

How to Better Encourage Homeownership

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One consequence of the inefficient, inequitable distribution of housing benefits is a low homeownership rate among those who could most use the opportunity to build assets.

The way federal housing benefits are doled out across the population suggests a U-shaped curve: subsidies are heaped on those at high and very low incomes, with little going to all the low- to middle-income households in between. The federal government will disburse about \$50 billion to renters in 2005—mainly through Section 8 vouchers or public housing—and nearly three times that in subsidies to homeowners through such tax incentives as the mortgage interest or real estate tax deductions. These subsidies raise the prices of owner-occupied housing while saddling subsidized renters with a hefty opportunity cost should they consider owning.¹ By almost any standard, the distribution of housing benefits is inefficient and inequitable. One consequence is a lower homeownership rate among those who could well use the opportunity to start building assets.

Homes, like pensions, are tax-preferred investments. Homeowners are not taxed on the fiscal rewards of owning their own home,² nor are they taxed on the capital gains from the resale of the home.³ Homeowners can also deduct their real estate taxes and borrowing costs from their adjusted gross income. These special tax preferences likely contribute to higher housing prices for everyone, but especially where land is scarce.⁴ However, as this brief considers, simply eliminating these tax incentives would have significant consequences as tax filers adjusted their behavior.

Homeownership rates reached an all-time high of 69 percent in 2004. For most middle-income households, housing wealth is the largest single source of savings, exceeding other assets such as pen-

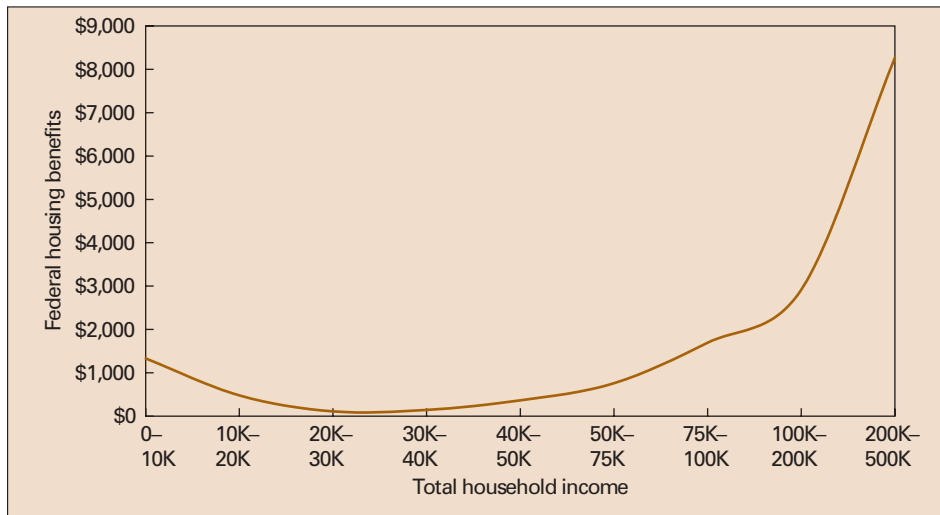
sions and personal savings. Homeownership serves not only as a financial solidifier, but also as a hedge against economic uncertainty and inflation. Moreover, owning a home correlates with greater educational attainment, greater likelihood of being married, better family outcomes, higher salaries, greater wealth, and increased ownership of other assets.⁵

This brief targets several reforms that would level out the U-shaped curve and deliver ownership subsidies more equitably and efficiently to households at lower income levels. This goal could be accomplished through a range of options described here, including several reforms of federal housing tax incentives—the mortgage interest and real estate tax deductions. Key considerations to be addressed in designing any comprehensive reform conclude this brief.

Options to Better Equalize Housing Benefits across Homeowners

The U-shaped curve of federal housing subsidies is the place to start when considering how to spur homeownership and more evenly distribute government largesse. Figure 1 uses data from the March 2002 Current Population Survey and the Urban Institute's Transfer Income Model to plot this curve, showing average household subsidies by income level. Families in the middle of the income distribution do not qualify for rental subsidies and may lack the means to buy a home; or, having bought one, lack the federal tax liability to itemize real estate taxes and mortgage interest payments. Low-income families

FIGURE 1. U-Shaped Curve: Average Annual Federal Housing Benefits (Subsidies and Tax Deductions) by Total Household Income



Source: The Urban Institute's Transfer Income Model, 2004.

Notes: The sample is restricted to individuals less than 65 years old. Chart includes households without subsidies. Housing subsidies include federal public housing and Section 8. Deductions include mortgage and property tax deductions. Not included are the exclusion of net imputed rental income, deductions such as the exception from passive loss rules for \$25,000 of rental loss, or accelerated depreciation on rental housing.

receive the bulk of direct assistance, while high-income households benefit from housing tax expenditures.

Thought of another way, the direct outlays that provide low-income families with housing subsidies are really *negative* homeownership subsidies. They represent the sums a low-income family must forgo—an opportunity cost, in other words—in buying a house. Seen in this light, the “U” curve becomes an “S” curve that effectively discourages homeownership at the low end of the income distribution (figure 2). The reform options laid out in this brief intend to improve the homeownership opportunities for these households.

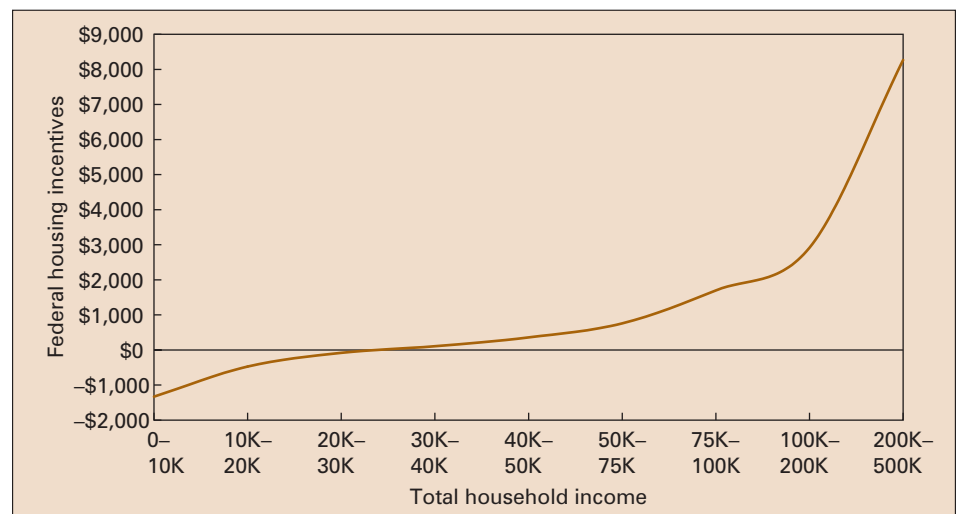
Past research has found that federal tax incentives influence an individual's decision whether to rent or to own and the cost of doing either. So, repealing or substantively altering current tax incentives might significantly affect households' homeownership decisions, with a positive effect at lower incomes as the price of owning a home is lowered relative to renting. Meanwhile, simulations of revenue-neutral reforms to the existing tax

incentives suggest that converting the mortgage interest tax deduction into a fixed percentage rate or flat credit distributes benefits more evenly, increasing benefits at the bottom and middle while reducing benefits at the top.

What's more, the gains to homeownership rates at the bottom and middle outweigh the losses at the top, boosting the overall homeownership rate by several percentage points. However, partly because of individuals' ability to avoid the intended effect of tax changes, there are limits on how far one can simply manipulate tax incentives to boost homeownership among desired groups. It should be viewed as one lever within a systemic remedy that would also include allowing households more readily to convert Section 8 and public housing rental subsidies (vouchers) into homeownership vouchers.

Any reform must first consider how the largesse of current tax incentives is distributed across households and income groups. To illustrate this distribution, the Urban Institute–Brookings Institution Tax Policy Microsimulation Model is used to estimate who benefits from the mortgage interest and real estate tax deductions.⁶ Table 1 gives the current, combined distribution of the mortgage interest and real estate tax deductions by quintiles of cash income.⁷ The deductions were worth

FIGURE 2. S-Shaped Curve: Average Annual Federal Housing Incentives (Subsidies and Tax Deductions) by Total Household Income



Source: The Urban Institute's Transfer Income Model, 2004.

Notes: The sample is restricted to individuals less than 65 years old. Chart includes households without subsidies and counts federal public housing and Section 8 as negative housing incentives. Deductions include mortgage and property tax deductions. Not included are the exclusion of net imputed rental income, deductions such as the exception from passive loss rules for \$25,000 of rental loss, or accelerated depreciation on rental housing.

TABLE 1. *Federal Deductions for Home Mortgage Interest and Real Estate Taxes in Current Law* (distribution of benefits by cash income percentile, 2005)

Cash income percentile ^a	Percent of tax units with tax benefit ^b	Percent of total federal tax benefits	Average federal Tax Benefit	
			Dollars	Percent
Lowest quintile	0.44	0.03	–1	–0.3
Second quintile	3.47	0.45	–13	–0.9
Third quintile	13.93	3.01	–85	–1.7
Fourth quintile	37.55	14.62	–411	–3.6
Top quintile	72.77	81.90	–2,303	–4.9
All	25.63	100.00	–562	–4.3

Source: Urban–Brookings Tax Policy Center Microsimulation Model (version 0305-1A).

Notes: Calendar year. Baseline is current law without the deductions for home mortgage interest and real estate taxes.

^a Income cut-offs for each quintile are as follows: lowest quintile: \$0–\$13,286; second quintile: \$13,287–\$25,633; third quintile: \$25,634–\$44,601; fourth quintile: \$44,602–\$78,646; top quintile: > \$78,646. Tax units with negative cash income are excluded from the lowest quintile but are included in the totals. For a description of cash income, see <http://www.taxpolicycenter.org/TaxModel/income.cfm>.

^b Includes both filing and non-filing units. Tax units that are dependents of other taxpayers are excluded from the analysis.

\$80.9 billion in FY 2005.⁸ Tax filers in the top quintile receive 82 percent of the benefits, while filers at the bottom receive just 0.3 percent.

The reform options presented in this brief are all *revenue-neutral* and target families at lower and moderate incomes who, for the most part, do not currently itemize on their tax returns and may have little or no tax liability.⁹ The tax credits are refundable—meaning that tax filers can claim the maximum amount even if they lack the tax liability to offset. The credit options are financed by curtailing current tax benefits from the mortgage interest deduction or the real estate tax deduction.

■ **Option 1—Fixed Percentage Mortgage Interest Credit**

Repeals the mortgage interest deduction and replaces it with a fully refundable tax credit equal to 16.7 percent of mortgage interest paid.

■ **Option 2—Flat Mortgage Interest Credit**

Repeals the mortgage interest deduction and replaces it with a fully refundable tax credit equal to 1.03 percent of home value up to \$100,000 (maximum of \$1,030).

■ **Option 3—Flat Real Estate Tax Credit**

Repeals the real estate tax deduction

and replaces it with a fully refundable tax credit equal to the lesser of \$280 or 50 percent of real estate taxes on the primary residence.

■ **Option 4—Flat Tax Credit in Lieu of Mortgage Interest and Real Estate Tax Deductions**

Repeals the mortgage interest and real estate tax deductions and replaces them with a single, fully refundable tax credit equal to the lesser of \$1,400 or 100 percent of the real estate tax on the primary residence.

The Urban–Brookings Tax Policy Microsimulation Model is used to calculate the revenue and distributional effects of each reform option. We simulate the effects of the reform on the federal individual income tax code against a baseline of tax year 2005 current law. For more detail on the Tax Model and its methodology, see the discussion paper version of this policy brief (Carasso, Steuerle, and Bell 2005) and Rohaly, Carasso, and Saleem (2005).

Results and Discussion

Since each option modeled is revenue-neutral, each redistributes tax benefits from some households to others. Winners receive greater tax

relief and losers receive less. Table 2 shows the distributional implications for Option 1. The fixed percentage mortgage interest credit provides less than \$100 in tax benefits on average to tax filers in the bottom two quintiles and about twice that to households in the third and fourth quintiles. Those in the top quintile lose more than \$500 in tax benefits from the repeal of the mortgage interest deduction. Notably, though, the adjacent column shows that, in percentage terms, the tax benefit gains are very large for filers in the first and second quintiles, while the tax benefit losses for filers in the top quintile are minute—less than 2 percent. The next two columns show the share of federal housing tax benefits that goes to each quintile under the baseline and the reform. The reform redistributes very modestly—mostly from the top quintile to the fourth and third. As a consequence of the reform, the top quintile receives 63.7 percent of housing tax benefits, compared with 81.9 percent under current law.

The first option distributes housing tax incentives more progressively than current law. It also provides a new, potentially positive incentive to hold onto borrowing for lower-income households, a somewhat negative feature. This holds especially when the credit rate is above the tax rate (which, with a refundable credit, may be zero for some households), since even borrowing against one's house to put money into interest-bearing assets can then make money. Like existing subsidies, Option 1 also tends to supply the greatest benefit to households with the highest levels of housing value.

The second, third, and fourth options, which convert the home-related tax deductions into a capped, flat credit related to the amount of home value or real estate taxes paid, allow the tax code to favor homeownership while being more neutral toward borrowing levels.

The distribution for Option 2—which turns the mortgage interest deduction into a flat, capped credit of \$1,030 for those owning a home worth

TABLE 2. Option 1—Federal Credit Equals 16.7 Percent of Mortgage Interest Paid on Primary Residence; Repeals the Mortgage Interest Tax Deduction (distribution of benefits by cash income percentile, 2005)

Cash income percentile ^a	Percent of Tax Units ^b		Average Federal Tax Change		Percent of Federal Housing Tax Benefits ^c		Average Federal Tax Rate ^d		
	With tax cut	With tax increase	Dollars	Percent	Current law	Proposal	Current law	Change (% points)	Proposal
Lowest quintile	9.9	0.0	−47	−19.5	0.0	1.7	3.2	−0.6	2.6
Second quintile	19.5	0.0	−95	−6.9	0.5	3.9	7.2	−0.5	6.7
Third quintile	30.8	0.2	−168	−3.4	3.0	9.2	14.2	−0.5	13.7
Fourth quintile	38.9	9.4	−182	−1.7	14.6	21.5	18.4	−0.3	18.1
Top quintile	25.2	46.8	542	1.2	81.9	63.7	24.7	0.3	25.0
All	24.8	11.3	9	0.1	100.0	100.0	20.7	0.0	20.8

Source: Urban–Brookings Tax Policy Center Microsimulation Model (version 0305-1A).

Notes: Calendar year. Baseline is current law.

^a Income cut-offs for each quintile are as follows: lowest quintile: \$0–\$13,286; second quintile: \$13,287–\$25,633; third quintile: \$25,634–\$44,601; fourth quintile: \$44,602–\$78,646; top quintile: > \$78,646. Tax units with negative cash income are excluded from the lowest quintile but are included in the totals. For a description of cash income, see <http://www.taxpolicycenter.org/TaxModel/income.cfm>.

^b Includes both filing and non-filing units. Tax units that are dependents of other taxpayers are excluded from the analysis.

^c Under current law, includes the benefits of the mortgage interest deduction and the real estate deduction. Under the proposal, includes the benefits of the particular reform option simulated.

^d Average federal tax (includes individual and corporate income tax, payroll taxes for Social Security and Medicare, and the estate tax) as a percentage of average cash income.

\$100,000 or more—is shown in table 3. Option 2 achieves a greater amount of redistribution than the first option: more than \$200 on average to the first quintile of households, nearly \$350 to the second quintile, and more than \$300 and \$200 to the third and fourth quintiles, respectively. The top quintile loses about \$1,135 per tax filer, since the credit is a set amount and no longer provides any additional tax incentive to those who borrowed more than \$100,000. Again, in percentage

terms, the adjacent column shows large gains for those lower down on the income ladder and minor losses (2.5 percent for the fifth quintile) for those at the top. Option 2 consequently makes a more dramatic impact on overall redistribution—those earning in the top quintile now receive only 41.5 percent of all housing tax benefits, half what they received under current law. The redistributed housing tax benefits go to the bottom four quintiles in comparable amounts.

Table 4 gives the distribution of tax benefits for Option 3, which would offer the minimum of a \$280 credit or 50 percent rebate against real estate taxes paid in lieu of the current real estate tax deduction. Crediting tax filers for their real estate taxes involves less redistribution of money. Filers in the bottom quintile receive \$80, while those in the second and third quintiles each receive about \$100, and filers in the fourth quintile receive \$52 on average. Filers in the

TABLE 3. Option 2—Federal Credit Equals 1.03 Percent of Primary Residence Value up to \$100,000; Repeals the Mortgage Interest Tax Deduction (distribution of benefits by cash income percentile, 2005)

Cash income percentile ^a	Percent of Tax Units ^b		Average Federal Tax Change		Percent of Federal Housing Tax Benefits ^c		Average Federal Tax Rate ^d		
	With tax cut	With tax increase	Dollars	Percent	Current law	Proposal	Current law	Change (% points)	Proposal
Lowest quintile	26.2	0.0	−225	−93.5	0.0	7.9	3.2	−3.0	0.2
Second quintile	39.2	0.1	−349	−25.4	0.5	12.9	7.2	−1.8	5.4
Third quintile	40.6	1.1	−328	−6.7	3.0	14.7	14.2	−1.0	13.3
Fourth quintile	43.2	2.8	−233	−2.1	14.6	22.9	18.4	−0.4	18.0
Top quintile	43.6	7.6	1,135	2.5	81.9	41.5	24.7	0.6	25.3
All	48.5	16.0	0	0.0	100.0	100.0	20.7	0.0	20.7

Source: Urban–Brookings Tax Policy Center Microsimulation Model (version 0305-1A).

Notes: Calendar year. Baseline is current law.

^a Income cut-offs for each quintile are as follows: lowest quintile: \$0–\$13,286; second quintile: \$13,287–\$25,633; third quintile: \$25,634–\$44,601; fourth quintile: \$44,602–\$78,646; top quintile: > \$78,646. Tax units with negative cash income are excluded from the lowest quintile but are included in the totals. For a description of cash income, see <http://www.taxpolicycenter.org/TaxModel/income.cfm>.

^b Includes both filing and non-filing units. Tax units that are dependents of other taxpayers are excluded from the analysis.

^c Under current law, includes the benefits of the mortgage interest deduction and the real estate deduction. Under the proposal, includes the benefits of the particular reform option simulated.

^d Average federal tax (includes individual and corporate income tax, payroll taxes for Social Security and Medicare, and the estate tax) as a percentage of average cash income.

TABLE 4. Option 3—Federal Credit Equals Minimum of \$280 or 50 Percent of Real Estate Taxes on Primary Residence; Repeals the Real Estate Tax Deduction (distribution of benefits by cash income percentile, 2005)

Cash income percentile ^a	Percent of Tax Units ^b		Average Federal Tax Change		Percent of Federal Housing Tax Benefits ^c		Average Federal Tax Rate ^d		
	With tax cut	With tax increase	Dollars	Percent	Current law	Proposal	Current law	Change (% points)	Proposal
Lowest quintile	29.8	0.0	–80	–33.2	0.0	2.8	3.2	–1.1	2.2
Second quintile	40.0	0.3	–106	–7.7	0.5	4.1	7.2	–0.6	6.6
Third quintile	42.5	2.3	–99	–2.0	3.0	6.4	14.2	–0.3	13.9
Fourth quintile	45.0	15.6	–52	–0.5	14.6	16.2	18.4	–0.1	18.3
Top quintile	31.6	50.0	288	0.6	81.9	70.4	24.7	0.2	24.8
All	37.8	13.6	–10	–0.1	100.0	100.0	20.7	0.0	20.7

Source: Urban–Brookings Tax Policy Center Microsimulation Model (version 0305-1A).

Notes: Calendar year. Baseline is current law.

^a Income cut-offs for each quintile are as follows: lowest quintile: \$0–\$13,286; second quintile: \$13,287–\$25,633; third quintile: \$25,634–\$44,601; fourth quintile: \$44,602–\$78,646; top quintile: > \$78,646. Tax units with negative cash income are excluded from the lowest quintile but are included in the totals. For a description of cash income, see <http://www.taxpolicycenter.org/TaxModel/income.cfm>.

^b Includes both filing and non-filing units. Tax units that are dependents of other taxpayers are excluded from the analysis.

^c Under current law, includes the benefits of the mortgage interest deduction and the real estate deduction. Under the proposal, includes the benefits of the particular reform option simulated.

^d Average federal tax (includes individual and corporate income tax, payroll taxes for Social Security and Medicare, and the estate tax) as a percentage of average cash income.

top quintile lose \$288 on average. Although this option provides less redistribution, it redistributes a bit more than Option 2 to the bottom two quintiles relative to the third and fourth quintiles.

Table 5 shows the distribution of tax benefits for Option 4, which is one combination of options 2 and 3: a refundable tax credit equal to the lesser of \$1,400 or 100 percent of real estate taxes paid and financed by the repeal of both the mortgage interest and real estate tax deductions. Under this reform, tax filers in the second and third quintiles receive the most tax benefits—more than \$350 on average. Even those in the bottom quintile receive more than \$200. Tax filers at the top lose \$1,264 on average, a 2.8 percent increase in their tax liability. The top quintile receives 37.3 percent of total housing tax benefits under the reform, compared with 81.9 percent under current law. By comparison, the lowest quintile rises from a virtual 0 percent share to 8.2 percent of all benefits, the second quintile rises from 0.5 to 13.2 percent, and the third from 3.0 to 16.2 percent. These increases are substantial and slightly greater than under Option 2.

In summary, the simulated reforms produce moderate-size winners at the bottom and middle of the

income distribution and a few bigger losers at the top. However, the tax benefit loss to tax filers at the top is still moderate in relation to their overall tax liability. Of course, there would be exceptions, such as taxpayers who now take very large deductions for purchases of very expensive first homes and vacation homes.

Note that we have not adjusted these estimates for increases or decreases in homeownership. A primary emphasis of earlier studies was to measure a reform's impact on homeownership rates rather than to examine how reform should be designed. As a consequence, these past efforts do not take into account behavioral adjustments to the reform that would clearly reduce the amount of revenue available for redistribution.

Other Considerations

Proposals to convert deductions into tax credits—in particular, deductions that affect pricing within one of the nation's largest economic sectors as well as the investment portfolio choices of a large swath of the nation's owners *and* renters—require careful design consideration.

Our reform simulations assume that some new world has been fully

implemented, replacing an old one. In fact, transition rules would be required to mitigate the tax burden on and behavioral adjustments of those who currently take advantage of existing subsidies. The \$1 million limitation in current law on home mortgages for which interest deductions are allowed, for instance, is not adjusted for inflation. Recent years of low inflation, however, have effectively meant that the real value of that limitation is no longer falling at the rate that once applied. One could speed up that process over time by applying a gradual reduction in that cap. Ratcheting down the cap, therefore, might be one way to gradually implement reform.

How much of any new credit should be spent on existing homeowners? If the goal is to increase homeownership, granting tax benefits to those already owning homes, even if they do hold onto mortgages, would do little to increase their incentives to buy homes (although it might affect their incentives to retain them). Any new subsidy might be better directed to new or recent homebuyers. A credit might be provided for only the first 20 years of homeownership (whether consecutive or not). In this last case, homebuyers would not be allowed to skirt the provision if,

TABLE 5. Option 4—Federal Credit Equals Minimum of \$1,400 or 100 Percent of Real Estate Tax on Primary Residence; Repeals the Mortgage Interest and Real Estate Tax Deductions (distribution of benefits by cash income percentile, 2005)

Cash income percentile ^a	Percent of Tax Units ^b		Average Federal Tax Change		Percent of Federal Housing Tax Benefits ^c		Average Federal Tax Rate ^d		
	With tax cut	With tax increase	Dollars	Percent	Current law	Proposal	Current law	Change (% points)	Proposal
Lowest quintile	29.8	0.0	–233	–96.9	0.0	8.2	3.2	–3.1	0.1
Second quintile	40.1	0.4	–355	–25.8	0.5	13.2	7.2	–1.9	5.3
Third quintile	42.6	3.3	–367	–7.5	3.0	16.2	14.2	–1.1	13.1
Fourth quintile	46.5	15.8	–280	–2.6	14.6	24.8	18.4	–0.5	17.9
Top quintile	32.3	51.3	1,264	2.8	81.9	37.3	24.7	0.7	25.4
All	38.3	14.2	5	0.0	100.0	100.0	20.7	0.0	20.8

Source: Urban–Brookings Tax Policy Center Microsimulation Model (version 0305-1A).

Notes: Calendar year. Baseline is current law.

^a Income cut-offs for each quintile are as follows: lowest quintile: \$0–\$13,286; second quintile: \$13,287–\$25,633; third quintile: \$25,634–\$44,601; fourth quintile: \$44,602–\$78,646; top quintile: > \$78,646. Tax units with negative cash income are excluded from the lowest quintile but are included in the totals. For a description of cash income, see <http://www.taxpolicycenter.org/TaxModel/income.cfm>.

^b Includes both filing and non-filing units. Tax units that are dependents of other taxpayers are excluded from the analysis.

^c Under current law, includes the benefits of the mortgage interest deduction and the real estate deduction. Under the proposal, includes the benefits of the particular reform option simulated.

^d Average federal tax (includes individual and corporate income tax, payroll taxes for Social Security and Medicare, and the estate tax) as a percentage of average cash income.

after owning a home for more than 20 years, they simply sold an old house and moved into a new one.

Along a related track, several barriers currently block a large-scale conversion of rental vouchers to ownership vouchers. Housing authorities receive fees for rental vouchers, making it more likely they will offer such vouchers over homeownership ones. Most important, housing authorities have no incentive to grant vouchers to individuals that might purchase housing elsewhere (Carasso, Bell, et al. 2005). One viable reform that would not entail large changes in tax administration would be to gradually expand ownership options among those who now receive housing vouchers. This might be enhanced by taking the revenues gained from capping other existing housing tax benefits.

Along a separate track, the government has legislated and begun funding Individual Development Accounts (IDAs), whose primary use is to help individuals save for the down payment and closing costs for a first-time home purchase. Housing credits might be expanded to include credits for those saving for home purchase, not just those who buy or have bought. If IDAs are continued, it would be worthwhile to consider

marrying any new tax incentives to the present IDA structure. Such a reform would make the tax system more neutral toward those saving to buy homes and those who buy homes with very high amounts of debt relative to equity.

Conclusion

Federal housing benefits are not distributed very rationally, efficiently, or equitably. Instead, the government bestows some rental subsidies in the form of direct outlays on only some households with modest means, while providing generous ownership subsidies in the form of tax incentives to most of those with ample means. The rental subsidies *in and of themselves* provide an additional barrier for low-income families to own, while the ownership subsidies encourage excessive borrowing and inefficient wealth allocation among households that by and large *already* possess the means to own a home. While homeownership is not realistic for all people—given the costs of ownership, risks involved, and particular needs of some households—there is little excuse for creating a subsidy system that strongly discourages many moderate-income people from owning.

Converting home-related tax deductions into refundable tax credits introduces greater progressivity into the system and encourages homeownership among low- and middle-income taxpayers. A flat, capped credit is more progressive than a fixed percentage rate credit tied to interest paid and does not contain some of the undesirable incentives to hold onto debt. Any loss of mortgage tax relief by households at the top may do less to affect the rates of homeownership than to reduce demand for very high value homes or second homes. Overall, the reforms we simulated generally produce many modest-size winners at the bottom and middle of the income distribution and some larger losers at the top—although even then, the losses are usually only a moderate percentage of income.

Thinking more broadly about reform requires moving beyond these types of calculations to a number of very important design issues. Policymakers may decide they do not wish to provide a blanket subsidy to all groups—such as those who have paid off their mortgages or who own multiple homes—but rather, to concentrate scarce budgetary resources on those who are about to buy their first home or are in the early stages of

home tenure. A credit that applies to the first 10 or 20 years of ownership and is financed by a tighter cap on home-related tax deductions, phased in gradually, may better align federal policy with homeownership promotion while minimizing federal interference with existing household investment decisions. More broadly, a variety of reforms should be considered that would level out the U-shaped curve of both *rental and ownership* subsidies for housing, as well as reduce or remove the negative incentives for *ownership* among low- and moderate-income households.

Notes

1. Economic theory asserts that a subsidy for homeownership can raise after-tax income and lower the after-tax price of owning, yet raise the before-tax price people are willing to pay. Thus, those with large subsidies for ownership may come out ahead, and those with zero or small subsidies come out behind, when price changes are taken into account. In the case of renters, on the other hand, rental subsidies are designed in such a way that renters forfeit this amount if they opt to buy a home, in addition to the costs of owning. In theory, the law provides that some of these latter rental subsidies could be converted to ownership, but in practice, for the most part, it simply is not allowed. For examples, see Rosen and Rosen (1980); Reschovsky and Green (1998); Green and Vandell (1999); Collins, Belsky, and Retsinas (1999); Olsen (2001); and Carasso, Bell, et al. (2005).
2. Since we typically think of the benefits of renting versus owning from the standpoint of cash flow, this concept can be elusive. A renter pays for the privilege to live somewhere, whereas an owner pays himself equity while getting to live somewhere “rent free.”
3. Assuming the seller lived in the home (as opposed to renting it out) for two of the prior five years. See IRS Publication 523 for details.
4. More precisely, the increase in demand increases prices more where supply is more inelastic and supply factors, such as land, tend to be scarce.
5. The education and financial findings are indicated by direct correlation using the 2001 Survey of Consumer Finances. Duda and Belsky (2001) and Collins et al. (1999) catalog the research that underlies the social findings.
6. Please see <http://www.taxpolicycenter.org> for details on the tax model and its data

sources. Also, note that the revenue and distributional estimates produced for this paper are *static*, meaning they do not factor in tax filers’ behavioral responses to the changes in the tax law that are considered.

7. A quintile is a fifth of the population of concern. The first or bottom quintile is the poorest fifth, the second quintile is the next poorest, on up until the fifth or top quintile, which is the richest fifth of the population. Cash income includes wages and salaries, employee contributions to tax-deferred retirement savings plans, business income or loss, farm income or loss, Schedule E income, interest income, taxable dividends, realized net capital gains, Social Security benefits received, unemployment compensation, energy assistance, Temporary Assistance for Needy Families (TANF), workers’ compensation, veterans benefits, Supplemental Security Income, child support, disability benefits, taxable IRA distributions, total pension income, alimony received, and other income, including foreign-earned income.
8. These estimates come from the Urban–Brookings tax model. Separately, the home mortgage interest deduction was worth \$69.7 billion in FY 2005 and the real estate tax deduction was worth \$18.6 billion. Note that, due to interaction effects, the cost of the two deductions taken together is \$80.9 billion rather than \$88.3 billion. That is, once one deduction is eliminated, the household is even less likely to be able to make full use of the other deduction since a standard deduction—offered in lieu of itemized deductions—is more likely to be greater in value than remaining itemized deductions.
9. We define revenue-neutral as creating less than a \$2 billion change to total tax revenues.

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