Fall 1979

A Tax Expenditure Analysis

Richard Pomp
University of Connecticut School of Law

Follow this and additional works at: https://opencommons.uconn.edu/law_papers
Part of the Law and Society Commons, and the Tax Law Commons

Recommended Citation
Pomp, Richard, "A Tax Expenditure Analysis" (1979). Faculty Articles and Papers. 95.
https://opencommons.uconn.edu/law_papers/95
Mortgage Interest and Property Tax Deduction: A Tax Expenditure Analysis

Richard Pomp

If the government decides to subsidize the mortgage interest and property tax paid by homeowners it can do so by providing them with a direct subsidy or a tax deduction. In this article, Professor Pomp reviews the criteria that should be applied in making this choice. He concludes that a heavy burden rests on those who would argue in favour of a tax deduction and that in this case they have not discharged it. He also examines the important social and economic consequences of subsidizing mortgage interest and property taxes.

The tax expenditure concept is a powerful analytical tool that has changed traditional ways of thinking about the income tax and the government spending process. The income tax has now come to be viewed as consisting of two parts. The first part contains those provisions which are required to implement a proper tax on net income. The second part contains those provisions which are intended to implement social or economic goals by providing financial assistance to select activities or taxpayers. The latter provisions, which are extraneous to the normative structure of the income tax, include special exclusions, deductions and credits that reduce or defer the recipient's tax liability. Since these special provisions represent a form of governmental assistance that is equal in amount to the taxes that would otherwise be collected, they have been termed "tax expenditures." To put it another way, any tax expenditure can be viewed as if the taxpayer had actually paid the full amount of tax owing in the absence of the special provision and had simultaneously received a grant equal to the savings provided by the special provision. Viewed in this manner, a tax expenditure is just one of a number of ways of providing governmental assistance; other means include direct grants, subsidies, and loans.

Because a tax expenditure is a form of government spending, any program implemented through the tax system can be translated into an equivalent direct spending program. Once translated into its spending analogue, a tax expenditure can then be analyzed in the same manner as any direct spending program — in terms of how much money is being spent, how this money is distributed, whether the desired goals and objectives are being accomplished, and other similar budget criteria.

Tax expenditure analysis can provide a good deal of insight into the two tax deductions that are being proposed by the Progressive Conservative Party of Canada: a deduction for home mortgage interest and a deduction for real estate taxes. These deductions are apparently being proposed in order (1) to provide financial assistance to homeowners; (2) to assist tenants in purchasing homes; and (3) to stimulate the depressed construction industry. Thus, since the proposed tax changes are being justified not by reference to principles underlying the normative structure of the Canadian income tax, but by reference to more general social and economic objectives of government, subjecting them to a tax expenditure analysis is appropriate.

Both of the proposed deductions have existed in the United States since the earliest days of the income tax. But in that country both deductions are part of two more general provisions: one that provides for the deduction of all interest, including interest incurred for non-business purposes, and another which provides for the deduction of all state and local taxes, including property taxes. Although neither of these general provisions were originally adopted to promote housing, both deductions are now defended on these grounds.

Tax Expenditure versus Direct Expenditure

A tax expenditure analysis of these deductions raises serious objections to their serving as part of a housing program. As tax expenditures, they have been attacked in the United States as being costly, inequitable, and inefficient. These criticisms are equally relevant to the Canadian proposals.

Cost. In 1978 the American government spent approximately $5.5 billion on the deduction for property taxes paid on owner-occupied homes and $7.6 billion on the deduction of mortgage interest. In contrast, the
government's direct expenditures on housing programs were approximately $3 billion.4 Ironically, the Commissioner of Internal Revenue outspent the Secretary of Housing and Urban Development with respect to housing programs.

Equity. Unlike the assistance provided by most of the direct housing programs in the United States, which are available primarily to the needy, the assistance provided by the property tax and interest deductions is distributed in a perverse and inequitable manner. The higher an individual's income, the higher his or her marginal tax rate, and thus the greater the benefit of the deductions. Conversely, the lower an individual's income, the lower his or her marginal tax rate, and the lower the benefit of the deductions. Indeed, an individual who is too poor to pay any income tax receives no benefit whatsoever from the deductions. Moreover, the deductions can become worthless at the time they are most needed. For example, an individual who becomes ill or unemployed during the year, or otherwise has a sudden and unexpected drop in income, may have no taxable income. Thus even though he or she is committed to both mortgage and property tax payments, and needs assistance now more than ever, the tax deductions will be of no value to him or her. It is difficult to imagine a direct spending program being adopted which had such a feature.

In view of the perverse manner in which the benefits of the deductions are distributed and of the fact that the incidence of home ownership rises with income, it is not surprising that the richest 10 per cent of American taxpayers receives 73 per cent of the benefits of the mortgage interest deduction and 79 per cent of the benefits of the property tax deduction.5 Indeed, the yearly income tax savings for households with annual incomes of $50,000 or more are nearly as great as the yearly benefits provided to low-rent public housing.6 Would any politician have the audacity to propose a direct spending program having these characteristics?

The "upside-down" effect of the tax expenditures would be eliminated if the deductions were replaced by tax credits equal to a percentage of an individual's property taxes or mortgage interest. A tax credit would give equal tax benefits to taxpayers having the same amounts of property taxes or mortgage interest and the tax benefits would be independent of the individuals' marginal tax brackets. If giving less assistance to rich taxpayers than to poor taxpayers were thought to be desirable, a vanishing credit could be adopted; that is, a credit which decreased in amount as the taxpayer's income increased.

Although a credit is more equitable than a deduction, it is of no benefit to an individual who is too poor to pay any income tax (or whose liability is less than the credit), unless the credit is refundable. A refundable credit, however, would constitute a direct expenditure. Correcting the defects inherent in using a tax expenditure ultimately requires some type of direct expenditure, such as a refundable credit. The logical question, therefore, is why a tax expenditure should be used at all. In other words, why should not the tax system be by-passed at the outset by adopting a direct expenditure program?

Efficiency. Not only are the deductions costly and inequitable, but they are also an inefficient means of encouraging home ownership. One source of inefficiency is derived from the upside-down manner in which the tax savings are distributed. Upper-income taxpayers, who derive the most benefit from the deductions, would very likely own homes even in the absence of the incentive. Lower-income tax-payers who need a financial incentive to purchase a home, benefit the least.

Another source of inefficiency is the lack of any restrictions on the amount of the deductions. All mortgage interest and all property taxes are deductible, regardless of the size, price, or location of the home, the amount of the mortgage, or the number of homes owned.7 A direct spending program would most likely have safeguards to ensure that the program was not abused.

Although nearly all economists agree that the interest and property tax deductions are inefficient in encouraging home ownership,8 little agreement exists about the impact of the deductions on the American housing market. These deductions, like many other tax expenditures, have never been subjected to periodic government review. A few private economists have studied the impact of the deductions on housing, but their studies9 differ in their methodologies and are rather inconclusive.10 Furthermore, for the purposes of comparison, the American experience might not be relevant in Canada, since the U.S. deductions have existed since 1913. The American experience is certainly of little value in predicting the short-term impact that the introduction of these deductions would have on the Canadian housing market and on Canadian mortgage rates.11 In any case, these economic studies have already been reviewed in the Canadian literature12 and elsewhere and therefore will not be pursued here.

Renters versus Homeowners

In defense of the proposed deductions, supporters argue that tenants already benefit from the deduction of mortgage interest and property taxes by their landlords, and that it is only fair, therefore, to extend these deductions to homeowners.13 The fallacy in this argument is easily exposed if one considers that landlords can deduct all of their business expenses. Because landlords can deduct the cost of hiring someone to clean the hallways of their apartment
To put the matter another way, if a landlord's rental income were not taxed, no reason would exist for granting him or her a deduction for property taxes, mortgage interest, or any other business expense. If tenants somehow benefit because their landlords deduct mortgage interest and property taxes, tenants must also benefit because their landlords are taxable on rental income. Yet, to the extent that the level of rents reflects the tax burden imposed on rental income, how do tenants benefit (all other things being equal) because rental income is taxable? To be sure, the tax burden on rental income would increase if landlords could not deduct property taxes, mortgage interest, as well as their other expenses. This result, however, does not lead to the conclusion that homeowners should be allowed to deduct their property taxes and mortgage interest. The only conclusion that can be drawn is that the burden on rental income is greater under a gross receipts tax (that is, an "income tax" that does permit the deduction of business expenses) than under an income tax levied at the same rate.

If homeowners were required to treat as taxable income the net rental value of their homes, then allowing them to deduct property taxes and mortgage interest would make some sense. The taxation of homeowners on the net rental value of their homes would recognize that a person has a choice between purchasing assets, such as stocks or bonds, that provide monetary income, and purchasing a home that provides services. A person who resides in his or her own home obtains income in the form of consumer services. In other words, a homeowner acts in a dual capacity — as an investor, a role in which he or she acts as landlord, and as a consumer, a role in which he or she acts as tenant. In many countries, though not in the United States or in Canada, this dual capacity is recognized by the tax law, by taxing the homeowner on his or her imputed income as a landlord.14

...a homeowner acts in a dual capacity — as an investor, a role in which he or she acts as landlord, and as a consumer, a role in which he or she acts as tenant.

The equity of taxing homeowners on the imputed rental value of their homes can be illustrated by an example. Consider two individuals, X and Y. Assume that each earns an annual salary of $20,000 and has cash savings of $40,000. Y invests $40,000 in securities that generate an annual salary of $20,000 and has cash savings of $40,000 in securities that provide monetary income, and purchasing a home that provides services. A person who resides in his or her own home obtains income in the form of consumer services. In other words, a homeowner acts in a dual capacity — as an investor, a role in which he or she acts as landlord, and as a consumer, a role in which he or she acts as tenant. In many countries, though not in the United States or in Canada, this dual capacity is recognized by the tax law, by taxing the homeowner on his or her imputed income as a landlord.14

...the proposed deductions would be costly, inequitable, and inefficient,...

Although the preceding tax expenditures bias the tax system in favor of homeownership, other tax provisions that favor rental housing may offset this bias. For example, Canadian and American investors in rental housing are eligible for liberal depreciation deductions that are justified by analogy to the business deductions available to landlords. Furthermore, if the taxation of imputed net rental income is viewed as part of the normative structure of an income tax, which is a common view of most Canadian and American tax specialists,16 then the exclusion of this imputed income already represents a tax expenditure for homeownership.20 Granting deductions for property taxes and mortgage interest would add yet another tax preference for homeownership. The possibility that the exclusion of imputed net rental income is a tax preference serves as a reminder that, even without deductions for property taxes and mortgage interest, the income tax may already contain tax expenditures that favor homeownership. For example, in Canada all of the profits arising from the sale of a home are exempt from tax.21 Again, a tenant who chooses to invest in securities rather than in a home is treated more harshly in that a capital gains tax will be paid on the sale of his or her investment.

Another Canadian tax expenditure is the registered homeownership savings plan (RHOSP),22 which allows an individual to save $1,000 per year tax-free for the purchase of a home. The $1,000 is deducted from taxable income, subject to a lifetime ceiling of $10,000. The funds can be withdrawn from savings tax-free as long as they are used to purchase a home. Since gains on the sale of a home are exempt from taxation, no tax will ever be paid on these funds.

...even without deductions for property taxes and mortgage interest, the income tax may already contain tax expenditures that favour homeownership.
probably in excess of true economic depreciation. To the extent that these liberal depreciation deductions result in lower rents, individuals are encouraged to rent, rather than to purchase housing.

The impact of these depreciation deductions on the level of rents is difficult to measure. Unlike a tax expenditure for owner-occupied housing, whose recipient is both investor and consumer, the tax expenditure for rental housing is paid to the investor-owner and not to the consumer-tenant. The extent to which the tax savings are passed through to the tenant must therefore be estimated. The empirical data are sketchy because few of the economists who have studied the tax expenditures for homeowners have focused on the tax expenditures for rental housing. It is generally agreed, however, that in the United States excess depreciation deductions represent tax expenditures of less than $300 million. They are thus overshadowed in amount by the tax expenditures for owner-occupied housing.

In addition to generous depreciation deductions for rental housing, the American tax system, though not the Canadian, contains another provision that may restore somewhat the balance between tenants and homeowners. Every American taxpayer has the option of either itemizing his or her personal deductions, which include interest, property taxes, charitable contributions, medical expenses, and casualty losses, or deducting a fixed amount called the standard deduction. Because the standard deduction is relatively high ($3,400 for married couples filing a joint return and $2,300 for single persons), only 23 per cent of all taxpayers itemize their deductions; most tenants use the standard deduction. An individual who chooses to itemize and thereby deduces property taxes and mortgage interest receives the benefit only of the amount by which his or her total deductions exceed the amount of the standard deduction to which he or she would otherwise have been entitled. The standard deduction thus helps to offset the benefits that homeowners receive from deducting their property taxes and mortgage interest. Since there is no similar Canadian tax deduction, the discrimination between homeowners and tenants would be much greater in Canada if property taxes and mortgage interest were deductible.

Defending the Deductions

Because the Canadian income tax already contains tax expenditures that favor homeownership and because the proposed deductions would be costly, inequitable, and inefficient, what can be said in their defense? First, the deduction for property taxes can be defended as an aid to intergovernmental fiscal relations. The deduction increases the taxing capacity of local governments, mitigates differences in the level of taxation among provinces and municipalities, and helps prevent the combined rate of local and federal taxes from approaching 100 per cent of income. Second, to the extent that the payment of the property tax can be characterized as an obligatory payment, rather than as a discretionary item of consumption, the deduction recognizes the individual's reduced taxing capacity. Under either of these rationales, however, all provincial and local taxes should be deducted, not just property taxes. Offering a deduction only for property taxes may result in a serious shift in the present mix of local taxes, because it will create pressure to impose or increase property taxes rather than sales or income taxes. Since the property tax might not be as progressive a tax as the income tax or the sales tax, it is questionable whether the federal government should adopt a proposal that biases local financing decisions in favor of a regressive form of taxation.

The case in favor of allowing a deduction for mortgage interest is more complicated. The normative income tax treatment of interest has not yet been fully developed, though many commentators apparently view the deduction for interest on consumer credit as a tax expenditure. No one in Canada, however, is defending the proposed deduction for mortgage interest as a change in the normative structure of the Canadian income tax. In the narrower context of homeownership, the most that can be said in support of the deduction is that it helps to differentiate between homeowners with mortgages and those without. Because imputed income is not taxable, however, the price paid for this differentiation is a further increase in the discrimination between homeowners and tenants.

Assuming...[that] encouragement of homeownership is desirable, a tax expenditure analysis of any proposal that would be implemented through the tax system,...is fully warranted. The proposed deductions are not the only alternatives for promoting homeownership.
proposed deductions for mortgage interest and property taxes, is fully warranted. The proposed deductions are not the only alternatives for promoting homeownership. Among others are direct grants, construction loans, mortgage guarantees, and interest subsidies. Each of these alternatives is likely to have different distributional and economic effects. Evaluating these other approaches will raise various fundamental questions that have not yet been raised. For example, what type of housing plan does the government want? Should the government influence the demand for housing or the supply of housing? Should assistance be directed toward new housing or toward existing housing? Should the government intervene directly in the credit market? Should benefits be directed toward the poor, toward large families, or toward the elderly? Should low-quality housing be upgraded?

If, after a full exploration of these issues, a subsidy for mortgage interest and property taxes emerges as the most desirable of the alternatives, the burden of proof should still be on those who want to provide that subsidy through the tax system. The question that must then be asked is, “What clear advantages are there in using the tax system to provide the financial assistance.” Only when that question has been answered satisfactorily can a responsible and well-informed choice be made.

* The author is indebted to Michael J. McIntyre, Professor of Law, Wayne State University, for his many helpful suggestions and comments.

Notes

1. The tax expenditure concept was developed by Professor Stanley S. Surrey of Harvard Law School. See Surrey, "The Tax Expenditure Analysis: The Concept and Its Uses," 1 Canadian Taxation (No. 2) 3 (1979). His work in this area reflects his experience as Assistant Secretary for Tax Policy under Presidents Kennedy and Johnson as well as the insights garnered through his other academic and scholarly pursuits. As Professor Kierans has noted, the “tax expenditure concept must be considered the major innovation in tax and public finance during the last twenty or thirty years.” Kierans, "The Tax Reform Process," in Canadian Taxation, forthcoming, (1979).

2. “Other tax expenditures whose origins were cloudy because of their antiquity and absence of articulation of initial intentions, are now defended on incentive grounds, such as the incentive to homeownership in the case of the deduction for mortgage interest and property taxes ...” S. Surrey, et al., 1 Federal Income Taxation: Cases and Materials. Mineola, N.Y.: Foundation Press, 1972, p. 246.

3. Special Analysis G: Tax Expenditures, Budget of the United States Government, 1980. Property taxes and interest that are attributable to profit-seeking activities are properly deductible in measuring net income and are therefore not considered to be tax expenditures. If either deduction were repealed, a taxpayer who now itemizes his deductions might elect the standard deduction, discussed infra. The loss in revenue would then be the difference between the amount of property tax and mortgage interest currently deductible and the amount of the standard deduction.

In Canada, the proposed deductions, once fully phased-in, would result in an estimated revenue loss of $3 billion per year. Smith, "Mortgage Interest and Property Tax Deductions," 1 Canadian Taxation (No. 1) 38 (1979).


Because the amount of property taxes and mortgage interest does not vary directly with income either within or among income classes, the deductions create both horizontal and vertical inequities. See Hellmuth, supra note 4, pp. 184-189; see also White and White, "Horizontal Inequality in the Federal Income Tax Treatment of Homeowners and Tenants," 18 National Tax Journal 225 (1965); and the studies cited in note 9 infra.


7. The Canadian proposals would grant a deduction for the first $1,000 of property taxes and for interest on mortgages of up to $50,000. These restrictions, however, do not eliminate the problems referred to in the text.

8. For a typical conclusion, see Hellmuth, supra note 4, p. 165: [T]hese homeowner tax preferences are relatively inefficient and expensive if they are considered as incentives to promote homeownership and the construction of more homes ... Tax incentives are, of course, of no value to those whose income is so low that they pay no federal income tax. And to the extent that the tax preferences increase the demand for owner-occupied homes, the price of such dwelling units rises and puts them further beyond the reach of low- and modest-income persons. The greater value of these preferences for persons with high incomes and high marginal tax rates is likely to draw more resources into the construction of large and expensive homes; on the other hand, income-neutral incentives would be likely to result in more dwelling units to meet the housing needs of more people.

Although international comparisons are often misleading, a Canadian report states that “… in spite of the expenditure of billions of dollars [on the deductions for property taxes and mortgage interest], the homeownership rate in the United States (which has allowed these deductions for decades) is virtually the same as in Canada.” See National Council of Welfare, supra note 5.


10. For a typical conclusion, see Goode, supra note 9, pp. 516-517: It is not clear whether income tax considerations were an important cause of the shift from renting to homeownership ... Factors other than income taxation no doubt also contributed to increasing homeownership. Non-tax factors which presumably were influential, and perhaps more important in the aggregate than the income tax, include the rise in real income; the increased availability of mortgage financing, and, until recently, low interest rates, owing partly to government programs; the inflation which has made possible large capital gains for home owners, especially those with large mortgages; and the movement of population to the suburbs. It is possible that many homeowners do not look on their houses as investments in the strict sense and may be willing to pay a premium for satisfactions not reflected in estimated rental values. House purchases by these families may have increased mainly because of rising disposable income rather than income tax considerations and other factors influencing the rate of return on housing equity.
11. Among the issues that need to be examined are the short-term and long-term effects of the deductions on: (1) mortgage interest rates; (2) the allocation of credit between the housing sector and other sectors; (3) the price of housing; (4) the construction industry; (5) the use of mortgage credit for non-housing consumption; and (6) the level of rents. A complete analysis would also have to take into account how the government will finance the revenue loss resulting from the deductions and the effects of rent control. For a discussion of these issues, see Smith, supra note 3.


15. If a homeowner were allowed to use accelerated depreciation, net imputed rental income might be negative in some instances.

16. The examples in the text would have to be modified for U.S. taxpayers to take into account their possible use of the standard deduction, discussed infra. See Gertz and Sullivan, "Housing Tenure and Horizontal Equity." 31 National Tax Journal 329 (1978).

17. To carry this illustration even further, assume that X rents his house for $7,000 and moves to another city where he leases an identical house for $7,000. Except for living in a different city, X has not altered his economic status, but, under current law, his tax liability would increase.

18. The Canadian Royal Commission on Taxation (the Carter Commission) stated: "... To ensure that all taxpayers bore their fair proportion of the local tax burden, it would be necessary to impute rental income to [a homeowner] ... The exclusion from income of imputed rental is therefore a substantial tax preference for homeownership ... An incentive of this magnitude leads to inequities between owners and renters." Report of the Royal Commission on Taxation, Volume 3. Ottawa: Queen’s Printers, 1969, pp. 47-49.


21. A tax expenditure analysis of the exclusion of imputed rental income is similar to the analysis of the deductions for mortgage interest and property taxes. See Aaron, supra note 9; Clayton, supra note 12; Good, supra note 9; Kitchen, supra note 18; Laidler, supra note 9; Shelton, The Cost of Renting Versus Owning a Home, 44 Land Economics 59 (1968); Tinney, supra note 9. A Canadian study of the exclusion of imputed rental income concluded: ... it may be observed that the non-taxation of imputed rent is an important subsidy which is provided to encourage homeownership. However, if this is the case it appears to be an inefficient subsidy. First it is designed to help the homeowners with high incomes and high marginal tax rates relatively more than the people in the lower income strata. Second, it does nothing towards providing the lower income groups, who are already exempt from tax, with more disposable income ... it appears that non-tax factors such as the rise in real income, the increased availability of mortgage financing, the capital gains resulting from inflation and the satisfaction which accrues to people from owning their own dwelling — are more influential and much more important in encouraging ownership.

22. See, e.g., supra note 18, p. 484.

23. A tax expenditure analysis of the exemption of the profits arising from the sale of a home is similar to the analysis of the deductions for mortgage interest and property taxes. See Wolff, supra note 18. The net effect of this exemption and the exclusion of imputed rent is to exempt a homeowner both on the annual return on his investment in a home and on any gain realized on the liquidation of that investment.

In 1978, the United States adopted a rule allowing taxpayers who are at least 55 years of age to exclude up to $100,000 of gain realized on the sale of a principal residence. Internal Revenue Code (IRC) § 121. In addition, the United States allows taxpayers to rollover part or all of the gain arising on the sale of a principal residence if another residence is purchased. IRC § 1034.

For a discussion of the registered home ownership savings plan, see National Council of Welfare, supra note 5, pp. 17-19. "RHOSPs, it would seem, have the most effect among the wealthiest of Canadians in terms of encouraging savings for a home." Id., p. 19.

24. For a study of the relationship between depreciation deductions for rental housing and the benefits that accrue to tenants from these deductions, see Sunley, "Tax Advantages of Homeownership Ver-

25. In 1977, the standard deduction became the "zero bracket amount." IRC § 63(e). The term "standard deduction" is used throughout this article, however, since it is more familiar to Canadian readers. The standard deduction is in lieu of itemizing personal deductions. Business-related deductions generally remain deductible even if the standard deduction is claimed, although the exact rules differ depending on whether the individual is an employee or is self-employed. See IRC, § 62.


27. Not all the studies in note 9, supra, have taken into account the use of the standard deduction by tenants who did not itemize. Whether this oversight distorts the results of the studies depends on the number of tenants who used the standard deduction in the years under study. Since neither the level of the standard deduction nor the level of the personal deductions that a taxpayer is permitted to itemize has remained constant, the number of taxpayers who have used the standard deduction has fluctuated from year to year.


29. In the United States, the Civil War income tax allowed tenants to deduct their annual rental payments on their residences. The deduction for rent was intended to offset the deduction of property taxes and mortgage interest by homeowners. Good, supra note 9, p. 523. Some states have levied property taxes directly on the tenant rather than on the owner in order to enable the tenant to claim the deduction. The IRS has resisted attempts by the tenant to claim the deduction under these circumstances. See, for example, Rev. Rul. 79-180, 197-197-23, 7; Rev. Rul. 75-558, 1975-2 C.B. 67. In general, see Freeman, "The Tenant Tax Act: Extending the Federal Real Estate Tax Deduction to Residential Tenants," 13 Harvard Journal on Legislation 298 (1976).

30. A Canadian report states: "Ironically, it is the U.S. property tax deduction — this supposed form of tax relief — that is often cited as a key factor in the high rate of American property taxes which has led, in turn, to the demand that taxpayers' revolts!" National Council of Welfare, supra note 5, p. 24.


32. As an illustration, consider three taxpayers: X, Y, and Z. Each receives a salary of $20,000 per year and has cash savings of $40,000. X uses his $40,000 of savings to purchase a home, and his housing expenses are $3,000 per year. Y invests his $40,000 in securities that generate income of $4,000, and he rents a house identical to Z's for $7,000 per year. Z purchases a home identical to X's and Y's, and he finances this purchase with cash of $20,000 and a $20,000 mortgage; Z invests his remaining cash of $20,000 in securities that generate income of $2,000. Z's housing expenses are $5,000 rather than $3,000; Z's additional expenses of $2,000 ($5,000 — $3,000) are attributable to the interest paid on his mortgage.

33. If taxpayers can arrange their lifestyles so that their taxes are equal to the benefits of the government services that they receive, such taxes can be viewed as discretionary consumption expenditures. See Good, supra note 28; Andrews, "Personal Deductions in an Ideal Income Tax," 86 Harvard Law Review 308, 376 (1972); Bittker, "Income Tax Deductions for Personal Expenditures," 16 Journal of Economics 193, 200 (1973); Due, supra note 28; see generally, Tiebout, "A Pure Theory of Local Expenditures," 64 Journal of Political Economy 416 (1956).