Recently Expired Individual Tax Provisions ("Tax Extenders"): In Brief

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Summary

Three individual temporary tax provisions expired in 2017. In the past, Congress has regularly acted to extend expired or expiring temporary tax provisions. Collectively, these temporary tax provisions are often referred to as “tax extenders.” Most recently, Congress addressed tax extenders in the Bipartisan Budget Act of 2018 (BBA18; P.L. 115-123). Three of the four individual income tax provisions that had expired at the end of 2016 were extended in the BBA18, retroactive to 2017. These include the

- Tax Exclusion for Canceled Mortgage Debt,
- Mortgage Insurance Premium Deductibility, and
- Above-the-Line Deduction for Qualified Tuition and Related Expenses.

Brief background information on these provisions is provided in this report. The other individual income tax provision that expired at the end of 2016, the medical expense deduction adjusted gross income (AGI) floor of 7.5% for individuals aged 65 and over, was expanded to all taxpayers through 2017 and 2018 in the December 2017 tax legislation (P.L. 115-97).

Options related to expired tax provisions in the 115th Congress include (1) extending all or some of the provisions that expired at the end of 2017 or (2) allowing expired provisions to remain expired.

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Introduction

In the past, Congress has regularly acted to extend expired or expiring temporary tax provisions. Collectively, these temporary tax provisions are often referred to as “tax extenders.” Of the 33 temporary tax provisions that had expired at the end of 2016 and extended retroactively through 2017, three are individual income tax provisions.

The three individual provisions that expired at the end of 2017 have been included in recent tax extenders packages. The above-the-line deduction for certain higher-education expenses, including qualified tuition and related expenses, was first added as a temporary provision in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA; P.L. 107-16), but has regularly been extended since. The other two individual extender provisions are housing related. The provision allowing homeowners to deduct mortgage insurance premiums was first enacted in 2006 (effective for 2007). The provision allowing qualified canceled mortgage debt income associated with a primary residence to be excluded from income was first enacted in 2007. Both provisions were temporary when first enacted, but in recent years have been extended as part of the tax extenders.

In recent years, Congress has chosen to extend most, if not all, recently expired or expiring provisions as part of “tax extender” legislation. The most recent tax extender package is the Bipartisan Budget Act of 2018 (BBA18; P.L. 115-123).

Information on costs associated with extending individual income tax expired provisions is provided in Table 1. The provisions that were extended in the BBA18 were extended for one year, retroactive for 2017. The estimated cost to make expired provisions permanent is reported by the Joint Committee on Taxation (JCT). The JCT reports estimated deficit effects of extending expired and expiring tax provisions through the 10-year budget window (2018–2027).

### Table 1. Estimated Cost of Extending Expired Individual Income Tax Provisions

(billions of dollars)

<table>
<thead>
<tr>
<th>Provision</th>
<th>Cost of Extension in P.L. 115-123</th>
<th>Cost to Make Permanent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax Exclusion for Canceled Mortgage Debt</td>
<td>$2.4</td>
<td>$23.0</td>
</tr>
<tr>
<td>Mortgage Insurance Premium Deductibility</td>
<td>$1.1</td>
<td>$6.5</td>
</tr>
<tr>
<td>Above-the-Line Deduction for Qualified Tuition and Related Expenses</td>
<td>$0.4</td>
<td>$1.7</td>
</tr>
</tbody>
</table>


Tax Exclusion for Canceled Mortgage Debt

Historically, when all or part of a taxpayer’s mortgage debt has been forgiven, the amount canceled has been included in the taxpayer’s gross income. This income is typically referred to


2 Section 108(a)(1)(E) of the Internal Revenue Code.
as canceled mortgage debt income. Canceled (or forgiven) mortgage debt is common with a “short sale.” In a short sale, a homeowner agrees to sell their house and transfer the proceeds to the lender in exchange for the lender relieving the homeowner from repaying any debt in excess of the sale proceeds. For example, in a short sale, a homeowner with a $300,000 mortgage may be able to sell their house for only $250,000. The lender would receive the $250,000 from the home sale and forgive the remaining $50,000 in mortgage debt.¹ Lenders report the canceled debt to the Internal Revenue Service (IRS) using Form 1099-C. A copy of the 1099-C is also sent to the borrower, who in general must include the amount listed in his or her gross income in the year of discharge.

It may be helpful to explain why forgiven debt is viewed as income from an economic perspective in order to understand why it has historically been taxable. Income is a measure of the increase in an individual’s purchasing power over a designated period of time. When individuals experience a reduction in their debts, their purchasing power has increased (because they no longer have to make payments). Effectively, their disposable income has increased. From an economic standpoint, it is irrelevant whether a person’s debt was reduced via a direct transfer of money to the borrower (e.g., wage income) that was then used to pay down the debt, or whether it was reduced because the lender forgave a portion of the outstanding balance. Both have the same effect, and thus both are subject to taxation.

The Mortgage Forgiveness Debt Relief Act of 2007 (P.L. 110-142), signed into law on December 20, 2007, temporarily excluded qualified canceled mortgage debt income that is associated with a primary residence from taxation. Thus, the act allowed taxpayers who did not qualify for one of several existing exceptions to exclude canceled mortgage debt from gross income. The provision was originally effective for debt discharged before January 1, 2010. The Emergency Economic Stabilization Act of 2008 (Division A of P.L. 110-343) extended the exclusion of qualified mortgage debt for debt discharged before January 1, 2013. The American Taxpayer Relief Act of 2012 (P.L. 112-240) subsequently extended the exclusion through the end of 2013. The Tax Increase Prevention Act of 2014 (Division A of P.L. 113-295) extended the exclusion through the end of 2014. The Protecting Americans from Tax Hikes Act of 2015 (PATH Act), enacted as Division Q of the Consolidated Appropriations Act, 2016 (P.L. 114-133) extended the exclusion through the end of 2016. The act also allowed for debt discharged after 2016 to be excluded from income if the taxpayer had entered into a binding written agreement to sell his or her house before January 1, 2017. Most recently, the BBA18 (P.L. 115-123) extended the exclusion through the end of 2017.

The rationales for extending the exclusion are to minimize hardship for households in distress and lessen the risk that nontax homeowner retention efforts are thwarted by tax policy. It may also be argued that extending the exclusion would continue to assist the recoveries of the housing market and overall economy. Opponents of the exclusion may argue that extending the provision would make debt forgiveness more attractive for homeowners, which could encourage homeowners to be less responsible about fulfilling debt obligations. The exclusion may also be viewed by some as unfair, as its benefits depend on whether a homeowner is able to negotiate a debt cancelation,

(...continued)

¹ Generally, any type of debt that has been canceled is to be included in a taxpayer’s gross income. Several permanent exceptions to this general tax treatment of canceled debt exist. They are discussed in CRS Report RL34212, Analysis of the Tax Exclusion for Canceled Mortgage Debt Income, by Mark P. Keightley and Erika K. Lunder.

² A lender must agree to a short sale prior to a borrower selling their house, or the borrower will still be obligated to repay the balance remaining on the mortgage.
the income tax bracket of the taxpayer, and whether the taxpayer retains ownership of the house following the debt cancellation.

The JCT estimated the one-year extension included in the BBA18 would result in a 10-year revenue loss of $2.4 billion (see Table 1).

**Mortgage Insurance Premium Deductibility**

Traditionally, homeowners have been able to deduct the interest paid on their mortgage, as well as any property taxes they pay as long as they itemize their tax deductions. Beginning in 2007, homeowners could also deduct qualifying mortgage insurance premiums as a result of the Tax Relief and Health Care Act of 2006 (P.L. 109-432). Specifically, homeowners could effectively treat qualifying mortgage insurance premiums as mortgage interest, thus making the premiums deductible if the homeowner itemized, and if the homeowner’s adjusted gross income was below a certain threshold ($55,000 for single, and $110,000 for married filing jointly). Originally, the deduction was only to be available for 2007, but it was extended through 2010 by the Mortgage Forgiveness Debt Relief Act of 2007 (P.L. 110-142). The deduction was extended again through 2011 by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312), through the end of 2013 by the American Taxpayer Relief Act of 2012 (P.L. 112-240), and through the end of 2014 by the Tax Increase Prevention Act of 2014 (Division A of P.L. 113-295). The Protecting Americans from Tax Hikes Act of 2015 (PATH Act), enacted as Division Q of the Consolidated Appropriations Act, 2016 (P.L. 114-113), extended the deduction through the end of 2016. Most recently, the BBA18 (P.L. 115-123) extended the exclusion through the end of 2017.

A justification for allowing the deduction of mortgage insurance premiums is the promotion of homeownership and, relatedly, the recovery of the housing market following the Great Recession (the Great Recession began in December 2007 and lasted to June 2009). Homeownership is often argued to bestow certain benefits to society as a whole, such as higher property values, lower crime, and higher civic participation, among others. Homeownership may also promote a more even distribution of income and wealth, as well as establish greater individual financial security. Last, homeownership may have a positive effect on living conditions, which can lead to a healthier population.

With regard to the first justification, it is not clear that the deduction for mortgage insurance premiums has an effect on the homeownership rate. Economists have identified the high transaction costs associated with a home purchase—mostly resulting from the downpayment requirement, but also closing costs—as the primary barrier to homeownership. The ability to deduct insurance premiums does not lower this barrier—most lenders will require mortgage insurance if the borrower’s downpayment is less than 20% regardless of whether the premiums are deductible. The deduction may allow buyers to borrow more, however, because they can deduct the higher associated premiums and therefore afford a higher housing payment.

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5 Section 163(h)(3)(E) of the Internal Revenue Code.

Concerning the second justification, it is also not clear that the deduction for mortgage insurance premiums is still needed to assist in the recovery of the housing market. Based on the S&P CoreLogic Case-Shiller U.S. National Composite Index, home prices have generally increased since the bottom of the market following the Great Recession. In addition, the available housing inventory is now slightly below its historical level. Both of these indicators suggest that the market as a whole is stronger than when the provision was enacted, and that it may no longer be warranted.

Economists have noted that owner-occupied housing is already heavily subsidized via tax and nontax programs. To the degree that owner-occupied housing is oversubsidized, extending the deduction for mortgage insurance premiums would lead to a greater misallocation of resources that are directed toward the housing industry.

The JCT estimated the one-year extension included in the BBA18 would result in a 10-year revenue loss of $1.1 billion (see Table 1).

### Above-the-Line Deduction for Qualified Tuition and Related Expenses

The BBA18 extended the above-the-line deduction for qualified tuition and related expenses through the 2017 tax year. This provision allows taxpayers to deduct up to $4,000 of qualified tuition and related expenses for postsecondary education (both undergraduate and graduate) from their gross income. Expenses that qualify for this deduction include tuition payments and any fees required for enrollment at an eligible education institution. Other expenses, including room and board expenses, are generally not qualifying expenses for this deduction. The deduction is “above-the-line,” that is, it is not restricted to itemizers.

Individuals who could be claimed as dependents, married persons filing separately, and nonresident aliens who do not elect to be treated as resident aliens do not qualify for the deduction, in part to avoid multiple claims on a single set of expenses.

The deduction is reduced by any grants, scholarships, Pell Grants, employer-provided educational assistance, and veterans’ educational assistance.

The maximum deduction taxpayers can claim depends on their income level. Taxpayers can deduct up to

- $4,000 if their income is $65,000 or less ($130,000 or less if married filing jointly); or

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9 Section 222 of the Internal Revenue Code.
10 Payments made with borrowed funds are eligible for the deduction: the year of eligibility is determined by the date payment is made to the institution and not when the loan is repaid.
11 Qualified expenses being deducted also must be reduced if paid with tax-free interest from Education Savings Bonds, tax-free distributions from Coverdell Education Savings Accounts, and tax-free earnings withdrawn from Qualified Tuition Plans (i.e., “529 Plans”).
$2,000 if their income is between $65,000 and $80,000 ($130,000 and $160,000 if married filing jointly).

Taxpayers with income above $80,000 ($160,000 for married joint filers) are ineligible for the deduction. These income limits are not adjusted for inflation.

One criticism of education tax benefits is that the taxpayer is faced with a confusing choice of deductions and credits and tax-favored education savings plans, and that these benefits should be consolidated. Tax reform proposals have consolidated these benefits into a single education credit in some cases.\(^\text{12}\)

Taxpayers may use this deduction instead of education tax credits for the same student. These credits include permanent tax credits: the Hope Credit and Lifetime Learning Credit. The Hope Credit has been expanded into the American Opportunity Tax Credit, a formerly temporary provision that was made permanent by the PATH Act. The American Opportunity Tax Credit and the Hope Credit are directed at undergraduate education and have a limited number of years of coverage (two for the Hope Credit and four for the American Opportunity Tax Credit).\(^\text{13}\) The Lifetime Learning Credit (20% of up to $10,000) is not limited in years of coverage. These credits are generally more advantageous than the deduction, except for higher-income taxpayers, in part because the credits are phased out at lower levels of income than the deduction. For example, for single taxpayers, the Lifetime Learning Credit begins phasing out at $56,000 for 2017.

The deduction benefits taxpayers according to their marginal tax rate. Students usually have relatively low incomes, but they may be part of families in higher tax brackets. The maximum amount of deductible expenses limits the tax benefit’s impact on individuals attending schools with comparatively high tuitions and fees. Because the income limits are not adjusted for inflation, the deduction might be available to fewer taxpayers over time if extended in its current form.

The distribution of the deduction in Table 2 indicates that some of the benefit is concentrated in the income range where the Lifetime Learning Credit has phased out, but also significant deductions are claimed at lower income levels. Because the Lifetime Learning Credit is preferable to the deduction at lower income levels, it seems likely that confusion about the education benefits may have caused taxpayers not to choose the optimal education benefit.\(^\text{14}\)

\(^\text{12}\) See, for example, President George W. Bush’s Advisory Panel’s proposal, *Simple, Fair, and Pro-Growth: Proposals to Fix America’s Tax System*, November 2005, which can be found at http://www.taxreformpanel.gov/; and the proposal by Chairman Camp of the Ways and Means Committee (The Tax Reform Act of 2014). An explanation of the education provision in this draft legislation can be found at the Joint Committee on Taxation’s technical discussion of the individual provisions, JCX-12-14, February 26, 2014, https://www.jct.gov/publications.html?func=startdown&id=4554.


Table 2. Distribution by Income Class of the Qualified Tuition Deduction, 2015

<table>
<thead>
<tr>
<th>Income Class ($ in the thousands)</th>
<th>Percentage Distribution of All Returns Claiming Deductions</th>
<th>Percentage Distribution of Dollars Deducted</th>
</tr>
</thead>
<tbody>
<tr>
<td>Below $10</td>
<td>24.2</td>
<td>32.9</td>
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<tr>
<td>$10 to $20</td>
<td>9.0</td>
<td>9.9</td>
</tr>
<tr>
<td>$20 to $30</td>
<td>7.2</td>
<td>6.7</td>
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<tr>
<td>$30 to $40</td>
<td>5.2</td>
<td>5.0</td>
</tr>
<tr>
<td>$40 to $50</td>
<td>3.3</td>
<td>3.2</td>
</tr>
<tr>
<td>$50 to $75</td>
<td>15.1</td>
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<td>$75 to $100</td>
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</tr>
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<td>$100 to $200</td>
<td>30.4</td>
<td>25.0</td>
</tr>
<tr>
<td>$200 and over</td>
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The JCT estimated the one-year extension included in the PATH Act would result in a 10-year revenue loss of $0.4 billion (see Table 1).
Appendix. Key Policy Staff

Table A-1 provides information on key policy staff available to answer questions with respect to specific provisions or policy areas.

<table>
<thead>
<tr>
<th>Table A-1. Key Policy Staff</th>
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<tbody>
<tr>
<td><strong>Topic and Provision(s)</strong></td>
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<td>-----------------------------</td>
</tr>
<tr>
<td>Extenders (General)</td>
</tr>
<tr>
<td>Housing Tax Policy</td>
</tr>
<tr>
<td>Tax Exclusion for Canceled Mortgage Debt</td>
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