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DRI STUDY DISTORTS FLAT TAX IMPACT ON HOME PRICES

Introduction and summary

One of the major concerns posed by Majority Leader Dick Armey's flat tax proposal is its elimination of the mortgage interest deduction. The proposal would also repeal the deduction for state and local taxes, including property taxes.[1] Quite understandably, the National Association of Realtors, homebuilders, and others are worried about the flat tax's consequences for real estate activity.

The DRI study's findings are grossly exaggerated due to serious errors in the analysis and serious misconceptions or distortions of the Armey flat tax proposal.

The NAR commissioned a study by DRI/McGraw Hill of the effect of a flat tax on real estate. Although the study is entitled "Residential Construction Impacts of Flat Tax Legislation", there is little mention in the study of the effect of repeal of the deductions on homebuilding. Instead, the study focuses on the effect on the prices of existing homes. The study predicts a decline in home prices and wealth for middle- and upper- income homeowners, and a consequent decline in their spending, leading to a short term recession. These highly questionable predictions could frighten existing homeowners into opposing any tax overhaul proposal, to the great detriment of the whole country.

The DRI study's findings are grossly exaggerated due to serious errors in the analysis and serious misconceptions or distortions of the Armey flat tax proposal.

The flat tax's elimination of the mortgage interest deduction would not reduce home prices because interest rates would drop, leaving mortgage borrowers and lenders virtually unaffected on an after-tax basis. The repeal of the property tax deduction, involving far smaller amounts, would somewhat increase the cost of home ownership, but not by as much as DRI assumes, and not by enough to hurt housing in the buoyant economy that the flat tax would generate.

Contrary to DRI's assertions, there would be no loss of wealth for upper-income homeowners, whose stocks and bonds would rise in value under the flat tax, and no short term recession due to a drop in spending by upper-income homeowners. In fact, there would be an increase in wealth at all income levels due to the resulting stronger economy.

Higher incomes and employment under the flat tax would increase the demand for housing. Construction of homes would rise.

DRI study distorts Armey flat tax proposal

The DRI study presented a caricature of the flat tax proposal of Representative Dick Armey (R-TX). The Armey bill eliminates all itemized deductions, including deductions for mortgage interest and property taxes, in exchange for a single 17 percent tax rate and a large exempt amount for individuals and families. The bill provides a net tax reduction for nearly all households. It also exempts all types of interestincome from tax (and denies deductions of all types of interest payments), which would reduce interest rates. The reduction in

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interest rates would reduce the interest expense of home ownership.

DRI, however, assumed a revenue neutral flat tax (no net tax cut), with a tax rate about 30% to 50% higher than in the Armey proposal (22%-25% vs. 17%), and apparently understated the effect of the bill's reduction in the tax on lenders. These and other analytical mistakes render the study useless as a guide to what would occur in the housing market if the Armey bill were to be enacted.

DRI estimates

DRI estimates that elimination of the income tax deduction for mortgage interest and property taxes on owner occupied homes would reduce their value by an average of 15% nationwide. They assume that home prices would drop to offset the capitalized value of the higher taxes that homeowner would have to pay over time if the deductions were eliminated. Since the value of the deductions is zero for low income taxpayers who do not itemize, and highest for upper income taxpayers facing the highest marginal tax rates, DRI expects the price of the most expensive homes to fall the most (in excess of 30%) and the least expensive homes to fall by much less than the average, if at all. Taxes saved by the mortgage interest deduction are about three times that of the property tax deduction. DRI, therefore, attributes about 75% of the predicted potential drop in home values to the elimination of the mortgage interest deduction.

Mortgage interest deduction loss offset by interest rate cuts

In reality, the loss of the mortgage interest deduction would be largely, if not entirely, offset by a drop in mortgage interest rates. Consequently, there would be little or no increase in the cost of home ownership, and little or no drop in home prices in the aggregate, as a result of the loss of the mortgage interest deduction.

The flat tax's elimination of the mortgage interest deduction would not reduce home prices because interest rates would drop, leaving mortgage borrowers and lenders virtually unaffected on an after-tax basis.

Mortgage interest rates would fall due to the exclusion of the interest from the taxable income of the lenders under a flat tax. The tax on lenders who receive mortgage interest under current law is generally at least as high as the tax saved by mortgage borrowers due to the deduction. Consequently, the interest rate adjustment should provide homeowners, on average, a complete offset to the loss of the deduction.

For example, assume that lenders and borrowers are in the 25% tax bracket, and that mortgage rates are currently 8%. Under existing law, the tax deduction for mortgage interest reduces the borrower's tax liability by a quarter, equal to 2 percentage points of the interest, resulting in an after-tax rate of 6%. The lender pays tax on the interest, equal to 2 percentage points of the interest, and keeps 6% after tax. Under the Armey flat tax, the borrower could not deduct the interest, but the lender would not be taxed on the interest. The borrower would not want to pay more than 6% to avoid an increase in the net of tax rate, but the lender would be willing to take 6% because it is the same net of tax rate as under current law. The mortgage interest rate would fall to 6%, leaving both parties no better off and no worse off than before.

In fact, lower-, middle-, and upper-income borrowers are in different tax brackets under current law, and they would experience different effects from elimination of the mortgage interest deduction. An interest rate reduction equal to the average amount of the current tax premium in interest rates would tend to over-compensate low income borrowers and under-compensate high income borrowers. There might be an increase in the price

of more modest homes and a reduction in the price of expensive homes from this effect. In total, however, there should be no significant net increase in the aggregate cost of home ownership nationwide, and no aggregate loss of home equity value from the elimination of the mortgage interest deduction.

New homebuyers, or current homeowners seeking to move, would receive the lower interest rates automatically. Existing homeowners would have to refinance their homes to get the lower interest rates. Refinancing involves significant fees, and a sudden rush to refinance could strain the processing capacity of mortgage lenders and might raise fees further. To avoid such costs, a flat tax proposal could "grandfather" existing mortgages, leaving the interest tax deductible for the borrowers and taxable to the lenders, as under current law. Since borrowers and lenders would be in identical tax brackets under the flat tax, grandfathering would involve no revenue loss to the Treasury. (DRI forgot that lenders would pay tax on interest on grandfathered mortgages, and erroneously assumed that grandfathering would lose revenue and require a higher tax rate.) Grandfathering would slightly complicate tax compliance and enforcement, but these effects would disappear over time as existing mortgages were paid off.

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The DRI study acknowledges that a reduction of interest rates would offset, to some extent, the effect of the loss of the mortgage interest deduction. However, DRI understates one of the features of the flat tax that would act to depress all currently taxable market interest rates, and consequently underestimates the degree to which mortgage interest rates would fall and the extent of the offset. DRI assumes that interest rates would fall to a limited degree because borrowers would resist paying the old mortgage rate if interest were not deductible. However, DRI gives little weight to the fact that, under the flat tax, lenders would not be taxed on the interest income, and would accept a lower rate. Both sides in the transaction would be content with a lower rate. Thus, the offset should be complete, not partial.

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DRI assumes that many mortgage lenders are already tax exempt, giving them a lower tax rate than borrowers, reducing the spread between taxable and non-taxable interest rates, and reducing the amount by which one would expect interest rates to drop under the flat tax. In particular, DRI claims that foreign lenders are currently not subject to tax on their U.S. interest income, lowering the average tax rate on lenders and limiting the amount by which interest rates would fall. Since July 1984, foreigners are generally not subject to U.S. tax withholding on most U.S. government securities, but are generally subject to tax on interest income in the United States, or, with few exceptions, in their home countries after a foreign tax credit for taxes paid in the United States. The correct statement of the situation is that a flat tax would reduce the global tax on foreigners' U.S. interest income where U.S. tax rates exceed those abroad, but not otherwise. Much of the foreign saving entering the U.S. is from nations whose citizens could expect to benefit from lower U.S. taxes.

DRI also errs in claiming that mutual funds are tax exempt lenders; each year, the funds' income must be passed through to the funds' shareholders, who are taxed. In any event, tax exempt lenders do not constitute major sources of incremental funds for the mortgage market.

DRI estimated the size of the reduction in mortgage interest rates from adoption of a flat tax by comparing rates on 10 year Treasury bonds and tax exempt bonds. DRI assumed that the interest rate on mortgages would decline by about as much as the difference in yield between the Treasury bonds (subject to federal tax, but not to state tax) and tax exempt state and municipal bonds (not subject to federal tax, nor to state tax if held by a state resident). That differential is only about 0.9% to 1.3%, less than the roughly 2.5% interest rate drop required to offset the loss of the mortgage interest deduction for upper bracket taxpayers at DRI's assumed rate of discount.

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However, tax exempt bonds are riskier than Treasury bonds (as shown by the Orange County bankruptcy, the WHOOPS debacle, and the California budget crisis of a few years ago), and more costly to trade, which raises the interest rate on tax exempt bonds closer to that on taxable federal securities. If Treasury bonds were as risky and costly to trade as tax exempt bonds, the interest rate on Treasury bonds would be higher than at present, and the interest differential would be greater.

In short, one must look at the taxes collected at the margin on mortgage interest, not interest rate spreads between two types of non-mortgage securities with different levels of risk and trading costs, to judge the interest rate effect of making mortgage interest transactions non-taxable.

Property tax deduction

Armey uses the added revenue from elimination of the property tax deduction to further reduce the flat tax rate, meaning that, on average, consumers of housing and other goods and services would not be injured in terms of disposable income by the loss of the deduction. Indeed, the lower tax rate would lower the cost of housing and other production by as much as repeal of the deduction raised it, and a taxpayer's disposable income would buy at least as much as under current law (and probably more, given Armey's net tax cut and the incentives to save and invest). There would be no loss of purchasing power.

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Elimination of the deduction for property taxes means that, in effect, the Armey bill would levy the income tax on the property tax. It is not clear, however, that this imposes a higher burden on home ownership than on any other type of asset or product. Property taxes are imposed on all types of real estate, whether owned directly by individuals or by businesses: on owner-occupied homes, on rental housing, on commercial, office, agricultural, and industrial structures. In addition, personal property taxes are imposed on many big ticket items, including business equipment, motor vehicles, boats, aircraft, and other personal property items. The disallowance of the deduction for property taxes would raise the cost of owning all of these assets and products. Elimination of the property tax deduction would affect the value of the businesses that underlie alternative assets such as stocks and bonds, and, therefore, would not put a home at a disadvantage as an investment asset. Elimination of the property tax deduction would affect the rent on rental housing, and would not put owner-occupied housing at a significant relative disadvantage as a source of housing services. Similarly, loss of the deduction would not raise the

cost of housing services relative to the cost of most other goods and services, which would be impacted as well.

The relative price of homes would slip only if property taxes are a higher fraction of the cost of owner-occupied housing services than of rental housing services or of the cost of other goods and services. It would injure homeowners only if it were to generate an increase in the relative cost of owning real estate compared to most other assets. Property taxes may be a relatively higher part of the cost of single family owner-occupied housing than some other goods and services, but DRI has not quantified that differential. Home prices might fall relative to the prices of other assets, goods and services by at most that differential fraction of the cost of the property tax times the flat tax rate. Even the full value of the deduction accounts for only one-quarter of the DRI result. If one accepts the rest of DRI's assumptions, the immediate effect of the flat tax on home prices could be, at most, a temporary decline of less than 4% on average, not the 15% claimed in the study, and probably a good deal less. Any such decline would soon be swamped by the increase in income due to the tax restructuring and the resulting increase in the demand for housing.

If there were some modest effect on existing home prices, it would be temporary, and would cause no injury to people who are not planning to sell their homes in the very near term. Any price effect would be temporary because homes are a stock of durable capital that can change over time. If the higher cost of the property tax slightly raised the cost of owning a home, then, for a short period of time, home prices might need to be lower than otherwise to attract potential buyers. The dip in prices would temporarily slow construction of new homes, reducing the growth of the housing stock relative to demand until the price of existing homes recovered lost ground. With lower production and maintenance costs tending to reduce prices of homes and other goods and services, and higher incomes tending to increase demand for homes and other goods and services, it is not clear whether prices of existing homes would ultimately rise or fall relative to prices of other products, but the effect would not be the one calculated by the DRI study.

The Armey bill reduces federal spending to pay for a net tax cut. DRI did not want to complicate its analysis by changing federal spending, and assumed this provision of the bill did not exist.

The DRI study also fails to incorporate the effect of reduced taxation of saving on the ease of building up a downpayment for a home, and the resulting increase in affordability of housing.

Armey tax and spending cuts would boost housing

The Armey bill reduces federal spending to pay for a net tax cut. DRI did not want to complicate its analysis by changing federal spending, and assumed this provision of the bill did not exist.

Reduction in federal spending in the Armey bill, however, would reduce government absorption of labor and materials. It would also permit a net tax cut to reduce taxes, both on average and at the margin, on labor, capital, and the cost of everything they produce. Consequently, it would free up and reduce the cost of resources for expanded private sector activity, including homebuilding. Houses, along with other products, would cost less to produce, to buy, and to maintain. There is no reason to suppose a drop in home prices relative to the prices of products the homeowner might wish to buy, including replacement housing if the homeowner were to sell the home and move.

These same features of the Armey bill would unambiguously strengthen the demand for homes by raising real incomes. Spending reduction and a net

tax cut would shift resources to the private sector, and increase capital formation and productivity. Pre-tax and after-tax incomes would rise. The added income would be spent, in part, on housing. This increase in investment, income, and the demand for housing is recognized by DRI, but is assumed, unrealistically, to come after considerable delay, and is not factored into their calculation of the effect of a flat tax on home prices.

The DRI study also fails to incorporate the effect of reduced taxation of saving on the ease of building up a downpayment for a home, and the resulting increase in affordability of housing. With a higher down payment, a homebuyer's mortgage debt and mortgage interest rate would be lower, reducing the interest cost of homebuying.

Effect on household wealth

DRI is concerned that the assumed reduction in home prices would reduce the wealth of homeowners, leading to an immediate increase in saving and a reduction in consumption spending by such households, and a recession. This is mistaken. Assets or "wealth" have value because they produce future after-tax income. DRI's calculated drop in home prices is the present value of the drop in after-tax income in all future years due to the loss of the deductions. Armey, however, would use the revenue from the elimination of the deductions to eliminate the tax on lenders and to lower the general tax rate; there would be no tax increase, no loss in after-tax income, and no drop in wealth from the elimination of the deductions when all taxpayers are considered, although there might be a slight shift of that income from upper income to lower income taxpayers, and a reallocation of wealth across assets. By looking only at one type of wealth and ignoring matching changes in other types of wealth and after-tax income, DRI creates a net loss when there is none.

DRI admits that, longer term, the flat tax would boost growth due to the incentives it provides to invest in plant, equipment, and commercial and residential rental properties.

DRI predicts the greatest drop in home prices and wealth would occur at the upper end of the market, on homes of above average price, and, consequently, that the loss in home equity values would occur chiefly for middle- and upper-income homeowners. There are several problems with this line of reasoning.

Much of the property tax effect in the Armey bill comes from the tax rate reduction, not the elimination of the property tax deduction per se. Even if it were retained, the value of the property tax deduction (and the mortgage interest deduction) would be less at a 17% tax rate (the rate proposed by Armey) than at current tax rates, and would be zero for people dropped from the tax rolls. When a tax rate is reduced, a deduction that sheltered income from the tax loses value in proportion, but if the deduction is only a fraction of taxable income, the taxpayer comes out ahead. The tax rate cut and the net tax reduction in the Armey bill would more than make up for the additional loss of value of the property tax deduction due to its complete elimination. Homeowners would gain. Their incentive to buy a house as opposed to some other asset may be reduced, but their income, wealth (including the value of their human capital, the present value of their lifetime after-tax labor income), and ability to afford a house must be greater, not less, as a result of the tax rate cut.

Even if prices were to fall on the homes of middle- and upper-income people, their wealth would not decline under the flat tax. Middle-income and high-income households have a relatively greater percentage of their assets in stocks and bonds, and a relatively smaller percentage in homes, than do lower-income households. The Armey bill would increase stock prices and the value of mutual fund holdings, raising household

wealth via assets other than owner- occupied housing. Middle- and upper-income households would benefit greatly from higher stock prices, suggesting that their wealth would not be depressed as severely as DRI contends, if at all. Middle- and upper-income households do the bulk of the nation's saving, and would clearly benefit, not suffer, from the elimination of the tax bias against saving. Realtors might be concerned if households choose to hold relatively more of their wealth in financial assets and relatively less in housing, but household wealth would be higher, not lower, under the flat tax than under current law.

DRI's notion that a drop in wealth (the capitalized amount of future income) would raise saving is mistaken in any case. If wealth – permanent income – were to decline, both saving and consumption would decline. The flat tax, of course, aims to increase saving and investment. DRI's notion that a higher saving rate (whatever caused it) would lead to recession is mistaken. In fact, a higher saving rate would not depress the economy, even temporarily; it would quickly lead to more investment, which is as good or better at generating jobs than consumption spending, and would lead to an increase in income and wealth.

Interest rate increase due to growth

DRI admits that, longer term, the flat tax would boost growth due to the incentives it provides to invest in plant, equipment, and commercial and residential rental properties. They err, however, by assuming that the faster growth would tend to raise interest rates in the financial markets, partly undoing the drop in rates stemming from the removal of the tax burden on interest and injure housing. Their concern is based on outdated Keynesian "loanable funds" analysis that is increasingly rejected by the research community.

First of all, there is no historical correlation between higher rates of economic growth and higher market rates of interest.

More fundamentally, the DRI analysis of the effect of an improved investment climate on interest rates is badly flawed. Interest rates are determined by basic factors such as the after-tax real rate of return people demand to give up a unit of consumption to add to saving, risk, inflation expectations, and the tax component of interest. The Armey bill should be understood to reduce the combined tax rates on saving and investment relative to consumption, compared to present law, so the amount of saving to finance additional investment would increase. The desired expansion of the manufacturing and commercial real estate sectors would not drain the credit markets and starve the residential mortgage markets of funds.

The flat tax's repeal of the mortgage interest deduction is purely for simplification... Mortgage interest would disappear from the borrower's and the lender's tax returns... If, instead, the deduction were retained, and mortgage lenders continued to be taxed as under current law, there would be virtually no tax revenue or tax rate consequence, and only a bit of simplification would be lost. The whole dispute is a tempest in a teapot.

At a given level of income, people save and invest more, the less it costs them to do so. The smaller the tax bite on the returns their saving and investment provide, the less the cost of saving and investment. With a smaller tax bite, savers-investors are willing to accept a smaller pretax return in order to have the same after-tax return. Businesses are prepared to accept lower pretax earnings on their capital outlays, hence are willing to undertake capital projects that would not have yielded a sufficiently high pretax return at the higher tax rate.

Of course, as capital outlays increase and the stock of capital increases, the pretax return on the marginal unit of capital decreases, unless Congress

and DRI have managed to repeal the law of diminishing returns. The growth in capital outlays will slow as the pretax returns decline. On the new and higher growth path, the level of saving and capital formation will produce pretax returns that afford after-tax returns just adequate to warrant the cost in terms of foregone consumption.

To be sure, as this adjustment occurs, the net of tax return to owners of existing capital could go up,principally in the form of increases in the market value of equity. This does not represent an increase in the cost of saving or an increase in real interest rates. On the contrary, it results from a decrease in the tax on what capital produces.

DRI's "loanable funds" analysis confuses the transitory increase in after-tax returns that would be received by the owners of capital following a tax cut with a (non-existent) increase in the after-tax interest rate demanded by savers to undertake the marginal dollar of saving. The higher initial returns on existing savings would not take the form of higher interest rates. Instead, the returns would materialize via an immediate jump in stock, bond, and commercial and rental residential property prices, which would rise in line with the higher after-tax earnings of the assets, and which would keep interest rates and dividend rates from rising. The higher after-tax returns would be an unexpected reward to people lucky enough to have been owners of capital when the tax was reduced. There is nothing about a tax cut that would cause an increase in the after-tax interest rate savers demand, and there would be no upward pressure on market interest rates on additional saving.

Elimination of the tax bias against saving and investment would result in expansion of the over-all economy and the stock of capital... Owner-occupied housing might constitute a diminished share of an expanded capital stock, but is unlikely to suffer any significant decline in absolute value... Indeed, with higher incomes across the board, Americans would be likely to increase their spending on homes in the future, and construction in general would boom.

Much of the additional saving would flow into investment via the equity markets, as higher share prices induce additional issuance of shares, or via direct investment by businesses, both domestic and foreign.

DRI's concern that saving will not rise sufficiently to finance all the desired additional investment, and thereby drive up financial market interest rates, is unfounded. Business and individual saving and investment are, jointly, a demand for more real, physical capital, not, respectively, the supply and demand for "loanable funds" or "credit". Saving is historically very responsive to enhanced investment opportunities. If anything, the financial markets move faster than business's ability to build new structures and acquire big ticket capital items.

Furthermore, a significant portion of existing U.S. saving now flows abroad. These amounts could be redirected to domestic investment in a more favorable tax climate. In its discussion of cross-border saving, DRI failed to note that domestic savers and lenders would generally receive a greater tax reduction on their U.S. interest and dividends than on their foreign source interest and dividends. They would increase their total saving, and, where they are subject to foreign taxes on foreign source interest and dividends, they would have an incentive to repatriate their savings and reinvest it in domestic markets. Such tax changes can have a dramatic effect on the behavior of domestic lenders. For example, following the tax rate reductions and investment incentives of the Economic Recovery Tax Act of 1981, U.S. bank lending abroad dropped by roughly $100 billion in two years, from $121

billion in 1982 to $24 billion in 1984, and was shifted to domestic lending.

Domestic saving, of course, need not be the sole source of financing additional investment. The United States no longer constitutes the bulk of the world's free market economies. Foreign saving in world capital markets exceeds a trillion dollars annually. A very small shift of that saving toward the United States would guarantee ample saving for all forms of investment, including housing. It is true that some foreign lenders would not benefit from lower U.S. taxes on interest income. However, much of the foreign saving flowing into the U.S. takes the form of direct and indirect business investment, which would certainly benefit from the reduction in taxation of business investment in plant, equipment, and real estate under the flat tax, and would free up domestic saving to finance the mortgage market. There would be nothing left of the "loanable funds" pressure on the credit markets that DRI assumes would raise interest rates.

Conclusion

DRI's estimates of the effect of a flat tax on owner occupied housing if the mortgage interest and property tax deductions are eliminated are grossly exaggerated.

If history is a guide, home prices will not be damaged if lower tax rates accompany the elimination of the real estate deductions, encouraging saving and lending at lower interest rates and boosting income growth. The Kennedy/Johnson (1963) and Reagan (1981) tax rate cuts, which simultaneously reduced the value of the mortgage interest deduction and the tax on interest income of lenders, did not hurt the housing sector.

The flat tax's repeal of the mortgage interest deduction is purely for simplification; the borrower would not deduct the interest, and the lender would not have to pay tax on the interest. Mortgage interest would disappear from the borrower's and the lender's tax returns. Interest rates would drop to leave both parties virtually unaffected on an after-tax basis. If, instead, the deduction were retained, and mortgage lenders continued to be taxed as under current law, there would be virtually no tax revenue or tax rate consequence, and only a bit of simplification would be lost. The whole dispute is a tempest in a teapot.

Elimination of the tax bias against saving and investment by adoption of a flat tax would result in expansion of the over-all economy and the stock of capital, especially in those industries where the current bias has most severely constrained activity, including manufacturing and commercial and rental real estate.

Reduced taxation of saving that induced growth of the manufacturing and commercial real estate sectors would not adversely affect homeowners. Potential homebuyers looking at the value of home ownership over many years would be unlikely to be influenced by transitory changes in returns on other assets. The public would not demand a higher after-tax return on housing, and the investment boom would have no permanent effect on housing prices via interest rate effects.

Owner-occupied housing might constitute a diminished share of an expanded capital stock, but is unlikely to suffer any significant decline in absolute value. In fact, as their real wealth increased along with their real incomes, people would demand more housing -- more luxurious, larger, more valuable, not less. Realtors dealing only in single family homes might see a relative decline in their product line, but builders, existing homeowners, and even realtors dealing in commercial and rental property would not suffer, and would likely gain from the move to a flat tax. Indeed, with higher incomes across the board, Americans would be likely to increase their spending on homes in the future, and construction in general would boom.

Tax restructuring may well result in shifts in the relative importance of some sectors of the economy,

and people with narrow parochial interests in those sectors might prefer the status quo. That hardly constitutes a reason for rejecting the gains to the over-all economy that would result from a more sensible tax system.

Stephen Entin
Resident Scholar

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Endnote

1. Flat tax proposals generally repeal all or most itemized deductions in return for a single low tax rate. The flat tax proposal by Representative Dick Armey (R-TX) would repeal all itemized deductions, including the mortgage interest deduction and the deduction for state and local income and property taxes. This treatment of interest on mortgage debt is identical to that accorded interest on other types of debt under the Armey bill. Borrowers would not deduct interest paid on any type of loan, including business borrowing, and lenders would not pay tax on interest received. A variant of the flat tax proposed by Senator Arlen Specter (R-PA) would retain the mortgage interest deduction. If the deduction is retained, mortgage lenders should be taxed on the interest.

Note: Nothing written here is to be construed as necessarily reflecting the views of IRET or as an attempt to aid or hinder the passage of any bill before Congress.