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Mortgage interest tax deduction cut criticized

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President Obama has grabbed what the real estate industry considers the third rail of tax reform: mortgage-interest deductions.

Among the many tax increases on the affluent laid out in his budget proposal Thursday was a plan to reduce the itemized deduction rate for families with incomes over \$250,000 to 28 percent, down from 33 or 35 percent. That would amount to as much as to \$70 less for every \$1,000 in mortgage-interest deductions.

The National Association of Realtors quickly responded with a strongly worded letter to the president, arguing the change could "trigger yet another crisis in home values," by reducing spending, increasing foreclosures and expanding job losses. Mary Trupo, the Realtor group's public issues director, said the impact would be particularly widespread in expensive housing markets like the Bay Area, where a large portion of home buyers are well-to-do.

Others contend that, at the upper end of the tax bracket, mortgage deductions amount to an unnecessary government giveaway to the wealthy, whose buying decisions won't be swayed by a few thousand dollars in tax savings.

Here's how the deductions basically work. A woman with a million-dollar home loan at a 5 percent interest rate would pay around \$50,000 in interest in the first year (and progressively less each year as she pays down the principal). If the homeowner is in the highest income tax bracket, 35 percent, she can now deduct \$17,500. Under the Obama plan, that would drop to \$14,000, a difference of \$3,500.

In fact, the difference could be even less than that because total allowable deductions begin being "phased out" above an adjusted gross income threshold, which stood at around \$160,000 in 2008.

"For the people in that income strata ... the dollar magnitude is not that great," said Richard Pon, senior tax manager at Lautze & Lautze in San Francisco. "But you will have a lot of irate taxpayers

complaining that their deductions are capped."

Christopher Thornberg, principal at Los Angeles research firm Beacon Economics, said the reduced deductions could slightly weigh down home prices, by 2 to 3 percent, but only on higher-priced properties that have been less affected by the housing downturn.

"It's like I'm standing in the middle of a forest fire and they say, 'Don't light that match,' " he said, noting prices across the state are already down more than 40 percent.

Under Obama's proposal, the additional revenue from this and other increased taxes on the wealthy would be used to expand health care coverage, invest in renewable energy and improve education.

"I work for the American people, and I'm determined to bring the change that the people voted for last November," Obama said in a speech Thursday. "And that means cutting what we don't need to pay for what we do."

The California Association of Realtors "will vigorously fight this provision in the halls of Congress," said James Liptak, president of the Los Angeles trade group, in a prepared statement.

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