Time to reform the mortgage interest deduction

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As the Senate considers the nomination of Steven Mnuchin for the role of Treasury secretary, members of Congress should just as seriously vet new opportunities for comprehensive tax reform. Indeed, Congress has a clear opportunity to enact tax reform that addresses the growing affordable rental housing crisis facing millions of low-income people in every state and community.

That starts with reforming the mortgage interest deduction. No longer a political "third rail," experts from across the ideological spectrum are increasingly calling it what it really is: a wasteful use of federal resources that encourages households to take on higher levels of debt, disrupts the housing market by increasing costs for everyone, and mostly benefits those who do not need federal assistance to live in a stable home.

It should be no surprise then that this issue brings together unexpected allies like ourselves. One of us is the director of financial regulation studies at one of the largest think tanks dedicated to the principles of individual liberty, limited government, and free markets. The other is CEO of a national advocacy organization focused on ensuring that people with the lowest incomes have a decent, affordable place to call home.

While we may disagree on some details, we recognize that scarce federal resources should be targeted to those who need them the most.

The National Low Income Housing Coalition's United for Homes campaign calls for reducing the amount of a mortgage eligible for a tax break from $1 million to $500,000—impacting fewer than 6 percent of mortgage holders nationally—and converting the deduction into a credit, allowing an additional 15 million low and moderate income homeowners to get a much-needed tax break.

The result would be $241 billion in savings over 10 years. The savings could be reinvested into critical rental housing solutions—like the national Housing Trust Fund and rental assistance—for those families with the most acute needs: those who are homeless or who are one crisis away from being homeless.

As Cato Institute's Director of Financial Regulation Studies, one of us has called for eliminating the mortgage interest deduction altogether and using the savings to reduce tax rates. This would promote work by reducing taxes on labor income, encourage investment to flow away from housing and toward productive capital, and improve the financial stability of families and the economy. Over-leveraged homeowners who took on more debt than they could afford directly contributed to the recent financial crisis. Eliminating the mortgage interest deduction would help end this harmful incentive.

A combination of these two positions should draw support from Republicans and Democrats alike.

Conservatives who want to see a simpler tax code should support reforms that do just that, as these reforms would put more money back in the hands of their red-state constituents. About half of all spending through the mortgage interest deduction benefits a small number of high-income households in blue states.

Progressives who are committed to addressing growing income inequality and racial inequities should support reforms that make the mortgage interest deduction fairer for more families. As it currently stands, the mortgage interest deduction is highly regressive.

Fully 75 percent of federal dollars--including tax expenditures--used to subsidize housing goes to high-income households through the mortgage interest deduction and other homeownership tax benefits. Seven million households with incomes of $200,000 or more receive a larger share of these resources than the 55 million households with incomes of $50,000 or less, even though lower-income families are far more likely to struggle to afford housing. Half of all homeowners receive no tax benefit from the mortgage interest deduction, and almost all of the tax break goes to households with incomes above $100,000. At the same time, only one in four of the poorest households that are eligible for housing assistance get the help they need because of chronic underfunding.

Now is the time to reform the mortgage interest deduction. It is unlikely that Congress will have another opportunity in the near term for comprehensive tax reform. With historically low interest rates, reforming the mortgage interest deduction now would cause the least amount of harm to existing homeowners. And, because economists have repeatedly found that the mortgage interest deduction does very little, if anything, to increase homeownership, reform would not negatively impact those who hope to become homeowners in the future. In fact, reform could make it easier for families to buy a home in high-cost cities where the mortgage interest deduction artificially inflates home prices.

Reforming the mortgage interest deduction would help address growing income inequality and racial inequity, improve the stability of families and the financial market, and generate significant savings. These savings, in turn, could provide some combination of tax cuts, deficit

reduction, and reinvestment in critical affordable rental housing programs that serve people with the greatest needs. Benefits like these explain why such a reform should be at the top of the list as Congress moves to consider tax reform.

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