REVISITING THE STATE AND LOCAL TAX DEDUCTION

Frank Sammartino and Kim Rueben

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ABSTRACT

Many federal tax reform proposals would eliminate the state and local tax (SALT) deduction. Although deficit reduction often is the rationale, there are arguments for eliminating the deduction based on economic efficiency, equity, and improved federal fiscal policy. Eliminating the deduction, however, could affect the mix of revenue sources used by state and local governments and could lead to reductions in spending for programs and services. In this report we consider arguments for and against maintaining the deduction, explore who claims it by state and income level, and estimate the revenue and distributional effects of options for changing the deduction.

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INTRODUCTION AND SUMMARY

The potential effect of federal tax reform on state and local governments is often overlooked. Federal, state, and local tax policies and tax administration interact in significant ways. Where they share a similar tax base, such as across individual and corporate income taxes, subnational governments derive significant benefits from the administrative and enforcement functions of the federal government. In other instances subnational governments can directly leverage features of federal tax law, such as provisions for state earned income tax credits based on the federal credit.

An area of direct interaction is through the federal individual income tax deduction for state and local taxes. By allowing taxpayers to deduct certain state and local tax payments, the federal government provides an indirect subsidy to state and local governments. Those jurisdictions are able to raise revenues from deductible state and local taxes that exceed the net cost to taxpayers of paying those taxes, in effect allowing those jurisdictions to export a portion of their tax burden to the rest of the nation. Because only some state and local taxes are deductible, it may also change the revenue mix of states.

Many federal tax reform proposals would eliminate the state and local tax (SALT) deduction. Although federal deficit reduction often is the rationale for eliminating the SALT deduction, there are arguments for eliminating the deduction based on economic efficiency, equity, and improved federal fiscal policy.

Eliminating the SALT deduction, however, would come at a cost to state and local governments. It could affect the mix of revenue sources used by state and local governments and could lead to reductions in spending for programs and services. If the benefits from that spending extend beyond the population of those jurisdictions (which is true for a significant portion of state and local government spending) some of those costs would spread across the entire nation. An obvious solution would be to use at least some of the additional federal revenues from eliminating the deduction to increase federal grants to state and local governments, but the political path to such a trade-off would be difficult to navigate because it would create winners and losers across different states.

In this report we consider different aspects of the current federal tax deduction for state and local taxes. We look at arguments for and against maintaining the deduction, review research on the effect of the deduction on the mix of subnational government taxes and total revenues, and explore data on the distribution of who claims the deduction by state and by income level.

We also consider the revenue and distributional effects of options for changing the current federal deduction, ranging from complete elimination to replacing the deduction with a tax credit. Using a method for imputing state weights to samples of federal taxpayers, we are able to simulate the effects of the options across the population grouped by both state of residence and income.[1]

We estimate that eliminating the SALT deduction would increase federal revenue by almost $1.3 trillion over 10 years. Limiting the deduction through a dollar cap would raise less revenue—about $870 billion over 10 years for the version of the cap simulated here. The revenue increase from replacing the deduction with a credit would vary depending upon the structure of the credit but would be much less than the increase from either eliminating or limiting the deduction. Replacing the deduction with a 15 percent credit available to all taxpayers would raise an estimated $96 billion over 10 years. If the credit were limited only to deductible taxes in excess of $1,000, the 10-year revenue increase would be an estimated $235 billion.

Eliminating the deduction would increase taxes for about 24 percent of taxpayers nationwide, but that percentage would be much greater in some states; for example, nearly 40 percent of taxpayers in Maryland and 35 percent of taxpayers in Connecticut would see tax increases. Taxpayers in California and New York would pay over 30 percent of the tax increase from eliminating the deduction; that share is commensurate with the 32 percent of the total state and local tax deduction claimed by taxpayers in those two states but greater than the 23 percent share of federal income taxes they pay.

Taxpayers with incomes over $100,000 would have the largest tax increases both in dollars and as a percentage of income. Those taxpayers would pay 90 percent of the tax increase from eliminating the deduction, and 40 percent of the total would be paid by just taxpayers with incomes over $500,000. If the deduction was not eliminated but instead subject to a $6,000 cap, taxpayers with incomes over $100,000 would pay 97 percent of the increase with 58 percent of the total coming from taxpayers with incomes over $500,000. About 13 percent of taxpayers would have a tax increase with a $6,000 cap.

Replacing the deduction with a 15 percent credit would create both winners and losers. Taxpayers who currently pay qualifying state and local taxes but do not itemize their deductions would be eligible for the credit. Taxpayers who currently itemize would also be eligible, but the credit would be worth less than the deduction for taxpayers whose marginal tax rate is greater than 15 percent. If the deduction were replaced by a 15 percent credit limited to qualifying state and local taxes in excess of $1,000, about 13 percent of taxpayers would have a tax increase while about 32 percent would receive a tax cut. The highest concentration of taxpayers with a tax cut (as a percentage of all taxpayers in an income group) would be in the $50,000 to $200,000 income range.

Eliminating or limiting the SALT deduction would reduce the number of taxpayers who would itemize their deductions as well as the number of taxpayers who would pay the individual alternative minimum tax (AMT). If the deduction were replaced with a tax credit, the number of taxpayers claiming the credit would be far greater than the number who currently claim the deduction. The number of taxpayers paying the AMT would also increase (assuming the new credit was not allowed under the AMT).

THE STATE AND LOCAL TAX DEDUCTION

Taxpayers who itemize deductions on their federal income tax returns can deduct certain state and local taxes from their taxable income. These include taxes on real estate and personal property as well as either income taxes or general sales taxes.[2] About 30 percent of tax filers itemize deductions on their federal income tax returns, and virtually all who do so claim a deduction for state and local taxes paid. State and local income taxes and real estate taxes make up the majority of total state and local tax deducted, about 60 percent and 35 percent, respectively; sales taxes and personal property taxes account for the remainder.

Two tax provisions place limits on the SALT deduction. A general limit on itemized deductions applies to higher-income taxpayers. If a taxpayer's adjusted gross income (AGI) exceeds a threshold ($300,000 for married couples and $250,000 for singles, indexed for inflation after 2013), itemized deductions, with some exceptions, are reduced by 3 percent of income in excess of the thresholds. The amount of the reduction is limited to 80 percent of the deductions claimed.[3]

The individual AMT also limits the deduction. The AMT is a parallel income tax system with fewer exemptions, deductions, and tax rates than the regular income tax. Taxpayers potentially subject to the AMT must calculate their taxes under both the regular income tax and the AMT and pay the higher amount. Taxpayers cannot claim the SALT deduction when calculating their AMT liability and the disallowance of the deduction is a major reason taxpayers pay the AMT.[4] Of the approximately 4 million taxpayers who currently pay the AMT, about 80 percent would not do so if they could claim the SALT deduction under the AMT.

The SALT deduction is among the largest federal tax expenditures.[5] The US Congress Joint Committee on Taxation estimates that the federal revenue cost of the deduction for state and local taxes will total $527 billion from 2015 to 2019 (Joint Committee on Taxation 2015). Of more than 100 tax expenditures in the individual income tax, only the exclusion of employer contributions for health care and health and long-term care insurance premiums, the net exclusion of pension contributions and earnings, and the preferential tax rates for long-term capital gains and dividends have a higher estimated revenue loss over that five-year period.

EFFECT ON STATE AND LOCAL TAXES AND SPENDING

The SALT deduction provides an indirect federal subsidy to state and local governments by decreasing the net cost to taxpayers of deductible state and local taxes. By lowering the net cost of taxes, the SALT deduction encourages state and local governments to levy higher taxes and provide more services than they otherwise would. It also encourages those entities to use deductible taxes in place of nondeductible taxes (such as selective sales taxes on alcohol, tobacco, and gasoline), fees, and other charges. And it encourages those governments, where possible, to shift more of the tax burden to higher-income taxpayers (who are likely to benefit the most from the federal deduction) to take full advantage of the deduction. Empirical evidence is mixed, however, about the magnitude of each of those effects.

INTERACTION BETWEEN FEDERAL AND STATE TAXES

States depend upon the federal government for the smooth functioning of their own tax systems. Tax administration and adjudication are much simpler for the states if they can piggyback on federal tax law. All states take advantage of this by conforming to the federal rules and definitions for the income tax base to some degree. Forty-one states and the District of Columbia (DC) have broad-based individual income taxes.[6] Twenty-nine states and DC start with federal adjusted gross income, seven states start with federal taxable income, and the remaining five do not use a federal starting point for determining the state income tax base; rather they generally use a measure similar to federal gross income. In the past, some states went even further by simply computing state income tax as a percentage of the federal income tax, but no state currently follows that practice.

Because the federal income tax base is the starting point for state income tax bases, changes to federal rules governing income exclusions (such as for employer-provided health insurance) and "above-the-line" adjustments (such as the deduction for student loan interest) directly flow through to the calculation of state taxable income. The same is true for federal rules concerning the standard or itemized deductions. Eleven states use the federal standard deduction and 33 states allow itemized deductions based on federal itemized deductions, although most states do not carry over the federal deduction for state and local taxes.[7]

States benefit from federal administrative and audit efforts for both corporate and individual income taxes. The audit resources available at the Internal Revenue Service (IRS), both in staffing and expertise, are not generally available in state tax departments, but because federal and state requirements are directly linked, states benefit from IRS resources. Delivering

benefits through the tax code via state earned income tax credits is another example of how states benefit from federal administration and enforcement.

Conforming to the federal tax code comes at a price, however. Because of the linkages, federal policy decisions can have significant revenue effects on the states and force state governments with balanced budget constraints to react quickly to federal tax law changes.

FEDERAL FINANCIAL SUPPORT FOR STATE AND LOCAL GOVERNMENTS

Federal and state taxes interact directly through the federal SALT deduction. The federal tax subsidy provided to state and local governments through the SALT deduction is one form of federal financial assistance to state and local governments, which typically occurs through grants, loans, and loan guarantees in addition to tax subsidies. Most federal assistance comes through grants, which were an estimated $628 billion in 2015 (Office of Management and Budget 2015). Federal tax subsidies through the SALT deduction and the federal tax exemption for state and local bond interest provided an addition $135 billion in implicit federal support for state and local governments.

The federal government subsidizes subnational governments for several reasons. It may do so, for example, to redistribute resources across different regions of the country to aid those regions that either have higher costs of providing services or a lower income base to support spending.[8] The federal government may also provide support through matching grants that encourage state and local governments to provide particular services and to contribute their own resources to such programs.

In addition, the federal government provides assistance because a significant portion of state and local government expenditures finance services, such as public assistance, education, and transportation, that "spill over" to people in other states and localities. These spillovers may be direct, such as when residents of other jurisdictions enjoy the benefits of such services, or indirect, such as when spending on programs that boost employment and earnings in a local jurisdiction leads to higher incomes and consequently to higher federal tax payments. Left on their own, state and local governments would provide less than the optimal amount of services from a national perspective because not all of the benefits go to residents of the local jurisdiction. Federal subsidies help ensure that subnational governments will provide a sufficient quantity of those services to capture the full national benefits. Funding those programs through subsidies to state and local governments rather than through a distinctly federal program allows the provision of those services to adapt to local circumstances.

But separating state and local services that benefit a broader population from those that are strictly local is difficult. To the degree that people choose to live in certain areas because of

the local services provided, the taxes they pay to state or local governments are similar to payments for purchases of private goods.[9] If state and local governments use deductible taxes to primarily fund services that benefit local residents with no spillovers to residents of other jurisdictions, then a key reason for federal support is absent. The original legislation enacting the federal income tax reflected this view of the SALT deduction by explicitly specifying that local taxes paid in return for local benefits were not deductible.

DISADVANTAGES OF THE DEDUCTION

Although there are strong reasons for federal support of state and local spending, subsidizing such spending through the SALT deduction may be less effective than providing support through grants or other means. The current deduction has some disadvantages regarding economic efficiency, equity, and federal fiscal policy.

Distorts State and Local Tax and Spending Decisions

The deduction may encourage states to adopt a less economically efficient mix of taxes, relying more heavily on deductible taxes than on nondeductible user fees. It can also distort choices about the level of subnational government spending, and rather than encouraging state and local governments to provide services that generate national benefits, it may only encourage subnational governments to spend more on strictly local goods and services.

On the other hand, the deduction may have additional positive externalities. It may cause states to tilt their revenue base in the direction of property taxes, which are also deductible and may come close to user charges. It may also cause higher-income taxpayers to accept higher local property taxes in areas with a mix of high- and low-income families, improving the economic diversity of such localities (Gramlich 1985).

The deduction may also cause states to rely more heavily on income taxes and more progressive income taxes in particular. Because the federal subsidy is based on the portion of taxpayers that itemize deductions and the federal marginal tax rate of those that do, states can capture more of the subsidy by having higher-income residents pay a greater share of deductible taxes. Greater progressivity of state income taxes may increase welfare if there is a local desire for income redistribution. Therefore, we might expect more progressive taxes to occur in states with a more unequal income distribution.

Greater state income tax progressivity because of the deduction, however, comes at the expense of reduced federal income tax progressivity. Most public-finance analysts would argue that tax progressivity is better achieved at the federal level because higher-income taxpayers can avoid progressive state and local taxes either by shifting income or physically moving to a

lower-tax state.[10] Because of the mix of income sources and differential federal taxes on different types of income, however, higher state income taxes may lead to more revenues because of the taxation of capital as ordinary income at the state level and allow the amount of redistribution to vary across states if individuals have different preferences for redistribution.

A Subsidy to High-Income Taxpayers

As noted, the deduction is foremost a transfer to higher-income taxpayers because those taxpayers are more likely to itemize their deductions, claim higher deduction amounts, and reduce their federal taxes by a greater percentage for each dollar of deduction claimed. Although state and local governments can claim some portion of the subsidy by raising their own taxes on taxpayers who benefit from the deduction, there is no guarantee that they will fully capture all the benefits. Administering a federal subsidy in this way can cause considerable leakage in the benefits going to the states. Further, because of federal limits imposed on deductible expenses, some taxpayers are likely to lose the SALT deduction (most often because they are subject to the AMT, which does not allow for the deduction of state and local taxes).

An Inefficient Federal Fiscal Policy

The deduction has several undesirable federal fiscal policy features. It is an open-ended subsidy available to all taxpayers who qualify and claim the deduction. Unlike some spending programs, its cost is not subject to annual appropriations by Congress and it is not directly recognized in the federal budget. Moreover, there is no federal oversight of the way state and local governments use the subsidy from the deduction.

In contrast to tax subsidies, federal grants to state and local governments receive significant federal control and oversight, although that oversight differs according to the type of grant (Congressional Budget Office 2013). Most grants are administered as categorical grants. Categorical grants have a narrow scope and often have rules about who qualifies for particular programs. Other grants are administered as block grants, which are more flexible and give states and localities wide discretion in how they spend federal funds but still with certain restrictions. For example, the federal government provides funding for Temporary Assistance for Needy Families (TANF) through a block grant. Although states may use those funds in any way that reasonably meets the program's goals, states must meet specific requirements regarding work participation by recipients and the length of time recipients can stay on the program. States also must contribute their own funding to meet the maintenance-of-effort requirement. The most flexible form of federal funding is through general revenue sharing, which allows the states to use funding for almost any purpose, but the last general revenue sharing program ended in 1986.

Federal grants are also classified by their categorization in the federal budget as either discretionary or mandatory programs. A key distinction is that federal spending on discretionary programs is subject to annual appropriations while spending on mandatory programs is not.

Although funding for mandatory grants is typically open ended, some mandatory programs have limits on the amount that can be spent each year. For example, both TANF and the Children's Health Insurance Program have limits on the amount of federal funds that can be spent each year. Most outlays for federal grants are through mandatory programs, and most of that is for health programs. Outlays for mandatory grants were $442.9 billion in 2014 (80 percent of all outlays for federal grants), of which $301.5 billion was for Medicaid.

EVIDENCE CONCERNING THE EFFECTS OF THE DEDUCTION

An important consideration is how much the SALT deduction actually affects state and local tax policy. Several empirical studies have found a measurable effect of the SALT deduction on the mix of state and local taxes, but only a few of them also have found an effect of the deduction on either total state and local revenues or expenditures. For the most part, these studies all consider the effect of the "tax price" of raising state and local revenues. The tax price of state and local taxes is one for most taxpayers in the state or locality, but the tax price for deductible state and local taxes is one minus their federal tax rate for taxpayers who itemize their federal deductions. For example, if state income taxes increase by $100, the net cost to a taxpayer in the 35 percent federal income tax bracket who itemizes his or her tax deductions will be $65: [$65 = $100 *(1 - .35)]. The marginal tax price of deductible taxes across the entire state or locality will therefore depend on the proportion of taxpayers who itemize federal deductions and their federal marginal tax rates.

Feldstein and Metcalf (1987) found that among a cross-section of states, a higher tax price lowered the use of state income taxes but had an indeterminate effect on the share of government revenues from nondeductible taxes and fees or on total own-source revenues. Metcalf (1993) used state data for the years 1980 to 1988, which allowed him to control for state-specific effects. He found that although the income tax share of total state own-source revenue was sensitive to the tax price, the sales tax share was not. Holtz-Eakin and Rosen (1988) found a similar effect on the share of revenues from income taxes in their study of 172 municipalities over a three-year period, but they also found that a higher tax price had a negative effect on local spending. In a separate study, Holtz-Eakin and Rosen (1990) found that a lower tax price increased local property tax rates. In more recent research, Metcalf (2011) found that a higher tax price had a negative effect on deductible taxes as a percent of personal income and on own-source state revenues but no statistically significant effect on nondeductible taxes.

The Tax Reform Act of 1986 (TRA86) provided a natural experiment on the effect of the deduction by eliminating the deduction only for general sales taxes. With the elimination of the federal tax deduction for sales taxes, states would be expected to reduce their use of sales taxes and either increase their use of other deductible taxes or possibly decrease total spending.

TRA86, however, also lowered federal marginal income tax rates, which raised the state tax price of individual income taxes and property taxes. Inman (1989), Courant and Gramlich (1990), and Metcalf (1993) all found that states did not reduce their reliance on general sales taxes after TRA86. They speculated that because state sales tax rates were not easily adjusted, it might take some time for state to adjust the mix of taxes. A later study by Izraeli and Kellman (2003) found that after several years there was some movement away from sale taxes, suggesting at least a partial adjustment to the loss of deductibility.

The Omnibus Budget Reconciliation Act of 1993 (OBRA93) provided a second opportunity to analyze the state response to changes in the deduction. OBRA93 temporarily reinstated the deduction for general sales taxes but only as an alternative to deducting income taxes. Taxpayers could choose to deduct either income taxes or sales taxes but not both. Heim and Abbas (2015) found an increase in sales tax revenue per capita following OBRA93 and a decrease in individual and corporate income taxes per capita but no statistically significant effect on the portion of state tax revenue from sales taxes. They also found no statistically significant effect on total tax revenues per capita or the composition of local tax revenues.

WHO CLAIMS THE DEDUCTION?

A major criticism of the SALT deduction is that the tax savings are distributed unevenly. The deduction benefits states with higher taxes in general, states in which deductible taxes are a major revenue source, and states with higher-income taxpayers who are more likely to claim the deduction. Individual taxpayers with higher incomes benefit more from the deduction than middle- and lower-income taxpayers because they pay higher state and local taxes, are more likely to itemize their federal income tax deductions, and realize larger tax savings from each dollar deducted.

DISTRIBUTION BY STATE

State or local governments that finance spending heavily through taxes that are deductible under the federal individual income tax receive a larger subsidy through the SALT deduction than do subnational governments that depend more on other sources of revenue. In addition, state or local governments whose taxpayers are more likely to itemize deductions also receive greater benefits, all else being equal.

Taxes are a significant source of revenue for most state and local governments, on average accounting for 54 percent of general revenue in 2013. Charges and miscellaneous fees were the next most significant revenue source (24 percent of general revenue) and intergovernmental transfers accounted for the remainder. [11] Those proportions varied widely across the states, however. For example, the tax share of general revenue was over 60 percent in Connecticut, Illinois, New Jersey, New York, and North Dakota and less than 45 percent in Alabama, Alaska, Louisiana, Mississippi, New Mexico, South Carolina, and Wyoming.

A relatively large tax share of general revenue does not directly translate into a disproportionate share of benefits from the SALT deduction, because not all the taxes imposed in a particular state may qualify as deductible taxes under federal tax rules. Under current rules, individual taxpayers may deduct state and local taxes on real estate, personal property, and either state income tax or general sales tax. Businesses may deduct state and local property and income taxes as business expenses.

Forty-one states and DC levy broad-based individual income taxes. New Hampshire and Tennessee levy a limited income tax only on dividends and interest. All but five states collect general sales tax revenue, and Alaska is the only state without an income tax or a general sales tax, albeit local governments are allowed to levy general sales taxes. All states levy selective taxes on items such as gasoline and tobacco, but those taxes are not deductible. Although state

governments tend to raise most of their tax revenues from income and sales taxes, local governments depend primarily on property taxes. Forty-one percent of local government general revenue came from taxes in 2013, with property taxes accounting for nearly three-quarters of that amount.

Using the sum of property tax (real estate tax and personal property tax), corporate income tax, and the greater of individual income tax or general sales tax as a rough measure of potentially deductible taxes, the potentially deductible portion of state and local taxes was about 32 percent of general revenues overall in 2013.The portion ranged from just under 15 percent in Alaska to over 45 percent in Connecticut and New Jersey.

The amount of potentially deductible taxes that are ultimately deducted on individual tax returns depends on the number of taxpayers who itemize their deduction and the amount of the deduction they claim. Higher-income taxpayers tend to have both higher state and local taxes and more other deductible expenses (such as mortgage interest) and therefore are more likely to itemize. Thus states and localities with relatively more high-income taxpayers will see a larger share of their taxpayers claiming the deduction.

About 30 percent of US income tax filers claimed the SALT deduction in 2013 (table 1). The percentage of federal tax filers claiming the deduction in each state varied from 45 percent in Maryland to 17 percent in South Dakota and West Virginia. In general, a higher percentage of taxpayers in states in the Northeast and the West claimed the deduction than did taxpayers in states in other regions. The average deduction claimed was also higher in those regions than in other parts of the country.

All else equal, states with larger populations will claim more of the SALT deduction, but some states account for a disproportionate share of taxpayers claiming the deduction and the amount of deductions claimed relative to their share of total federal taxpayers and federal taxes paid. For example, California and New York together accounted for 21 percent of all returns claiming the deduction, slightly higher than their combined percentage of total federal tax returns filed (18 percent). Residents of the two states accounted for 32 percent of the total SALT deduction claimed but 23 percent of total federal income taxes.

The composition of the SALT deduction varies across the states. The option to claim a deduction for general sales taxes in lieu of income taxes helps residents in states such Texas, Florida, Nevada, and Washington, which do not have an income tax. Although only 7 percent of all US taxpayers claim a federal deduction for state and local sales tax, about 26 percent of taxpayers in Washington, 20 percent in Nevada, and 18 percent in Texas and Florida claim a sales tax deduction. Washington, Texas, and Florida together account for about 56 percent of the total sales tax deduction claimed.

TABLE 1

State and Local Tax Deduction

by state, 2013

	All Tax Units			Tax Units Claiming the Deduction			Amount of Deduction Claimed				
	Number (thousands)	Percent of all tax units in the US	Percent of total federal income taxes	Number (thousands)	Percent of tax units in the US claiming the deduction	Percent of all tax units in the state	Total (millions of dollars)	Percent of total deduction claimed in the US	Percent of total adjusted gross income in the state	Average per tax unit (dollars)	Average per claimant (dollars)
California	17,172	11.7	13.8	5,882	13.3	34.3	96,580	19.0	8.2	5,624	16,420
New York	9,443	6.4	9.1	3,265	7.4	34.6	66,894	13.2	9.6	7,084	20,489
New Jersey	4,327	3.0	4.2	1,791	4.1	41.4	29,886	5.9	8.9	6,907	16,682
Illinois	6,101	4.2	4.6	2,016	4.6	33.0	25,395	5.0	6.4	4,163	12,595
Texas	11,889	8.1	8.7	2,681	6.1	22.5	19,447	3.8	2.6	1,636	7,254
Pennsylvania	6,154	4.2	3.9	1,804	4.1	29.3	18,822	3.7	5.1	3,059	10,431
Massachusetts	3,301	2.3	3.4	1,234	2.8	37.4	17,605	3.5	6.7	5,333	14,262
Maryland	2,942	2.0	2.2	1,330	3.0	45.2	16,151	3.2	7.9	5,490	12,143
Ohio	5,537	3.8	2.9	1,528	3.5	27.6	15,509	3.1	5.2	2,801	10,147
Virginia	3,835	2.6	2.9	1,449	3.3	37.8	15,177	3.0	5.7	3,958	10,472
All other states	75,148	51.8	44.5	21,163	48.0	29.1	185,188	36.7	4.9	2,464	8,751
U.S. total	146,543	100.0	100.0	44,217	100.0	30.2	507,722	100.0	5.6	3,465	11,483

Source: Urban-Brookings Tax Policy Center based on data from the Internal Revenue Service.

SOI Tax Stats - Historic Table 2

DISTRIBUTION BY INCOME GROUPS

High-income households are more likely than low- or moderate-income households to benefit from the SALT deduction. The amount of state and local taxes paid, the probability that taxpayers itemize their deductions, and the reduction in federal income taxes for each dollar of state and local taxes deducted all increase with income.

Although about 30 percent of all tax filers claimed the SALT deduction in 2013, the percentage claiming the deduction varied widely among income groups. About 11 percent of tax filers with income under $50,000 claimed a deduction compared with about 82 percent of tax filers with income over $100,000 (table 2). The latter group, which made up 12 percent of tax filers, accounted for 73 percent of total state and local tax deductions claimed, with an average of about $20,400 in deductible taxes for each return on which the deduction was claimed. That average, however, ranged from nearly $11,000 for those claiming a deduction and income between $100,000 and $200,000 to $57,000 for those with income between $500,000 and $1 million to $288,000 for those with income over $1 million.

Individuals who claim the SALT deduction decrease their federal tax liability by the amount of their deductible state and local taxes multiplied by their marginal tax rate under the federal individual income tax. For example, each additional $100 of state income tax for taxpayers in the 35 percent federal tax bracket would increase their net combined federal and state tax by only $65 if they claimed the SALT deduction on their federal return. Because both the likelihood of itemizing and the marginal tax rate increase with income, a large share of the benefits from the deduction is concentrated among higher-income taxpayers. As noted, however, even those who claim the SALT deduction may benefit little or not at all from it if they pay the AMT.

TABLE 2

State and Local Tax Deduction

by adjusted gross income, 2013

Adjusted Gross Income (thousands of 2013 dollars)	All Tax Units			Tax Units Claiming the Deduction			Amount of Deduction Claimed				
	Number (thousands)	Percent of all tax units in the US	Percent of total federal income taxes	Number (thousands)	Percent of tax units in the US claiming the deduction	Percent of all tax units in the income group	Total (millions of dollars)	Percent of total deduction claimed in the US	Percent of total adjusted gross income in the income group	Average per tax unit (dollars)	Average per claimant (dollars)
Less than 20	48,876	33.2	0.5	2,344	5.3	4.8	8,125	1.6	2.9	166	3,466
20–50	44,688	30.3	5.7	8,222	18.7	18.4	31,887	6.3	2.2	714	3,878
50–75	19,229	13.0	7.7	7,972	18.1	41.5	43,622	8.6	3.7	2,269	5,472
75–100	12,574	8.5	8.3	7,328	16.7	58.3	53,057	10.5	4.9	4,220	7,241
100–200	16,425	11.1	22.6	12,922	29.4	78.7	142,502	28.2	6.4	8,676	11,028
200–500	4,488	3.0	20.3	4,205	9.6	93.7	97,598	19.3	7.6	21,746	23,213
500–1,000	724	0.5	10.2	668	1.5	92.2	38,086	7.5	7.8	52,586	57,035
More than 1,000	346	0.2	24.8	317	0.7	91.6	91,314	18.0	8.4	264,003	288,351
All	147,351	100.0	100.0	43,977	100.0	29.8	506,191	100.0	5.6	3,435	11,510

Source: Urban-Brookings Tax Policy Center based on data from the Internal Revenue Service.

SOI Tax Stats - Individual Statistical Tables by Size of Adjusted Gross Income

OPTIONS FOR MODIFYING THE SALT DEDUCTION

There have been many proposals to eliminate or modify the SALT deduction. The Reagan administration proposed eliminating the SALT deduction in 1984. That proposal was scaled back to eliminating only the deduction for sales tax in the TRA86. Although subsequent legislation has permanently reinstated the sales deduction, giving taxpayers the option of deducting either income or sales tax but not both, almost all recent tax reform proposals have included provisions that would limit or eliminate the SALT deduction or at least the non–property tax portion of the deduction. Those proposals often reflected bipartisan support. The 2005 President's Advisory Panel on Federal Tax Reform, chaired by former Senators Connie Mack and John Breaux; the 2010 National Commission on Fiscal Responsibility and Reform, chaired by former White House chief of staff Erskine Bowles and former Senator Alan Simpson; the 2012 Debt Reduction Task Force of the Bipartisan Policy Center, chaired by former Office of Management and Budget and Congressional Budget Office director Alice Rivlin and former Senator Pete Domenici; and the 2014 comprehensive tax reform plan released by former Ways and Means Committee chairman Dave Camp (the "Tax Reform Act of 2014") all proposed eliminating the SALT deduction (Debt Reduction Task Force 2010; National Commission on Fiscal Responsibility and Reform 2010; President's Advisory Panel on Federal Tax Reform 2005; US House Committee on Ways and Means 2014).

DESCRIPTION

We consider four options for changing the SALT deduction:

- eliminating the deduction
- capping the deduction at $6,000
- replacing the deduction with a 15 percent tax credit
- replacing the deduction with a 15 percent tax credit with a $1,000 floor

Eliminating the deduction would remove a significant federal subsidy for subnational governments which, if not offset by other federal aid, could lead to changes in the amount of services those governments provide and the methods by which those governments raise revenues. Eliminating the deduction would raise significant federal revenues, however, that could be used to increase federal grants and other support for states and localities. Eliminating the deduction would simplify tax returns for many people as more taxpayers would take the standard deduction rather than itemize their deductions, and far fewer would need to calculate and pay the AMT.

Eliminating the deduction would increase marginal tax rates for some taxpayers by pushing them into higher federal tax brackets. Higher marginal rates would be an incentive to work or save less because the after-tax returns from those activities would fall. Eliminating the deduction would also increase average tax rates (taxes as a percentage of income), which would have the opposite incentives on work and savings if taxpayers desire to maintain the same income after-tax.

Capping the deduction would have effects similar to but more modest than complete elimination. It would continue to provide federal subsidies for state and local governments but would limit the incentive for subnational governments to levy deductible taxes in excess of the cap.

The effects of limiting the deduction would depend on the type of cap imposed. A cap equal to a percentage of AGI would continue to subsidize states with higher-income taxpayers and higher costs of providing services. A cap of $6,000 would eliminate much of the variation in the average deduction claimed across states (to the detriment of higher-tax states) and across taxpayers. Lawmakers could choose to index the cap for inflation or maintain the same fixed dollar. If unindexed, the cap would effectively approach complete elimination of the deduction over time.

Replacing the deduction with a 15 percent tax credit would maintain a federal subsidy for state and local government spending and an incentive for them to raise revenues through deductible taxes. The size of that incentive would change, however, because taxpayers with marginal tax rates in excess of 15 percent would receive a smaller subsidy for each dollar deducted. Because the credit would be available to all taxpayers, many taxpayers currently claiming the standard deduction would receive a tax cut. Restricting the credit to eligible state and local taxes in excess of $1,000 would limit the benefits from the credit and the number of taxpayers receiving the benefit.

REVENUE EFFECTS

Eliminating the deduction would increase federal revenue by an estimated $1.26 trillion over the 10-year period from 2016 through 2025 (table 4). Limiting the deduction to $6,000 would increase revenue by an estimated $870 billion over that same period. Replacing the deduction with a 15 percent credit would increase revenue by considerably less because many taxpayers' taxes would be reduced. Replacing the deduction with a credit equal to 15 percent of all eligible state and local taxes would increase federal revenue by $96 billion over 10 years. Limiting the credit to eligible state and local taxes in excess of $1,000 would increase federal revenue by $235 billion over the same period, but would be more regressive than a credit with no floor.

The revenue estimates assume that, with the changes to the SALT deduction, taxpayers will choose either to continue to itemize their deductions or to claim the standard deduction depending upon which choice minimizes their federal income tax. As a result, many taxpayers likely will switch from itemizing deductions to claiming the standard deduction. The estimates also assume that taxpayers will change the amount they earn or save if their marginal federal income tax rate changes, although the effects of those changes on these particular revenue estimates are quite small.

TABLE 3

Effects on Federal Revenues from Options for Changing the SALT Deduction
in billions of dollars, by fiscal year

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2016–20	2021–25	2016–25
Eliminate the deduction	69.8	99.7	108.3	116.5	125.0	132.3	139.5	147.5	155.8	163.1	519.3	738.3	1257.5
Cap the deduction at $6,000	45.8	65.8	71.9	78.2	85.1	91.1	97.2	104.2	111.5	117.7	346.8	521.8	868.6
Replace the deduction with a 15 percent credit													
No floor	0.9	3.4	6.0	8.1	10.0	11.3	12.3	13.5	14.6	15.3	28.4	67.1	95.5
$1,000 floor	10.7	16.7	19.5	21.9	24.1	25.7	27.0	28.5	30.0	31.0	92.9	142.3	235.1

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0515-1)

Notes: SALT = state and local tax. Revenue estimates include the effects of microdynamic responses. Estimates assume a fiscal split of 75-25 (fiscal year revenue is estimated to be 25 percent of revenue from the previous calendar year and 75 percent of revenue from the current calendar year). Baseline is current law. Effective 01/01/2016.

The estimates do not incorporate any changes to state and local tax policies. As noted, states and localities may choose to change the mix of revenue sources or reduce total revenues in light of an increase in the tax price of state and local taxes. This could include shifting from personal income taxes to taxes on businesses. Because state and local taxes paid by businesses would still be deductible at the federal level under these options, this would lower business taxable income and thus federal revenues, offsetting some of the revenue increase from the change to the SALT deduction.

EFFECTS BY STATE AND ACROSS INCOME LEVELS

The effects of eliminating or modifying the SALT deduction would vary across states and household income groups. Tax increases from eliminating or limiting the deduction would be concentrated among high-income, high-tax states and among taxpayers with incomes over $100,000. Fewer taxpayers would itemize deductions and fewer would pay the AMT. Replacing the deduction with a tax credit would create both winners and losers. More of the winners would be concentrated in lower-income states with deductible taxes and among taxpayers with incomes of at least $50,000 but less than $100,000.

Eliminating the Deduction

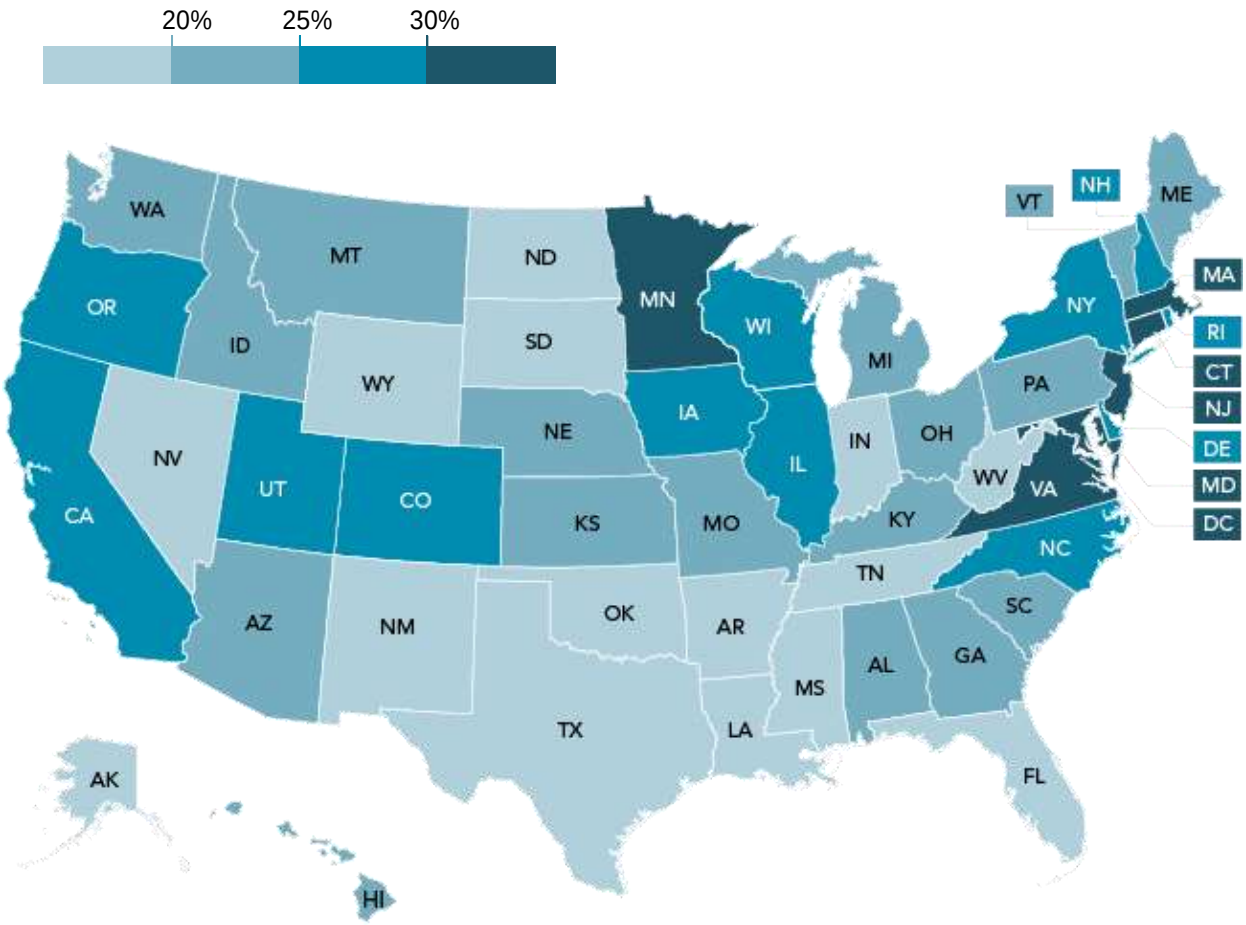
Eliminating the SALT deduction would increase federal taxes for about 24 percent of all tax units. The percentage of tax units with a tax increase would range from 13 percent in South Dakota to

39 percent in Maryland (figure 1). The average increase in taxes for those units with a tax increase would be about $2,350 overall but again would vary a great deal across the states, ranging from under $1,000 for affected taxpayers in Alaska, Tennessee, and Wyoming to over $4,000 for affected taxpayers in Connecticut and New York (figure 2).[12]

Taxpayers in California and New York, both populous states with relatively high taxes and many high-income taxpayers, would pay 31 percent of the total tax increase from eliminating the deduction. Sixty-three percent of the tax increase would be concentrated in the 10 states with the highest shares of the increase.

FIGURE 1

Percentage of Tax Units with Increase from SALT Repeal



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0515-1).

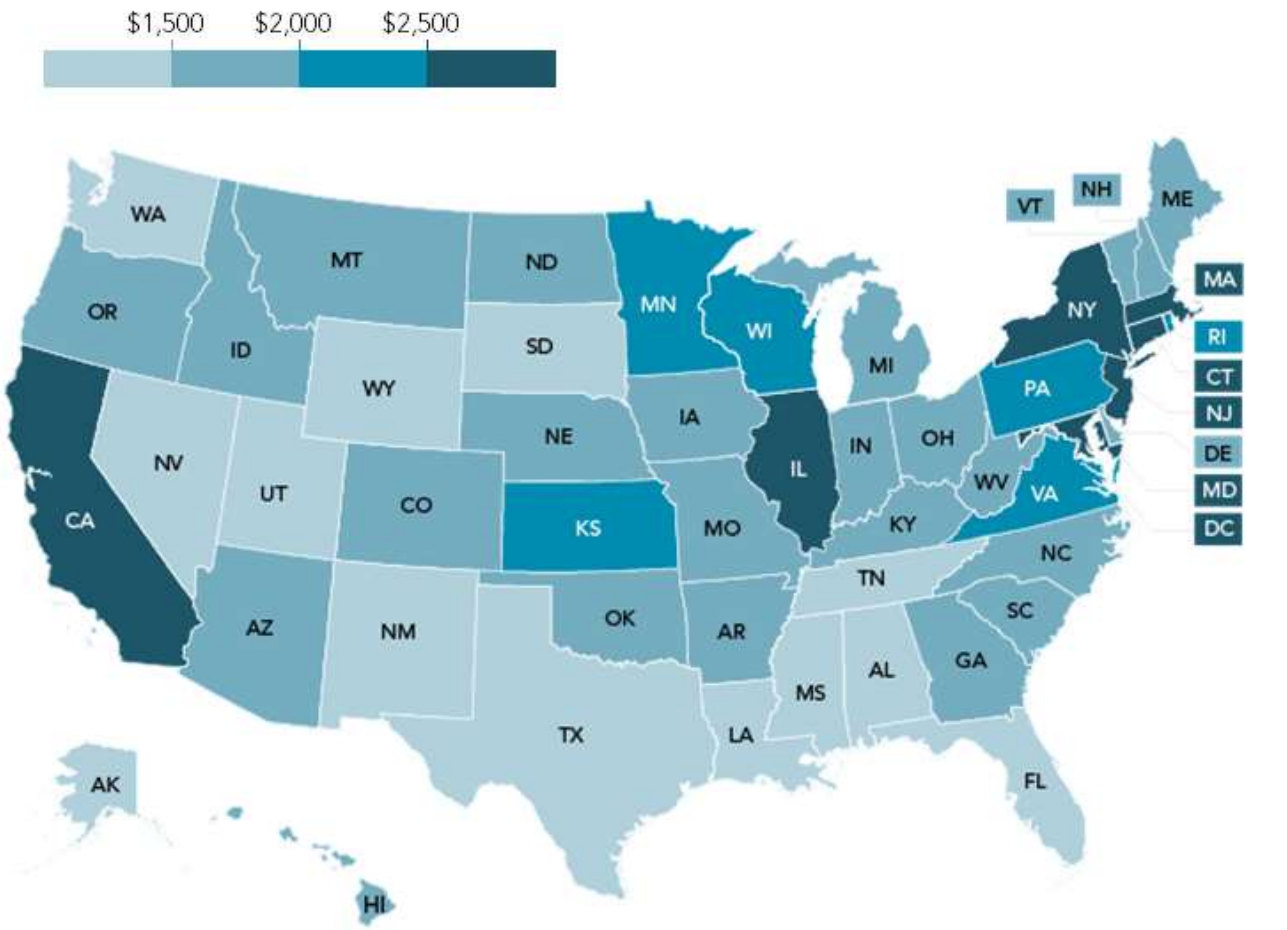
The percentage of tax units with a tax increase and the size of the increase would vary significantly by income. Among those with incomes over $100,000 (approximately 23 percent of all units), eliminating the deduction would increase taxes for two-thirds of tax units (table 4). The option would increase taxes by significantly different amounts, ranging from about $1,500 for

taxpayers with incomes between $100,000 and $200,000 to over $46,000 for taxpayers with income above $1 million.

The tax increase would lead to an average 2.0 percent reduction in average income measured after individual income taxes (after-tax income) for taxpayers in the highest-income groups; the average reduction in after-tax income would be about 1.0 percent for taxpayers with income between $100,000 and $500,000. Taxpayers with incomes over $100,000 would pay about 90 percent of the tax increase, with taxpayers with incomes above $500,000 accounting for 40 percent of the additional taxes. Eliminating the deduction would cut the number of AMT taxpayers by about two-thirds.

FIGURE 2

Average Tax Increase from Repealing SALT



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0515-1).

Note: Average increase only among tax units with tax increase from repeal of the state and local tax deduction.

Limiting the Amount of the Deduction

The distribution of tax increases across states and income groups would look noticeably different with a $6,000 cap compared with elimination of the deduction. Overall 13 percent of taxpayers would see a tax increase, and the percentage of taxpayers with tax increases would exceed 20 percent in only four states (Connecticut, Maryland, Massachusetts, and New Jersey); the increase would be 5 percent or less in eight states.

The tax increase from a $6,000 cap would be more concentrated in fewer states than would the increase from complete elimination of the deduction. Taxpayers in California and New York will pay 36 percent of the increase in taxes while taxpayers in the 10 states with the highest share of the tax increase (including California and New York) would pay nearly 70 percent of the increase.

Grouping taxpayers by income shows the extent of this concentration. Taxpayers with incomes over $100,000 would pay 97 percent of the tax increase from limiting deductible taxes to $6,000 (table 5). Taxpayers with incomes over $1 million would pay 45 percent of the increase.

Replacing the Deduction with a Credit

Replacing the deduction with a refundable tax credit equal to 15 percent of the amount of qualified state and local taxes would increase taxes for some taxpayers but lower them for others. If the credit were limited to deductions in excess of $1,000, taxes would increase for an estimated 13 percent of taxpayers; taxes would fall for an estimated 32 percent, though the average tax increase would be nearly 5 times as large as the average tax reduction.

About four times as many taxpayers with incomes between $50,000 and $100,000 would receive a tax cut as the number in that income range who would receive a tax increase (table 6). In contrast, 61 percent of taxpayers with incomes over $200,000 would have a tax increase compared with about 22 percent who would see a decrease.

The gains for taxpayers with tax cuts would outweigh the losses for taxpayers with tax increases in 9 states and would be nearly equal in 10 other states. Unsurprisingly given the cross-state distribution of income and tax rates, almost half of the net increase in tax revenues will come from residents in California and New York.

TABLE 4

Effect of Repealing the SALT Deduction

Tax change by expanded cash income level, 2016

Expanded Cash Income Level (thousands of 2016 dollars)[a]	Tax Units With Tax Increase[b]		Percent Change in After-Tax Income[c]	Share of Total Federal Tax Change	Average Federal Tax Change	
	Percent of Tax Units	Average Tax Increase			Dollars	Percent
Less than 10	0.0	0	0.0	0.0	0	0.0
10–20	0.5	148	0.0	0.0	1	0.1
20–30	2.0	197	0.0	0.1	4	0.3
30–40	6.5	263	-0.1	0.3	17	0.6
40–50	12.1	315	-0.1	0.5	38	0.7
50–75	22.2	562	-0.2	3.1	124	1.4
75–100	36.5	873	-0.4	5.3	319	2.2
100–200	59.2	1,500	-0.8	25.3	887	3.3
200–500	82.9	2,796	-1.1	25.1	2,317	3.4
500–1,000	87.7	8,555	-1.5	10.3	7,507	3.8
More than 1,000	87.6	46,550	-2.0	30.0	40,774	3.8
All	23.6	2,348	-0.8	100.0	555	3.1

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0515-1).

Number of AMT Taxpayers (millions). Baseline: 4.5 Proposal: 1.6

Notes: SALT = state and local tax. Proposal repeals the SALT deduction. For a description of TPC's current law baseline, see http://www.taxpolicycenter.org/taxtopics/Baseline-Definitions.cfm.

[a] Includes both filing and non-filing units but excludes those that are dependents of other tax units. Tax units with negative adjusted gross income are excluded from their respective income class but are included in the totals.

[b] Includes tax units with a change in federal tax burden of $10 or more in absolute value.

[c] After-tax income is expanded cash income less: individual income tax net of refundable credits; corporate income tax; payroll taxes (Social Security and Medicare); estate taxes; and excise taxes.

TABLE 5

Effect of Capping the SALT Deduction at $6,000

Tax change by expanded cash income level, 2016

Expanded Cash Income Level (thousands of 2016 dollars)[a]	Tax Units With Tax Increase[b]		Percent Change in After-Tax Income[c]	Share of Total Federal Tax Change	Average Federal Tax Change	
	Percent of Tax Units	Average Tax Increase			Dollars	Percent
Less than 10	0.0	0	0.0	0.0	0	0.0
10–20	*	**	0.0	0.0	0	0.0
20–30	0.1	184	0.0	0.0	0	0.0
30–40	0.5	219	0.0	0.0	1	0.0
40–50	1.0	351	0.0	0.1	3	0.1
50–75	3.8	540	0.0	0.8	20	0.2
75–100	12.0	624	-0.1	1.9	75	0.5
100–200	38.3	1,014	-0.3	16.9	388	1.4
200–500	69.2	1,934	-0.6	22.2	1,338	2.0
500–1,000	82.4	7,557	-1.3	13.1	6,227	3.2
More than 1,000	86.0	46,315	-2.0	45.0	39,828	3.8
All	13.0	2,797	-0.5	100.0	362	2.1

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0515-1).

Number of AMT Taxpayers (millions). Baseline: 4.5 Proposal: 1.7

* Less than 0.05

** Insufficient data

Notes: SALT = state and local tax. Proposal caps the SALT deduction at $6,000. For a description of TPC's current law baseline, see http://www.taxpolicycenter.org/taxtopics/Baseline-Definitions.cfm.

[a] Includes both filing and non-filing units but excludes those that are dependents of other tax units. Tax units with negative adjusted gross income are excluded from their respective income class but are included in the totals.

[b] Includes tax units with a change in federal tax burden of $10 or more in absolute value.

[c] After-tax income is expanded cash income less: individual income tax net of refundable credits; corporate income tax; payroll taxes (Social Security and Medicare); estate taxes; and excise taxes.

TABLE 6

Effect of Replacing the SALT Deduction with a 15 Percent Nonrefundable Tax Credit for Taxes in Excess of $1,000

Tax change by expanded cash income level, 2016

Expanded Cash Income Level (thousands of 2016 dollars)[a]	Tax Units With Tax Increase or Cut[b]				Percent Change in After-Tax Income[c]	Share of Total Federal Tax Change	Average Federal Tax Change	
	With Tax Cut		With Tax Increase					
	Percent of Tax Units	Average Tax Cut	Percent of Tax Units	Average Tax Increase			Dollars	Percent
Less than 10	*	**	0.0	0	0.0	0.0	0	0.0
10–20	2.5	-136	0.1	46	0.0	-0.5	-3	-0.6
20–30	20.1	-110	0.8	79	0.1	-2.9	-21	-1.6
30–40	24.3	-144	3.4	88	0.1	-3.1	-32	-1.0
40–50	33.0	-164	4.8	100	0.1	-4.0	-49	-0.9
50–75	51.8	-203	11.0	203	0.2	-12.0	-83	-1.0
75–100	64.1	-274	17.9	395	0.1	-10.1	-105	-0.7
100–200	61.1	-384	31.9	638	0.0	-5.2	-31	-0.1
200–500	23.9	-536	58.5	1,075	-0.2	31.5	501	0.7
500–1,000	9.5	-850	72.7	4,499	-0.7	25.5	3,191	1.6
More than 1,000	16.9	-7,167	76.1	26,382	-0.9	80.8	18,858	1.8
All	32.0	-287	13.4	1,399	-0.1	100.0	95	0.5

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0515-1).

Number of AMT Taxpayers (millions). Baseline: 4.5 Proposal: 4.6

* Less than 0.05

** Insufficient data

Notes: SALT = state and local tax. Proposal replaces the SALT deduction with a 15 percent nonrefundable tax credit. For a description of TPC's current law baseline, see http://www.taxpolicycenter.org/taxtopics/Baseline-Definitions.cfm.

[a] Includes both filing and non-filing units but excludes those that are dependents of other tax units. Tax units with negative adjusted gross income are excluded from their respective income class but are included in the totals.

[b] Includes tax units with a change in federal tax burden of $10 or more in absolute value.

CONCLUSION

Eliminating the SALT deduction would simplify federal tax filing, make federal income taxes more progressive, and raise a significant amount of revenue. Limiting the deduction with either a dollar or percentage of AGI cap would reduce the potential gains in simplicity, tax progressivity, and revenues. Replacing the deduction with a credit would increase complexity because the number of taxpayers claiming the credit would be much greater than the number claiming the deduction, but this option would increase the progressivity of federal income taxes much more than the other options. Replacing the deduction with a credit would raise far less federal revenues than eliminating the deduction and could decrease revenues, depending upon the size of the credit and whether or not there was a floor on the amount of state and local taxes paid to qualify for the credit.

Eliminating or limiting the SALT deduction would raise the tax price of state and local taxes. State and local governments could respond by shifting their mix of revenues toward fees and other charges and to deductible business taxes or by reducing formerly deductible taxes (and thus total revenues). They might also offset the effect of the loss of deductibility on higher-income taxpayers by reducing the progressivity of state income taxes or by compensating those taxpayers in some other way.

Part of the variation in state tax policy, especially divergence in state income tax policy, is largely driven by political beliefs, but it may also be influenced by the SALT deduction. Thus the presence of the SALT deduction, and most notably the role of allowing deductions of income or sales taxes, may exacerbate trends across states, with some states that value progressivity relying more on a progressive income tax while encouraging other states to possibly cut their income taxes and move solely to using sales taxes.

APPENDIX TABLES

TABLE A1

Effect of Repealing the SALT Deduction

Distribution of federal tax change by state, 2016

	Tax Units with Tax Increase[a]		Percent change in after-tax income[b]	Share of total federal tax change	Average Federal Tax Change	
	% of tax units	Average tax increase			Dollars	Percent
Alabama	20.6	1,211	-0.4	0.6	250	1.9
Alaska	18.4	992	-0.3	0.1	182	1.0
Arizona	22.9	1,518	-0.6	1.2	348	2.4
Arkansas	18.1	1,605	-0.5	0.4	291	2.3
California	26.2	3,218	-1.1	17.9	842	4.3
Colorado	29.0	1,834	-0.7	1.6	532	2.7
Connecticut	34.9	4,286	-1.5	3.1	1,495	4.7
Delaware	28.0	1,848	-0.7	0.3	517	3.0
District of Columbia	31.6	3,556	-1.3	0.4	1,122	4.1
Florida	14.9	1,453	-0.4	2.7	216	1.4
Georgia	24.2	1,805	-0.7	2.6	436	3.2
Hawaii	23.0	1,692	-0.6	0.3	389	2.7
Idaho	23.4	1,526	-0.6	0.3	358	2.8
Illinois	26.6	2,548	-0.9	5.1	678	3.6
Indiana	19.0	1,579	-0.5	1.2	301	2.3
Iowa	25.4	1,686	-0.6	0.7	429	2.7
Kansas	22.5	2,040	-0.7	0.8	459	2.9
Kentucky	21.4	1,672	-0.6	0.8	357	2.8
Louisiana	17.2	1,388	-0.4	0.6	238	1.7
Maine	24.9	1,839	-0.7	0.3	457	3.2
Maryland	39.0	2,564	-1.2	3.4	1,001	4.6
Massachusetts	32.1	3,174	-1.2	3.9	1,018	3.9
Michigan	21.7	1,814	-0.6	2.3	393	2.8
Minnesota	31.6	2,261	-0.9	2.2	714	3.7
Mississippi	17.1	1,223	-0.4	0.3	209	2.0
Missouri	22.4	1,844	-0.6	1.4	413	2.8
Montana	23.0	1,561	-0.6	0.2	359	2.6
Nebraska	24.4	1,901	-0.7	0.5	465	2.8
Nevada	17.1	1,084	-0.3	0.3	186	1.2
New Hampshire	28.0	1,734	-0.6	0.4	485	2.3
New Jersey	32.9	3,522	-1.4	6.0	1,157	4.7
New Mexico	17.8	1,408	-0.5	0.3	250	2.1
New York	26.9	4,250	-1.4	13.3	1,142	4.7
North Carolina	25.2	1,895	-0.8	2.5	478	3.4
North Dakota	16.5	1,629	-0.4	0.1	268	1.4
Ohio	24.0	1,950	-0.7	3.1	468	3.2
Oklahoma	19.3	1,682	-0.5	0.6	324	2.2
Oregon	29.0	1,975	-0.9	1.2	573	3.9
Pennsylvania	23.5	2,182	-0.8	3.9	512	3.1
Rhode Island	28.0	2,333	-1.0	0.4	654	3.9
South Carolina	22.2	1,619	-0.6	0.9	358	2.8
South Dakota	12.8	1,017	-0.2	0.1	130	0.8
Tennessee	14.8	938	-0.2	0.5	138	1.0
Texas	16.2	1,453	-0.3	3.3	235	1.3
Utah	29.6	1,485	-0.7	0.6	440	3.0
Vermont	23.6	1,983	-0.7	0.2	468	3.0
Virginia	32.5	2,333	-0.9	3.4	757	3.6
Washington	24.1	1,238	-0.4	1.2	299	1.5
West Virginia	13.6	1,694	-0.4	0.2	230	1.9
Wisconsin	27.8	2,105	-0.9	1.9	585	3.7
Wyoming	15.0	943	-0.2	0.1	141	0.8
United States	23.6	2,348	-0.8	100.0	555	3.1

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0515-1).

Note: Baseline uses current law. Number of AMT taxpayers is 4.5 million under baseline and 1.6 million under the proposal. Proposal eliminates the SALT deduction. For a description of TPC's current law baseline, see http://www.taxpolicycenter.org/taxtopics/Baseline-Definitions.cfm.

[a] Includes tax units with a change in federal tax burden of $10 or more in absolute value.

[b] After-tax income is expanded cash income less individual income tax net of refundable credits, corporate income tax, payroll taxes (Social Security and Medicare), estate taxes, and excise taxes.

TABLE A2

Effect of Capping the SALT Deduction at $6,000

Distribution of federal tax change by state, 2016

	Tax Units with Tax Increase[a]		Percent change in after-tax income[b]	Share of total federal tax change	Average Federal Tax Change	
	% of tax units	Average tax increase			Dollars	Percent
Alabama	6.0	1,763	-0.2	0.4	106	0.8
Alaska	4.8	900	-0.1	0.0	43	0.2
Arizona	7.9	2,151	-0.3	0.9	170	1.2
Arkansas	8.0	2,002	-0.3	0.4	160	1.3
California	16.8	3,543	-0.8	19.3	595	3.0
Colorado	12.7	2,250	-0.4	1.3	287	1.5
Connecticut	26.2	4,537	-1.2	3.8	1,187	3.7
Delaware	13.9	2,016	-0.4	0.2	280	1.7
District of Columbia	19.3	4,174	-0.9	0.5	806	3.0
Florida	3.9	2,838	-0.2	2.1	112	0.7
Georgia	11.6	2,096	-0.4	2.2	242	1.8
Hawaii	11.0	1,833	-0.3	0.3	202	1.4
Idaho	9.9	1,909	-0.3	0.2	188	1.5
Illinois	17.9	2,547	-0.6	5.3	455	2.4
Indiana	9.0	1,787	-0.3	0.9	160	1.2
Iowa	14.8	1,712	-0.4	0.6	252	1.6
Kansas	13.2	2,197	-0.4	0.7	289	1.8
Kentucky	10.8	1,902	-0.4	0.7	206	1.6
Louisiana	5.4	2,148	-0.2	0.4	117	0.8
Maine	15.7	1,791	-0.4	0.3	281	2.0
Maryland	25.6	2,476	-0.8	3.3	634	2.9
Massachusetts	22.9	3,181	-0.8	4.3	728	2.8
Michigan	12.1	1,844	-0.4	2.0	222	1.6
Minnesota	19.5	2,328	-0.6	2.1	453	2.3
Mississippi	5.3	1,771	-0.2	0.2	94	0.9
Missouri	11.3	2,137	-0.4	1.2	241	1.6
Montana	11.2	1,728	-0.3	0.2	193	1.4
Nebraska	14.7	1,971	-0.4	0.5	289	1.8
Nevada	2.7	2,989	-0.1	0.2	81	0.5
New Hampshire	15.4	1,758	-0.3	0.3	271	1.3
New Jersey	23.5	3,689	-1.0	6.9	867	3.5
New Mexico	7.0	1,641	-0.2	0.2	115	1.0
New York	18.4	4,996	-1.1	16.4	919	3.8
North Carolina	13.0	2,154	-0.4	2.3	279	2.0
North Dakota	6.1	2,498	-0.2	0.1	153	0.8
Ohio	14.2	2,063	-0.5	3.0	292	2.0
Oklahoma	8.0	2,277	-0.3	0.6	183	1.2
Oregon	17.6	1,940	-0.5	0.0	341	2.3
Pennsylvania	15.0	2,158	-0.5	3.8	324	1.9
Rhode Island	19.0	2,203	-0.6	0.4	418	2.5
South Carolina	9.8	1,932	-0.3	0.7	188	1.5
South Dakota	2.9	1,704	-0.1	0.0	49	0.3
Tennessee	2.4	1,980	-0.1	0.3	47	0.3
Texas	6.0	1,825	-0.2	2.3	109	0.6
Utah	12.8	1,685	-0.3	0.5	215	1.5
Vermont	15.1	1,967	-0.5	0.2	296	1.9
Virginia	19.6	2,285	-0.6	3.1	449	2.1
Washington	7.9	1,357	-0.1	0.6	108	0.6
West Virginia	6.5	2,023	-0.2	0.2	131	1.1
Wisconsin	18.9	2,045	-0.6	1.9	387	2.4
Wyoming	1.4	4,324	-0.1	0.0	62	0.3
United States	13.0	2,797	-0.5	100.0	362	2.1

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0515-1).

Note: Baseline uses current law. Number of AMT taxpayers is 4.5 million under baseline and 1.7 million under the proposal. Proposal caps the SALT deduction at $6,000. For a description of TPC's current law baseline, see http://www.taxpolicycenter.org/taxtopics/Baseline-Definitions.cfm.

[a] Includes tax units with a change in federal tax burden of $10 or more in absolute value.

[b] After-tax income is expanded cash income less individual income tax net of refundable credits, corporate income tax, payroll taxes (Social Security and Medicare), estate taxes, and excise taxes.

TABLE A3

Effect of Replacing the SALT Deduction with a 15 Percent Nonrefundable Tax Credit for Taxes in Excess of $1,000

Distribution of federal tax change by state, 2016

	Tax Units with Tax Increase or Cut[a]				Percent change in after-tax income[b]	Share of total federal tax change	Average Federal Tax Change	
	With Tax Cut		With Tax Increase					
	% of tax units	Average tax increase	% of tax units	Average tax increase			Dollars	Percent
Alabama	32.2	-252	11.1	693	0.0	-0.1	-4	0.0
Alaska	32.1	-234	13.1	555	0.0	0.0	-2	0.0
Arizona	32.0	-251	13.1	897	-0.1	0.8	37	0.3
Arkansas	33.3	-269	9.2	964	0.0	0.0	-1	0.0
California	28.1	-280	16.0	1,870	-0.3	27.3	220	1.1
Colorado	34.3	-264	17.1	1,064	-0.1	1.6	91	0.5
Connecticut	32.2	-355	20.4	2,773	-0.5	5.4	452	1.4
Delaware	34.8	-268	16.7	1,011	-0.1	0.2	76	0.5
District of Columbia	29.8	-229	21.8	1,997	-0.4	0.9	368	1.4
Florida	30.6	-233	9.0	899	0.0	0.7	9	0.1
Georgia	26.5	-266	13.7	1,032	-0.1	2.5	71	0.5
Hawaii	33.8	-254	13.4	897	-0.1	0.2	34	0.2
Idaho	33.3	-271	11.5	935	0.0	0.1	18	0.1
Illinois	31.8	-310	15.0	1,485	-0.2	5.5	124	0.7
Indiana	33.8	-287	9.5	963	0.0	-0.1	-6	0.0
Iowa	40.9	-311	11.9	1,031	0.0	0.0	-4	0.0
Kansas	34.9	-307	11.3	1,296	-0.1	0.4	39	0.2
Kentucky	33.7	-296	10.6	992	0.0	0.1	5	0.0
Louisiana	33.7	-250	9.9	786	0.0	-0.1	-7	-0.1
Maine	38.7	-312	11.9	1,072	0.0	0.0	6	0.0
Maryland	30.1	-295	24.6	1,318	-0.3	4.7	235	1.1
Massachusetts	34.0	-305	19.1	1,884	-0.3	5.7	256	1.0
Michigan	31.5	-291	11.6	1,060	-0.1	1.1	31	0.2
Minnesota	36.1	-308	17.0	1,350	-0.2	2.1	119	0.6
Mississippi	30.4	-243	9.1	700	0.0	-0.1	-10	-0.1
Missouri	34.1	-278	11.6	1,153	-0.1	0.8	39	0.3
Montana	34.9	-284	11.6	940	0.0	0.0	10	0.1
Nebraska	38.6	-305	12.0	1,173	0.0	0.1	23	0.1
Nevada	32.9	-228	9.9	659	0.0	-0.1	-10	-0.1
New Hampshire	37.1	-279	17.7	896	-0.1	0.2	54	0.3
New Jersey	29.5	-339	19.5	2,026	-0.3	9.0	295	1.2
New Mexico	30.4	-251	10.0	773	0.0	0.0	1	0.0
New York	29.1	-367	15.7	2,664	-0.4	21.2	311	1.3
North Carolina	31.1	-276	13.5	1,107	-0.1	2.0	64	0.5
North Dakota	44.8	-251	9.3	1,001	0.0	0.0	-19	-0.1
Ohio	35.9	-299	12.2	1,165	-0.1	1.4	35	0.2
Oklahoma	34.8	-269	10.0	1,064	0.0	0.2	13	0.1
Oregon	31.6	-307	15.8	1,053	-0.1	0.0	69	0.5
Pennsylvania	34.2	-297	12.7	1,269	-0.1	2.6	59	0.5
Rhode Island	32.8	-300	15.6	1,311	-0.2	0.4	105	0.6
South Carolina	31.4	-259	12.0	931	-0.1	0.4	30	0.2
South Dakota	40.7	-241	6.8	602	0.1	-0.2	-57	-0.4
Tennessee	34.4	-256	7.5	556	0.1	-1.0	-47	-0.3
Texas	33.4	-271	9.3	848	0.0	-0.9	-11	-0.1
Utah	33.5	-287	14.9	887	-0.1	0.3	36	0.2
Vermont	37.7	-299	11.9	1,169	0.0	0.1	26	0.2
Virginia	32.9	-268	20.1	1,256	-0.2	4.3	164	0.8
Washington	37.1	-286	13.6	646	0.0	-0.4	-19	-0.1
West Virginia	36.4	-272	6.8	1,028	0.1	-0.2	-30	-0.2
Wisconsin	36.1	-350	13.3	1,274	-0.1	0.8	43	0.3
Wyoming	38.3	-232	9.2	562	0.1	-0.1	-38	-0.2
United States	32.0	-287	13.4	1,399	-0.1	100.0	95	0.5

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0515-1).

Note: Baseline uses current law. Number of AMT taxpayers is 4.5 million under baseline and 4.6 million under the proposal. Proposal replaces the SALT deduction with a 15 percent refundable tax credit with a $1,000 floor. For a description of TPC's current law baseline, see http://www.taxpolicycenter.org/taxtopics/Baseline-Definitions.cfm.

[a] Includes tax units with a change in federal tax burden of $10 or more in absolute value.

[b] After-tax income is expanded cash income less individual income tax net of refundable credits, corporate income tax, payroll taxes (Social Security and Medicare), estate taxes, and excise taxes.

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NOTES

[1] For a description of the methodology see Khitatrakun, Mermin, and Francis (2015).

[2] The American Jobs Creation Act of 2004 partially reinstated the sales tax deduction, which the Tax Reform Act of 1986 had eliminated. Before the Tax Reform Act of 1986, taxpayers could deduct both income taxes and general sales taxes. The 2004 law allowed taxpayers to deduct either income taxes or sales taxes, but not both. Subsequent legislation has extended that provision, and the December 2015 budget deal made this provision permanent.

[3] The limit only affects the marginal benefit from deducting state and local taxes for taxpayers with large deductions relative to their income. For 95 percent or more of taxpayers with income above the thresholds, 3 percent of AGI is less than 80 percent of their countable itemized deductions, thus the amount of the reduction is unaffected by claiming additional deductions. For a detailed discussion see Viard (2015).

[4] AMT taxpayers whose regular tax would exceed their AMT in the absence of the SALT deduction still receive some benefits from the deduction even though they pay the AMT.

[5] Some provisions of the individual and corporate income tax are termed tax expenditures because they are comparable in certain respects to spending programs. The Congressional Budget and Impoundment Control Act of 1974 defines tax expenditures as "those revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability."

[6] Mason (2013) discusses the advantages and disadvantages of state conformity with the federal tax base.

[7] Six states allow taxpayers to claim a deduction for federal income taxes, which allows for reverse tax exporting from the federal government to the states.

[8] Gordon, Auxier, and Iselin (2016) find that federal grants are not particularly well targeted toward filling these gaps between revenue capacity and expenditure need.

[9] This describes a model in which taxpayers vote with their feet by moving to jurisdictions with the desired mix of spending and taxes (Tiebout 1956). An alternative view is that government spending provides purely public goods and therefore the tax used to finance that spending should be deductible but the benefits should be taxable. As a practical matter, however, assigning the benefits from public goods to individual taxpayers would be very difficult (Kaplow 1996).

[10] Although there is not strong evidence that high-income taxpayers move in response to higher tax rates (Mazerov 2014), higher taxes may discourage those taxpayers from locating in high-tax jurisdictions in the first place.

[11] Tax Policy Center. 2015. State and Local Finance Data Query System. Urban Institute and Brookings Institution, Washington, D.C.

[12] Tables showing state-by-state results for each option are in the appendix.