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# Long-treasured mortgage interest deduction may face changes

*'Fiscal cliff' debate has put home mortgage interest deduction on the table. Critics contend it benefits the wealthy much more than the middle class.*

December 10, 2012 | By Jim Puzzanghera, Los Angeles Times

WASHINGTON — At 70, Frank White isn't a typical first-time home buyer. But a key reason he ditched his Altadena apartment and bought a three-bedroom house in nearby Pasadena has been common for decades: He wanted the tax break.

"I pay very high taxes, and I have no deductions," said White, who owns an apartment rental business with his two brothers. Now, after purchasing the $500,000 home in November, he's looking forward to writing off the interest on his 30-year mortgage.

But the longtime tax break could face major changes as Washington policymakers search for ways to reduce the deficit as part of the debate on the so-called fiscal cliff. And that's sending shivers through home buyers such as White and much of the housing industry.

"My deductions are important to me, what few I have," White said. "We need to go after the corporations that don't pay a ... cent. Let's go after those guys first. But leave me alone."

The home mortgage interest deduction is one of the most cherished in the U.S. tax code. It's also one of the most expensive, estimated to cost the federal government $100 billion this fiscal year.

**Primer: Understanding the fiscal cliff**

For that reason, the deduction taken on income tax returns is expected to be on the table in Washington's search for more money to reduce the budget deficit and resolve the fiscal cliff.

But the specter of scaling back the tax break, particularly with the housing market still trying to recover from the collapse of the subprime mortgage bubble, is raising alarms among homeowners, Realtors and home builders.

It's also sparking a debate about the true effect of the deduction, which critics argue benefits the wealthy much more than the middle class. They contend that the break hurts first-time home buyers by driving up house prices and that other countries that have no such deduction still have high homeownership rates.

"If we really care about homeownership, then the deduction is just the absolute wrong way to go," said Dennis Ventry, a UC Davis law professor who has studied its effect.

There is agreement that reducing the interest deduction — no one is talking about eliminating it — would cause prices to drop as buyers scale back the amount they could afford to spend.

The concerns are even greater in Southern California and other high-priced regions where homeowners benefit more from the deduction because their mortgages are larger.

"A lot of people buy rather than rent simply because, after the mortgage deduction, it's more affordable," said Syd Leibovitch, president of Rodeo Realty in Beverly Hills. "To limit it or take it away, I think you're going to be surprised at the shocking effect it has on the real estate market."

**QUIZ: How much do you know about the fiscal cliff?**

President Obama's deficit commission proposed lowering the limit on mortgage principal eligible for a deduction to $500,000 from the current $1 million, removing any break for interest on a second home and turning the deduction into a tax credit capped at 12% of interest paid.

A tax credit would allow homeowners who don't itemize deductions to subtract the interest from the taxes they owe. But while more taxpayers could take advantage of the benefit, a cap would mean those with large mortgages on expensive homes couldn't get a credit for all the interest they pay.

Other proposals have called for similar changes.

Supporters of the tax break worry that proposed changes would not only push down prices but also spook potential buyers.

Lawrence Tang, 38, and his wife own a house in West Covina. But they are renting in San Gabriel and looking for a house there, near where he works as a school technology director. They don't want to sell the West Covina house because the drop in home values wiped out most of their equity.

So the proposed changes would limit how much interest they could deduct on their first house and prevent them from deducting any interest on what would be their second home, Tang said.

"That would pretty much price us out of that market and push us back to the sideline," Tang said. Just talk of changes to the mortgage interest deduction is making them hesitant to buy, he said.

The mortgage interest deduction is one of the most popular tax breaks. In a nationwide poll released this week by Quinnipiac University, two-thirds of respondents said they opposed eliminating it.

The deduction has been around since the federal government began collecting income tax in 1913. But contrary to popular belief, the deduction wasn't put in the tax code to encourage home ownership. All consumer interest was deductible then.

Over the years, however, Congress has pared back interest deductions. The 1986 tax code overhaul eliminated the ability to deduct auto loan and credit card interest.

But lawmakers specifically kept the deduction for home mortgage interest. Then-President Ronald Reagan said he wanted to keep it because it symbolized the American dream.

"For people of my generation, the baby boomers, from the time we were kids we were told by the federal government and its policies to build our nest eggs around housing," said Gerald M. Howard, chief executive of the National Assn. of Home Builders, one of the strongest supporters of the deduction.

"Now our elected officials are going to tell us in the name of tax simplification they're going to further reduce the value of our housing by 10% to 15% right as we're about to retire?" Howard said. "When you make that kind of case to lawmakers, you should see their eyes widen."

But a lot of that concern is based on the misconception that the deduction is a boon for average Americans, critics said.

"This is a sacred cow to the real estate industry, and it's almost an entitlement to homeowners," said Anthony Sanders, a real estate finance professor at George Mason University. "They could cut it in half and it would not harm a lot of middle-income households."

An analysis by Congress' Joint Committee on Taxation found that 78% of the $83 billion in mortgage interest deductions in 2010 went to households with income of more than $100,000. Households with incomes of more than $200,000 got 35% of the benefit.

Wealthier people own more expensive houses and have more interest to deduct. And because their income is taxed at a higher rate, the benefit of the deduction is greater.

The average savings from the mortgage interest deduction was $2,454 in 2010. But for households making more than $200,000, it was $6,370.

In addition, people in high-cost areas benefit the most from the deduction. A 2001 study found that three metropolitan areas — Los Angeles, San Francisco and New York — combined to receive more than 75% of the deduction's benefit.

"When you turn the light on and see what's really under the bed, I don't think there's really much there," said Glenn Kelman, chief executive of online real estate company Redfin, which is based in Seattle.

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