

## **Ten Questions on Cutting Back Itemized Deductions**

1. Why are itemized deductions getting so much more attention in budget negotiations than other tax breaks?

A. Itemized deductions show up on tax returns, so they are among the most visible of all tax subsidies or adjustments. Other tax breaks tend to be harder for politicians and the public to understand.

2. Why do most proposals to limit itemized deductions focus on higher-income taxpayers?

A. Politicians run from telling the middle class that they get most government benefits, pay most government taxes, and eventually will have to get less and pay more to help get our budget under control. Meanwhile, Democrats want to increase taxes on higher-income taxpayers, but Republicans don't want to increase tax rates. Itemized deductions for higher-income taxpayers are among the few options that fit amidst these limitations.

3. How much of the revenue lost from all tax expenditures or subsidies comes from the itemized deductions being discussed?

A. By one estimate, individual tax expenditures will cost the government about [\\$1.2 trillion](#) a year in 2015. If other policies aren't changed, itemized deductions will cost about [\\$180 billion](#) by then, or about 15 percent of the total. Itemized deductions taken by those making more than \$200,000 as individuals or \$250,000 for couples (the president's proposed level for starting to deny deductions) make up about 8 percent, or about \$100 billion. See [this graph](#) on the revenue gained from various tax proposals and how this compares to the deficit.

4. How many taxpayers would be affected by these limits, and how much revenue would be raised

A. Many proposals to cut back on itemized deductions affect only about 2 or 3 percent of taxpayers and would raise \$15—\$60 billion in 2015, compared with a deficit of close to \$900 billion under current policies. A tougher cap would raise more revenue but affect more taxpayers. Obviously, a lot depends upon the actual legislation.

5. Are limits on other tax expenditures being discussed?

A. Yes. Some proposals would increase the tax on dividends and capital gains back to its level before the Bush-era tax cuts. Some would cap the exclusion allowed to employees buying health insurance from their employers. The president has proposed a number of other, generally smaller cutbacks, including removing tax breaks for employee contributions to 401(k) and similar retirement plans. Most of these have gotten less attention.

6. What's the appeal of across-the-board limits on itemized deductions?

A. Politicians think various constituencies will less strongly oppose across-the-board limits that don't single out any particular provision. To some supporters, these limits appear to attack

interest groups even-handedly.

7. But do they attack various interests even-handedly?

A. No. Across-the-board limits would hit charitable deductions the hardest since people can quickly offset the tax increase by giving less to charity. State and local tax deductions, on the other hand, are less discretionary. Also, higher-income taxpayers give a large portion of all charitable contributions, so that sector is hit worse than, say, housing, where mortgage interest deductions are more concentrated in a middle class usually unaffected by the proposal.

8. Do different caps affect behavior differently?

A. Yes. An overall limit of \$50,000 on itemized deductions effectively gives a 0 percent subsidy for, say, an extra dollar of home mortgage interest above that limit. Other proposals simply limit the subsidy to 25 cents or 28 cents but generally place no extra bounds (beyond current law) on how many dollars can be deducted.

9. What are the drawbacks of overall deduction caps?

A. Some deductions, just like government programs, are more justifiable than others. For instance, society may want to encourage charitable giving but not want to encourage debt to buy bigger homes or second homes. Almost all tax experts—left, right, and independent—feel that the best way to reform government programs, whether hidden in the tax code or not, is to tackle each one on its own merits.

10. How does tackling a particular incentive on its own merits work?

A. Consider the itemized deduction for charitable contributions. Instead of discouraging giving that might be quite desirable societally, policymakers could focus on lowering deductions for items with low compliance rates. For example, the deductions that people claim for donating used clothes seem significantly larger than the value the charities derive from such donations. Congress could also restrict subsidies for the first dollars of giving, such as the first 1 or 2 percent of income—amounts taxpayers would likely give in absence of any incentive. The incentive would then remain for the more discretionary giving above that floor. Finally, some of the revenue gained could then be spent where giving would be more responsive to the incentive. For instance, Congress could allow taxpayers to take deductions for contributions made up until they file their tax returns, or it could provide a deduction above a floor to those who currently don't itemize.

In effect, Congress could strengthen its fiscal posture and the charitable sector at the same time. The same argument could be made for allocating homeownership subsidies better. In sum, blanket rules are arbitrary when applied to programs of different effectiveness and merit.

**The Government We Deserve** is a periodic column on public policy by Eugene Steuerle, an Institute fellow and the Richard B. Fisher Chair at the nonpartisan Urban Institute. Steuerle is also a former deputy assistant secretary of the Treasury. The opinions are those of the author and do not necessarily reflect those of the Urban Institute, its trustees, or its sponsors.

*Note to Editors:* Publication of this column is encouraged and permission is hereby granted, provided that the author is properly cited. To make comments, visit the blog at <http://blog.governmentwedeserve.org/2012/12/11/ten-questions-on-cutting-back-itemized-deductions/>.