# Home Mortgage Interest

## Tax Expenditure Initial Review - TEB 1.66

**Tax Expenditure Facts**

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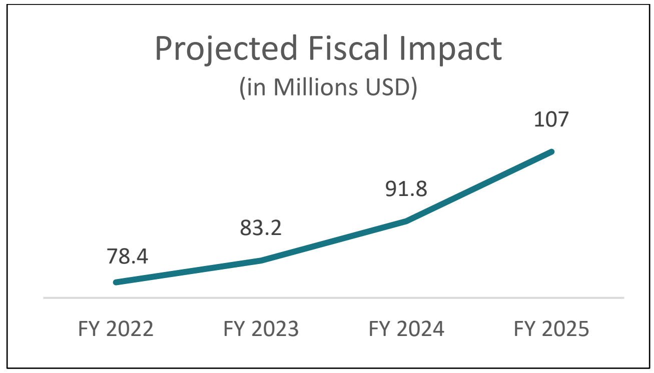
|---|---|
| Year Enacted | 1933 |
| Statute | Minn. Stat. § 290.0122, Subd. 2, 5 and 290.0132, Subd.19(b) |
| Tax Type | Individual Income Tax |
| Provision Type | Minnesota Personal Deduction |
| Latest Fiscal Impact Estimate | $91,800,000 – Fiscal Year 2024 |
| Latest Claims Estimate | 138,100 – Tax Year 2021 |
| Expiration Date | None |




**Tax Expenditure Description**

A taxpayer may take an itemized deduction for interest paid on debt secured by a principal or second residence. Mortgage interest is deductible on up to $750,000 of debt used to buy, build, or improve a principal or second residence. If the debt is used for any other purpose, the limitation is $100,000 of debt. If more than one home is involved, the limitations apply to the total amount. This deduction is one of several deductions subject to the limitation of itemized deductions for higher-income taxpayers.

Home mortgage interest was deductible without limitation until restrictions were enacted in 1987. In 2018, the federal limitation was temporarily decreased from $1 million to $750,000 in debt. In 2019, Minnesota established its own itemized deduction for home mortgage interest, with a limit of $750,000.

**Additional Background Information**

The existing Minnesota mortgage interest deduction (MID) limit of $750,000 was adopted under HF5 of the first special session of 2019, aligning with the Federal MID limit established by The Tax Cuts and Jobs Act (TCJA) of 2017.

A federal interest expense deduction has existed since the inception of the income tax in 1913. The initial deduction covered any business and personal interest expenses.[i] Over the last century, household use of debt has become more commonplace, and in response, the deduction has been limited to personal mortgage interest with restrictions on deductible amounts and eligible homes.[ii] MID only applies for a secured mortgage debt. Interest on home equity is deductible at the federal level only if the borrowed funds are to buy, build, or significantly improve the home that the equity is secured against.[iii] However, home equity interest is explicitly excluded from qualified residence interest that can be deducted under Minnesota Statutes, section 290.0122, subdivision 5(1).

The MID is an itemized deduction. This means that to benefit from it, taxpayers must forgo the standard deduction. The standard deduction was nearly doubled under the TCJA of 2017. This has led to fewer taxpayers itemizing their deductions and thus fewer taxpayers benefiting from the MID.[iv]

Beneficiaries of this tax expenditure are homeowners with mortgage interest payments who file an itemized deduction. This exemption is administered by the Department of Revenue. The MID reduces the amount of income tax revenue that would otherwise be generated. State income tax collections are deposited in the state General Fund except as directed by Minnesota Statutes, section 290.62.

**Proposed Tax Expenditure Objective for Consideration**

The objective of the Minnesota Home Mortgage Interest Deduction is to recognize expenses incurred in generating personal income or wealth.

### Sources

An explicit tax expenditure objective was not identified in the Minnesota legislative record.

The proposed objective is informed by a 2013 report published by The Minnesota House of Representatives Research Department, *A Review of Selected Tax Expenditures*.[v] The House Research report summarizes modern arguments for the policy's rationale and suggest the rationale for the policy was "more likely to allow recognition of expenses related to generating income." This objective is proposed in the context that an interest deduction against the income tax was allowed on all interest, without distinction between personal, business, household, and living expenses, dating back to the introduction of the federal income tax in 1913.[vi] Restrictions to the mortgage interest deduction were introduced at the federal level in 1986 and consequently adopted by Minnesota.[vii]

Additionally, the Congressional Research Service (CRS) proposes that tax deductions serve four key purposes in the tax code: to account for substantial personal expenses; encourage activities like homeownership and charitable giving; alleviate burdens from state and local taxes; and adjust for income-earning expenses.[viii] These arguments were also taken into consideration in developing a proposed objective.

### Other Considerations Regarding Proposed Tax Expenditure Objective

A popular argument for the MID is that it was designed to encourage homeownership and home maintenance. The CRS argues that there is no evidence in the legislative record that this was the purpose of the MID.[ix] Additionally, research suggest that there is little evidence that MID increases the rate of home ownership and may actually have unintended economic impacts to the housing market.[x]

### Potential Metrics and Performance Measures

A calculation of the average effective tax rate of taxpayers claiming a MID can help assess the impact of the deduction on tax rates.

An assessment of the rate of claims before and after the TCJA of 2017 can be useful in understanding how take-up of the MID has been impacted by the expansion of the standard deduction.

The commission may want to understand how the MID interacts with horizontal equity, the equal treatment for taxpayers in similar financial situations. This can encompass a comparison of effective tax rates of homeowners who take the MID with those who do not but have a similar income level. Granted, there are many variables that factor into homeownership status besides a tax filer's reported income level and there are limitations in identifying the homeownership status of taxpayers that do not claim the deduction.

Similarly, the commission may want to understand how the MID impacts vertical equity to evaluate whether the MID contributes to making the income tax system progressive and whether it has impacted the equitable distribution of tax burdens. This can involve an analysis of the distribution of MID benefits across different income levels to assess the income tax liability distribution and compare that to average effective tax rates.

Ultimately, the commission may want to understand trends in homeownership rates over time and if there is a correlation with MID claims.

**Contact Information and Disclaimer**

This tax expenditure review was prepared by the Legislative Budget Office for the Tax Expenditure Review Commission pursuant to Minnesota Statute, section 3.8855, subdivision 4.

Notice: Proposed tax expenditure objective statements are not binding authority and should not be used as a legal interpretation of any tax expenditure statute.

For questions regarding this review, please contact Legislative Budget Office at 651-297-7146 or lbo@lbo.mn.gov.

For more information, please visit the [Tax Expenditure Review Commission website].

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[i] Joint Committee on Taxation. *Present Law and Background Relating to Tax Incentives for Residential Real Estate*. July 18, 2022. Available at https://www.jct.gov/publications/2022/jcx-16-22/

[ii] Congressional Research Service. *Tax Expenditures Compendium of Background Material on Individual Provisions, Committee on the Budget United States Senate*. December 2022. Available at https://www.congress.gov/117/cprt/SPRT49569/CPRT-117SPRT49569.pdf

[iii] Internal Revenue Service. *Publication 936 (2023), Home Mortgage Interest Deduction*. Last updated January 10, 2024. Available at https://www.irs.gov/publications/p936

[iv] Hembre, Erik and Dantas, Raissa, *Tax Incentives and Housing Decisions: Effects of the Tax Cut and Jobs Act.* October 8, 2021. Page 5. Available at https://ssrn.com/abstract=3779520

[v] Minnesota House of Representatives House Research Department. *A Review of Selected Tax Expenditures*. November 2013. Pages 31-34. Available at https://www.house.mn.gov/hrd/pubs/taxexpend.pdf

[vi] Keightley, Mark. The Mortgage Interest and Property Tax Deductions: Analysis and Options. Congressional Research Service. Published January 18,2011. Updated March 18, 2014. Page 4. Available at https://crsreports.congress.gov/product/pdf/R/R41596

[vii] Supra note V.

[viii] Lowry, Sean. *Tax Deductions for Individuals: A Summary*. Congressional Research Service. March 17, 2017. Available at https://crsreports.congress.gov/product/pdf/R/R42872

[ix] Congressional Research Service. Background Material on Individual Provisions. Page 385.

[x] Sommer, Kamila, and Paul Sullivan. 2018. "Implications of US Tax Policy for House Prices, Rents, and Homeownership." *American Economic Review*, 108 (2): 241–74.