The Pew Charitable Trusts

The Geographic Distribution of the Mortgage Interest Deduction

Overview

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Pew Overview

Policymakers continue to debate how to reduce the federal budget deficit and how to simplify the federal tax code. One point on which there seems to be emerging agreement is that reducing or eliminating tax expenditures could contribute to one or both efforts. Tax expenditures are special deductions, exemptions, and other provisions that allow people or businesses to reduce their income tax liability and, consequently, reduce federal tax revenue.[1] Because they reduce the revenue that the government would otherwise collect, tax expenditures are similar to direct government spending.

Tax expenditures totaled about $1.1 trillion in fiscal 2011,[2] rivaling the total federal discretionary spending that funds programs supporting activities ranging from national defense to education to highways. One of the largest tax expenditures in the U.S. tax code is the deduction for home mortgage interest. Tax filers who own a home and itemize their deductions are allowed to subtract interest paid on mortgage debt from their income.[3] In tax year 2011, filers deducted about $360 billion in mortgage interest, resulting in roughly $72 billion in forgone federal income tax revenue.[4] Only two federal tax expenditures were larger that year, and in years past this deduction has often ranked second behind the exclusion for employer-provided health insurance.[5]

Informed decisions about whether or how to change or eliminate tax expenditures such as the mortgage interest deduction require, among other things, detailed analysis of who benefits from current policy and how changes could affect the distribution of those benefits. Decision-making also will require data on the fiscal costs and benefits. Many organizations—including the Joint Committee on Taxation, the U.S. Department of the Treasury, and a number of national deficit commissions—have examined federal tax expenditures at the national level.[6] Analyses of the impact of federal tax expenditures at finer levels of geography have been much more limited, and there has been relatively little attention paid to how changes to these federal policies could affect states and their budgets.

The geographic distribution of mortgage interest deduction claims

"The Geographic Distribution of the Mortgage Interest Deduction," commissioned by The Pew Charitable Trusts and written by Andrew Hanson of Marquette University, Ike Brannon of the R Street Institute, and Zackary Hawley of Texas Christian University, examines the geographic distribution of mortgage interest deduction claims across and within the states.[7] The report also explores how changing the deduction could alter this distribution of claims.

Not surprisingly, the report shows that the geographic distribution of this tax expenditure generally is skewed toward areas with relatively high incomes and property values. (See maps beginning on page 6.) There are notable concentrations, particularly along parts of the East Coast and in parts of the West. The report also, for the first time, uses detailed ZIP-code-level data from the Internal Revenue Service to show that the distribution of the deduction appears even more skewed at the metropolitan-area level, with tax filers in and around major metropolitan areas generally claiming the deduction at much higher rates and greater average amounts than filers in less-populous areas.

While the geographic concentration in areas where property values and incomes tend to be higher may not be surprising given the current structure of the mortgage interest deduction, there are other factors that could influence the distribution, including differences in housing turnover frequency and the proportion of tax filers living in rental housing. With changes to tax expenditures under consideration, data showing the current geographic distribution of the mortgage interest deduction are an important element of an informed discussion about how changes to tax policy would affect the states.

Any modification to the deduction—such as eliminating it, capping itemized deductions generally, limiting deductions to mortgage interest paid for first homes, or replacing the deduction with a credit—would likely alter the distribution of this federal tax expenditure across geographic areas. Depending on how any changes are structured, federal taxes could increase in some areas and decrease in others.

As with many federal tax changes, this could affect economic activity both across and within states, and indirectly affect state and local revenues. Policymakers should be aware of the geographic implications of changes in federal tax policy as debates over federal deficit reduction and tax reform move forward.

This analysis uses Internal Revenue Service state-level data (from 2010) and ZIP-code-level data (from 2007) on the number of filers (that is, tax returns), the number of mortgage interest deduction claims, the amount of interest deducted, and federal income taxes paid.

The federal-state fiscal relationship and the mortgage interest deduction

This report is part of a series by Pew examining the mortgage interest deduction and housing subsidies. An earlier report, "Costs and Benefits of Housing Tax Subsidies," looked at the distribution of the mortgage deduction's benefits across income groups.[8] Future research will analyze how changes to the deduction could directly affect state tax revenues. This series will provide facts and analysis as policymakers consider options for changing or eliminating the deduction or other tax expenditures over the next several years. It explores the connections between this federal policy and the states, but makes no recommendations regarding whether the deduction should or could be changed, or how.

Congress has yet to directly address changing the mortgage interest deduction, though it has started to address tax expenditures by recently reinstating a provision of law, eliminated in 2010, that limits the amount of itemized deductions that higher-income tax filers can claim.[9] This provision effectively reduces the tax expenditures associated with certain deductions for higher-income filers, including the mortgage interest deduction, the deduction for state and local taxes, and the charitable deduction. Although policymakers have not yet identified which specific tax expenditures they recommend changing or eliminating, they are actively discussing changes to this category of federal spending that occurs through the tax code. The home mortgage interest deduction will likely be part of this discussion.

Benefits and costs

Research shows links[10] between homeownership and more stable and cohesive neighborhoods, stronger attachment to communities, greater civic participation, and lower rates of crime.[11]

For many, the deduction for mortgage interest is associated with the American Dream of homeownership and any benefits that are linked to it. Yet empirical evidence suggests the mortgage interest deduction as currently structured may be ineffective at increasing homeownership rates.[12]

Fewer than half of all homeowners[13]—and about a quarter of tax filers[14]—claim the mortgage interest deduction. It is available only to homeowners who itemize deductions. For those who do claim the deduction, the benefit increases with the size of the mortgage—the bigger the mortgage, the greater the tax benefit. The benefit also rises with a taxpayer's marginal tax rate, which, in part, explains why higher-income taxpayers—who likely would buy a house regardless of the tax treatment—receive a disproportionate share of the benefit.

As with many tax subsidies designed to encourage specific activities and achieve certain policy goals, the mortgage interest deduction has economic costs. It affects the allocation of capital across the economy: By effectively lowering the price of owner-occupied housing relative to other goods and services, this tax expenditure encourages investment in and consumption of housing over other types of investments, goods, and services.[15] Finally, the deduction results in significant forgone revenue, not just at the federal level but also in states with tax codes that link to this federal tax expenditure.

The housing market collapse and the mortgage interest deduction

From 2007 to 2010, mortgage interest deduction claims and overall claim amounts declined significantly, the result of the collapse of the housing bubble, the drop in interest rates that followed—which made the deduction less valuable for new purchasers or those who refinanced into a lower-rate mortgage—and the Great Recession of 2007-2009 and its aftermath. These events affected states' claims differently.

The varying effects changed to some degree the geographic distribution of this deduction, suggesting that differences in economic conditions can affect how federal tax benefits are spread across states.

Before the onset of the housing crisis and the beginning of the Great Recession, the total mortgage interest deducted by tax filers hit its peak in 2007, resulting in $543 billion in deductions and roughly $85 billion in forgone revenue. Between 2007 and 2010, the total deduction amount fell 28 percent, and the number of claims declined by 12 percent.

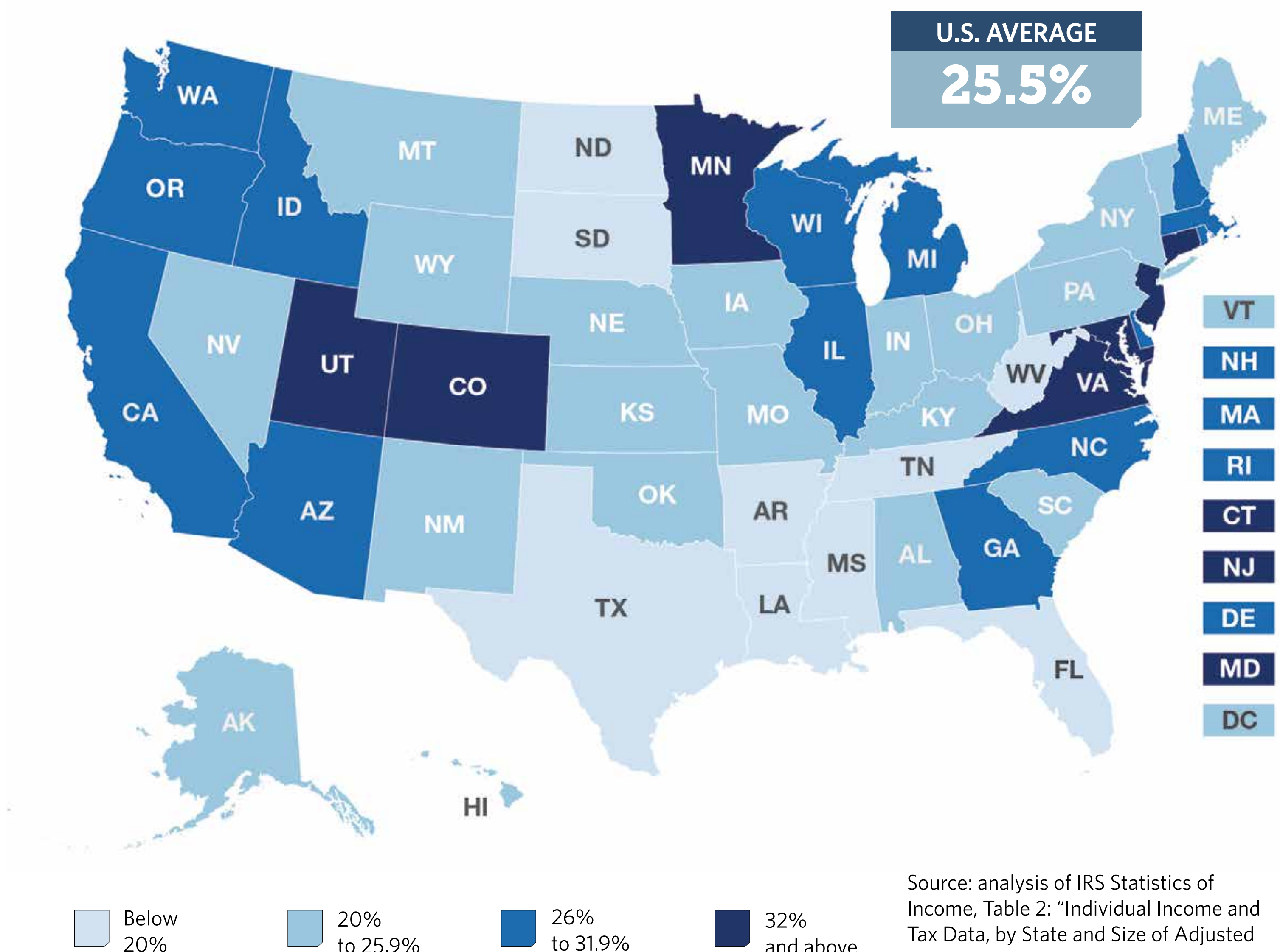
Nationally, the decrease in mortgage interest deduction claims lines up with the housing crisis and recession, but these events affected states to varying degrees. Although no region was particularly immune, the declines appear to have been most severe in the West and in the corridor stretching from the Southeast to the Great Lakes region, and less severe in the middle of the country west of the Great Lakes area.

Finding #1: Uneven Distribution Across States

MAP 1

Claim rates across states

Percentage of each state's tax filers who claim the mortgage interest deduction, 2010



Source: analysis of IRS Statistics of Income, Table 2: "Individual Income and Tax Data, by State and Size of Adjusted Gross Income, Tax Year 2010."

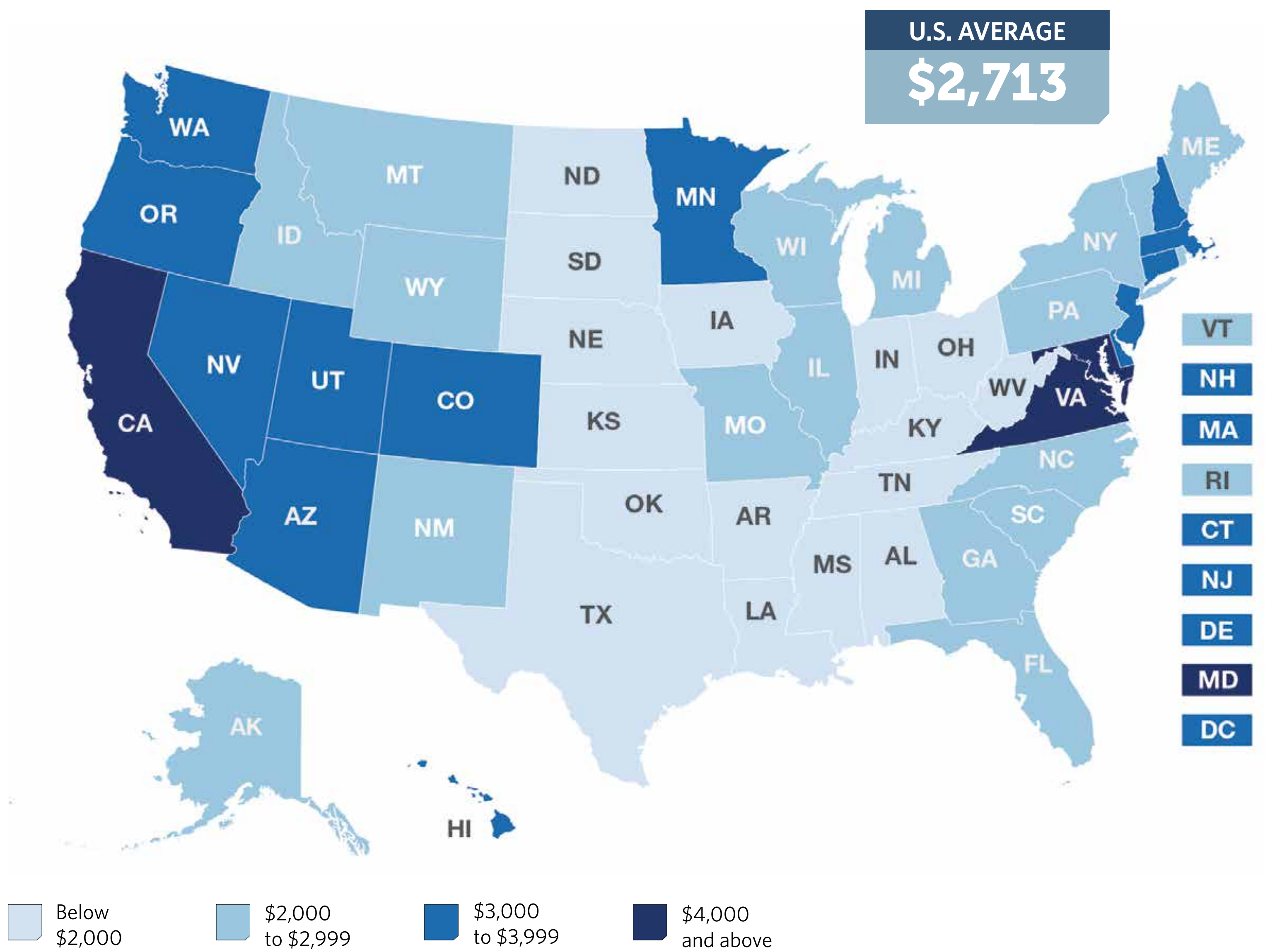
The percentage of tax filers deducting mortgage interest in 2010 ranged from a high of nearly 37 percent in Maryland to a low of 15 percent in West Virginia and North Dakota. States with the highest claim rates were concentrated along the East Coast and in parts of the West; those with the lowest claim rates were mostly in the South, particularly in the band from Texas to Mississippi and stretching up to West Virginia. (See Map 1.)

MAP 2

Average deduction amounts across states

Average mortgage interest deduction per tax filer, by state, 2010

The average mortgage interest deduction for all tax filers (not just those taking the deduction) in 2010 varied from a high of $4,580 per tax filer in Maryland to a low of $1,192 per tax filer in North Dakota.[16] In general, states along the northern East Coast and in parts of the West had the highest average per-filer deduction amounts, and states in the South and Midwest had the lowest. (See Map 2.)



Note: The per-filer average is the average for all tax filers in an area, including those who do not claim the deduction.

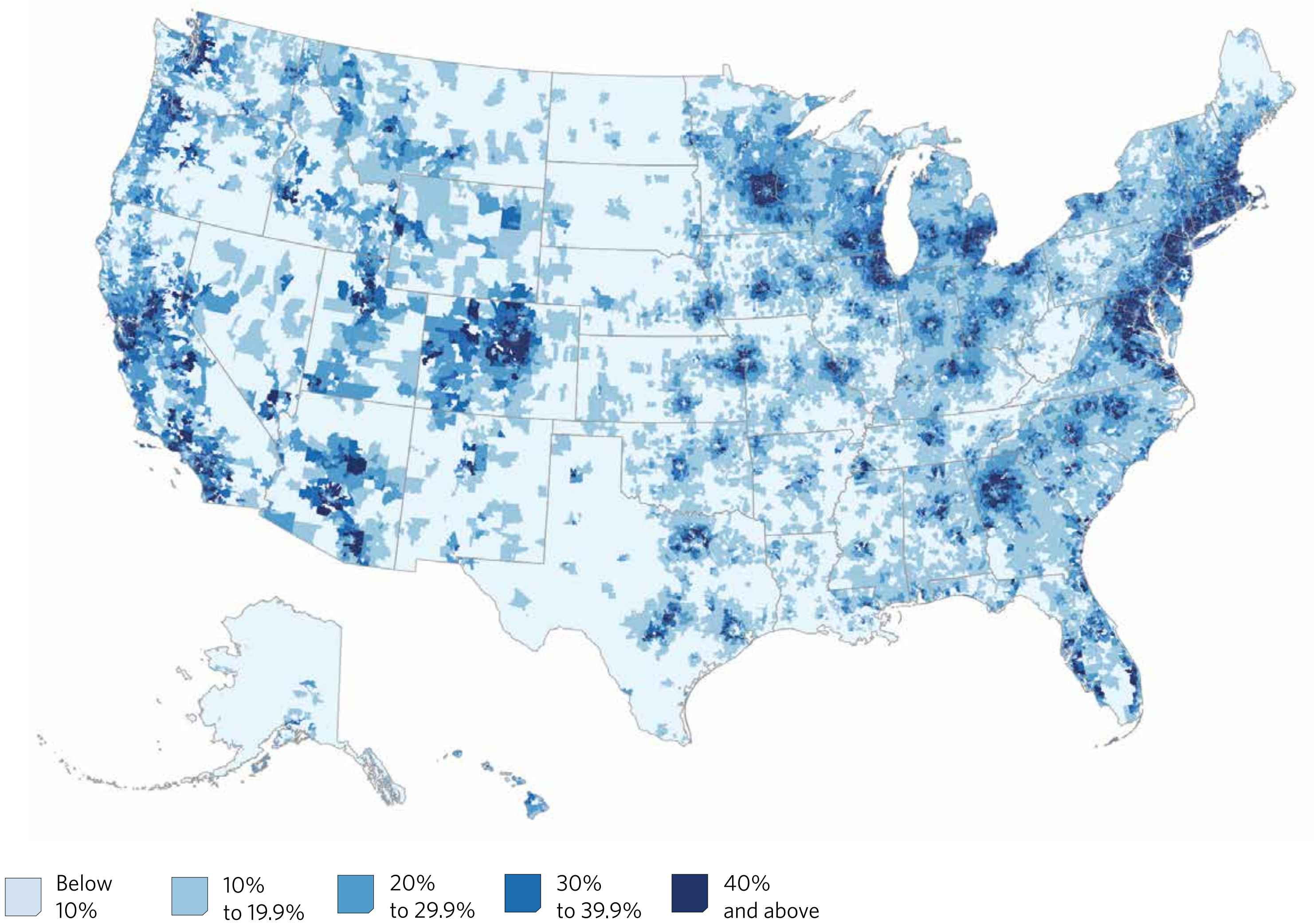
Source: analysis of IRS Statistics of Income, Table 2: "Individual Income and Tax Data, by State and Size of Adjusted Gross Income, Tax Year 2010."

Finding #2: Uneven Distribution Across Metropolitan Areas

MAP 3

Claim rates across ZIP codes

Percentage of each ZIP code's tax filers who claim the mortgage interest deduction, 2007



Note: Bottom category includes areas not covered by ZIP codes.

Source: analysis of IRS Statistics of Income, Individual Income Tax Statistics, ZIP Code Data, Tax Year 2007.

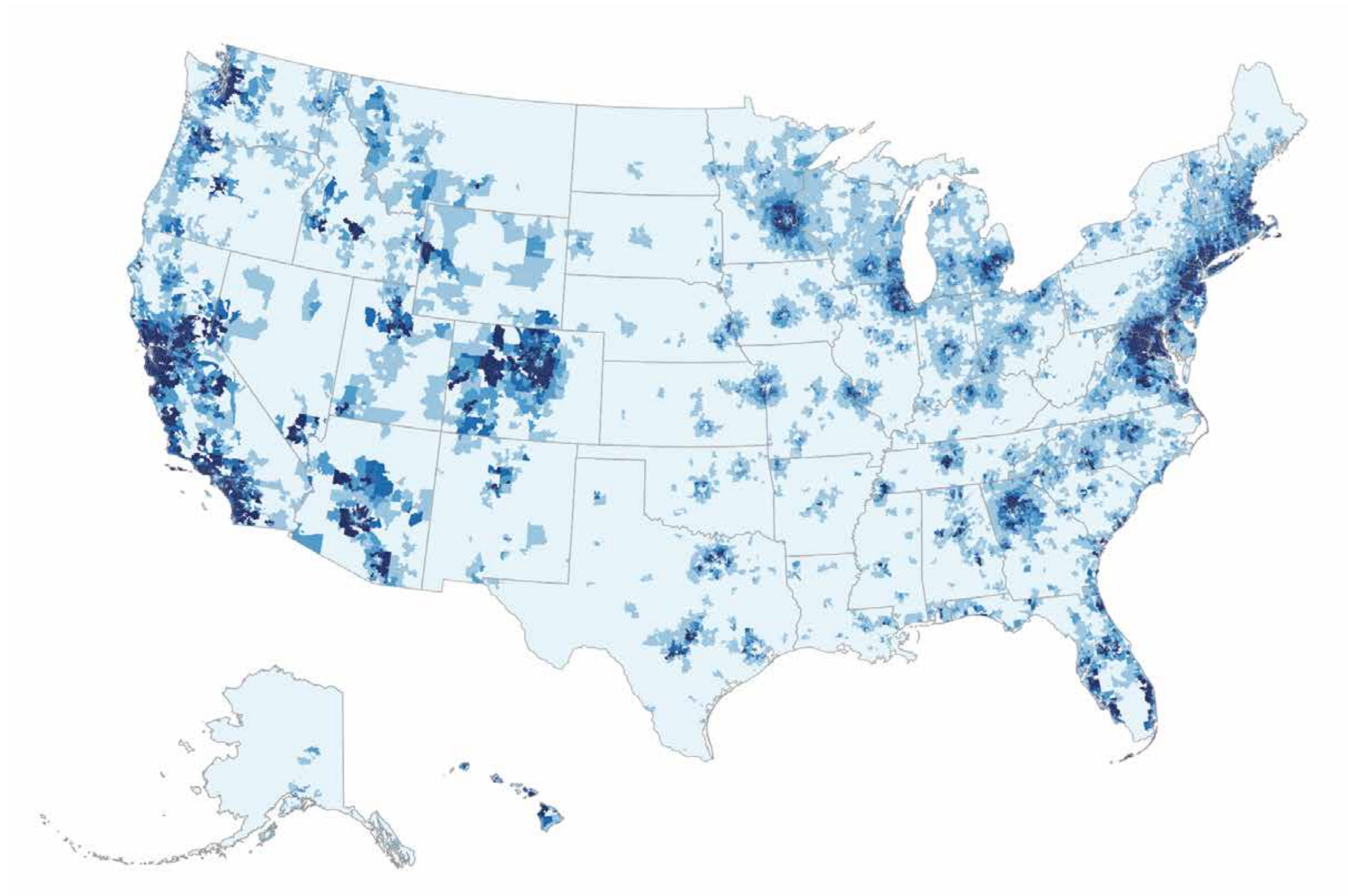
In 2007, tax filers in and around larger metropolitan areas (as measured by the number of tax filers in the area) generally claimed the mortgage interest deduction at higher rates than filers in less-populous areas. There were concentrations of high claim rates in and around major metropolitan areas throughout the country, especially along the Boston-Washington corridor. (See Map 3.)

In 2007, the average mortgage interest deduction for all tax filers (not just those taking the deduction) generally was higher in and around larger metropolitan areas, while less-populous areas tended to have lower average deductions. There were concentrations of high average deduction amounts in the Boston-Washington corridor, in and around metropolitan areas in California and Colorado, in certain metropolitan areas around the Great Lakes region, and in a handful of other major metropolitan areas in the rest of the country. (See Map 4.)

MAP 4

Average deduction amounts across ZIP codes

Average mortgage interest deduction per tax filer, by ZIP code, 2007



Below $1,300
$1,300 to $2,599
$2,600 to $3,899
$3,900 to $5,199
$5,200 and above

Note: The per-filer average is the average for all tax filers in an area, including those who do not claim the deduction. The bottom category includes areas not covered by ZIP codes.

Source: analysis of IRS Statistics of Income, Individual Income Tax Statistics, ZIP Code Data, Tax Year 2007.

Finding #3: Uneven Distribution Within States

The geographic concentration of the mortgage interest deduction among a relatively small number of metropolitan areas throughout the United States translates into an uneven distribution of the deduction *within* states.

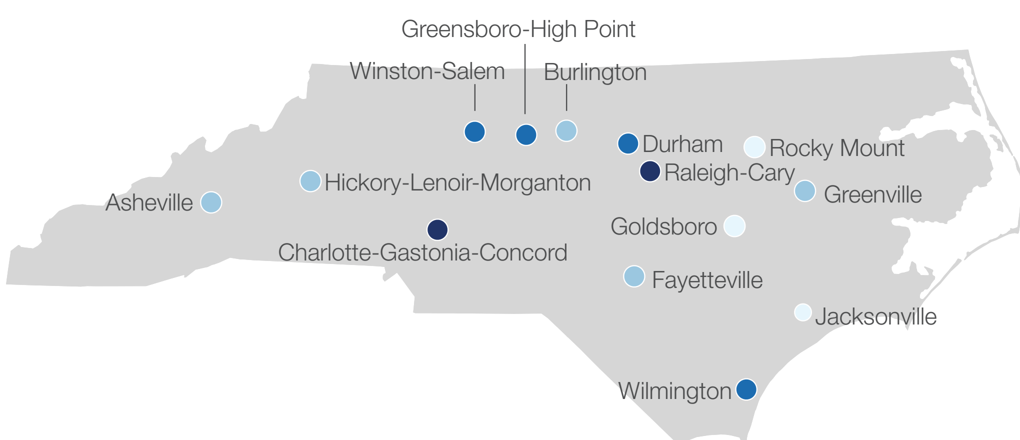
This finding is confirmed by a closer look at the metropolitan-area claim rates and average deduction amounts in three representative states: North Carolina, Pennsylvania, and Texas.

Across **North Carolina**, the deduction claim rates and average deduction amounts varied significantly. Both the rates and the amounts generally were highest in the larger metropolitan areas (as measured by the number of tax filers), such as the Raleigh-Cary area, and lowest in the less-populous areas, such as Goldsboro.[17] (See Maps 5 and 6.)

MAPS 5 | 6

Distribution across North Carolina

Claim rates: Percentage of each metropolitan area's tax filers who claim the mortgage interest deduction, 2007



Below 22%

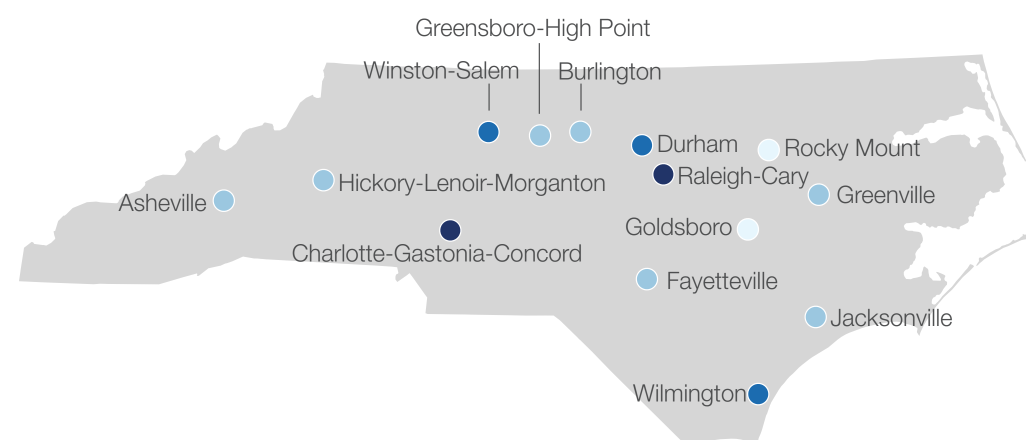
22% to 27.9%

28% to 33.9%

34% and above

Source: analysis of IRS Statistics of Income, Individual Income Tax Statistics, ZIP Code Data, Tax Year 2007.

Deduction amounts: Average mortgage interest deduction per tax filer, by metropolitan area, 2007



Below $1,700

$1,700 to $2,699

$2,700 to $3,699

$3,700 and above

Note: The per-filer average is the average for all tax filers in an area, including those who do not claim the deduction.

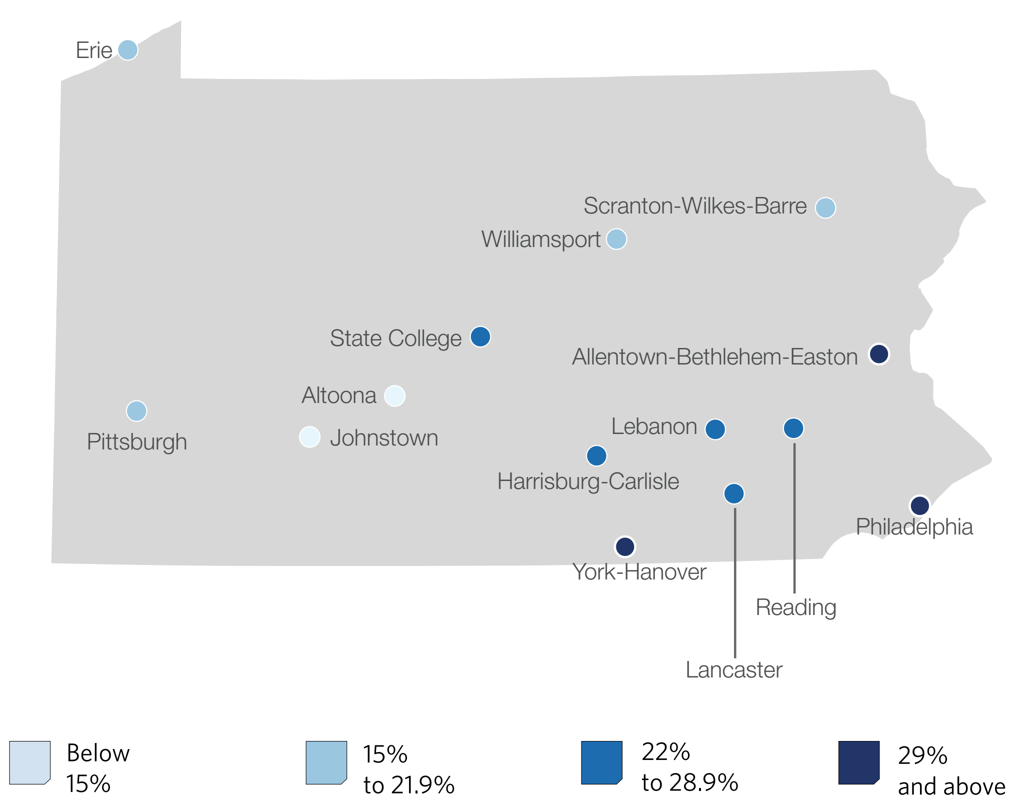
Source: analysis of IRS Statistics of Income, Individual Income Tax Statistics, ZIP Code Data, Tax Year 2007.

Pennsylvania's mortgage interest deduction claim rates and average deduction amounts ranged widely across its metropolitan areas. But unlike North Carolina, the distribution did not line up according to the number of tax filers in each metropolitan area. Some of the state's larger areas, such as the Pittsburgh area, had relatively low claim rates and average deduction amounts. Some of the moderately sized areas, such as the York-Hanover area, had relatively high claim rates and average deduction amounts. (See Maps 7 and 8.)

MAPS 7 | 8

Distribution across Pennsylvania

Claim rates: Percentage of each metropolitan area's tax filers who claim the mortgage interest deduction, 2007



Source: analysis of IRS Statistics of Income, Individual Income Tax Statistics, ZIP Code Data, Tax Year 2007.

Deduction amounts: Average mortgage interest deduction per tax filer, by metropolitan area, 2007

Note: The per-filer average is the average for all tax filers in an area, including those who do not claim the deduction.

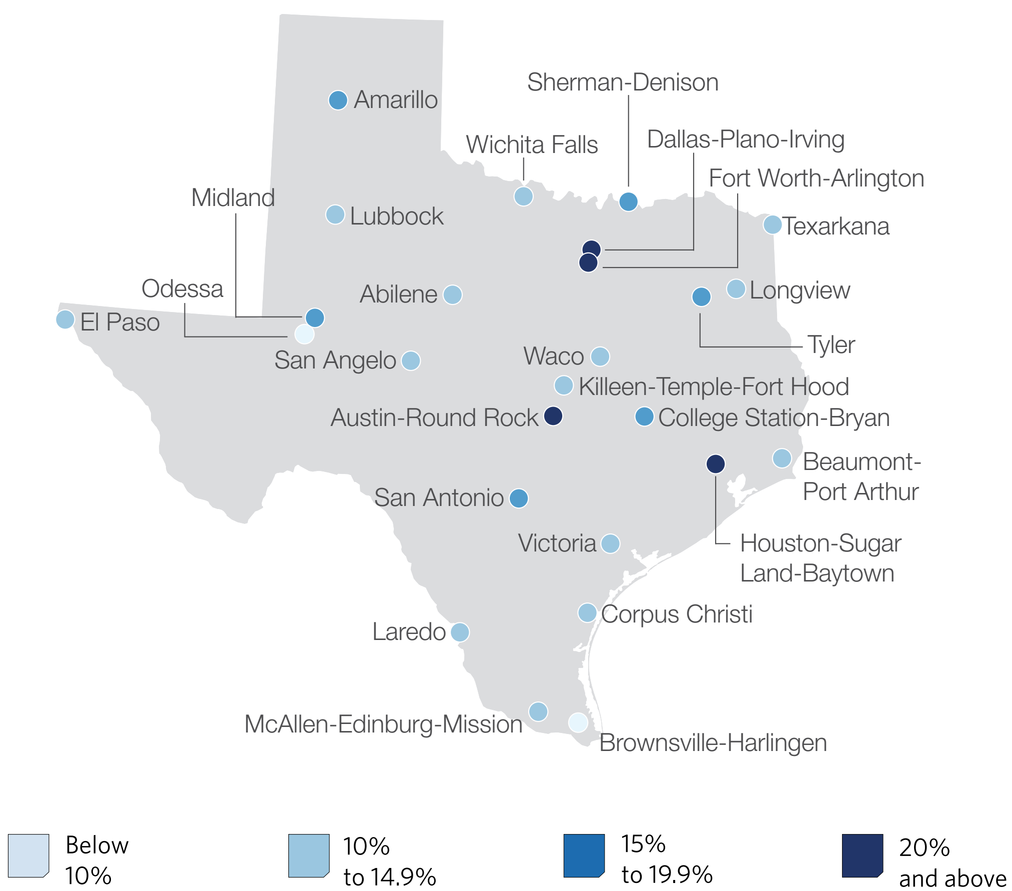
Source: analysis of IRS Statistics of Income, Individual Income Tax Statistics, ZIP Code Data, Tax Year 2007.

Texas had the greatest differences between the top and bottom claim rates and average deduction amounts, compared with North Carolina and Pennsylvania. The highest claim rate, in the Austin-Round Rock area, was nearly four times the lowest rate, in Odessa, and the highest average deduction amount, also in the Austin area, was more than six times the lowest amount, in Odessa. As in North Carolina, Texas' largest metropolitan areas, such as Dallas-Plano-Irving, had the highest claim rates and average deduction amounts, and smaller metropolitan areas, such as San Angelo, generally had lower claim rates and amounts. (See Maps 9 and 10.)

MAPS 9 | 10

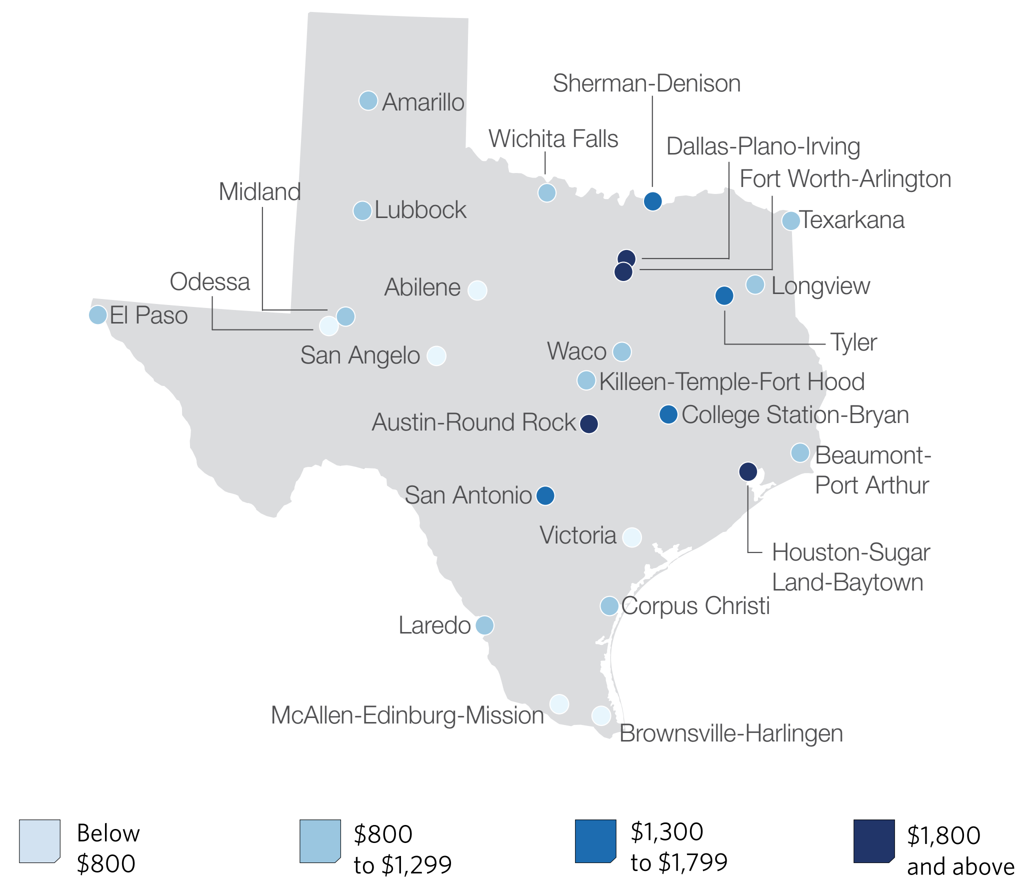
Distribution across Texas

Claim rates: Percentage of each metropolitan area's tax filers who claim the mortgage interest deduction, 2007



Source: analysis of IRS Statistics of Income, Individual Income Tax Statistics, ZIP Code Data, Tax Year 2007.

Deduction amounts: Average mortgage interest deduction per tax filer, by metropolitan area, 2007



Note: The per-filer average is the average for all tax filers in an area, including those who do not claim the deduction.

Source: analysis of IRS Statistics of Income, Individual Income Tax Statistics, ZIP Code Data, Tax Year 2007.

Methodology

This analysis uses Internal Revenue Service data from tax year 2010 on the number of tax filers, the number of mortgage interest deduction claims, the amount of interest deducted, and federal income taxes paid at the state level. It also uses the IRS' only release of comprehensive data on mortgage interest deduction claims, including the number of claims, at the ZIP code level. These data, for tax year 2007, allow for an examination of the within-state distribution of this federal deduction. This report does not analyze the many factors that could influence the geographic distribution of the deduction as currently structured, such as differences in income, housing costs, housing turnover rates, rental-vs.-homeownership rates across geographic areas, and others. (See Appendix II in the report for the full methodology.)

Endnotes

[1] Credits, exclusions, deferrals, and preferential rates are other types of tax expenditures. For a full list of federal income tax expenditures, see Pew's Tax Expenditure Database, pewstates.org/research/reports/tax-expenditure-database-85899429743.

[2] Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2013, Analytical Perspectives*, Table 17-1, (Washington: U.S. Government Printing Office, 2013), whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/receipts.pdf. Summing tax expenditures often provides a reasonably good estimate for the total cost of groups of tax expenditures, though it does not capture potential interactions among tax expenditures or behavioral responses if any single one is modified or repealed.

[3] Under current law, tax filers can deduct interest paid on a mortgage up to $1 million, including interest paid on second homes. They can also deduct interest paid on home equity loans up to $100,000. These limits are halved for married filers who file separate returns.

[4] The deduction estimate is for tax year 2011, the latest year for which the data are available. Internal Revenue Service, Statistics of Income, "Individual Income and Tax Data, by State and Size of Adjusted Gross Income, Tax Year 2011," *SOI Tax Stats-Historic Table 2*, accessed April 29, 2013, irs.gov/uac/SOI-Tax-Stats---Historic-Table-2. The forgone revenue estimate is for fiscal 2011. Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2013*, whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/spec.pdf. The Joint Committee on Taxation estimated the fiscal 2011 forgone revenue from the mortgage interest deduction to be $78 billion. Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2011-2015*, JCS-1-12, Table 1 (Washington, Jan. 17, 2012), jct.gov/publications.html?func=startdown&id=4386. OMB's fiscal 2014 *Supplemental Materials* (Table 16-1) estimates the mortgage interest deduction would result in $93 billion in forgone revenues in fiscal 2013 (Washington: U.S. Government Printing Office, 2013), whitehouse.gov/omb/budget/Supplemental. The JCT's estimate is $70 billion for that year. Joint Committee on Taxation, *Estimates Of Federal Tax Expenditures For Fiscal Years 2012-2017*, JCS-1-13, Table 1 (Washington, D.C., Feb. 1, 2013), www.jct.gov/publications.html?func=startdown&id=4503.

[5] According to U.S. Treasury estimates reported in the president's budget, the two larger tax expenditures in 2011 were the exclusion of employer-provided health insurance ($163 billion) and the accelerated depreciation of machinery and equipment ($119 billion). Office of Management and Budget, *Budget of the U.S. Government, Fiscal Year 2013*. The Joint Committee on Taxation estimated that in 2011 the deduction for mortgage interest ranked third behind the exclusion of employer-provided health insurance ($109 billion) and reduced rates of tax on dividends and long-term capital gains ($90 billion). Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2011-2015*.

[6] Joint Committee on Taxation, *Estimate of Federal Tax Expenditures For Fiscal Years 2012-2017*, jct.gov/publications.html?func=startdown&id=4503; Office of Management and Budget, *Budget of the U.S. Government, Fiscal Year 2013*, whitehouse.gov/omb/budget/Supplemental; National Commission on Fiscal Responsibility and Reform, *The Moment of Truth*, December 2010, fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12_1_2010.pdf; The Debt Reduction Task Force, *Restoring America's Future*, November 2010, bipartisanpolicy.org/sites/default/files/BPC%20FINAL%20REPORT%20FOR%20PRINTER%2002%2028%2011.pdf; The President's Advisory Panel on Federal Tax Reform, *Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System*, November 2005, govinfo.library.unt.edu/taxreformpanel.

[7] This report uses the most recently available data at the time of analysis. The analysis does not explore the many factors that could influence the current geographic distribution of this tax expenditure, such as differences in income, housing costs, housing turnover rates, rental-vs.-homeownership rates, and others.

[8] Robert Carroll, John F. O'Hare, and Phillip L. Swagel, *Costs and Benefits of Housing Tax Subsidies*, The Pew Fiscal Analysis Initiative and Subsidyscope, June 2011, pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Economic_Mobility/Pew_Housing_Report.pdf.

[9] The "Pease" limitation calculation is based on a household's income, not the amount of a household's total itemized deductions. See Thomas L. Hungerford, *Deficit Reduction: The Economic and Tax Revenue Effects of Personal Exemption Phaseout (PEP) and Limitation on Itemized Deductions (Pease),* Congressional Research Service, Feb. 1, 2013, fas.org/sgp/crs/misc/R41796.pdf.

[10] It is not clear, however, what the direction of causation is.

[11] Mark R. Lindblad, Kim R. Manturuk, and Roberto G. Quercia, "Sense of Community and Informal Social Control Among Lower Income Households: The Role of Homeownership and Collective Efficacy in Reducing Subjective Neighborhood Crime and Disorder," *American Journal of Community Psychology* 51, no. 1–2 (March 1, 2013); Kim Manturuk, Mark Lindblad, and Roberto G. Quercia, "Homeownership and Civic Engagement in Low-Income Urban Neighborhoods: A Longitudinal Analysis," *Urban Affairs Review* 48, no. 5 (May 7, 2012); William M. Rohe, Shannon Van Zandt, and George McCarthy, "The Social Benefits and Costs of Homeownership: A Critical Assessment of the Research," in *Low Income Homeownership: Examining the Unexamined Goal* by Nicolas Paul Retsinas and Eric S. Belsky (Washington: Brookings Institution Press, 2002); Edward Glaeser and Denise DiPasquale, "Incentives and Social Capital: Are Homeowners Better Citizens?" *Journal of Urban Economics* 45, no. 2 (1999); Brian J. Mccabe, "Are Homeowners Better Citizens? Homeownership and Community Participation in the United States," *Social Forces* (Jan. 7, 2013).

[12] Edward Glaeser and Jesse Shapiro, "The Benefits of the Home Mortgage Interest Deduction," *National Bureau of Economic Research: Tax Policy and the Economy* 17, (2003). Andrew Hanson, "Size of Home, Home Ownership, and the Mortgage Interest Deduction," *Journal of Housing Economics* 21, no. 3 (2012).

[13] Carroll, O'Hare, and Swagel, *Costs and Benefits of Housing Tax Subsidies*.

[14] Internal Revenue Service, Statistics of Income, "Individual Income and Tax Data, by State and Size of Adjusted Gross Income, Tax Year 2011," *SOI Tax Stats-Historic Table 2*, accessed April 29, 2013, irs.gov/uac/SOI-Tax-Stats---Historic-Table-2.

[15] Carroll, O'Hare, and Swagel, *Costs and Benefits of Housing Tax Subsidies*.

[16] Variation in the average deduction among filers claiming the deduction—the *per claimant* average—shows a similar picture of the uneven distribution of the mortgage interest deduction. For purposes of examining the geographic distribution, however, the average deduction per *filer*, not claimant, is a particularly useful metric because it enables a comparison of the aggregate impact of the deduction on each geographic area.

[17] Areas are ranked by number of tax filers.

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