Center for American Progress Action Fund

April 15, 2013

The Honorable Sam Johnson
Chair
Real Estate Tax Reform Working Group
United States House of Representatives
Washington, D.C. 20515

The Honorable Bill Pascrell Jr.
Vice Chair
Real Estate Tax Reform Working Group
United States House of Representatives
Washington, D.C. 20515

Dear Representatives Johnson and Pascrell:

The Center for American Progress Action Fund is pleased to submit our comments in support of progressive, revenue-enhancing, and simplifying tax reform. We propose a federal tax reform plan that raises adequate revenue progressively while making the tax system more efficient, simple, fair, and comprehensible.

Our current tax system falls short in three key ways. First, federal revenue levels today are at their lowest level since the 1950s, and our tax system does not raise sufficient funds to pay for critical public investments or to protect our most vulnerable citizens. Second, our tax system has become less progressive over the past several decades, with the highest-income households enjoying substantial tax cuts even as their incomes have risen.

Third, our tax code is too complex and contains too many narrowly targeted special interest breaks. The Center for American Progress Action Fund recommends a tax reform plan that addresses these failings. Our plan redesigns the income tax code so that it will generate adequate levels of revenue to meet our crucial goals, raises this revenue in a progressive way by asking those in the top income brackets to pay more, simplifies the filing process, and streamlines the code. Specifically, we support the top marginal tax rate on personal income of 39.6 percent, a top marginal tax rate of 28 percent on capital gains as it was under President Ronald Reagan, converting tax deductions to tax credits, closing tax loopholes, simplifying the tax system by reducing the number of filers who itemize, and repealing the alternative minimum tax.

While specific policy proposals are outlined below for your consideration, our principal view is that tax reform should help our nascent housing recovery, raise much needed revenue, and make our tax system work for more Americans.

We offer the following recommendations to you as the chair and vice chair of the Real Estate Tax Reform Working Group:

- Convert the mortgage interest deduction to an itemized, nonrefundable credit: As part of the Center for American Progress Action Fund's tax reform plan, the mortgage interest deduction, or MID, would be converted to an 18 percent itemized, nonrefundable credit. For homeowners in tax brackets over 18 percent, the conversion would be phased in over 10 years. Reforming the mortgage interest deduction this way makes sense for a number of reasons.
  First, the MID as currently structured is very expensive. The MID is the second-largest tax expenditure behind employer-provided health insurance. Likewise, the MID is the largest U.S. housing program: The Joint Committee on Taxation estimates the MID will cost $70 billion to $80 billion each year, which contrasts with the $47.6 billion requested for the entire Department of Housing and Urban Development in 2014.

  Second, the MID disproportionately benefits those who need housing assistance the least. In 2012, close to 80 percent of the benefits of the deduction went to homeowners with incomes above $100,000, while 3 percent of the benefits went to homeowners with incomes below $50,000. Converting the MID to a credit will increase the number of low- and moderate-income homeowners who benefit from the credit.

  Third, reforming the MID will raise revenue, a necessary component of any deficit reduction plan. A similar proposal for a 15 percent non-refundable credit that is phased in over five years would raise $197 billion over 10 years.

  Fourth, contrary to critics' claims, reforming the MID will likely not harm the housing recovery or decrease home prices. This is because converting the MID to a credit will allow it to help more homeowners. Additionally, phasing the reform in over 10 years, as we have proposed, will further reduce the likelihood that the reform will disrupt housing markets.

- Extend and broaden the Mortgage Debt Relief Act: In the wake of the foreclosure crisis, difficult public policy and legal work has taken place to reduce the number of foreclosures. Alternatives such as short sales—in which lenders allow the sale of a home for less than they are owed on a mortgage—and deeds in lieu of foreclosure—where lenders and homeowners agree to avoid the foreclosure process altogether, but the property is still forfeited—are crucial tools in working through the legacy of our housing crash. Likewise, loan modifications that make mortgage payments more affordable—in particular through reduction of principal balances—are essential tools in preventing unnecessary foreclosures and encouraging our nascent housing recovery. Each of these tools—as well as foreclosures in some cases—requires some forgiveness of mortgage debt.

  Until 2007 forgiven mortgage debt was treated as taxable income to the borrower. As a result, homeowners who sold their houses in short sales or received principal reductions intended to make their mortgage payments more affordable received a 1099 from the lender and were required to pay tax unless the cancellation of debt income was excluded for another reason. To ensure that the tax code did not work counter to the policy efforts to prevent foreclosures, Congress passed the Mortgage Debt Relief Act of 2007, which was recently extended through the end of 2013.

We urge the House Ways and Means Committee to further extend the Mortgage Debt Relief Act. While we have seen encouraging trends in the housing market recently, our housing crisis will not be over by the end of this year. Many foreclosures are yet to come. Approximately 1.2 million homes are in some stage of foreclosure, and even more households are 90 or more days delinquent on their mortgages, meaning they are at risk of foreclosure--for comparison, approximately 4.2 million foreclosures have been completed since September 2008. Homeowners who receive loan modifications or other foreclosure alternatives in 2014 and beyond deserve the same protection from tax bills that other struggling homeowners received.

We also urge your committee to broaden the Mortgage Debt Relief Act. Right now, only the portions of the mortgage used to purchase a home or make major home improvements are exempt from taxation. If a homeowner refinances his or her mortgage, takes money out to consolidate bills, pay for minor home repairs, or cover education or medical costs, those portions of the mortgage are still taxable. These portions of the mortgage should also be exempt from tax bills if the homeowner is forgiven mortgage debt.

Any plan for balanced and realistic deficit reduction must include progressive tax reform. We urge the committee to embrace a tax reform plan that asks those who can most afford it to bear their fair share of the burden while protecting seniors, the middle class, and those striving to get into the middle class.

The Center for American Progress Action Fund thanks you for your consideration of our views on tax reform. We welcome the opportunity to provide additional information or to discuss our recommendations in greater detail.

Sincerely,

Julia Gordon
Director of Housing Finance and Policy
Center for American Progress Action Fund