

CAPITAL COMMENTARY

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A Good Tax-Reform Proposal

At a time of considerable turmoil and uncertainty in Washington, President Bush and Congress should take bipartisan action on a tax-reform proposal presented by the President's Advisory Panel on Federal Tax Reform. Some may argue that the president is now so weakened by recent events and low poll numbers that he does not have the ability to push a major reform through Congress. After all, look what happened to his ardent, lengthy pitch for Social Security reform. Yet here is a proposal that could help reconnect the president and Congress with economic reality and with the American people.

The advisory panel, according to David Brunori (*Washington Post* 10/23/05), has proposed that the federal tax break people receive for interest payments on their mortgages be limited to mortgage amounts up to \$312,000. Moreover, the panel proposes eliminating altogether the mortgage-interest deduction for vacation homes and for home equity loans. All of this is part of accomplishing the president's desire to simplify the tax code.

What are the merits of this proposal and how will it help? First of all, as Brunori points out, only a tiny percentage of those who itemize deductions, including mortgage interest, have mortgages of \$312,000 or more. The original purpose of the deduction was to encourage home ownership. But those who can afford a home with a mortgage of more than \$312,000 hardly need to be encouraged to own a home. Limiting the benefit as proposed "would not prevent anyone from basking in the joys of home ownership," according to Brunori. And that is even more true for people who can afford a vacation home. In the latter case, a mortgage deduction for a second home is what Brunori calls a "vacation subsidy" by the federal government, paid for by all taxpayers.

Approximately 30 percent of Americans do not earn enough money to own a home. Why then should federal tax policy give a tax break to those who can afford homes worth more than \$312,000—and even

vacation homes on the side—when that does nothing to help those who are unable to buy homes. Current deduction levels are both unnecessary and inequitable.

"The home equity interest deduction is even more absurd," argues Brunori. "We do not allow people to deduct interest on their credit card debt or unsecured bank loans. Why in the world do we allow them to deduct interest on their home equity loans?" Those loans allow borrowers to buy anything they want.

Not only would the proposed reforms simplify the tax code but, unlike the tax-reduction craze of the past few years, they would "shift the burden of paying for our government needs to those best able to pay," writes Brunori. In other words, collecting more taxes from the wealthy would allow for policies that could ease the burden on the middle and lower classes. This is something that should win the support of Democrats. And it should certainly be taken up by Republicans in control of Congress and the White House who are finally beginning to sense that the growing federal debt and their continuing deficit spending are disenchanting the American public—particularly fiscal conservatives.

In general, tax deductions are a means of encouraging certain kinds of action. The deduction for charitable gifts, for example, encourages philanthropy. However, dozens of tax deductions now on the books complicate the tax code in ways that can pit one purpose against another and keep government from collecting the taxes it needs. Those deductions can also negatively impact decisions in the marketplace. "People do not buy houses because of tax benefits," says Brunori. "They buy houses so that they have a place to call home." Widespread home ownership is what government should encourage, not tax deductions for the wealthy for reasons that are unnecessary.

—James W. Skillen
President

The Center for Public Justice

P.O. Box 48368 * Washington, DC 20002 * 410-571-6300 * Fax 410-571-6365 * www.cpjustice.org *
capcomm@cpjustice.org

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