THE DISTRIBUTIONAL AND REVENUE CONSEQUENCES OF REFORMING THE MORTGAGE INTEREST DEDUCTION

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The mortgage interest deduction (MID) is costly, and half the benefits accrue to the top 10 percent of taxpayers. This paper analyzes how five modifications to the MID would affect federal individual income tax revenue and the distribution of the tax burden. Under full repeal, federal individual income tax revenue is estimated to increase by up to $1.3 trillion, equal to 0.7 percent of GDP, between 2012 and 2021. Converting the deduction to a 15 percent non-refundable credit could increase federal individual income tax revenue by up to $599 billion, equal to 0.3 percent of GDP, over this period.

Keywords: mortgage interest deduction, tax expenditures, tax reform
JEL Codes: H24, H68, K34

I. INTRODUCTION

The mortgage interest deduction (MID) is perhaps the best known tax benefit for homeowners in the federal individual income tax system.1 Of the 143 million tax returns filed for tax year 2007, 29 percent claimed the MID, and among the 50.5 million returns on which taxpayers itemized their deductions, 82 percent claimed the MID (Internal Revenue Service, 2009). In total, taxpayers claimed $524.8 billion in mortgage interest, or $12,712 per return that claimed the MID. In the Administration’s fiscal year 2012 budget (U.S. Office of Management and Budget, 2011), the tax expenditure for the MID was estimated at $98.6 billion for fiscal year 2012. In contrast, the Administration

1 Unless otherwise noted, the analysis and discussion in this paper refer only to the federal individual income tax.

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requested $41.7 billion for program funding in fiscal year 2012 for the Department of Housing and Urban Development.

In part because of its price tag, the MID has been a frequent but elusive target for elimination or reform. The Congressional Budget Office (1981) analyzed five major tax expenditures related to homeownership, including the MID, and presented policy options in a report to Congress. Nearly 30 years later, the National Commission on Fiscal Responsibility and Reform (2010) proposed to replace the MID with a 12 percent non-refundable tax credit for mortgage interest paid on the first $500,000 of mortgage debt on primary residences only. The Bipartisan Policy Center (2010) proposed to replace the MID with a 15 percent refundable tax credit for the first $25,000 of home mortgage interest expenses on a principal residence.

This paper analyzes five potential modifications to the MID, focusing on how each modification would affect tax revenue and the distribution of the tax burden. We also briefly discuss the administrative requirements and compliance burdens for each of the modifications, as well as how the modifications might affect the housing market more generally.

The remainder of the paper unfolds as follows. Section II presents a basic description of the MID. Section III describes who benefits from the MID. Section IV contains a brief review of the literature regarding the effects of the MID on house prices, homeownership rates, and tax revenue. Section V describes policies that would modify the MID and the data and methods used in the analysis. The estimation results are found in Section VI. Section VII concludes.

II. DESCRIPTION OF THE MORTGAGE INTEREST DEDUCTION

Under a comprehensive income tax, homeowners would pay tax on their imputed rental income but would be allowed to deduct expenses associated with earning such rental income, such as interest on mortgage debt, depreciation, property taxes, casualty insurance, and repair and maintenance costs. In contrast, under the current tax system, homeowners do not pay tax on their imputed rental income but are allowed deductions for certain housing expenses, including mortgage interest. These deviations from a comprehensive income tax system — the non-taxation of imputed rental income and the deductibility of mortgage interest expenses in the absence of taxing imputed rental income — are tax expenditures. As a result of the MID, the costs of homeownership are subsidized, but the benefits (imputed rental income) are not taxed. Symmetric treatment would require either taxing imputed gross rental income and allowing deductions for housing expenses, including mortgage interest, or not taxing imputed gross rental income and disallowing deductions for housing expenses, including mortgage interest.

Taxpayers who itemize their deductions may deduct qualified interest on debt from their primary or secondary residences. Qualifying debt includes both “acquisition debt” and “home equity debt.” Acquisition debt is debt that taxpayers incur when acquiring, constructing, or substantially improving their qualified residences. The aggregate amount treated as acquisition debt cannot exceed $1 million ($500,000 in the case of a married individual filing a separate return). This amount is not indexed for inflation.
Home equity debt refers to any debt (other than acquisition debt) secured by a qualified residence. Home equity debt may not exceed the difference between the fair market value of the qualified residence and the amount of acquisition debt with respect to the primary residence. The aggregate amount treated as home equity debt cannot exceed $100,000 ($50,000 in the case of a married individual filing a separate return). This amount is not indexed for inflation. In calculating taxable income under the Alternative Minimum Tax (AMT), the taxpayer may deduct interest paid on acquisition debt but not interest paid on home equity debt.

III. WHO BENEFITS FROM THE MID?

To see how the benefits of the MID are distributed across taxpayers, we use data from the Statistics of Income (SOI) division of the Internal Revenue Service (IRS). For each taxpayer, including those who do not itemize their deductions, we first construct the taxpayer’s mortgage interest expenses by summing the mortgage interest payments on the taxpayer’s Form(s) 1098 (Mortgage Interest Statement). We then combine this with information on the taxpayer’s Form 1040 (Individual Income Tax Return) and utilize the U.S. Department of the Treasury’s Individual Tax Model (ITM) to calculate the tax value of the MID for each taxpayer, which we define as the increase in the taxpayer’s final tax liability when the MID is repealed. The tax value of the MID is computed assuming no behavioral response on the part of the taxpayer, i.e., it is a tax expenditure estimate at the taxpayer level.

High-income taxpayers are more likely to claim the MID, deduct larger amounts of mortgage interest expenses, and receive larger tax benefits from the MID than lower-income taxpayers. In Figure 1, all taxpayers in 2007 age 18 or older with positive adjusted gross income (AGI) are first grouped into $5,000-wide AGI bins. Then, for each group, the proportion of taxpayers that had mortgage interest expenses, the proportion of taxpayers that claimed the MID, the (unconditional) mean value of mortgage interest expenses, and the (unconditional) mean tax value of the MID are plotted. For reference, 36.4 percent of taxpayers in the sample had mortgage interest expenses, 29.4 percent

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2 We use the word ‘taxpayer’ instead of ‘tax unit’ for stylistic reasons. The underlying data refer to tax units.
3 For more information on the data and the ITM, see Section V.
4 Taxpayers are still assumed to minimize their tax liabilities. For example, if a taxpayer who itemizes his deductions and claims the MID would realize a lower tax liability were the MID repealed by switching to the standard deduction, the taxpayer is assumed to do so.
5 Non-filers are excluded from this sample. Further, unless otherwise noted, in instances where we restrict the sample based on the age of a taxpayer, we base the restriction on the age of the primary filer on the tax return.
6 Because unconditional means are reported, filers who do not have mortgage interest expenses or who do not claim the MID are used in the calculations of the mean values of mortgage interest expenses and the tax value of the MID. The underlying results that mortgage interest expenses and the tax value of the MID increase with AGI do not change if the means were calculated using only taxpayers who have mortgage interest or only taxpayers who claim the MID. Note also that the number of taxpayers within an income bin is smaller at higher levels of AGI.
claimed the MID, and the average value of mortgage interest expenses and the average tax value of the MID for taxpayers in the sample were $3,771 and $659, respectively. The proportion of taxpayers that had mortgage interest expenses and the proportion of taxpayers that claimed the MID increase steeply over the first $100,000 of AGI and then remain flat at around 80 percent for higher income taxpayers.  

If, instead, the share with mortgage interest expenses, the share claiming the MID, the average value of mortgage interest expenses, and the average tax value of the MID are plotted by the age of the primary taxpayer, life-cycle effects become evident. All four series exhibit hump-shaped patterns, with mortgage interest expenses and the share claiming the MID peaking in middle-age.
two lines shows that the proportion of taxpayers that claimed the MID conditional on having mortgage interest expenses is 71 percent in the $30,000 to $35,000 AGI group and converges to nearly 100 percent for groups with larger amounts of AGI.

The mean value of mortgage interest expenses and the mean tax value of the MID rise more slowly with AGI. For taxpayers at the median of the AGI distribution — roughly $32,000 — 27 percent had mortgage interest expenses, 19 percent claimed the MID, and the average value of mortgage interest expenses and the tax value of the MID were roughly $2,000 and $130, respectively. At the 90th percentile of the AGI distribution — roughly $110,000 — 77 percent of taxpayers had mortgage interest expenses, 73 percent claimed the MID, and the average value of mortgage interest expenses and the tax value of the MID were $9,500, and $2,100, respectively.

The average value of the MID increases with income, in part, because mortgage interest expenses increase with income. In addition, because high-income taxpayers face a higher statutory marginal tax rate than lower-income taxpayers, a dollar of mortgage interest expense has a greater tax value for high-income taxpayers.

The mean tax value of the MID for an AGI group can mask considerable variation of the benefits of the MID within that group — variation that can stem from differences in filing status, the price of housing in different areas of the country, and tenure within a house. Figure 2 plots the mean tax value of the MID within the AGI groups from Figure 1 and also plots for each group the 25th percentile, the median, and the 75th percentile of the tax value of the MID.

Even within the $5,000-wide bins, the tax value of the MID is right-skewed. The mean value of the MID is greater than the median value in each AGI group, and the inter-quartile range increases as one moves up the AGI distribution. Both results stem from the fact that a large share of taxpayers in the lower AGI groups do not claim the MID. At the higher end of the AGI distribution, where nearly 80 percent of taxpayers claim the MID, mortgage interest expenses are also right-skewed.8

To see more starkly how the tax benefits of the MID accrue to high-income taxpayers, Figure 3 plots for 2007 the cumulative shares of mortgage interest expenses and the tax value of the MID by the AGI percentiles of tax returns.9 The 45-degree line shows what a uniform distribution of mortgage interest expenses and benefits from the MID would look like. The grey curve lies to the right of the 45-degree line, showing that higher income taxpayers have a disproportionately large share of mortgage interest expenses. The top 17 percent of taxpayers — those with AGI of approximately $84,000 or more — incurred roughly half of all mortgage interest expenses in 2007, while the bottom 50 percent incurred roughly 12 percent of all mortgage interest expenses in 2007.

8 The interquartile range of mortgage interest expenses exhibits a similar pattern to that of the tax value of the MID.
9 Non-filers are excluded from this sample.
Were the tax benefits of the MID directly proportional to mortgage interest expenses, the curve plotting these benefits would lie atop the curve for mortgage interest expenses. In reality, high-income taxpayers’ share of the benefits of the MID exceeds their share of mortgage interest expenses. The progressivity of the tax system and the fact that many lower-income taxpayers who have modest amounts of mortgage interest expenses do not itemize their deductions account for the concentration of benefits of the MID among high-income taxpayers.

In 2007, taxpayers in the top 10 percent of the AGI distribution incurred roughly 35 percent of mortgage interest expenses but received roughly 56 percent of the total value of the MID. Taxpayers in the top 5 percent of the AGI distribution — those with AGI of approximately $152,000 or more — incurred roughly 21 percent of mortgage interest expenses but received roughly 37 percent of the value of the MID. The concentration
of the income tax benefits of the MID among high-income taxpayers is not surprising given the concentration of income and the income tax burden among these taxpayers. In 2007, taxpayers in the top 10 percent and 5 percent of the AGI distribution accounted for 48 percent and 37 percent of all AGI, respectively, and 70 percent and 59 percent of all federal individual income tax receipts, respectively.

Table 1 shows more generally which groups of taxpayers in 2007 benefited from the MID. Column (1) provides coefficient estimates for a linear probability model for whether a taxpayer claimed the MID. Columns (2) and (4) show coefficient estimates for a model of the dollar value of mortgage interest expenses incurred by a taxpayer and for a model of the tax value of the MID, respectively. Columns (3) and (5) replicate
### Table 1
Taxpayer Characteristics Influencing Take-up of the MID, the Value of Mortgage Interest Expenses, and the Value of the MID, 2007

<table>
<thead>
<tr>
<th>Dependent Variable</th>
<th>Claim MID</th>
<th>Mortgage Interest Expenses ($)</th>
<th>Value of MID ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
</tr>
<tr>
<td>Constant</td>
<td>–0.52**</td>
<td>–5,934.40*</td>
<td>7,343.58**</td>
</tr>
<tr>
<td></td>
<td>(0.03)</td>
<td>(1,260.15)</td>
<td>(647.93)</td>
</tr>
<tr>
<td>Age</td>
<td>0.03**</td>
<td>365.92**</td>
<td>137.35**</td>
</tr>
<tr>
<td></td>
<td>(0.00)</td>
<td>(49.28)</td>
<td>(23.85)</td>
</tr>
<tr>
<td>Age squared</td>
<td>–0.00**</td>
<td>–3.64**</td>
<td>–2.13**</td>
</tr>
<tr>
<td></td>
<td>(0.00)</td>
<td>(0.46)</td>
<td>(0.29)</td>
</tr>
<tr>
<td>Tax filing status</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Married filing</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>jointly</td>
<td>0.16**</td>
<td>3,022.52**</td>
<td>2,857.18**</td>
</tr>
<tr>
<td></td>
<td>(0.02)</td>
<td>(427.07)</td>
<td>(297.31)</td>
</tr>
<tr>
<td>Married filing</td>
<td>0.04*</td>
<td>248.14</td>
<td>498.43</td>
</tr>
<tr>
<td>separately</td>
<td>(0.01)</td>
<td>(178.56)</td>
<td>(653.97)</td>
</tr>
<tr>
<td>Head of household</td>
<td>–0.13**</td>
<td>–1,920.99*</td>
<td>125.48</td>
</tr>
<tr>
<td></td>
<td>(0.01)</td>
<td>(201.59)</td>
<td>(182.00)</td>
</tr>
<tr>
<td>Number of dependent children</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>One</td>
<td>0.03**</td>
<td>515.73**</td>
<td>56.55</td>
</tr>
<tr>
<td></td>
<td>(0.01)</td>
<td>(77.26)</td>
<td>(274.13)</td>
</tr>
<tr>
<td>Two</td>
<td>0.11**</td>
<td>1,641.43**</td>
<td>–25.24</td>
</tr>
<tr>
<td></td>
<td>(0.01)</td>
<td>(161.92)</td>
<td>(351.23)</td>
</tr>
<tr>
<td>Three</td>
<td>0.15**</td>
<td>2,710.74**</td>
<td>736.00</td>
</tr>
<tr>
<td></td>
<td>(0.01)</td>
<td>(204.25)</td>
<td>(476.94)</td>
</tr>
<tr>
<td>Four or more</td>
<td>0.13**</td>
<td>2,486.65**</td>
<td>176.09</td>
</tr>
<tr>
<td></td>
<td>(0.03)</td>
<td>(471.27)</td>
<td>(756.61)</td>
</tr>
<tr>
<td>Census division of residence</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Middle Atlantic</td>
<td>–0.05**</td>
<td>–714.46**</td>
<td>–454.30**</td>
</tr>
<tr>
<td></td>
<td>(0.00)</td>
<td>(12.56)</td>
<td>(11.30)</td>
</tr>
<tr>
<td>South Atlantic</td>
<td>–0.02**</td>
<td>–2.50</td>
<td>736.81**</td>
</tr>
<tr>
<td></td>
<td>(0.00)</td>
<td>(12.13)</td>
<td>(11.92)</td>
</tr>
<tr>
<td>Dependent Variable</td>
<td>Claim MID (1)</td>
<td>Mortgage Interest Expenses ($) (2)</td>
<td>Value of MID ($) (3)</td>
</tr>
<tr>
<td>-------------------</td>
<td>---------------</td>
<td>-------------------------------------</td>
<td>----------------------</td>
</tr>
<tr>
<td>East South Central</td>
<td>–0.09**</td>
<td>–1,616.80**</td>
<td>–2,680.00**</td>
</tr>
<tr>
<td></td>
<td>(0.00)</td>
<td>(22.30)</td>
<td>(26.98)</td>
</tr>
<tr>
<td>West South Central</td>
<td>–0.12**</td>
<td>–1,954.81**</td>
<td>–2,953.48**</td>
</tr>
<tr>
<td></td>
<td>(0.00)</td>
<td>(17.66)</td>
<td>(29.09)</td>
</tr>
<tr>
<td>East North Central</td>
<td>–0.03**</td>
<td>–986.48**</td>
<td>–2,193.57**</td>
</tr>
<tr>
<td></td>
<td>(0.00)</td>
<td>(11.89)</td>
<td>(29.40)</td>
</tr>
<tr>
<td>West North Central</td>
<td>–0.05**</td>
<td>–1,258.43**</td>
<td>–2,546.12**</td>
</tr>
<tr>
<td></td>
<td>(0.00)</td>
<td>(15.61)</td>
<td>(31.34)</td>
</tr>
<tr>
<td>Mountain</td>
<td>–0.01**</td>
<td>184.92**</td>
<td>1,060.99**</td>
</tr>
<tr>
<td></td>
<td>(0.00)</td>
<td>(13.17)</td>
<td>(20.77)</td>
</tr>
<tr>
<td>Pacific</td>
<td>–0.02**</td>
<td>1,564.57**</td>
<td>5,987.21**</td>
</tr>
<tr>
<td></td>
<td>(0.00)</td>
<td>(11.54)</td>
<td>(15.82)</td>
</tr>
<tr>
<td>(R^2)</td>
<td>0.214</td>
<td>0.176</td>
<td>0.128</td>
</tr>
<tr>
<td>Observations</td>
<td>304,968</td>
<td>304,968</td>
<td>137,479</td>
</tr>
<tr>
<td>Mean of dependent</td>
<td>0.294</td>
<td>3.771</td>
<td>12,085</td>
</tr>
</tbody>
</table>

Notes: Estimation was done using ordinary least squares. For columns (1), (2), and (4), the sample includes taxpayers age 18 and above with positive AGI. Non-filers and qualifying widows are excluded from the sample. For columns (3) and (5), the sample is restricted further to taxpayers who claim the MID. The average age of taxpayers in the sample is 44.3 but rises to 48.1 in the restricted sample. The regressions include a cubic spline function of income with five knots and dummy variables for the number of dependents claimed on the tax return. The observations are weighted to reflect the total filing population. Robust standard errors, in parentheses, are clustered at the Census Division of Residence level. Asterisks denote significance at the 1 percent (**) and 5 percent (*) levels.

Source: Authors’ calculations based on data from the SOI Division of the IRS.
columns (2) and (4), respectively, restricting the sample to taxpayers who claimed the MID. 10

Unsurprisingly, other things equal, married taxpayers and taxpayers with dependent children are more likely to claim the MID than single taxpayers with no dependent children. All else equal, taxpayers who live in the Northeast Census Division are more likely to claim the MID than are taxpayers who live elsewhere, as shown by the coefficients on the Census Division dummy variables. Repealing the MID is likely to have the biggest effects on high-income taxpayers and taxpayers who are married, have children, and live in expensive housing markets.

All else equal, married taxpayers filing joint returns claimed about $3,000 more in mortgage interest expenses, on average, than did single filers, and the tax value of the MID was, on average, $460 more for joint filers than for single filers. Filers with dependent children, on average, incurred more mortgage interest expenses and received more tax benefits from the MID than did filers without dependent children, all else equal. Reflecting differences in income, homeownership rates, and home prices across regions, taxpayers in the Mountain and Pacific Census Divisions claimed more in mortgage interest expenses than those in the Northeast, and only those in the Pacific Census Division received a greater tax benefit from the MID than those in the Northeast, on average.

When the sample is restricted to taxpayers claiming the MID, the average amount of mortgage interest expenses rises to $12,085, and the average tax value of the MID increases to $2,238, indicating how skewed mortgage interest expenses are across taxpayers. The qualitative results regarding how mortgage interest expenses and the tax value of the MID vary by filing status and across Census Divisions persist in the restricted sample. However, for this sample, heads of households no longer have less mortgage interest expenses, on average, than single filers. Among taxpayers who claimed the MID, mortgage interest expenses for households with dependent children are not statistically significantly greater than they are for childless households, and the tax value of the MID for households with one child is no longer statistically significantly greater than it is for childless households.

IV. LITERATURE REVIEW: THE EFFECTS OF THE MID

Supporters of the MID argue that the subsidy increases homeownership rates. However, analyses by Glaeser and Shapiro (2003) and Gale, Gruber, and Stephens-Davidowitz (2007) suggest that the MID does not substantively increase homeownership rates. Further, Hilber and Turner (2010) find that, for each renter household that is converted

10 For each regression in the table, sampling weights are used. All regressions include a cubic spline of income with five knots and dummy variables for the number of dependents claimed on the tax return. The omitted category for the dummy variables is single taxpayers in the Northeast Census Division with no dependent children. The standard errors are clustered at the Census Division of Residence level.
to a homeowner household through the MID, the federal government annually forgoes roughly $54,000 in individual income tax revenue.\(^{11}\)

There are several reasons why the MID is unlikely to bolster homeownership. As shown in Figures 1 and 3 and discussed in Sullivan (2011), the tax benefits of the MID largely accrue to high-income taxpayers. These high-income taxpayers are likely to be homeowners even in the absence of the MID. Further, the MID is unlikely to increase homeownership because the MID may lead to increases in house prices, and higher home prices are negatively associated with homeownership rates.\(^ {12}\) The MID lowers the user cost of capital for housing, which will translate into higher home prices in areas where housing supply is relatively inelastic. Poterba and Sinai (2011) find that removing the MID would increase the user cost of housing by 3 to 5 percent, and Andersen, Clemens, and Hanson (2007) show that capping the MID would substantively increase the user cost of housing for homeowners above the cap. Hilber and Turner (2010) find that the MID has a negative effect on homeownership in larger coastal cities where the housing supply is relatively inelastic. Capozza, Green, and Henderschott (1996) estimate that eliminating the MID and the property tax deduction would reduce home prices between 2 to 13 percent.

Capitalization of the MID into home prices will discourage homeownership by down payment constrained taxpayers. Bourassa and Yin (2008) find that home price capitalization of the MID disproportionately deters younger potential homeowners, a group that is likely to be down payment constrained simply as a result of life cycle effects.

Replacing the MID with a non-trivial tax credit for mortgage interest expenses may bolster homeownership rates relative to the MID, other things equal. Lower-income taxpayers who are on the margin of homeownership are more likely to benefit from a tax credit on mortgage interest than from the MID since they need not itemize their deductions to claim a tax credit. Gale, Gruber, and Stephens-Davidowitz (2007) and Reschovsky and Green (1999) suggest that replacing the MID with a tax credit would increase homeownership rates.

Changes to the MID will also affect tax revenue. Reducing the value of the MID reduces the extent to which debt financing of homeownership is tax-preferred relative to equity financing. If faced with a lower subsidy on mortgage debt, households will reallocate their assets in order to decrease the value of their outstanding mortgage bal-

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\(^ {11}\) The authors estimate that the MID increases the number of homeowner households by a net 1.7 percent from a base of 115 million households in 2010. To derive their per-household result, they divide the tax expenditure estimate of $104.5 billion for 2011 from the U.S. Office of Management and Budget (2011) by the estimated 1.95 million converted homeowner households.

\(^ {12}\) Using data on homeownership rates and the median value of owner-occupied housing across states for the 2005–2009 period from the U.S. Census Bureau, a univariate regression shows that a $100,000 increase in the median value of owner-occupied housing across these states during this period (roughly equal to a one standard deviation increase) is associated with, on average, a 3.8 percentage point decrease in the homeownership rate.
This type of behavior could reduce tax revenues by as much as 20 to 40 percent relative to keeping financial portfolios constant in response to the removal of the MID (Poterba and Sinai, 2011; Hendershott and Pryce, 2005; and Gale, Gruber, and Stephens-Davidowitz, 2007). This offsetting revenue effect should be lower if the MID is capped, or replaced by a tax credit, because debt financing will remain tax-preferred.

V. METHODOLOGY FOR EVALUATING MODIFICATIONS TO THE MORTGAGE INTEREST DEDUCTION

We examine five modifications to the MID, beginning with the limiting case of repealing the MID without replacement. This produces an upper bound estimate of the tax revenue available from modifying the MID. The remaining four modifications limit the value of the tax subsidy for homeownership.

The second modification reduces the limit on acquisition debt from $1 million to $500,000. The third modification restricts to 28 percent the value of the MID taken by high-income taxpayers. Under this modification, taxpayers may still deduct mortgage interest if they itemize their deductions. For taxpayers whose marginal tax rate is greater than 28 percent, the (marginal) value of the deduction would be calculated at 28 percent, rather than at their marginal rate. The fourth modification limits the MID to primary residences only. The final modification replaces the MID with a 15 percent tax credit on the first $25,000 of mortgage interest from primary residences only. We examine a refundable and a non-refundable credit.

We use the ITM to analyze these modifications. The ITM, developed and maintained by the Department of the Treasury’s Office of Tax Analysis, is a micro-simulation model of the United States’ individual income tax system that uses a detailed tax calculator, a sample of individual tax returns, and a representative sample of non-filer returns to simulate tax liabilities under different tax policy options. A detailed description of the model can be found in Cilke and Wyscarver (1987) and in Cilke (1994).

Programming the ITM to analyze the modifications is relatively straightforward in all but two cases: reducing the limit on acquisition debt from $1 million to $500,000 and limiting the MID to primary residences. The difficulties stem from the limited information currently provided on Form 1098. Basic information about the taxpayer’s mortgage, such as the address of the property associated with the mortgage, the initial or outstanding mortgage balance, the origination date of the mortgage, the interest rate, and whether the interest payment is on acquisition debt or on home equity debt, is not listed on Form 1098. It is impossible to determine with a high degree of confidence

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13 This is similar in spirit to the Administration’s fiscal year 2012 budget proposal to limit the tax rate at which high-income taxpayers can take itemized deductions to a maximum of 28 percent (U.S. Office of Management and Budget, 2011; U.S. Department of the Treasury, 2011).

14 Non-filer returns are constructed using information returns, e.g., Forms W-2 (Wage and Tax Statement) and Forms 1099, of non-filers who would have been included in the individual tax file had they filed a return, as well as imputations from the Current Population Survey.
the level of acquisition debt or home equity debt based only on the amount of interest paid, which is what is listed on Form 1098. To impose the restriction from $1 million to $500,000 in acquisition debt, we limit the amount of mortgage interest expenses a taxpayer may claim to $25,000 per year. This corresponds roughly to the interest paid in the first year of a 30-year fixed rate mortgage of $500,000 with an annual interest rate of 5 percent.

Identifying taxpayers claiming the MID for interest expenses paid on a secondary residence is made difficult because taxpayers report on Schedule A (Itemized Deductions) the total value of mortgage interest paid. Taxpayers are not required to itemize the interest paid on each property, nor does Form 1098 report the address of the property for which mortgage interest expenses are claimed. It is therefore impossible to distinguish between a taxpayer who receives multiple Forms 1098 for multiple properties versus a taxpayer who receives multiple Forms 1098 for a single property.

To identify taxpayers who are likely claiming the MID for both primary and secondary residences, we combined information from a taxpayer’s Form(s) 1098 with information on the taxpayer’s Form 1040. Data from the American Housing Survey indicate that, in 2007, among the 50.8 million occupied units with a mortgage, 88 percent had two or fewer mortgages (U.S. Census Bureau, 2008). Therefore, to operationalize the restriction to primary residences, we assume that taxpayers who receive more than two Forms 1098 own a secondary residence and that the IRS can observe this fact. We further assume taxpayers who report rental income have rental properties rather than second residences.

All of the estimates take as given the Administration’s macroeconomic forecast from the fiscal year 2012 budget. The revenue estimates presented are “micro-dynamic,” meaning that the estimates do not take into account potential effects the modifications to the MID would have on macroeconomic variables such as GDP or interest rates. The revenue effects are estimated against a “current law” baseline, modified by patching the AMT.

15 The estimates that cap the amount of mortgage interest that may be claimed and the estimates that limit the subsidy to primary residences only assume that the IRS has perfect knowledge of the amount of mortgage debt a taxpayer has and the property to which it is related. However, the IRS does not have perfect information under current rules.
16 This approach flags roughly 13 percent of taxpayers in the 2007 IRS data claiming the MID as owning a secondary residence. When the sampling weights are applied, this corresponds to 5.12 million second residences for which taxpayers claim the MID. By comparison, estimates from the U.S. Census Bureau’s Housing Vacancy Survey indicate that in 2007 the total number of second homes — assumed to be the sum of “seasonal vacant,” “temporarily occupied by persons with usual residence elsewhere,” and “for occasional use” — was roughly 7.6 million. Based on our estimate, this implies that roughly 67 percent of second residences are included on the MID.
17 The Administration’s fiscal year 2012 forecast is found in U.S. Office of Management and Budget (2011).
18 Under current law, marginal tax rates are scheduled to rise mechanically beginning in 2013. These tax rate increases are assumed in our baseline. In addition, under current law, the AMT is “patched” only through 2011, i.e., the exemption amounts have been increased to prevent a large number of taxpayers from being subject to the AMT. We assume the parameters of the AMT continue to be indexed to inflation beyond 2011.
To simplify the analysis, we assume homeownership and labor supply are unchanged, and we do not model the impact of changes to the MID on home prices. That is, we are conducting a partial equilibrium analysis. However, we do analyze the modifications under two extreme sets of behavioral assumptions. First, we assume that taxpayers do not alter their financial portfolios in response to changes in the tax treatment of housing debt. For the modifications that limit the subsidy to primary residences, we limit the amount of mortgage interest expenses that may be claimed to the amount on the Form 1098 that has the largest mortgage expense so that homeowners with second properties lose the full value of the MID on second residences. This approach produces an estimate of the upper bound of the revenue effect, which is similar in spirit to estimating the modification’s tax expenditure.

For the second set of estimates, taxpayers alter their financial portfolio in response to the tax changes and shift equity across residences. In these calculations, we assume that taxpayers pay down their mortgage debt by drawing down their financial assets, because reducing the value of the MID reduces the benefit of debt financing over equity financing. As a result, the Federal income tax base has the potential to shrink because taxpayers will be selling income-generating assets. This can offset federal income tax revenue increase brought about by the modifications to the MID. Poterba and Sinai (2011), Gale, Gruber, and Stephens-Davidowitz (2007), Hendershott and Pryce (2005), Gervais and Pandey (2005), and Follain and Dunsky (1997) examine this type of behavior in the context of modifying the MID. Gervais and Pandey (2005) estimate that eliminating the MID will lead taxpayers to lower their loan-to-value ratio by 25 percent.

To model portfolio reallocation behavior, we follow the approach used by Gale, Gruber, and Stephens-Davidowitz (2007). We assume taxpayers reduce their financial asset income — defined as the sum of interest income, dividends, and positive capital gains realizations — by the value of the MID or, if the value of the MID exceeds the value of asset income, completely. We assume that taxpayers draw down assets in the following order: assets that pay tax-exempt interest, assets that bear taxable income, dividends, and, lastly, capital gains.

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19 If the taxpayer draws down assets in a savings or money market account, the tax base will shrink. However, if the taxpayer sells an interest-bearing asset, his interest income falls, but the interest income of the purchaser of the asset rises. Depending on the differences in the taxpayers’ marginal tax rates, tax revenue could be reduced, could stay the same, or could increase. We do not model who purchases the assets that are sold as a result of modifications to the MID. We therefore are estimating the maximum revenue offset from this portfolio reallocation behavior and the lower bound of the revenue effect of the modifications to the MID.

20 Implicit in this approach is an assumption that the implied interest rate on financial assets is equal to the interest rate on mortgage balances, so that a one dollar reduction in financial income will lower mortgage interest payments by $1.

21 Following both Poterba and Sinai (2011) and Gale, Gruber, and Stephens-Davidowitz (2007), we abstract from increases in capital gains tax liability that will result from taxpayers who sell their assets to retire mortgage debt.
To model the portfolio adjustment for modifications that limit — but do not fully repeal — the MID, the reduction in the taxpayer’s financial income determined under the full repeal of the MID is multiplied by the ratio of the tax value of the modification under consideration to the value of the MID. This method results in a proportional reduction in financial income and allows for a large behavioral response to modifications of the MID. For example, when limiting the MID to $25,000 of interest, taxpayers are allowed to pay down their principal balance below the $25,000 cap.

Under the modifications that limit the subsidy to primary residences, taxpayers who own multiple residences are likely to shift housing debt across primary and secondary residences to maximize their subsidy. For example, taxpayers may claim the property with the largest interest expense as the primary residence or leverage the equity in their primary residence to pay off the mortgage on a secondary residence. To estimate the lower bound of government revenue that may be collected, we assume that taxpayers will fully shift equity across properties in order to maximize their housing subsidy.

VI. EMPIRICAL RESULTS

Table 2 shows the estimated revenue effects over the 2012–2021 period from each of the modifications. The figures in roman type incorporate portfolio reallocation behavior and equity shifting behavior across properties. The figures in italic type do not incorporate either of these behaviors.

Under the baseline tax system where the MID is unaltered, federal individual income tax revenue is forecast to be $18.7 trillion, or 9.15 percent of GDP over the 2012–2021 period. If the MID were fully repealed, federal individual income tax revenue is estimated to be 9.71 percent of GDP over this period, an increase of $1.1 trillion or 6.1 percent over the baseline forecast. Absent portfolio reallocation behavior, full repeal of the MID is estimated to raise $1.3 trillion more than the baseline tax system over the period. The portfolio reallocation behavior thus reduces the estimated revenue effect of repealing the MID by 15 percent, which is similar in magnitude to what other authors have estimated. For example, studying the impact of MID repeal in a single year, Poterba and Sinai (2011) estimate that portfolio reallocation would offset the increase in tax revenue from repealing the MID by roughly 20 percent. Gale, Gruber, and Stephens-Davidowitz (2007) estimate that taxpayer behavior would offset the tax revenue increase by roughly 16 percent relative to the case without such behavior.

When the MID is replaced with the other modifications, the tax system is estimated to yield individual income tax revenue between 9.15 and 9.39 percent of GDP over the period. Because of the current law baseline assumption, the baseline tax system and the tax system including any of the modifications are estimated to raise substantially more revenue beginning in 2013. Increases in the marginal income tax rates are scheduled to occur in 2013. These increases in marginal tax rates are forecast to raise tax receipts and will mechanically increase the tax value of the MID. In 2021, under full repeal and including portfolio reallocation and equity shifting behavior across properties, federal
individual income tax revenue is estimated to be 10.62 percent of GDP, compared to 9.99 percent under the baseline tax system.

Limiting the MID to the first $25,000 of interest expenses is estimated to raise $164 billion more than the baseline tax system over the period. This modification raises substantially less than does full repeal of the MID because few taxpayers have mortgage interest expenses exceeding $25,000. \footnote{In 2007, only 2.6 percent of tax returns claimed mortgage interest expenses in excess of $25,000.}

Limiting the MID to the 28 percent rate is estimated to increase federal individual income tax revenue by $3.3 billion, less than 0.1 percent, over the baseline tax system during the period. This modification raises a smaller amount of tax revenue relative to full repeal for three reasons. First, taxpayers whose marginal rate is below 28 percent are unaffected by this modification, and there are many such taxpayers. \footnote{In 2007, roughly 6 percent of tax returns were in the 28 percent bracket or a higher tax bracket.} Second, even

\begin{table}[h]
\centering
\caption{Federal Income Tax Response to Modifi cations of the MID, 2012–20}  
\begin{tabular}{lccc}
\hline
\textbf{Change in Tax Revenue} & \textbf{$\text{Million}$} & \textbf{Percent} & \textbf{Share of GDP} \\
\hline
Repeal MID & 1,142,024 & 6.1 & 0.6 \\
& 1,338,857 & 7.1 & 0.7 \\
Limit MID to $25,000 of interest expenses & 164,072 & 0.9 & 0.1 \\
& 200,614 & 1.1 & 0.1 \\
Limit MID to 28 percent & 3,253 & <0.1 & <0.1 \\
& 90,651 & 0.5 & <0.1 \\
Limit MID to primary residences & 0 & 0 & 0 \\
& 104,060 & 0.6 & 0.1 \\
Non-refundable 15 percent credit & 482,654 & 2.6 & 0.2 \\
& 598,551 & 3.2 & 0.3 \\
Refundable 15 percent credit & 391,352 & 2.1 & 0.2 \\
& 508,431 & 2.7 & 0.2 \\
\hline
\end{tabular}
\end{table}

Notes: Over this period, federal individual income tax receipts and GDP are forecast to be $18.7 trillion and $204.7 trillion, respectively. The tax credits are limited to the first $25,000 of mortgage interest expenses on primary residences only. Figures in roman type incorporate portfolio reallocation behavior and full shifting of equity across properties in order to maximize the benefits of the mortgage subsidy. Figures in italic type do not incorporate either of these behaviors. Non-filers are included in this sample. Source: Authors’ calculations based on data from the SOI Division of the IRS.
taxpayers who have marginal rates greater than 28 percent retain a large share of the value of their MID. Third, financial income — and therefore the ability to pay down mortgage debt — is concentrated among high-income taxpayers who would be subject to the limitation. Absent portfolio reallocation behavior, this modification is estimated to raise $90.7 billion more than the baseline tax system over the period.

If taxpayers are able to shift equity across principal and secondary residences fully, there will be, by definition, no increase in federal tax revenue, relative to the baseline tax system, from limiting the MID to primary residences. However, if taxpayers are not able to do this and if taxpayers do not reallocate their financial portfolio, limiting the MID to primary residences is estimated to raise $104 billion more than the baseline tax system over the period.

Converting the MID to a 15 percent, non-refundable credit for the first $25,000 of mortgage interest expenses from primary residences only is estimated to raise $483 billion (2.6 percent) more than the baseline tax system over the period. Converting the MID to a refundable credit is estimated to raise $391 billion (2.1 percent) more than the baseline tax system over the period. Thus, the cost of making the credit refundable is approximately $92 billion over this period.

Unlike the MID, the tax credits for mortgage interest expenses allow non-itemizing taxpayers who pay mortgage interest to benefit from the subsidy. In the case of the non-refundable credit, it is estimated that 8.3 million tax returns that do not itemize in the presence of the MID but have mortgage interest expenses will have a lower tax liability. Their average tax reduction is estimated to be $484 in 2021. Among these returns, 58 percent have AGI of $75,000 or less.

Replacing the MID with a tax credit would cause many taxpayers to claim the standard deduction instead of itemizing their deductions. In the case of the non-refundable credit, it is estimated that 18.4 million tax returns will switch to the standard deduction in 2021. Tax liability for these filers is estimated to increase by around $420, on average. However, not all returns switching to the standard deduction experience an increase in tax liability. Roughly 8 million returns that switch to the standard deduction are forecast to have a tax decrease, averaging about $500.

Table 3 shows the dollar change in federal tax revenue, in nominal dollars, across the AGI distribution in 2021 for each of the modifications. For most modifications, the majority of the estimated increased tax revenue comes from taxpayers with AGIs between $100,000 to $500,000. Under full repeal, taxpayers with AGIs between $100,000 to $200,000 and between $200,000 to $500,000 are estimated to account for 39 and 31 percent of the total additional revenue raised, respectively, although they account for only 15 and 6 percent of all tax returns with positive AGI, respectively.

Repeal of the MID is estimated to increase taxes by 9 percent and 0.5 percent for taxpayers with AGIs between $50,000 to $75,000 and taxpayers with AGIs of more than $1 million, respectively. In contrast, the non-refundable credit provides tax relief for lower-income returns and relatively smaller increases for middle-income returns, compared to full repeal. Under this credit, taxpayers with AGIs less than $75,000 are forecast to have a reduced tax liability, taxpayers with AGIs between $75,000 to
Table 3
Change in Federal Individual Income Tax Liability ($Million) Under MID Modifications, by AGI Group, 2021

<table>
<thead>
<tr>
<th>Adjusted Gross Income ($Thousand)</th>
<th>Number of Returns (Thousand)</th>
<th>Baseline Tax Receipts</th>
<th>Limit MID to $25,000 of Interest Expenses</th>
<th>Limit MID to 28 Percent</th>
<th>Limit MID to Primary Residences</th>
<th>Non-refundable 15 Percent Credit</th>
<th>Refundable 15 Percent Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Zero or negative</td>
<td>1,450</td>
<td>–37</td>
<td>7</td>
<td>4</td>
<td>0</td>
<td>0</td>
<td>–4</td>
</tr>
<tr>
<td>0–50</td>
<td>101,700</td>
<td>34,930</td>
<td>4,556</td>
<td>57</td>
<td>0</td>
<td>0</td>
<td>–2,326</td>
</tr>
<tr>
<td>50–75</td>
<td>24,757</td>
<td>136,457</td>
<td>12,177</td>
<td>548</td>
<td>0</td>
<td>0</td>
<td>–670</td>
</tr>
<tr>
<td>75–100</td>
<td>16,142</td>
<td>151,755</td>
<td>15,446</td>
<td>1,029</td>
<td>0</td>
<td>0</td>
<td>2,368</td>
</tr>
<tr>
<td>100–200</td>
<td>27,359</td>
<td>528,540</td>
<td>61,281</td>
<td>6,948</td>
<td>7</td>
<td>0</td>
<td>28,821</td>
</tr>
<tr>
<td>200–500</td>
<td>10,614</td>
<td>599,182</td>
<td>48,679</td>
<td>13,073</td>
<td>29</td>
<td>0</td>
<td>33,171</td>
</tr>
<tr>
<td>500–1,000</td>
<td>1,658</td>
<td>302,887</td>
<td>11,740</td>
<td>5,591</td>
<td>107</td>
<td>0</td>
<td>9,764</td>
</tr>
<tr>
<td>&gt; 1,000</td>
<td>707</td>
<td>733,165</td>
<td>3,786</td>
<td>2,175</td>
<td>204</td>
<td>0</td>
<td>3,520</td>
</tr>
<tr>
<td>Total</td>
<td>184,386</td>
<td>2,486,900</td>
<td>157,672</td>
<td>29,425</td>
<td>347</td>
<td>0</td>
<td>74,644</td>
</tr>
</tbody>
</table>

Notes: All dollar values are in nominal (2021) dollars. The tax credits are limited to the first $25,000 of mortgage interest expenses on primary residences only. The figures incorporate portfolio reallocation behavior and full shifting of equity across properties in order to maximize the benefits of the mortgage subsidy. An example of a taxpayer who has negative AGI is one who has losses from a business reported on Schedule C. Sums of the rows may not equal the total because of rounding. Non-filers are included in this sample.
Source: Authors’ calculations based on data from the SOI Division of the IRS.
Table 4
Change in Federal Individual Income Tax Liability per Return ($) Under MID Modifications, by AGI Group, 2021

<table>
<thead>
<tr>
<th>Adjusted Gross Income ($'Thousand)</th>
<th>Number of Returns (Thousand)</th>
<th>Baseline Tax Liability per Return</th>
<th>Modification</th>
<th>Limit MID to $25,000 of Interest Expenses</th>
<th>Limit MID to 28 Percent</th>
<th>Limit MID to Primary Residences</th>
<th>Non-refundable 15 Percent Credit</th>
<th>Refundable 15 Percent Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Zero or negative</td>
<td>1,450</td>
<td>–25</td>
<td>5</td>
<td>3</td>
<td>0</td>
<td>0</td>
<td>–2</td>
<td>–796</td>
</tr>
<tr>
<td>0–50</td>
<td>101,700</td>
<td>343</td>
<td>45</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>–23</td>
<td>–103</td>
</tr>
<tr>
<td>50–75</td>
<td>24,757</td>
<td>5,512</td>
<td>492</td>
<td>22</td>
<td>0</td>
<td>0</td>
<td>–27</td>
<td>–54</td>
</tr>
<tr>
<td>75–100</td>
<td>16,142</td>
<td>9,403</td>
<td>957</td>
<td>64</td>
<td>0</td>
<td>0</td>
<td>147</td>
<td>138</td>
</tr>
<tr>
<td>100–200</td>
<td>27,359</td>
<td>19,319</td>
<td>2,240</td>
<td>254</td>
<td>0</td>
<td>0</td>
<td>1,053</td>
<td>1,047</td>
</tr>
<tr>
<td>200–500</td>
<td>10,614</td>
<td>56,453</td>
<td>4,586</td>
<td>1,232</td>
<td>3</td>
<td>0</td>
<td>3,125</td>
<td>3,101</td>
</tr>
<tr>
<td>500–1,000</td>
<td>1,658</td>
<td>182,689</td>
<td>7,081</td>
<td>3,372</td>
<td>64</td>
<td>0</td>
<td>5,889</td>
<td>5,858</td>
</tr>
<tr>
<td>More than 1,000</td>
<td>707</td>
<td>1,037,647</td>
<td>5,358</td>
<td>3,078</td>
<td>289</td>
<td>0</td>
<td>4,981</td>
<td>4,974</td>
</tr>
<tr>
<td>Total</td>
<td>184,386</td>
<td>13,487</td>
<td>855</td>
<td>160</td>
<td>2</td>
<td>0</td>
<td>405</td>
<td>347</td>
</tr>
</tbody>
</table>

Notes: All dollar values are in nominal (2021) dollars. The tax credits are limited to the first $25,000 of mortgage interest expenses on primary residences only. The figures incorporate portfolio reallocation behavior and full shifting of equity across properties in order to maximize the benefits of the mortgage subsidy. An example of a taxpayer who has negative AGI is one who has losses from a business reported on Schedule C. Non-filers are included in this sample. Source: Authors’ calculations based on data from the SOI Division of the IRS.
$100,000 are estimated to experience only a 1.6 percent increase in taxes, and taxpayers with AGIs between $200,000 to $500,000 experience a 5.5 percent increase in taxes.

Table 4 shows average changes in federal tax liability by AGI in 2021. Under full repeal, it is estimated that tax liability per return would increase by $855, or 6.3 percent. Taxpayers with positive AGI but below $50,000 are estimated to experience tax increases of $45 (13 percent), on average. Taxpayers with AGI between $100,000 to $500,000 are estimated to experience tax increases of between 8 and 12 percent, on average. The three highest income groups are estimated to have the largest dollar tax increases, $5,400, $7,100, and $4,600, respectively, yet these groups account for only 7.1 percent of total tax returns (0.4, 0.9, and 5.8, respectively).

Figure 4

Average Tax Rates Under Current Law and Repeal of MID by AGI Percentile, 2007

As was shown for 2007 in Figure 2, there is considerable variation in the tax value of the MID within income groups, and this variation increases as AGI increases.
Converting the deduction into a 15 percent, non-refundable credit on primary residences is estimated to increase tax liability per return by $405, or 3.0 percent. Taxpayers with AGI of $75,000 or less are estimated to experience a tax reduction on average, and taxpayers with AGI between $75,000 and $100,000 are estimated to experience a tax increase of 1.6 percent, on average. For taxpayers with AGI between $100,000 and $500,000, tax liability is estimated to increase by roughly 5.5 percent. Once again, the three highest income groups have the largest per return increase in liability at $5,000, $5,900, and $3,100, respectively. In percentage terms, these increases are 0.5 percent, 3.2 percent, and 5.5 percent, respectively.

Finally, in Figure 4, we group taxpayers in 2007 age 18 and above with positive AGI into AGI percentiles, as was done in Figure 3, and plot for each percentile the average tax rate under the law in 2007, which included the MID.25 The gray line plots the average tax rate by percentile if the MID were fully repealed in 2007. To show the upper bound for the increase in average tax rates, the gray line does not incorporate any portfolio reallocation behavior.

Across percentiles, the average increase in the average tax is estimated to be 0.6 percentage points. Taxpayers in the bottom half of the AGI distribution are estimated to experience an increase in their average tax rate of 0.1 percentage points, on average. The largest increase in average tax rates, 2.1 percentage points, is estimated to occur at the 97th percentile — those with AGI of roughly $192,000. Converting the deduction to a non-refundable credit would result in a smaller increase in average tax rates.

VII. CONCLUSION

Amid growing concerns over the size of the medium- and long-term deficits, the MID has been a frequent but elusive target for elimination or reform. Modifying the MID may allow policymakers to reduce medium- and long-term deficits without undercutting homeownership rates. However, eliminating or reducing the value of the MID may lead to a decrease home prices, which could further strain an already fragile housing market which has seen real prices decrease by 40 percent since their peak values in 2006.26

Compared to current law modified by patching the AMT, fully repealing the MID is estimated to increase federal individual income tax revenue by $1.1 trillion, or 0.6 percent of GDP, between 2012 and 2021. Converting the MID to a 15 percent non-refundable credit would raise a substantial amount of revenue ($483 billion between 2012 and 2021), maintain a subsidy for homeownership, and increase the progressivity of the tax system. Limiting the MID to primary residences, to $25,000 of mortgage interest expenses, or to the 28 percent tax rate for high-income taxpayers is estimated to raise less than 15 percent of the amount raised under full repeal.

25 Non-filers are excluded from this sample.
26 After a long period of stability beginning in the 1950s, real home prices, as measured by the Case-Shiller Real Home Price Index, increased 86 percent from 1996–2006. At the beginning of 2011, real home prices were roughly at the same levels as they were in the middle of 1999.
In order to aid the IRS in enforcing the current law and in enforcing any modification to the MID that would restrict the subsidy to the taxpayer’s primary residence, it may be helpful to modify Form 1098 to include the physical address of the property for which mortgage interest expenses were paid and to have taxpayers itemize the mortgage interest expenses they have for each property on Schedule A, much like they do on Schedule E if they have multiple rental properties with mortgage interest expenses. Further, if the subsidy for mortgage debt continues to be limited based on the amount of mortgage debt a taxpayer has, as opposed to limiting it based on the amount of mortgage interest expenses a taxpayer has, it may be useful to modify Form 1098 to include the taxpayer’s outstanding mortgage balance and whether the mortgage debt is for acquisition debt or home equity debt. In theory, it should be relatively straightforward for lenders to add to Form 1098 the physical address of the property to which the mortgage is attached and the outstanding mortgage balance for that property. In contrast, it may be difficult for lenders to know what is acquisition debt and what is home equity debt, e.g., when a taxpayer uses a home equity loan to finance a renovation to his property and then rolls over the home equity loan into a mortgage.

ACKNOWLEDGEMENTS AND DISCLAIMERS

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