The Mortgage Interest Deduction

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The mortgage interest deduction (MID) is a federal tax expenditure that allows homeowners to deduct from their federal taxable income the interest paid on the first $750,000 of a home mortgage. Although the "Tax Cuts and Jobs Act of 2017" significantly reduced its cost, the MID remains a regressive tax benefit for higher-income homeowners at a cost of $163 billion between 2018 and 2022 in lost federal tax revenue (Joint Committee on Taxation, 2018: Estimates of Federal Tax Expenditures For Fiscal Years 2018-2022).

HOW IT WORKS

Taxpayers can subtract from their federal taxable income either a fixed dollar amount known as the standard deduction or itemized deductions allowed by the federal tax code. Taxpayers must itemize their tax deductions to benefit from the MID. Most taxpayers, however, find it more advantageous to claim the standard deduction, because their itemized deductions are lower. The Joint Committee on Taxation estimated that less than 11% of the nation's 171 million federal tax returns would include itemized deductions in 2018. The Joint Committee also estimated that 8% of taxpayers would claim the MID in 2018, 73% of whom have incomes over 100,000.

MID's value depends on the taxpayers' marginal tax rate. Taxpayers in the 37% tax bracket can reduce their taxes by 37% of the interest paid for their mortgage, while taxpayers in the 22% tax bracket can reduce their taxes by 22% of the interest paid. Because higher-income homeowners are more likely to claim the MID and the value of the MID increases with income, taxpayers with incomes over $100,000 receive 92% of MID's benefits (Tax Policy Center, 2018: Individual Income Tax Expenditures October 2018, Table T18-0170).

HISTORY

Contrary to popular belief, the MID was not created to encourage homeownership. When the federal income tax was implemented in 1913, personal interest on all loans was an allowable deduction from taxable income. At the time, it was too difficult to differentiate between personal consumption and home loans from business loans for farms, small businesses, and individual proprietors (Ventry, D., 2010: The Accidental Deduction: A History and Critique of the Tax Subsidy for Mortgage Interest. Law and Contemporary Problems, 73(1): 233-284). There is no evidence that Congress intended to use the interest deduction to encourage homeownership. While one-third of homeowners had a mortgage in 1910, few benefited from the interest deduction since 98% of households were initially exempt from the federal income tax given its generously high tax-free income threshold (Ibid). The post-World War II housing boom, fueled by FHA- and VA-insured mortgages, and the transformation of the federal income tax to a more broad-based tax made the interest deduction available to an increasing number of homeowners with mortgages. The cost of MID grew significantly through the 1980's to late 2000's, along with the growth in homeownership rates and home values. Prior to tax reform in 2017, the cost of MID was approximately $70 billion per year.

The "Tax Cuts and Jobs Act of 2017" made significant changes to the value of the MID to taxpayers. The act reduced the amount of a mortgage eligible for MID from $1,000,000 to $750,000 for loans taken after December 15, 2017 and eliminated the MID for home equity loans not for substantial home improvement. Previously, interest paid on up to $100,000 on any home equity loans could be deducted. The act also significantly increased the standard deduction for taxpayers, making itemized deductions less likely for middle-income taxpayers.

The "Tax Cuts and Jobs Act of 2017" reduced the cost of the MID from approximately $70 billion per year prior to tax reform to an estimated $31 billion in 2020 (Joint Committee on Taxation, 2018: Estimates of Federal Tax Expenditures For Fiscal Years 2018-2022), but skewed the MID's benefits even more to affluent taxpayers. The Tax Policy Center estimates that taxpayers with incomes greater than $319,100 (the 95th percentile of incomes) would receive approximately 46% of MID's benefits in 2018, up from 32% before tax reform (Tax Policy Center, 2018: Individual Income Tax Expenditures (October 2018),Tables T18-0171 and T18-0169). The same analysis indicates that the share of MID benefits received by middle-income households (40th to 60th percentile) would decline from 6% to 4%.

OTHER THINGS TO KNOW ABOUT THE MID

A study of MID reform in Denmark indicated that the tax benefit does not promote homeownership, but induces homeowners to buy larger, more expensive homes and incur greater debt than they otherwise would (Gruber, J., Jensen, A., and Kleven, H., 2017: Do People Respond to the Mortgage Interest Deduction? Quasi-Experimental Evidence from Denmark. National Bureau of Economic Research, Working Paper Series No. 23600). The MID also contributes to racial and gender inequities. In a recent study, single women were 6.2% less likely than single men of the same age and income to own a home with a mortgage (Chacon, F., 2016: Minorities and Women are Losing Out On Homeownership and Tax Breaks). Black and Hispanic households were 56.9% and 50.9%, respectively, less likely than white households to own a mortgaged home. Without mortgages, single women and minority households do not receive MID benefits to the same extent as white households. A study by the Institute on Assets and Social Policy (IASP) at Brandeis University and NLIHC found that white households, prior to 2017 tax reform, received 78% of MID's benefits even though they accounted for 67% of all households. African American and Latino households each accounted for 13% of the nation's households, yet they received only 6% and 7% of the MID's benefits (Sullivan, L., Meschede, T., Shapiro, T., and Escobar, M.F., 2017: Misdirected Investments: How the Mortgage Interest Deduction Drives Inequality and the Racial Wealth Gap). White households are more likely to benefit from the MID because they are more likely to own a home, have larger mortgages, and earn higher incomes. This disparity in MID benefits has likely worsened since tax reform.

After tax reform, the MID still remains a costly federal tax expenditure that disproportionately benefits higher-income households who do not need assistance to afford their home. At the same time, nearly eight million extremely low-income renters spend more than half of their incomes on housing (National Low Income Housing Coalition, 2019: *The Gap: A Shortage of Affordable Homes*), forcing them to sacrifice other necessities. The federal revenue lost to the MID would be better spent on housing assistance for these lowest-income households who have the greatest need.