their own budget problems.

In addition, the provision would place unprecedented demands on the IRS that would likely make it impossible to administer. At least 40,000 towns, counties, and school districts levy property taxes, and in many cases, their boundaries do not correspond to zip codes or other geographic data easily available to the IRS.²⁵

- **The House-passed tax package is fully paid for, in compliance with Pay-As-You-Go (PAYGO) rules.** In contrast, the Senate bill is deficit financed; the Joint Tax Committee calculates that the net cost of the tax cuts in the Senate bill would be \$14 billion.

Congress agreed to waive PAYGO for the economic stimulus legislation enacted in February, on the grounds that it was important to act rapidly to boost aggregate demand and that including offsets in the bill might dampen its stimulus effect and delay its enactment.

That decision should not be abused to justify waiving PAYGO for provisions that are not economic stimulus measures and that, in the case of the Senate tax package, would do little to address the foreclosure crisis. Such abuses undermine the PAYGO rules and make them more difficult to sustain in other cases.

The Senate housing bill itself already provides some evidence of the corrosive effect such practices can have. Shortly before passing the bill, the Senate voted to add to it about \$8.3 billion in unpaid-for extensions of expiring energy tax breaks that have nothing to do with foreclosures or problems in housing markets. This was a clear case of using legislation intended to address the foreclosure crisis as an excuse to circumvent PAYGO for provisions that are unrelated to the supposed purpose of the bill.

Effectively Addressing the Foreclosure Crisis Will Require Non-Tax Measures

While the House-passed tax package improves substantially on the Senate version and includes a number of meritorious provisions, by itself it does not do much to address the foreclosure crisis. Out of the entire package, only the housing bond provision would help families struggling to keep their homes.

This is perhaps appropriate. In general, expenditure programs are likely to work better than tax cuts in addressing a problem like the foreclosure crisis, because they have more mechanisms available to target assistance to the families and communities that need it.

Two types of measures will be especially important for addressing the foreclosure crisis.

- **Proposals to have the Federal Housing Administration (FHA) guarantee restructuring**

²⁵ For more discussion of the troubling Senate provision, see “Statement by Iris Lav, Deputy Director, on Provision in Bipartisan Senate Housing Package Affecting Local Property Taxes,” Center on Budget and Policy Priorities, April 3, 2008, <http://www.cbpp.org/4-3-08sfp-stmt.htm>.

of mortgages on certain properties that are at risk of foreclosure. The House-passed housing bill has included a version of this proposal. The Senate Banking Committee has approved another version. Both proposals would provide a mechanism for large numbers of homeowners at risk of foreclosure to work out new mortgage arrangements. Many experts believe that such an approach affords the best opportunity of any measure under consideration to limit the number of foreclosures and to allow more homeowners in danger of defaulting on their mortgages to stay in their homes. Former Federal Reserve Vice-Chairman Alan Blinder has written that this proposal, “while not a panacea, offers a smart approach to a knotty set of problems — an approach that should breathe some life into the housing market, the mortgage markets, and the related securities markets.”²⁶

Because of the enormous changes over the past several years in the way mortgages are marketed and securitized, opportunities for face-to-face negotiations between homeowners and their mortgage holders are much rarer than they were in the days when the local bank held and serviced the mortgage. Indeed, many mortgages are now in effect owned by investors in various types of commercial securities, rather than lenders. In many cases, there is no entity with the clear power to “make a deal” to write down the value of the mortgage or restructure interest payments in order to avoid the substantial costs of foreclosure and enable homeowners to stay in their home under restructured arrangements.

The measures passed by the House and approved by the Senate Banking Committee by a wide bipartisan margin would encourage mutually beneficial restructurings by having the Federal Housing Administration (FHA) guarantee new mortgages issued to struggling homeowners. Essentially, new lenders would pay off existing mortgages at below face value (reflecting the new reality of home prices) and issue new mortgages to the homeowners. The FHA would guarantee the new mortgages issued. While the provision would need to be carefully crafted to prevent abuses and guard against risks, it appears to be the best available option for addressing the foreclosure problem and would likely do more than any other option on the table to help a substantial number of families keep their homes.²⁷

- **Help for communities especially hard-hit by foreclosures.** Foreclosure rates differ greatly across the country.²⁸ Some areas are particularly hard-hit. For example, recent data indicate that one in every 50 homes in Las Vegas has been foreclosed.²⁹ Where foreclosures are concentrated, neighborhoods can spiral downward. Vacant homes can attract crime and become an eyesore; properties may be vandalized and stripped of valuable materials, increasing the cost of returning them to use. The glut of properties and deteriorating conditions can then

²⁶ Alan S. Blinder, “How to Cast a Mortgage Lifeline?” *New York Times*, March 30, 2008.

²⁷ From comments this week in the press and at the Financial Services Committee hearings, it appears that Chairman Frank believes that to make such a provision more effective, it may be necessary to create additional incentives for mortgage holders to agree to participate. Two types of policies have been suggested for this purpose: legal immunity from litigation by investors for mortgage servicers that agree to accept less than the face value of mortgages (proposed by Rep. Castle), and flexibility for bankruptcy courts to reduce mortgage debts on some primary residences. Both options would entail no cost for the government.

²⁸ The *New York Times* recently published a helpful map of the foreclosure crisis. See http://www.nytimes.com/imagepages/2008/04/05/business/20080406_METRICS.html.

²⁹ David Abromowitz, “Addressing Foreclosures,” Center for American Progress, January 31, 2008.

further reduce the property values of remaining homeowners. And local governments suffer a double hit, as revenues from property taxes decline while the costs of basic public services such as police protection and trash collection increase. Some of the communities most adversely affected by foreclosures had only recently reemerged as desirable places to live; concentrated foreclosures in these areas undermine the progress made by decades of public and charitable investment.

The Senate housing bill would provide \$4 billion to hard-hit communities to help them buy foreclosed or abandoned properties at a discount, rehabilitate them as needed, and resell them or make them available for rent. The House has passed legislation authorizing \$10 billion for a combination of grants and loans for these purposes. In addition to reversing neighborhood decline, such efforts could yield a needed expansion of affordable housing opportunities.³⁰

As the House and Senate work to resolve their differences and formulate final housing legislation, policymakers should bear in mind that the most important measures, from the perspective of addressing the housing crisis, are those that would help homeowners keep their homes and help communities rehabilitate foreclosed and abandoned properties, not the tax measures in either bill. If the final housing legislation includes a tax package, as it almost surely will, the package should include the meritorious measures from the House package, exclude the most troubling components of the Senate bill, and include revenue-raising measures that offset the tax cuts' cost.

³⁰ Claims that providing such assistance to communities would reward speculators and abusive lenders are largely incorrect, since the properties to be purchased and restored have already been foreclosed upon. The potential benefit to the neighborhoods and their remaining residents, which generally are innocent victims of others' misdeeds and misjudgments, would far outweigh any undue gain to lenders.

Appendix Table 1: Comparison of the Major Provisions of the House and Senate Tax Packages

Provision	Description	Cost (2008-2018)	Evaluation
Provisions in BOTH Tax Packages			
Property tax deduction for non-itemizers*	Creates a temporary tax deduction for property tax payments by filers who do not itemize their deductions. Senate deduction is \$1,000 per couple, \$500 per individual; House version is \$700 per couple, \$350 per individual. Senate bill would deny the deduction to taxpayers who live in jurisdictions that increase property tax rates between now and next January.	Senate version: \$1.5 billion House version: \$1.2 billion	<i>Not targeted.</i> Benefits all homeowners who do not itemize (and who have incomes high enough to benefit from a deduction), instead of targeting those most likely to need help. Because the assistance is spread so thin, the amounts are too small to be much help — only \$150 for a couple in the 15 percent tax bracket even in the Senate version. <i>Senate version hurts local governments.</i> Senate version would effectively prevent localities from raising tax rates to help compensate for shrinking property tax revenues, which could seriously worsen localities' fiscal problems and lead to sharper cuts in schools, police, and other services. This provision also would be virtually impossible for the IRS to administer.
Increase in housing bond authority and changes to allowable uses for housing bonds	Provides state and local governments with a one-time increase in tax-exempt housing bond authority. Also allows them to use these bonds to help homeowners refinance subprime mortgages, rather than only to help homeowners take out new mortgages or to finance multi-family rental housing.	Senate version: \$1.8 billion House version: \$1.4 billion**	<i>Would help a modest number of low- and moderate-income families keep their homes.</i> Increased housing bond authority and increased flexibility in the use of these bonds could allow state and local governments to provide significant help to households hurt by the foreclosure crisis. Tax-exempt housing bonds are generally used to help low- and moderate-income families, and this provision could help a modest number of such families avoid foreclosure.
Other Provisions in SENATE Tax Package			
Extension of net operating loss carryback period and refunds of certain AMT and R&E credits.	Allows businesses to use 2008 and 2009 losses to obtain refunds of prior four years' tax payments (instead of two years' payments as under current law).	\$7.4 billion	<i>Does little or nothing to help the housing sector.</i> Supposedly would help the housing sector by boosting the homebuilding industry, but unlikely to change builders decisions about whether to invest, retain workers, or sell houses at "firesale" prices. Could even <i>encourage</i> "firesales" by making it easier for sellers to take immediate tax write-offs for the resulting losses. <i>Provides an unwarranted special interest tax break.</i> Much of the tax benefit would go to firms that have no relation to housing. And the tax break is unlikely to help the economy — in its recent report on economic stimulus options, CBO gave this proposal the <i>lowest</i> of its three ratings for cost-effectiveness as stimulus.
Credit for purchases of foreclosed homes	Provides a \$7,000 tax credit, spread over two years, to taxpayers who purchase foreclosed homes within the next year	\$1.6 billion	<i>Unlikely to provide any help to homeowners.</i> Unlikely to boost overall housing demand enough to benefit homeowners by raising home values. Instead, most of the benefits would likely go to those who would have purchased homes anyway, without the tax incentive. To the degree that the credit boosts demand for foreclosed homes, beneficiaries would mostly be banks and other lenders who have repossessed homes. <i>Could even make problems worse.</i> Could have unintended adverse effects, such as boosting prices for foreclosed homes at the expense of other homes or making lenders quicker to foreclose by increasing demand for foreclosed homes. <i>Not well-targeted.</i> Not well-targeted to help communities hard-hit by foreclosures.

Provision	Description	Cost (2008-2018)	Evaluation
Extensions of tax breaks for renewable energy	Extends various expiring renewable energy and energy efficiency tax incentives for one year.	\$8.3 billion	<i>Does not belong in this bill.</i> The energy tax incentives have nothing to do with preventing for foreclosures or addressing problems in the housing market. Including them in this bill was a clear attempt to circumvent the Pay-As-You-Go rules that would otherwise require them to be paid for instead of deficit financed.
Other Provisions in HOUSE*** Tax Package			
First-time homebuyer credit	Provides a \$7,500 interest-free loan to first-time homebuyers; beneficiaries are not required to pay back the full credit amount if they sell their homes at a loss. Credit is refundable and begins phasing out for couples with incomes above \$140,000 (singles with incomes above \$70,000).	\$4.0 billion	<i>Goal of spurring housing demand probably inadvisable.</i> If households are encouraged to enter the housing market before the housing bubble has fully deflated, this could result in losses for both the federal government and the households themselves. <i>Not the best use of resources.</i> Credit would probably mostly help families that would have bought homes anyway. Funds would be better spent on alleviating the problems caused by the foreclosure crisis.
Low-Income Housing Tax Credit (LIHTC) reforms	Temporarily increases the amount of credits states are permitted to allocate to developers; also revises various rules governing the LIHTC.	\$1.8 billion	<i>Would promote construction and rehabilitation of affordable housing.</i> Provisions would help state agencies that allocate and administer these Low-Income Housing Tax Credits to address longstanding affordable housing shortages, create opportunities for additional low-income families to live in low-poverty neighborhoods that currently lack moderately priced rental housing, and help revitalize distressed communities.
Changes to the AMT treatment of various housing-related tax benefits	Allows filers to use the LIHTC and various other housing-related tax benefits to reduce their AMT liability.	\$2.1 billion	<i>Would increase the value of Low-Income Housing Tax Credits.</i> By allowing investors subject to the AMT to benefit from the LIHTC, the provision would increase the pool of potential purchasers for the credits, likely raising their prices. This would generate more funds to support affordable housing.
House-passed revenue offsets			
Capital gains basis reporting	Requires financial institutions to report the purchase price of financial assets to taxpayers and the IRS.	Saves \$8.0 billion	
One-year delay in corporate tax break	Delays for one year a corporate tax cut that will allow firms to use a more favorable formula for apportioning certain tax deductions between U.S. and foreign income****	Saves \$3.2 billion	

*The House-passed tax "extenders" bill also includes this measure, again estimated to cost \$1.2 billion over ten years.

** The different cost estimates for the mortgage revenue bond proposals in the two bills reflect a technical scoring issue, not a substantive difference between the proposals. Both the Senate and the Ways and Means tax package change the AMT treatment of housing bonds. In the case of the Senate tax package, this change is included in the cost estimate for the housing bond provision; in the case of the Ways and Means tax package, it is instead included in the cost estimate for changing the AMT treatment of various housing-related tax benefits.

*** Estimates for the House bill are based on the House tax package as reported by the Committee on Ways and Means; estimates for the final bill are not yet available.

****The House-passed tax "extenders" bill (H.R. 6049) uses a broader version of this measure to offset extensions of various existing tax breaks and new tax incentives for renewable energy.