



## Impact of Proposed 2010 Tax Changes Including Mortgage Interest Deduction

The following analysis accounts for the proposed change the allowable tax deductions, including the Mortgage Interest Deduction (MID) in the new budget plan for 2010. The proposed change would affect all allowable tax deductions, for California this also includes the deductions for property taxes, state and local taxes (including income, car license fees, etc.), education, and charitable deductions. The proposed change would affect households making \$250,000<sup>1</sup> and above thus affecting over 417,900 households or three percent of households in the state of California (according to Claritas, Inc. 2008 estimates).

For the purpose of illustrating the impact of this change in the MID on individual households, this analysis only accounts for mortgage interest and property tax deduction while excluding all other allowable deductions. The following example is for a household whose income is slightly above the bottom income threshold of the parties affected by the change. With an annual income of \$250,400, this is the minimum qualifying income required to purchase a home at \$1,050,000, with a loan amount of \$840,000 (20 percent downpayment) assuming the monthly mortgage accounts for no more than 30 percent of that homeowner's monthly income. Other assumptions include the prevailing composite effective interest rate on a Fixed-Rate Mortgage (FRM), property tax deduction at one percent of the purchase price, and a 35 percent tax rate.<sup>2</sup>

<b>Table 1. Tax Loss to Individuals Affected By MID Change</b>			
	<b>Current MID</b>	<b>Proposed Change to MID 5.</b>	<b>Differential</b>
Household Income	\$250,400	\$250,400	
Mortgage Interest Deduction	\$50,372	\$50,372	
Property Tax Deduction	\$10,500	\$10,500	
Total Deduction	\$60,872	\$48,697	
<b>Total Taxable Income</b>	<b>\$189,528</b>	<b>\$201,703</b>	<b>\$12,174</b>
<b>Expected Tax Owed in First Year of Ownership</b>	<b>(\$66,335)</b>	<b>(\$70,596)</b>	<b>(\$4,261)</b>

Assumptions:

1. Underlying assumptions for the Mortgage Interest Deduction and Property Tax deduction are based on a home price of \$1,050,000 with the traditional HAI assumptions used to calculate MID and Property Tax deduction (1% of the purchase price)

<sup>1</sup>Applies to individuals making over \$200,000/year and couples filing jointly making over \$250,000.

<sup>2</sup> Another thing to note is that if the Bush tax cuts expire (2011), the new tax rate for this group would change to 39.6 percent; however the change would only allow a tax benefit of 28%.

2. Incomes are based on the underlying assumptions for the Traditional HAI assumptions, which is the Minimum Qualifying Income to afford a home price of \$1,050,000
3. Tax rate based on 2008 IRS Schedule Y-1 Married Filing Jointly in 35% tax bracket.
4. Interest deduction based on the HAI underlying effective FRM interest rate of 6.03%, a 20% downpayment, and a \$840,000 loan amount.
5. Proposed MID Change calculation allows for 80% of the total MID/Prop tax deduction, or 28%/35% change.
6. 2008 Household estimate in CA from Claritas, Inc.
7. Assuming full year mortgage interest deduction.

Under the current tax law at the given assumptions, the mortgage interest would be \$50,400 and the property tax deduction would be \$10,500 bringing this household's approximate tax liability to \$66,300 allowing for the entire MID/Property tax deduction. While the proposed changes to this provision would lower the tax benefit by about 80 percent for households in that tax bracket. This impact would increase the total tax liability for the same household to \$70,600 thus raising the total taxes owed in the first year of ownership by \$4,300.<sup>3</sup> This is one example of how the proposed change will impact households near the lower end of this tax bracket.

Another way of analyzing this tax change is for every \$10,000 deduction in taxable income currently benefits households in this tax bracket by \$3,500. With the change in the tax law, the tax benefit would be only \$2,800, thus lowering the tax benefit by \$700 for every \$10,000 in deductions.

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<sup>3</sup> The actual impact depends on many factors including the home loan amount and prevailing market factors.