Better Value for Housing Subsidies

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1 The Bottom Line: Home Ownership

Is the tax expenditure of the Mortgage Interest Deduction a good value for the money in terms of promoting home ownership?

2 Background

The Tax Expenditure Budget for the State of Minnesota indicates that there will be approximately $1,039 million of implicit spending during the 2010-2011 biennium for the home mortgage interest deduction. [1] "Tax expenditures," as defined by the Minnesota Department of Revenue, are "... statutory provisions which reduce the amount of revenue that would otherwise be generated [assuming no reduction in general tax rates], including exemptions, deductions, credits, and lower tax rates. These provisions are called "expenditures" because they are similar to direct spending programs." [2]

Ostensibly the home mortgage interest deduction, a tax expenditure, is in place to assist in increasing home ownership rates in the United States.[3]

- Research shows that the home interest deduction **has little or no bearing on home ownership rates.**[4] Home ownership rates in the U.S. are about the same as in Canada, Australia and England, which do not have the deduction.[5]
- According to the National Association of Realtors, only about 27 percent of people nationally take advantage of the mortgage interest deduction.[6] In Minnesota approximately 29 percent of income tax returns included this deduction in 2007.[7] Generally, there is a perception that many will benefit from the mortgage interest deduction. This is shown by information provided by the home builders and realtors professional associations' web sites as well as a home ownership analysis some realtors show clients. In many of these analyses there is a spot that explicitly lists the tax deduction. However, more than 70 percent of people find that they cannot benefit from using this deduction, because they don't itemize (many instead use the standard deduction) or possibly because the homeowner does not have a mortgage but owns the home outright.
- According to the Joint Committee on Taxation, a little over half of the benefit is taken by just 12 percent of taxpayers, those with incomes of $100,000 or more.[8]
- The legislative history is not immediately apparent indicating that the mortgage interest deduction was a deliberate policy set by Congress. Until 1986 all interest was deductible. In the Tax Reform Act of 1986 Congress eliminated the interest deduction on credit cards and consumer loans, but left the mortgage interest deduction.[9]

- Research suggests that without the deduction houses would cost a little less – some estimate 10 to 15 percent.[10] Others estimate the actual increase is less than 5 percent, but either way, in today's economy with home prices already considered depressed, any governmental action that further reduces wealth (i.e., the price or value of a home) could be seen as counter productive.
- The State of Minnesota collected approximately $7,759 million in income tax revenue in 2008. [11]

3 Another Approach to Home Ownership

Eliminating the mortgage interest deduction at the state level would provide additional revenue to the State. Correspondingly, eliminating the state level deduction would likely have no impact on housing purchasing habits since the value of federal government deduction is approximately three to four times that of the state level deduction.

4 Impact: Burdens and Benefits

Burdens

Those who benefit from the Home Mortgage Interest deduction may be concerned about the loss of the tax deduction. In addition, there are concerns that the loss of the deduction will depress housing prices (as noted above).

The state along with individual tax filers would also have some administrative cost in order to convert collection and payment systems to account for the difference between this change and the federal system.

Benefits

Eliminating the mortgage interest deduction at the state level would provide additional revenue to pay for alternative home ownership enhancing programs, such as:

- Foreclosure prevention
- Down payment assistance
- Credit enhancement

These types of programs directly target those in need of assistance and increase housing related policy outcomes. [12]

Depending on the amount of revenue redirected for housing assistance programs, there would likely be additional revenue available to the State. This additional revenue could provide for the overall income tax rates to be reduced for all Minnesotans.

It should be noted that in areas where people own their houses outright (e.g., many agricultural regions), they cannot take advantage of the Mortgage Interest Deduction.

MINNESOTA'S BOTTOM LINE

($ in millions)

FISCAL YEAR	2010	2011	2012	2013
Savings	495.3	543.9	543.9	543.9
Transition Investment	1.0			
NET SAVINGS	494.3	543.9	543.9	543.9

Experience indicates that the number one reason attempted changes fail is that they are undercapitalized. Therefore, for this approach to succeed, a *one-time* investment is suggested to facilitate the transition to a new system. The funds for the investment are taken from the projected savings.

The investments contained in the above tables are not a calculation of actual costs. That calculation is beyond the scope of this project.

Questions for Public Dialogue

1. Should state government be in the business of subsidizing housing?

2. If so, what is the best approach for this purpose – a tax expenditure? a refundable tax credit? some other direct expenditure?

Notes

[1] State of Minnesota Tax Expenditure Budget Fiscal Years 2008-2011. Minnesota Revenue Tax Research Division. February 2008. p. 59

[2] State of Minnesota Tax Expenditure Budget Fiscal Years 2008-2011. Minnesota Revenue Tax Research Division. February 2008. p. 1

[3] Edward L. Glaeser and Jesse M. Shapiro, "The Benefits of Home Mortgage Interest Deduction", Harvard Institute of Economic Research Oct. 2002: Discussion Paper 1979.

[4] Edward L. Glaeser and Jesse M. Shapiro 20.

[5] http://www.nationmaster.com/graph/peo_hom_own-people-home-ownership. Economist, 30 March, 2002. Euromonitor.

[6] www.realtor.org/press_room/public_affairs/tpmortgageinterestdeduction

[7] Tax Expenditure Budget, p. 59; Minnesota Tax Handbook: A profile of State and Local Taxes in Minnesota. Minnesota Revenue Tax Research Division, January 2009. p. 3

[8] United States, Joint Committee on Taxation, Selected Data Related to the Federal Tax System Mar. 2007: 11

[9] United States, President's Advisory Panel on Federal Tax Reform. Final Report: Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System, November 2005: 14.

[10] Roger Brimer, Mark Lasky, and David Wyss, "The Real Estate Market Impacts of a Flat Tax," Data Resources Incorporated, May 1995.

[11] Minnesota Tax Handbook: A profile of State and Local Taxes in Minnesota. Minnesota Revenue Tax Research Division, January 2009. p. 2

[12] Most researchers credit the availability of credit enhancement through Fannie Mae (Federal National Mortgage Association established in 1938) as being the impetus for facilitating the rise in home ownership in the U.S. by making credit available.