NAR Resort and Second Home Property Specialist (RSPS) Webinar

Tax Reform 2017
What to Watch Out For

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What is Tax Reform?

For Most Democrats

For Most Republicans

Barriers to Tax Reform

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Tax Reform Factors

Pulling it to "YES"

- Broad consensus between parties on corporate & international reform
- Republicans control White House and both Houses of Congress
- Power of "bully pulpit" and President's willingness to use it

Pulling it to "NO"

- Different visions of parties on what is tax reform
- Procedural rules in Senate requiring 60 votes to pass bills
- Need to keep it revenue neutral
- Comprehensive tax reform is very hard to do

House Republican Tax Reform Blueprint

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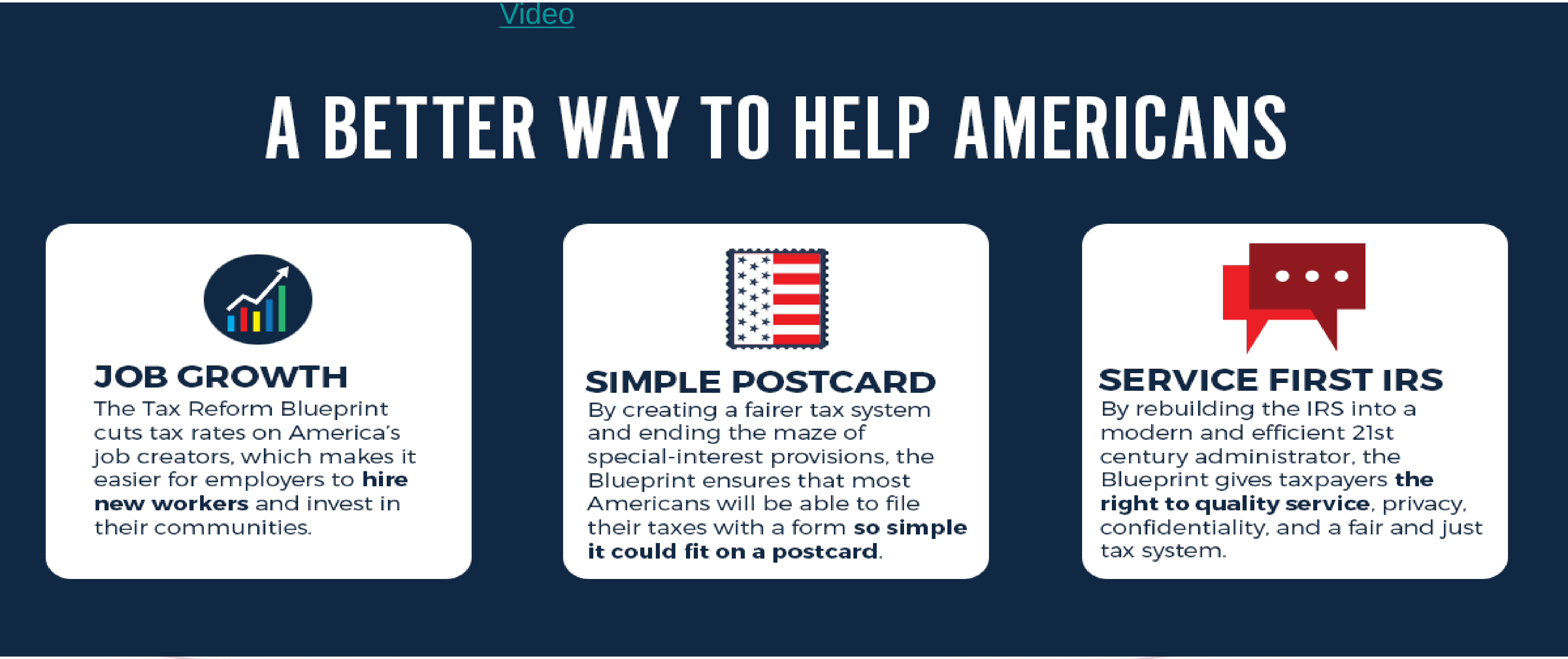
Blueprint: Focus is on Growth, Simplicity, IRS

Video



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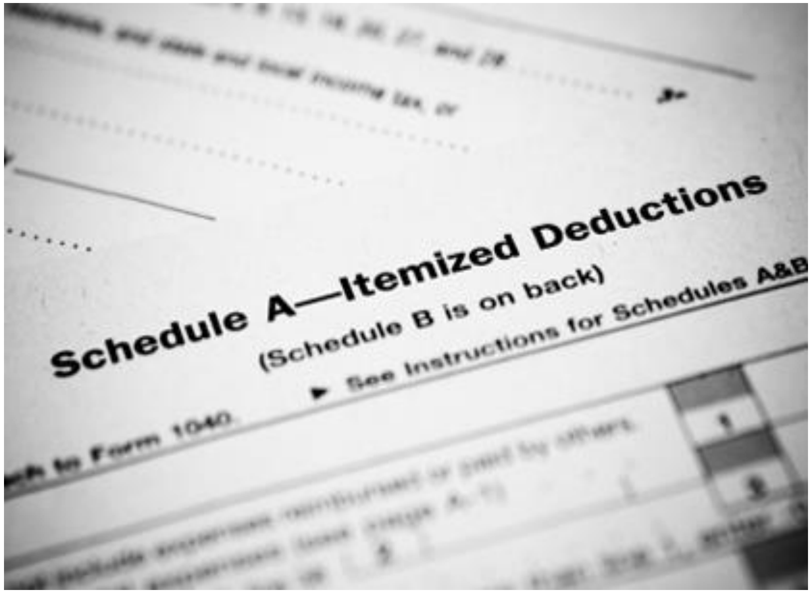
Blueprint

Doubles Standard Deduction

Repeals Most Itemized Deductions



What Happens If Standard Deduction Goes Up Significantly?

- Itemized deductions become less relevant and fewer people claim them.
- If one or more of the major itemized deductions is repealed (such as deduction for state and local taxes), effect is compounded.
- The result is a <u>simpler</u> tax system, but one where tax incentives of home ownership could evaporate even while taxes are not necessarily being reduced.

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Blueprint Could Demolish Tax Benefits of Homeownership

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Leading tax reform plans promise to leave the mortgage interest deduction largely <u>unchanged</u>

But this is not the case.

Dave Camp's Tax Reform Act of 2014

"The [mortgage interest deduction] provision would **preserve a substantial tax benefit** for homeownership without affecting most taxpayers . . . And for those taxpayers who would continue to itemize, **no existing mortgage would be affected by this provision**, and 95 percent of future mortgages are also expected to be **unaffected**."

Tax Reform Act of 2014 Discussion Draft Section-by-Section Summary, p. 19.

Ron Wyden's Tax Reform Plan (2011)

"Wyden-Coats retains many of the most commonly claimed individual tax credits and deductions, **<u>including deductions for mortgage interest</u>** and charitable contributions, credits for children and earned income."

Summary of The Bipartisan Tax Fairness and Simplification Act of 2011.

House Republican Tax Reform "Blueprint" (2016)

"The Blueprint will preserve a mortgage interest deduction for homeowners. . . For those taxpayers who continue to itemize deductions, **<u>no existing mortgage will be affected by any changes in the tax code</u>**. Similarly, no changes will affect re-financings of existing mortgages."

A Better Way: A Pro-Growth Tax Code For All Americans.

Technically, they are correct!

- The tax reform plans highlighted <u>do not repeal</u> the mortgage interest deduction (MID).
  - In fact, the Wyden plan and the Blueprint do not touch MID at all.

- But in many cases, these plans would not only <u>limit or eliminate the ability to claim the MID</u>, but **would also largely nullify the tax benefits of homeownership**.

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Example – Meet Barbara Buyer

- Barbara is 33, single, and a renter paying $1,000 per month in Colorado.
- She earns $65,000/year and buys a condo for $263,000, making a 5% down payment.
- Her monthly P&I payment would be $1,193, before the tax benefits.
- Under current law, her 2016 tax benefits of home ownership would be $3,325 or $277/month.*

*assumes 30-year fixed rate mortgage loan of $249,850 at 4.0%

Tax Reform Could Greatly Limit Tax Advantages of Buying over Renting

Here are Barbara's tax benefits of homeownership under the three tax reform plans:

Tax Plan	Tax Benefit from Owning a Home
Camp	$91
Wyden	$650
Blueprint	$166
Current Law	$3,325

Barbara Buyer's Itemized Deductions Under Current Law

Deduction	Rents	Buys
Mortgage Interest	$0	$9,914
Real Estate Taxes	$0	$1,686
Mortgage Insurance Premium	$0	$1,999
Other State/Local Taxes	$3,250	$3,250
Charitable Contributions	$2,750	$2,750
Total	$6,000	$19,599
Standard Deduction	*$6,300*	*$6,300*
Higher of Total or Standard Deduction?	$6,300	$19,599
Tax Benefits of Homeownership =	**$3,325**	

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Barbara Buyer's Itemized Deductions Under Camp Plan

Deduction	Rents	Buys
Mortgage Interest	$0	$9,914
Real Estate Taxes	$0	$0
Mortgage Insurance Premium	$0	$0
Other State/Local Taxes	$0	$0
Charitable Contributions	$1,450	$1,450
Total	$1,450	$11,364
Standard Deduction	*$11,000*	*$11,000*
Higher of Total or Standard Deduction?	$11,000	$11,364
Tax Benefits of Homeownership =	**$91**	

Thus, there is very little tax advantage for buying over renting.

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Barbara Buyer's Itemized Deductions Under Wyden Plan

Deduction	Rents	Buys
Mortgage Interest	$0	$9,914
Real Estate Taxes	$0	$1,686
Mortgage Insurance Premium	$0	$0
Other State/Local Taxes	$3,250	$3,250
Charitable Contributions	$2,750	$2,750
Total	$6,000	$17,600
Standard Deduction	*$15,000*	*$15,000*
Higher of Total or Standard Deduction?	$15,000	$17,600
Tax Benefits of Homeownership =	**$650**	

Thus, there is still little tax advantage for buying over renting.

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Barbara Buyer's Itemized Deductions Under Blueprint

Deduction	Rents	Buys
Mortgage Interest	$0	$9,914
Real Estate Taxes	$0	$0
Mortgage Insurance Premium	$0	$0
Other State/Local Taxes	$0	$0
Charitable Contributions	$2,750	$2,750
Total	$2,750	$12,664
Standard Deduction	*$12,000*	*$12,000*
Higher of Total or Standard Deduction?	$12,000	$12,664
Tax Benefits of Homeownership =	**$166**	

Again, there is even less tax advantage for buying over renting.

Young Couple with One Child - UT

Income = $ 61,000

Mortgage = $ 163,000

**4.5% (2nd year)*

Deductions	Amount
MID	$7,160
Real Estate Taxes	$1,189
Mortgage Insurance	$1,304
Other State & Local Taxes	$2,250
Charitable Contributions	$6,100
Medical Expense Deduction	$2,500

Tax Benefits of Homeownership	
Current Law	$1,185
Camp Plan	$0
Wyden Plan	$0
Blueprint	$0

2016 Tax Liability	
Current Law	$2,325
Camp Plan	$2,400
Wyden Plan	$1,828
Blueprint	$2,940

Family of Four - VA

Income = $ 260,000
Mortgage = $ 500,000 **4% (4th year)*

Deductions	Amount
MID	$18,719
Real Estate Taxes	$7,848
Mortgage Insurance	$0
Other State & Local Taxes	$14,300
Charitable Contributions	$9,000
Medical Expense Deduction	$0

Tax Benefits of Homeownership	
Current Law	$7,439
Camp Plan	$130
Wyden Plan	$6,953
Blueprint	$1,228

2016 Tax Liability	
Current Law	$41,287
Camp Plan	$45,075
Wyden Plan	$46,377
Blueprint	$45,348

Family of Four – VA (with 2nd home)

Income = $ 260,000

1st home mortgage = $ 500,000 *4% (4th year)*

***2nd* home mortgage = $ 240,000** *4.5% (1st year)*

Deductions	**1st Home**	**2nd Home**
MID	$18,719	$11,203
Real Estate Taxes	$7,848	$2,391

Tax Benefits Of Homeownership		
	One Home	Two Homes
Current Law	$7,439	$11,246
Blueprint	$1,228	$4,095
Difference	$6,211	$7,151

2016 Tax Liability		
	One Home	Two Homes
Current Law	$41,287	$37,480
Blueprint	$45,348	$42,481
Difference	+ $4,061	+ $5,001

Single Mom with 2 Kids - CA

Income = $ 135,000

Mortgage = $ 340,000 **3.75% (3rd year)*

Deductions	Amount
MID	$12,157
Real Estate Taxes	$4,081
Mortgage Insurance	$0
Other State & Local Taxes	$9,655
Charitable Contributions	$4,000
Medical Expense Deduction	$0

Tax Benefits of Homeownership	
Current Law	$4,059
Camp Plan	$615
Wyden Plan	$1,849
Blueprint	$0

2016 Tax Liability	
Current Law	$16,537
Camp Plan	$22,738
Wyden Plan	$16,614
Blueprint	$21,198

Newly-Retired Couple Working Part-Time, Just Downsized – OH

Income = $ 95,000

Mortgage = $ 180,000 **4% (1st Year)*

Deductions	Amount
MID	$7,142
Real Estate Taxes	$5,580
Mortgage Insurance	$0
Other State & Local Taxes	$3,250
Charitable Contributions	$3,800
Medical Expense Deduction	$1,875

Tax Benefits of Homeownership	
Current Law	$2,176
Camp Plan	$0
Wyden Plan	$0
Blueprint	$0

2016 Tax Liability	
Current Law	$8,860
Camp Plan	$7,300
Wyden Plan	$8,535
Blueprint	$8,520

Widower, Mortgage Paid Off – WI

Income = $ 46,000
Mortgage = paid off

Deductions	Amount
MID	$0
Real Estate Taxes	$2,940
Mortgage Insurance	$0
Other State & Local Taxes	$2,300
Charitable Contributions	$2,000
Medical Expense Deduction	$10,950

Tax Benefits of Homeownership	
Current Law	$441
Camp Plan	$0
Wyden Plan	$441
Blueprint	$0

2016 Tax Liability	
Current Law	$3,100
Camp Plan	$3,500
Wyden Plan	$3,564
Blueprint	$4,080

Summary

		Tax Benefits of Owning a Home			
Homeowner		**Current Law**	**Camp Plan**	**Wyden Plan**	**Blueprint**
Young Single		$3,325	$91	$650	$166
Couple w/ Child		$1,185	$0	$0	$0
Family of Four		$7,439	$130	$6,953	$1,228
Single Mom		$4,059	$615	$1,849	$0
Retired Couple		$2,176	$0	$0	$0
Widower		$441	$0	$441	$0

		2016 Tax Liability			
Homeowner		**Current Law**	**Camp Plan**	**Wyden Plan**	**Blueprint**
Young Single		$6,109	$7,762	$7,088	$8,190
Couple w/ Child		$2,325	$2,400	$1,828	$2,940
Family of Four		$41,287	$45,075	$46,377	$45,348
Single Mom		$16,537	$22,738	$16,614	$21,198
Retired Couple		$8,860	$7,300	$8,535	$8,520
Widower		$3,100	$3,500	$3,564	$4,080

Main Takeaway

Beware of tax reform that promises to retain the current deduction for mortgage interest.

If tax reform offers much larger standard deduction, particularly when combined with repeal of state and local tax deduction, it is likely to gut the tax benefits of homeownership, even if it does not repeal or even modify MID itself.

The Real Question

- Every taxpayer's situation will be different – some will pay more tax, some will pay less under tax reform. A higher standard deduction will simplify the tax system. But at what cost?

- The plans outlined largely eliminate the current tax incentives of homeownership, which have been a hallmark of our system for more than a century.

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PwC Study

<u>Goals of Study:</u>

- Develop model of a tax reform proposal that lowers tax rates, doubles standard deduction & eliminates all itemized deductions except MID & charitable contributions.
  - Estimate impact of tax reform vs. current law by income class, homeowner status, & number of households paying more and less tax.
  - Estimate of value of MID and property tax deduction under current law vs. tax reform.
  - Estimate of short-run effect of tax reform on home values and on negative equity.
  - Estimate tax credit equivalent and impact of replacing MID with a credit by income class.

Tax Reform Blueprint's Border Adjustment Tax

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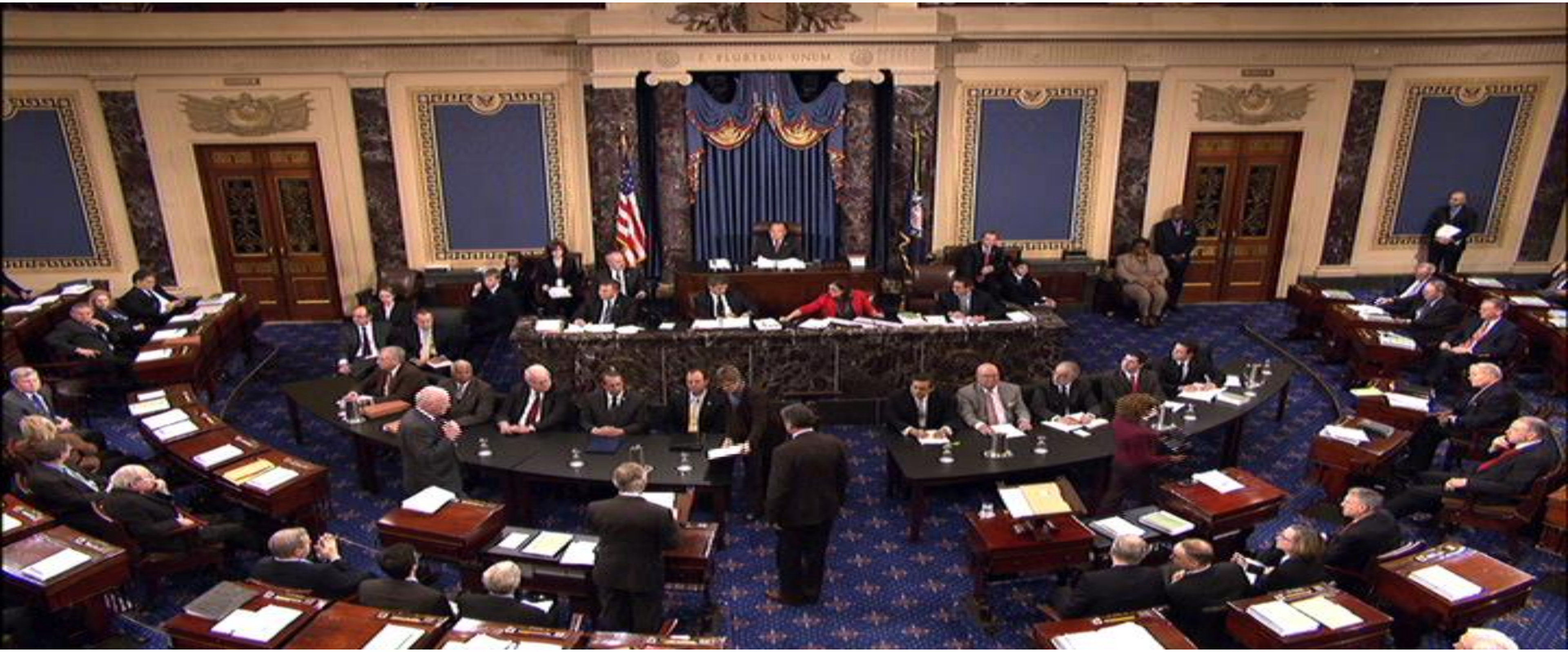
What About Tax Reform in the Senate?



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Pluses & Minuses of Tax Reform for Commercial Real Estate

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Trump / Blueprint Tax Plan

<u>Pluses:</u>

- Immediate expensing?
- Lower tax rates
- Infrastructure spending

<u>Minuses:</u>

- Denial of interest deduction
- Carried interest taxed as ordinary income
- Repeal of like-kind exchanges?

Immediate Write-off of Commercial Buildings – Is It Realistic?

Possible Questions:

- Available for passive investors?
- How would net operating losses be treated?
- Would it be optional?
- Would it lead to see-through buildings?
- Is it worth losing interest deductibility for?

Why 1031 Like-Kind Exchanges Are in Danger

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Why is 1031 Such a Target?

1. Lack of understanding its role by policy makers
2. Perception that it is a loophole
3. Estimated revenue repeal could raise
4. Limited knowledge of provision by public

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Lack of Understanding Role of 1031 Exchanges

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Perception That 1031 is a Tax Loophole

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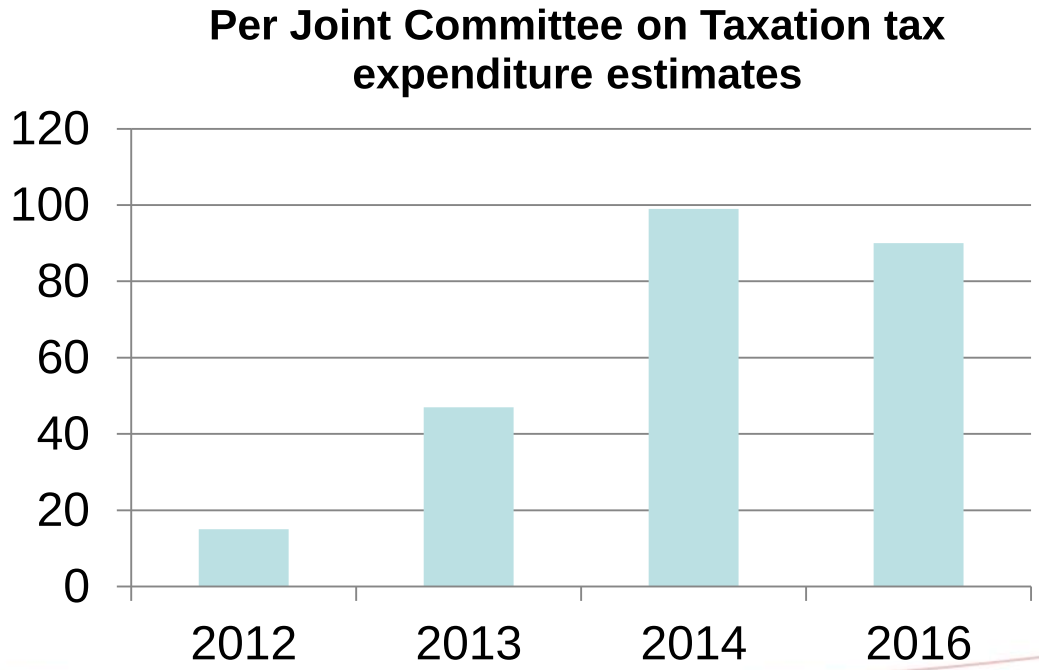
Possible Revenue Raised by Repealing 1031 Exchanges

($billions over 5 years)



Limited Knowledge of 1031 by General Public

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Questions?