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Key Issues in Tax Policy: The Mortgage Interest Deduction

The mortgage interest deduction is of interest to policymakers due to its association with homeownership. The mortgage interest deduction is also of interest because it is one of the largest tax benefits available to homeowners in terms of forgone federal tax revenue. For FY2024, the Joint Committee on Taxation (JCT) estimates that the deduction will reduce revenues by $25.4 billion: the only larger housing-related tax expenditure is the exclusion for capital gains on the sale of a principal residence, at a FY2024 revenue cost of $38.1 billion. This In Focus provides a brief overview of the mortgage interest deduction.

P.L. 115-97, often referred to as the Tax Cuts and Jobs Act (TCJA), changed the tax treatment of mortgage interest for tax years 2018 through 2025. Although the mortgage interest deduction is still generally available, the TCJA reduced the maximum mortgage balance eligible for the deduction and restricted the deduction of interest associated with home equity loans. The TCJA also temporarily increased the standard deduction, which reduced the number of taxpayers who claim itemized deductions generally, including for mortgage interest. After the expiration of temporary TCJA provisions, the JCT estimates that the mortgage interest deduction will reduce revenues by $81.3 billion in FY2026 and $100.6 billion in FY2027.

Summary of Current Law

A taxpayer may claim an itemized deduction for "qualified residence interest," which includes interest paid on a mortgage secured by a principal residence and a second residence. The amount of interest that is deductible depends on when the mortgage debt was incurred. For mortgage debt incurred on or before December 15, 2017, the deduction is limited to the interest incurred on the first $1 million ($500,000 for married filing separately) of combined mortgage debt. For mortgage debt incurred after December 15, 2017, the limit is $750,000 ($375,000 for married filing separately).

If a taxpayer has mortgage debt exceeding the applicable mortgage limit ($750,000 or $1 million), he or she may still claim a deduction for a percentage of interest paid equal to the applicable mortgage limit divided by the remaining mortgage balance. For example, a homeowner whose mortgage was originated after December 15, 2017, and has a balance of $1 million could deduct 75% ($750,000 divided by $1 million) of the interest payments.

Refinanced mortgage debt is treated as having been incurred on the origination date of the original mortgage for purposes of determining the applicable mortgage limit ($750,000 or $1 million). The balance of the new loan resulting from the refinance, however, may not exceed the balance of the original loan. This may occur, for example, when a homeowner "cashes out" equity in the home by obtaining a larger loan than is necessary to pay off the current mortgage balance.

For purposes of the deduction, mortgage debt includes home equity loans secured by a principal or second residence that are used to buy, build, or substantially improve a taxpayer's home. Mortgage debt *does not include* home equity loans when the proceeds are used for purposes unrelated to the property securing the loan. For example, interest associated with a home equity loan that is used to pay off a credit card balance, go on a vacation, or send a child to college does not qualify for the mortgage interest deduction. The restrictions on the use of home equity loans apply irrespective of when the loan was originated.

After 2025, the mortgage interest deduction will revert to the law that existed prior to TCJA.

Comparison to Prior Law

Under prior law, a homeowner was allowed an itemized deduction for the interest paid on the first $1 million of combined mortgage debt associated with a primary or secondary residence. As with current law, a homeowner could deduct a percentage of interest paid if the mortgage balance exceeded the $1 million limit. Additionally, a homeowner was allowed to deduct the interest on the first $100,000 of home equity debt regardless of whether or not the taxpayer incurred the debt to finance costs associated with the home. For example, under prior law, a homeowner could use a home equity loan to purchase a boat, pay for a child's college, cover medical costs, or any number of other things not involving the property that secured the loan and still deduct the associated interest.

Impact of the TCJA

Impact on Homeowners

The reduced mortgage limits under TCJA decrease the amount of interest that would otherwise be deducted under prior law, though the reduction *itself* will likely not have a significant impact on the number of homeowners claiming the deduction. However, other changes enacted by TCJA, specifically the near doubling of the standard deduction and the $10,000 limit placed on the deduction for state and local income taxes (SALT), are estimated to have reduced the itemization rate generally, and will therefore reduce the number of homeowners claiming the mortgage interest deduction. The most recent data from the Internal Revenue Service show that the overall itemization rate fell from 30.6% in 2017 to 9.2% in 2021. Because taxpayers must itemize to claim the mortgage interest deduction, fewer homeowners now benefit from the deduction.

The lower itemization rate and the fact that higher-income homeowners have larger mortgage balances on average means that the benefits of the mortgage interest deduction disproportionately accrue to taxpayers at the upper end of the income distribution (see **Table 1**), and more disproportionately than under prior law. This does not necessarily mean that homeowners who no longer claim the mortgage interest deduction will pay higher taxes because the standard deduction and other changes enacted by TCJA may more than compensate for the loss of the deduction.

Table 1. Distribution of Mortgage Interest Deduction Tax Expenditure by Income Class, 2023

Income Class (in thousands)	Share of Claimants	Share of Tax Expenditure
Below $15	0.0%	0.0%
$15 to $30	0.5%	0.1%
$30 to $40	0.6%	0.1%
$40 to $50	1.0%	0.3%
$50 to $80	7.0%	2.1%
$80 to $100	7.4%	3.5%
$100 to $200	36.2%	23.9%
$200 and over	47.3%	70.1%
Total	**100%**	**100%**

Source: CRS calculations using estimates reported in U.S. Congress, Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2023-2027*, 118th Cong., 1st sess., December 7, 2023, JCX-59-23.

Although more homeowners claimed the mortgage interest deduction before TCJA, it is important to note that less than half of homeowners claimed the deduction prior to TCJA. This is because some homeowners have no mortgage, and hence no interest to deduct. Others claimed the standard deduction because they were toward the end of their mortgage repayment period and interest payments were a small proportion of their total mortgage payment, they lived in a state with low state and local taxes, or they lived in a low-cost area and therefore had relatively small mortgages.

The effect on the homeownership rate from the changes enacted by TCJA is likely to be small even though fewer homeowners will benefit from the deduction. The economic literature has generally found that the deduction's structure prior to TCJA did little to promote homeownership, because the deduction does not address the largest barriers to homeownership—the down payment required by banks and closing costs. Because the TCJA did not change the deduction's fundamental structure, previous analysis of the deduction's structural effect on homeownership still applies. The TCJA changes' impact could appear in slightly lower home values, as the literature suggests that the deduction is partly capitalized into home prices, though the impact may be difficult to measure empirically.

Budgetary Impact

The JCT estimates that the newly structured deduction will reduce revenues by $25.4 billion in 2024 and by $25.6 billion in 2025. After the limits expire, the revenue loss is estimated to increase to $81.3 billion in 2026 and $100.6 billion in 2027.

Policy Considerations

The TCJA's temporary modifications to the mortgage interest deduction limits—as well as the standard deduction and other itemized deductions—are scheduled to expire after 2025, barring further congressional action. In addition to extending these temporary changes or allowing them to expire, Congress could choose to pursue a number of other options that have been part of the debate over the mortgage interest deduction.

Eliminate the Deduction

One possible option would be to eliminate the mortgage interest deduction, either abruptly or gradually over time. Gradually phasing out the deduction could mitigate any negative consequences for the economy and housing market. For example, the deduction could be phased out over a 20-year period with a fixed date after which it would no longer be available. Current owners could deduct interest for 20 years. Those who become new owners next year could deduct interest for 19 years, and so on.

Further Limit the Deduction

Continuing in the same direction as the TCJA, the deduction could be further limited. One option would be to reduce the combined maximum mortgage limit. The ability to deduct interest on second homes could also be eliminated. Another option would be to leave the combined mortgage limits unchanged, but limit the amount of interest that could be deducted. For example, the amount of interest that could be deducted could be limited to a percentage of homeowners' adjusted gross income (AGI), such as 10%, 12%, or 22%. The deduction could also be limited to those homeowners below a certain income threshold.

Replace the Deduction with a Credit

The mortgage interest deduction could be replaced with a tax credit. The deduction currently tends to provide a proportionally bigger benefit to higher-income homeowners because they buy more expensive homes and are subject to higher marginal tax rates. The requirement that homeowners itemize their tax returns also limits the number of owners who receive the tax benefit. A tax credit for mortgage interest could provide a benefit to more homeowners because itemization would no longer be required. Depending on the design of the credit, it could create a more consistent rate of subsidization across homeowners. Making the tax credit refundable would serve to make it better targeted to lower-income homeowners.

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