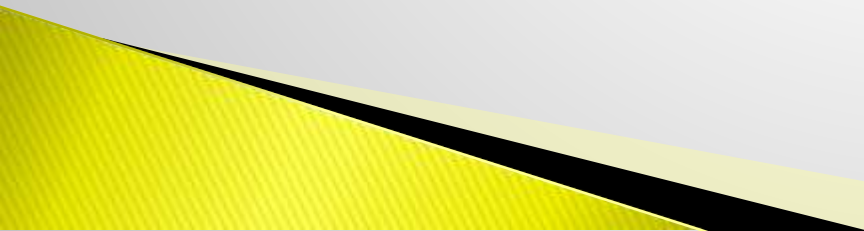


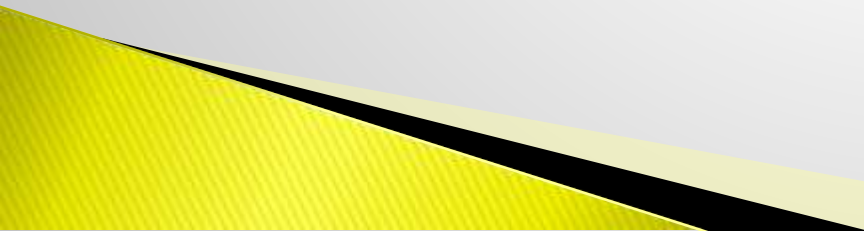
# **An Analysis of Policy Concerning the Mortgage Interest Deduction**

**By Desirai Lopez**

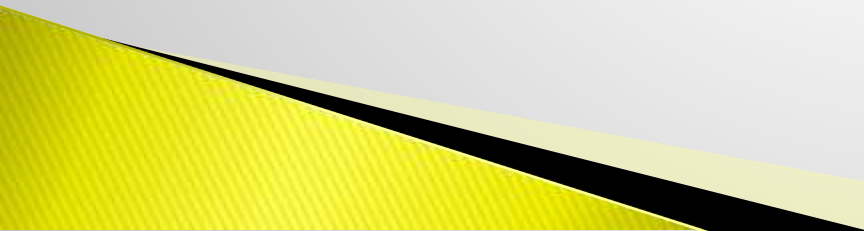
# Overview

- National Commission on Fiscal Responsibility and Reform (NCFRR) proposes to reduce the mortgage interest deduction (MID)
  - Possible Benefits: Reduce the deficit/national debt; help lower-income taxpayers
  - Possible Costs: Further damage housing market and home values; values; increase taxes for higher-income taxpayers who already pay most federal income taxes
  - Possible Solution: Alter the proposal by the NCFRR
- 

# Outline

1. Introduce the NCFRR (the “Commission”)
  2. Define the proposal
  3. Analyze arguments supporting a change in MID
  4. Consider arguments against the change in MID
  5. Discuss alternative solutions
  6. Conclusion
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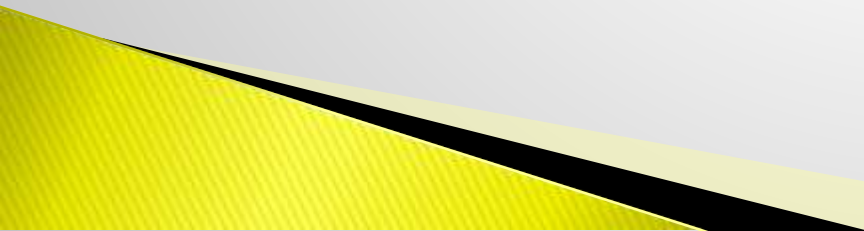
# National Commission on Fiscal Responsibility and Reform

- Established February 8, 2010
  - Bipartisan
  - Purpose: “put forward proposals to balance the budget excluding interest payments on the debt (the so-called primary budget) by 2015 and to meaningfully improve the long-term fiscal outlook” (Orszag, 2010)
  - Recommendation issued December 1, 2010 with a plan consisting of discretionary spending cuts, tax reform, health policies, other mandatory policies, social security, and process reform (NCFRR, 2010).
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# Proposed Change

- NCFRR proposes to reduce the MID:
  - Reduce cap from \$1.1 million to \$500,000
  - Disallow MID on secondary homes/home equity loans
  - 1040 line item deduction (12%) rather than Schedule A itemized deduction

# Supporting the change (summary)

- National debt -> \$14.37 trillion
  - MID in 2010 -> 5.14% of increase in debt
  - MID in 2011 -> \$119.9 billion in costs to gov't
  
  - 1. Affluent individuals enjoy greater benefits than mid- and low-income individuals
  - 2. MID fails to achieve its purpose
  - 3. MID social benefits not commensurate with cost
  - 4. Some ethical arguments support the change
- 

# 1. Affluent individuals enjoy greater benefits

<b>Household income</b>	<b>&lt; \$40,000</b>	<b>\$40,000- \$75,000</b>	<b>\$75,000- \$125,000</b>	<b>\$125,000- \$250,000</b>	<b>&gt; \$250,000</b>
<b>Average MID tax savings</b>	<b>\$91</b>	<b>\$523</b>	<b>\$1,264</b>	<b>\$2,703</b>	<b>\$5,459</b>
<b><u>Avg. tax swing</u> avg. income</b>	<b>&gt; 0.23%</b>	<b>0.91%</b>	<b>1.26%</b>	<b>1.44%</b>	<b>&lt; 2.18%</b>

Table by Seth Hanlon (2011) except for the last row

## 2. MID fails to achieve its purpose

“The Mortgage Interest Deduction and its Impact on Homeownership Decisions” – Hilber and Turner, 2010

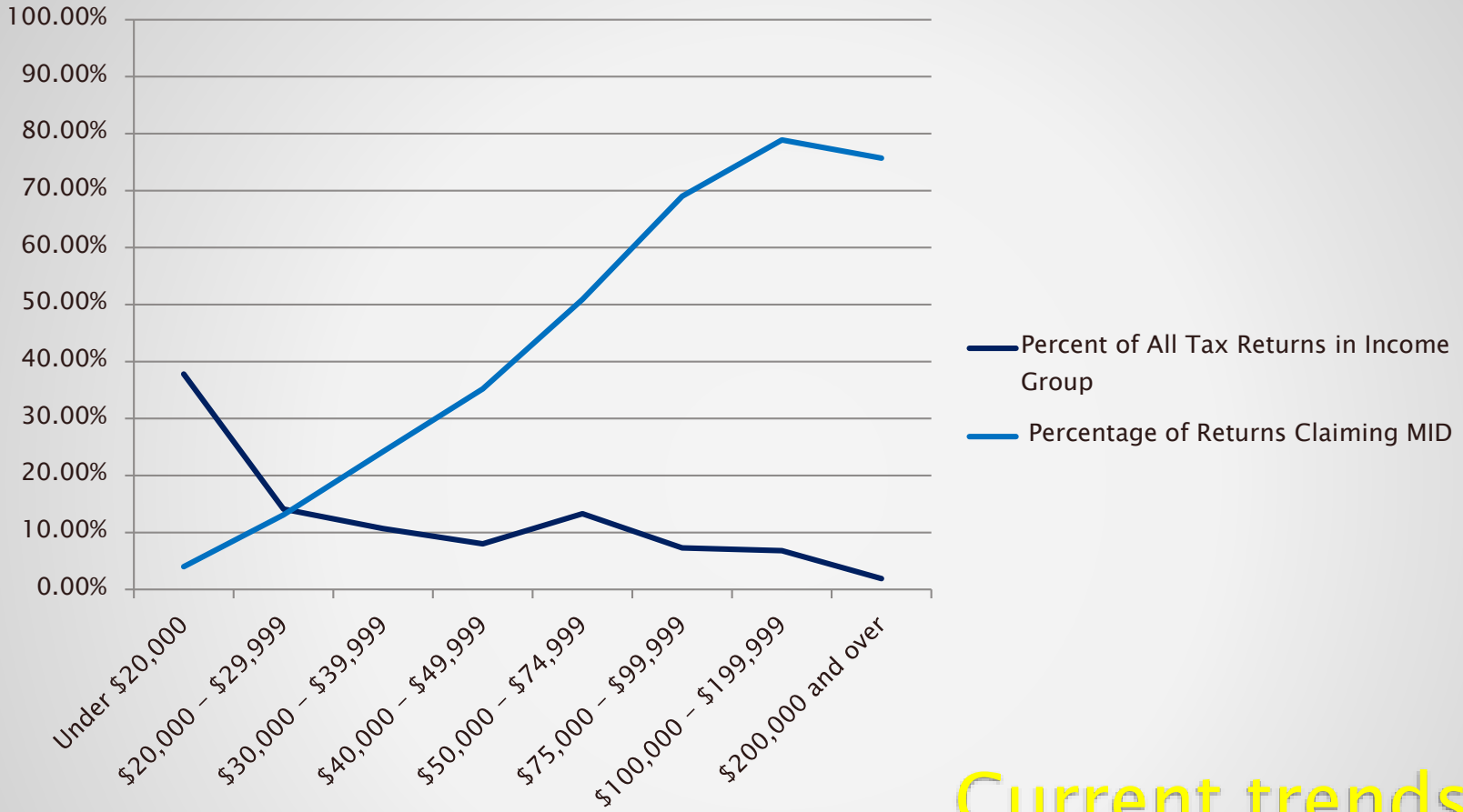
Considered MID-driven homeownership differences across states, over time, and from inter-state moves of households in order to measure subsidy effects on homeownership decisions.

In highly urbanized areas, increasing MID fails to increase homeownership

In un-urbanized areas, MID positive impact according to income level but higher income households are unresponsive to changes in the MID



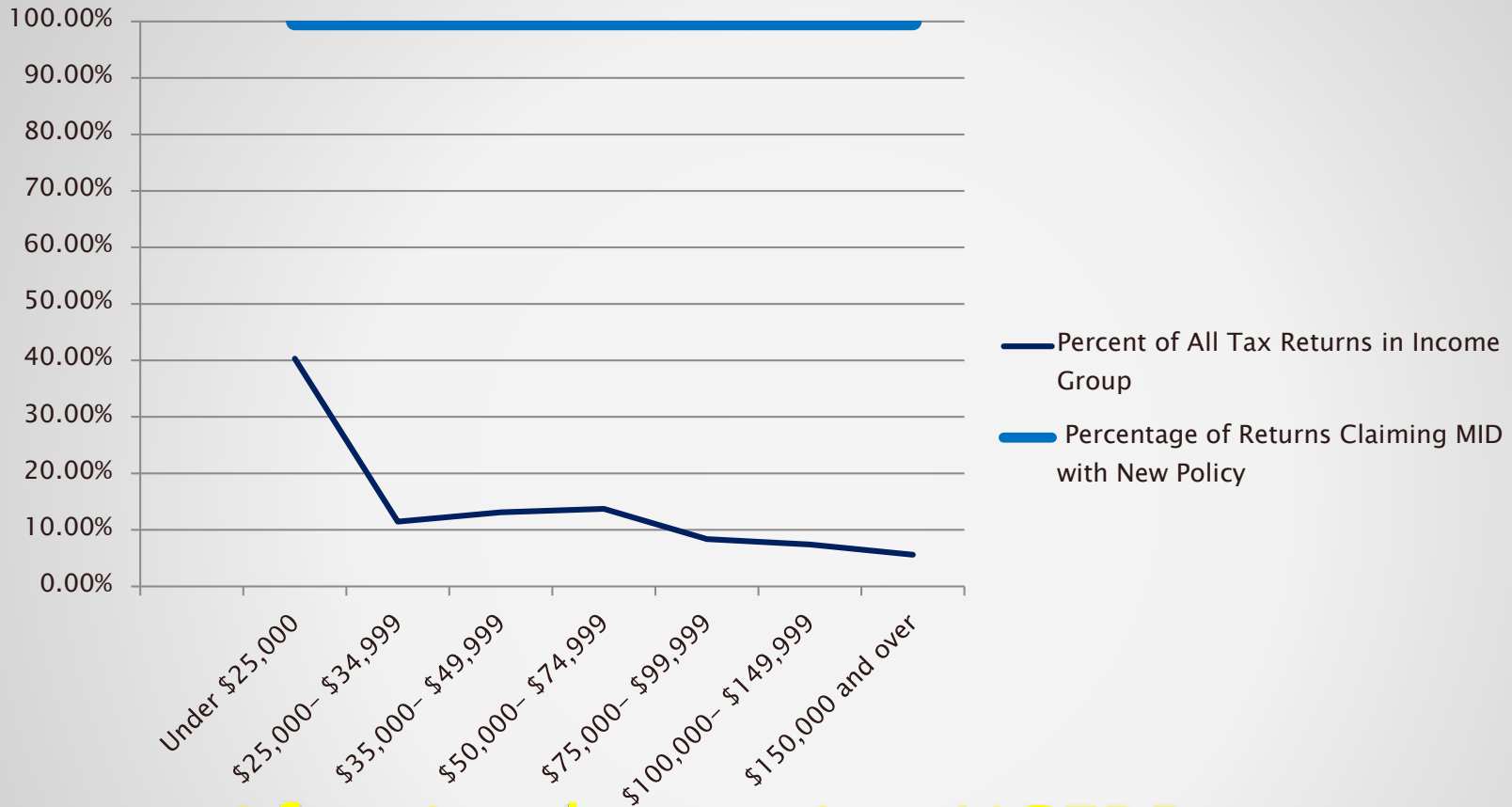
# 3. Benefits not commensurate with costs (a)



Current trends >>

Created from IRS data via Tax Foundation's calculations (Prante, 2003)

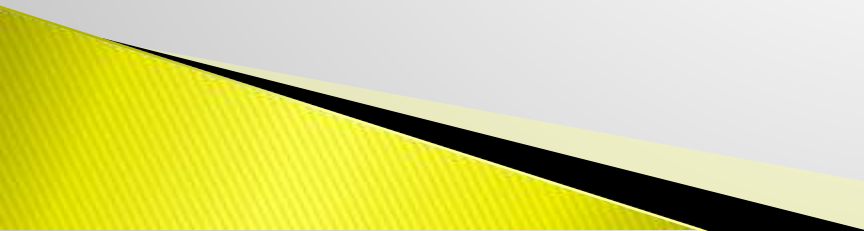
# 3. Benefits not commensurate with costs (b)



After implementing NCFRR proposal >>>

Created from 2008 IRS data and 2009 Census Bureau data

## 4. Some ethical arguments in support of the proposed change

- Utilitarianism (Jeremy Bentham, John Stuart Mill)
  - Rights and Duties (Immanuel Kant)
  - Justice and Fairness (David Hume, John Rawls)
- 

# Opponents of proposed change

- MORTGAGE BANKERS ASSOCIATION

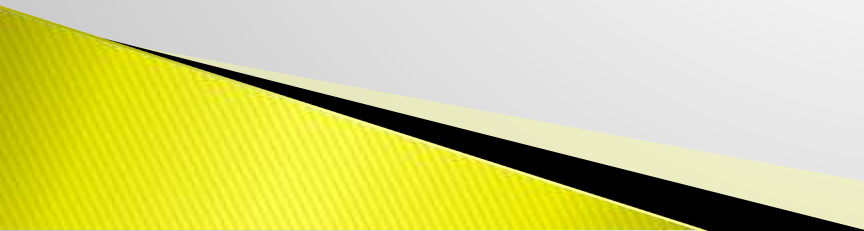
“devastating impact on both present and future homeowners in this country” (Yedinak, 2010)

- NATIONAL ASSOCIATION OF REALTORS

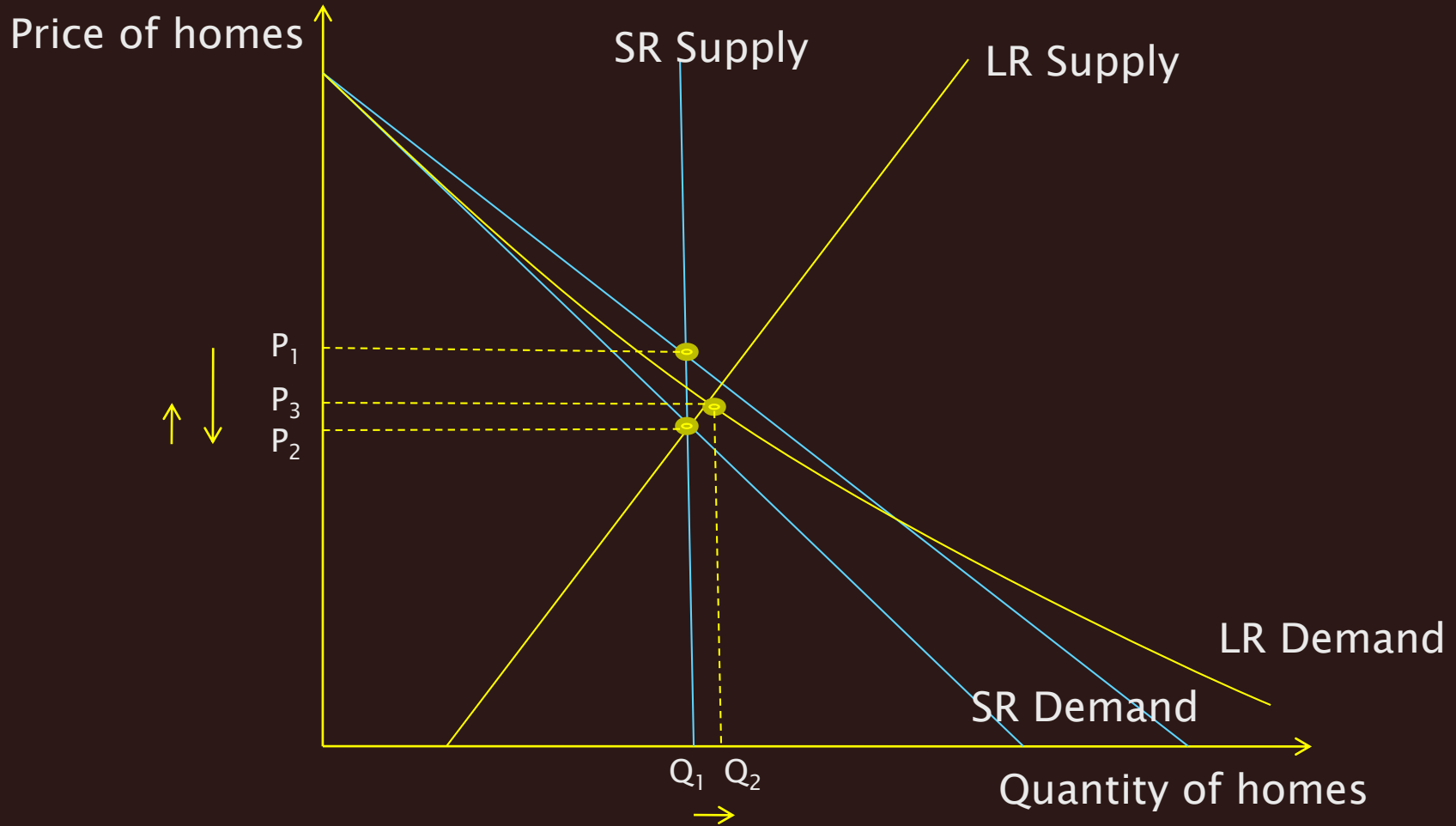
Chief Economist Lawrence Yun projected that home values could fall an additional 15% below currently depressed levels, and threaten a double-dip recession (Jarratt, 2011)

- SMALL BUSINESS OWNERS

“purposeful plan to destroy capitalism” (Root, 2011)



# Supply and Demand in Housing Market



# Alternative Solutions

Alteration among components of proposed solution:

- Cap
- How MID is claimed on individual's tax return
- What is allowed

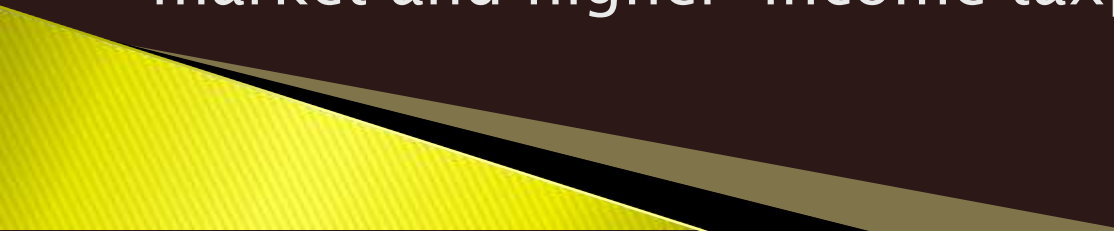
“The national interest, **not special interests**, must prevail. We urge leaders and citizens with principled concerns about any of our recommendations to follow what we call the Becerra Rule: **Don't shoot down an idea without offering a better idea in its place**” –

NCFRR, 2010

# Proposed alternative solution

- Cap
  - \$500,000
- How deductible on tax return
  - Line item
- What is allowed
  - Allow deduction on principal residence at a rate of 12%
  - Allow deduction on second residence at a rate of 5%
  - Don't allow deduction on home equity loans

# Conclusion

- NCFRR MID proposal is most effective offered so far
  - MID goal is better attained
  - Arguably more equitable
  - Short-run effects versus long-run effects
  - Policy needed to reduce budget deficit/national debt
  - However, alternative solution won't hurt housing market and higher-income taxpayers as much
- 



I would like to express my utmost gratitude to:

Dr. Richard McGinity

Dr. Teresa Stephenson

Dr. David Finnoff

Dr. Penne Ainsworth

UW Honors Program

**Thank you!**





# Questions?

- Countdown to graduation =  
6 days, 18 hours, 25 minutes