Recent calls for simplifying the U.S. tax code have sparked heated debate about the relative merits of consumption-based taxes and flat tax rates. A particular concern in those debates is removal of the mortgage interest deduction, which many fear will depress housing prices.

Home ownership rises with income. Almost 40% of families making less than $10,000 a year own their own homes, compared to 84% of those earning more than $50,000. However, nearly all the wealth of families earning less than $10,000 is in their homes, while housing accounts for only 40% of the wealth of families earning over $50,000.

Very few families in the lower income categories benefit from the interest deduction, because few itemize on their income tax returns. For families who do itemize, however, the overall effect on wealth also depends on how the tax revision affects prices of both housing and nonhousing assets. Since housing as a fraction of wealth declines with income, a flat tax system would offset wealth losses to the extent that it causes the value of other assets to rise. Further, the large decrease in marginal income tax rates in 1981 did not depress housing prices, contrary to what might have been expected. Normal fluctuations in the housing market may swamp changes brought on by such revisions in the tax code.