Options to Reform the Home Mortgage Interest Deduction

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Testimony Before the Committee on Ways and Means
United States House of Representatives
Hearing on Tax Reform and Residential Real Estate

April 25, 2013

Chairman Camp, Ranking Member Levin, and Members of the Committee:

Thank you for inviting me to testify today on reforming the mortgage interest deduction. The mortgage interest deduction is one of the largest individual tax preferences in the Internal Revenue Code. The Joint Tax Committee (2013) estimates that the deduction will reduce federal receipts by about $70 billion in fiscal year 2013 and by about $380 billion between fiscal years 2013 and 2017. Homeowners also benefit from the deduction of real property taxes ($153 billion between 2013 and 2017) and the exemption of the first $250,000 ($500,000 for joint returns) of capital gains on the sale of principal residences ($130 billion between 2013 and 2017).

If the Committee is to achieve its stated goals of reducing the top individual income tax rate to 25 percent and maintaining receipts at their baseline projected level of 19.4 percent of GDP by the end of the decade, it will be necessary to eliminate or pare back some major tax expenditures. But the mortgage interest deduction is one of the most popular benefits in the tax law, and politicians have in the past viewed it as untouchable. The mortgage interest deduction is the only tax benefit that President Reagan promised to protect in 1984 when his Treasury Department was preparing the wide-reaching reform proposals that would form the basis for the 1986 Tax Reform Act.[1] In 2015, according to Tax Policy Center (TPC) estimates, about 40 million taxpayers will benefit from the deduction.

In my testimony, I will provide some brief historical background on the mortgage interest deduction and then discuss the reasons for reform and some of the major proposals that have been put forward in the past few years. I will conclude with an assessment of the effects of proposed reforms on the size and distribution of federal tax burdens, and comment on how it might affect housing markets.

Background on the Home Mortgage Interest Deduction

The mortgage interest deduction was not originally placed in the income tax law to subsidize home ownership. When Congress enacted the modern federal income tax in 1913 shortly after ratification of the 16th amendment to the U.S. Constitution, the tax code allowed deductions for all interest payments. Congress viewed interest payments as an expense of earning business and investment income and therefore not a part of a taxpayer's net income. Congress made no distinction between interest incurred to generate taxable income and interest on loans used to finance the purchase of household assets such as homes, cars, and other consumer durables that do not generate taxable income. Subsequently, however, Congress did eliminate

[1] In January 1984, President Reagan asked the Treasury Department to develop a plan to "simplify the tax code sot that all taxpayers big and small are treated fairly and make the tax base broader so that personal tax rates could come down, not up." The president allowed the Treasury wide discretion to eliminate tax preferences, except for a specific commitment in a May 1984 speech that the administration would retain the home mortgage interest deduction.

deduction of interest used to finance the purchase of tax-exempt municipal securities.[2]

In the early years of the federal income tax, the deductibility of mortgage interest hardly affected the housing market. Until World War II, exemptions were high enough to exclude the vast majority of households from paying any income tax. And the rate of home ownership was much lower than it is today.

World War II and the post-war boom that followed changed all that. Lower amounts of exempt income converted the income tax from a class tax to a mass tax. Home ownership rates increased with postwar prosperity, the availability of 30-year fixed-rate mortgages with low down payments, and low interest rates. As marginal tax rates facing middle-income Americans increased, the mortgage interest deduction became a major subsidy for middle- and upper-middle-income home owners. From the 1970s, when the Office of Management and Budget (OMB) and congressional agencies first began publishing annual lists of tax expenditures, until now, the mortgage interest deduction has been one of the most costly preferences in the tax law.

The 1986 Tax Reform Act (TRA 86) eliminated many preferences in the federal individual and corporate income taxes to finance reduced marginal tax rates on individuals and corporations. Among other provisions, TRA eliminated the deductibility of all consumer interest, including credit card debt and loans to finance cars, furniture, and other consumer durable items. But Congress left the deductibility of mortgage interest largely intact. It limited the amount of debt eligible for the interest deduction to the first $1 million incurred to purchase or refinance a principal or secondary residence and permitted taxpayers to deduct interest on an additional $100,000 of loans secured by home equity.[3] These limits were not indexed to changes in the consumer price index and have remained the same since 1988.

Although the mortgage interest deduction was not originally put into the tax code as an incentive for home ownership, and at first only affected a very small share of taxpayers, many people regard it today as a critical support for the American dream of home ownership. But in recent years, designers of tax reform proposals have questioned its effectiveness in promoting home ownership. In the following section, I review possible rationales for the deduction and discuss reasons for eliminating or restructuring it.

[2] An exception to this limitation for commercial banks was repealed in 1986.

[3] In practice, home equity loans are often used to finance the purchase of cars and other household durables.

Reasons for Reform

In this section, I make four main points:

- The mortgage interest deduction is a subsidy that favors investment in home ownership over investment in rental housing and most other business assets.
- The main beneficiaries of the deduction are upper-middle-income households, and use of the deduction varies greatly among states.
- The issue of whether home ownership should be subsidized is debatable, with points to be made on both sides of the issue.
- If the goal is to promote home ownership, the mortgage interest deduction should be restructured, with more of the subsidy directed to low- and middle-income taxpayers who are more likely to be deciding whether to own or rent.

Is the Deduction a Subsidy or an Appropriate Adjustment for Measuring Income?

Under a comprehensive income tax, returns to investment, net of investment expenses, are included in taxable income. The taxation of income from rental properties largely conforms to income tax principles. Owners of rental properties must include gross rents received in their income but can deduct expenses of owning and operating their properties, including costs of repairs and maintenance, depreciation, interest payments, and residential property taxes. Any gains from the subsequent sale of rental properties are treated as taxable capital gain.[4] Rental housing receives some tax subsidies, including somewhat accelerated depreciation schedules for residential structures, the low-income housing tax credit, and limited availability of tax-exempt financing for some rental properties. But these tax subsidies are small compared with the subsidies for home ownership.

Home owners, in contrast, are not taxed on the gross rental returns on their housing properties—that is, on the gross rent the home owner would have to pay to rent the same property from someone else. In other words, one can view the return to the home owner as the saving in rent she would otherwise pay to live in an equivalent dwelling. But, although the home owner is not taxable on this gross "imputed rental income," she can nonetheless under current law deduct interest payments and residential property taxes as if they were costs of earning income and use those deductions to offset tax on her wages and other sources of income.[5] In addition, single homeowners can exempt the first $250,000 of gain on the sale of any personal

[4] Long-term capital gains from the sale of rental housing are taxed at favorable rates, but no more favorable than rates applied to long-term gains from sales of corporate shares or ownership shares in other businesses.

[5] The OMB (2014) includes the exclusion of net imputed rent in its list of tax expenditures, but the JCT does not. On both administrative and political grounds, no one in the United States is seriously considering including imputed rent in the tax base. Gale, Gruber, and Stephens-Davidowitz (2007), citing Sorensen (2001), note that some European countries do tax imputed rental income.

residence owned for at least two years and lived in for two of the five years before the sale, and married homeowners can exempt $500,000 of such gains.

The main argument for retaining a mortgage interest deduction under an income tax is that it treats equally people who must borrow to buy a home and people who are wealthy enough to purchase a home by selling other assets. For example, if all returns are taxable, and the interest rate is 5 percent, a taxpayer in the 28 percent rate bracket who finances a home purchase by selling taxable bonds will sacrifice 3.6 cents in income per dollar invested in her home. If mortgage interest were not deductible, however, a taxpayer with the same income who needs to borrow money to buy home would face a net interest cost of 5 percent. The deduction, by this reasoning, equalizes the costs of debt and equity finance, by extending the subsidy to equity finance from the exclusion of imputed rent to those without sufficient wealth to purchase a house outright. Of course, by so doing, it extends the subsidy from the small share of taxpayers with sufficient wealth to purchase a house outright to the much larger number who must use debt finance.

The above argument presumes, however, that the alternative to buying a house for most taxpayers is to invest in an asset that generates taxable investment income. With the expansion of access to tax-deferred retirement saving accounts and increases in contribution limits, most wealth held by people outside the very highest income groups is either in home equity or in tax-deferred retirement saving accounts (Toder 2009). The return to these assets is tax free, so in reality most taxpayers do not pay any capital income tax on the vast majority of their investment returns. And interest on other forms of non-business borrowing is not deductible. Increasingly, the deduction for mortgage interest stands out as the only way most individuals can finance the purchase of a household asset at an after-tax interest cost. The exception is a minority of wealthy and mostly older households who have sufficient financial assets that generate taxable income to enable them to pay down their mortgage debt if the deduction were eliminated without incurring a net increase in tax liability.

Who Benefits from the Mortgage Interest Deduction?

The mortgage interest deduction (MID) provides the largest benefits in total and as a share of income to upper-middle-income taxpayers (table 1). The Tax Policy Center (TPC) estimates that 24 percent of tax units will benefit from the deduction in 2015, compared with 47 percent who will have some mortgage interest expense.[6] The percentage of tax units who will benefit ranges from over 60 percent for taxpayers with cash incomes between $100,000 and $500,000 in 2012 dollars to less than 10 percent for taxpayers with incomes less than $40,000.[7] Low-income

[6] Tax units are either married couples or single individuals (including head of household filers), but exclude those who are dependents of other tax units. Tax units include both filing units and non-filers.

[7] The Tax Policy Center's measure of pretax cash income starts with AGI and adds tax-exempt interest, the untaxed portion of Social Security benefits, employer-paid payroll taxes and the

households receive less benefit from the MID than others because fewer of them own homes, and many who are paying mortgage interest either have no positive income tax liability or claim the standard deduction, and therefore do not benefit from itemized deductions. A larger share of the highest-income households benefits from the MID than for the population as a whole, but a smaller share benefits than among those in upper-middle-income groups. Some of the very highest income households have already paid off their mortgages; and, among those paying mortgage interest, some could sell off taxable assets to paid down debt and thereby avoid a tax increase if the MID were eliminated.

Upper-middle-income households also receive the largest benefits from the MID as a share of their income. Households with cash incomes between $75,000 and $500,000 (27 percent of all tax units) will earn 48 percent of all cash income in 2015 but will receive 77 percent of the tax savings from the mortgage interest deduction. The tax benefit from the MID is worth more than 1 percent of pretax income on average to them, compared with 0.6 percent for the population as a whole and 0.1 percent or less for tax units with incomes under $30,000 and those with incomes over $1,000,000. The latter receive relative little benefit from the MID as a share of income because their housing expenses do not rise in proportion to their incomes and, for many of them, their mortgage debt is either paid off or could be paid off from the proceeds of other assets if the deduction were removed.

Use of the MID varies considerably among regions, with home owners in large metropolitan regions benefiting more from the preference than others (Gyourko and Sinai, 2003). Use of the MID also varies significantly among states (table 2), with relatively more deductions claimed in high-tax states and states with high housing costs. IRS data for tax year 2011 show that 24 percent of tax return filers claimed mortgage interest deductions amounting to 4.3 percent of adjusted gross income (AGI). The share of filers claiming MID ranged from over 30 percent in Colorado, Connecticut, Maryland, Massachusetts, Minnesota, New Jersey, Oregon, Utah, and Virginia to less than 20 percent in Arkansas, Florida, Louisiana, Mississippi, North Dakota, Oklahoma, South Dakota, Tennessee, Texas, West Virginia, and Wyoming. Deductions as a share of AGI ranged from over 6 percent in California and Hawaii to 1.8 percent in North Dakota.

Should Home Ownership Be Subsidized?

The main justification for the MID is that it may encourage more people to own homes instead of renting them. Proponents of home ownership subsidies cite social benefits of home ownership in excess of the direct benefits received by owners. A large body of research cited in Toder et al. (2010) has found evidence that owner-occupied homes are better maintained than rental properties, home owners have higher rates of civic participation than renters, and crime rates are lower in areas

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taxpayer's estimated share of the burden of the corporate income tax. See Rohaly, Carasso, and Saleem (2005).

with more home owners, after adjusting for other determinants of these behaviors.[8] It is difficult to demonstrate, however, whether home ownership causes these benefits or whether people who are civic-minded or less likely to commit crimes are the ones more likely to purchase homes. Others suggest that promoting home ownership may help low-income individuals accumulate wealth and thereby promote social mobility. On the other side, home ownership may limit job market mobility because of the large transactions costs associated with house purchases. And, as we have seen in the past few years, excessive home mortgage debt can expose individuals and the broader economy to significant risks.

In summary, while arguments can be made in favor of taxpayer subsidies for home ownership, the case for such subsidies is by no means conclusive.

Is the Mortgage Interest Deduction the Most Effective Way to Promote Home Ownership?

Assuming that promoting home ownership is a desirable goal, the current mortgage interest deduction is not a very effective instrument. The MID provides no subsidy to taxpayers who do not itemize deductions and only a very modest subsidy to taxpayers in the 15 percent rate bracket. The subsidy value is largest among upper-middle-income taxpayers, who are the ones most likely to own a home without a subsidy. Instead, the main incentive the MID provides is an incentive for those who would own a home without a subsidy to purchase larger or more expensive homes.

Some empirical research and observations confirm this lack of a relationship between the MID and home ownership rates. Glaeser and Shapiro (2003) and Gale, Gruber, and Stephens-Davidowitz (2007) find no evidence that change in the value of the MID over time has affected home ownership rates in the United States. Gale (1997) finds a similar result for the United Kingdom when it reduced their mortgage subsidy. Looking across similar countries, home ownership rates in countries culturally similar to the United States including Canada, New Zealand, and Australia have in recent years been at least as high as in the United States even though they do not allow deductibility of mortgage interest.

If the goal is to use tax subsidies to increase the rate of home ownership, a better approach would be to focus the subsidies on those who might be on the margin of buying or renting and reduce the subsidy rate for high-income borrowers. This could be done by converting the MID to either a uniform percentage tax credit for mortgage interest or an investment credit for first-time home purchases. The lower subsidy rate for mortgage interest borrowers in high tax brackets would help pay for expanding mortgage subsidies to individuals who currently do not itemize deductions or, beyond that, to individuals without positive income tax liability.

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[8] Researchers who have identified these social benefits of homeownership include DiPasquale and Glaeser (1999); Galster (1983); Glaeser and Sacerdote (2000); Glaeser and Shapiro (2003); and Rossi and Weber (1996).

Further budgetary savings could be achieved by lowering the cap on the amount of debt eligible for a tax subsidy, limiting the deduction to principal residences only, and eliminating the deductibility of interest on home equity loans.

Major Reform Proposals

In recent years, tax reform plans by presidential commissions and prominent private groups have included proposals to limit and restructure the MID:

- The President's Advisory Panel on Federal Tax Reform (2005), appointed by President George W. Bush, proposed replacing the MID with a nonrefundable credit, available to both itemizers and non-itemizers, equal to 15 percent of interest paid on a principal residence. The panel also proposed to limit the amount of debt eligible for the credit to 125 percent of the median sale price in each county and to eliminate the subsidy for home equity loans.
- The National Commission on Fiscal Responsibility and Reform (2010), appointed by President Barack Obama and chaired by Erskine Bowles and Alan Simpson, proposed to replace the MID with a 12 percent nonrefundable credit for all taxpayers on principal residences only and to reduce the cap on debt eligible for an interest subsidy to $500,000.
- The Bipartisan Policy Center Debt Reduction Task Force (2010), chaired by Alice Rivlin and Pete Domenici, proposed to replace the MID with a 15 percent refundable credit on up to $25,000 of interest on a principal residence.

These proposals were included as part of broader tax reform plans that reduced personal and corporate income tax rates, eliminated the alternative minimum tax, and eliminated or scaled back many other tax preferences. So the panels that proposed these plans were not targeting the home mortgage interest alone. Nonetheless, it is significant that all the major tax reform review panels in recent years have included proposals to scale back the mortgage interest deduction and substitute in part some form of mortgage credit in their overall reform packages.

President Obama has proposed limiting the tax saving from itemized deductions and some other tax preferences to 28 percent of the amount of the deductions and exclusions, most recently in the fiscal year 2014 budget released in April 2013. The president has not singled out the MID but has included it among the benefits he would limit. During his 2012 presidential campaign, Governor Mitt Romney proposed a fixed dollar cap on itemized deductions, which again would have limited the MID without singling it out specifically. The Obama and Romney MID proposals are both more limited than the proposals of the tax reform and debt reduction commissions, and both would reduce benefits mainly for very high income taxpayers. Obama's proposal would raise taxes only on those taxpayers in the 28 percent bracket and above. The Romney proposal introduced in the election campaign would have affected only taxpayers with very large absolute amounts of itemized deductions.

Analysis of Proposals

TPC has recently analyzed four proposals to reform the mortgage interest deduction in two recent documents: a report on an expert conference on how reforming the mortgage interest deduction would affect the housing market (Turner et al. 2013) and a report prepared for the National Low Income Housing Coalition that analyzed the effects of replacing the mortgage interest deduction with a nonrefundable credit and lowering the cap on the amount of debt eligible for the subsidy to $500,000 (Eng et al. 2013).

The proposals are as follows:

- Eliminate the mortgage interest deduction entirely
- Reduce the cap on the amount of deductible interest to $500,000
- Replace the mortgage interest deduction with a refundable credit of 15 percent of mortgage interest paid, and limit the amount of creditable interest to $25,000 a year
- Replace the mortgage interest deduction with a nonrefundable credit of 20 percent of mortgage interest paid, and reduce the cap on the amount of creditable interest to $500,000

TPC scored all the proposals against current law as of January 2013. The model TPC used to score the estimates has been updated to include the effects of the American Tax Relief Act of 2012 (ATRA) enacted at the end of 2012 but has not yet been updated to incorporate the most recent CBO economic projections. These estimates will change once we have updated our baseline projections to account for the new economic assumptions.

Distributional Effects

Eliminating the mortgage interest deduction would raise taxes by $696 per household in 2022, including both those affected and those not affected by changing the deduction (table 3, first column). The tax increase as a percentage of income would be 0.66 percent for all households (table 4, second column). Taxpayers in the 60–99th percentiles would experience on average a larger increase in their tax rate than all households and taxpayers in the bottom three quintiles, and the top 1 percent would face a smaller increase in their tax rate. The largest tax increase as a share of income (1.28 percent) would be faced by households in the 80th–90th percentiles—that is, those who are in the bottom half of the top quintile of the income distribution. Tax increases would be relatively small in the bottom three quintiles because in those income groups the share of home owners in the population is smaller than average, a large proportion of taxpayers claim the standard deduction, and those who do claim a mortgage deduction are mostly in the 10 and 15 percent brackets so they would not experience that big a tax increase per dollar of additional taxable income. Tax increases would be relatively small in the top 1 percent because those taxpayers have smaller mortgage payments as a share of income, and some will be able to pay down their mortgage and avoid a tax increase when the deduction is eliminated.

If marginal tax rates were lowered as part of tax reform, the revenue increase from eliminating the MID would be smaller, and a relatively smaller share would be paid by the highest-income households, who would no longer benefit from as large an interest subsidy at the lower rate.

Capping the deduction to the first $500,000 of home acquisition debt would raise taxes by an average of $84 per household, about one-eighth of the increase from eliminating the deduction entirely (table 3, column 3). The proposal would have only a minimal effect on the bottom four quintiles because few taxpayers in those income brackets have that much mortgage debt. But taxpayers in the top 1 percent of the distribution would face a tax increase almost half as large as from eliminating the deduction entirely. Taxes would rise by 0.08 percent of income overall, with taxpayers in the 80th–99th percentiles of the distribution experiencing larger than average increases in tax rates, taxpayers in the bottom four quintiles seeing little or no tax increase, and taxpayers in the top 1 percent experiencing a tax rate increase only slightly less than the average for the entire population (table 4, column 3).

The effect of a $500,000 cap would be felt disproportionately in a small number of geographic areas with high housing costs. It would have the biggest effect on younger very high income earners who have not yet accumulated enough wealth to pay down their mortgage debt.

Replacing the mortgage interest deduction with a 15 percent refundable credit and capping eligible interest at $25,000 would raise taxes in some income groups and lower taxes in others. This is the option included in the Bipartisan Policy Center (BPC) reform plan. The BPC plan would reduce individual income tax rates to 15 and 27 percent and convert those tax subsidies they are not eliminating (the MID and charitable deduction) into refundable credits at a 15 percent rate. BPC would also eliminate the current law provisions to relieve low-income families of income tax burdens (the standard deduction, the earned income tax credit, the child credit, and head of household filing status) and substitute two new tax benefits: a fixed dollar per child credit and a flat-rate percentage earnings credit up to a maximum earnings level. BPC would deliver the charitable and mortgage interest credits as matching payments to charities and financial institutions, so individuals would not have to claim these benefits on their tax returns. The motivation behind these broad changes in the basic structure of the income tax is to enable many taxpayers (about 50 percent by TPC's 2010 estimate of the BPC proposal) to escape a requirement for filing tax returns. These simplification benefits would not be achieved by enacting only the mortgage interest proposal without the other parts of the BPC plan.

The BPC proposal for reforming the MID, when scored against the current-law baseline without including the other parts of the BPC plan, would raise taxes by an average of $105 per household (table 3, column 4). Households in the bottom four quintiles in the income distribution would see their taxes fall. Many of these households cannot claim the current mortgage interest deduction either because they have no income tax liability or because they claim the standard deduction, but they would be able to claim the refundable credit. Even some taxpayers currently claiming the MID would come out ahead because they would not have to give up the standard deduction to claim the new credit. Taxpayers in the top quintile of the distribution would pay more tax, however, because the 15 percent interest subsidy is less than the subsidy they receive from the current MID and because of the $25,000 cap on creditable interest. Overall, taxes would increase by 0.12 percent of income (table 4, column 4). Taxpayers in the 95th–99th percentiles of the distribution would experience the biggest tax increase as a share of income (0.77 percent), while taxpayers in the bottom quintile would receive the largest proportional tax cut (0.54 percent of income).

Replacing the mortgage interest deduction with a 20 percent nonrefundable credit and capping eligible debt at $500,000 would have similar effects as the BPC proposal, but it would provide relatively smaller benefits to the lowest-income households and larger benefits to middle-income households and raise taxes slightly less on upper-middle-income households. This option would be close to revenue neutral, raising taxes by an average of $8 per household (table 3, column 5). Like the BPC option, it would reduce taxes on average for households in the bottom four quintiles, but the largest benefit as a share of income would go to the middle quintile (0.36 percent of income) instead of the lowest quintile (table 4, column 5). The benefits to the bottom quintile would be limited because many in those groups (especially families benefiting from the current-law earned income and child credits) face little or no positive income tax liability and therefore would not be able to use the credits. Middle-income taxpayers with positive liability who currently claim the standard deduction would benefit from the new credit and some taxpayers who currently itemize would benefit from switching to the standard deduction and claiming the credit. Upper-income taxpayers would experience net tax increases, as in the BPC proposal, but the net tax increases would be smaller because the 20 percent credit would replace more of their lost MID subsidy than the 15 percent credit.

Effects on the Housing Market

The biggest concern about proposals to pare back the mortgage interest deduction is how they might affect housing prices. Many housing markets across the country are just beginning to recover from the large drop in prices that occurred over the past few years, but the overall market is still fragile. And any precipitous shock to the housing market could endanger the economic recovery that appears to have begun.

I have not conducted an independent assessment of the effects of reforming the MID on housing prices, but the issue was discussed recently by a panel of experts at the Urban Institute (Turner et al. 2013). Some past research has found substantial effects on prices of eliminating current law housing tax incentives. For example, a widely cited paper by Capozza, Green, and Hendershott (1996) estimates that eliminating the mortgage interest and property tax deductions would reduce housing prices in the short run by average of 13 percent nationwide, with changes among regions ranging from 8 to 27 percent. The authors calculated the effects of changes in tax provisions on the amount home owners should be willing to pay for houses producing a given rental value and validated their predictions by examining the relationship between their measure of the user cost of housing and price-to-rent ratios among different regions. An attempt to replicate these results with 2006–10 data, however, failed to identify any effect of the MID on housing prices. It is possible that the recent unsettled housing market conditions, however, made it difficult to identify a relationship between prices and tax provisions that in fact will hold up in more normal periods.

Participants in the Urban Institute roundtable cited several reasons changes in the MID might not have as large an effect on housing prices as previously estimated. The points participants raised included:

- With interest rates so low, the MID has less effect on housing costs than in earlier time periods, so eliminating it would have less effect on housing prices
- The current low price-to-rent ratio is attracting investors into the market who would be not affected by elimination of the MID for home owners
- Affluent home owners with high wealth could pay off a portion of their mortgage debts, a possibility not considered in the earlier estimates
- Many reform proposals would increase tax subsidies for some buyers, leading to a firming up of housing prices in some markets

All that said, however, it would be prudent to introduce changes in the MID slowly to avoid risking a major market disruption. And any transition rules adopted would reduce short-term revenue gains from any reform.

Conclusions

The mortgage interest deduction is one of the largest tax subsidies in the Internal Revenue Code. Achieving a revenue-neutral tax reform that reduces marginal tax rates significantly would be difficult or impossible to achieve without cutting back the mortgage interest deduction or some other equally popular and widely used provisions.

Among the incentives in the income tax, the MID is one of the most difficult to justify on policy grounds. Both theory and available evidence suggests it does little to encourage home ownership, but instead mostly encourages upper-middle-households to buy larger and more expensive homes. It would be possible to provide a larger incentive for home ownership at a lower fiscal cost by converting the deduction to some form of uniform credit and placing additional limits on the amount of debt eligible for the subsidy and the use of the subsidy for home equity loans and second homes. Bipartisan tax reform and debt reduction commissions have endorsed this type of approach.

But any reform undertaken must take account of possible short-run adverse effects on housing markets. Designing appropriate transition rules that prevent market disruption while retaining the benefits of removing or redirecting the preference will be challenging.

Table 1. Tax Units That Benefit from the Mortgage Interest Deduction (MID) by Cash Income Level, Tax Year 2015

Cash income level (2012 dollars)	Percent of tax units	Percent of cash income	Percent within group with mortgage interest	Percent within group benefiting from MID	Benefit from MID as percent of cash income	Percent of benefit from MID
Less than $10,000	8.6%	0.6%	17.6%	*	*	*
$10,000–$20,000	14.2%	2.8%	22.9%	1.1%	*	0.1%
$20,000–$30,000	11.9%	3.9%	31.9%	3.8%	0.1%	0.5%
$30,000–$40,000	11.0%	5.2%	42.5%	8.6%	0.2%	1.3%
$40,000–$50,000	9.1%	5.4%	51.1%	16.8%	0.3%	2.5%
$50,000–$75,000	16.8%	13.6%	58.0%	29.6%	0.6%	11.7%
$75,000–$100,000	9.7%	11.2%	64.3%	47.1%	0.8%	13.4%
$100,000–$200,000	13.6%	23.6%	71.5%	63.1%	1.1%	40.1%
$200,000–$500,000	3.7%	13.5%	75.1%	67.4%	1.1%	23.9%
$500,000–$1 million	0.5%	4.7%	70.1%	55.9%	0.6%	4.3%
More than $1 million	0.4%	15.9%	59.8%	34.1%	0.1%	2.2%
All tax units	**100.0%**	**100.0%**	**47.1%**	**24.1%**	**0.6%**	**100.0%**

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0412-8)
Notes:
* less than 0.05 percent
Data include both filing and non-filing units but excludes those that are dependents of other tax units. Tax units with negative cash income are excluded from the lowest income class but are included in the totals.

Table 2. Percentage of Tax Returns Claiming Mortgage Interest Deduction (MID) and Ratio of MID to Adjusted Gross Income (AGI) by State, 2011

State	Percent claiming MID	Ratio of MID to AGI	State	Percent claiming MID	Ratio of MID to AGI
All USA	24.4%	4.3%	Missouri	23.6%	3.7%
Alabama	22.0%	3.8%	Montana	22.7%	4.2%
Alaska	21.0%	3.8%	Nebraska	23.0%	3.0%
Arizona	25.8%	5.4%	Nevada	22.2%	4.9%
Arkansas	18.3%	2.9%	New Hampshire	28.9%	4.5%
California	26.1%	6.2%	New Jersey	31.1%	4.6%
Colorado	31.1%	5.5%	New Mexico	20.3%	4.2%
Connecticut	32.2%	4.1%	New York	22.4%	3.3%
Delaware	29.4%	5.4%	North Carolina	27.0%	4.6%
DC	24.4%	4.5%	North Dakota	14.7%	1.8%
Florida	17.9%	3.8%	Ohio	24.5%	3.5%
Georgia	25.8%	4.9%	Oklahoma	19.4%	2.7%
Hawaii	22.6%	6.3%	Oregon	30.2%	5.8%
Idaho	26.0%	5.0%	Pennsylvania	24.2%	3.6%
Illinois	27.1%	4.1%	Rhode Island	28.9%	4.6%
Indiana	21.8%	3.3%	South Carolina	23.8%	4.4%
Iowa	23.6%	3.0%	South Dakota	14.4%	2.3%
Kansas	23.2%	3.1%	Tennessee	18.6%	3.5%
Kentucky	23.1%	3.6%	Texas	19.0%	2.9%
Louisiana	17.9%	2.9%	Utah	31.2%	5.7%
Maine	24.8%	4.1%	Vermont	23.6%	3.8%
Maryland	35.5%	6.1%	Virginia	31.9%	5.8%
Massachusetts	30.4%	4.4%	Washington	28.8%	5.5%
Michigan	24.3%	3.8%	West Virginia	14.7%	2.4%
Minnesota	31.4%	4.8%	Wisconsin	28.2%	3.9%
Mississippi	16.8%	3.0%	Wyoming	18.8%	3.0%

Source: Internal Revenue Service, Statistics of Income Division, at http://www.irs.gov/uac/SOI-Tax-Stats---Historic-Table-2

Table 3. Average Change in Tax Burdens for Selected Options by Income Group, Tax Year 2022 (in dollars)

Income group	Eliminate the MID	Cap home acquisition debt at $500,000	Replace the MID with a 15% refundable credit and cap eligible interest at $25,000	Replace the MID with a 20% nonrefundable credit and cap home acquisition debt at $500,000
Lowest quintile	9	0	-104	-17
Second quintile	95	1	-219	-136
Middle quintile	408	10	-199	-270
Fourth quintile	948	40	-33	-334
80–90th percentiles	2,088	174	698	215
90–95th percentiles	2,987	363	1,570	1,034
95–99th percentiles	4,573	1,145	3,118	2,577
Top 1 percent	4,215	2,082	3,657	3,453
All tax units	**696**	**84**	**105**	**8**

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0412-8)

Note: The income percentile classes in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks (in 2012 dollars) are: 20% $27,797; 40% $48,516; 60% $76,595; 80% $$113,780; 90% $181,697; 95% $227,157; 99% $657,697.

Table 4. Average Change in Tax Burdens as Percentage of Cash Income for Selected Options by Income Group, Tax Year 2022

Income group	Eliminate the MID	Cap home acquisition debt at $500,000	Replace the MID with a 15% refundable credit and cap eligible interest at $25,000	Replace the MID with a 20% nonrefundable credit and cap home acquisition debt at $500,000
Lowest quintile	0.05%	0.00%	-0.54%	-0.09%
Second quintile	0.21%	*	-0.48%	-0.30%
Middle quintile	0.55%	0.01%	-0.27%	-0.36%
Fourth quintile	0.82%	0.03%	-0.03%	-0.29%
80–90th percentiles	1.28%	0.11%	0.43%	0.13%
90–95th percentiles	1.21%	0.15%	0.63%	0.42%
95–99th percentiles	1.14%	0.28%	0.77%	0.64%
Top 1 percent	0.13%	0.07%	0.12%	0.11%
All tax units	**0.66%**	**0.08%**	**0.10%**	**0.01%**

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0412-8)

Note: The income percentile classes in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks (in 2012 dollars) are: 20% $27,797; 40% $48,516; 60% $76,595; 80% $$113,780; 90% $181,697; 95% $227,157; 99% $657,697.

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