



# **Trump Tax Law Hurts Homeowners in California's 45th District and Helps Real Estate Developers**

*Prepared for Rep. Porter*

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## EXECUTIVE SUMMARY

Homes are often the largest source of savings for American families, and homeowners generally build equity with each mortgage payment they make. Since Congress enacted a federal income tax more than a century ago, homeowners have been allowed to deduct interest on their home loans, as well as on property taxes on their homes.

On December 22, 2017, President Donald Trump signed the Tax Cuts and Jobs Act. As many Americans are learning as they prepare their 2018 tax returns, this law significantly reduces deductions for homeowners, while providing lucrative tax breaks for real estate developers. No Democratic Members voted in favor of the bill.

Under the Republican tax law, homeowners are now prohibited from deducting interest on home equity loans if they use the funds for unexpected medical emergencies, to pay for college education, or for any purpose other than home improvement. This retroactive provision applies even to future interest payments on loans taken out by homeowners in the past. Homeowners also are no longer allowed to deduct property taxes on their homes to the extent that state and local taxes, including property taxes, are more than \$10,000.

This report was prepared by the staff of the House Committee on Oversight and Reform at the request of Representative Katie Porter. It summarizes the specific effects of the Republican tax law on homeowners in California's 45th Congressional District based on multiple sources of data. The report finds:

- **None of the approximately 160,600 homeowners currently living in California's 45th District will be allowed to claim deductions for interest on home equity loans they use for any purposes other than home improvement.**
- **About 27,700 homeowners in California's 45th District with existing home equity loans will not be allowed to claim full home equity interest deductions on their 2018 taxes as they did in the past.**
- **Although 109,400 homeowners in California's 45th District used to be able to deduct their full property taxes, about 42,100 no longer will be allowed to do so.**

In contrast, the Republican tax law grants commercial real estate developers significant new tax breaks worth billions of dollars. Real estate developers are now allowed to take new deductions on pass-through income, pay dividends that are taxed at reduced rates, take advantage of an exemption from a provision that otherwise limits businesses from deducting interest, and utilize another exemption to avoid paying taxes on property exchanges. According to estimates from the Joint Committee on Taxation, these tax giveaways to real estate developers total \$66.7 billion in lost revenue over ten years. Just this year, the windfall for real estate developers due to these four tax changes will total nearly \$3.7 billion.

## METHODOLOGY

This report is based on data from the following sources:

- “2017 American Community Survey” from the U.S. Census Bureau;
- “2017 Survey of Consumer Expectations” from the Federal Reserve Bank of New York;
- “2016 Survey of Consumer Finances” from the Federal Reserve Board of Governors; and
- “2016 Individual Income Tax Returns: Selected Income and Tax Items by State, ZIP Code, and Size of Adjusted Gross Income” from the Internal Revenue Service.

Estimates of the impacts on homeowners with property taxes are based on a 2018 simulation by the Institute on Taxation and Economic Policy. Estimates of the impacts on homeowners with home equity loans are based on a methodology from Co-Equal.

This report does not seek to determine whether a specific family will pay more or less under the Republican tax law. That is a fact-specific determination that families will have to make each year based on many factors, including how much income they make, where they live, and the tax law’s other changes, such as additional cost increases caused by changes to the Affordable Care Act.

## I. NEW FINANCIAL PENALTIES ON AMERICAN HOMEOWNERS

Homes are often the largest source of savings for American families, and home equity loans are often the most affordable way for these families to obtain credit. In addition to taking out primary mortgages, homeowners generally may borrow against the equity in their homes by refinancing their primary mortgages to access additional funds, taking out second mortgages, or obtaining Home Equity Lines of Credit (HELOCs) to withdraw funds up to certain limits.

Funds from these loans may be used for a wide range of purposes, including covering unexpected medical expenses, paying for children to go to college, or consolidating or reducing interest rates on other more costly loans.

On December 20, 2017, the United States Senate approved the tax bill by a vote of 51 to 48, with Democrats opposing it and Republicans supporting it.<sup>1</sup> The same day, the House of Representatives approved the bill by a vote of 224 to 201, with Democrats opposing it and all but 12 Republicans supporting it.<sup>2</sup>

The Republican tax law made several changes to existing tax provisions covering homeowners:

- ***Limited the Home Equity Interest Deduction:***  
For over one hundred years, homeowners have been allowed to deduct interest on their home loans. Before the Republican tax law was passed, homeowners were allowed to deduct interest on home equity loans of up to \$100,000. The Republican tax law now limits homeowners to deducting interest related only to home improvement rather than other uses.
- ***Limited the Property Tax Deduction:***  
Homeowners used to be allowed to deduct property taxes as part of the deduction for state and local taxes. The Republican tax law set a limit of \$10,000 for the amount homeowners may deduct in combined state and local taxes, including property taxes.
- ***Capped the Size of Mortgages with Interest Deductions:***  
The Republican tax law reduced the size of the initial principle balance of mortgages on which homeowners may deduct interest from \$1,000,000 to \$750,000.

## **II. ESTIMATED EFFECTS OF REPUBLICAN TAX LAW ON HOMEOWNERS IN CALIFORNIA'S 45TH DISTRICT**

The Republican tax law has a significant impact on homeowners across the country.

In California's 45th Congressional District, approximately 160,600 homes are owner-occupied, and approximately 39,800 of these homeowners have home equity loans. Approximately 27,700 of these homeowners with home equity loans used proceeds from these loans for purposes other than home improvement, assuming they follow national trends. None of these 27,700 homeowners are allowed to claim full interest deductions on payments made after December 31, 2017.

For example, if parents refinanced their mortgage or took out a home equity loan in 2016 to cover medical bills for a loved one or college tuition for a child, they would have had every expectation that they would be able to continue deducting interest on those loan payments well into the future. Under the Republican tax bill, they are now prohibited from doing so.

If homeowners itemized deductions under the previous law and used home loan funds for a purpose other than home improvement, the Republican tax law significantly increases their after-tax interest rate. For families who still have years—if not decades—remaining to pay off loans they took out in the past, this new retroactive penalty raises serious concerns. If their banks had imposed retroactive increases on their interest rates, there is no doubt that many of these families would have sought immediate redress. In this case, however, these retroactive changes were imposed by congressional Republicans and President Trump.

Finally, under prior law, about 109,400 homeowners in California's 45th District could deduct their property taxes, claiming an average deduction of about \$6,761. Under the Republican tax law, however, about 42,100 homeowners in California's 45th District have lost the ability to deduct the full amount of their property taxes because their combined state and local tax deductions are more than \$10,000.

### III. LUCRATIVE TAX BREAKS FOR REAL ESTATE DEVELOPERS

In contrast to American homeowners, real estate developers were rewarded richly under the Republican tax law. According to estimates issued by the Joint Committee on Taxation, four new tax breaks will result in a stunning \$66.7 billion windfall for real estate developers over the next ten years, including lost taxpayer revenue of \$3.7 billion in 2019 alone.

These new tax breaks include:

- ***\$30 Billion Windfall for New Pass-Through and Real Estate Dividend Deductions:*** The tax law created a new deduction for 20% of pass-through “qualified business income.” During the House-Senate conference, a mysterious break for commercial real estate companies was inserted into the final bill to allow developers to use an alternative test using the purchase price of their depreciable real property in order to qualify for the deduction, which in turn could reduce the top rate from 37% to 29.6% for pass-through income from real estate development.

In addition, before 2003, corporate dividends were taxed at ordinary income rates, leading the Bush Administration to decry this as “double taxation” because these dividends were taxed at both the corporate and individual levels. In 2003, Congress created a lower tax rate for “qualified dividends” paid by corporations previously taxed at the corporate level. Dividends from real estate investment trusts (REITs)—which contain portfolios of real estate—were exempted from the lower rate because they do not pay corporate taxes on shareholder dividends. The tax law now provides a 20% deduction for qualified dividends paid by these trusts—despite the fact that there is no double taxation—and there is now a 29.6% effective federal income tax rate on REIT dividends for taxpayers in the 37% bracket.

According to estimates from the Joint Committee on Taxation, the combined effects of these two tax breaks amount to an estimated \$28.9 billion in lost revenue over ten years.

- ***\$16 Billion Windfall for Real Estate Exemption from Limitations on Interest Deductions:*** The Republican tax law imposes a 30% limitation on interest deducted by large businesses, which may disadvantage domestic businesses that utilize debt financing. However, the new law included a special exemption for real estate developers so they can continue to deduct this interest. According to the Joint Committee on Taxation, this provision results in an estimated \$16 billion windfall over ten years.
- ***\$22 Billion Windfall for Real Estate Exemption from Like-Kind Exchange Repeal:*** The new tax law repealed a provision allowing businesses to avoid capital gains taxes through “like-kind” exchanges of business assets. However, the real estate industry was exempted from this repeal. Like-kind exchanges are

used by real estate investors to defer payment of capital gains on property by deferring them to other properties without recognizing transactions that would make them taxable. According to the Joint Committee on Taxation, this exemption costs taxpayers an estimated \$21.7 billion in lost revenue over ten years.

Multiple experts and commentators have highlighted the windfall that real estate developers are now receiving under the Republican tax law:

- Steven M. Rosenthal of the Urban-Brookings Tax Policy Center, stated: “If enacted, the commercial real-estate industry will have hit the jackpot.”<sup>3</sup>
- David Miller, a tax partner at Proskauer Rose LLP, stated that the new tax rate for REITs is “unprecedented.”<sup>4</sup>
- Jim Tankersley, writing in the *New York Times* about the new exemption for real estate from the repeal of like-kind exchanges, stated: “by adding a single word to the newly written tax code—‘real’—the law now allows only real estate swaps to qualify for that special treatment.”<sup>5</sup>
- Kenneth Weissenberg, the chair of real estate services at the accounting firm EisnerAmper, stated: “Real estate is a big-time winner.”<sup>6</sup>
- James Repetti, a tax professor at Boston College Law School, stated: “This is a windfall for real estate developers like Trump.”<sup>7</sup>

## CONCLUSION

President Trump and Republicans in Congress made a clear choice when they enacted the tax bill in December 2017. They chose to take away longstanding tax deductions that American families have relied on for decades while at the same time creating \$66 billion in new tax breaks for real estate developers.

Although some have reaped large financial windfalls as a result of the changes in the new tax law, many American families are being penalized despite their ongoing efforts to faithfully invest in their single biggest asset—their home.

## ENDNOTES

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<sup>1</sup> *How Every Senator Voted on the Tax Bill*, New York Times (Dec. 19, 2017) (online at [www.nytimes.com/interactive/2017/12/19/us/politics/tax-bill-senate-live-vote.html](http://www.nytimes.com/interactive/2017/12/19/us/politics/tax-bill-senate-live-vote.html)).

<sup>2</sup> *House Passes Tax Bill, Again and with Fixes, Sending Final \$1.5 Trillion Package to Trump*, USA Today (Dec. 21, 2017) (online at [www.usatoday.com/story/news/politics/2017/12/20/house-set-pass-tax-bill-again-and-fixes-sending-final-1-5-trillion-package-trump/968722001/](http://www.usatoday.com/story/news/politics/2017/12/20/house-set-pass-tax-bill-again-and-fixes-sending-final-1-5-trillion-package-trump/968722001/)).

<sup>3</sup> *Tax Bill a Boom to Commercial Real Estate Owners*, Dow Jones Newswires (Dec. 17, 2017) (online at [www.foxbusiness.com/features/tax-bill-a-boom-to-commercial-real-estate-owners](http://www.foxbusiness.com/features/tax-bill-a-boom-to-commercial-real-estate-owners)).

<sup>4</sup> *REIT Investors to Gain from Tax Legislation*, Wall Street Journal (Dec. 19, 2017) (online at [www.wsj.com/articles/reit-investors-to-gain-from-tax-legislation-1513725520](http://www.wsj.com/articles/reit-investors-to-gain-from-tax-legislation-1513725520)).

<sup>5</sup> *A Curveball from the New Tax Law: It Makes Baseball Trades Harder*, New York Times (Mar. 19, 2018) (online at [www.nytimes.com/2018/03/19/us/politics/baseball-tax-law-.html](http://www.nytimes.com/2018/03/19/us/politics/baseball-tax-law-.html)).

<sup>6</sup> *How Real Estate Investors Can Cash-in Under New Tax Law*, San Francisco Chronicle (Jan. 11, 2018) (online at [www.sfchronicle.com/business/networth/article/How-real-estate-investors-can-cash-in-under-new-12491965.php](http://www.sfchronicle.com/business/networth/article/How-real-estate-investors-can-cash-in-under-new-12491965.php)).

<sup>7</sup> *Trump, Real Estate Investors Get Late-Added Perk in Tax Bill*, Bloomberg (Dec. 17, 2017) (online at [www.bloomberg.com/news/articles/2017-12-18/trump-real-estate-investors-get-last-minute-perk-in-tax-bill](http://www.bloomberg.com/news/articles/2017-12-18/trump-real-estate-investors-get-last-minute-perk-in-tax-bill)).