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THE MORTGAGE INTEREST DEDUCTION ACROSS ZIP CODES

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ABSTRACT

This brief examines characteristics of the mortgage interest deduction by utilizing zip-code level data on taxes and demographics. In the following sections, we focus on the relationship between the mortgage interest deduction and Adjusted Gross Income, the demographic characteristics of zip codes with particularly high proportions of taxpayers claiming the mortgage interest deduction, and the variation in MID claiming across counties.

The opinions expressed here are solely those of the authors and do not necessarily reflect the views of the Urban-Brookings Tax Policy Center.

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I. INTRODUCTION

The federal tax code affords several major tax expenditures for homeownership, the largest of which is the mortgage interest deduction (MID) on owner-occupied homes. The MID allows taxpayers to deduct mortgage interest on up to $1 million in debt used to purchase or refinance a primary or secondary home, as well as for up to $100,000 of home equity debt not used to buy, build, or improve the home. The MID is available only to the minority of households whose combined itemized deductions—which include such items as state and local taxes paid and charitable contributions, as well as mortgage interest—exceed the standard deduction. (In 2013, the standard deduction was $12,200 for married filers and $6,100 for single filers.) Taxpayers whose combined itemized deductions are less than the standard deduction do not directly benefit from this provision in that year.

Tax expenditures for homeownership are often justified on the basis of the benefits of homeownership (referred to by economists as "positive externalities"). These benefits typically fall into two categories: spillover effects (e.g., more engaged civic participation and lower crime) and benefits of higher wealth accumulation. Even if one accepts that homeownership can promote these ends, research suggests that existing tax expenditures for homeownership are poorly designed to achieve them. For example, tax expenditures for homeownership are regressive, providing larger subsidies for higher-income homeowners and larger houses, neither of which correlates with spillover effects for the rest of society. Homeownership tax expenditures also lead to substantial lost revenue, with the mortgage interest deduction costing $69.7 billion in 2013 alone.

The goal of this brief is to examine characteristics of the mortgage interest deduction by utilizing zip-code level data on taxes and demographics. In the following sections, we focus on the relationship between the mortgage interest deduction and Adjusted Gross Income (AGI), the demographic characteristics of zip codes with particularly high proportions of taxpayers claiming the mortgage interest deduction, and the variation in MID claiming across counties.

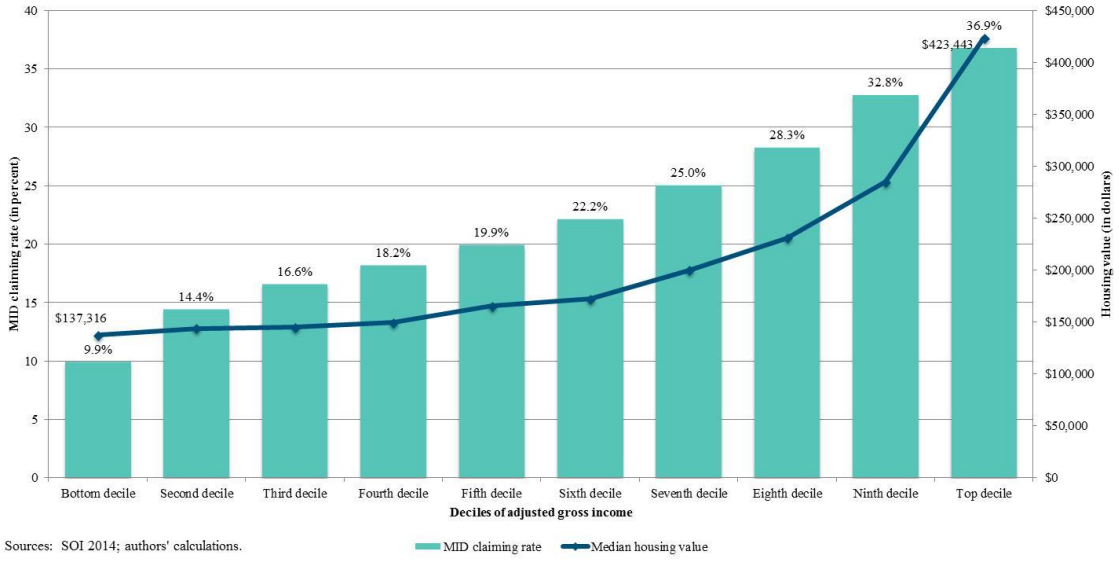
II. MORTGAGE INTEREST DEDUCTION AND ZIP-CODE LEVEL INCOME

The mortgage interest deduction is worth more, measured as a share of after-tax income, for higher-income homeowners. This regressivity occurs for three main reasons. One, the MID is valuable only to taxpayers whose total itemized deductions exceed the value of the standard deduction, which is more likely for high-income taxpayers with higher state and local taxes, larger mortgages, and larger charitable contributions; two, itemized deductions are worth more for taxpayers in higher tax brackets; and three, higher-income taxpayers typically have a higher MID, as a share of income, above the standard deduction threshold.

Not surprisingly, therefore, high-income taxpayers in richer zip codes are more likely to claim the mortgage interest deduction, while taxpayers in low- and middle-income zip codes frequently have relatively low claiming rates (Figure 1). The claiming rates (i.e., the percent of tax returns with mortgage interest paid) increase with income: zip codes in the top AGI decile exhibit a MID claiming rate of 36.9 percent, over three times higher than that of the bottom AGI decile with a

rate of 9.9 percent. Zip-code level median home value also rises with AGI. For those zip codes in the bottom income decile, the median home value is $137,316; this value increases steadily until sharply rising from $285,197 to $423,443 from the ninth to tenth deciles.

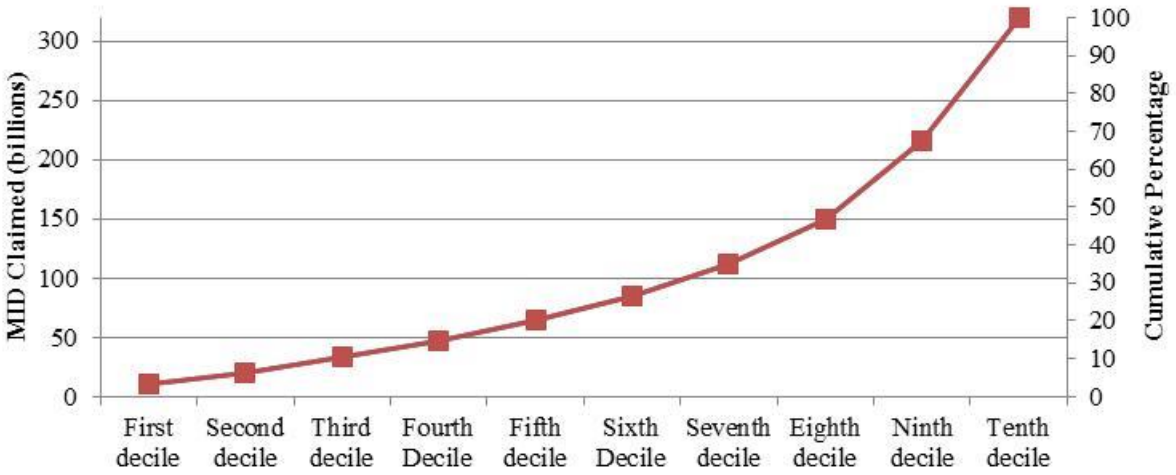
Figure 1. Mortgage Interest Deducation (MID) Claiming Rate and Median Housing Value by Zip Code Adjusted Gross Income



Sources: SOI 2014; authors' calculations.

The majority of tax returns with mortgage interest paid accumulate at the higher end of the household income distribution (Figure 2). Of all tax returns with mortgage interest paid, about one-third—32.8 percent—filed in zip codes in the top income decile. In comparison, just 20.1 percent of the aggregate deductions are filed in the bottom 50 percent of zip codes by AGI.

Figure 2. Cumulative Distribution of Total Mortgage Interest Deduction (MID) Claimed

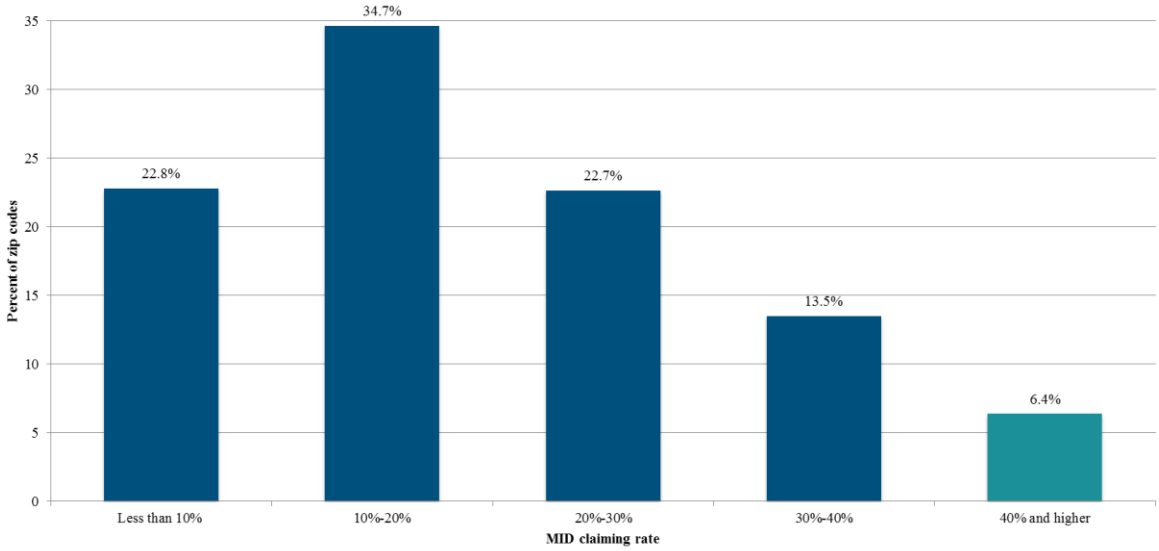


Sources: SOI 2014; authors' calculations.

III. CHARACTERISTICS OF ZIP CODES WITH HIGH MID CLAIMING RATES

The percent of tax returns deducting mortgage interest paid varies substantially across zip codes. The majority of zip codes have mortgage interest deduction claiming rates of less than 20 percent: 22.8 percent of zip codes have claiming rates of less than 10 percent and an additional 34.7 percent have claiming rates between 10 percent and 20 percent (Figure 3). Only 6.4 percent of zip codes have MID claiming rates of 40 percent and higher.

Figure 3. Zip Code Mortgage Interest Deducation (MID) Claiming Rate



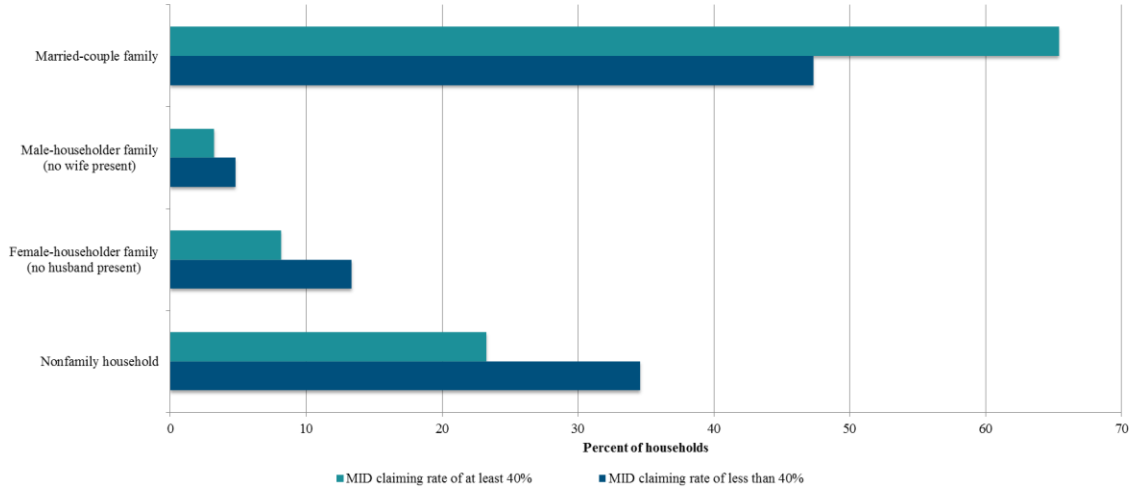
Sources: SOI 2014; authors' calculations.
Note: The MID claiming rate is equal to the number of tax returns with mortgage interest paid divided by the total number of tax returns within a given zip code. Data are derived from SOI (2014) and are for tax year 2012.

The characteristics of zip codes with MID claiming rates greater than 40 percent are considerably different than those with sub-40 percent claiming rates. As seen in Figure 4, household composition particularly differs in the distribution of married-couple families and other household types. For those zip codes with high claiming rates, 65.4 percent of households are married-couples families and 23.3 percent are in what Census calls nonfamily households, that is, singles and those sharing residences with unrelated individuals. The corresponding percentages are 47.3 percent and 34.6 percent, respectively, in the sub-40 percent group. An additional 11.3 percent of households in high-claiming zip codes are headed by an adult without a spouse present, compared to 18.1 percent in the sub-40 percent group.

The zip codes with MID claiming rates of greater than or equal to 40 percent also differ in age composition. This difference is most prevalent when considering the 20–34 age group and the 35–54 age group. Among the high-claiming zip codes, only 14.9 percent of the population is in the 20–34 age range, whereas 20.9 percent of the population in the sub-40 percent zip codes falls in this range (Figure 5). On the other hand, 32.2 percent of the population in the high-claiming zip codes falls within the 35–54 age group, compared to only 27.4 percent of the population in the sub-40 percent group.

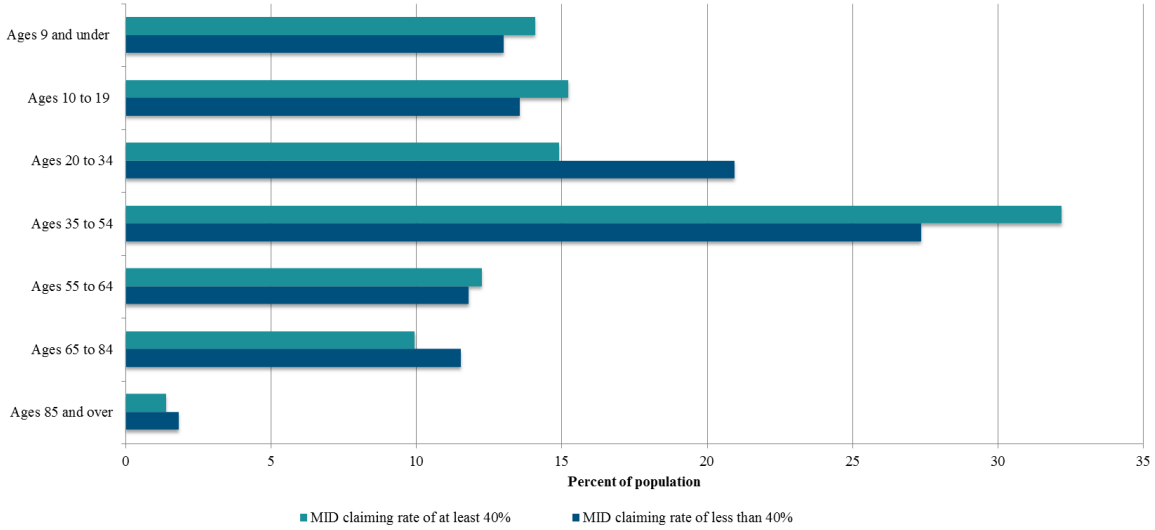
Finally, Figure 6 illustrates the difference in racial composition between the two groups. Among the high-claiming zip codes, 5.6 percent of the population is African American, and 82.5 percent of the population is white (note: Hispanic or Latino is not a racial classification). Among the lower-claiming zip codes, 13.4 percent of the population is African American, and 73.3 percent of the population is white. An additional 7.4 percent of the population among the high-claiming zip codes is Asian (compared to 4.5 percent in the remaining zip codes), and 1.7 percent is comprised of other races (compared to 5.1 percent).

Figure 4. Household Composition by Zip-Code Level Mortgage Interest Deduction (MID) Claiming Rate



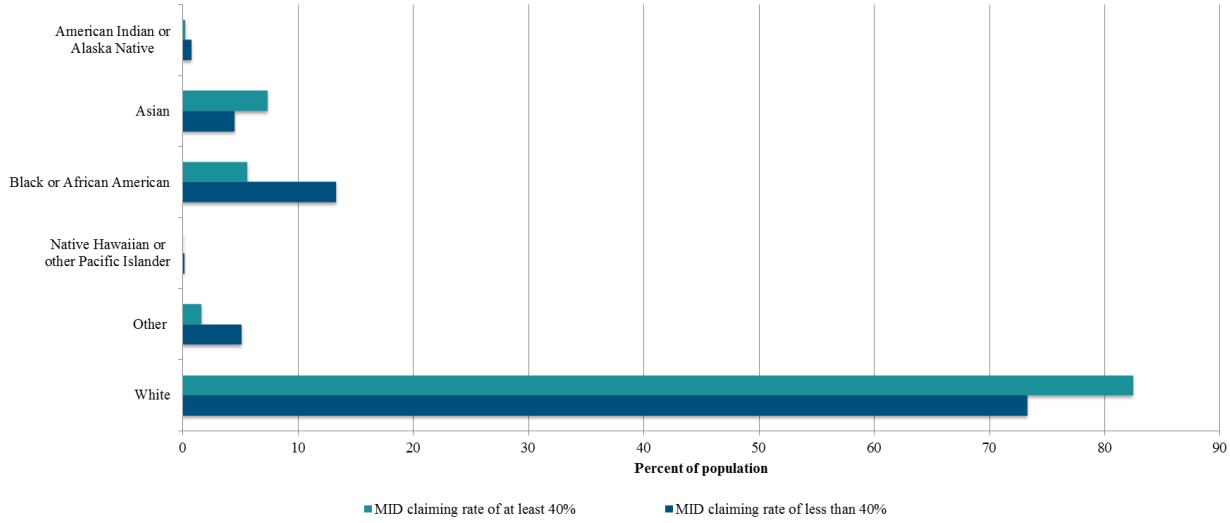
Sources: SOI 2014; U.S. Census Bureau n.d.; authors' calculations.
Note: Household types are weighted using the total households in each zip code. The MID claiming rate is equal to the number of tax returns with mortgage interest paid divided by the total number of tax returns within a given zip code. Data are derived from SOI (2014) and are for tax year 2012. Household data are derived from U.S. Census Bureau (n.d.) and are five-year estimates from 2008–2012.

Figure 5. Age by Zip-Code Level Mortgage Interest Deduction (MID) Claiming Rate



Sources: SOI 2014; U.S. Census Bureau n.d.; authors' calculations.
Note: Age groups are weighted using the total population in each zip code. The MID claiming rate is equal to the number of tax returns with mortgage interest paid divided by the total number of tax returns within a given zip code. Data are derived from SOI (2014) and are for tax year 2012. Age group data are derived from U.S. Census Bureau (n.d.) and are five-year estimates from 2008–2012.

Figure 6. Race by Zip-Code Level Mortgage Interest Deduction (MID) Claiming Rate



Sources: SOI 2014; U.S. Census Bureau n.d.; authors' calculations.
Note: Racial composition is weighted using the total population in each zip code.The MID take-up rate is equal to the number of tax returns with mortgage interest paid divided by the total number of tax returns within a given zip code. Data are derived from SOI (2014) and are for tax year 2012. Race data are derived from U.S. Census Bureau (n.d.) and are five-year estimates from 2008–2012.

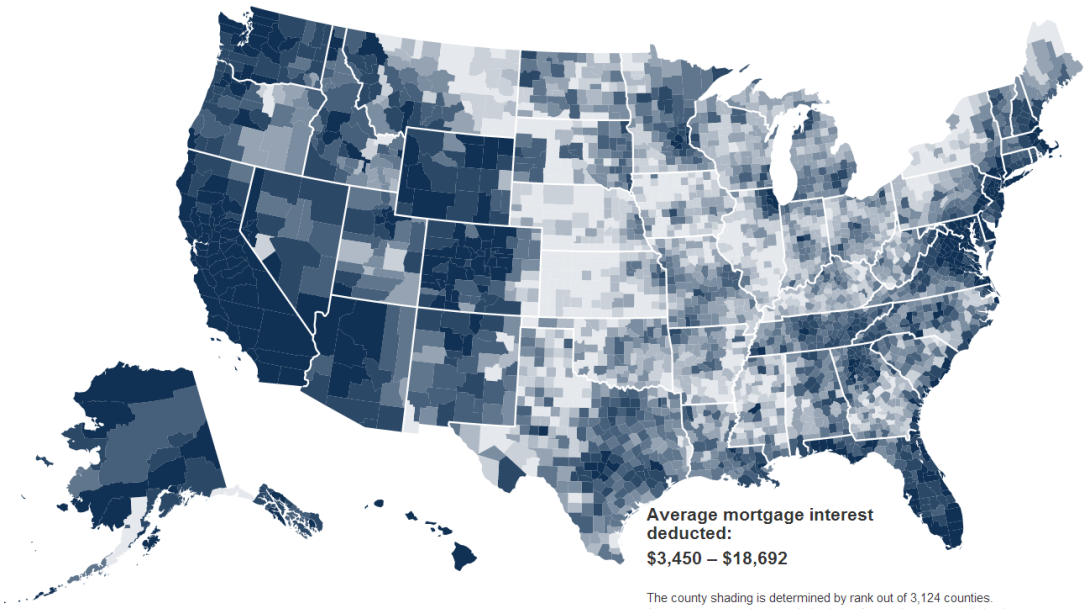
IV. COUNTY-LEVEL VARIATION IN MID CLAIMING

Income and housing differences fuel geographic variation in the mortgage interest deduction. As noted above, higher-income taxpayers are more likely to have itemized deductions that exceed the standard deduction; taxpayers in areas with high housing values are also more likely to have larger mortgages and subsequently pay more in mortgage interest.

This geographic variation leads to a large gap between low- and high-claiming counties. The bottom decile of counties has taxpayer claim rates of 7.3 percent or lower, while the top decile has claiming rates of 28.3 percent or higher. The average amount of deduction, conditional on claiming the deduction, shows similar variation. When considering only those who do itemize deductions, the bottom decile of counties has mortgage interest deductions of $5,241 or lower, while the top decile has conditional deductions of $9,433 or greater.

As can be seen in the map below, average mortgage interest deducted varies by region. Deductible mortgage interest tends to be highest in the West, on the East Coast, and near some metropolitan areas inland. Deductible mortgage interest is particularly high in California and the Northeast. Inland states east of the Mississippi tend to have lower housing values and, subsequently, fewer deductions for mortgage interest.

Average mortgage interest deducted, 2012, in dollars



V. CONCLUSION

The mortgage interest deduction is the largest tax expenditure for home ownership, but its value is not distributed equally across the income distribution or localities. In particular, we find that roughly half of the aggregate mortgage interest deductions are claimed by twenty percent of zip codes; zip codes with high claiming rates tend to be disproportionately white, middle-aged, and married; and counties west of the Mississippi River and on the East Coast disproportionately benefit from the MID.