

5-1-2013

# Is the Mortgage Interest Deduction Consistent with Principles of Distributive Justice?

Benjamin Proce

Follow this and additional works at: [https://scholarship.shu.edu/student\\_scholarship](https://scholarship.shu.edu/student_scholarship)

---

## Recommended Citation

Proce, Benjamin, "Is the Mortgage Interest Deduction Consistent with Principles of Distributive Justice?" (2013). *Law School Student Scholarship*. 166.

[https://scholarship.shu.edu/student\\_scholarship/166](https://scholarship.shu.edu/student_scholarship/166)

***Is the Mortgage Interest Deduction Consistent with Principles of Distributive Justice?***

***Corporate Integrity and Accountability (Course #9131).***

***Benjamin J. Proce, CPA, MBA, JD  
Candidate (May 2013)***

***April 25, 2013***

***Professor: Sister Melanie Dipietro***

## PART I. INTRODUCTION

Death and taxes were considered by Benjamin Franklin to be the only two certainties in life.<sup>1</sup> In fact, even death carries with it an additional tax on the property that one leaves behind.<sup>2</sup> While many would agree that taxes are an unavoidable part of civilized society, there is little consensus as to how the burdens of taxation should be shared among taxpayers.

John Finnis, in discussing distributive justice, refers to "subject matter that is common". He defines 'subject matter that is common' as follows:

"it is part of no individual person and has not been created by anybody, but is apt for use for the benefit of anyone or everyone: for example, solar energy and light, the sea, its bed and its contents, land and its contents, rivers, air and airspace, the moon..."<sup>3</sup>

Since there is almost universal taxation of any income earned by individuals<sup>4</sup> in the U.S. tax system, taxes fit within Finnis' description of 'subject matter that is common'.<sup>5</sup> Taxes are created by the government, they are universal in that everyone is subject to taxes, at least, in principle and taxes pay for the government to work for the common good.

Finnis suggests that any 'subject-matter that is common' is relevant to questions of distributive justice.<sup>6</sup> Finnis described justice as the quality of character favoring the common good of one's community and further explained that problems of distributive justice consider

---

<sup>1</sup> BENJAMIN FRANKLIN, THE WRITINGS OF BENJAMIN FRANKLIN 69 (Albert Smith ed., The Macmillan Company 1907).

<sup>2</sup> 26 U.S.C. § 2001(a) (West 2012). ("A tax is hereby imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.").

<sup>3</sup> JOHN FINNIS, NATURAL LAW AND NATURAL RIGHTS 167 (H.L.A. Hart ed., Oxford University Press 2003) (1980).

<sup>4</sup> 26 U.S.C. § 1(c) (West 2012). ("There is hereby imposed on the taxable income of every individual ...a tax determined in accordance with...").

<sup>5</sup> JOHN FINNIS, NATURAL LAW AND NATURAL RIGHTS 88 (H.L.A. Hart ed., Oxford University Press 2003) (1980).

<sup>6</sup> *Id.* at 174.

to whom and on what conditions the 'subject matter that is common' is distributed.<sup>7</sup> In the context of housing, every person needs to have some type of shelter whether it be via home ownership, renting or through charitable means. While housing, like taxes, is created by someone, the benefit of its creation is for everyone. Therefore, given the commonness of taxes and housing, this paper will adapt Finnis' concept of 'subject-matter that is common' to the interrelatedness of taxes and housing.

This paper will examine the mortgage interest deduction provided for by the Internal Revenue Code<sup>8</sup> and analyze to whom its benefits and burdens are distributed and on what conditions. The thesis of this paper is that the mortgage interest deduction does not comport with the principles of distributive justice as defined by John Finnis because the current structure of the mortgage interest deductions unfairly allocates benefits to higher income taxpayers with disproportionate burden falling to lower income taxpayers and renters with no comparable benefit.<sup>9</sup> Renters receive no tax benefit for their housing payments but bear a cost because the mortgage interest deduction is a tax expenditure.

This thesis will be developed in several parts. Part one will provide necessary background information: the rationale for the mortgage deduction from taxes; the history and description of the mortgage interest deduction and the socioeconomic impact of the deduction. Part two will discuss Finnis' concepts of justice, distributive justice and the relevance of 'subject matter that is common' to distributive justice. Part three will apply the

---

<sup>7</sup> *Id.* at 155.

<sup>8</sup> 26 U.S.C. § 163(h)(2)(D) (West 2012). ("For purposes of this subsection, the term "personal interest" means any interest allowable as a deduction under this chapter other than...any qualified residence interest (within the meaning of paragraph 3)").

<sup>9</sup> Alan L. Feld, *Redeployment of Tax Expenditures for Housing*, 23 TAX NOTES 1441, 1443 (1984).

principles of distributive justice described in part two to the operation of mortgage interest deduction. Part four will contain the conclusion of this analysis.

## **PART I. BACKGROUND INFORMATION**

### **A. Rationale for the Mortgage Interest Deduction**

There are two primary rationales which support the imposition of each provision of U.S. income tax law: the first is economic, the government's basic need to raise revenue; the second is non-economic, the government's desire to achieve certain social policy objectives.

The purpose of government as defined by the preamble to the Constitution is in part to provide for the common defense and promote the general welfare.<sup>10</sup> This purpose is carried out through such services such as the protection of citizens through the armed forces, the protection of natural resources, the interstate highway system, etc. Each of these functions fit Finnis' definition of 'subject matter that is common'. While clean air and water fit directly into Finnis' definition of 'subject-matter that is common' most of government services such as food and health safety, though created by persons, affects every person. In order to carry out these functions, the government must raise revenue. The primary source of this revenue is income taxes levied on all individuals and corporations.

To raise revenue, the federal income tax operates under the broad principle that all income, from whatever source, is subject to taxation.<sup>11</sup> Internal Revenue Code ("IRC" or "Code") Sections 61 and 63 establish the basic principle that all individuals are taxed on all their income, regardless of its source, less explicitly "allowable deductions" provided for by

---

<sup>10</sup> U.S. Const. pmbl.

<sup>11</sup> 26 U.S.C. § 1(c) (West 2012). ("There is hereby imposed on the taxable income of every individual ...a tax determined in accordance with...").

the Code.<sup>12</sup> Congress has provided exceptions to that broad principle in the form of deductions, credits and exemptions.<sup>13</sup>

A deduction<sup>14</sup> is an expense incurred by a taxpayer which may be used to reduce the amount of income subject to tax.<sup>15</sup> Typical examples include employee wages, marketing expenses, state and local income taxes and the costs of business equipment.<sup>16</sup> These are often allowed because the deduction is deemed necessary to reflect the economic reality of a transaction or series of transactions. A simple example of such a deduction is an employer's deduction for the costs of wages paid to employees from gross income before computing a tax liability. The IRC allows this deduction because it reflects the economic reality that the employer must transfer a portion of the gross income to his employees in the form of wages. The IRC follows this economic reality and allows the employer to deduct any such amounts paid to employees from his gross income, therefore allowing him to reduce the amount of taxes to be paid. The IRC also reflects the economic reality from the perspective of the employees who have received a portion of the employer's gross income in the form of wages and therefore treats such wages as taxable to the employee who receives it.<sup>17</sup> With respect to deductions such as the one described above, the underlying rationale and calculus are economic principles related more to production of income than to social behavior or the provision of social goods.

---

<sup>12</sup> 26 U.S.C. § 62-63 (West 2012). ("...the term "taxable income" means gross income minus the deductions allowed by this chapter...").

<sup>13</sup> *Id.*

<sup>14</sup> 26 U.S.C. § 162 (West 2012). ("In computing taxable income under section 63, there shall be allowed as deductions the items specified in this part, subject to the exceptions provided in part IX...").

<sup>15</sup> 26 U.S.C. § 63(a) (West 2012). ("...the term "taxable income" means gross income minus the deductions allowed by this chapter...").

<sup>16</sup> 26 U.S.C. § 162(a)(1) (West 2012). ("...There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—(1) a reasonable allowance for salaries or other compensation for personal services actually rendered...").

The second rationale for tax provisions is the government's desire to achieve certain social policy objectives. The mortgage interest deduction is an example of the government trying to achieve a social policy, specifically, increasing the rate of home ownership. For many, owning a home is the culmination of the American Dream. As President George W. Bush exclaimed in a December 2000 news conference, "there's no greater American value than owning something, owning your own home and having the opportunity to do so."<sup>18</sup> The fact that, 65.5% of American's owned a home in the second quarter of 2012<sup>19</sup> is not only a testament to the place of home ownership in American culture as a core American value but has been supported by consistent federal government policy supporting home ownership. The mortgage interest deduction is deeply rooted in the policy rationale that home ownership increases the general welfare of society by increasing the wealth of home owners. Home owners invest in their communities and owning a home provides economic security to working families.<sup>20</sup>

Those who support the mortgage interest deduction make various arguments for its existence all based around the theory that it is good policy to encourage owning a home.<sup>21</sup>

The first common argument is that home ownership costs less, to society at large than

---

<sup>18</sup> Gerhard Peters and John T. Woolley, George W. Bush: "The President-Elect's News Conference Announcing the Nomination of Ann Veneman as Secretary of Agriculture, Mel Martinez as Secretary of Housing and Urban Development and Donald Evans as Secretary of Commerce" (2000), <http://www.presidency.ucsb.edu/ws/index.php?pid=84888#axzz11Ng1ocTH>.

<sup>19</sup> Rober R. Callis and Melissa Kresin, U.S. Census Bureau News: Residential Vacancies and Homeownership in the Second Quarter 2012 (2012) at 1, <http://www.census.gov/housing/hvs/files/qtr212/q212press.pdf>.

<sup>20</sup> Robert F. Mann, *The (Not So) Little House on the Prairie: The Hidden Costs of the Home Mortgage Interest Deduction*, 32 Ariz. St. L.J. 1347, 1355 (2000) (Secretary, Andrew Cuomo, stated in a recent press release: "Home ownership has many benefits. Homeowners generally enjoy better living conditions than renters; accumulate wealth as their investment in their homes grows; strengthen the economy by purchases of homes, furniture and appliances; and tend to be more involved in promoting strong neighborhoods and good schools than renters." Homeowners also maintain their homes in better condition than renters, increasing values in the neighborhood as a whole and saving society's resources by extending the life of housing. In a broader sense, private home ownership arguably benefits the environment. Homeowners are likely to be more concerned than renters about pollution and toxic waste, and thus more likely to take action to protect their environment.).

<sup>21</sup> J. PAUL MITCHELL, *FEDERAL HOUSING POLICY AND PROGRAMS: PAST AND PRESENT* 165 (3rd ed. 1993).

renting. This argument is based on the theory that home ownership provides an incentive for the occupier to maintain and invest in their home. For tenants, there is no upside or economic incentive, at times, to invest time or capital in maintaining their dwelling.<sup>22</sup> As a result, neighborhoods with high incidence of rentals would fall in disrepair compared to counterparts with higher rates of home ownership.

Second, owning a home is a capital intensive activity that requires substantial cash outlays and usually debt, or a mortgage. However, this use of capital carries with it a rate of return. This return includes both the value of the rent that the home owner would otherwise have paid a landlord and the increase in property values which in turn increases the owner's personal wealth.<sup>23</sup> This opportunity is one that some argue is worth helping many American's achieve by subsidizing housing through the mortgage interest deduction.

A third argument often made is that owning a home provides economic security to workers.<sup>24</sup> Importantly, equity in the home is often gained via the paydown of the mortgage and / or an increase in the home's value. As a result, home owners are often able to obtain an important economic resource to lean on in time of unemployment or other financial difficulty. Homes have historically been secure assets and thus provided more economic security than stocks or other more risky investments. In addition, a home mortgage is a way of forced savings, the portion of the monthly payment going towards the principle helps increase a home owner's net worth. If not paid to a mortgage, a home owner could use the excess cash on consumption which would not increase their net worth. Since its inception,

---

<sup>22</sup> *Id.* at 166.

<sup>23</sup> *Id.*

<sup>24</sup> *Id.* at 167.

the deduction for home mortgage interest has long been considered one of the most politically popular tax expenditures and therefore untouchable when it came to reforming the tax code.<sup>25</sup>

Since housing is a need of every person and the social rationale is that the whole community benefits from home ownership, the use of a mortgage deduction through the general tax structure appears appropriate on its face. The point of this paper, however, is whether in fact the operation of this deduction fairly distributes the social policy benefits and the burden of payment for the benefit by classes of taxpayers is proportionate to the enjoyment of the benefit by those taxpayers who ultimately pay for it through the operation of the tax system.

## **B. Legislative History and Description of the Mortgage Interest Deduction**

The mortgage interest deduction originated in 1913 and was based on an already existing personal deduction allowable for any interest paid on any personal indebtedness regardless of the source. For example, interest on a credit card would be deductible under the 1913 law. In particular the statute stated,

"That in computing net income for the purpose of the normal tax there shall be allowed as deductions...all interest paid within the year by a taxable person on indebtedness..."<sup>26</sup>

In 1986, the Tax Reform Act of 1986 ("Act"), in an effort to raise revenue, removed the general deduction for "personal interest".<sup>27</sup> This general deduction, until 1986, was the

---

<sup>25</sup> Dennis J. Ventry, Jr., *The Accidental Deduction: A History and Critique of the Tax Subsidy for Mortgage Interest*, *Law & Contemp. Probs.*, 233, 235 (2010). (The author gives numerous examples, contemporaneous to the negotiations of the Tax Reform Act of 1986 supporting the conclusion that the mortgage interest deduction political popularity including Ronald Regan's declaration that the deduction was "off limits" when it came to reforming the tax code.)

<sup>26</sup> Revenue Act of 1913, Pub. L. No. 63-16, 38 Stat. 114, 167.

mechanism by which home mortgage interest had been deducted. As a result of the 1986 Act's repeal of this provision, home mortgage interest would not be deductible without additional action from Congress.

Congress did take action and the Act included, for the first time, a specific deduction for mortgage interest. In effect, Congress created a specific exclusion for the mortgage interest deduction from the general prohibition on personal interest deductions.

The statute allowing the deduction currently reads, in part:

"The term "qualified residence interest" means any interest which is paid or accrued during the taxable year on acquisition indebtedness with respect to any qualified residence of the taxpayer, or home equity indebtedness with respect to any qualified residence of the taxpayer."<sup>28</sup>

In order to understand how the mortgage interest deduction works, especially in the context of this analysis of distributive justice, one must understand how the term "qualified residence" is defined in the Treasury Regulations as the "principal residence" of the taxpayer and "one other residence of the taxpayer which is selected by the taxpayer as a residence".<sup>29</sup>

The term principal residence generally means the primary home in which the taxpayer resides.<sup>30</sup> The "other residence" referred to in the statute relates to what is commonly known

---

<sup>27</sup> 26 U.S.C. § 163(h)(1) (West 2012). ("In the case of a taxpayer other than a corporation, no deduction shall be allowed under this chapter for personal interest paid or accrued during the taxable year." Personal interest is later defined to include all interest except for specified categories of interest listed in the statute. The listing includes the mortgage interest deduction.)

<sup>28</sup> 26 U.S.C. § 163(h)(2)(a)-(f) (West 2012). ("The term "acquisition indebtedness" means any indebtedness which...is incurred in acquiring, constructing, or substantially improving any qualified residence of the taxpayer...").

<sup>29</sup> 26 U.S.C. § 163(h)(4)(A)(i) (West 2012). ("...the principal residence (within the meaning of section 121) of the taxpayer, and...1 other residence of the taxpayer which is selected by the taxpayer for purposes of this subsection for the taxable year and which is used by the taxpayer as a residence...").

<sup>30</sup> 26 C.F.R. § 1.121-1(b)(2) (West 2012). (Considerations in determining a taxpayer's primary residence include but are not limited to: the taxpayer's place of employment; the principal place of abode of the taxpayer's family members; the address listed on the taxpayer's federal and state tax returns, driver's license, automobile

as the "vacation home" deduction.<sup>3132</sup> This deduction is not available for investment properties so the most common application of this provision is for taxpayers who own a second recreational or vacation home. Since 1986 there has been no significant change to the provisions which allow for this deduction and it remains in force today as enacted 26 years ago.

### **C. Deductions that Operate as Government Expenditures**

The mortgage interest deduction effectively operates as a tax expenditure. The concept of tax expenditures is generally used in reference to deductions, credits or exemptions enacted to achieve social or policy goals rather than to reflect economic principles. This notion was explored by Stanley Surrey while serving as Assistant Secretary of the Treasury for Tax Policy in the 1960's.<sup>33</sup>

The mortgage interest deduction is classified as tax expenditures because these provisions operated in a manner similar to direct government expenditures such as direct grants, subsidized loans, etc. Stanley recognized that any government assistance could be structured as either a direct expenditure or the same end result could be achieved through the tax code via tax expenditures. The cost of tax expenditures is the tax revenue the government would have collected in the absence of the mortgage interest deduction within the IRC. The

---

registration, and voter registration card; the taxpayer's mailing address for bills and correspondence; the location of the taxpayer's banks; and the location of religious organizations and recreational clubs with which the taxpayer is affiliated.)

<sup>31</sup> § 163(h)(4)(A). (The term "qualified residence" means the principal residence (within the meaning of section 121) of the taxpayer, and 1 other residence of the taxpayer which is *selected by the taxpayer* for purposes of this subsection for the taxable year and which is used by the taxpayer as a residence.").

<sup>32</sup> The allowance of 1 other residence is commonly known as the "vacation home" deduction. By its very nature this provision requires the taxpayer to own more than one residence. In many cases the second residence for which a deduction is claimed are vacation homes of high-income taxpayers.

<sup>33</sup> Allaire Urban Karzon, *Review Essay: Tax Expenditures and Tax Reform by Stanley S. Surrey and Paul R. McDaniel*, 38 Vand. L. Rev. 1397, 1398 (1985).

official definition of tax expenditures is "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability."<sup>34</sup>

Mark Hodge, President of the Tax Foundation testified before congress on the subject of tax expenditures in March of 2011 and made the following remarks:

"...they are an attempt to achieve certain public policy goals by inducing of incenting taxpayers with the prospect of a lower tax bill. Essentially, lawmakers are trying to get taxpayers to achieve these policy objectives by using their own money, not 'the government's'."<sup>35</sup>

#### **D. Socioeconomic Effects**

The cost of tax expenditures, such as the mortgage interest deduction, has greatly increased over time. According to John Hodge, President of the Tax Foundation, "In 2002, the Organisation for Economic Co-operation and Development ("OECD") identified 135 separate tax expenditures in the U.S. tax code. By 2010, the number had increased to 164, a jump of 21 percent." These expenditures account for approximately 1 trillion dollars of lost revenue in the federal budget. If the top 15 tax expenditures were eliminated, the federal tax revenue would increase by a staggering 70%.<sup>36</sup> The cost of the mortgage interest deduction expenditure amounted to \$90.8 billion in 2010, via lost revenue, and is estimated to cost

---

<sup>34</sup> 2 U.S.C. § 622(3) (West 2012). ("The term "tax expenditures" means those revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability; and the term "tax expenditures budget" means an enumeration of such tax expenditures.")

<sup>35</sup> Scott Hodge, Prepared Statement: Hearing on Distribution and Efficiency of Spending in the Tax Code, at 4, <http://taxfoundation.org/sites/taxfoundation.org/files/docs/testimony%20of%20scott%20hodge%20before%20us%20senate%20budget%20committee--hearing%20on%20distribution%20and%20efficiency%20of%20spending%20in%20the%20tax%20code.pdf>.

<sup>36</sup> Brian H. Jenn, *The Case for Tax Credits*, 61 Tax Law 549, 549 (2008). ("For the 2007 fiscal year, the largest

taxpayers \$484 billion through 2014.<sup>37</sup> The cost to taxpayers is generally calculated as taxes which would otherwise have been paid but for the deduction. The mortgage interest deduction is, in fact, the second largest tax expenditure in the entire US Federal budget trailing only the exclusions employer provided healthcare and pension contributions from an individual's taxable income.<sup>38</sup>

### **E. Disparate Economic Impact of the Mortgage Interest Deduction on Consumers of Housing**

To understand the disparate economic impact of the mortgage interest deduction on consumers, one must understand a few basic tax concepts. First, the federal personal income tax system is progressive. In simple terms, this means the higher one's income the higher one's rate of tax or marginal tax rate. The marginal tax rate is the rate at which one's last dollar of income is taxed.<sup>39</sup> In a progressive system a deduction is worth more to those with higher incomes and than those with lower incomes. Since a tax deduction reduces income taxed at the highest marginal tax rate, this rate should be used when measuring the tax benefit or cash savings enjoyed by the taxpayer. To illustrate, a family with \$250,000 of income with a marginal rate of 35% will receive \$3,500 of benefit for a \$10,000 deduction. On the other hand, a family with \$50,000 of income and a marginal rate of 15% will receive a \$1,500 benefit from the same \$10,000 deduction.

---

<sup>37</sup> Staff of the Joint Committee on Taxation, Estimates of Federal Tax Expenditures For Fiscal Years 2010-2014 (2010) at 38-41 <http://www.jct.gov/publications.html?func=startdown&id=3718>

<sup>38</sup> Staff of the Joint Committee on Taxation, Estimates of Federal Tax Expenditures For Fiscal Years 2010-2014 (2010) at 38-41 <http://www.jct.gov/publications.html?func=startdown&id=3718>

<sup>39</sup> For example, if one earn \$10,000 and the progressive rates are: 10% of first \$2,500 and 20% on next \$7,500 one's total tax would be \$1,750 for an effective tax rate of 17%, however, the last dollar or 10,000th one earned was taxed at the higher 20% which is one's marginal rate. In a progressive tax system, a taxpayer's marginal tax rate is always higher than the effective tax rate on their total income. The effective rate is the rate that actually determines your tax bill.

Second, the mortgage interest deduction is an "itemized deduction". Itemized deductions are specifically identified deductions available to all taxpayers but only taken advantage of by some. This is because every taxpayer is also entitled to a "standard deduction" of a pre-determined amount which for 2012 was \$11,400. Taxpayers must choose between either the itemized deduction or the standard deduction when computing their tax liability. When evaluating their decision, a taxpayer would need to have itemized deductions above and beyond \$11,400 to choose the itemized deduction over a standard deduction. As a result, taxpayers with lower incomes who tend to have lower itemized deductions generally choose the standard deduction because it will be greater than their total itemized deductions. This principle is important in the evaluation of the mortgage interest deduction because it is an itemized deduction. The practical implication is that lower income taxpayers with smaller homes and mortgages do not have enough mortgage interest expense to benefit from itemized deductions and therefore they choose the standard deduction. Since they are entitled to the standard regardless of whether or not they have a mortgage, no incremental benefits are provided to these lower income taxpayers.

In summary, home owners benefit differently from the mortgage interest deduction and renters receive no deduction for expenses related to securing necessary shelter. As explained above, the mortgage interest deduction only provides an incentive and benefit to higher income taxpayers buying larger homes while providing no incentive or benefit to lower income taxpayers buying more modest homes.<sup>40</sup> Renters receive no benefit at all because rental payments are not eligible for any tax deduction. The last section of this paper

---

<sup>40</sup> J. PAUL MITCHELL, FEDERAL HOUSING POLICY AND PROGRAMS: PAST AND PRESENT 165 (3rd ed. 1993).

will evaluate this dynamic and discuss whether the mortgage interest deduction complies with principles of distributive justice.

### **PART III. JUSTICE**

#### **A. General Justice**

The notion of justice can be examined using several different theories.<sup>41</sup> This section focuses only on the basic elements of justice as outlined by John Finnis. Before exploring the specific elements of distributive justice, it is important to understand the context from which John Finnis begins his discussion of justice. Finnis first explores the notion of Sociability (friendship), community and the common good.<sup>42</sup>

Finnis begins this discussion with the statement that, "there are human goods that can be secured only through the institution of human law, and requirements of practical reasonableness that only those institutions can satisfy."<sup>43</sup> Finnis identifies seven basic forms of human good, one of which is Sociability.<sup>44</sup> Included in the good of Sociability is the concept of friendship. Finnis defines friendship as the common good of mutual self-constitution, self-fulfillment and self-realization;<sup>45</sup> the "most communal form of human community". Friendship is a "common good for human beings" because it is good for every human being. In friendship, Finnis explains that one must act taking into account what is

---

<sup>41</sup> KAREN LEBACQZ, SIX THEORIES OF JUSTICE\_10 (1st Ed. 1993). (The author compares justice to an elephant examined by blindfolded explorers, each having their own perspective and ideas and describing the elephant differently. While at first glance seemingly incompatible, each explorer contributes, nonetheless, to the elephant's description.)

<sup>42</sup> JOHN FINNIS, NATURAL LAW AND NATURAL RIGHTS 85 (H.L.A. Hart ed., Oxford University Press 2003) (1980).

<sup>43</sup> *Id.* at 3.

<sup>44</sup> *Id.* at 85.

<sup>45</sup> *Id.* at 141.

best not only for just one's self, but also for one's friend.<sup>46</sup> Finnis links Friendship to community by describing friendship "as the most communal, though not the most extended or elaborated form of human community".<sup>47</sup> Community is a "matter of relationships and interactions."<sup>48</sup> The human person realizes human goods not just in himself but also in common in community.<sup>49</sup> Justice is therefore examined in the context of community.

Finnis outlines three elements of justice. First, justice is other directedness. "There is a question of justice and injustice only when there is a plurality of individuals and some practical question concerning their situation and / or interactions *vis a vis* each other."<sup>50</sup> Second justice involves an element of duty.<sup>51</sup> Third, justice involves an examination of equality.<sup>52</sup> Equality must be understood in an analogical sense. It is better to think of proportionality or even equilibrium or balance.<sup>53</sup> This element usually involves comparisons.<sup>54</sup> Finnis' theory of justice includes principles of assessing how one person should treat another. The requirements of justice then, favor and foster the common good of one's community.<sup>55</sup>

Finnis describes "the object of justice as not equality but the common good..."<sup>56</sup> Finnis further argues that there is no reason to suppose that treating everyone identically

---

<sup>46</sup> *Id.* at 142.

<sup>47</sup> *Id.* at 143.

<sup>48</sup> *Id.* at 135.

<sup>49</sup> *Id.* at 161.

<sup>50</sup> *Id.* at 164.

<sup>51</sup> *Id.*

<sup>52</sup> *Id.*

<sup>53</sup> *Id.*

<sup>54</sup> *Id.* at 162-163.

<sup>55</sup> *Id.* at 165.

<sup>56</sup> *Id.* at 174.

promotes the common good.<sup>57</sup> Instead, it is the fairness of the distribution of basic goods and resources in meeting basic needs that is more important. This question of distribution leads to the examination of distributive justice.<sup>58</sup>

Friendship and the common good have in common the notion that they both exclude arbitrary self-preference and instead require one to act in the best interest of another or of a group of people. Justice includes the concept of equality or proportionality because it looks to the common good of the community and not just the good of "any individual or group in disregard of the well being of the other."<sup>59</sup> Justice "looks to the common good, which entails a reference to standards of fittingness or appropriateness relative to the basic aspects of human flourishing, which are pertinent whether or not an interpersonal comparison is being made."<sup>60</sup>

The common good is described by Finnis as the purpose or object of justice. Specifically, Finnis defines the common good as:

"a set of conditions which enables the members of a community to attain for themselves reasonable objectives, or to realize reasonably for themselves the value(s), for the sake of which they have reason to collaborate with each other (positively and / or negatively) in a community."<sup>61</sup>

Finnis concludes that, "few will flourish and no one will flourish unless there is a coordination of goods and enterprises that create the ensemble of conditions that enhance the

---

<sup>57</sup> *Id.*

<sup>58</sup> *Id.* at 174.

<sup>59</sup> *Id.* at 164.

<sup>60</sup> *Id.*

<sup>61</sup> *Id.* at 155.

well being of all members of the community, the common good."<sup>62</sup> This coordination of resources and goods leads to the discussion of distributive justice.

## **B. Distributive Justice**

Distributive justice is the application of the formal principle of justice to groups in society. Finnis describes an individual's willingness to work together or pool resources to improve their common position as second type of 'subject matter that is common'.<sup>63</sup> An example of this type of 'subject matter that is common' includes income taxes.

Finnis includes the appropriation of taxes as a practical problem of distributing resources:

"...there are problems of *distributing* resources, opportunities, profits and advantages, roles and office, responsibilities, taxes and burdens - in general, the *common stock* and *incidence of communal enterprise*, which do not serve the common good unless and until they are appropriated to particular individuals. The theory of distributive justice outlines the range of reasonable responses to these problems."<sup>64</sup>

Finnis acknowledges that many believe the State or community is responsible for maintaining distributive justice.<sup>65</sup> Finnis argues that the State's role, when fulfilling this obligation, is to enforce obligations individuals already had under principles of distributive justice.<sup>6667</sup> Finnis argues that a state can only justly impose on its citizens the obligations

---

<sup>62</sup> *Id.* at 165.

<sup>63</sup> *Id.* at 167.

<sup>64</sup> *Id.* at 166.

<sup>65</sup> *Id.* at 186.

<sup>66</sup> *Id.*

<sup>67</sup> *Id.* at 187. (Finnis further argues that Nozick's theory of "coercion" is not applicable unless the burden imposed on a member of society by the state if it is wrongful under both theories of law and of justice.)

they already have under distributive justice principles.<sup>68</sup> Finnis concludes that the role of the state is providing the mechanisms to facilitate and enforce those responsibilities are subsidiary to the role of individuals.<sup>69</sup>

#### **PART IV. APPLICATION OF THE PRINCIPLES OF DISTRIBUTIVE JUSTICE TO THE MORTGAGE INTEREST DEDUCTION**

##### **A. Analysis**

First, justice is other directedness. Housing is an issue of practical concern and since housing is needed by everyone, as illustrated earlier, the mortgage deduction takes a group of people with a need they can't escape and excludes some from the benefits while assessing the tax burden on all of them via the cost of the mortgage interest deduction as a tax expenditures. As discussed earlier, taxes can be considered 'subject matter that is common' and therefore there is a question of justice and/or injustice in the context of a plurality of individuals and some practical question concerning their situation and / or interactions vis a vis each other.

Since Finnis identifies taxes as a form of common stock and incidence of communal enterprise, it is logical to conclude that the payment of taxes is a duty in justice that an individual already has in community because of the principle of Sociability. The distribution of benefits and burdens among members of society must be apportioned reasonably or fairly among members of society to serve the common good.<sup>70</sup> The mortgage interest deduction will now be examined by the application of the criterion of fairness in applying distributive justice principles.

---

<sup>69</sup> *Id.* at 188.

<sup>70</sup> *Id.* at 166.

The mortgage interest deduction fails to meet the fairness requirement of distributive justice because it unfairly allocates benefits to higher income taxpayers with disproportionate burdens falling to lower income taxpayers and renters who receive no comparable benefit. Such benefits, enjoyed by upper classes of taxpayers, are then ultimately paid for by all taxpayers through the operation of the tax system creating this unfair balance of benefits and burdens.

Several characteristics of the mortgage interest deduction support this conclusion. First, taxpayers must itemize deductions to receive a benefit from the mortgage interest deduction. Second, the mortgage interest deduction allows those who claim its benefits to purchase a capital assets which increases in value over time. When that capital asset is disposed of, a substantial portion of any appreciation is tax-free to the homeowner. Thirdly, the mortgage interest deduction applies not only to primary residences but also to vacation homes. Lastly, renters have an absolute burden with no benefit because rental payments are not eligible for a tax deduction; however, renters share equally in the burden of raising revenue for the government.

The ability to itemize deductions, and therefore qualify to claim the mortgage interest deduction, is relevant because the vast majority of taxpayers who itemize are high income. This scenario where benefits accrue to higher income taxpayers could be considered inequitable and violate principles of distributive justice. A tax system is considered to have vertical equity when individuals with greater incomes pay a greater share of their incomes in tax than those with lesser incomes.<sup>71</sup> An example of this is the US federal tax system with progressive tax rates. All else being equal those with higher incomes pay tax at a greater

---

<sup>71</sup> Brian H. Jenn, *The Case for Tax Credits*, 61 Tax Law 549, 551 (2008).

progressive tax rate. This concept has been embedded in American tax law since the enactment of an income tax and is commonly accepted as a very popular notion of tax fairness. As a result of this, according to the Tax Foundations 2011 Fiscal Facts publication the top 1% of taxpayers paid a disproportionate 36.7% of income taxes paid.

Research has shown, however, that the mortgage interest deduction benefits higher earning tax payers disproportionately dollar for dollar over lower income taxpayers and absolutely over renters.<sup>72</sup> As explained earlier, tax rates increase for higher income taxpayers because of the progressive nature of our tax system. A deduction from income at a higher rate is worth more in real dollar terms than a deduction at lower rates of income. As a result, high earning taxpayers with a high marginal tax rate enjoy a larger real dollar benefit in terms of cash taxes saved from the mortgage interest deduction as compared to their lower earning counterparts.<sup>73</sup> This is illustrated by the following comparison of two families:

One, with \$ 30,000 annual income and two children, purchased a \$ 60,000 home; the other, with \$ 50,000 income and no children, purchased a \$ 100,000 home. Each obtained an 80 percent mortgage at 13 percent interest and paid property taxes of 2 percent of purchase price. Tax savings for the first couple constituted 24.6 percent of first year costs (mortgage payments, property taxes, utilities, maintenance and insurance). But for the higher income family tax savings covered 37.9 percent of first year costs, more than half again as large a share. The federal benefit declines slightly in each subsequent year as the interest component of the annual mortgage service decreases.)".

In addition, to gain any benefit from the mortgage interest deduction a taxpayer must itemize their deductions. This is because every taxpayer is entitled to a set dollar amount of a standard deduction regardless of their actual expenses. As a result, no incremental benefit is

---

<sup>72</sup> Alan L. Feld, *Redeployment of Tax Expenditures for Housing*, 23 TAX NOTES 1441, 1443 (1984).

<sup>73</sup> *Id.* at 1443. ("The Congressional Budget Office illustrated the first and third points in a 1981 report, by contrasting the effects of deductions on two families.

gained for a taxpayer whose mortgage interest deduction is less than or equal to the standard deduction. Importantly, two-thirds of all taxpayers take a standard deduction and therefore receive no incremental cash tax savings from their mortgage interest deduction. By a substantial margin, higher earning taxpayers itemize their deductions. Lastly, those who earn more spend more on housing and therefore the highest earners enjoy the greatest benefits of home ownership.

The mortgage interest deduction is a benefit more valuable to those with more resources and income than it is with those individuals with lower resources and income. This argument is supported by the data in the table<sup>74</sup> below which shows the distribution of the benefits of the home mortgage interest deductions between taxpayers based on 2003 data:

Adjusted Gross Income	Percent of Home Mortgage Interest Deduction Claimed	Percent of All Tax Returns in Income Group	Average Mortgage Interest Deduction Per Return	Percentage of Returns Claiming Mortgage Interest Deduction
Under \$20,000	4.2%	37.8%	\$278	4.0%
\$20,000 - \$29,999	5.1%	14.1%	\$910	13.1%
\$30,000 - \$39,999	7.2%	10.7%	\$1,674	24.2%
\$40,000 - \$49,999	7.9%	8.0%	\$2,462	35.2%
\$50,000 - \$74,999	21.7%	13.3%	\$4,068	50.9%
\$75,000 - \$99,999	18.2%	7.3%	\$6,210	69.0%
\$100,000 - \$199,999	24.4%	6.8%	\$8,928	78.9%
\$200,000 and over	11.2%	1.9%	\$14,374	75.7%

As illustrated above, the number of taxpayers claiming the benefits of a mortgage interest deduction rises sharply with income. In addition, the dollar value of the benefits claimed also rises sharply with income.

The higher income taxpayers who benefit from the mortgage interest deduction are able to obtain a capital asset which will be in part subsidized by all other taxpayers. Furthermore, when this asset is sold, the Internal Revenue Code allows a substantial portion of any gains to

---

<sup>74</sup> Gerald Prante, [Who benefits from the Home Mortgage Interest Deduction?](http://taxfoundation.org/article/who-benefits-home-mortgage-interest-deduction) (2006) <http://taxfoundation.org/article/who-benefits-home-mortgage-interest-deduction>.

be treated as tax free. Lastly, the mortgage interest deduction as applied to vacation homes clearly fails any notion of justice because in these instances, the social policy arguments which promote the idea of home ownership as beneficial for neighborhoods and community clearly fail because the owners do not live in these homes and as such there is no community benefit.

Relevant to the problem of renters, another notion of tax fairness is horizontal equity. Horizontal equity basically requires that similarly situated individuals are treated similarly.<sup>75</sup> Tax expenditures can be a key driver of horizontal equity. For example, two individuals with the same income can be treated differently when one engages in an activity favored by the tax code through an expenditure and another participates in an activity not favored. For example, if one individual gives a portion of his income to a charitable organization favored by the internal revenue code he will receive a deduction equal to his contribution multiplied by his marginal tax rate.

First, the mortgage interest deduction is not horizontally equitable, that is it does not treat similarly situated taxpayers equally. For example, two people with the same job, family and income would be treated differently depending on how they chose to fill their need for housing. In that case, the mortgage interest deduction would favor the individual who chose to consume housing via ownership versus renting. This is true even if the two individuals have the same exact income, same exact family size and even if they live in the same exact home. One could argue that benefiting from the provision is predicated on a voluntary decision to buy a home and therefore the taxpayer must take responsibility for one's own

---

<sup>75</sup> Brian H. Jenn, *The Case for Tax Credits*, 61 Tax Law 549, 552 (2008).

decision. The counter, however, is that the decision whether or not to buy a home is in large part involuntary because of capacity. That is, lower income taxpayers generally lack the resources to make the down payment and otherwise obtain financing to complete a home purchase.

## **B. Alternative Solutions**

The issues of distributive justice could be solved through the reform of the mortgage interest deduction. The most common suggestion by scholars is to change the deduction to a credit. Converting a deduction to a credit achieves the important end of eliminating the dependence of the ultimate benefit to an individual's income and marginal tax rate.<sup>76</sup> In certain instances the value of a tax credit to an individual can be the same exact dollar amount as a tax deduction. However, the credit can be designed to decouple the value of the credit from rates of income and tax.

The mortgage interest deduction is a perfect example of a deduction which could be conformed to notions of justice and fairness if converted into a cleverly designed credit. This would at least eliminate the regressive nature of the benefit. Currently, an individual who rents receives no tax benefit for their consumption of housing while an individual who owns receives a tax benefit from the mortgage interest paid. In addition, individuals who own their

---

<sup>76</sup> *Id.* at 552. ("Converting a deduction into a credit is fairly straightforward in light of the basic equivalence between credits and deductions. For a taxpayer in the 15% tax bracket with positive tax liability, the replacement of a deduction for a particular expenditure with a 15% tax credit for the same expenditure should be a matter of indifference because it leaves the taxpayer's tax bill unchanged. On the other hand, where the taxpayer's marginal tax rate exceeds the credit rate, the conversion of a deduction into a credit results in a higher final tax bill. Where the taxpayer's marginal tax rate is below 15%, the credit is more attractive than the deduction. Nevertheless, it is the basic equivalence between credits and deductions where the credit rate and taxpayer's marginal tax rate are the same that, as a matter of tax mechanics, makes possible proposals to transform deductions into credits.").

home but have low incomes receive little or no benefit from the mortgage interest deductions for two reasons.

A tax credit has three important characteristics which make it fairer and equitable if properly administered. First, a credit reduces a person's tax liability not their taxable income. This means that whether they itemize their deductions or take the standard deduction the credit will be available to provide incremental benefits. In addition, both individuals with smaller incomes and homes would be on an equal playing field with those with higher incomes and homes in terms of being able to achieve qualification for a benefit. Second, the computation of a credit does not necessarily depend on an individual's marginal tax rate. Therefore, congress could say that all mortgage interest is entitled to a 15% credit. While before Joe Poor took a benefit at this marginal tax rate of 10% and Joe Rich took a benefit at his much higher 35% tax rate, the new credit would treat both equally and entitled them to a 15% tax benefit on the mortgage interest they paid.

Thirdly, the disparate treatment of homeowners and renters could be fixed by allowing those who rent to count a portion of their rent payments, i.e., those attributable to the payment of the underlying mortgage on the home, towards the housing consumption credit. Lastly, a credit can be deemed "refundable" which means that taxpayers who pay little or no tax due to other deductions, low income or losses are eligible for a direct payment from the federal government in lieu of a reduction of a pre-existing tax liability. This is important because it would insure that all consumers of housing, even those at the lowest of the income scale would be entitled to a proportionally equal benefit.

Reforming the mortgage interest deduction and administering it as a credit resolves only the issue of the regressive nature of the deduction. As a credit the benefits would be equally

distributed between low income and high income taxpayers and home owners and renters. A separate question, however, is whether even a fairly distributed subsidy for housing is a fair distribution of benefits and burdens by the federal government.

John Finnis defines the common good as, "a set of conditions which enables the members of a community to attain for themselves reasonable objectives...". Finnis sees the primary criteria when determining if a distribution was just as: need, function, capacity, deserts and contributions and assumption of risk and the requirements of practical reasonableness.

## **PART V. CONCLUSION**

The mortgage violates principles of distributive justice as defined by John Finnis. As discussed in this paper, in its current form the mortgage interest deduction is regressive and provides disproportionate benefits to high income taxpayers with greater resources. Further, it provides very little, if any, benefit to lower income taxpayers with fewer resources. In addition, homeowners receive a benefit from the mortgage interest deduction while a renter in the same housing and with the same income would receive no benefit. In these regards, the mortgage interest deduction is inconsistent with the notions of distributive justice that require a reasonable apportionment of common subject-matter between individuals and also requires equals to be treated equally.

An alternative which would render the mortgage interest deduction "equitable" under principles of distributive justice would be to convert the deduction into a credit with a varying scale depending on income which would also be available to renters. Even with such reform, however, the mortgage interest subsidy would transfer benefits to current taxpayers

who occupy a home with the burdens of paying for this subsidy falling on future generations who must pay the interest and debt costs incurred by the current taxpayers.

Based on the foregoing analysis, the conclusion of this paper is that the federal government should repeal the subsidy for mortgage interest paid by current taxpayers. The repeal of this provision would remove the unjust distribution of benefits and burdens currently in existence today.