

Who Benefits from Asset-Building Tax Subsidies?

C. Eugene Steuerle, Benjamin H. Harris, Signe-Mary McKernan, Caleb Quakenbush, and Caroline Ratcliffe

Opportunity and Ownership Initiative Fact Sheet
September 2014



In 2013, US federal income tax expenditures totaled roughly \$1.2 trillion, about the amount of revenue raised by the individual income tax. Of this total, \$384 billion went toward asset building: subsidies for homeownership, retirement and other savings, and higher education investments in human capital (figure 1).

Despite this large sum, these subsidies do little to help most households build wealth, particularly those with low or average incomes (Harris et al. 2014). Those households are helped in other ways: for example, the amount of income tax they pay is limited by the standard deduction and personal exemptions. Still, as a result of this combination of policies, the tax policies largely intended to help households save simply fail to do so, while providing the most incentive to higher-income households who likely need it less.

Homeownership tax subsidies include the mortgage interest deduction and the deduction for property taxes paid on owner-occupied property. About 70 percent of subsidies from these two deductions goes to the top 20 percent of taxpayers, as measured by income; 8 percent goes to the middle 20 percent, and less than 2 percent to the bottom 40 percent of taxpayers (figure 2 and table 1).

For households with low or moderate incomes, homeownership has proved the primary source for building wealth. Yet these households miss out on the incentives to own homes. Current homeownership tax subsidies are poorly designed; much go toward encouraging the purchase of larger homes and the accrual of higher debt rather than increasing homeownership and home equity (Harris, Steuerle, and Eng 2013).

About 66 percent of **retirement subsidies** for employer-based retirement savings and individual retirement accounts (IRAs) go to the top 20 percent of taxpayers, and the next 20 percent receives much of the rest (about 18 percent). The middle 20 percent of taxpayers receives roughly 10 percent, and the bottom 20 percent receives less than 1 percent. Lack of access to employer-based retirement savings is one factor. About two-thirds of private-industry employees work for an employer that sponsors a retirement savings plan, such as a 401(k), but access varies considerably by income and industry, favoring higher-income occupations. Further, only about half of all workers participate in these plans. Though IRAs are available to all, take-up and contributions to them remain lower, around 20 percent (Holden and Schrass 2012).

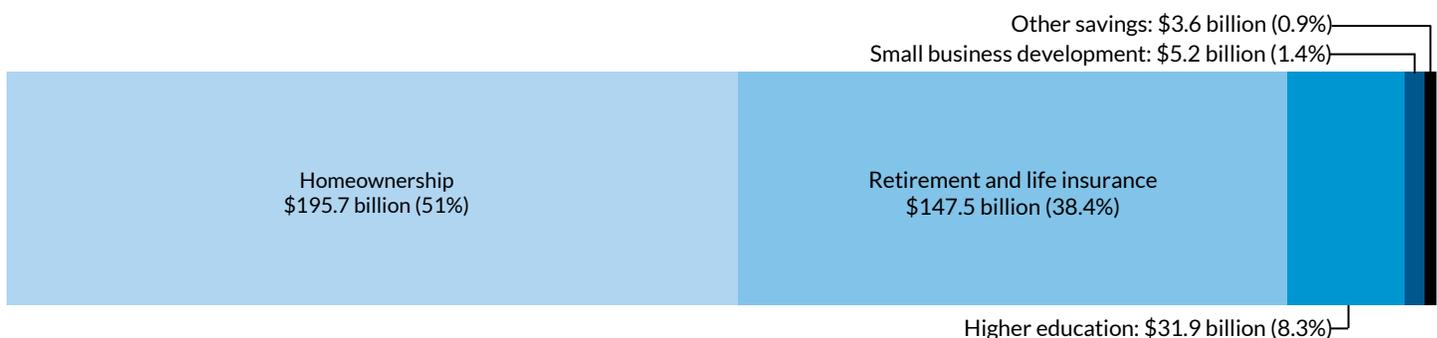
The saver's credit, which provides a percentage match for contributions to a qualified retirement savings account, is better targeted to moderate-income families. However, many of these families cannot use it because the credit is nonrefundable (unavailable to those with no tax liability) and phases out at moderate income levels. Evidence on whether these various retirement tax subsidies result in a net increase in saving is decidedly mixed (Attanasio and DeLeire 2002; Benjamin 2003; Chetty et al. 2012; Gale and Scholz 1994; Poterba, Venti, and Wise 1995; Steuerle and Galper 1983).

Higher education subsidies are more widely available to middle-income taxpayers than homeownership and retirement subsidies. A more equitable 27 percent of both the American Opportunity Tax Credit and the student loan interest deduction goes to the top 20 percent of

FIGURE 1

Homeownership and Retirement Subsidies Dominate Asset-Building Tax Subsidies

Tax subsidies for asset building, 2013

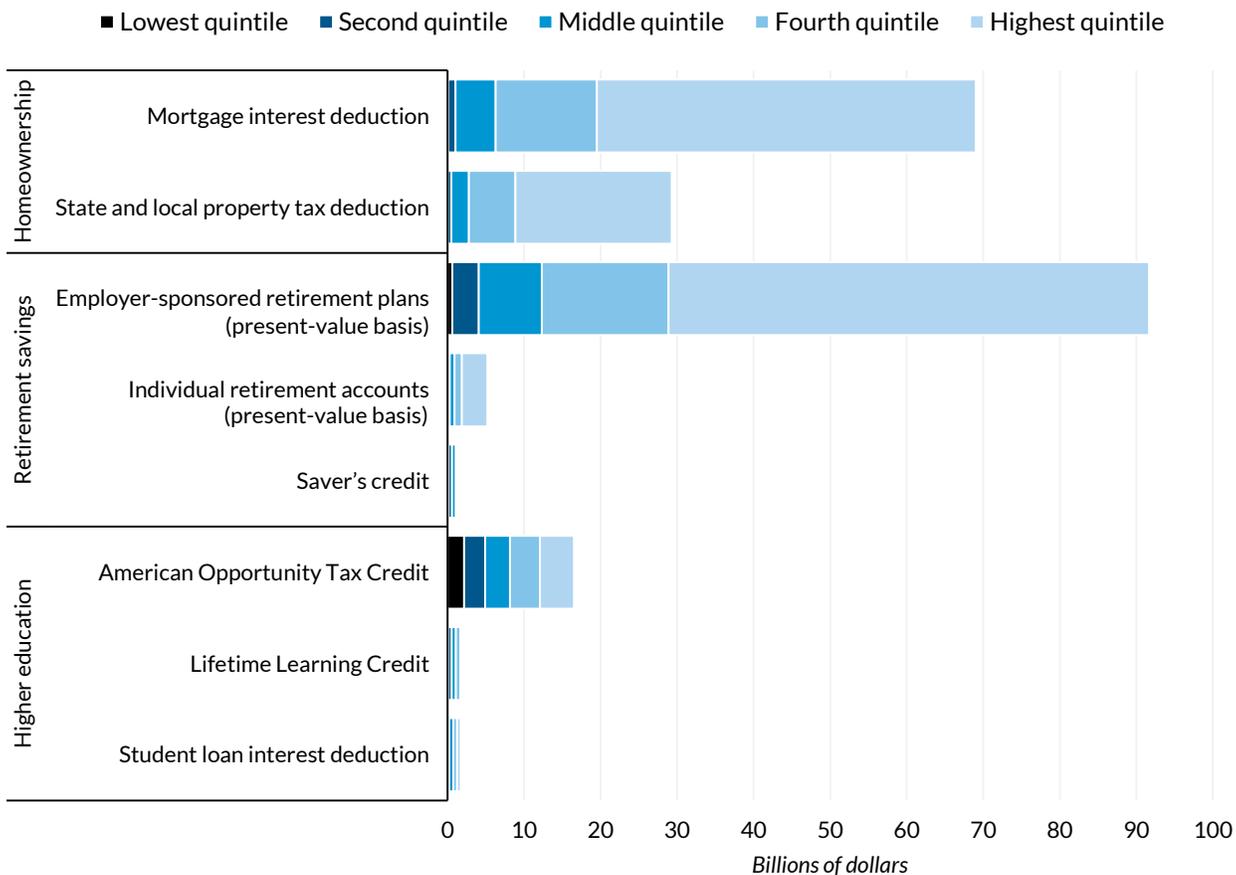


Source: Authors' estimates from Joint Committee on Taxation and Treasury estimates of tax expenditures. Presented in Harris et al. (2014).

FIGURE 2

Higher-Income Taxpayers Receive Most of the Asset-Building Tax Subsidies

Size and distribution by income quintile of select subsidies, 2013



Source: Authors' calculations based on distributional estimates from the Urban-Brookings Tax Policy Center microsimulation model and Treasury's fiscal year 2015 *Analytical Perspectives*.

Note: Though it is technically imprecise to multiply shares by expenditure costs because of differences in tax expenditure estimation methodology and interactions between tax expenditures, this approach illustrates the approximate magnitude of benefits flowing to different groups under current policy.

taxpayers, although the bottom 20 percent receives only 13 and 2 percent, respectively. Nearly 90 percent of the Lifetime Learning Credit goes to the middle 60 percent of taxpayers, with the top and bottom 20 percent receiving roughly 5 percent each. Evidence on whether the various tax benefits for higher education (credits, but also deductions for tuition and related education expenses, tax-preferred education savings accounts, and deductions for student loan interest) encourage individuals to enroll in and complete college remains limited, and findings are mixed (LaLumia 2012; Long 2004; Turner 2011). Further, if colleges raise their tuitions or reduce financial awards in response to education subsidies, some or many benefits to students can be lost. The federal government supports higher education through direct spending as well, for example through Pell grants and student loans.

Do asset-building subsidies work? This fact sheet presents the distribution of benefits from saving incentives, not their net impact. But given the limited

national saving in the midst of all these government incentives—in some years, the tax subsidies exceeded total personal saving, as estimated by the Bureau of Economic Analysis (Bell, Carasso, and Steuerle 2004)—it seems clear that much of the subsidies' benefits go to people who shift assets from unsubsidized to subsidized savings accounts or borrow more against their assets.

The efficacy of tax subsidies for asset development is limited, and the distribution of their benefits belies their purpose. The exclusions and itemized deductions, which make up the bulk of asset-building subsidies, mainly benefit higher-income taxpayers. Credits, and especially refundable credits, can be better targeted toward low- and moderate-income households, but they form a much smaller portion of asset-building subsidies. Many credit proposals, however, subsidize transactions (e.g., each deposit of money into an account) regardless of net saving or how long the money is saved, so their design must be carefully considered.

TABLE 1

Size and Distribution of Select Asset-Building Tax Subsidies, 2013

	Percentage share by taxpayer income quintile					Expenditure (billions)
	Lowest	Second	Middle	Fourth	Highest	
Homeownership						
Mortgage interest deduction	0.1	1.4	7.6	19.2	71.7	\$69.0
State and local property tax deduction	0.1	1.6	7.9	20.7	69.7	\$29.3
Retirement savings						
Employer-sponsored retirement plans	0.7	3.8	9.0	18.0	68.4	\$91.7
Individual retirement accounts	0.8	4.8	11.7	18.8	63.9	\$5.2
Saver's credit	12.5	37.5	40.7	8.9	0.3	\$1.2
Higher education						
American Opportunity Tax Credit	13.1	16.7	19.6	23.4	26.9	\$16.6
Lifetime Learning Credit	4.8	24.5	30.0	33.8	6.8	\$1.8
Student loan interest deduction	2.0	11.0	31.2	29.3	26.5	\$1.7

Source: Urban-Brookings Tax Policy Center microsimulation model. Tax expenditure estimates from the Treasury's fiscal year 2015 *Analytical Perspectives*.

Note: "Income" refers to the Tax Policy Center's "expanded cash income" measure, which is described in Rosenberg (2013).

References

- Attanasio, Orazio P., and Thomas DeLeire. 2002. "The Effect of Individual Retirement Accounts on Household Consumption and National Saving." *Economic Journal* 112: 504–38.
- Benjamin, Daniel J. 2003. "Does 401(k) Eligibility Increase Saving? Evidence from Propensity Score Subclassification." *Journal of Public Economics* 87 (5): 1259–90.
- Bell, Elizabeth, Adam Carasso, and C. Eugene Steuerle. 2004. "Retirement Saving Incentives and Personal Saving." *Tax Notes* 105 (13): 1689.
- Chetty, Raj, John N. Friedman, Soren Leth-Petersen, Torben Nielsen, and Tore Olsen. 2012. "Active vs. Passive Decisions and Crowdout in Retirement Savings Accounts: Evidence from Denmark." Working Paper 18565. Cambridge, MA: National Bureau of Economic Research.
- Gale, William G., and John Karl Scholz. 1994. "IRAs and Household Saving." *American Economic Review* 84 (5): 1233–60.
- Harris, Benjamin H., C. Eugene Steuerle, and Amanda Eng. 2013. "New Perspectives on Homeownership Tax Incentives." *Tax Notes* 141 (12): 1315–32.
- Harris, Benjamin H., C. Eugene Steuerle, Signe-Mary McKernan, Caleb Quakenbush, and Caroline Ratcliffe. 2014. *Tax Subsidies for Asset Development: An Overview and Distributional Analysis*. Washington, DC: Urban Institute.
- Holden, Sarah, and Daniel Schrass. 2012. "The Role of IRAs in US Households' Saving for Retirement, 2012." *Research Perspective* 18 (8). Washington, DC: Investment Company Institute. <http://www.ici.org/pdf/per18-08.pdf>.
- LaLumia, Sara. 2012. "Tax Preferences for Higher Education and Adult College Enrollment." *National Tax Journal* 65 (1): 59–90.
- Long, Bridget T. 2004. "The Impact of Federal Tax Credits for Higher Education Expenses." In *College Choices: The Economics of Where to Go, When to Go, and How to Pay for It*, edited by Caroline M. Hoxby. Chicago: University of Chicago Press.
- Poterba, James M., Steven F. Venti, and David A. Wise. 1995. "Do 401(k) Contributions Crowd Out Other Personal Saving?" *Journal of Public Economics* 58: 1–32.
- Rosenberg, Joseph. 2013. "Measuring Income for Distributional Analysis." Washington, DC: Urban-Brookings Tax Policy Center.
- Steuerle, C. Eugene, and Harvey Galper. 1983. "Tax Incentives for Saving." *The Brookings Review* 2 (2): 16–23.
- Turner, Nicholas. 2011. "The Effect of Tax-Based Federal Student Aid on College Enrollment." *National Tax Journal* 64 (3): 839–62.
- This fact sheet draws from *Tax Subsidies for Asset Development: An Overview and Distributional Analysis*, by Benjamin H. Harris, C. Eugene Steuerle, Signe-Mary McKernan, Caleb Quakenbush, and Caroline Ratcliffe.
- C. Eugene Steuerle** is an Institute fellow and Richard B. Fisher chair at the Urban Institute. **Benjamin H. Harris** is the policy director of the Hamilton Project and deputy director of the Retirement Security Project at the Brookings Institution. **Signe-Mary McKernan** and **Caroline Ratcliffe** are senior fellows in Urban's Center on Labor, Human Services, and Population. **Caleb Quakenbush** is a research associate in Urban's executive office for research.
- Copyright © September 2014. Urban Institute. Permission is granted for reproduction of this file, with attribution to the Urban Institute. The authors acknowledge generous research support from the Ford Foundation and Asset Funders Network. The views expressed are those of the authors and should not be attributed to the Urban Institute, its trustees, or its funders.