RICH, POOR, AND IN BETWEEN

Who Benefits from the Mortgage Interest Deduction?

JOHN C. WEICHER

HUDSON INSTITUTE

RICH, POOR, AND IN BETWEEN

Who Benefits from the Mortgage Interest Deduction?

JOHN C. WEICHER

HUDSON INSTITUTE

CONTENTS

LIST OF TABLES

EXECUTIVE SUMMARY

In the ongoing policy discussions about changing the tax laws, the mortgage interest deduction has often come under fire. The most common criticism is that the deduction primarily benefits upper-income taxpayers, because many homeowners are unable to take advantage of it. In fact, lower-income families receive more tax benefit—and high-income taxpayers substantially less—from the mortgage interest deduction than from the deductions for either state and local income taxes or charitable contributions. Over 35 million families claim the deduction, more than the number claiming the deduction for state and local taxes and just slightly fewer than those claiming the deduction for charitable contributions. In addition, more than 5.5 million families claim the deduction but do not have to pay any income tax as a result of their deductions, more than the number of such families claiming the deduction for charitable contributions (4.6 million) or for state and local income taxes (3.5 million). About three-quarters of homeowner families with a household head younger than 65 have a mortgage; almost 90 percent of them itemize. Among older families, only one-quarter have a mortgage, because most of them have been able to pay off their mortgage; of those who still have a mortgage, almost 85 percent claim the deduction.

The equity that owners have in their homes is an important share of the net worth of American families. For most of the last 25 years, homeowners' equity has constituted about a quarter of total household wealth, about as much as their ownership of stocks (including the amounts in retirement accounts and mutual funds), and more than the value of unincorporated businesses and commercial and rental real estate combined.

Together, these three categories include three-quarters of total household wealth. Unlike the other two, home equity is distributed widely among American families, rather than being concentrated among the richest households, even taking account of the amounts owed on home mortgages. Home equity accounts for more than half of the net worth of all families in the lower half of the wealth distribution and less than 15 percent of the net worth of the wealthiest one percent. Even after the Great Recession, widespread homeownership is the most important factor helping to reduce the extent of wealth inequality in the United States.

EARNING INCOME, PAYING TAXES, CLAIMING DEDUCTIONS

The mortgage interest deduction has come under intense political fire since the Simpson-Bowles Commission included a proposal to repeal it as part of its deficit reduction plan in December 2010. It was discussed during the debates about tax policy during 2011 and 2012, and it remains an issue in the spring of 2013. The most common criticism of the mortgage interest deduction is that it is inequitable, in that most of the benefit goes to high-income households. A few examples, from across the political spectrum, are illustrative of these comments:

The mortgage interest deduction subsidizes big houses and bigger mortgages, but that's not a good use of tax dollars. Its benefits flow disproportionately to the wealthy and do nothing for the working poor. [1]

The deduction overwhelmingly benefits high-income households….By contrast, low-income households that do not itemize and senior citizens with little mortgage debt get almost no direct benefit from the deduction. [2]

Taxpayers in the top two quintiles receive almost all the benefit of these two deductions [the mortgage interest and property tax deductions].[3]

More than three-fourths of the benefit from the mortgage-interest deduction goes to the 14 percent of tax filers reporting six-figure incomes. Almost one-third of the subsidy goes to the population reporting incomes of $200,000 or more. Those 3 percent of tax filers at the very top receive about the same amount as do the 86 percent earning less than six figures.[4]

THE MORTGAGE INTEREST DEDUCTION IN A PROGRESSIVE INCOME TAX SYSTEM

This sort of criticism, however, leaves out several important facts. The federal income tax is progressive; not only do higher income taxpayers claim more of most deductions, they also pay more of the total tax burden. Table 1 illustrates the pattern for 2007, the last year before the Great Recession. The five income categories in the table have been chosen because they correspond approximately to significant points in the income distribution. Almost half of all tax returns report an income of less than $50,000, while only five percent report an income over $200,000 and only one percent report an income over $500,000. The December 2012 tax law changes raised rates for individuals with more than $400,000 income and families with more than $450,000. The policy debates leading up to that legislation were focused on $200,000 for individuals and $250,000 for married couples, and some tax changes do apply at those income levels. The published IRS data include all taxpayers with incomes between $200,000 and $500,000 in the same bracket, so those are the best available thresholds, corresponding most closely to various definitions of "the rich."[5] The other two categories approximately divide the rest of the returns in half, and there are notable distinctions between them with respect to their taxes and deductions.

As Table 1 shows, the richest 5 percent of all taxpayers received about one-third of the total income of all taxpayers and the richest 1 percent received close to one-quarter, while the bottom half received only about one-seventh. The distribution of taxes paid is much more unequal. The richest 5 percent pay more than half of all personal income taxes and the richest 1 percent pay over one-third, while the bottom half pay less than 10 percent. This is the main reason why a substantial share of most of the major income tax deductions goes to higher-income households: they are paying most of the taxes to begin with.

The table also shows that the distributions of *taxpayers* claiming each deduction are very similar, with the exception of medical expenses. About 16 percent of the taxpayers claiming each of the other deductions are in the bottom half of the income distribution; about a quarter have incomes between $50,000 and $75,000; about half have incomes between $75,000 and $200,000; about 8 percent have incomes between $200,000 and $500,000, and about 2 percent have incomes over $500,000. Even though taxpayers have to own a house and make mortgage payments in order to claim the mortgage interest deduction, these requirements do not result in a different distribution of taxpayers from those who claim deductions for charity and taxes.

The distributions of *deduction amounts*, however, are very different. The richest 5 percent of taxpayers receive less than 20 percent of the mortgage interest deduction. By

TABLE 1.
DISTRIBUTION OF HOUSEHOLDS BY INCOME, TAXES PAID AND MAJOR DEDUCTIONS IN 2007

(Percent of taxpayers who claim each deduction and the share of the total value of each deduction that goes to households within each income bracket)

				Mortgage Interest Deduction		Charitable Contributions		Medical Expenses		State & Local Taxes		Property Taxes	
Household Income	Share of Taxpayers	Share of Income	Share of Taxes Paid	Share of Households	Share of Deduction	Share of Households	Share of Deduction	Share of Households	Share of Deduction	Share of Households	Share of Deduction	Share of Households	Share of Deduction
Up to $50,000	49%	15%	8%	**16%**	6%	16%	5%	38%	20%	18%	3%	16%	7%
$50,000–$75,000	20%	15%	9%	**25%**	22%	24%	12%	31%	32%	25%	10%	24%	17%
$75,000–$200,000	26%	35%	29%	**50%**	54%	49%	34%	30%	41%	47%	36%	49%	50%
$200,00–$500,000	4%	12%	18%	**8%**	13%	8%	13%	1%	5%	8%	17%	8%	16%
$500,000 and more	1%	23%	37%	**2%**	5%	3%	37%	0.1%	1%	2%	34%	2%	10%

NOTES: Heading "State and local taxes" comprises individual income taxes and general sales taxes.
Column percentages may not add up to 100% because of rounding.
SOURCE: Calculated from Justin Bryan, "Individual Income Tax Returns, 2007," *Statistics of Income (SOI) Bulletin*, Fall 2009, pp. 5–69, Tables 1 and 3, available at http://www.irs.gov/pub/irs-soi/09fallbulindincomeret.pdf.

contrast, these taxpayers receive half of the deductions for charitable contributions and for state and local taxes. More than half of the mortgage interest deduction goes to taxpayers with incomes between $75,000 and $200,000—families who are certainly reasonably well off, but not "rich" by any definition. These households receive about one-third of the deductions for charitable contributions and for state and local taxes. Similarly, taxpayers with incomes between $50,000 and $75,000 receive over 20 percent of the mortgage interest deduction, about double their share of the other two deductions. Even in the lower half of the income distribution, taxpayers benefit more from the mortgage interest deduction than from the others.[6]

Perhaps not surprisingly, the distribution of the mortgage interest deduction is closer to the distribution of the property tax deduction than to any of the others. The property tax is paid by all homeowners, not only by those with mortgages, and rates vary substantially by state and by counties within a state, so there are certainly differences in the distribution of the two deductions, but the differences are relevant to an understanding of the mortgage interest deduction. Taxpayers with incomes over $200,000 receive about a quarter of all property tax deductions, compared to about one-fifth of all mortgage interest deductions. Those with incomes over $500,000 receive about 10 percent of the property tax deduction and about five percent of the mortgage interest deduction. Other tax-payers within the top half of the income distribution claim a larger share of the mortgage interest deduction than of the property tax; taxpayers in the lower half of the distribution claim a very slightly larger share of the property tax deduction.

COMPARING DEDUCTIONS

It is often asserted that the mortgage interest deduction is flawed because few households claim it. In fact, as shown in Table 2, the number of households claiming each of the major deductions is fairly similar, with one exception. Between 33 million and 38 million taxpayers, out of a total of 96 million, claimed the deductions for mortgage interest, charitable contributions, state and local income taxes, or property taxes. Since 44 million taxpayers itemized deductions, clearly most taxpayers who claimed any of these deductions were able to claim several. The mortgage interest deduction is not dramatically different from any of the

TABLE 2. TAXPAYERS CLAIMING THE MAJOR DEDUCTIONS IN 2007

Major Deductions	Number of Taxpayers Claiming	Average Deduction
Property Taxes	38.0 million	$3,899
Charitable Contributions	36.5 million	$4,985
Mortgage Interest	**35.2 million**	**$11,684**
State and Local Income Taxes	33.2 million	$7,882
Medical Expenses	7.5 million	$4,923
All Taxpayers	**96.3 million**	

SOURCE: Justin Bryan, "Individual Income Tax Returns, 2007," *Statistics of Income (SOI) Bulletin*, Fall 2009, pp. 5–69, Table 3, available at http://www.irs.gov/pub/irs-soi/09fallbulindincomeret.pdf.

other three: more than 35 million taxpayers claimed it, more than the number claiming state and local income tax deductions. As with Table 1, medical expenses are again the exception; about 7.5 million, fewer than 10 percent of all taxpayers, claimed the medical deduction.

In addition, these deductions were also claimed by income tax filers who did not owe any federal income tax because their exemptions and deductions reduced their taxable income to zero. Table 3 reports the number of filers owing no tax who claimed each deduction. The mortgage interest deduction is certainly the most important in enabling these tax filers to avoid paying any income tax. Some 5.6 million of them claimed the mortgage interest deduction, more than any other deduction except that for property taxes; these filers on average claimed over $14,000, far more than for any other deduction. These are by and large lower-income households. The personal exemption in 2007 was $3,400; a married couple with two children would have been able to claim $13,600. The standard deduction was $10,700 per family. A family that was able to avoid paying any income tax by claiming these exemptions and deductions was probably a lower-income family; if it claimed the average for each of these deductions, its adjusted gross income was less than $50,000.[7] This is further evidence that the mortgage interest deduction is not particularly a benefit to the rich, but helps lower-income families as well.

It has been an objective of nearly every major tax law for many years to exempt more low-income households from having to pay the federal individual income tax. The mortgage interest deduction makes a notable contribution to this policy goal.

In short, the mortgage interest deduction is the least regressive of the major deductions, with the exception of the deduction for medical expenses. Those who believe the mortgage interest deduction is a benefit for the well-to-do should consider it in the context of the distribution of the other deductions, and the distribution of taxes paid.

THE MORTGAGE INTEREST DEDUCTION OVER THE LIFE OF A FAMILY

Part of the argument that the mortgage interest deduction is inequitable is the assertion that not all homeowners can take advantage of it. Often, critics have lower-income homeowners in mind, families with not enough income

TABLE 3. TAX FILERS CLAIMING THE MAJOR DEDUCTIONS AND OWING NO INCOME TAX IN 2007

Deduction	Tax filers owing no taxes	Average deduction
Property Taxes	5,710,000	$ 3,339
Mortgage Interest	**5,571,000**	**$14,370**
Charitable Contributions	4,613,000	$ 2,521
State and Local Income Taxes	3,468,000	$ 2,176
Medical Expenses	2,999,000	$ 1,925

SOURCE: Justin Bryan, "Individual Income Tax Returns, 2007," *Statistics of Income (SOI) Bulletin*, Fall 2009, pp. 5–69, Table 3, available at http://www.irs.gov/pub/irs-soi/09fallbulindincomeret.pdf.

to benefit from itemizing. In fact, most homeowners with mortgages in any particular year are able to itemize in that year. Further, most families have been or will be homeowners for a substantial period of their lives whether or not they are owners at present, and most homeowners have claimed the deduction at some time during their lives, whether or not they are claiming it today.

Table 4 shows the number of homeowners as of 2007 who have mortgages and the number of those owners who itemize. The table reports households with heads age 65 or older separately from younger households, as well as the total.

Homeowners with mortgages nearly always itemize. As Table 4 shows, about three-quarters of homeowning households with heads under age 65 have a mortgage; of those who do, almost 90 percent claim the mortgage interest deduction. Only one quarter of homeowners with heads age 65 and older have a mortgage; about 85 percent of them also claim the deduction. Overall, more than 60 percent of all homeowners have a mortgage, and nearly 90 percent of them itemize their deductions and claim the mortgage interest deduction.[8]

But Table 4 is only a snapshot. The life of a family is much more like a movie; its circumstances change over time. This is certainly the case for the family's housing.

The homeownership rate rises over the life of a family, The peak years for homeownership are age 55 to 64. During the period 1982–1994, the years before the homeownership boom that began in the mid-1990s, the homeownership rate among these families was 79.8 percent.[9] It is reasonable to infer that this percentage is a lower bound for the share of households who are homeowners for some period of time. Some households will own homes at a younger age but will no longer own when they are in this age bracket, for personal reasons, demographic changes, or economic changes; some—probably not many—will not own homes until they are older than 65.

Moreover, nearly all of the homeowners who did not have mortgages as of 2007 did take out a mortgage at the time when they bought their homes. Of the 75.6 million homeowners in Table 4, about 6.4 million reported that they bought their home outright, and 3.4 million reported that they received their home as a gift or an inheritance. Excluding households who did not answer these ques-

TABLE 4. HOMEOWNERS, MORTGAGORS, AND THE MORTGAGE INTEREST DEDUCTION BY AGE

	All Owners	Owners with Mortgages		Mortgagors Claiming the Deduction	
		Number	Percent	Number	Percent of Mortgagors
Under age 65	57.3 million	42.0 million	73%	37.0 million	88.1%
65 and older	18.3 million	4.5 million	25%	3.8 million	84.4%
All	75.6 million	46.5 million	62%	40.8 million	87.8%

SOURCES: Number of Owners and Number of Mortgagors: U.S. Census Bureau, American Housing Survey for the United States: 2007, issued September 2008, Table 3-13; Number Claiming the Mortgage Interest Deduction: Bryan, "Individual Income Tax Returns, 2007," Table 3.[7]

tions, some 85.0 percent of homeowners took out a mortgage when they bought their home.[10] And of those with a mortgage, Table 4 shows that 87.8 percent claimed the mortgage interest deduction in 2007. These figures imply that about 60 percent of American families will claim the mortgage interest deduction for some period of years during their lifetimes, regardless of whether they are owning or renting in any particular year. This is far more than the 37 percent of all households who claimed the deduction in 2007.[11]

Older taxpayers on average have higher incomes than younger ones, as well as being more likely to have paid off their mortgage. This is one reason why the mortgage interest deduction is less important to the richest taxpayers. The correlation between age and income and its significance for the mortgage interest deduction are demonstrated in Table 5. Homeownership increases with age, until the retirement years. Over 80 percent of taxpayers 55 or older own their own home.[12] These taxpayers also have the highest incomes; their average adjusted gross income was over $85,000 in 2007, compared to a national average of about $60,000.[13] It would therefore be expected that their share of income taxes paid would be higher than their share of income, and this is indeed the case. Their shares of the claimed deductions for property taxes are proportional to their shares of taxes paid. But their shares of the claimed deductions for mortgage interest are smaller. They pay almost 40 percent of all individual income taxes, but they receive only 25 percent of the mortgage interest deduction. This age pattern helps to explain the strong and widespread public support for the mortgage interest deduction, among those who are not receiving the deduction as well as those who are. Many households who are not now receiving the deduction have

TABLE 5. INCOME, TAXES, AND HOMEOWNERSHIP BY AGE IN 2007
(Shares of total household income, taxes paid, and deductions claimed)

Age of Head of Household	Homeownership Rate	Total Income	Taxes Paid	All Deductions	Mortgage Interest Deduction	Property Tax Deduction
Under 25	23%	19%	5%	2%	**1%**	1%
25–34	48%	17%	12%	9%	**14%**	8%
35–44	68%	19%	22%	21%	**30%**	23%
45–54	76%	19%	26%	29%	**29%**	29%
55–64	80.6%	14%	20%	23%	**18%**	22%
65 and older	80.4%	13%	14%	16%	**7%**	16%

NOTE: The highest two age brackets are carried to three significant digits to show the very slight difference in the homeownership rates.
SOURCES: U.S. Census Bureau, American Housing Survey for the United States: 2007, Table 2-9; Jeff Curry and Jonathan Dent, "Individual Income Tax Returns, by Age of Primary Taxpayer, Tax Years 1997 and 2007," *Statistics of Income (SOI) Bulletin*, Spring 2011, pp. 1–119, Tables 1b and 2b, available at http://www.irs.gov/pub/irs-soi/11inincomeretsprbul.pdf.

claimed it in the past, when they were paying off their mortgages. They have enjoyed the benefit of the deduction. If they have adult children who are young or middle-aged and who have bought a home, they are probably in favor of their children being able to receive the deduction in turn. As for the youngest households, most are not yet homeowners and are not claiming the deduction, and they generally have lower incomes than older households; but they can very reasonably expect to buy a home in the next several years, as their incomes rise and they have children, and they can see the advantage of the mortgage interest deduction as they plan ahead.

A Gallup Poll in April 2011 asked if respondents would favor repealing the mortgage interest deduction in order to either lower the federal income tax rate or reduce the budget deficit. By margins of 2 to 1, the respondents opposed repeal for either reason. Democrats, Republicans, and independents all opposed repeal. Those who were not currently claiming the deduction were opposed, as well as those who were.[14]

The criticism that not all homeowners are able to claim the mortgage interest deduction can be raised against other major deductions as well:

- At least 90 percent of all homeowners paid a property tax in 2007, and that figure is undoubtedly low. The American Housing Survey reports on the dollar amount of property taxes paid. There is no category for "did not pay property taxes"; the lowest category is "less than $25 per month," reported by 8.0 million households. Of the 67.7 million households that we know paid property taxes, about 65 percent (43.7 million taxpayers) claimed a deduction for

TABLE 6. DO YOU FAVOR REPEALING THE MORTGAGE INTEREST DEDUCTION?

	Favor	Oppose
By Purpose		
If used to reduce the deficit	33%	**60%**
If used to lower tax rates	31%	**61%**
By Party		
Democrat	31%	**58%**
Independent	38%	**54%**
Republican	23%	**72%**
By Personal Benefit		
Now claim the deduction	21%	**77%**
Do not claim the deduction	39%	**49%**

SOURCE: *USA Today*/Gallup poll of April 13, 2011, available at http://www.gallup.com/poll/147125/americans-oppose-eliminating-income-tax-deductions.aspx?version=print.

their property tax payments. If all of the 8.0 million in the lowest category did pay property taxes, the share of property tax payers who itemized was about 58 percent.

• Many state income taxpayers also do not claim a deduction. The share who did in 2007 was about 30 to 35 percent, varying by state.[15] The IRS reports that only 36.7 million taxpayers claimed this deduction.

• Seven states have no tax on any type of income but do have a general sales tax, which can be deducted on the federal level. It is certainly reasonable to assume that any federal taxpayer in these states is also paying the state sales tax. The proportion of federal taxpayers in these states who did in fact claim the sales tax deduction in 2010 ranged from 17 percent in South Dakota to 30 percent in Washington state; across all seven states, 22 percent claimed the deduction.[16]

The medical expense deduction also has a pronounced age pattern, though a very different one from the mortgage interest deduction. About 40 percent of those households who claim the medical deduction have a primary taxpayer age 65 or over, and they claim 58 percent of the total deduction. Conversely, about 1.5 percent of those who claim the deduction are 25 or younger, and they claim about one percent of the deduction. Only about 10 to 11 million tax filers claimed the medical deduction in 2007, far fewer than the 37 to 44 million claiming each of the other major deductions, but this does not seem to diminish public support for the medical deduction. (These numbers include both those who paid some income tax and those who had no tax liability because of their deductions.)

HOMEOWNERSHIP AND THE WELL-BEING OF AMERICAN FAMILIES

HOMEOWNERSHIP AND FAMILY WEALTH

The age distribution of home ownership matters for more than housing. It is important for understanding the distribution of wealth among American families. The home they own is a very important component of wealth for most households. The Survey of Consumer Finances, conducted every three years by the Federal Reserve Board since 1989, has information about assets and debts. It tracks the age distribution of homeownership and the value of the homes that people own, as well as many categories of financial assets and several other categories of real assets. It also reports debts by category. Table 7 presents data on several important assets, for three different age cohorts, spanning the life of a family.

For most young people starting their working lives, the first two assets they own are a checking account and a car.[17] Many if not most of them have already established a checking account and bought a car before they have finished their education and started to work. The next two assets are a retirement account and a home. By the time they are in their early thirties, close to half have an IRA, a 401(k), or a 403(b), and close to half own a home—a single-family home, a row house, or a condo. As a generation ages, these will be the most commonly owned assets over the rest of their adult lives, by far. When they are middle-aged, with the head of the family about 50 years old, over 90 percent have a checking account and own a car, 65 percent have a retirement account, and 77 percent own a home.[18] About 12 percent own their home free and clear; the rest have a mortgage. From then on, the proportion who own a home will rise slightly and the portion with a mortgage will drop steadily, to 42 percent by about age 70, and to 14 percent for households with a head 75 years old or more.[19] No other major type of asset is owned by even a quarter of the population, at any stage of their lives.

For younger households, the value of these four assets amounts to more than their total net worth. This is because about one-third of younger individuals or families have education debt, averaging about $35,000, and few have other assets. For middle-aged families, the equity in their home (home value minus the mortgage balance) accounts for over a quarter of their net worth, and the four assets combined account for over half. For older households, their home equity is still almost a quarter of their net worth, while the other three assets are less important. Some older households (about 20 percent) have managed to save enough over their working lives so that they have been able to invest in stocks or mutual funds, and some (also about 20 percent) have built up a small business. These assets can be very important financially to those households who own them. There are, of course, other elderly households who have little in the way of wealth besides their home.

This distribution of household wealth may be surprising. Mention "wealth" in a conversation, and most people

TABLE 7. THE IMPORTANCE OF OWNING A HOME AS AN ASSET IN 2007

PANEL A - AGE UNDER 35

	% Owning	Mean Value Of Asset	Mean Value Net of Debt	Share of Net Worth
Cars/Other Vehicles	85%	$18,400	$15,700	14%
Transaction Account	87%	$8,300	$8,300	7%
Retirement Accounts	42%	$26,200	$26,200	10%
Owner-Occupied Home	**41%**	**$244,700**	**$99,300**	**89%**
Mean Net Worth			$111,100	

PANEL B - AGE 45–55

	% Owning	Mean Value Of Asset	Mean Value Net of Debt	Share of Net Worth
Cars/Other Vehicles	90%	$26,000	$23,500	3%
Transaction Account	92%	$35,300	$35,300	5%
Retirement Accounts	66%	$162, 200	$162,200	15%
Owner-Occupied Home	**77%**	**$352,100**	**$272,100**	**39%**
Mean Net Worth			$694,900	

PANEL C - AGE 65–74

	% Owning	Mean Value Of Asset	Mean Value Net of Debt	Share of Net Worth
Cars/Other Vehicles	91%	$26,200	$23,700	2%
Transaction Account	95%	$43,300	$43,300	4%
Retirement Accounts	52%	$279,700	$279,700	16%
Owner-Occupied Home	**86%**	**$360,500**	**$308,200**	**31%**
Mean Net Worth			$1,061,700	

NOTE: About one-third of households with head younger than 35 years old have substantial education debt. "Mean Value" is calculated for those owning the asset and does not include debt to purchase a vehicle, or the home mortgage. "Mean Value Net of Debt" is net of car loans and mortgages; there are no debts for transaction accounts and retirement accounts. "Share of Net Worth" is the percentage of mean net worth consisting of the asset category among all households in the age cohort; it is calculated by multiplying the percent of households owning the asset by the mean value net of debt, and dividing by mean net worth.
SOURCE: Federal Reserve Board, "2010 Survey of Consumer Finances, Summary Results: Tables Based on the Public Data," available at http://www.federalreserve.gov/econresdata/scf/scf_2010.htm.

seem to hear "stock market."[20] Stocks are certainly an important part of our wealth, being claims to ownership of publicly traded corporations, but they are only one part. Most of the wealth of Americans falls into one of three categories: stocks, unincorporated business, and home equity in owner-occupied homes. For the last twenty years, these categories have comprised two-thirds to three-quarters of net worth for American families. Table 8 shows their importance over that period.

Stock ownership is the most volatile of these three categories, partly because of the growth of retirement accounts during these twenty years, and partly because of the dot.com bubble from the later 1990s until 2001. Stocks constituted more than twice as large a share of American families' wealth in 2001 as they did just twelve years earlier, in 1989.

Both homeowners' equity in their homes and households' equity in unincorporated business have been more stable. Both decreased as a share of total family wealth during the dot.com bubble, and rose again after 2001. Homeowners' equity has been in the range of 20 to 25 percent of total family wealth, and business equity has been in the range of 25 to 30 percent. Both have declined during the Great Recession; not surprisingly, home equity has seen a greater decline.

HOMEOWNERSHIP AND ECONOMIC INEQUALITY

Economic inequality is increasingly seen as an important economic issue—most often in terms of income inequality, but also with respect to wealth.[21] Wealth is distributed unequally, for a variety of reasons. The most important reason is that most households gradually acquire more assets and reduce their debts as they grow older. In 2007, the median net worth of young households (household head younger than 35) was about $12,000, while the median net worth of households nearing retirement (household head between 55 and 64) was about $266,000, over twenty times

TABLE 8. THE MAJOR CATEGORIES OF FAMILY WEALTH DURING 1989–2010
(Shares of total wealth)

	Stocks	Business	Homes	Combined
1989	11.3%	30.0%	**26.4%**	67.7%
1992	13.8%	29.9%	**25.4%**	69.1%
1995	19.0%	26.0%	**22.5%**	67.5%
1998	27.6%	25.0%	**20.6%**	73.2%
2001	29.4%	24.3%	**20.5%**	74.2%
2004	23.1%	24.8%	**24.8%**	72.6%
2007	23.0%	27.1%	**24.2%**	74.4%
2010	22.5%	25.8%	**20.8%**	69.2%

NOTE: "Stocks" includes direct holdings of common stock and indirect holdings in mutual funds, retirement accounts, and other managed accounts. "Business" includes net equity in unincorporated and closely-held business, and net equity in commercial and rental real estate owned by individuals. "Homes" includes value of owner-occupied homes less outstanding mortgage balances.
SOURCE: Federal Reserve Board, "2010 Survey of Consumer Finances, Summary Results: Tables Based on the Public Data," available at http://www.federalreserve.gov/econresdata/scf/scf_2010.htm.

as much. (The difference in income was much smaller: $39,000 for the typical younger household and $57,000 for the older household.)

Wealth would be distributed much more unequally than it is in America if we were not largely a nation of homeowners. This is clear from Table 9, which reports the shares of total household wealth, and the shares of each of the broad wealth categories listed in Table 8, that are owned by households comprising different sectors of the wealth distribution. Both the richest one percent and the richest 10 percent have been categorized as "the rich" in the professional literature about wealth.

Families' equity in their homes is much more equally distributed than the other major categories of household wealth. The richest one percent of U.S. families owned about 12 percent of all home equity; the richest 10 percent owned less than half, about 45 percent.

By contrast, the richest one percent owned about 40 percent of all other household wealth, and the richest 10 percent owned about 80 percent. Three-quarters of all stocks and bonds, and over 90 percent of unincorporated business equity, were owned by the richest 10 percent. Overall, the richest one percent owned about one-third of all household wealth, and the richest 10 percent about three-quarters. These are similar to their shares in earlier years. The richest one percent have owned about one-third of all household wealth in each triennial Survey of Consumer Finances since 1995. The share of the richest 10 percent in 2007 is moderately higher than the 67 to 69 percent reported between 1989 and 2004.[22]

Owner-occupied homes keep those percentages from being markedly higher. The households in the bottom half of the wealth distribution do not own much wealth, but they own a much larger share of home equity than of any other asset. In an economy and society where homeownership opportunities are limited, the distribution of wealth would be markedly more concentrated among "the rich" than it is now.

The data in Table 9 also bring out the importance of homeownership to families in the lower half of the in-

TABLE 9. HOMEOWNERSHIP AND INEQUALITY IN 2007

Asset Category	Share of Asset Owned by:			
	Wealthiest 1%	2–10%	10–50%	Bottom 50%
Owner-Occupied Homes	**12%**	**33%**	**48%**	**5.8%**
Net Worth Excluding Home Equity	41%	40%	19%	1.4%
Stocks and Bonds	34%	42%	22%	2.1%
Unincorporated Business	58%	33%	8%	0.5%
Total Net Worth	34%	38%	26%	2.5%

NOTE: "Owner-Occupied Homes" is calculated as value of home minus outstanding principal balance on mortgages. "Net Worth Excluding Home Equity" is calculated net of debts other than mortgages. "Stocks and Bonds" includes direct ownership of bonds plus direct holdings of common stock and indirect holdings in mutual funds, retirement accounts, and other managed accounts. "Business" includes net equity in unincorporated and closely-held business, and net equity in commercial and rental real estate owned by individuals.
SOURCE: Arthur B. Kennickell, "Ponds and Streams: Wealth and Income in the U.S., 1989 to 2007," Finance and Economics Discussion Paper, Working Paper No. 2009-13, January 7, 2009, Figure A3a.

come distribution. More than half of their net worth—57 percent—consists of the equity in the homes they own. By contrast, less than one-quarter of the net worth of upper-income families consists of home equity. The percentage drops, sharply, for higher income households.[23] Among the richest one percent, the equity in their homes is only about 7 percent of their wealth. Table 10 shows this pattern.

Not all families in any income category own their own home, any more than do all families in any category own a particular type of asset. But among families in the lower half of the income distribution, just over half do own their home, and the equity that these families have in their homes is substantially larger than the equity that all families in the lower half have in all other assets combined.[24] At the same time, the wealth of the richest households mainly consists of unincorporated business and stocks.

Virtually no other assets are as widely held as the equity in owner-occupied homes. Table 11 calculates the 1%, 5%, and 10% concentration ratios for most of the individual asset categories reported in the Survey of Consumer Finances. Only two are more widespread: cars and other vehicles, and U.S. Savings Bonds. Neither constitutes a very large share of families' net worth. The total net worth of American households was about $65 trillion in 2007. Home equity was about $16 trillion. Cars and other vehicles had a total value of about $1.6 trillion, net of loans to purchase them; U.S. Savings Bonds had a total value of just over $100 billion. Among the major asset categories, retirement accounts have the closest concentration ratios to the equity in owner-occupied homes, and the total value of the assets in these accounts is slightly more than half the value of home equity—$9 trillion to $16 trillion. (CDs have a similar distribution to retirement accounts, but with a total value of $1 trillion.)

It has been asserted by many analysts in recent years that the mortgage interest deduction contributes to economic inequality. This is ironic in two respects: most of the other large deductions are more likely to contribute to inequality; and homeownership has been perhaps the most important factor in reducing wealth inequality among American families. Those who are especially concerned about inequality should keep this in mind as they consider policies to achieve a more equal distribution of wealth.

TABLE 10. THE IMPORTANCE OF HOMEOWNERSHIP IN FAMILY WEALTH IN 2007

(Home equity as a share of net worth among all households)

Income Category	Home Equity Share of Net Worth
Lower Half	57%
Upper Half	24%
Richest 10% to 50%	25%
Richest 1% to 10%	21%
Top 1%	7%

SOURCES: Calculated by author from data in Tables 8 and 9.

TABLE 11. CONCENTRATION RATIOS FOR ASSET CATEGORIES IN 2007

Asset Category	**Richest 1%**	**Richest 5%**	**Richest 10%**
Equity in Owner-Occupied Homes	**12%**	**40%**	**46%**
Less concentrated among the richest households than home equity:			
Cars/Vehicles	7%	18%	26%
U.S. Savings Bonds	7%	27%	38%
About as concentrated as home equity:			
Retirement Accounts	14%	42%	59%
CDs	15%	39%	51%
More concentrated than home equity:			
Life Insurance (cash value)	22%	41%	54%
Transaction accounts	23%	49%	60%
Commercial and Rental Real Estate	36%	71%	82%
Mutual Funds	47%	78%	88%
Stocks (direct ownership)	52%	82%	90%
Bonds	62%	93%	98%
Privately Owned Businesses	63%	88%	94%

SOURCE: Arthur B. Kennickell, “Ponds and Streams: Wealth and Income in the U.S., 1989 to 2007,” Finance and Economics Discussion Paper, Working Paper No. 2009-13, January 7, 2009, Figure A3a. The classifications “less concentrated” and so on are my own, not Kennickell’s.

CONCLUSION

Who benefits from the mortgage interest deduction? More than half of all American families for some period of time in their lives.

During the most recent normal year, about 37 percent of all families benefited. The share is higher if older households are not included, about 47 percent. Most older households (those with a household head age 65 or older) own their own homes but have paid off their mortgages. Most of them probably were able to claim the deduction during the years after they bought their first home.

The main beneficiaries are families whose incomes are above average, but are not "rich" by any current policy definition. Those families receive about three-quarters of the total amount of the deduction.

But families in the lower half of the income distribution benefit also. Many are able to avoid paying tax altogether because of their mortgage deduction, and many others who claim the deduction do pay taxes, though less than they would without the deduction. These two groups comprise 11 million households—a higher number than benefit from any other major deduction.

High-income households (those with an income above $200,000) certainly benefit also if they own a home and have a mortgage. But in the aggregate they receive only about 10 percent of the total dollar value of the deduction. The fact that so many benefit from it over the course of their lives probably helps to explain why a majority of Americans support it, even among those who are not now benefiting from it.

As homeowners pay down their mortgages over time, the value of their equity in their home becomes a substantial share of their wealth.

Home equity has been about one-quarter of the wealth of all American households since at least the 1980s, which is as far back as consistent household wealth data is available. It is particularly important for families in the lower half of the income distribution; for them, the equity in their home is over half of their wealth. It constitutes almost half of their wealth for those families who are in the upper half of the distribution, but are not "rich." For the rich, however defined, it is a small share of their wealth. The pattern is very different for stocks and other financial assets, and for unincorporated business; those assets are a large share of the wealth of the rich, and a small share for lower-income families.

Because home equity is important for lower-income families in particular, it helps to generate a more equal distribution of wealth in America. This is not to say that the distribution of wealth in America is equal; that is certainly not the case. But the distribution of wealth is more equal than it would be if most families were not homeowners. To the extent that a more equal distribution of wealth is a significant public policy objective, we all benefit from the mortgage interest deduction.

END NOTES

1. Doyle McManus, "Tax Reform that Hits Home," *Los Angeles Times*, February 6, 2013, available at http://articles.latimes.com/2013/feb/06/opinion/la-oe-mcmanus-mortgage-deduction-20130206.
2. Anthony Randazzo and Dean Stansel, "The Upper-Class Entitlement: It's Time to End the Mortgage Interest Deduction," October 18, 2011, available at http://reason.org/news/show/the-upper-class-entitlement.
3. Eric J. Toder, Benjamin H. Harris, and Katherine Lim, "Distributional Effects of Tax Expenditures," Schwartz Center for Economic Policy Analysis, the New School of Research and Urban-Brookings Tax Policy Center 2009, p. 9. Available at http://www.taxpolicycenter.org/UploadedPDF/411922_expenditures.pdf. An accompanying table states that households in the highest quintiles (the top 20 percent of the income distribution, above about $60,000 adjusted gross income in 2009) receive 68 percent of the mortgage interest deduction.
4. *Chicago Tribune* editorial, "Pre-Empt the Next Crisis," March 22, 2011, available at http://articles.chicagotribune.com/2011-03-22/news/ct-edit-mortgage-20110322_1_tax-filers-mortgage-interest-deduction-housing-crisis.
5. Justin Bryan, "Individual Income Tax Statistics 2007," *Statistics of Income (SOI) Bulletin*, Fall 2009, pp. 5-69, available at http://www.irs.gov/pub/irs-soi/09fallbulindincomeret.pdf. In addition, the published income tax data do not separate individuals from married couples. Given these limitations, I have chosen $200,000 and $500,000 as the best approximations to the thresholds in the recent tax policy debates.
6. No more than three million filers could have claimed all of these deductions. Some seven million filers claimed one or more of them and were able to avoid paying income tax, so it is unlikely that many filers were able to claim the average for each of these deductions. Published *Statistics of Income* data do not differentiate between mortgages on primary residences and mortgages on second homes. The Federal Reserve Board's Survey of Consumer Finances publishes a breakdown of mortgage debt between primary residences and other residences; in 2007, debt on primary residences was 88 percent of the total. The data do not include interest rates or payments, but it seems unlikely that the inclusion of interest on second homes in the mortgage interest deduction data should significantly affect the distribution (Federal Reserve Board of Governors, "2010 Survey of Consumer Finances, Summary Results: Tables Based on the Public Data," available at http://www.federalreserve.gov/econresdata/scf/scf_2010.htm).
7. Bryan, "Individual Income Tax Statistics 2007," Table 3, does not separately report the income distribution of filers owing no tax, reporting instead the income distribution for all filers, both paying and not paying any income tax. On the assumption that those not required to pay any tax are the lowest-income tax filers, all those with adjusted gross incomes under $35,000 would owe no tax, at least in part because of their mortgage interest deduction.
8. The American Housing Survey interviews were conducted between April and September 2007; households are classified as homeowners or renters as of the date of the interview. The IRS reports households claiming the mortgage interest deduction on their 2007 income tax returns, who may have owned the home for part or all of the calendar year.
9. Calculated by the author from U.S. Census Bureau, *Housing Vacancies and Homeownership* (CPS/HVS)," Historical Tables #12, Estimates of the Housing Inventory by Age of Householder: 1982 to Present, available at http://www.census.gov/housing/hvs/data/histtabs.html.
10. *American Housing Survey 2007*, Table 3-14.
11. In addition to the 75 million owners shown in Table 4, there were 35 million renters, for a total of 110 million households. The 41 million itemizers in 2007 constituted 37 percent of all households.
12. *Statistics of Income* does not report data for cohorts of elderly taxpayers other than "65 or over." Census data on household tenure show that homeownership rates are quite similar for at least the younger cohorts of the elderly: 81.7 percent for households with primary taxpayer age 65–69; 82.4 percent for households with primary taxpayer age 70–74; and 78.8 percent for households with primary taxpayer age 75 and over. These data are for 2007. U.S. Census Bureau, *Housing Vacancies and Homeownership (CPS/HVS, Historical Tables,* Table 12, "Estimates of the Housing Inventory by Age of Householder: 1982 to Present," available at http://www.census.gov/hhes/www/housing/hvs/historic/index.html.

13. This is not shown in Table 5, but it can be calculated from data in Jeff Curry and Jonathan Dent, "Individual Income Tax Returns, by Age of Primary Taxpayer, Tax Years 1997 and 2007," *Statistics of Income (SOI) Bulletin,* Spring 2011, pp. 1–119, available at http://www.irs.gov/pub/irs-soi/11inincomeretsprbul.pdf.
14. Jeffrey M. Jones, "Americans Oppose Eliminating Income Tax Deductions," April 15, 2011, available at http://www.gallup.com/poll/147125/americans-oppose-eliminating-income-tax-deductions.aspx?version=print.
15. *Statistics of Income* reports the number of federal taxpayers who claim each deduction by state, but not all states report the number of taxpayers who pay a state income tax. Among the large states, New York, Illinois, and Ohio do report this information. In 2007, about 36 percent of New York state income taxpayers claimed an itemized deduction on their federal tax form; for Illinois and Ohio, the share was about 32 percent in each case.
16. Tax returns by state are based on the location of the tax preparer rather than the taxpayer in published *Statistics of Income* data. The percentages reported in the text may therefore be slightly incorrect, but the basic point, that not many federal taxpayers in states with only a general sales tax itemize the sales tax deduction, is still correct.
17. It is sometimes argued that cars should not be included in household wealth because they are acquired to be used rather than as part of a household's portfolio, e.g. Edward N. Wolff, "Changes in Household Wealth in the 1980s and 1990s in the U.S.," in Edward N. Wolff, ed., *International Perspectives on Household Wealth*, (Northampton, Mass: Edward Elgar Publishing, Inc., 2008, pp. 109–150). As Kennickell points out, debt to buy a car is commonly counted as a liability, and it is asymmetric to exclude the value of the car; in addition, there are well-developed markets for the sale of cars, even more so since the creation of eBay and other internet websites. Arthur B. Kennickell, "Ponds and Streams: Wealth and Income in the U.S., 1989 to 2007," Finance and Economics Discussion Paper, Working Paper No. 2009-13, January 7, 2009, pp. 10–11.
18. These data are taken from Jesse Bricker, Arthur B. Kennickell, Kevin B. Moore, and John Sabelhaus, "Changes in U.S. Family Finances from 2007 to 2010: Evidence from the Survey of Consumer Finances," *Federal Reserve Bulletin,* vol. 98, no. 2 (June 2012), Tables 6 and 9. Age of household head is reported in brackets of ten years; the statements in the text apply to households with a head age 45 to 54. The data are for the year 2007, for consistency with other data in this paper. The same statements could be made for 2010, and for earlier years back to 1989, except that retirement accounts have grown in popularity over those two decades; about 35 percent of households in the 45–54 age bracket had a retirement account in 1989.
19. The same pattern of fewer households having a mortgage in older age cohorts applies as well to cars and other vehicles. About 44 percent of families under 35 have an outstanding car loan; the share drops steadily to about 39 percent for households around age 50, to 22 percent for households around age 70, and to 6 percent for households headed by an individual over 75 years old.
20. This is based on personal experience. I have written several papers and monographs about the distribution of wealth in America, and when I mention that research—to business people, journalists, and even some economists—they react by talking about the stock market, or asking me for advice on particular stocks.
21. See, for example, Edward N. Wolff, *Top Heavy: A Study of the Increasing Inequality of Wealth in America* (New York: The Twentieth Century Fund Press, 1995). When our son was in college in the late 1990s, wealth inequality was discussed in his Principles of Economics course and in introductory economics courses in other colleges and universities that his friends were attending.
22. Unless otherwise indicated, all data in this section are taken from Kennickell, "Ponds and Streams: Wealth and Income in the U.S., 1989 to 2007."
23. These percentages can be calculated by multiplying the share of home equity owned by households in an income bracket, shown in Table 9, by the share of home equity in the wealth of all American households, shown in Table 8. For example, families in the bottom half of the income distribution own 5.8 percent of all home equity, and home equity constitutes 24.2 percent of all family net worth; thus home equity among the bottom half of the income distribution is about 1.4 percent of all household wealth. Families in the bottom half of the income distribution hold 1.4 percent of all other assets, which constitute 75.7 percent of all family net worth; thus other assets owned by families in the bottom half of the income distribution are about 1.1 percent of all household wealth.
24. In 2007, about 52 percent of the families in the lower half of the income distribution owned their home. U.S. Bureau of the Census, "Housing Vacancies and Homeownership," Historical Tables, Table 17, available at http://www.census.gov/housing/hvs/data/histtab17.xls.

REFERENCES

Jesse Bricker, Arthur B. Kennickell, Kevin B. Moore, and John Sabelhaus, "Changes in U.S. Family Finances from 2007 to 2010: Evidence from the Survey of Consumer Finances," *Federal Reserve Bulletin,* vol. 98, no. 2 (June 2012).

Justin Bryan, "Individual Income Tax Statistics 2007," *Statistics of Income (SOI) Bulletin*, Fall 2009, pp. 5–69, available at http://www.irs.gov/pub/irssoi/09fallbulindincomeret.pdf.

Jeff Curry and Jonathan Dent, "Individual Income Tax Returns, by Age of Primary Taxpayer, Tax Years 1997 and 2007," *Statistics of Income (SOI) Bulletin,* Spring 2011, pp. 1–119, available at http://www.irs.gov/pub/irs-soi/11inincomeretsprbul.pdf.

Federal Reserve Board of Governors, "2010 Survey of Consumer Finances, Summary Results: Tables Based on the Public Data," available at http://www.federalreserve.gov/econ resdata /scf/scf_2010.htm.

Jeffrey M. Jones, "Americans Oppose Eliminating Income Tax Deductions," April 15, 2011, available at http://www.gallup.com/poll/147125/americans-oppose-eliminating-income-tax-deductions.aspx?version=print.

Arthur B. Kennickell, "Ponds and Streams: Wealth and Income in the U.S., 1989 to 2007," Finance and Economics Discussion Paper, Working Paper No. 2009-13, January 7, 2009, pp. 10–11.

Doyle McManus, "Tax Reform that Hits Home," *Los Angeles Times*, February 6, 2013, available at http://articles.latimes.com/2013/feb/06/opinion/la-oe-mcmanus-mortgage-deduction-20130206.

Anthony Randazzo and Dean Stansel, "The Upper-Class Entitlement: It's Time to End the Mortgage Interest Deduction," October 18, 2011, available at http://reason.org/news/show/the-upper-class-entitlement.

Eric J. Toder, Benjamin H. Harris, and Katherine Lim, "Distributional Effects of Tax Expenditures," Schwartz Center for Economic Policy Analysis, The New School of Research and Urban-Brookings Tax Policy Center, 2009, available at http://www.taxpolicycenter.org/UploadedPDF/411922_expenditures.pdf.

U.S. Census Bureau, *American Housing Survey for the United States: 2007*, issued September 2008.

U.S. Census Bureau, *Housing Vacancies and Homeownership (CPS/HVS, Historical Tables)*, available at http://www.census.gov/hhes/www/housing/hvs/historic/index.html.

Edward N. Wolff, "Changes in Household Wealth in the 1980s and 1990s in the U.S.," in Edward N. Wolff, ed., *International Perspectives on Household Wealth* (Northampton, Mass: Edward Elgar Publishing, Inc.).

Edward N. Wolff, *Top Heavy: A Study of the Increasing Inequality of Wealth in America* (New York: The Twentieth Century Fund Press, 1995).

ABOUT THE AUTHOR

John C. Weicher is a senior fellow at Hudson Institute and Director of the Center for Housing and Financial Markets. From 2001 to 2005 he served as Assistant Secretary for Housing and FHA Commissioner at the U.S. Department of Housing and Urban Development. He previously served as Assistant Secretary for Policy Development and Research at HUD and as Chief Economist at both HUD and the Office of Management and Budget. During 2007–2008 he chaired the Committee to Evaluate the Research Plan of the Department of Housing and Urban Development of the National Research Council. He has also been a member of the Millennium Housing Commission, the Census Advisory Committee on Population Statistics, and the Committee on Urban Policy of the National Research Council. He was President of the American Real Estate and Urban Economics Association in 1982 and received the Association's George Bloom Award for Career Achievement in 1993. He is the author or editor of fourteen books and the author of numerous popular and scholarly articles on housing and urban economics, housing finance, and the distribution of income and wealth. He has testified before Congressional committees on more than forty occasions. He holds an A.B. in English from the University of Michigan and a Ph.D. in economics from the University of Chicago.

The author is grateful for the research assistance of David Block, Shefali Khanna, Brett McCully, and Michael Socarras, while taking responsibility for any errors. The views expressed in this paper are those of the author alone, and do not necessarily reflect the views of any other party.

ABOUT HUDSON INSTITUTE

Hudson Institute is a nonpartisan policy research organization dedicated to innovative research and analysis promoting security, prosperity, and freedom.

Founded in 1961 by Herman Kahn, Hudson challenges conventional thinking and helps manage strategic transitions to the future through interdisciplinary and collaborative studies in defense, international relations, economics and trade, philanthropy, society and culture, technology, science and health, and law. Headquartered in Washington, D.C., Hudson seeks to guide public policy makers and global leaders in government and business through a vigorous program of publications, conferences, and policy briefings and recommendations.
www.hudson.org

HUDSON INSTITUTE

1015 15TH STREET, N.W., SIXTH FLOOR,
WASHINGTON, D.C. 20005
TELEPHONE 202-974-2400 WWW.HUDSON.ORG