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Who Benefits from the Home Mortgage Interest Deduction?

by Gerald Prante

Despite recent attempts by real estate, home building, and mortgage-lending organizations to portray the home mortgage interest deduction as vital to middle-income family budgets, an analysis of data from the Internal Revenue Service tells a different story.

The most recent IRS data show few low- and middle-income taxpayers benefit from the home mortgage interest deduction. Those who filed tax returns with under $30,000 in adjusted gross income (AGI) in 2003 received just 9 percent of deductions for home mortgage interest, despite filing 52 percent of all tax returns. (The median taxpayer's AGI was approximately $29,000 in 2003.) In contrast, 36 percent of home mortgage interest deductions were claimed by taxpayers with AGIs over $100,000.[1]

Table 1 illustrates the regressive nature of the home mortgage interest deduction. Those in lower income groups claim few deductions, while those earning over $75,000 in AGI claim the vast majority.

Table 1. Home Mortgage Interest Deduction Disproportionately Benefits Upper-Income Taxpayers, 2003

Adjusted Gross Income	Percent of Home Mortgage Interest Deduction Claimed	Percent of All Tax Returns in Income Group	Average Mortgage Interest Deduction Per Return	Percentage of Returns Claiming Mortgage Interest Deduction
Under $20,000	4.2%	37.8%	$278	4.0%
$20,000 - $29,999	5.1%	14.1%	$910	13.1%
$30,000 - $39,999	7.2%	10.7%	$1,674	24.2%
$40,000 - $49,999	7.9%	8.0%	$2,462	35.2%
$50,000 - $74,999	21.7%	13.3%	$4,068	50.9%
$75,000 - $99,999	18.2%	7.3%	$6,210	69.0%
$100,000 - $199,999	24.4%	6.8%	$8,928	78.9%
$200,000 and over	11.2%	1.9%	$14,374	75.7%

Source: Internal Revenue Service, Tax Foundation calculations.

Factors Affecting the Distribution

There are four key factors causing the home mortgage interest deduction to be more valuable for high-income earners than low-income earners.

First, to claim the mortgage interest deduction, taxpayers must itemize when filing federal tax returns, rather than taking the standard deduction. Because of the progressive nature of the federal income tax, the value of itemized deductions rises as income rises. Those facing the highest marginal tax rates—high-income taxpayers—receive a much more powerful tax benefit from tax deductions than low-income taxpayers receive. As a result, low-income taxpayers are less likely to itemize, placing the benefits of the home mortgage interest deduction out of reach. This factor is enhanced by the gradual elimination of the phase-out on itemized deductions—known as the "Pease provision"—that currently limits the amount of itemized deductions high-income individuals can claim.

Second, low-income taxpayers tend not to own homes, especially those who are younger and live in urban areas. Additionally, many low-income retirees tend to have less interest outstanding on home loans—i.e., their home mortgages are "paid off"—and rely primarily on Social Security income which is not included in AGI. This reduces the tax benefit of the home mortgage interest deduction to them.

Third, high-income earners tend to have more valuable homes. In general the greater the home value, the greater the interest payment on the associated mortgage. As a result, the President's Advisory Panel on Federal Tax Reform has criticized the home mortgage interest deduction for primarily encouraging the construction of larger homes, and not necessarily broadening home ownership among middle-income Americans.[2]

Finally, speculators in real estate markets—those looking to hold a specific piece of real estate for a small period of time—tend to both earn high incomes and prefer interest-only mortgages. Both of these characteristics lead them to claim a disproportionate share of the tax benefits of the home mortgage interest deduction.

Despite the claims of various industry groups that the home mortgage interest deduction is an important factor promoting broad-based home ownership, IRS data show the bulk of mortgage interest deductions are claimed by a relatively small fraction of Americans with incomes well above average. As a result, it is likely that the deduction primarily encourages larger and more expensive homes among a relatively small share of taxpayers, rather than promoting broad-based home ownership among ordinary Americans.

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[1] Adjusted gross income (AGI) may appear lower than other estimates of median income because it excludes many sources of income for everyone. For example, personal income as defined by the Bureau of Economic Analysis was approximately 45 percent higher than AGI in 2003. This distinction, however, has little impact on the distributional analysis here.

[2] President's Advisory Panel on Federal Tax Reform, "Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System" (November 2005).