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How can a home-buyer's tax credit hurt you?

If you agree that the government should get involved more or less directly in running the economy, you probably agree that the American Recovery and Reinvestment Act of 2009 is a pretty good idea. All told, it provides more than \$500 billion in spending on infrastructure, health care, education, energy, homeland security, and law enforcement, and \$275 billion in tax cuts.

It's no secret that it included a provision to cut a home-buyer's federal tax bill by \$8,000. According to www.federalhousingtaxcredit.com, "The American Recovery and Reinvestment Act of 2009 authorizes a tax credit of up to \$8,000 for qualified first-time home buyers purchasing a principal residence on or after January 1, 2009, and before December 1, 2009."

This might come as a shock, but this legislation has some drawbacks.

How is it intended to work? It's not necessarily about getting people into homes. It's about getting people to crack open their wallets for related expenses. Indirectly propping up home sales is like throwing a rock into a pond; both send ripples out in every direction. Purchasing a home often leads to many expenditures—renting a moving van, buying a new appliance or two, purchasing some new furniture, maybe picking up a few gallons of paint to fix up the new place. That doesn't seem like a bad idea, does it?

Well, on the surface it isn't a bad idea, but the bill itself was written badly. This might come as another shock, but it seems that our 100 senators and 435 representatives didn't think this one through. As pointed out by the editorial staff of The Boston Herald, in a column under the tongue-in-cheek title "**'Stimulating' tax fraud**," no home purchase documentation is required. Of those who have filed, 19,000 hadn't bought homes yet; 74,000 had owned homes previously; and one was four years old.

It gets better. As noted in The Wall Street Journal article "**Home-buyer credit tempts tax cheats**," 53 of the illegal or inappropriate claims for the credit came from Internal Revenue Service (IRS) employees. Now that's moxie!

Back to the economics of the situation. Here come the drawbacks. First, it probably boosted home prices by several thousand dollars because buyers suddenly had \$8,000 more to work with, and sellers knew it. Second, it is a transfer program, the bane of economics. It doesn't create something of value; it simply moves money around from one group of people to another. Tax-paying homeowners and renters—and businesses such as yours—can do nothing but watch as first-time home buyers benefit from this subsidy. Third, it's too concentrated; it's too much money in too few hands. Sure, they'll spend some of it, but many argue that the spending won't amount to much. It might turn into a few ripples, but it's not likely to create big waves surging through the economy. Last, we really don't know how the money will get spent. A new appliance or two, or some new furniture? Maybe. I'd guess much more will be spent on plasma screen televisions, DVD players, and other fancy electronic gadgets, few of which are made in the U.S.

In short, individuals and businesses likely will pay more in taxes to fund this program but won't get much benefit from them. If you're a manufacturer, it might end up hurting you more than helping you.

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