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FACTSHEET: BENEFICIARIES OF TAX EXPEDITURES ACROSS ZIP CODES

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ABSTRACT

This fact sheet summarizes the key conclusions from a series of briefs aimed at contributing to the knowledge of select tax expenditures—the EITC, MID, and preferential rates on capital gains—by analyzing zip code-level tax data.[1] In particular, the goal of the research was to better characterize various economic, demographic, and geographic characteristics associated with select tax expenditures. Largely due to data constraints, these relationships have received little attention to date.

[1] The referenced briefs can be found using the following links: EITC Claiming Across Zip Codes, The Mortgage Interest Deduction Across Zip Codes, and Net Capital Gains Across Zip Codes

The opinions expressed here are solely those of the authors and do not necessarily reflect the views of the Urban-Brookings Tax Policy Center.

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I. INTRODUCTION

Tax expenditures are deductions, preferences, exclusions, and credits administered through the tax code aimed at promoting various social goals. In 2014, over $1 trillion in tax expenditures were dedicated to objectives deemed beneficial to society, including tens of billions of dollars in incentives for retirement saving, homeownership, charitable giving, and employer-provided health insurance. Despite their sizeable impact on the budget, tax expenditures receive little scrutiny relative to direct budget outlays.

Prior research has established some key characteristics about various tax expenditures. For example, distributional estimates released by the Urban-Brookings Tax Policy Center have estimated the impact of various expenditures across the income distribution. A broad academic literature has identified various economic impacts of the larger tax expenditures, with the Earned Income Tax Credit (EITC), the mortgage interest deduction (MID), and the preferential rate on capital gains all receiving notable attention from economists.

In a series of briefs, researchers Benjamin H. Harris and Lucie Parker aimed to contribute to the knowledge of select tax expenditures—the EITC, MID, and preferential rates on capital gains—by analyzing zip code-level tax data. In particular, the goal of the research was to better characterize various economic, demographic, and geographic characteristics associated with select tax expenditures. Largely due to data constraints, these relationships have received little attention to date. This fact sheet summarizes the key conclusions from the briefs.

II. EARNED INCOME TAX CREDIT

Since its creation in 1975, the EITC has played a major role in the U.S. safety net. In 2011, 27.9 million low- and middle-income families received the EITC, which is designed to alleviate poverty and promote employment among working families. A household’s EITC benefit depends on income, marital status, and number of children; notably, households without children receive almost no benefit. As earned income increases, the credit amount begins to phase out until it reaches zero. Importantly, the EITC is a refundable credit: if the credit’s amount exceeds a family’s income tax liability, the remainder of the credit is paid as a tax refund.

Key findings from include:

- Given that the EITC is designed to benefit low-income families, it is not surprising to find a positive correlation between zip-code level poverty rates and the EITC claiming rate. As the share of families living below the poverty level increases in a given zip code, the percent of tax returns claiming the EITC also increases.
- Among those zip codes with familial poverty rates of 10 percent and below (57.4 percent of zip codes), the EITC claiming rate is only 12.9 percent, nearly four times lower than that of the 1.0 percent of zip codes with poverty rates exceeding 50 percent. In zip codes where over 40 percent of tax filers claim the EITC, 45.7 percent of the population is African American and 38.3 percent is white.

- In the majority of zip codes, between 10 percent and 30 percent of families receive the EITC (43.9 percent of zip codes have claiming rates between 20 and 30 percent). A small share of zip codes (3.9 percent) have EITC claiming rates of at least 40 percent, and 15.1 percent of zip codes have EITC claiming rates below 10 percent.
- The racial composition of zip codes with high EITC claiming rates differs from that of lower-claiming zip codes. Among the high-EITC-claiming zip codes, 45.7 percent of the population is black or African American, and 38.3 percent of the population is white, whereas among the lower-EITC-claiming zip codes, 10.8 percent of the population is African American, and 76.1 percent of the population is white.
- The regional variation in EITC claiming is stark. The counties with the highest share of taxpayers claiming the EITC are overwhelmingly located in the Southeast. With few exceptions, almost all counties with high EITC claiming are located in the South, while the Northeast and the Midwest have much lower claiming rates in comparison.

III. MORTGAGE INTEREST DEDUCTION

The federal tax code affords several major tax expenditures for homeownership, the largest of which is the MID on owner-occupied homes. The MID allows taxpayers to deduct mortgage interest on up to $1 million in debt used to purchase or refinance a primary or secondary home, as well as for up to $100,000 of home equity debt not used to buy, build, or improve the home. Research suggests that existing tax expenditures for homeownership are poorly designed to achieve socially beneficial effects. For example, tax expenditures for homeownership are regressive, providing larger subsidies for higher-income homeowners and larger houses, neither of which correlates with positive impacts for the rest of society. Homeownership tax expenditures also lead to substantial lost revenue, with the mortgage interest deduction costing $69.7 billion in 2013 alone.

- Taxpayers in low- and middle-income zip codes frequently have relatively low claiming rates (i.e., the percent of tax returns with mortgage interest paid). The claiming rates increase with income: zip codes in the top AGI decile exhibit a MID claiming rate of 36.9 percent, over three times higher than that of the bottom AGI decile's rate of 9.9 percent.
- The majority of zip codes have mortgage interest deduction claiming rates of less than 20 percent: 22.8 percent of zip codes have claiming rates of less than 10 percent and an additional 34.7 percent have claiming rates between 10 percent and 20 percent. Only 6.4 percent of zip codes have MID claiming rates of 40 percent and higher.
- Household composition particularly differs in the distribution of married-couple families and other household types. For those zip codes with high claiming rates, 65.4 percent of households are married-couple families and 23.3 percent are in nonfamily households. The corresponding percentages are 47.3 percent and 34.6 percent, respectively, in zip codes with lower claiming rates.
- Average mortgage interest deducted varies by region. Deductible mortgage interest tends to be highest in the West, on the East Coast, and near some metropolitan areas inland. Deductible mortgage interest is particularly high in California and the Northeast. Inland

states east of the Mississippi tend to have lower housing values and, subsequently, fewer deductions for mortgage interest.

IV. REPORTED NET CAPITAL GAINS

Capital gains are the profits from sales of capital assets, such as corporate stock, real estate, or businesses. The taxation of capital gains is exceptionally complex, with a separate schedule of tax rates depending on taxpayers' marginal income tax bracket and length of asset ownership, type of asset, and other factors. Long-term capital gains, which apply to assets held for more than one year, enjoy preferential treatment under the tax code. Between 2004 and 2012, top statutory tax rates on most long-term capital gains were at the lowest levels since the Great Depression. Taxpayers above the 15 percent individual income tax bracket faced a 15 percent capital gains tax rate, while taxpayers in the 15 percent tax bracket or below faced a capital gains tax rate of zero. Beginning in January 2013, the tax rates on both short-term and long-term capital gains rose for high-income taxpayers.

- Not surprisingly, the share of tax returns reporting capital gains—the capital gains reporting rate—rises with income. In 2012, between the bottom and ninth income deciles, the reporting rate increased steadily from 3.4 percent to 19.8 percent. The top income decile showed a markedly higher rate of 31.6 percent.
- The concentration of capital gains by zip code is stark. In 2012, nearly three-fourths of capital gains (73.6 percent) were reported by the 16.4 percent of filers residing in zip codes in the top AGI decile. Lower-income zip codes reported a small share of capital gains; the bottom 50 percent of zip codes by income, representing 40.5 percent of filers, reported just 5.2 percent of capital gains in 2012.
- Those zip codes with reporting rates exceeding 30 percent differ significantly in their demographic characteristics from those zip codes with sub-30-percent reporting rates. For example, high-reporting zip codes had an African-American population of just 3.3 percent, while the white population of these zip codes was 83.2 percent. In contrast, among the lower-reporting zip codes, 13.4 percent of the population was African American and 73.4 percent of the population was white.
- Reporting rates vary substantially by geographic location, and are much higher in coastal counties and those located in the Midwest. The high coastal reporting rates are likely driven by higher levels of income, which is correlated with higher rates of capital gains realizations. The high reporting rates in the Midwest are likely driven in part by the agricultural sector, which exhibits rates of capital gains reporting that are roughly twice that of other taxpayers. The Southeast, which has high rates of poverty, exhibits lower reporting rates than other regions.