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The Isakson Tax Credit: Another Approach that Won't Fix the Mortgage Mess

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With the financial and housing markets in turmoil and the recent actions of the Federal Reserve being cited as a reason why Congress "must" act to help overstretched homeowners, attention has been focused on several plans to ease problems in the housing market. Unfortunately, there are no simple or quick solutions to a highly complex financial situation. While Senator Johnny Isakson (R–GA) has clearly put some thought into his proposal, it is unlikely to improve the current mortgage situation.

Senator Isakson's Proposal. Senator Isakson has introduced legislation that would provide buyers of either a newly constructed house or one that is in foreclosure or default with a one-time, $15,000 refundable tax credit. The bill would apply to purchases made between February 28, 2008, and March 1, 2009. To qualify, newly constructed houses would have to have been built on or before September 30, 2007. Owner-occupied structures in default or foreclosure must have been in default prior to March 1, 2008, even though the actual sale would take place after that date, although there is no such restriction on foreclosed structures owned by a mortgage company or its agent.

The proposal suffers from the following weaknesses:

- As a general principle, an explicit federal subsidy for the purchase of certain homes is both bad tax policy and bad housing policy.
- This subsidy rewards those who have been the most irresponsible. It would benefit homeowners at any income level who either irresponsibly borrowed all of their home equity or took out a loan that they could not repay but hoped to profit from by reselling the property in a rising market. However, those who have made the effort to pay their mortgages on time would not be assisted at all, regardless of their financial circumstances.
- Homebuilders who ignored signs that the market was slowing and built houses in hopes of finding a buyer would get assistance in selling houses that should not have been built in the first place.
- Responsible homeowners who must move for a new job or for family reasons would suffer because the sale of their homes would not qualify for a tax credit, while those of their less responsible neighbors would qualify for one. The potential plight of responsible homeowners could be cited as a reason to expand this credit to all home sales, thus increasing the cost to all taxpayers.
- Since the credit is refunded only after the end of the next taxable year, the money would not be available at the time of purchase. In practice, this limits its effect to those buyers who have the money to make a purchase up front; i.e., upper-income homebuyers.

This paper, in its entirety, can be found at:
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- By applying the credit only to homeowners in default before March 1, 2008, the bill leaves out those homeowners whose mortgage interest rate will reset after that date. This provision may be intended to reduce incentives for default, but it is so poorly written that it essentially rewards those who were irresponsible early while excluding those who were victims of circumstance after that date.

Conclusion. The press for Congress to "do something" about the large number of mortgages that are either in default now or at risk of defaulting once their interest rates rise to market levels remains extremely intense. Unfortunately, the Isakson approach, while well intentioned, is bad policy and would not really do anything to solve the problem.

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