FULL EXPENSING FOR RENTAL HOUSING

Preston Brashers, Research Fellow

ADVANCING AMERICAN FREEDOM

TOPLINE: Congress should facilitate more housing construction by allowing rental housing developers to fully expense construction costs when the property is made available for rent, instead of delaying deductions by up to 27.5 years, as under current law.

BACKGROUND: The federal tax code has generous subsidies for housing development projects that state housing authorities select to receive allocations of low-income housing tax credits (LIHTCs). Unfortunately, these subsidies are enormously complicated, distortionary, and ineffective at expanding supply.

Simultaneously, the tax code has *punitive* treatment for developers *not* receiving those subsidies because of the tax system's slow depreciation of new housing investments. Businesses deduct most costs when they're incurred, but those related to housing construction or improvements are typically capitalized and depreciated over 27.5 years from the time the property is available for rent. Therefore, roughly speaking, a developer who incurs $1 million in construction costs can only deduct $36,364 of that amount per year for 27.5 years. The taxpayer can gradually recover the full $1 million in deductions, but the value of deductions erodes with inflation and borrowing costs over the nearly three-decade period.

Action Items (Congress):

- **Allow companies to fully deduct residential rental property** construction and improvement costs when the property is made available for rent.
  - Short of that ideal, Congress could allow residential rental housing to follow an accelerated depreciation schedule (15 years or less).
  - Alternatively, Congress could enact neutral cost recovery for residential rental property, which would increase the amount of deductions after the first year to account for inflation and interest costs.
- **Phase out LIHTC subsidies**.

How It Would Make Life More Affordable:

- It would free up capital for developers who don't claim government subsidies, allowing them to expand the housing supply.

What About Owner-Occupied Housing? The inability to expense construction costs is less problematic for developers who *sell* to homebuyers, because the capitalized costs can be deducted from the gain they realize *upon the sale of the house*.

Related Legislation: CREATE JOBS Act (S. 2056, H.R. 3967).

BOTTOMLINE: Housing costs have soared over the decades as the government has picked winners and losers with subsidy programs. More subsidies aren't the answer. Instead, the government should end implicit tax penalties for builders.