NAHREP'S ANALYSIS ON TAX REFORM: THE "TAX CUTS AND JOB ACT"

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OVERALL COMMENTARY

As the advocate in D.C. on Hispanic homeownership issues and the small businesses that support the market, NAHREP has been working to make sure these interests are heard in D.C. While there are elements of this tax effort that fall short of expectations, there are a few gains which positively affect the balance sheets of NAHREP members and homeowners in the immediate short-term. However, it is probable that these gains will likely be eliminated for most NAHREP members and homeowners in the next two to three years.

A core disappointment was the fact that this important piece of legislation was put together so quickly and enacted into law without reasonable discussion or review. NAHREP fundamentally believes that legislation prepared without bipartisan, open, and transparent input is a troubling precedent. We have to be wary and suspicious of legislation composed behind closed doors for fear that it will only favor the special interest groups who wield influence based on power rather than merit. Admittedly, in the past decade of hyper-partisanship in Washington D.C., executive orders and legislation that is assembled largely in secret and then crammed through Congress is more the norm than the exception. This is unfortunate; the American people deserve better.

The following is a break down some of the most significant details. As always, before making any major financial decisions, you should always consult a business or tax professional.

MACRO-ECONOMIC ANALYSIS

With the changes in the way homeownership (mortgage interest, state and local property taxes) is handled in the bill, there are fewer incentives for homeownership over renting. Some in our industry are very concerned about this impact. NAHREP's approach is more pragmatic, understanding that Hispanic families do not pursue homeownership for the tax benefits; however, we know that every dollar matters in a tight family budget. The cap on state and local taxes (both income and property) of $10,000 will disproportionately impact some of the most desirable areas to live, where taxes are also high (and presumably where the schools and public infrastructure are also highly rated) or states with higher taxes like New York, California, New Jersey, Maryland, and a few others. This disproportionate treatment for the upwardly mobile is unfair and bad public policy.

With the changes in the tax brackets, higher wage households may find that more of their income is taxed at a lower rate in the first two or so years. However, because the brackets and deductions for state and local taxes are not tied to inflation, most economists think that nearly every taxpayer is going to pay more in taxes by 2021, a few years before these provisions expire in 2025. This is the main source of disappointment in the legislation. Hispanic families deserve better than a plethora of complicated tax rules that create surprises on April 15th.

However, things could have been much bleaker. Thanks to the advocacy efforts of many in the industry, along with NAHREP member calls and emails to Members of Congress, key provisions of the tax code were preserved or the radical changes abandoned in favor of a more moderate approach.

> One element that was dialed back, thanks to intense advocacy, was the "gain on sale" provision that would have penalized families who upgraded to a new home or moved without having spent three of the last eight years in the home they were selling. Instead, the "current" rule that only requires one to live in their house for two of the last five years to be able to sell without paying capital gains taxes is retained. This status quo is not going to further exacerbate the lack of inventory- but it does little to help the problem.

> Homeowners with existing mortgages will not see any changes to their mortgage interest deduction; however, the interest on any new mortgage is limited to $750,000 of the unpaid balance and can include second homes.

> The ability to deduct up to $2,500 of student loan interest is preserved.

THE NAHREP SCORECARD ON TAX REFORM

NAHREP's holistic view of the tax reform bill asks the fundamental questions: What is the impact on the family balance sheet? Does it help Hispanic families build wealth, or erode it?

OUR CONCLUSION

While the chance to lower taxes this year and next is encouraging, the projected increased taxes in each year that follows are concerning and disappointing. Following is NAHREP's in-depth analysis that outlines how changes in four key areas will impact its membership: new standard deduction, rate reduction, itemized deductions and our friends in Puerto Rico.

NEW STANDARD DEDUCTION

1 This new tax bill doubles the standard deduction from $12,700 to $24,000 for married couples. Practically speaking, this change means more people may find an advantage in taking the standard deduction, rather than filling out extra itemized deductions. A typical married couple earning about $75,000 used to be the breaking point where it may have made sense to itemize. Under the new plan, a typical married couple earning $214,462 becomes the new breaking point — this is the top 5% of wage earners.

RATE REDUCTION

2 We all know about tax brackets and know that it is a "progressive" system, but spend a moment to recall, your effective rate is really what we are all watching. According to the Joint Committee on Taxation, the outcome of the Senate bill would reduce average tax rates on wage income by about one percentage point, while reducing effective rates on wages by about 2.4 percentage points for the first year or so, but reverses course in about five years and most folks will end up paying slightly more in taxes by that time.

PRO If you are a family earning between $20,000 and $400,000, you will see more of your income taxed at a slightly lower rate.

ITEMIZED DEDUCTIONS

3 The elimination of many special provisions does make things simpler and reduces the funny anxiety we get each year wondering if we are missing a savings or deduction somewhere. However, the lack of adjustments for inflation is deeply concerning, as are critical reductions on the things we care about, such as state and local property taxes, healthcare viability, and moving expenses.

MORTGAGE INTEREST

PRO The mortgage interest deduction is preserved for the most part. It is slightly reduced, with a new $750,000 limit on eligible loans, down from $1 million.

CHILD TAX CREDIT

PRO Now children up to 16 years old result in a $2,000 deduction, subject to a higher phase out threshold of $400,000 (previously $110,000 for married couples). This is an increase from current law.

HEALTHCARE MANDATE

CON The Affordable Care Act's mandate to require health insurance or face a tax penalty was eliminated. Many experts in health insurance fear that this could cause the collapse of the vulnerable healthcare exchanges that serve many self-employed workers and employees of small businesses.

MOVING EXPENSES

CON Moving costs are no longer deductible starting in 2018 (with key exceptions for members of the military).

HELOC

CON Home Equity Lines of Credit (HELOC) will no longer be deductible if you obtain a HELOC at some point after buying your home. This means that tapping into the equity of your home for major life expenses is no longer as advantageous as it once was.

MEDICAL EXPENSE DEDUCTION

PRO For 2017 and 2018, taxpayers can deduct any expense over 7.5% of their income. This is a short-term but welcome development for families with expensive health costs.

CON In 2019, the tax reverts to the 10% threshold.

TUITION

PRO Federal 529 plans are now applicable to not only colleges and universities, but also to K-12 private schools. Under the new rules, families can take out up to $10,000 per year from these pre-tax accounts to pay for K-12 private schools, as well as universities.

STATE AND LOCAL TAXES

PRO The first $10,000 of both property and income taxes (combined) are tax deductible.

CON This is a change from the current tax code where property and income taxes are fully deductible. In states where property taxes can be $30,000 to $50,000, this $10,000 cap is a significant penalty for living in a state or locality with excellent schools or infrastructure.

SMALL BUSINESSES

PRO Small business owners will be able to deduct 20% of their business income if they have organized as a partnership, S corporation, or sole proprietorship, thus reducing most businesses' tax rate, also known as "pass through".

FOR OUR FRIENDS IN PUERTO RICO

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THEFT AND DISASTER DEDUCTIONS

CON Losses, loosely defined to include fire, storms, shipwreck, and theft, not covered by insurance used to be deductible. Now, only losses not covered by insurance from presidentially declared disasters that exceed 10% of income can be deducted.

BASE EROSION ANTI-EVASION TAX

CON This tax penalty, which was intended to punish companies that moved operations off-shore, includes Puerto Rico as an "off-shore" territory, and makes it subject to the tax. While there are vague promises about a repeal of this element in some future legislation, we are disappointed that it remains.

WHAT IS NEXT?

As the voice for Hispanic real estate, NAHREP won't rest until it has exhausted every channel to improve today's tax bill. We know that over the coming weeks and months Members of Congress are going to start to consider "clean-up" edits to the legislation. Our association will be there advocating for our friends in Puerto Rico, and making sure every day and in every way that Hispanic homeowners and aspiring homeowners have their voices heard.