Tax Policy Analysis
First-Time Homebuyer Credit Act of 2018
S.3364 (115th Congress)

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Background

On August 22, 2018, First-Time Homebuyer Credit Act of 2018 (S.3364, 115th Congress) was introduced in the Senate by Senator Ron Wyden and was referred to the Committee on Finance. This bill aims to extend and modify the first-time homebuyer tax credit that had temporarily been in the law, expiring in 2010.

S. 3364 makes a refundable tax credit available for first-time buyers of their first principal residence in the United States. The buyer must be at least 18-years-old and not claimed as a dependent by others. This credit is calculated as 2.5 percent of the purchase price of home, but it is also subject to a three-step limitation process which includes a $10,000 limitation and limitations based on the purchase price and modified adjusted gross income. This bill also includes a recapture rule which makes first-time homebuyers liable for additional tax if they buy and dispose of their first principal residence within five years. Exceptions to this recapture rule exist such as for death, divorce, or relocation of a military duty station.

To demonstrate how this bill works, assume Tony and Jenny are a newly married couple in the state of Oregon. They are both over 18 and looking forward to purchasing their first principal residence. Their modified adjusted gross income is $170,000. They found a house in Portland and purchased it for $620,000 in 2019. In this case, Tony and Jenny can claim a tax credit of $4,000. Even though the calculation indicates that the credit is $15,500 ($620,000x 2.5% = $15,500), it is subject to the first limitation of $10,000. Next, because the purchase price exceeds $600,000, the credit is reduced by $2,000 ($10,000 x (($620,000-$600,000)/$100,000) = $2,000), leaving a credit of $8,000. For the final limitation, because their modified adjusted income exceeds $160,000, the credit is reduced by $4,000 ($8,000 x (($170,000-$160,000)/$20,000) = $4,000), leaving a credit of $4,000 which would claim on their 2019 return (if enacted).

If Tony and Jenny sell this principal residence in 2022, which is three years after they purchased it, the recapture rule applies. Tony and Jenny would need to repay $1,600 to the Treasury ($4,000 x 40% = $1,600). However, if either spouse is on active duty in the military, and is ordered to relocate to another military duty station in 2022, they will not be subject to $1,600 tax liability under the recapture rule.

Next, S 3364 is analyzed using the twelve principles set out in the AICPA's *Guiding principles of good tax policy: A framework for evaluating tax proposals*.[1]

[1] American Institute of Certified Public Accountants (AICPA) Tax Division. (January 2017). *Tax Policy Concept Statement 1 - Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals*; available at https://www.aicpa.org/ADVOCACY/TAX/downloadabledocuments/tax-policy-concept-statement-no-1-global.pdf.

Principles of Good Tax Policy Worksheet

Criteria	Does the proposal satisfy the criteria? (explain)	Result
Equity and Fairness – Are similarly situated taxpayers taxed similarly? Consider the tax effect as a percentage of the taxpayer's income for different income levels of taxpayers.	U.S taxpayers with similar income but who purchase their first principal residences in different locations will receive a different homebuyer's credit because the amount of the tax credit is based on the prices of the homes, which vary significantly throughout the U.S. For example, assume there are three taxpayers with the same modified adjusted gross income which doesn't exceed the threshold based on modified adjusted gross income, but one lives in Oregon, one lives in California, and one lives in Missouri. The average home prices in Oregon, California, and Missouri are $338,300, $544,900 and $155,700 respectively.[2] If each purchase their first principal residences at the average home prices in their locations, the taxpayer in Oregon will receive a tax credit of $8,458 ($338,300 x 2.5%), the taxpayer in California will receive the maximum tax credit of $10,000 ($554,900 x 2.5%=$136223) and the taxpayer in Missouri will receive a tax credit of $3,893 ($155,700 x 2.5%). Based on the calculations above, taxpayers with the same taxable income but who live in different locations can receive significantly different tax credits. Therefore, this tax policy does not meet the principle of horizontal equity. If there are two taxpayers who live in California with different modified adjusted gross income buying their first principal residence at the average price mentioned previously, both taxpayers need to pay $108,980 ($544,900 x 20% = $108,980) as down payments based on the conventional 20 percent down payment.[3] If the taxpayer's modified adjusted gross income doesn't exceed the threshold limitation, he can get the maximum first-time homebuyer credit. However, for this taxpayer, this credit does not solve his urgent need which is making a 20 percent down payment of $108,980. Also, he receives the credit	+/-

[2] The data of the average home prices is from Zillow, https://www.zillow.com/.
[3]The data of conventional down payment percentage is from Zillow, https://www.zillow.com/mortgage-learning/down-payments/.

	after he first makes the down payment (after he files his tax return for that year). For the taxpayer with modified adjusted gross income above the threshold of the third limitation, he receives a tax credit which is less than $10,000. It is less difficult for him to pay $108,980 and he has a tax saving on his tax return. However, in this case, a taxpayer with a lower modified adjusted gross income receives a higher tax credit, and a taxpayer with a higher modified adjusted gross income receives a smaller tax credit. Therefore, the bill meets the principle of vertical equity. This bill meets the principle of vertical equity but fails to meet the principle of horizontal equity.	
Certainty – Does the rule clearly specify when the tax is owed and how the amount is determined? Are taxpayers likely to have confidence that they have applied the rule correctly?	This bill clearly states that taxpayers can claim a credit on their tax returns when they purchase their first principal residence and meet the other requirements. The bill includes a three-step limitation process to determine the credit available for taxpayers to claim. It also includes a recapture rule and some exceptions to this recapture rule, which are clearly explained. Therefore, this bill meets the principle of certainty.	+
Convenience of payment – Does the rule result in tax being paid at a time that is convenient for the payor?	This bill does not add an extra burden on taxpayers to pay their taxes because it only involves additional credits on their tax returns which does not affect the date they pay their taxes and the methods they use for paying taxes. However, the credit is not available at the time that the homebuyer most needs it – when they buy the home. Consideration should be given to whether there is a way to provide an advance credit at the time of purchase. Otherwise, this bill meets the principle of convenience of payment.	+
Effective Tax Administration – Are the costs to administer and comply with this rule at minimum level for both the government and taxpayers?	There are two main concerns regarding this bill which can hinder the effectiveness of tax administration. The first one is that the IRS needs to update multiple tax return forms which can be time-consuming. The second one is that because of the recapture rule, the IRS needs to keep track of taxpayers' addresses to stop people from abusing this tax credit. It is even more	+

	challenging than the first concern because it involves updating the IRS's current information systems and keeping track of those taxpayers who claimed this credit and disposed of their residence in less than five years after claiming the credit. However, based on a calculation from the National Association of Home Builders (NAHB), an average home buyer is expected to stay in a home for 13 years.[4] Therefore, the IRS should assume that only a small number of taxpayers will be subject to this recapture rule. The burden of keeping track of the addresses of those taxpayers should not be heavy. Therefore, this bill meets the principle of effective tax administration.	
Information Security – Will taxpayer information be protected from both unintended and improper disclosure?	There are specific reporting requirements for taxpayers to receive this credit. They must provide their social security number, street address, the purchase price of the principal residence, the date of purchase of the primary residence and the closing disclosure relating to the purchase. Social security and street address are standard information reported on tax returns. Purchase price and purchase date of the principal residence are also public information. The closing disclosure relating to the purchase is confidential information. However, it is unlikely the information is misused due to unintended and improper disclosure. Therefore, this bill meets the principle of information security.	+
Simplicity - Can taxpayers understand the rule and comply with it correctly and in a cost-efficient manner?	The calculation of the credit amount can be complicated because it involves a three-step process to determine the tax credit which includes a limitation on the dollar amount, purchase price of the principal residence and modified adjusted gross income. Furthermore, it includes a recapture rule which makes it more difficult for taxpayers to understand the rule. Therefore, this bill does not meet the principle of simplicity.	-
Neutrality – Is the rule unlikely to change taxpayer behavior?	The bill intends to encourage people to purchase their first principal home. However, based on a report in 2017 from the National Association of Realtors, "35% of all home buyers are first-time home buyers. The main reason for	

[4] Latest Calculations Show Average Buyer Expected to Stay in a Home 13 Years by National Association of Home Builders; http://nahbclassic.org/generic.aspx?GenericContentID=194717.

	first-time home buyers to purchase their homes is the desire to own a home of their own".[5] Therefore, this tax credit is not the primary motivation for people to purchase their first principal homes. Therefore, this bill meets the principle of neutrality in that it won't affect decision making of all buyers but will help more to afford a first home.	+
Economic growth and efficiency – Will the rule not unduly impede or reduce the productive capacity of the economy?	Homeownership is a central part of national ethos, in which the American dream is achieved. Homeownership is good for economic growth. However, according to the report by the United States Census Bureau, homeownership rates for all age group were lower in 2017 than in 2006, the year before the Great Recession (2007-2009)".[6] The clear intention of this bill is to increase the homeownership in the U.S. For most Americans; they usually own more than one home in their lifetime. "Homeowners typically sell their starter home and trade up after 7-to-10 years".[7] Homeownership can contribute to economic growth and job creation because there are many expenditures related to home ownership such as a mortgage, remodeling, moving, lawn improving all of which generally requires professionals to help. Therefore, this bill meets the principle of economic growth and efficiency.	+
Transparency and Visibility – Will taxpayers know that the tax exists and how and when it is imposed upon them and others?	Realtors and brokers will become active in promoting this tax credit because they consider it is beneficial to their business. They will let the first-time home buyers know their purchases can provide additional tax benefits. However, the complicated three-step limitation process makes it difficult for taxpayers to understand how this tax	-

[5]Home Buyer and Seller Generational Trends Report 2017 by National Association of Realtors, https://www.nar.realtor/sites/default/files/reports/2017/2017-home-buyer-and-seller-generational-trends-03-07-2017.pdf.

[6] Derick Moore, "Homeownership Remains Below 2006 Levels for All Age Group" United States Census Bureau, Aug 13, 2018 https://www.census.gov/library/stories/2018/08/homeownership-by-age.html.

[7] Lawrence Yun "Why Homeownership Matters", Forbes, Aug,12, 2016. https://www.frbsf.org/community-development/publications/community-development-investment-review/2016/august/homeownership-and-the-stability-of-middle-neighborhoods/.

	credit benefits them, and they are likely not to be aware of the existence of the recapture rule of this credit. Therefore, the bill does not meet the principle of transparency.	
Minimum tax gap – Is the likelihood of intentional and unintentional non-compliance likely to be low?	One concern regarding noncompliance tied to this tax credit is whether people will ignore the recapture rule and not pay their tax liability when they sell their first principal home within five years after they claimed the credit. The report from the National Association of Home Builders (NAHB) indicates that the average home buyer keeps his residence for 13 years. Therefore, it is only a small number of people who will be subject to the recapture rule, and it is only a fraction of those people will push their luck to not paying their tax liabilities when they sell their first principal residence within five years. Another concern is that some buyers may claim the credit even though it is not their first residence as defined in the bill. However, the IRS is likely to catch these problems. Therefore, the bill meets the principal of minimum tax gap.	+
Accountability to taxpayers – Will taxpayers know the purpose of the rule, why needed and whether alternatives were considered? Can lawmakers support a rationale for the rule?	This bill has a strong intention to encourage people to purchase their first principal home. However, one of the biggest challenges for people to purchase their homes is the down payment. Taxpayers receive this credit only after they purchased their homes and pay the down payment. Therefore, it does not relieve the burden of those taxpayers in the first place. Alternatives such as providing an affordable mortgage with a low percentage of down payment should be considered because it directly addresses the main concern of those taxpayers. Therefore, the bill does not meet the principal of Accountability.	-

Appropriate government revenues – Will the government be able to determine how much tax revenue will likely be collected and when?	The government has data from agencies such as the United States Census Bureau and U.S. Department of Housing and Urban Development. The government can produce a reasonable estimate on the number of first-time homebuyers who can claim the credit, and the amount of tax credit returned because of the recapture rule. Therefore, the bill meets the principle of appropriate government revenues.	+

Conclusion

S.3364 (115th Congress) mostly meets the principles of good tax policy as it meets eight out of the twelve principles. It is considered neutral in one principle, and it fails the principle of simplicity, transparency, and accountability. The failure in the principles of simplicity, transparency, and accountability can be improved by modifying the threshold on the dollar amount limitation and eliminating certain limitations. Because this credit reduces government revenue, it is crucial for the government to consider an alternative to mitigate the shortfall. A thorough study should be done as to whether there is a suitable provision such as reducing the mortgage interest deduction. The government should consider enacting this bill because the advantages of this bill outweigh the disadvantages.

Suggestions for improvement:

1. Consider reducing the threshold of the limitation on the purchase price. Instead of setting the limitation on purchase price of a residence over $600,000, change the amount to be closer to the average home price for each state (or particular regions in the states) to better meet the principle of horizontal equity.
2. The combination of the three-step limitation process and the recapture rule can be complicated. Consideration should be given to keeping the dollar limitation but eliminating the last two steps in the three-step limitation process to simplify the calculation of the tax credit so that it is easier for taxpayers to understand and comply with the rules.