Appendix 1: Discussion of Alternative Credit Models

The paper proposes a renters' credit that would be capped and allocated by states, and that would count as taxable income for the entity that claims it. This appendix discusses the alternative approaches of providing an uncapped, entitlement tax credit that is available to all eligible families and of making the credit tax exempt.

Capped and Uncapped Credits

An uncapped credit would have the major advantage of helping all families in need of assistance, while a capped credit would only address a portion of the need. For two reasons, however, it would be infeasible to establish an uncapped renters' credit assisting poor and near-poor families, at least for the foreseeable future. First, it is unlikely that Congress would provide enough funding in the context of tax reform and deficit reduction to cover the cost of an uncapped credit that would be sufficient to enable the neediest families to afford housing. Second, for a credit to be available to all eligible families it would likely need to be claimed by the low-income tenants themselves (rather than by owners or lenders), but a tenant-claimed low-income renters' credit would face major political and policy obstacles.

Credit Costs and Amounts

As discussed in the analysis, a $5 billion tax expenditure would be sufficient to provide credits covering the gap between a modest rent and 30 percent of a family's income to about 1.2 million households. By comparison, about $49 billion would be needed to make a comparable uncapped credit available to all renter households with high housing cost burdens. (See Table 4. Appendix 2 describes the sources and methods used for these calculations.)

Costs would be lower under a shallower uncapped credit. One possible design would set the credit at 15 percent of a family's rental costs regardless of income. Several tax reform proposals have called for replacing the mortgage interest deduction with a credit equal to 12, 15, or 20 percent of mortgage interest. A 15 percent rent credit would provide renters a comparable benefit. An uncapped refundable credit using this design would cost about $37 billion per year, but only about half of this amount would go to poor or near poor families. If a 15 percent credit were phased out gradually by deducting 30 percent of income above $10,000 from the credit amount, the credit would be more tightly targeted on families who need help to afford housing and the cost would drop to about $5 billion annually.

It is unclear, however, how effective such a shallow, uncapped credit — which would provide average subsidies of just $82 a month, a small fraction of the subsidies under our capped credit proposal — would be in addressing severe housing problems. Research has shown that deep voucher subsidies (which average about $650 per month) result in large reductions in homelessness, crowding, and housing instability among poor families. There is no research showing similar effects from very shallow subsidies. A very shallow credit could be expected to help families that are currently renting housing and struggling to make ends meet, but it is difficult to see how such a shallow credit could enable families to consistently pay the rent if they are now homeless or doubled up and have incomes far too low to afford housing. As a result, a shallow universal credit likely would be ineffective in aiding a large segment of the population most in need of housing assistance.

Table 4				
Approximate Costs and Households Assisted Under Alternative Credit Designs				
Credit Design	**Total Annual Cost**	**Households Assisted**	**Average Credit Amount**	**Share of Credit Amounts Going to Families Below 150% of Poverty**
Capped Credit Covering Gap Between Rent and 30 Percent of Income	$5 billion	1.17 million	$4,268	~100%
Uncapped Credit Covering Gap Between Rent and 30 Percent of Income	$49 billion	11.06 million	$4,404	77%
Credit for 15 Percent of Rent	$37 billion	27.87 million	$1,320	37%
Credit for 15 Percent of Rent with Phase-Out Above $10,000	$5 billion	5.57 million	$984	98%

Obstacles to a Tenant-Claimed Credit

A credit intended to reach all eligible families would likely need to be claimed by the tenant household directly. This is because the owner- and lenders-claimed model the analysis proposes for a capped credit would not be able to reach all families, since some owners and lenders would be unable or unwilling to participate. A tenant-claimed credit, however, would pose other serious challenges.

For a tenant-claimed credit to help the poorest families afford housing, it would need to be refundable — that is, the federal government would have to make payments to cover the amount of the credit that exceeds the household's tax liability. This could make enactment considerably more difficult politically. A credit that operates by reducing the tax liability of the owner or lender, by contrast, could assist the poorest families without being refundable.

In addition, delivering periodic payments of a refundable renters' credit would face administrative challenges. Low-income families must pay their rent every month, so a renters' credit would be far more effective in helping families afford housing if it were provided on a monthly basis — rather than as a lump sum at year's end. IRS, however, does not currently make monthly payments under the individual income tax. The health care premium subsidy tax credits established under the 2010 Affordable Care Act will be paid monthly to insurance companies on behalf of eligible families, starting in 2014, establishing a potential precedent for monthly payment of a renters' credit. But creating a new system for a small capped renters' credit likely would be considered excessively burdensome and resisted by the IRS.

By contrast, it would be quite straightforward for an owner- or lender-claimed credit to provide periodic rental subsidies. The owner would be required to reduce the family's rent on a monthly basis, and the credit would be delivered by reducing required quarterly estimated tax payments (or more frequent tax withholding).

Finally, a credit claimed on a tenant's return would need to use the tax system's income definition, which excludes child support payments and public benefits under Temporary Assistance for Needy Families, state General Assistance programs, and Supplemental Security Income (SSI), and counts a

portion of Social Security benefits only for tax filers with incomes above $25,000 for single filers and $32,000 for married filers (although a special definition of income that includes all Social Security benefits was adopted for purposes of the health care premium credits).

This narrow income definition would be a significant disadvantage for a renters' credit assisting poor families, since it would reduce the credit's efficiency in matching the amount of assistance to the level of need and would favor public assistance recipients over the working poor. An owner- or lender-claimed credit would not encounter these problems, since the family's income would be determined by the state, owner, or lender and consequently could use a broader definition that counts the full amount of all of these income sources.

Taxable and Non-Taxable Credits

In the initial version of this analysis, we proposed that the renters' credit — like most federal tax credits — not count toward the taxable income of the entity that claims it. This approach would result in a double tax benefit to owners and lenders who claim the credit. They would receive the credit itself, and their tax liability would fall because they would replace some taxable rental or interest income with a non-taxable credit.

We proposed to allow states to offset this added benefit by setting the renters' credit below 100 percent of the rent reduction, so that the total tax benefit comes out close to the rent loss. For example, if a state anticipates that an owner claiming the renters' credit would have a 35 percent marginal tax rate, it could set the credit at 70 percent of the rent reduction and the total tax benefit would come out to 105 percent of the rent reduction.

It would have been challenging, however, for states to select the right credit percentage. A non-taxable credit would be worth more to an owner in a higher tax bracket since the drop in taxable income would reduce that owner's tax liability more than it would reduce the liability of an owner in a lower tax bracket. But a state often would not know the owner's tax bracket when it issues the credit. The state would therefore risk either setting the percentage too high to offset the benefit from lower taxable rental income (creating excess subsidy) or too low (which would deter some owners from participating).

In the current analysis, we have proposed to avoid this complication by making the renters' credit taxable. This would be similar to the treatment of credits under federal tax credit bond programs, which provide tax credits to holders of bonds issued for certain purposes, such as school construction or renewable energy projects. The bond credits, which are provided in place of interest payments on the bonds, are treated as taxable income for the entity that receives them.

If the renters' credit were taxable there would be no uncertainty about its value. A credit equal to 100 percent of the rent reduction would create the same tax liability as the rent payment it replaces and would therefore have essentially the same value as the rent payment, regardless of what tax bracket the owner is in. A taxable credit consequently would be simpler to administer (since it would spare states the task of trying to determine the optimal percentage for a credit whose value will vary from one owner to another) and more efficient (since it would be less likely than a non-taxable credit to result in unnecessary excess subsidies).

Under a taxable credit, we are proposing to provide states authority to set credit percentages up to 110 percent (or some other cap somewhat above 100 percent). Modest supplemental credits above the rent reduction may be needed to encourage owners to accept the credit and compensate them for drawbacks of doing so (which would include the modest delays that would sometimes occur between the time the owner incurs the cost of the rent reduction and receipt of the credit, and for some owners, the uncertainty about whether their tax liability will be sufficient to claim the full credit in the current year) and for any administrative costs they bear as a result of the credit. Under this proposal, however, the added credits would be capped at a level far below the potential excess subsidies under a non-taxable credit. Moreover, states would only provide added credits by deliberately choosing a credit rate above 100 percent when they determine it is warranted, not inadvertently because they are unable to determine the value of the credit to the owner.

Table 5

Taxable and Non-Taxable Renters' Credit for a Sample Owner

Taxable Credit		Non-Taxable Credit	
$400	Rent Reduction to Family	$400	Rent Reduction to Family
x 105%	Credit Percentage	x 70%	Credit Percentage
$420	Credit to Owner	$280	Credit to Owner
		$400	Rent Reduction to Family
		x 35%	Owner's Marginal Tax Rate
		$140	Tax Benefit from Reduction in Taxable Rent
		$280	Credit to Owner
		+ $140	Tax Benefit from Reduction in Taxable Rent
		$420	Total Tax Benefit to Owner
Total Tax Benefit to Owner: $420		**Total Tax Benefit to Owner: $420**	