Eliminating Rental Tax Break Won't Harm the Furniture Market
by Andrew Brod
Greensboro *News & Record*, March 26, 2000

Recently the Clinton administration proposed eliminating a tax break that benefits some homeowners in the Triad. Currently, income from renting one's home out for 15 days or less in a given year is not subject to federal income tax. Under the proposal, all rental income would be taxable.

The people in this area who would be affected directly by the proposal are those who rent out their homes to visitors to High Point's biannual International Home Furnishings Market. Naturally, those folks prefer tax-free income to taxable income, but does it really matter to the rest of us?

Would the result be, as U.S. Representative Howard Coble of Greensboro has claimed, "economic disruption" in the Triad? Would there be a dramatic shortage in temporary housing for Market attendees?

Before we address that question, we could ask a more fundamental one: Was it fair to exempt this type of income in the first place? None of us is exempt from paying taxes on what we earn in the first 15 workdays of the year. Why should short-term home-renters be treated differently?

It *would* make sense for them to be treated differently if the current exemption served a significant public-policy goal. For example, U.S. tax law allows a deduction for mortgage interest in order to further the government's goal of encouraging home ownership.

The alternative to in-home lodging during Market is additional hotel space, and it's reasonable for public policy to discourage the wasteful construction of hotel rooms that would be used only twice a year. And so we return to the original question: Would repealing this income-tax exemption cause a significant shortage in short-term housing?

Some simple economic analysis can help us answer this. When something is taxed (or when a tax exemption is removed), the outcome depends on the responsiveness of both supply and demand to changes in price.

Let's first consider the demand for short-term housing. In order to earn the same amount as before the tax, homeowners would have to charge higher rents to Market visitors. Would it be too much for the short-term housing market to bear?

The evidence is that it would not. Homeowners already command healthy rents for the use of their homes for a week or so. Market visitors who are unable to get into area hotels or unwilling to stay many miles away from downtown High Point readily pay these rents. Certainly they'd pony up a little more if they have to. After all, what options would they have?

In contrast, the supply of temporary housing is quite responsive to price changes. It's inconvenient to get one's home ready for visitors and then move out for a week. Few of us would put up with the inconvenience and expense if the price weren't right.

Moreover, the homes that attract Market attendees tend not to be the homes of lower-income folks. This implies that the rental income is mostly supplementary, and not essential to homeowners' livelihoods.

So what we have is a commodity (short-term rental housing) whose supply is highly responsive to price and whose demand is highly unresponsive. For such a commodity, we can conclude two things:

- A tax has a small effect on quantity
- A tax-induced price increase is almost fully passed on to buyers

In other words, removing the tax exemption on the first 15 days of rental income would not dramatically reduce the number of homes available for rent during Market. To be sure, the local media would report higher rents and interview annoyed Market visitors, but there would be no significant decrease in short-term housing.

So while removing this tax exemption wouldn't help those Triad homeowners who currently benefit from it, neither would it dramatically hurt them. The burden of the tax increase would be borne primarily by out-of-town Market attendees, who have in the past displayed a willingness to pay premium prices for temporary lodging.

What about the long run? Until now, furniture retailers and manufacturers have been willing to incur the expense of coming to Market, but removing the tax exemption would make it more expensive. Could increased lodging costs put at risk the long-run competitiveness of High Point's Market "franchise"?

This could happen only if there were viable substitutes for the High Point Market as *the* forum for exhibiting home furnishings to retailers. But both Market officials and industry traditionalists claim that furniture "dot.com" companies can't replace the act of touching and feeling new furniture lines, or provide a better environment for making deals.

Each new showroom that goes up in downtown High Point demonstrates that investors agree with this view. The market for capital appears to believe that the Furniture Market is unique and will continue to be the focus for manufacturers and retailers.

If investors are right, then High Point needn't worry about the elimination of this little tax exemption, in the short run *or* the long run.