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Pew: Mortgage interest deduction's geographic distribution highlights uneven impact of federal tax policy on the states

Washington – The mortgage interest deduction is one of the largest tax expenditures in the U.S. tax code but the rate at which it is claimed and the average amount deducted vary widely across and within states, according to a new report released today by The Pew Charitable Trusts. For example, the percentage of tax filers deducting mortgage interest ranged from nearly 37 percent in Maryland to 15 percent in West Virginia and North Dakota. The variation across metropolitan areas within states is even greater. In Texas, for example, the state's highest claim rate—in the Austin area—is 4 times larger than the lowest rate, in the Odessa area.

"Policymakers are actively discussing whether to modify tax expenditures, such as the mortgage-interest deduction, as they consider federal deficit reduction and tax reform," said Pew's Anne Stauffer, an expert on federal and state fiscal policy. "Looking at who benefits by state should inform federal policymakers as they consider options for changing or eliminating tax expenditures over the next several years."

The mortgage interest deduction generally allows tax filers who own a home and itemize their deductions to subtract interest paid on mortgage debt from their gross income. In 2011, tax filers deducted nearly $360 billion in mortgage interest, resulting in roughly $72 billion in foregone federal income tax revenue.

The geographic concentration in areas where property values and incomes tend to be higher is not surprising given the current structure of the mortgage interest deduction. However, there are other factors that could also influence the distribution, such as differences in housing turnover frequency and the proportion of tax filers living in rental housing.

If the deduction is modified or eliminated, the geographic distribution of the benefits would likely change—meaning tax filers in certain states, or areas within a state, would pay higher, or lower, federal income taxes than under current policy. The actual impact on any given area would depend on the details of how any modifications to the deduction were structured.

The number of filers who take the deduction and the size of the actual deduction vary widely across states. In 2010, the average deduction ranged from a high of $4,580 per filer in Maryland to a low of $1,192 in North Dakota. The national average was $2,713.

Similar to the variation across states, tax filers within states claim the deduction at different rates and amounts depending on where they reside. In 2007 (the latest available data for intra-state analysis), tax filers in and around larger metropolitan areas generally claimed the mortgage interest deduction at much higher rates and at higher amounts than those in less populous areas.

This report was written by Andrew Hanson, assistant professor of Economics at Marquette University, Zackary Hawley, assistant professor of Economics at Texas Christian University, and Ike Brannon, senior fellow at the R Street Institute, and was commissioned by Pew as part of its work examining the fiscal relationship between the federal government and the states. It is part of a series looking at housing tax subsidies and follows a Pew report that examined the distribution of the mortgage interest deduction's benefits across income groups. Future research will quantify how modifications to the deduction will directly impact state budgets.

To read the full report, as well as the accompanying charts and maps, please visit pewstates.org.

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