

Department of Revenue

Without Legislative Action the Mortgage Interest Deduction Will Remain Regressive and Inequitable

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Audit Highlights

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Why this audit is important

- The Mortgage Interest Deduction (MID) is a regressive tax expenditure that is estimated to cost the state over \$1 billion for the 2021-23 biennium in forgone revenue. It is the largest housing-related tax expenditure and seventh largest overall.
- The Governor's message in the 2021-23 Tax Expenditure Report calls for more review of tax expenditures, like the MID, from an equity and racial justice perspective.
- Many tax expenditures have largely escaped the same level of rigorous review typical for direct appropriations. Forgone revenue from tax expenditures could be used to fund other critical state services or to lower overall tax rates.
- The Legislature established in statute that Oregon's tax system adhere to the basic values of fairness and equity and that tax proposals should be evaluated based on a set of guiding principles including ability to pay, efficiency, and even distribution.

What we found

1. Higher income taxpayers receive most of the benefits from the MID. For example, roughly 18,000 taxpayers with incomes in the top 1% received more benefit from the MID than the 727,000 taxpayers in the bottom 40% combined. ([pg. 12](#))
2. Average MID benefits and the percentage of taxpayers receiving them vary considerably among Oregon counties, with a handful of mostly urban counties receiving a disproportionate share. For example, in the 2018 tax year taxpayers in Clackamas County received an average benefit of \$331, while taxpayers in Wheeler County received an average of \$71. ([pg. 14](#))
3. Due to significant differences in homeownership rates and income, people of color in Oregon receive disproportionately less MID benefits than white people, especially for Black or African American, Latino, and Native American people. For example, the homeownership rate for Black people in Oregon is more than 30% lower than for white people. ([pg. 17](#))
4. Promoting homeownership is a commonly cited purpose for the MID. ([pg. 21](#)) However, we did not find any evidence to support this assertion. In Oregon, the primary barriers faced by prospective low- to moderate-income homebuyers include high home prices, limited funds for down payments, and credit issues, none of which are addressed by the MID. ([pg. 19](#))
5. The MID receives no state-level evaluation, limiting accountability for its regressive outcomes. Without this information, policymakers, the media, and the public cannot fully participate in decisions about how to allocate state resources. ([pg. 24](#))

What we recommend

While our auditee was the Department of Revenue, our two recommendations are directed to the Legislature. The Department of Revenue's response can be found at the end of the report.

Introduction

The home mortgage interest deduction (MID) is a tax expenditure known as an itemized deduction that allows some, but not all, homeowners to reduce their taxable income by the amount of interest paid on their mortgage. Tax expenditures like the MID represent a substantial investment on the part of the state in the form of forgone revenue.

The Oregon Legislature established a goal in statute that the state's income tax system be equitable and fair and follow guiding principles including ability to pay, even distribution, and efficiency, making it critical these significant investments are regularly evaluated to ensure these principles and their intended purpose are met.

The Department of Revenue is charged with administering the MID for the state, but the authority to change the policy rests with the Legislature. The objective of this audit was to examine the distribution and equity of the mortgage interest deduction and determine the current level of review the deduction receives.

The mortgage interest deduction is an itemized deduction that costs the state over \$1 billion biennially

The MID is one of a handful of itemized deductions that Oregon taxpayers can claim on both their state and federal income tax returns. It is one of more than 375 tax benefits considered to be a tax expenditure in Oregon and is expected to cost the state over \$1.1 billion in the 2021-23 biennium. Oregon allows taxpayers to deduct mortgage interest due to the state's connection to the federal definition of taxable income, and the state typically follows federal limitations and rules for the MID.

Oregon taxpayers can claim their mortgage interest as an itemized deduction on both their state and federal income tax returns

It has long been the practice in the United States to encourage specific taxpayer behavior by subsidizing certain costs through tax deductions from both federal and state taxes. These deductions can be claimed by taxpayers on their federal income tax return and are expenditures that can be subtracted from adjusted gross income to reduce their tax bill.

The mortgage interest deduction is one of more than 375 tax benefits considered to be a tax expenditure in Oregon and is expected to cost the state over **\$1.1 billion** in the 2021-23 biennium.

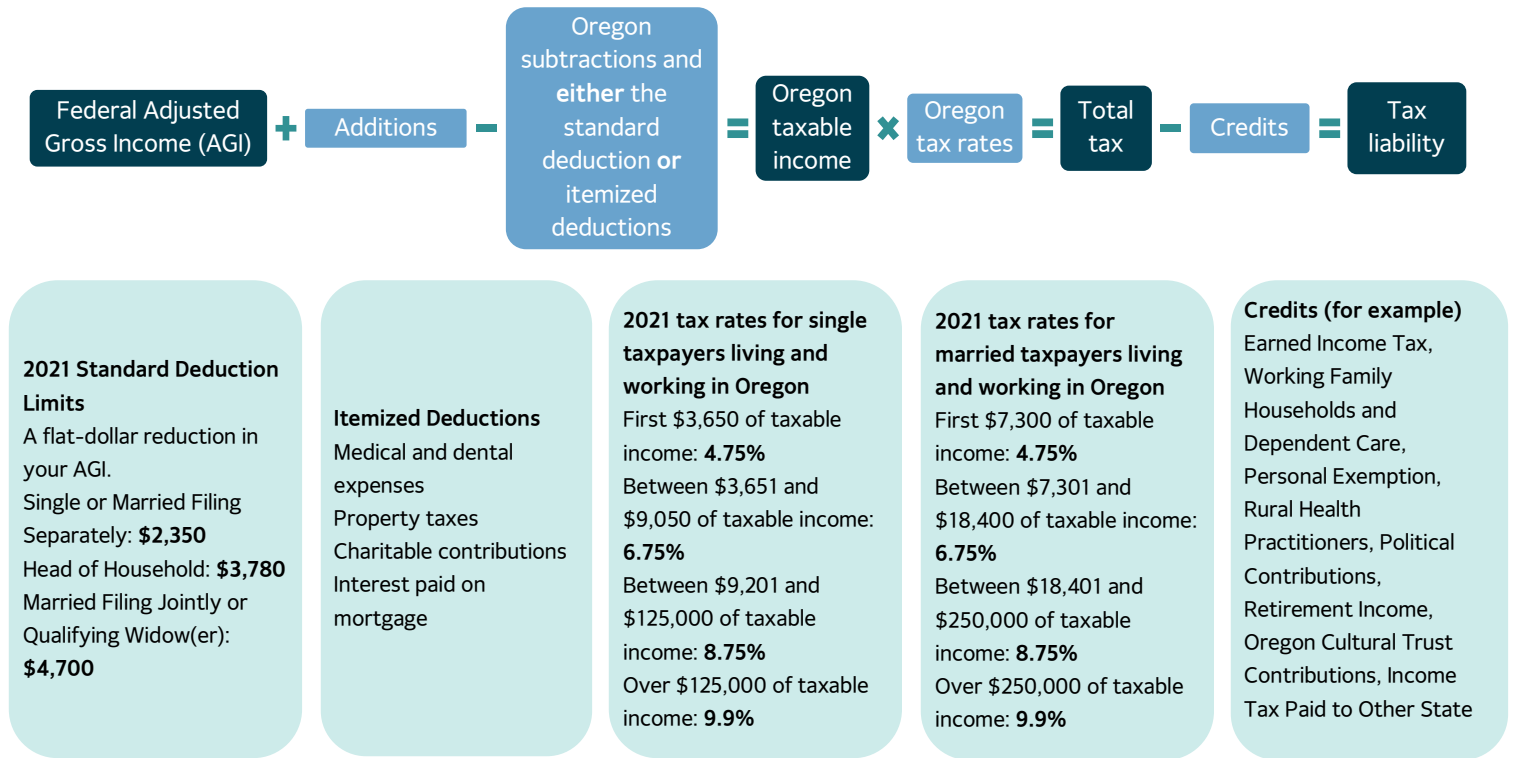
There are two types of deductions a taxpayer can claim: the standard deduction and itemized deductions. Thirty states and the District of Columbia allow taxpayers to claim numerous types of itemized deductions. Apart from the exemption for Oregon income tax and other states' sales tax, Oregon allows the same itemized deductions as the federal government. Examples of itemized deductions

available in Oregon include a deduction for property taxes paid, charitable gifts, medical and dental expenses, and home mortgage interest. However, not all taxpayers benefit from itemizing their deductions.

While itemized deduction amounts vary, the standard deduction is a one-size-fits-all reduction in the amount of an individual's taxable income. For it to be advantageous for a taxpayer to claim itemized

deductions like property taxes, charitable gifts, or mortgage interest, their total deductible expenses must exceed the standard deduction for their filing status. Figure 1 shows how personal income tax is calculated in Oregon.

Figure 1: There are multiple steps to calculating personal income tax in Oregon



The MID is one of the costliest income tax expenditures in Oregon

The MID is one of hundreds of tax benefits defined as a “tax expenditure” by Oregon statute. Tax expenditures can be viewed as government spending administered through the tax code because they grant special tax preferences to incentivize specific activities. They are a significant financial commitment and source of state spending.

A “Tax Expenditure” is...

“[...] any law of the federal government or this state that exempts, in whole or in part, certain persons, income, goods, services or property from the impact of established taxes, including but not limited to tax deductions, tax exclusions, tax subtractions, tax exemptions, tax deferrals, preferential tax rates and tax credits.”

ORS 291.201

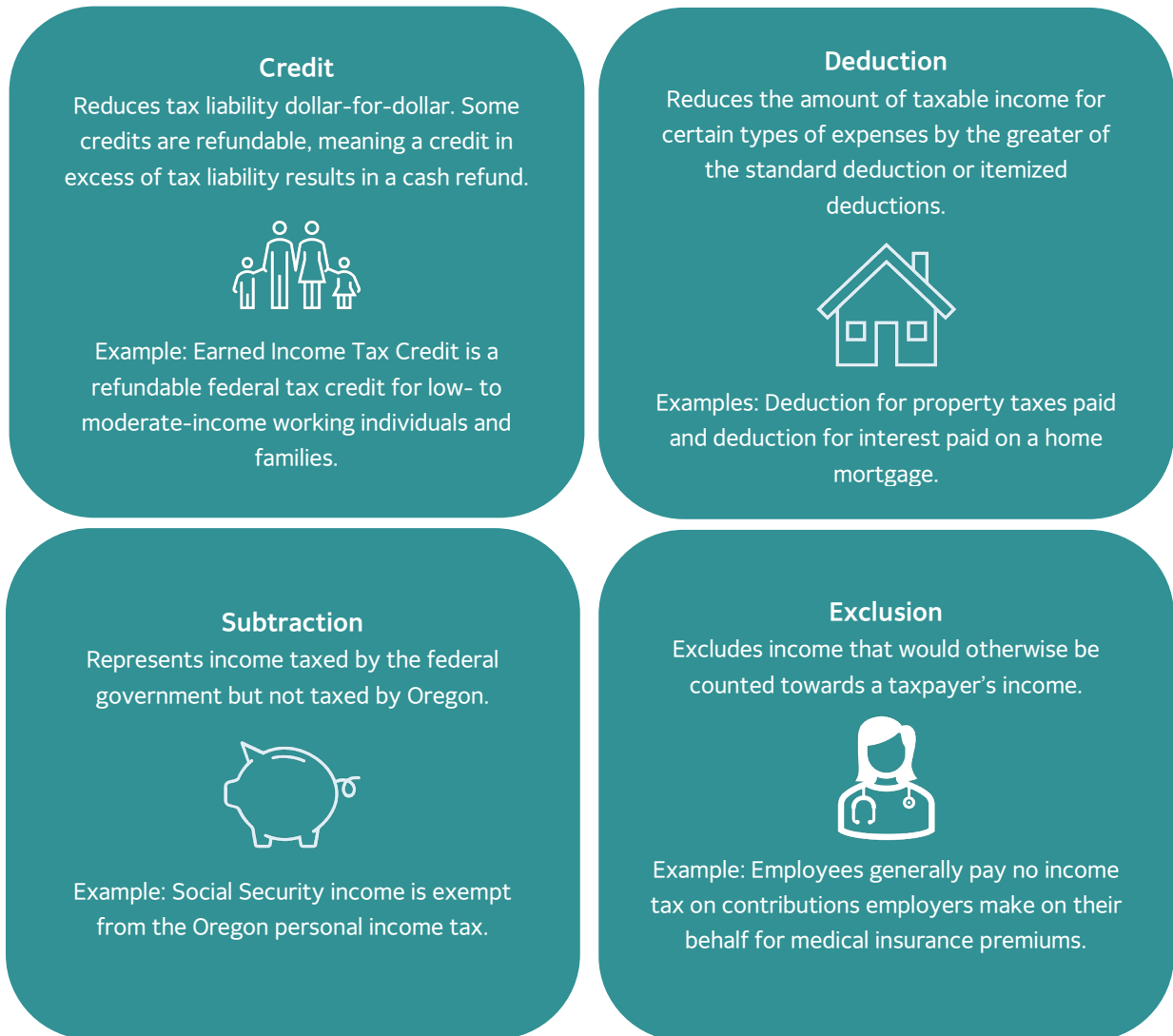
In the 2019-21 biennium, forgone revenue from tax expenditures reduced tax collections by an estimated \$24.5 billion.¹ While there are 377 individual tax expenditures currently specified in Oregon and federal law, there are several extremely large income tax expenditures influencing that total.

¹ State of Oregon 2021-23 Tax Expenditure Report, “The revenue impact is generally estimated as the amount of tax not collected due to the tax expenditure, but the dollar impact is not the amount of revenue that could be gained by repealing the tax expenditure.” As a result, this total is only a rough estimate of the magnitude of all tax expenditures.

Because tax expenditures like the MID are written into the tax code, they often will continue indefinitely — regardless of how costly or effective they are for the state.

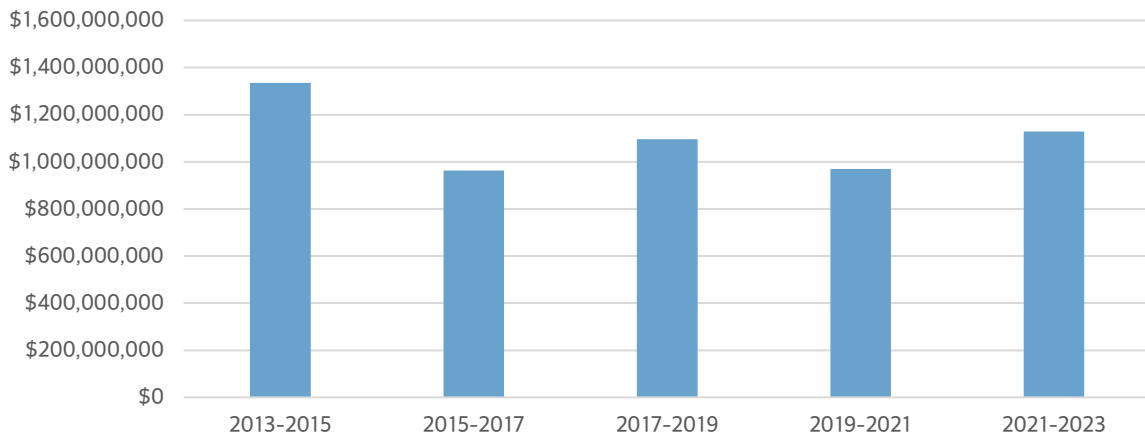
Tax expenditures in Oregon come in a variety of forms, including: exclusions, deductions, subtractions, and credits. Figure 2 describes each of these types of common income tax expenditures and provides an example.

Figure 2: Examples of four common types of income tax expenditures



In Oregon, the deduction for home mortgage interest for the 2021-23 biennium will be the largest housing related tax expenditure, the fourth largest personal income tax expenditure, and the seventh largest tax expenditure overall. As shown in Figure 3, the revenue impact estimate for the MID for the 2021-23 biennia is \$1.1 billion. In 2018, the most recent tax year with available data, the MID reduced state personal income tax revenue by \$440 million, nearly 5% of the total personal income tax liability for the year. Funds forgone from the MID could be used to fund other state programs or be used to reduce overall income tax rates.

Figure 3: The MID's biennial revenue impact has been around \$1 billion since 2013



Source: State of Oregon Tax Expenditure Reports 2013 – 2023.

Note: For all but 2021-23, we used the revised revenue impacts from the following biennium.

Taxpayers can claim the MID on their federal tax returns and it is a substantial tax expenditure at the federal level. The Congressional Research Service estimated the deduction for mortgage interest amounted to \$25.5 billion in forgone federal revenue in fiscal year 2020.

Oregon's income tax system typically conforms to federal tax law

Oregon's income tax code closely parallels the federal personal income tax code. This means changes in federal deductions like the MID often directly affect Oregon taxpayers' taxable income and tax liability. Since 1969, Oregon's definition of taxable income has been based on the federal definition of taxable income, as defined by the Internal Revenue Service (IRS). Since 1997, the Oregon Legislature opted to automatically connect to the federal tax code for all future changes in taxable income. Automatic connection or "rolling reconnect" means specific legislation is required to disconnect from Federal tax law. Even with this automatic connection, Oregon's Legislature must annually consider updating the federal connection as it relates to items other than taxable income.

The state has maintained this conformity to federal tax law due to concerns about keeping administrative costs low and minimizing complexity for taxpayers, among other reasons. However, the Legislature has chosen to disconnect from some specific tax policies over the years. For example, in 1975 the Legislature decided to disconnect from increases made to the federal standard deduction by establishing Oregon's own standard deduction and personal exemption policies separate from federal policies.

In Oregon, taxpayers can compare their potential state standard deduction to their potential state itemized deduction and claim whichever provides a lower tax bill². For example, if a taxpayer claimed the standard deduction on their federal return, they could itemize their deductions on the Oregon return, and vice versa.

² The standard deduction for a taxpayer whose filing status is married, filing separately is \$0 if their spouse chooses to itemize deductions.

As shown in Figure 4, Oregon’s standard deduction is substantially lower than the federal standard deduction.³ The 2021 federal standard deduction amount for a taxpayer who is married filing separately is over five times larger than Oregon’s standard deduction amount. This is partially due to the Federal 2017 Tax Cuts and Jobs Act (TCJA), which nearly doubled the federal standard deduction. After the 2017 TCJA changes went into effect, the number of taxpayers itemizing at the federal level decreased significantly, and many Oregon taxpayers now use itemized deductions to calculate Oregon tax but not federal tax.

Figure 4: The federal standard deduction is more than five times higher than Oregon’s standard deduction

	Single or Married Filing Separately	Married Filing Jointly or Qualifying Window(er)	Head of Household
Federal	\$12,550	\$25,100	\$18,800
Oregon	\$2,350	\$4,700	\$3,780

Source: Oregon Department of Revenue Form OR-W-4; IRS Form W-4

Oregon still adheres to the federal limits and definitions for the MID. In addition to doubling the standard deduction at the federal level, the TCJA reduced the maximum mortgage amount that qualifies from \$1 million to \$750,000.⁴ It also limited the deductibility of home equity debt related to purchasing, building, or substantially improving a qualified home. Under prior law, a homeowner could also deduct interest on the first \$100,000 of home equity-related debt regardless of how it was used. For example, a taxpayer could have used the proceeds from a home equity loan to purchase a boat and still qualify for the deduction. Without action by Congress, these changes to the mortgage interest deduction and standard deduction will revert to pre-TCJA law after 2025.

Taxpayers may claim the MID for both a primary and secondary qualified residence, although the total limits apply to the total that can be claimed and not individual residences. The IRS defines a “qualified residence” as a house, condominium, cooperative, mobile home, house trailer, boat, or similar property that has sleeping, cooking, and toilet facilities.

DOR is charged with administering Oregon’s income tax system and plays a key role in reporting on tax expenditures

By statute, the Department of Revenue (DOR) is responsible for administering the revenue and tax laws of Oregon, with some exceptions. The agency is responsible for administering 36 different tax programs, including personal income and corporate excise taxes, the corporate activities tax, state marijuana tax, as well as a variety of other taxes. The agency also administers 10 fee programs and 11 other revenue related programs. DOR is also responsible for providing oversight of local property tax administration by counties, valuing most industrial and other large-scale properties, and administering several property tax relief programs. DOR also provides debt collection services for more than 180 state agencies and local governments. DOR’s total 2019–21 budget was \$339.1 million with 983 full-time equivalent staff.

³ Standard deduction amounts can change between tax years, with Oregon’s standard deduction amounts tied to inflation.

⁴ These limits are lower for taxpayers who file as Single, or Married Filing Separately. Prior to TCJA, taxpayers who filed as Single or Married Filing Separate could only claim interest on the first \$500,000 of mortgage debt. This amount was reduced to \$375,000 by the TCJA.

DOR's Research Section is part of the Administrative Services Division and provides statistical tax data and reports for use by the public and other partners. The Research Section also plays a key role in the development of the biennial tax expenditure report. In 2018, the Legislature added two economists dedicated to supporting the internal efforts of the agency. For the 2019-21 biennium, the Research Section had a budget of \$2.8 million with 10 full-time equivalent employees.

DOR's Personal Tax and Compliance Division administers the personal income tax program. Responsibilities include auditing and encouraging voluntary compliance for the personal income tax. In addition, the division provides help to taxpayers by telephone through the Tax Services Unit, in person at field office locations, and through informational publications. For the 2019-21 biennium, the Personal Tax and Compliance Division's budget was \$81.5 million with 391 full-time equivalent employees.

DOR plays a key role in reporting on tax expenditures through the biennial tax expenditure report

Since 1996, the tax expenditure report has been one of the primary sources identifying and reviewing existing tax expenditures in Oregon. The 1995 Budget Accountability Act declares the necessity of “a review of the fairness and efficiency of all tax deductions [...] It is in the best interest of this state to have prepared a biennial report of tax expenditures that will allow the public and policymakers to identify and analyze tax expenditures and to periodically make criteria-based decisions on whether expenditures should be continued.” In the most recent 2021-23 Tax Expenditure Report, the Governor explains the report should be used by the public and policymakers “to see how individual tax policies are working, and, importantly, who pays or benefits from those tax policies.”

Governor's message at beginning of 2021-23 Tax Expenditure Report

“Our tax code says as much about our values as the budget for which it pays. That's why this 2021-23 Tax Expenditure report is such an important tool. Using it, the public and policymakers can see how individual tax policies are working, and, importantly, who pays or benefits from those tax policies.”

DOR is the primary coordinator for the development and release of the tax expenditure report, with input from the Governor's Office, Legislative Revenue Office, and the Department of Administrative Services. DOR relies on subject matter experts in the applicable state agencies to provide evaluations on whether the tax expenditures achieve their purpose within the report. DOR also relies on information from the federal Joint Committee on Taxation and the Congressional Research Service to evaluate expenditures resulting from Oregon's connection with the federal definition of taxable income.

The Governor and Legislature set Oregon's income tax policy

Both the Governor and the Legislature play key roles in establishing income tax policies in Oregon. There have been attempts made by both the Legislature and the Governor to make changes to the MID, but none have been successful to date.

Oregon's Constitution requires a balanced budget be passed every biennium, making the budget process a key factor in determining the tax policy of the state. Each biennium, the Governor presents the Governor's Recommended Budget to the Legislature as a starting point for budget negotiations during the legislative session. This budget includes proposed spending for each executive branch agency as well as any tax policy changes necessary to ensure expenses do not exceed revenues. The

Legislature reviews and revises the Governor's Recommended Budget and passes tax laws, as necessary, to provide revenue. The Governor can veto laws, including those changing tax policy, preventing them from taking effect.

There has been some interest within the Legislature to make changes to the MID since the 2017 legislative session, but none have been successful. In 2017, House Bill 2006 sought to limit the MID by restricting eligibility to individuals with incomes of \$100,000 or less (\$200,000 if married filing jointly). It also put a cap on the amount of interest eligible for the deduction at \$15,000 and restricted its use to primary residences.

House Bill 3349 in 2019 would have scaled back deduction limits for taxpayers with incomes greater than \$200,000, eliminating the deduction at incomes of \$250,000 and above while also limiting the MID to primary residences.

In 2021, House Bill 2578 and Senate Bill 852 proposed changes to the MID similar to those considered in 2019. Each of these bills proposed using the revenue created from limiting the MID to fund other housing-related programs, with an emphasis on promoting affordable homeownership and preventing homelessness. Senate Bill 852 was estimated to generate more than \$180 million in revenue in the 2023-25 biennium.

The Governor also called for a change to the MID in her 2021-23 recommended budget. She recommended removing the eligibility of second homes and estimated this change would generate \$21 million for the 2021-23 biennium. This change was not approved by the Legislature.

Attaining homeownership in Oregon is a challenge, and people of color disproportionately experience barriers

With the ninth lowest homeownership rate in the country and a chronic housing shortage, attaining homeownership in Oregon is a challenge. Additionally, racially discriminatory lending practices both explicit and implicit and economic trends in wealth building have made attaining homeownership even more difficult for people of color living in Oregon.

Oregon ranks low in homeownership rate nationally and is predicted to face additional housing challenges

Oregon has a statewide housing shortage. The Oregon Housing and Community Services (OHCS) agency's 2021 Regional Housing Needs Analysis⁵ estimated over the next 20 years, an additional 584,000 new homes are needed to meet housing demand, with nearly one quarter of these homes necessary to accommodate the state's current population.⁶ To meet this need, Oregon developers would need to increase current production of housing two-fold. Affordable housing units in Oregon are in particularly short supply. OHCS reports "failing to make progress on underproduction will lead to worsening trends of rising prices and cost burdening that will most affect those at the lowest end of the income spectrum."

⁵ [Building on New Ground: Meeting Oregon's Housing Need, A Companion Document to the Regional Housing Needs Technical Report, February 2021](#)

⁶ The statute requiring this analysis requires estimates include attached and detached single-family housing, multifamily housing, manufactured dwellings, and mobile homes.

According to the U.S Census, at the end of 2020 the State of Oregon had a homeownership rate of 64% — the ninth lowest rate in the country. The national average homeownership rate at the end of 2020 was 67%. Oregon’s homeownership rate has consistently ranked in the bottom third of states over the last five years. OHCS’ 2019–23 Statewide Housing Plan⁷ identifies expanding homeownership for low- and moderate-income people as a priority.

Rental housing units affordable to low-income households are in short supply in Oregon, and rental costs have continued to rise, outpacing incomes. According to the 2021–23 Statewide Housing Plan, there is a shortage of 85,000 units affordable to households with income below 30% Median Family Income,⁸ and 27% of Oregon renter households have “severe housing cost burden.” Severe housing cost burden means these families are spending more than half of their income on housing and utilities. This burden falls disproportionately on people of color, with more than 50% of African American, Native American, Alaska Native, and Pacific Islander households identifying as severely housing cost burdened, compared to 34% for white households.

Severe housing cost burden falls disproportionately on people of color, with more than 50% of African American, Native American, Alaska Native, and Pacific Islander households identifying as severely housing cost burdened, compared to 34% for white households.

Oregon is also faced with a growing unhoused population. Higher homelessness rates can indicate difficulty finding affordable housing as well as decreased access to the resources needed to stay housed. According to the U.S Department of Housing and Urban Development’s Point-In-Time count, in Oregon approximately 15,800 people experienced homelessness in 2019, an increase of 19% since 2015.⁹ At the time of that 2019 count, only 25% of people experiencing homelessness were concentrated in the Portland Metro area and most of Oregon’s homeless families lived in coastal counties and southern Oregon. In the OHCS 2021 Analysis of Impediments report, stakeholders indicated that in addition to increasing the stock of affordable housing, increasing emergency shelter beds, mental health resources, permanently supportive housing units, and emergency rent assistance have the greatest potential to help people experiencing homelessness or who are at risk of homelessness.

History of discriminatory policies like red lining and racial deed covenants have shaped current racial inequities in homeownership

The wealth building benefits of homeownership have not been equally available to all people living in Oregon. People of color disproportionately experience barriers to attaining homeownership. Past discriminatory homeownership practices including redlining, racial deed covenants, and economic trends in wealth building have shaped current inequities in homeownership.

⁷ [Breaking New Ground: Oregon’s Statewide Housing Plan, 2019–23](#)

⁸ Median Family Income is a standard measure of annual income that varies by geography and family size. In rough terms, Median Family Income represents the midpoint income for families in a particular geography.

⁹ OHCS: “The numbers obtained during the [Point-in-Time Count](#) do not provide a full picture of everyone experiencing homelessness in Oregon. This number should be understood as an absolute minimum number of people experiencing homelessness in Oregon.”

The Oregon Constitution of 1857 included racial provisions against Black and Asian Americans. When Oregon was founded in 1859 and became the 33rd state in the union, it also became the only state in the union to forbid Black Americans from working, living, or owning property within its borders. Racially restrictive covenants were added to property deeds to prevent property owners from selling, leasing, or renting their property to non-white people. While these laws were eventually repealed in later years, it was not until 2002 when the discriminatory language was removed from the Oregon Constitution by voters.

Between 1935 and 1940, the Home Owners' Loan Corporation, a federal agency, created "Residential Security" maps of major American cities. These maps were used by loan officers as part of a systematic appraisal process that included neighborhood-level characteristics for evaluation of mortgage lending risk. The racial makeup of neighborhoods were explicit factors that were often decisive in assigning risk levels for specific neighborhoods. The neighborhoods that received the lowest marks were shaded in red on these maps, leading to the term "redlining." The Federal Housing Authority (FHA) would then discourage banks from granting mortgage loans to properties located in these redlined neighborhoods.

White people in Oregon are twice as likely to own a home than Black or African American, Native Hawaiian and other Pacific Islander people in Oregon.

The use of the Home Owners' Loan Corporation "Residential Security" maps and other discriminatory mortgage loan practices were made illegal with the passage of the Fair Housing Act of 1968,

and racially restrictive covenants no longer have legal legitimacy. However, racially discriminatory lending practices and neighborhood segregation have created intergenerational wealth and homeownership gaps for people of color in Oregon that are still present today.

For example, the effects of this discrimination can be seen when comparing Oregon's white homeownership rate to the homeownership rates for communities of color. American Community Survey (ACS) five-year estimates for 2018 show homeownership rates were lower for communities of color in Oregon than for whites. In Oregon, white people were twice as likely to own a home than people who identify as Black or African American, Native Hawaiian and other Pacific Islander. The homeownership rate was roughly 20% higher for white people than it was for American Indian and Alaska Natives.

Even with the existence of the Fair Housing Act, people of color continue to be denied conventional mortgage loans at a higher rate than white people. Home Mortgage Disclosure Act data show in 2018, even among the highest income cohort, denial rates were considerably higher in Oregon for Black and Hispanic or Latino applicants. In Oregon, denial rates for white people in the highest income cohort were 11% compared to 21% and 18% for Black and Hispanic or Latino people, respectively. Studies of mortgage lending practices before the Great Recession from 2004 to 2007 also concluded African Americans were 30% more likely than white Americans to get higher-priced subprime mortgage loans.

Wealth is often intergenerational and accumulates over a long period of time, and while homeownership is an important opportunity to build wealth, the benefits of homeownership are not equally accrued by all Americans. Communities of color have been systematically denied opportunities to build long-term wealth throughout Oregon's history, the effects of which are still experienced. For example, in 2019 the Federal Reserve reported nationally, white households have higher levels of equity in their homes.

White households have a mean net housing equity (value minus any debts on the home) of \$215,800, compared to Black and Hispanic households who have only \$94,400 and \$129,800 of equity in their homes, respectively.

Audit Results

Oregon's income tax policy requires evaluation of the tax system based on the following principles: ability to pay, fairness, equity, efficiency, even distribution, and that it not be regressive. Oregon's income tax system is generally progressive, as called for by statute, but the MID is not.

The MID is designed in a way that systematically benefits higher income taxpayers because they are more likely to itemize their deductions, typically own more expensive homes, and have higher marginal tax rates. The most commonly cited purpose for the MID is the promotion of homeownership; however, this assertion is not supported by our analysis of current and past federal and state tax laws. The deduction is poorly suited for this purpose because its benefits primarily accrue to higher-income taxpayers who are less likely to need support to achieve homeownership. The MID is an ineffective tool for promoting homeownership, especially for people who have lower incomes, are from historically underserved groups including people of color, and those struggling in rural areas.

The Center for Budget and Policy Priorities, National Conference of State Legislatures, and the Government Accountability Office call for tax expenditures to receive similar scrutiny to budgeted spending. Even though it is the state's largest housing subsidy and one of the largest tax expenditures overall, the MID receives no state-level evaluation. Historic budget issues, limited state-level administration, and the fact there is not an agency directly accountable for its performance contribute to this limited scrutiny. This lack of transparency limits the visibility and accountability for the MID's regressive outcomes.

MID benefits are not equitably distributed among Oregon taxpayers, and it does not address the most significant barriers experienced by low and moderate-income homebuyers

Per statute, Oregon's income tax system adheres to the basic values of fairness and equity. Tax proposals should be evaluated based on a set of guiding principles including ability to pay, efficiency, and even distribution.¹⁰ Because fairness and equity are subjective criteria, we conducted a distributional analysis using 2018 individual income tax data to determine who benefits from the MID by income and geography. We also assessed the distribution by race and ethnicity using data from the American Community Survey.¹¹

We found the MID's benefits disproportionately accrue to higher income taxpayers who live in urban counties in Oregon. Using data from the American Community Survey, we found in Oregon, people of color have significantly lower homeownership rates and were less likely to be represented at higher income levels than white people. Due to these discrepancies, we conclude in Oregon, white people disproportionately benefit from the MID when compared to people of color.

¹⁰ [ORS 316.003](#)

¹¹ The American Community Survey is a nationwide survey that collects and produces information on the social, economic, housing, and demographic characteristics about the nation's population every year. It is conducted by the U.S. Census Bureau.

MID benefits primarily accrue to higher income Oregon taxpayers

DOR estimates the benefits of a tax expenditure by modelling what each taxpayer's tax liability would be with and without the expenditure, with the difference being the revenue impact, or cost, of the expenditure. Using 2018 individual income tax return data provided by DOR, we calculated the distribution of MID benefits by income.¹² We categorized taxpayers by income percentile and found the majority of MID benefits accrue to the highest income taxpayers. We also found both the likelihood a taxpayer will benefit from the MID and the average size of the benefit received increases based on income level.

In 2018, the MID reduced income tax liability of Oregon residents by nearly \$414 million dollars with an additional reduction of \$26 million for non-resident and part-year resident taxpayers. As shown in Figure 5, the highest income taxpayers received the largest proportion of MID tax benefits, with taxpayers in the top 20% receiving 59% of the total. The roughly 18,000 taxpayers in the top 1% received more benefit as a total of the group from the MID than the 727,000 taxpayers in the bottom 40% combined.

Figure 5: Higher income taxpayers receive the majority of MID benefits

Income Percentile	AGI Range	Total MID Benefit	Percent of Total MID Benefit
Lowest 20%	Below \$16,100	\$1,553,800	<1%
Second 20%	\$16,100-\$32,900	\$12,815,400	3%
Middle 20%	\$32,900-\$57,100	\$43,831,900	11%
Fourth 20%	\$57,100-\$100,100	\$113,120,000	27%
Next 15%	\$100,100-\$202,600	\$157,003,600	38%
Next 4%	\$202,600-\$458,700	\$64,804,100	16%
Top 1%	More than \$458,700	\$20,698,900	5%
Total Resident		\$413,827,700	100%

Source: OAD analysis of 2018 DOR full-time resident personal income tax data.

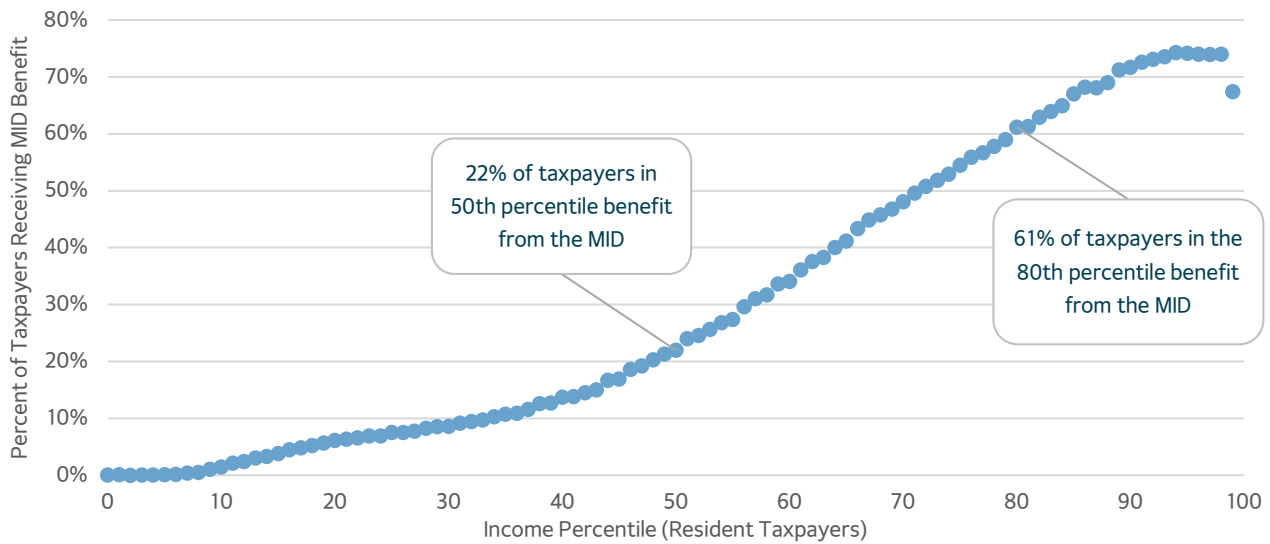
More than half a million Oregon taxpayers benefited from the MID in 2018, making it a widely used tax deduction. However, the likelihood that a taxpayer will benefit from the MID increases significantly with income. For example, of the taxpayers in the 50th percentile of the income distribution, meaning their income averages \$44,000, just 22% benefit from the MID. Meanwhile, 61% of taxpayers at the 80th percentile — with average incomes greater than \$100,000 — benefit from the deduction. Figure 6 shows the percentage of taxpayers who benefit from the MID by income percentile.

Roughly 18,000 taxpayers in the top 1% received more benefit from the MID than the 727,000 taxpayers in the bottom 40% combined.

Additionally, not all taxpayers living in Oregon who claim the MID actually benefit from it. For example, only a quarter of taxpayers in the lowest 20% who claimed the deduction realized a reduction in their tax liability.

¹² We used adjusted gross income as our measure of income, consistent with DOR reporting of similar information.

Figure 6: The percentage of taxpayers benefitting from the MID increases as income increases



Source: OAD analysis of 2018 DOR resident tax return data.

The average MID benefit received across all Oregon taxpayers in 2018 was \$227, but average benefits increased substantially with income. The average taxpayer in the middle of the income distribution had their tax liability decreased by \$120, whereas the average benefit to the top 1% was nearly ten times as high at \$1,138. Figure 7 shows the average MID benefits by income percentile.

Even when only considering taxpayers who do receive a benefit from the deduction, the difference in the average benefits is dramatic. At \$1,688, the average benefit for taxpayers in the top 1% is more than triple the \$540 average benefit a taxpayer in the middle of the income distribution receives.

Figure 7: Average MID benefits increase dramatically with income

Income Percentile	AGI Range	Average MID benefit	Average MID reduction for those who benefit
Lowest 20%	Below \$16,100	\$4	\$222
Second 20%	\$16,100-\$32,900	\$35	\$396
Middle 20%	\$32,900-\$57,100	\$120	\$540
Fourth 20%	\$57,100-\$100,100	\$311	\$658
Next 15%	\$100,100-\$202,600	\$575	\$844
Next 4%	\$202,600-\$458,700	\$891	\$1,203
Top 1%	More than \$458,700	\$1,138	\$1,688
Total Resident		\$227	\$760

Source: OAD analysis of 2018 DOR resident tax return data.

The fairness and equity of tax systems and policies is often assessed based on how a taxpayer's ability to pay factors into their level of taxation. In a vertically equitable tax system, those who are more capable of bearing the burden of taxes pay a greater share of their income than those with less ability to pay and vertical equity is the basis of progressive income tax systems.

Oregon's income tax statute calls for a system that uses equity and fairness as guiding principles and notes tax proposals should be assessed based on factors including ability to pay, equity, and even

distribution. Oregon's overall income tax system is considered progressive because tax rates and tax liability as a percentage of income typically increase with income.

However, the MID does not meet these principles because a taxpayer's likelihood of benefitting, and the average benefit they receive, increases as income increases, thus reducing their overall tax liability. These higher-income taxpayers have a greater ability not only to shoulder a heavier tax burden, but also to pay for their mortgages. By providing the largest benefits to those with the greatest ability to pay, the MID is a regressive, vertically inequitable tax expenditure.

The ability to deduct the interest on second homes is another example of the inequity of the MID. Although there is not adequate data to determine the distribution of second home MID benefits, DOR estimates providing the deduction to taxpayers that own second homes will result in forgone revenue of roughly \$30 million in the 2021-23 biennium, just a fraction of the \$1.1 billion total of the program. However, providing this benefit to owners of second homes when others struggle to afford a first home further increases the inequity of the MID.

Regressive: Tax liability is a smaller percentage of a taxpayer's income as income increases.

Progressive: The tax liability as a percentage of income increases as income increases.

Ability to Pay: Those who are more capable of bearing the burden of taxes should pay more taxes than those with less ability to pay.

Vertical Equity: Taxpayer's with different ability to pay receive different benefits, with higher income taxpayers paying a greater share.

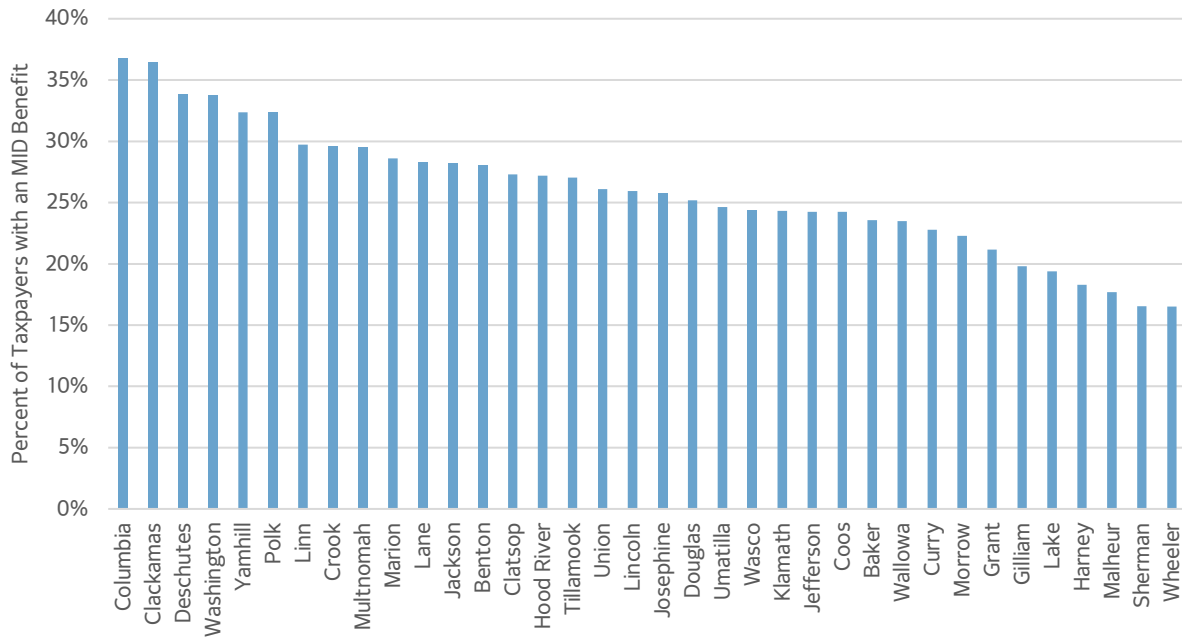
MID benefits disproportionately accrue to taxpayers living in a handful of Oregon's urban counties

We also assessed the distribution of the MID by county using 2018 tax return data. Based on this analysis, we found there is significant variation in both the percentage of taxpayers benefiting from the MID and the average benefits received by county. We also assessed the distribution of MID benefits between rural and urban counties and found the MID's benefits accrue disproportionately in a handful of Oregon's urban counties.¹³

Figure 8 shows the percentage of taxpayers by county who benefited from the MID. The percentage ranges from a high of 37% in Columbia County to a low of 17% in Wheeler County. The percentage of taxpayers who benefit from the MID across all of Oregon's 36 counties is 30%. Only six of Oregon's counties exceed this statewide rate.

¹³ OHCS defines rural counties as those that do not include any part of a metropolitan statistical area.

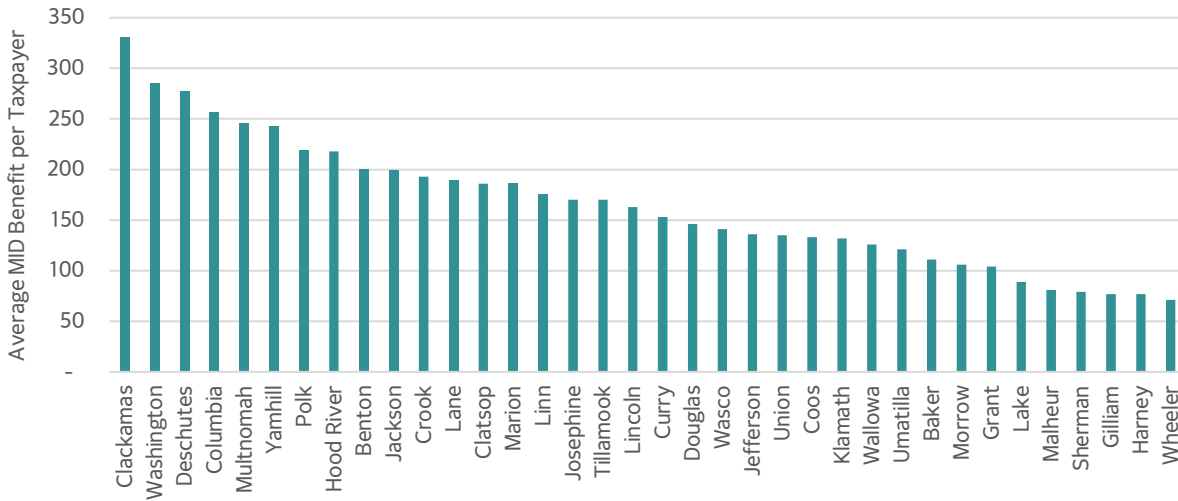
Figure 8: The percentage of taxpayers who benefit from the MID varies by county



Source: OAD analysis of 2018 DOR full-time resident tax return data.

Similarly, as shown in Figure 9, there is significant variation in average MID benefits by county. With an average benefit of \$331, Clackamas County is the highest, nearly five times larger than the \$71 average in Wheeler County. There are only six counties — Washington, Clackamas, Multnomah, Yamhill, Deschutes, and Columbia — whose average is greater than the statewide average of \$227.

Figure 9: Average taxpayer benefits from the MID vary widely by county



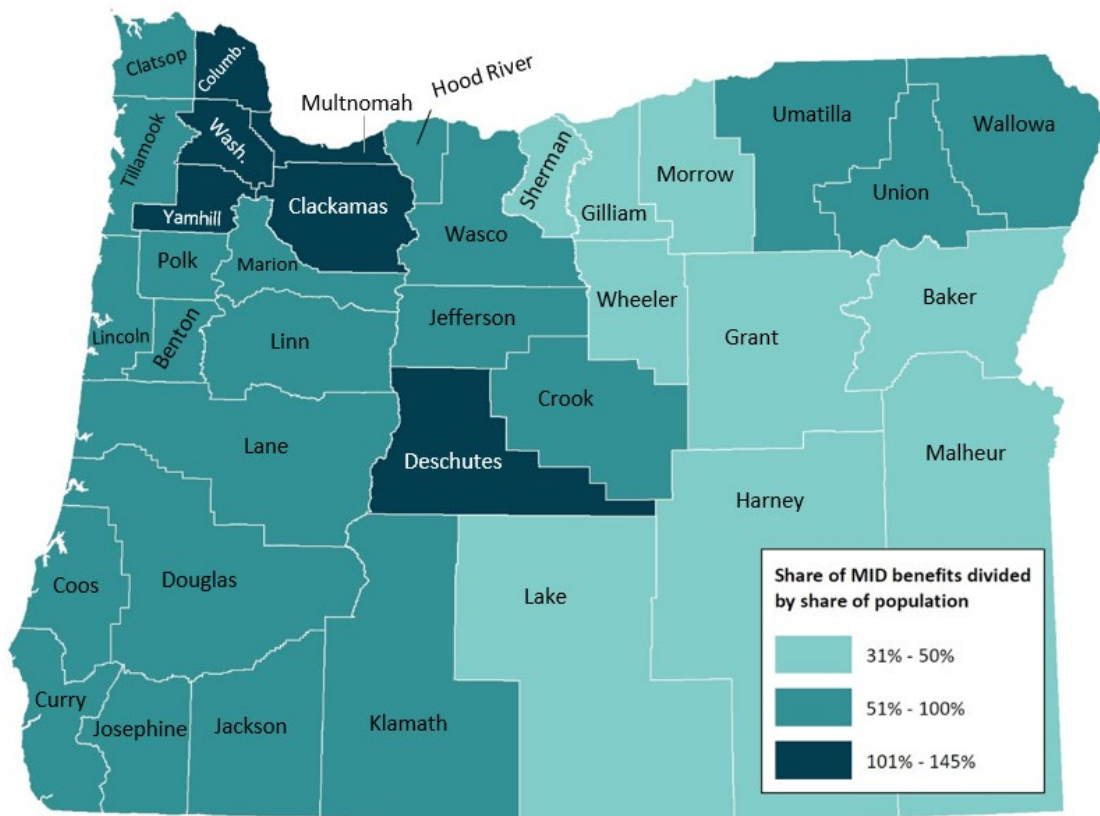
Source: OAD analysis of 2018 DOR full-time resident tax return data.

We also assessed the county-level distribution of the MID’s benefits by population by dividing each county’s share of MID benefits by their share of the state’s population. Any county with a ratio of MID benefits to population greater than 100% means that county received a disproportionate share of the MID’s benefits. We also performed this analysis using adjusted gross income instead of population. We

found a handful of primarily urban counties disproportionately benefit from the MID using both measures.

- The following counties received a disproportionate share of MID benefits by taxpayer population: Clackamas, Washington, Deschutes, Columbia, Multnomah, and Yamhill. All are defined as urban by OHCS.
- The following counties received a disproportionate share of MID benefits by adjusted gross income: Columbia, Clackamas, Yamhill, Deschutes, Polk, Crook, Jackson, Clatsop, and Washington. All but Crook and Clatsop are considered urban by OHCS.

Figure 10: A handful of urban counties disproportionately benefit from the MID by taxpayer population



Source: OAD analysis of 2018 DOR full-time resident tax return data, county map layer from the Oregon Geospatial Library.

There are many factors that might explain the disproportionate distribution of MID benefits by county, including higher home prices and incomes in urban counties. We found the average adjusted gross incomes in rural counties was nearly 30% lower than in urban counties. This significant income discrepancy indicates the disproportionate distribution of MID benefits by county is likely correlated with the deduction's greater benefit for those with higher incomes.

We did not assess the impact of higher home prices in urban areas. However, a 2018 study by the Oregon Office of Economic Analysis found while the median income for people who live in rural Oregon was similar to the nation as a whole, median home prices in rural areas were 30% higher. This indicates

people who live in rural areas in Oregon face greater housing affordability challenges than the rest of rural America.

MID benefits disproportionately accrue to higher-income homeowners, who tend to be white

Assessing the distribution of the MID based on race and ethnicity is challenging because this information is not gathered on Oregon tax returns. However, when analyzing the distribution of the MID there are two factors that are particularly relevant: the MID is available only to homeowners, and its regressive nature means its benefit increases with income.

We examined homeownership rates and household income by race and ethnicity using data from the 2018 American Community Survey. Based on significant differences in homeownership rates and income, we can conclude people of color in Oregon receive disproportionately less benefit from the MID than white people, especially for people that identify as African American, Latino, and Native American.

The American Community Survey reports homeownership rates by race and ethnicity using self-reported demographic information from the primary householder. Figure 11 shows the homeownership rate in Oregon by race and ethnicity.

Figure 11: White people are much more likely to own homes than people of color in Oregon

2018 American Community Survey Race Categories	Homeownership Rate
White	64%
Black or African American	31%
American Indian and Alaska Native	45%
Asian	59%
Native Hawaiian and Other Pacific Islander	31%
Some other race	42%
Two or more races	47%
2018 American Community Survey Ethnicity Categories ¹⁴	Homeownership Rate
Hispanic or Latino origin	41%
White alone, not Hispanic or Latino	65%

Source: OAD analysis of 2018 5-Year American Community Survey data.

As is the case nationwide, white people in Oregon are far more likely to own their homes than are people from most other races. In Oregon, people who identify as white are more than twice as likely to be homeowners than people who identify as Black or African American and Native Hawaiian and other Pacific Islander. The white homeownership rate is roughly 20% higher than it is for American Indian and Alaska Natives as well as for individuals who identify as some other race and for those that identify as two or more races. The result is similar by ethnicity, with Hispanic or Latino homeownership 24% lower than it is for individuals who identify as white and do not identify as Hispanic or Latino. Even with the existence of the MID, these discrepancies in homeownership rates by race and ethnicity have remained relatively unchanged over the last 20 years.

¹⁴ Race and ethnicity are reported separately in the American Community Survey.

We also examined the relationship between race, ethnicity, and income using data from the 2018 American Community Survey and found a similar result. Nearly 70% of taxpayers with incomes greater than \$100,000 benefit from the MID and they receive nearly 60% of its total benefits, while making up only 20% of the population.

Discrepancies in homeownership rates by race and ethnicity have remained relatively unchanged over the last 20 years.

As Figure 12 shows, people in Oregon who identify as white are significantly more likely to have household earnings greater than \$100,000 than people who identify as Black or African American, American Indian or Alaska Native, and some other race. The only other group significantly more likely to have incomes greater than \$100,000 are people who identify as Asian.

The result by ethnicity is similar in Oregon with people who identify as Hispanic or Latino being nearly half as likely to have household incomes of \$100,000 or more than people who identify as white, non-Hispanic or Latino. Based on these significant discrepancies in homeownership rate and income levels by race and ethnicity, and the relationship these factors have to the distribution of the MID, we can conclude the MID in Oregon disproportionately benefits white, non-Latino people.

Figure 12: White households are more likely to earn more than \$100,000 than households of other races and ethnicities

2018 American Community Survey Race Categories	Percent of households with incomes \$100,000 or more
White	26%
Black/African American	15%
American Indian/Alaska Native	14%
Asian	37%
Native Hawaiian/Pacific Islander*	26%
Other	14%
Two or More Races	21%

2018 American Community Survey Ethnicity Categories	Percent of households with incomes \$100,000 or more
Hispanic or Latino	15%
White, Not Hispanic or Latino	27%

Source: OAD analysis of 2018 5-year American Community Survey data.

Note: The difference between the White and Native Hawaiian/Pacific Islander sub-groups is not statistically significant. The American Community Survey and uses a different definition of income than the adjusted gross income taken from the tax return data. Also, American Community Survey data is presented at the household, not taxpayer level.

The State of Oregon’s Diversity, Equity, and Inclusion Action Plan notes “equity is the effort to provide different levels of support based on an individual’s or group’s needs in order to achieve fairness in outcomes.” In Oregon, the MID is a racially inequitable policy based on this standard because its benefits flow disproportionately to higher income, white people, who already have significantly better homeownership rate outcomes when compared to people of color.

Oregon Diversity, Equity, and Inclusion Action Plan: Definition of Equity

“Acknowledges that not all people, or all communities, are starting from the same place due to historic and current systems of oppression. Equity is the effort to provide different levels of support based on an individual’s or group’s needs in order to achieve fairness in outcomes. Equity actionably empowers communities most impacted by systemic oppression and requires the redistribution of resources, power, and opportunity to those communities.”

The lack of data on race and ethnicity complicates analysis of the MID, however stakeholders expressed concerns about collecting these data

Currently there are no data that clearly tie race and ethnicity to the MID. At the federal level, the IRS does not collect data on the race and ethnicity of taxpayers on tax forms and federal analysis of tax data does not typically include race and ethnicity. Similarly, race data is not collected on tax forms in Oregon¹⁵.

Not collecting these data hinders efforts by policymakers to evaluate whether a tax policy, like the MID, produces disparate racial impacts and provide remedies for these inequities. While collecting disaggregated race and ethnicity data are important in the effort to develop equitable policy, some key stakeholders we spoke with had concerns about collecting race and ethnicity data on tax forms.

These concerns included:

- Collecting these data may lead to further racial discrimination in the creation and administration of tax laws, such as through disparate tax enforcement and racially targeted tax policies.
- Data on the race and ethnicity of taxpayers is too private for tax agencies to collect and could be used in a discriminatory manner.
- Taxpayers may refuse to disclose this information, leading to non-response bias that may skew analysis of outcomes.

The Governor, in her introductory letter at the beginning of the 2021-23 Tax Expenditure Report, called for better data collection so tax expenditures can be better evaluated from an equity and racial justice perspective in the future. The Governor’s Office, DOR, and the newly formed Racial Justice Council are currently meeting with other agencies and community groups to begin discussing how racial justice and equity can be incorporated into tax policy in Oregon.

The MID does not address the primary barriers experienced by prospective low-to-moderate income homebuyers

As the largest housing subsidy in Oregon, the MID does not address challenges related to obtaining a home in the state, particularly for low- to moderate-income homebuyers. We met with homeownership counselors and staff from seven Oregon Homeownership Centers to learn the primary barriers faced by low- to moderate-income home buyers and how the MID addresses them. Six of the seven centers we spoke with told us the MID is not an effective tool for helping their clients become homeowners. While

¹⁵ Senate Bill 1569, considered during the 2022 Legislative Session, would direct DOR to collect voluntarily reported and self-identified taxpayer race and ethnicity data for the purpose of analyzing revenue policy. This bill was under consideration during the drafting of our report.

most of the centers we spoke with agreed the MID does not help their clients, one center told us when they discuss the benefits of homeownership with their clients, they use the potential tax benefits from the MID as a motivator.

There are 18 Homeownership Centers that provide housing counseling services in each of Oregon's 36 counties. Certified Housing Counselors at these centers provide, among other services, homebuyer education and financial literacy courses and one-on-one loan default and post-purchase counseling targeted to low-to moderate-income prospective homebuyers and communities of color. They are supported through grants from OHCS and their counselors are required to be certified through an approved housing counseling certification program.

"I can't think of a single client that the mortgage interest deduction ever made a difference for."

-Homeownership Center, Housing Counselor

We selected seven Homeownership Centers serving counties across the state, including two Culturally Specific Organizations focused on serving Communities of Color, and asked them what barriers their clients face in becoming first-time homeowners. The primary barriers they identified were:

- Limited funds for a sufficient down payment;
- The high price of homes in the current housing market; and
- Credit issues including bad credit or no credit.

We also asked them if they viewed the MID as an effective tool for overcoming these barriers and helping their clients achieve homeownership. Six of the seven told us the MID did not address these barriers or help their clients. They noted many of their clients do not have sufficient itemized expenses to benefit from the deduction and are simply struggling to get into a home in the first place.

One housing counselor told us: "The MID is a tool that serves people at the higher end of the income spectrum [...] and the nature of the housing market is that there is no path for most people to benefit from the MID." Another housing counselor told us: "I can't think of a single client that the MID ever made a difference for." We heard from homeownership counselors the MID does not provide any upfront benefit that can assist their clients in completing a home purchase.

This mismatch between benefit and need limits the value of the MID for low- and moderate-income homebuyers. In an economic analysis of the MID, the Congressional Research Service found high transaction costs associated with a home purchase, like down payment and closing costs, are the primary barrier to homeownership nationally and "because the MID does not lower the primary barrier to homeownership, its effect on the homeownership rate may be small."

The Congressional Research Service found high transaction costs associated with a home purchase, like down payment and closing costs, are the primary barrier to homeownership nationally and "because the MID does not lower the primary barrier to homeownership, its effect on the homeownership rate may be small."

The MID's design and lack of a clear purpose contribute to its inequitable outcomes

Identifying the purpose or legislative intent of a tax expenditure is a critical step to determine its effectiveness because it provides criteria that can be used to judge its outcomes. Oregon's tax expenditure report identifies the MID's purpose as "promoting homeownership by reducing the cost of mortgages," a purpose that is commonly cited by other entities. However, based on our review of federal and state statute and the relevant literature, it is clear the MID was not originally intended to promote homeownership and its design makes it a regressive tax policy that is poorly suited for this purpose.

There is no evidence that the MID was originally intended to promote homeownership

A commonly cited purpose for the MID is that it promotes homeownership; however, neither federal nor state statute identifies a clear purpose or intent for the deductibility of mortgage interest and the Congressional Research Service states in an annual report: "There is no evidence in the legislative history that the interest deduction was intended to encourage homeownership or to stimulate the housing industry."¹⁶

When the original federal income tax was instituted in 1913, mortgage interest was deductible along with other types of interest payments made for business, personal, living, or family expenses.¹⁷ When Oregon instituted its own income tax in 1923, it mirrored the treatment of interest used by the federal government. By 1986, the housing industry considered the preservation of the MID as its most important issue and it was popular among Americans, even though only one-fourth of the population at the time benefitted from it. The federal Tax Reform Act of 1986 removed the deductibility of most types of consumer interest but maintained the MID while placing limitations on the number of homes and the total mortgage amount that could be claimed. These limits on consumer interest were adopted for taxpayers in Oregon, due to Oregon's connection with federal income tax law.

The design of the MID contributes to its inequitable outcomes

Regardless of its original intent, the MID is designed in a way that systematically benefits higher income taxpayers for three key reasons. First, higher income taxpayers are more likely to itemize their deductions. Second, higher income taxpayers are more likely to own more expensive homes which result in larger deductions. Finally, higher income taxpayers have higher marginal tax rates leading to a larger benefit per dollar deducted.

For example, based on our review of 2018 income tax data, we found that for every \$100 deducted, Oregon taxpayers in the top 20% received a benefit of \$9.20, while taxpayers in the second 20% only received a tax benefit of \$5.60; see Figure 13.

¹⁶ "Tax Expenditures: Compendium of Background Material on Individual Provisions." DOR uses this document to help identify the purpose of federally connected tax expenditures for the biennial tax expenditure report.

¹⁷ 1913 Revenue Act, i.e., Underwood Tariff Act, provides general offset for "all interest paid within the year by a taxable person on indebtedness." Also, provides offset for, among other things "the necessary expenses actually paid in carrying on any business [...] all national, State, county, school, and municipal taxes paid within the year [...] losses actually sustained during the year incurred in trade or arising from fires, storms or shipwreck [...] [and] the amount of income the tax upon which has been paid or withheld for payment," etc.

Figure 13: MID benefit per \$100 deducted increases as incomes increase

2018 Income Percentile	Income Range	MID Benefit per \$100 deducted
Lowest 20%	Below 16,100	\$0.90
Second 20%	16,100-32,900	\$5.60
Middle 20%	32,900-57,100	\$8.30
Fourth 20%	57,100-100,100	\$8.80
Top 20%	100,100 and above	\$9.20
All Resident Taxpayers		\$8.50

Source: OAD analysis of 2018 DOR resident income tax return data.

The design of the MID contributes to the inequitable and regressive outcomes we found. However, without a clearly stated purpose in statute beyond Oregon’s connection to the federal person income tax code, it is difficult to know what the original intent was and what the current goals are for the MID in Oregon. This lack of a purpose specific to the MID makes it difficult to assess its effectiveness. The Government Accountability Office notes that “identifying a tax expenditure’s purpose is a necessary first step in determining how the tax expenditure’s performance should be assessed.” While it is difficult to assess the effectiveness of the MID, the fact that it is a regressive tax policy makes it inconsistent with the goals stated in Oregon’s income tax statutes.

Some states have designed limitations that may reduce the regressivity of deductions like the MID

The MID is a common deduction at the state level, with 30 states and Washington D.C. offering it as an itemized deduction. We examined the itemized deduction practices used by the states that offer the MID and found 12 have established limits that may mitigate its regressivity. Other types of tax expenditures, like tax credits, may also provide a more equitable way to encourage homeownership.

States provide itemized deductions to taxpayers in a variety of ways. Some states require taxpayers to itemize at the federal level in order to claim the same deductions at the state level. Others, like Oregon, allow taxpayers to itemize regardless of how they filed their federal taxes. Some states use the federal standard deduction amount, while others, including Oregon, set their own.

We identified 12 states that limit itemized deductions through a variety of approaches, including phase-downs, phase-outs, flat dollar caps, and credits in lieu of deductions. It is important to note that these limitations apply to itemized deductions generally, not just to the MID, making it difficult to assess their impact on specific types of itemized deductions.

Phase-down: Reduces the deduction(s) by a fixed percentage, for taxpayers above a specified income threshold. The phase-down reduction is typically capped at 80%. Example: A 3% phase down, \$160k threshold - Every dollar of income earned above \$160k results in a 3-cent reduction in itemized deduction(s) that can be claimed. Total reduction capped at 80%.

Phase-out: Similar to a phase-down, but completely eliminates itemized deductions. Example: A 3% phase-out, with a phase-out beginning at \$160k- Every dollar of income above \$160k results in a 3-cent reduction in itemized deductions. At higher-income levels can result in the elimination of itemized deductions.

Flat dollar cap: Limits the total amount of deductions that can be claimed to a maximum dollar amount. Example: For cap set at \$10k, only \$10k worth of combined deductions can be claimed.

Credit in lieu: Replaces each deduction with a credit equal to a fixed percentage of the deduction amount. Example: \$50k in itemized deductions at a 5% rate would reduce tax liability by \$2,500.

Of these, the practices used in Washington D.C., Maine, Utah, and Wisconsin likely have the greatest potential to reduce the regressivity of the MID.

- Washington D.C. applies a phase-out to all itemized deductions reducing the amount of itemized deductions that can be claimed by 5% of every dollar of adjusted gross income greater than \$200,000. For example, if a taxpayer's income was \$250,000, the amount deducted from their income would be reduced by \$2,500.
- Maine also has a phase-out provision that reduces itemized deductions for taxpayers with adjusted gross incomes starting at \$83,850 (\$167,700 if married filing jointly). It also applies a flat cap on the total amount of itemized deductions that can be claimed. The maximum amount that could be claimed is indexed to inflation and was \$30,050 in 2021.
- Both Utah and Wisconsin require taxpayers to convert their itemized deductions into a credit at a rate of 6% and 5%, respectively. Utah also applies a phase-out at a rate of 1.3% that takes effect at a relatively low threshold of \$29,758 for couples who file jointly.

Each of these approaches has the potential to reduce the regressivity of itemized deductions. Phase-down or phase-out provisions can enhance equity by reducing or eliminating the itemized deductions for higher-income taxpayers. Flat caps prevent high-income earners with significant itemized deductions from receiving outsized benefits compared to moderate- and lower-income taxpayers.

Credits can be targeted to enhance after-tax income for low-income taxpayers and prevent higher-income taxpayers from receiving greater per dollar benefits. Tax credits, especially when they are refundable, can be seen as more progressive than itemized deductions because they can be used by lower income taxpayers who do not itemize, and because they reduce tax liability by a fixed amount regardless of the income tax rate paid.

Mortgage Credit Certificates are an example of a tax credit program designed specifically to support low- to moderate-income homebuyers. This federal program allows states to convert a portion of their private activity bond allocation into Mortgage Credit Certificates issued to qualified homebuyers. When

a qualified homebuyer purchases a home, they are entitled to an annual federal tax credit equal to a percentage of their mortgage interest for the life of the mortgage. The tax credit percentages vary by state, typically between 20-40%, and the total credit cannot exceed \$2,000 in any given year. The program is limited to first-time homebuyers and states are required to set sale price and income limits. Based on our review, 27 states have an active Mortgage Credit Certificate program. Oregon does not have an active program, but statute allows for one to be established¹⁸.

The MID receives no state-level evaluation, limiting accountability for its regressive outcomes

Best practices call for tax expenditures to receive similar scrutiny to budgeted spending. Oregon's tax expenditure report provides valuable information to policymakers and the public. However, like in most other states, the MID receives no evaluation in Oregon's tax expenditure report. Historic budget issues, limited state-level administration, and the fact there is not an agency directly accountable for its performance contribute to the lack of scrutiny the MID receives in Oregon. This lack of transparency limits the visibility of and accountability for the MID's regressive outcomes.

Best practices call for consistent and rigorous evaluation of tax expenditures like the MID, but these reviews are rare at the state level

The Center for Budget and Policy Priorities, National Conference of State Legislatures, and the Government Accountability Office call for tax expenditures to receive similar scrutiny to budgeted spending. Spending that occurs as part of the budget process, such as funding agency programs and K-12 education, typically receives regular review and subsequent change throughout the budget process. In contrast, many tax expenditures have been permanently incorporated into the tax code and require special legislative action for them to be changed. In other words, even though tax expenditures like the MID are often as costly as budgeted spending programs, they are not subjected to the same level of legislative review.

National Conference of State Legislatures best practices state "when lawmakers decide to use the tax system to make budget decisions or influence behavior, these decisions should be explicit and subject to frequent evaluation and review." The organization further states "increasingly the public and policymakers agree that an accounting and review of tax expenditures should be part of regular sound budget practices" and to do this, "a complete and frequently updated tax expenditure report is essential for good policymaking."

We analyzed tax expenditure review practices of all 50 states and the District of Columbia, and concluded tax expenditure reports are the primary, and often only, method used for reviewing tax expenditures at the state level. The Center for Budget and Policy Priorities provides criteria for the elements that should be included in tax expenditure reports, including that the report be accessible, detailed, and evaluates the extent to which the purpose of the expenditure has been accomplished, as well as provide distribution of benefits by income level.

¹⁸ [ORS 456.605](#)

However, state reviews of the MID are rare. Out of the 30 states that have a state income tax and offer itemized deductions, only 12 states and the District of Columbia include a review of the MID in their tax expenditure report, and even fewer provide detailed evaluations.

The District of Columbia and California publish relatively comprehensive and informative reports on the MID. Washington, D.C.'s most recent report provides a lengthy evaluation of the MID incorporating external data from the Congressional Research Service and Urban Institute. The report released by the California Franchise Tax Board includes an extensive discussion section of the MID where they weigh the pros and cons of making changes to the MID. In addition to state reviews, the MID is regularly evaluated at the federal level by the Congressional Research Service in the annual Compendium of Tax Expenditures.¹⁹

Oregon state statute requires the Governor work with DOR and the Department of Administrative Services to produce a tax expenditure report each biennium to complement the Governor's recommended budget. The required elements for each tax expenditure in the report include, among other things:

- Identification of the statutory authority,
- A description of its purpose,
- An estimate of the amount of revenue loss for the coming biennium,
- A determination of whether each tax expenditure has successfully achieved the purpose for which it was enacted including an analysis of the persons that benefit.

In addition to the tax expenditure report, statute requires the Legislative Revenue Office release a biennial report that evaluates expiring tax credits, often referred to as sunset tax credits. Oregon has many sunset tax credits that are staggered so one-third of Oregon's income tax credits come up for review every two years when the Legislature sets its biennial budget. The most recent 2021 Tax Credit Report contains an in-depth analysis of 11 tax credits which all include a discussion of the policy purpose, a description of the program, an extensive policy analysis section, and a comparative analysis of the tax policy in other states. Oregon is listed as best practice for setting sunset dates and producing this Tax Credit Report; however, most exemptions and deductions like the MID are not set to sunset, so they do not receive this more intensive level of review.

DOR coordinates the development of the biennial tax expenditure report which provides no evaluation of whether the MID meets its purpose

Oregon's tax expenditure report has been identified as a model for other states. DOR plays the primary role in the development of the tax expenditure report, coordinating its development, calculating revenue impacts, and organizing evaluations from subject matter agencies. The MID is included as part of Oregon's tax expenditure report. However, no evaluation is made as to whether it achieves its intended purpose.

DOR does the bulk of the coordinating work for the tax expenditure report, with input from the Governor's office on points of emphasis at the beginning of each reporting cycle. In July of each reporting year, DOR sends a letter to all applicable state agencies requesting they provide evaluations

¹⁹ The December 2020 version can be found [online at Gov.info.gov](https://www.govinfo.gov).

of the tax expenditures that are relevant to their program area and relevant data for the report. For these evaluations, DOR relies on information provided from agencies with missions related to the tax expenditure's purpose and engages with each agency throughout the process by providing instructions and suggestions. If the Governor's Office requests more detailed evaluations from agencies for specific expenditures, DOR will request more information from these agencies.



The cover of 2021-23 Tax Expenditure Report

The Department of Administrative Services Chief Financial Office provides input on deadlines at the beginning of the reporting cycle and reviews the report toward the end of the process.

Department of Administrative Services budget analysts review the tax expenditure material as part of their biennial budget development process. DOR also consults with the Legislative Revenue Office to get feedback on the cost estimates for each expenditure.

For the MID, the 2021-23 Tax Expenditure Report includes estimates of both the current and future biennial costs of the MID, a brief description of the tax expenditure, the relevant legal citation and year of enactment, its purpose, and a description of who benefits from the expenditure broken out by income level. The report does not

provide evaluation of the extent to which the MID has achieved its purpose, as required by statute. The 2007-09 Tax Expenditure Report was the last time the MID was evaluated to determine whether it was meeting its intended purpose, with Oregon Housing and Community Services providing the review.

In 2008, due to budget constraints, DOR and the Governor's Office made the decision to stop conducting evaluations of income tax expenditures resulting from Oregon's connection to federal law in the report. Instead, DOR notes they rely on the evaluations conducted by the federal Congressional Research Service for federally connected tax expenditures in the tax expenditure report. However, DOR does not include these evaluations of the MID in the report.

The lack of evaluation of the MID limits public information and hinders the ability of policymakers to make informed decisions

In addition to the past budget constraints noted above, we identified several factors that contribute to the lack of evaluation the MID currently receives in Oregon, including a perceived lack of political feasibility in changing the policy, limited state-level administration, and the fact there is not an agency directly accountable for its performance. It is critical a \$1 billion-dollar biennial tax program such as the MID be regularly reviewed and evaluated to ensure policymakers and the public can make informed decisions about its costs and benefits.

Generally, DOR has held it does not advise the Legislature on tax policy issues unless directed to do so. Although state statute allows DOR the ability to review and recommend changes to Oregon tax law, the agency has interpreted this statute to extend only to correcting administrative inequities, closing

loopholes and administrative inefficiencies, and establishing incentives for voluntary participation and compliance. Some stakeholders told us making changes to the MID has not been seen as politically feasible, limiting the perceived value of evaluating it.

Another cause for the MID's lack of evaluation is that other than being included as a deduction on state tax returns, it requires limited state-level administration. As a result, there is not an agency directly accountable for its performance or incorporates it into its strategy. While OHCS provided previous evaluation of the MID, it does not have the data required for a systematic evaluation. Although DOR is the state agency administering the MID and has most of the data required for a systematic evaluation, it is an administrative agency and not responsible for the housing program area.

The Government Accountability Office reports “for tax expenditures without logical connections to program agencies, such as those with tax administration purposes like the exclusion from income of capital gains from the sale of a principal residence, [the U.S] Treasury may be the most appropriate agency to conduct an evaluation. For many tax expenditures, evaluations will likely require collaboration among agencies.” It is possible cross-agency collaboration will be required to ensure the MID receives sufficient and regular review.

According to best practices, including a detailed evaluation of tax expenditures like the MID, along with a clearly defined purpose, promotes meaningful discourse about whether a particular tax expenditure should be retained, modified, or eliminated. In addition, the Center for Budget and Policy Priorities notes it is important for state policymakers to have the information they need to decide whether the benefits of conforming to the federal tax code are worth the resulting revenue loss. Without information on the costs and benefits of the MID, lawmakers cannot make an informed decision on whether its continuation is in Oregon's best interest. Currently, stakeholders, constituents, and the media may not have enough information to have a meaningful debate about the value of the MID.

Recommendations

Due to its role as a tax administration agency, DOR management told us the agency is not responsible for the design of the MID or its outcomes; therefore, we did not make recommendations to the agency to address the findings. Additionally, while DOR plays a key role in the tax expenditure reporting process, statute does not specifically identify it as accountable for evaluating the MID.

Barring Legislative action, the MID, as currently designed, will continue to produce inequitable results. To inform potential changes for a more equitable policy, a regular evaluation is warranted.

To help guide future evaluations and inform policymakers and the public, we recommend the Legislature:

1. Identify a clear purpose for the MID in statute and determine if changes to the design of the MID are necessary to ensure that the identified purpose is met.
2. Identify a state agency that will be responsible for regularly evaluating the MID to ensure it meets its legislatively identified purpose.

Objective, Scope, and Methodology

Objective

This audit had two objectives:

- Determine the distribution and equity of the MID in Oregon by income, geography, and race and ethnicity.
- Determine the current level of review the MID receives and who should be accountable for assessing its effectiveness.

Scope

This audit focused on the distribution and equity of the MID as part of Oregon's income tax system using data from the 2018 tax year, the most recent year available. We did not review controls or monitoring practices used by DOR to ensure taxpayer compliance with the MID's rules.

We focused primarily on the level of review the MID receives from DOR and other relevant state agencies. We also, as appropriate, examined the practices used in Oregon, other states, and by the federal government to review and evaluate tax expenditures more generally.

Methodology

To address our objectives, we used a methodology that included, but was not limited to: conducting interviews, reviewing documentation, reviewing leading practices and approaches used in other states, and analyzing 2018 Oregon income tax data and data from the 2018 American Community Survey.

To learn about the views, opinions, and perspectives of stakeholders we conducted interviews with the Oregon Association of Certified Public Accountants, the Coalition of Communities of Color, the Oregon Realtors Association, the Oregon Homebuilders Association, the Oregon Bankers Association, Housing Oregon, the Welcome Home Coalition, and the Oregon Center for Public Policy. We also met with members of the Oregon Legislature and staff at the Legislative Revenue Office.

We met with DOR staff and management to gain an understanding of DOR's role in administering and evaluating the MID. We also met with staff from the Governor's Office to gain an understanding of the Governor's role in the current tax expenditure review process.

To learn the barriers faced by low- to moderate-income prospective homebuyers and the MID's effectiveness at addressing these barriers, we met with homeownership counselors from the following seven OHCS certified Homeownership Centers:

- Columbia Cascade Housing Corporation;
- Community Connection of Northeast Oregon;
- Hacienda Community Develop Corporation;
- Neighborworks Umpqua;
- NeighborImpact
- The African-American Alliance for Homeownership and
- DevNW

We reviewed state and federal statutes, IRS Code, and other government publications to determine how the MID is supposed to operate and to determine the level of review it is supposed to receive. We reviewed current and past tax expenditure report and other public income tax reports created by DOR.

We reviewed research reports and other studies as well as practices in other states in order to identify leading practices for enhancing the equity of itemized deductions like the MID, as well as to identify leading practices for the review and evaluation of MID policies, and tax expenditures more generally.

To determine the distribution of the MID by income and county we analyzed income tax data provided by DOR for the 2018 tax year that included DOR's tax expenditure calculations for the MID. This data included more than 2.1 million taxpayer records. We focused this analysis on full-time resident taxpayers. To determine the distribution by race and ethnicity we relied on data on homeownership and income from the 2018 American Community Survey. We assessed the reliability of these data and found them to be sufficiently reliable for our purposes.

Internal control review

We determined internal controls were not relevant to our audit objectives and did not review them as part of our planned work.²⁰

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We sincerely appreciate the courtesies and cooperation extended by officials and employees of DOR during the course of this audit.

Audit team

Olivia Reched, MPA, Audit Manager
Jonathan Bennett, MPA, Lead Auditor
Hillary Hahn, MPP, Staff Auditor

About the Secretary of State Audits Division

The Oregon Constitution provides that the Secretary of State shall be, by virtue of the office, Auditor of Public Accounts. The Audits Division performs this duty. The division reports to the elected Secretary of State and is independent of other agencies within the Executive, Legislative, and Judicial branches of Oregon government. The division has constitutional authority to audit all state officers, agencies, boards and commissions as well as administer municipal audit law.

²⁰ Auditors relied on standards for internal controls from the U.S. Government Accountability Office, report [GAO-14-704G](#).



Oregon

Kate Brown, Governor

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March 11, 2022

Kip R. Memmott, Director
Secretary of State, Audits Division
255 Capitol Street N.E., Suite 500
Salem, Oregon 97310

Dear Mr. Memmott:

The Department of Revenue appreciates the attention devoted to the Mortgage Interest Deduction audit by the Audits Division and for allowing us to provide comments on the report.

As part of the biennial budget process, the governor is required by statute to develop a report on all "tax expenditures" for all tax programs in Oregon. The Department of Revenue has been the main organizer and contributor to this report since it first began more than two decades ago. Oregon statute requires that the biennial Tax Expenditure Report, "determine whether each tax expenditure has successfully achieved the purpose for which the tax expenditure was enacted and currently serves" (ORS 291.203). Yet, for most tax expenditures, Oregon statute does not specify the purpose of the expenditure. To address this shortcoming, a 2013 law change (ORS 173.025) required that Revenue Impact Statements prepared by the Legislative Revenue Office "must include a statement describing the public policy purpose of the tax expenditure." Although this change has been helpful in providing clarity of purpose, it has only addressed tax expenditures that have been created or extended since 2013. The purpose of most tax expenditures remains unknown.

The federal government reviews and analyzes federal tax policies. In the upcoming 2023-25 Tax Expenditure Report, the department will incorporate clear citations of these federal analyses where Oregon law connects to the federal tax expenditure, including for the mortgage interest deduction, to better inform readers.

Thank you again for your partnership and for including us in the review of the draft audit.

Betsy Imholt
Director



Secretary of State
Shemia Fagan



Audits Director
Kip Memmott

This report is intended to promote the best possible management of public resources.
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