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 home mortgage debt. The MID is a regressive tax benefit for higher-income homeowners at a projected potential loss of more than $382 billion in federal tax revenue between 2024 and 2028 (The Joint Committee on Taxation (JCT), 2024: https://bit.ly/4iABAIT). Without changes to tax law, the cost of MID in lost federal revenue could increase from roughly $25 billion in 2024 to more than $94 billion in 2026 when provisions of the 2017 federal tax reform package expire. Without reform, the cost of MID will be more than $119 billion per year by 2028. At the same time, eight million extremely low-income renters spend more than half of their incomes on housing (National Low Income Housing Coalition, 2024: https://nlihc.org/gap), forcing them to sacrifice other necessities. The revenue lost to the MID would be better spent on housing assistance for the lowest-income households with the greatest housing needs.

How it Works

Taxpayers can subtract from their federal taxable income either (1) a fixed dollar amount known as the standard deduction or (2) 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. Fewer than 9% of the nation's 189 million federal tax returns include itemized deductions. Further, tax returns with reported annual incomes of more than $100,000 accounted for 33% of all tax returns, but they accounted for 78% of tax returns with itemized deductions and 85% of tax returns with the MID (JCT, 2024: https://bit.ly/4iABAIT).

MID's value to taxpayers depends on their marginal tax rate. Taxpayers in the 24% tax bracket, for example, can reduce their taxes by 24% of the interest paid for their mortgage, while taxpayers in the 12% tax bracket can reduce their taxes by 12% of the interest paid. Because higher-income homeowners are more likely to claim the MID and the value of the MID increases with income, JCT estimates that taxpayers with incomes over $100,000 will receive nearly 95% of MID's benefits in 2024 while taxpayers with incomes over $200,000 will capture 71% of MID's benefits (Ibid: https://bit.ly/4iABAIT).

History

Contrary to popular belief, 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: https://bit.ly/3GoJqb2). Congress likely did not intend 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. Before 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. Without an extension, these provisions will expire in 2026 when the mortgage eligibility for MID returns to $1,000,000 and the standard deduction returns to pre-2017 levels. JCT estimates that the cost of MID to the federal Treasury will increase to $94 billion in 2026 and $119 billion in 2028, as a result (JCT, 2024: https://bit.ly/4iABAIT).

Other Things to Know about 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: https://www.nber.org/papers/w23600).

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: https://www.trulia.com/research/minorities-women-mortgage/). 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 people of color do not receive MID benefits to the same extent as white households. An analysis: https://bit.ly/4iwYAIq by the Institute for Economic and Racial Equity (IERE) 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 more than 26% of U.S. households.