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 $125 billion between 2020 and 2024 in lost federal tax revenue (Joint Committee on Taxation (JCT), 2020). The revenue lost to the MID would be better spent on housing assistance for the lowest-income households with the greatest needs.

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, do not itemize their deductions, because their standard deduction is higher. Affluent households are more likely to itemize their deductions and, therefore, benefit from MID. The Joint Committee on Taxation (JCT) estimated that less than 10% of the nation's 175 million federal tax returns in 2020 would include itemized deductions and that 70% of tax returns with itemized deductions would report annual incomes of more than $100,000.

MID's value to taxpayers depends on their marginal tax rate. Taxpayers in the 37% tax bracket, for example, 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, 76% of tax returns with the MID are from taxpayers with incomes over $100,000 and they receive 90% of MID's benefits (Ibid).

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 difficult to differentiate personal consumption and home loans from business loans for farms, small businesses, and individual proprietors (Ventry, D., 2010). There is no evidence that Congress intended to use the interest deduction to encourage homeownership. One-third of homeowners had a mortgage in 1910, but 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 broadening of the federal income tax to cover more households 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 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 $25.5 billion in 2020 (JCT, 2020), but skewed the MID's benefits even more to affluent taxpayers. JCT estimates that 62% of MID's benefits today go to taxpayers with annual incomes over $200,000, up from 46% before tax reform (JCT, 2017).

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).

The MID also contributes to racial and gender inequities. A study by Trulia found that 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). Black and Hispanic households were 56.9% and 50.9%, respectively, less likely than white households to own a mortgaged home. With fewer mortgages, single women and people of color do not receive MID benefits to the same extent as white households. An analysis by the Institute on Assets and Social Policy (IASP) at Brandeis University and NLIHC found that white households received 71% of MID's benefits even though they account for 66% of households in the United States. Black and Latino households received only 18% of MID's benefits yet they account for 26% of U.S. households.

The MID is a costly federal tax expenditure that disproportionately benefits higher-income households who do not need assistance to afford their homes. 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, 2020), 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.