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A Fair Way to Limit Tax Deductions

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Download state-by-state data on each option presented in this report

The cap on federal tax deductions for state and local taxes (SALT) that is in effect now under the Tax Cuts and Jobs Act (TCJA) is a flawed provision but repealing it outright would be costly and provide a windfall to the rich. Congress should consider replacing the SALT cap with a different type of limit on deductions that would avoid both of these outcomes. Using the ITEP microsimulation tax model, this report provides revenue estimates and distributional estimates for several such options, assuming they would be in effect in 2019.[1]

BACKGROUND

When President Trump and Congress crafted and enacted the Tax Cuts and Jobs Act (TCJA) at the end of 2017, they could have found any number of ways to offset the cost of tax cuts. They could have limited existing tax breaks in a broad way to pay for the rate reductions included in the law, which would have made the tax system simpler overall. Instead, the new law mostly relies on a combination of deficit-financing,[2] budget gimmicks,[3] and one serious provision to offset the cost of tax cuts for high-income individuals.

That single, serious, cost-controlling provision is the $10,000 cap on the amount of state and local taxes (SALT) deducted on federal returns.[4] Instead of broadening the income base that is taxed or simplifying the tax system, the cap on SALT deductions seems designed mainly to target residents of high-tax states.

While the cap on federal deductions for SALT certainly has its problems, this does not mean that Congress should simply repeal it, as some proposals introduced during the 115th Congress would do. Simply repealing the cap would reduce federal revenue by $88 billion in 2019 alone and 63 percent of the resulting tax cut would go to the richest one percent of taxpayers. Even if repealing the cap was coupled with a provision to offset the cost, the result would not be desirable because badly needed revenue would go towards financing a tax cut for the rich.[5]

If lawmakers want to repeal TCJA's cap on SALT deductions, they should replace it with a different type of limit, one that will raise revenue or at least be revenue-neutral, without raising taxes on low- and middle-income households or cutting taxes on high-income households.

It is worth noting that TCJA dramatically reduced the number of tax filers itemizing their deductions, so much so that lawmakers could reasonably consider eliminating what remains of itemized deductions. As illustrated by Table 1a, TCJA will cause the overall share of taxpayers itemizing their deductions to drop in 2019 from 30 percent to 13 percent. Table 1b shows that TCJA will cut the share of taxpayers claiming the mortgage interest deduction from 23 percent to 11 percent. Table 1c shows that the share claiming the charitable deduction is cut from 26 percent to 12 percent. In each case, the drop is not nearly as great for high-income households, who will now make up a greater share of the total number of itemizers than would be the case if TCJA was never enacted.

TABLE 1a

Total Itemizers in 2019

	Share of Each Income Group Itemizing		Share of Total Itemizers	
	pre-TCJA	TCJA	pre-TCJA	TCJA
Poorest 20%	2%	1%	1%	1%
Second 20%	9%	3%	6%	4%
Middle 20%	23%	8%	15%	11%
Fourth 20%	43%	17%	28%	24%
Next 15%	72%	33%	35%	36%
Next 4%	90%	57%	12%	16%
Richest 1%	95%	85%	3%	6%
ALL	**30%**	**13%**	**100%**	**100%**

Source: Institute on Taxation & Economic Policy, November 2018.

TABLE 1b

Mortgage Interest Deduction in 2019

	Share of Each Income Group Claiming Deduction		Share of Total Claiming Deduction	
	pre-TCJA	TCJA	pre-TCJA	TCJA
Poorest 20%	1%	0%	1%	1%
Second 20%	5%	1%	4%	3%
Middle 20%	16%	5%	13%	9%
Fourth 20%	34%	14%	29%	25%
Next 15%	60%	29%	37%	38%
Next 4%	69%	49%	11%	17%
Richest 1%	84%	80%	4%	7%
ALL	**23%**	**11%**	**100%**	**100%**

Source: Institute on Taxation & Economic Policy, November 2018.

TABLE 1c

Charitable Deduction in 2019

	Share of Each Income Group Claiming Deduction		Share of Total Claiming Deduction	
	pre-TCJA	TCJA	pre-TCJA	TCJA
Poorest 20%	2%	1%	1%	1%
Second 20%	6%	2%	5%	3%
Middle 20%	18%	6%	14%	10%
Fourth 20%	37%	14%	27%	24%
Next 15%	65%	31%	37%	38%
Next 4%	84%	54%	13%	18%
Richest 1%	93%	84%	3%	7%
ALL	**26%**	**12%**	**100%**	**100%**

Source: Institute on Taxation & Economic Policy, November 2018.

TCJA reduced the number of itemizers by expanding the standard deduction while shrinking the total amount of itemized deductions that many people could claim (primarily through the limit on SALT deductions). As a result, the standard deduction is more generous than itemized deductions for far more taxpayers than before.

In other words, TCJA has cut the number of taxpayers who rely on itemized inductions by more than half and concentrated those deductions more among the well-off. Given this, it would be reasonable for Congress to repeal itemized deductions entirely and create a new tax code that is both simpler and fairer.

This report, however, focuses on less dramatic proposals for lawmakers who are simply interested in replacing the existing cap on SALT deductions with a different type of limit on deductions.[6]

The options presented here are estimated with the assumption that nothing else about tax law changes in 2019. Of course, many of the important tax rules in place in 2019 will expire without action from Congress after 2025 and lawmakers may repeal or alter them sooner than that. Each of the options presented here would have different impacts if included as part of a broader package of tax policy changes.

This report assumes the rest of tax law remains unchanged in 2019 because it is impossible to predict how other provisions, such as tax rates and brackets, the size of the standard deduction and the existence of personal exemptions, will change. Even if other tax provisions are altered, the estimates here likely will continue to illustrate the general magnitude and direction of the effects on revenue and distribution.

POLICY OPTIONS TO REPLACE THE $10,000 CAP ON FEDERAL DEDUCTIONS FOR SALT

Option I: Repeal the cap on federal deductions for SALT.

Option II: Replace the SALT cap with a dollar cap on all itemized deductions ($50,000 for married couples, $30,000 for singles).

Option III: Replace the SALT cap with a rule allowing each taxpayer no more than 24 cents of tax savings for each dollar of itemized deductions. This is a modified version of a proposal from President Obama that would have limited the tax savings from each dollar of itemized deductions (and other tax breaks) to 28 cents.

Option IV: Replace the SALT cap with new rules that repeal the deduction for mortgage interest, leave the medical expenses deduction unchanged, and limit other itemized deductions each to the excess of 3 percent of a taxpayer's adjusted gross income (AGI). This means that, for example, a taxpayer who has AGI of $100,000 and pays $10,000 in SALT would be allowed to deduct $7,000 of her SALT on her federal return because that is the amount of SALT exceeding 3 percent of her AGI.

Option V: Replace the SALT cap with new rules that repeal the deduction for mortgage interest, leave the medical expenses deduction unchanged, and limit other itemized deductions each to the excess of a percentage of AGI that slides from 3 percent to 5 percent, depending on the taxpayer's AGI. (The limit would be 3 percent for taxpayers with AGI below $250,000 and 5 percent for taxpayers with AGI above $1 million.)

TABLE 2

Alternatives to Replace the Cap on Deductions for State and Local Taxes (SALT): National Impacts in 2019

Option	Revenue Impact in 2019 ($billions)	Share of Tax Increase Paid by Bottom 60%	Share of Tax Increase Paid by Richest 1%	Average Tax Change Bottom 60%	Average Tax Change Top 1%
Option I					
Repeal the cap on SALT deductions.	$ –88	N.A.	N.A.	$ —	$ –35,390
Option II					
Replace SALT cap with dollar cap on all IDs ($50k, $30k, $40k).	$+22	0%	155%	$ —	$+21,470
Option III					
Limit the tax savings from each dollar of deductions to 24 cents.	$ –35	0%	N.A.	$ —	$ –8,470
Option IV					
Repeal MID, leave medical unchanged and limit other IDs (each individually) to excess of 3% of AGI.	$+27	6%	N.A.	$+20	$ –1,020
Option V					
Repeal MID, leave medical unchanged and limit other IDs (each individually) to the excess of percentage of AGI that slides from 3% to 5% depending on AGI.	$+39	3%	41%	$+10	$+10,200

Source: Institute on Taxation & Economic Policy, November 2018.

The options presented here are meant to serve as examples of the types of proposals that lawmakers could pursue. Lawmakers could formulate different versions of these options or could choose to overhaul the tax system in a more fundamental way. If lawmakers feel that itemized deductions provide important incentives, they could also convert many deductions into credits, which is not considered in this report.[7]

There are at least three criteria that lawmakers could use to evaluate these options.

Criterion #1: Do not reduce federal revenue.

By this standard, Option I is not advisable because it would reduce federal revenue by $88 billion in 2019 alone. Option III also fails by this standard because it would reduce federal revenue by $35 billion in 2019 alone. The other options presented here raise revenue and could be adjusted to raise more or less than is shown here.

Criterion #2: Do not make the tax system more regressive than it is now.

Lawmakers should look to the distributional impact of each option, whether they make the tax system overall more or less fair than it is now. Options II, IV, and V would each raise revenue compared to current law in 2019, but they would differ in their distributional impacts.

For example, Option II, which would cap all itemized deductions at $50,000 for married couples and $30,000 for singles, would raise revenue almost entirely from the richest one percent of taxpayers while cutting taxes or leaving them mostly unchanged for other income groups, making the tax system more progressive than it is today. As illustrated in Table 2, the average taxpayer in the bottom 60 percent of the income distribution would see no change while the richest one percent would see an average tax hike of more than $21,000. (More detailed distributional tables are provided for each option.)

On the other hand, Option IV, eliminating the deduction for mortgage interest and limiting most other itemized deductions to the excess of 3 percent of AGI, would make the tax system slightly less progressive than it is now. As illustrated in Table 2, the typical taxpayer in the bottom 60 percent would see a tax hike of $20, while the typical taxpayer among the top 1 percent would see a tax cut of $1,020.

Criterion #3: Preserve or strengthen the right incentives.

Still another criterion to assess these options is their effect on various incentives. In theory, many itemized deductions are supposed to encourage particular activities, like home ownership or charitable giving, and altering the deductions could alter people's behavior. But the effect of tax changes on behavior is uncertain. The report provides figures on the overall amounts claimed for each deduction under the different options assuming no changes in taxpayer behavior, but even these figures do not always provide straightforward answers.

For example, as explained later on, Option II (capping all itemized deductions to $50,000 for married couples and $30,000 for singles) would appear to allow more total deductions for charitable giving than Option IV (limiting most itemized deductions to the excess of 3 percent of AGI). But does that really mean that Option II provides a greater incentive to give to charity than Option IV? Much of the charitable deductions allowed under Option II arguably subsidize giving that would have occurred in the absence of any tax deduction. The charitable deductions allowed under Option IV only subsidize giving that is greater than 3 percent of a taxpayer's AGI. One could argue that Option IV therefore focuses the tax subsidy better on the marginal giving that could be influenced by tax considerations.

FISCAL AND DISTRIBUTIONAL IMPACTS

Option I: Repeal the cap on federal deductions for SALT.

Members of Congress from New York and New Jersey have introduced legislation to repeal the $10,000 cap on SALT deductions.[8] These proposals are included in this report as Option I. If one of these bills is enacted without other changes, federal revenue would drop by $88 billion in 2019 alone. Nearly two-thirds of the tax cut would go to the richest one percent.

The state-by-state data (which can be downloaded with the hyperlink at the start of this report) illustrate that in nearly every state, at least half of the benefits would flow to the top 1 percent of households in 2019.

The addendum in Table 3a shows that TCJA is already providing the richest one percent with an average tax cut of $52,290 in 2019 alone. If this option is combined with TCJA as originally enacted, the average tax cut for this group would grow to nearly $88,000.

TABLE 3a

Option I: Repeal the cap on federal deductions for SALT.

	Option I					Addendum	
	Tax Change in 1,000s	Average Change	Share of Change	Percentage with tax hike	Percentage with tax cut	Average tax change under TCJA	Average tax change under TCJA + Option
Poorest 20%	$ –3,500	$0	0%	0%	0%	$ –80	$ –80
Second 20%	$ –13,800	$0	0%	0%	0%	$ –380	$ –380
Middle 20%	$ –104,400	$0	0%	0%	1%	$ –730	$ –730
Fourth 20%	$ –1,231,700	$ –40	1%	0%	6%	$ –1,260	$ –1,300
Next 15%	$ –10,387,300	$ –440	12%	0%	30%	$ –2,430	$ –2,870
Next 4%	$ –21,051,300	$ –3,350	24%	0%	68%	$ –10,970	$ –14,320
Richest 1%	$ –55,225,400	$ –35,390	63%	0%	91%	$ –52,290	$ –87,680
ALL	**$ –88,022,500**	**$ –540**	**100%**	**0%**	**9%**	**$ –1,750**	**$ –2,290**
BOTTOM 60%	**$ –121,700**	**$0**	**0%**	**0%**	**0%**	**$ –420**	**$ –420**

Source: Institute on Taxation & Economic Policy, November 2018.

Option II: Replace the SALT cap with a dollar cap on all itemized deductions ($50,000 for married couples, $30,000 for singles and $40,000 for heads of households).

This simple dollar cap would raise $22 billion in 2019. It is the most progressive of all the options presented here because it would raise taxes almost exclusively from the richest one percent of households. This option would leave taxes generally unchanged for the bottom 60 percent of taxpayers. It would reduce taxes for the typical households among the richest forty percent, aside from the richest 1 percent.

Under this option, 59 percent of those taxpayers who are among the richest 1 percent would face a tax increase. But the typical taxpayer among the richest 1 percent would nonetheless enjoy a large tax cut compared to what they would have paid if TCJA had never been enacted. As illustrated in the addendum in Table 3b, TCJA provides the richest one percent with an average tax cut of $52,290 in 2019. This option would only scale that tax cut down somewhat to $30,820. In other words, the average high-income person would see that most of her tax cut from TCJA would remain intact even if this option was enacted.

TABLE 3b

Option II: Replace the SALT cap with a dollar cap on all itemized deductions ($50,000 for married couples, $30,000 for singles).

	Option II					Addendum	
	Tax Change in 1,000s	Average Change	Share of Change	Percentage with tax hike	Percentage with tax cut	Average tax change under TCJA	Average tax change under TCJA + Option
Poorest 20%	$ –2,000	$0	0%	0%	0%	$ –80	$ –80
Second 20%	$ –13,000	$0	0%	0%	0%	$ –380	$ –380
Middle 20%	$ +29,600	$0	0%	0%	1%	$ –730	$ –730
Fourth 20%	$ –355,500	$ –10	-2%	1%	6%	$ –1,260	$ –1,270
Next 15%	$ –5,457,800	$ –230	-25%	4%	28%	$ –2,430	$ –2,660
Next 4%	$ –6,052,600	$ –960	-28%	13%	58%	$ –10,970	$ –11,930
Richest 1%	$ +33,498,200	$ +21,470	155%	59%	34%	$ –52,290	$ –30,820
ALL	**$ +21,657,700**	**$ +130**	**100%**	**2%**	**8%**	**$ –1,750**	**$ –1,620**
BOTTOM 60%	**$ +14,600**	**$0**	**0%**	**0%**	**0%**	**$ –420**	**$ –420**

Source: Institute on Taxation & Economic Policy, November 2018.

Option III: Replace the SALT cap with a rule allowing each taxpayer no more than 24 cents of tax savings for each dollar of itemized deductions.

This is a modified version of a proposal from President Obama that would have limited the tax savings from each dollar of itemized deductions (and other tax breaks) to 28 cents. This option would reduce federal revenue by $35 billion in 2019 alone because it would not restrict deductions as much as the existing $10,000 cap on SALT deductions does.

The details of Option III differ from the Obama proposal in several ways. President Obama initially presented his proposal in his first budget plan in 2009 and included it in subsequent budget and deficit-reduction plans each year after that. The original proposal applied only to itemized deductions, as does Option III. Obama later expanded the proposal to limit other tax expenditures, which Option III does not address.[9]

President Obama's proposal also made some very complicated changes to the alternative minimum tax (AMT). Option III does not make any such changes, which would be largely irrelevant because TCJA has scaled back the AMT dramatically.[10]

TABLE 3c

Option III: Replace the SALT cap with a rule allowing each taxpayer no more than 24 cents of tax savings for each dollar of itemized deductions.

	Option III					Addendum	
	Tax Change in 1,000s	Average Change	Share of Change	Percentage with tax hike	Percentage with tax cut	Average tax change under TCJA	Average tax change under TCJA + Option
Poorest 20%	$ –3,300	$0	0%	0%	0%	$ –80	$ –80
Second 20%	$ –13,700	$0	0%	0%	0%	$ –380	$ –380
Middle 20%	$ –104,400	$0	0%	0%	1%	$ –730	$ –730
Fourth 20%	$ –1,231,700	$ –40	4%	0%	6%	$ –1,260	$ –1,300
Next 15%	$ –9,383,000	$ –400	27%	1%	30%	$ –2,430	$ –2,830
Next 4%	$ –10,773,700	$ –1,720	31%	11%	60%	$ –10,970	$ –12,690
Richest 1%	$ –13,216,900	$ –8,470	38%	26%	67%	$ –52,290	$ –60,760
ALL	**$ –34,729,000**	**$ –210**	**100%**	**1%**	**9%**	**$ –1,750**	**$ –1,960**
BOTTOM 60%	**$ –121,500**	**$0**	**0%**	**0%**	**0%**	**$ –420**	**$ –420**

Source: Institute on Taxation & Economic Policy, November 2018.

Option IV: Replace the SALT cap with new rules that repeal the deduction for mortgage interest, leave the medical expenses deduction unchanged, and limit other itemized deductions each to the excess of 3 percent of a taxpayer's adjusted gross income (AGI).

Option IV is designed to limit deductions while still allowing taxpayers to benefit from deductions in a way that is more proportional to their income compared to the flat dollar cap provided by Option II. Option IV is also designed to maximize certain incentives that are considered desirable for society, which is discussed more in the next section of this report.

Such an approach would not make sense for all itemized deductions, however. For example, few people would suggest that tax policy should be altered to encourage people to borrow even more to purchase a home than they do today, so the mortgage interest deduction is eliminated rather than included in this option. Also, the deduction for medical expenses is designed to help people with catastrophic medical expenses rather than the more predictable expenses faced by everyone, so this option does not change the rule that limits that deduction to expenses that exceed a higher level of AGI.

Option IV would raise $27 billion in 2019 alone, which is relatively close to the revenue impact of Option II (which would raise $22 billion). However, the distributional impact would be quite different. Whereas Option II would raise taxes on the richest one percent by an average $21,470, Option IV would cut their taxes by an average of $1,020.[11]

TABLE 3d

Option IV: Replace the SALT cap with new rules that repeal the deduction for mortgage interest, leave the medical expenses deduction unchanged, and limit other itemized deductions to the excess of 3 percent of a taxpayer's adjusted gross income (AGI).

	Option IV					Addendum	
	Tax Change in 1,000s	Average Change	Share of Change	Percentage with tax hike	Percentage with tax cut	Average tax change under TCJA	Average tax change under TCJA + Option
Poorest 20%	$ +7,800	$0	0%	0%	0%	$ –80	$ –80
Second 20%	$ +204,400	$ +10	1%	2%	0%	$ –380	$ –370
Middle 20%	$ +1,278,600	$ +40	5%	6%	0%	$ –730	$ –690
Fourth 20%	$ +5,661,300	$ +180	21%	16%	1%	$ –1,260	$ –1,080
Next 15%	$ +12,580,000	$ +530	47%	31%	2%	$ –2,430	$ –1,900
Next 4%	$ +8,431,400	$ +1,340	32%	49%	14%	$ –10,970	$ –9,630
Richest 1%	$ –1,586,100	$ –1,020	-6%	53%	37%	$ –52,290	$ –53,310
ALL	**$ +26,586,600**	**$ +160**	**100%**	**12%**	**1%**	**$ –1,750**	**$ –1,590**
BOTTOM 60%	**$ +1,490,800**	**$ +20**	**6%**	**3%**	**0%**	**$ –420**	**$ –400**

Source: Institute on Taxation & Economic Policy, November 2018.

Option V: Replace the SALT cap with new rules that repeal the deduction for mortgage interest, leave the medical expenses deduction unchanged, and limit other itemized deductions to the excess of a percentage of AGI that slides from 3 percent to 5 percent, depending on the taxpayer's AGI.

Option V is like Option IV except that it is modified to make it more progressive and maximize the potentially desirable incentive effects. Instead of limiting allowable deductions to the excess of 3 percent of AGI, this option would raise the AGI threshold from 3 percent for taxpayers with AGI below $250,000 up to 5 percent for taxpayers with AGI above $1 million. The AGI threshold would rise on a sliding scale, meaning a taxpayer with AGI right in the middle of that scale (AGI of $625,000), for example, would only be allowed these deductions to the extent that they exceed 4 percent of her AGI.

As illustrated in Table 3e, Option V would raise taxes on the bottom 60 percent of taxpayers by an average of $10 and would raise taxes on the richest one percent of taxpayers by an average of $10,200. As illustrated in the table's addendum, the richest one percent of taxpayers would see that this option scales back the tax cut they received from TCJA only by a fraction (from $52,290 to $42,090).

TABLE 3e

Option V: Replace SALT cap with rules that repeal the deduction for MID, leave the medical expenses deduction unchanged, and limit other itemized deductions to the excess of a percentage of AGI that slides from 3 percent to 5 percent.

	Option V					Addendum	
	Tax Change in 1,000s	Average Change	Share of Change	Percentage with tax hike	Percentage with tax cut	Average tax change under TCJA	Average tax change under TCJA + Option
Poorest 20%	$ +6,100	$0	0%	0%	0%	$ –80	$ –80
Second 20%	$ +141,900	$0	0%	1%	0%	$ –380	$ –380
Middle 20%	$ +927,400	$ +30	2%	5%	0%	$ –730	$ –700
Fourth 20%	$ +4,200,200	$ +130	11%	13%	2%	$ –1,260	$ –1,130
Next 15%	$ +9,180,500	$ +390	23%	28%	6%	$ –2,430	$ –2,040
Next 4%	$ +8,872,200	$ +1,410	23%	49%	16%	$ –10,970	$ –9,560
Richest 1%	$ +15,914,000	$ +10,200	41%	65%	25%	$ –52,290	$ –42,090
ALL	**$ +39,252,100**	**$ +240**	**100%**	**10%**	**2%**	**$ –1,750**	**$ –1,510**
BOTTOM 60%	**$ +1,075,400**	**$ +10**	**3%**	**2%**	**0%**	**$ –420**	**$ –410**

Source: Institute on Taxation & Economic Policy, November 2018.

IMPACTS ON INCENTIVES

The three options presented in this report that would raise rather than lose revenue are Options II, IV, and V. These three options would create very different incentives for taxpayers.

For example, Option II would provide a flat dollar limit for all itemized deductions. Under this option, a taxpayer would probably fill their deduction cap (which would be $50,000 in the case of a married couple) with deductions for activities that are unavoidable, such as paying state and local taxes and paying medical expenses. Only if these deductions do not exceed the dollar cap would a taxpayer be likely to then claim deductions for activities that are discretionary, like charitable giving. For this reason, Option II would nearly eliminate the charitable deduction for very high-income taxpayers, who are likely to have state and local taxes that exceed the dollar cap. For middle- and upper middle-income people whose total itemized deductions do not exceed the dollar cap, the tax incentive for charitable giving would be unchanged.

Options IV and V could have the reverse effect. They would preserve the tax incentive for charitable giving for high-income taxpayers who make donations that are at least large enough to exceed 3 percent of their AGI (or up to 5 percent of their AGI in the case of Option V). But for some middle-class taxpayers who itemize and high-income taxpayers who make smaller donations, Options IV and V would allow smaller deductions, or no deductions at all, for their charitable giving.

In short, Option II would provide a cap for itemized deductions while Options IV and V would provide a floor for most itemized deductions. Given their disparate impact on different types of taxpayers, it is unclear how these policies affect incentives overall. Table 4 illustrates the total amount of deductions that would be allowed under each option. (In the case of the flat dollar cap in Option II, there is no accurate way of knowing exactly which deductions taxpayers would choose so it is assumed that they prioritize deductions for activities that are less discretionary over those that are more discretionary, as explained above and in the notes accompanying the table.)

Table 4 does not take into account changes in behavior that may result from these policy options. To take one example of the findings presented in this table, it shows that Option II would allow more total charitable deductions in 2019 ($157 billion) than Options IV and V, which would both allow less than $90 billion in total charitable deductions. But again, this table does not take into account changes in behavior that might result. Arguably, much of the deductions allowed for charitable giving in Option II are "wasted" in the sense that they subsidize giving that would occur even in the absence of any tax incentive. Options IV and V only subsidize giving that exceeds a certain percentage of a taxpayer's income and could therefore encourage some, particularly high-income taxpayers, to give more. If this happens, the amount of deductions allowed could exceed what is shown in the table for Options IV and V.

The Congressional Budget Office (CBO) has explained that studies attempting to measure the relationship between tax incentives and charitable giving vary widely in their results. Assuming the relationship falls somewhere in the middle of what various studies have concluded, CBO analyzed an option to limit the charitable deductions for giving in excess of 2 percent of AGI (similar to Option IV of this report which would set the threshold at 3 percent of AGI) and found that total giving would decline by just 1.5 percent.[12]

TABLE 4

Amounts (in billions of dollars) of Itemized Deductions Allowed Under Policy Options in 2019

For dollar caps on overall amount of itemized deductions, estimates assume taxpayers prioritize deductions in this order: 1) state and local taxes (SALT), 2) medical expenses, 3) mortgage interest, 4) other non-charitable deductions, 5) charitable.

	State and Local Taxes (SALT) Deductions	Medical Expense Deductions	Mortgage Interest Deductions	Charitable Deductions	Alternative Minimum Tax Paid
Current Law (TCJA)					
$10k cap on SALT deductions, no Pease, scaled back AMT.	$+171	$+69	$+255	$+214	$+2
Pre-TCJA Law					
No dollar limits on SALT or other IDs but limited by AMT and Pease.	$+635	$+89	$+385	$+281	$+44
Option I					
Repeal the cap on SALT deductions.	$+552	$+70	$+273	$+227	$+16
Option II					
Replace SALT cap with dollar cap on all IDs ($50k, $30k, $40k).	$+294	$+53	$+255	$+157	$+2
Option III					
Limit the tax savings from each dollar of deductions to 24 cents.	N.A.	N.A.	N.A.	N.A.	N.A.
Option IV					
Repeal MID, leave medical unchanged and limit other IDs (each individually) to excess of 3% of AGI.	$+239	$+60	$ —	$+76	$+13
Option V					
Repeal MID, leave medical unchanged and limit other IDs (each individually) to the excess of percentage of AGI that slides from 3% to 5% depending on AGI.	$+260	$+65	$ —	$+89	$+11

Source: Institute on Taxation & Economic Policy, November 2018.

The discussion so far assumes that tax incentives (for charitable giving, in the example used here) are worth preserving at all. Lawmakers could, of course, take bolder steps and eliminate some or all of these itemized deductions.[13] On the other hand, this discussion also does not address other options that would better target tax incentives, such as converting some of them into credits, which is beyond the scope of this report.

Table 4 also shows how the options impact different tax deductions and the Alternative Minimum Tax (AMT). The estimates of the amounts of each deduction allowed do not take into account the AMT, which limits several types of tax expenditures in addition to certain itemized deductions. However, Table 4 provides (in the last column) the total amount of AMT liability under each option. For example, the table illustrates that in 2019, current law allows $171 billion of total deductions for state and local taxes, whereas Option V would increase that amount to $260 billion. However, the AMT would claw some of those SALT deductions back because it would rise from $2 billion under current law to $11 billion under Option V.

Table 4 could lead one to favor certain options for other reasons. For example, if one is concerned about maximizing the amount of state and local taxes that can be deducted, of the three options that actually raise revenue, Option II would allow the largest amount ($294 billion) of SAL T to be deducted in 2019. Unlike charitable giving, there is little reason to expect payment of state and local taxes to change very much in response to these policy options, at least not directly. However, these options could indirectly affect the amount of SALT paid. That would happen if state and local policymakers are more willing to raise taxes on high-income taxpayers if those taxpayers are allowed more generous federal tax deductions for their SALT to soften the impact. In that case, anyone favoring progressive state and local taxes might favor Option IV or V, which would allow greater SALT deductions for very high-income taxpayers.

ENDNOTES

1 See ITEP Microsimulation Tax Model Overview, https://itep.org/itep-tax-model-simple/.

2 Even with the cap on SALT deductions, TCJA will increase the federal deficit by $1.9 trillion over a decade. See Congressional Budget Office, “The Budget and Economic Outlook: 2018 to 2028,” April 9, 2018. https://www.cbo.gov/publication/53651

3 For example, nearly all of the significant personal income tax provisions in TCJA expire after 2025 even though lawmakers who drafted the law made clear from the start that they intend to make these provisions permanent, adding hundreds of billions of dollars of cost to TCJA in the first decade and trillions beyond.

4 Before TCJA, taxpayers could deduct an unlimited amount of SALT on their federal tax returns, although other provisions, like the Alternative Minimum Tax (AMT), could limit the benefits. The AMT was reduced substantially by TCJA.

5 Of course, lawmakers might overhaul the tax code in a different, more fundamental way to ensure that, overall, high-income taxpayers pay more and revenue is raised, regardless of whether any limit on SALT deductions or other deductions is included. This report is meant to provide options for lawmakers who seek less dramatic options to replace the SALT cap.

6 TCJA made several other changes to itemized deductions, none of which are addressed in this report. For example, taxpayers can now deduct the amount of cash they donate to charity not exceeding 60 percent of their adjusted gross income, up from 50 percent under prior law. The miscellaneous deductions limited to the excess of 2 percent of AGI under prior law were eliminated by TCJA. The options presented in this report would not change these provisions of TCJA.

7 For example, for a review of proposals that would convert the deduction for home mortgage interest into a credit, see Will Fischer and Chye-Ching Huang, “Mortgage Interest Deduction Is Ripe for Reform,” Center on Budget and Policy Priorities, revised June 25, 2013. https://www.cbpp.org/research/mortgage-interest-deduction-is-ripe-for-reform

8 H.R.4740, the SALT Deductibility Act, and H.R.4789, the Cutting Local Taxes by Reinstating SALT Act.

9 President Obama eventually expanded his proposal to limit the value of certain “above-the-line” deductions (which can be claimed by taxpayers who do not itemize), such as the deduction for health insurance for the self-employed and the deduction for contributions to individual retirement accounts (IRA). The proposal was also expanded to include certain tax exclusions, such as the exclusion for interest on state and local bonds and the exclusion for employer-provided health care. Exclusions provide the same sort of benefit as deductions, the only difference being that they are not counted as part of a taxpayer’s income in the first place (and therefore do not need to be deducted). Option III of this report does not address any of these tax expenditures.

10 The AMT is a backstop tax, meaning it forces well-off people who effectively reduce their taxable income with various deductions and exclusions to pay some minimal tax. If a tax change only increases the regular income tax and not the AMT, some taxpayers who currently pay AMT will not be affected at all. Very generally, one of the AMT changes in the Obama proposal essentially ensured that the increase in a taxpayer’s regular income tax would also be applied to the AMT so that the tax increase would show up on the final income tax bill. The other AMT change in the Obama proposal would have limited the savings for each dollar of deductions or exclusions to 28 cents for those whose income is within the “phase-out range” for the exemption that prevents most people from being affected by the AMT. These changes are not included in this report because the AMT itself was scaled back dramatically under TCJA.

11 This is true even though slightly over half of the taxpayers among the richest one percent would receive a tax increase in 2019 under Option IV, as illustrated in Table 3d. The average tax change for the richest one percent would nonetheless be a tax cut of $1,020 in 2019.

12 Congressional Budget Office, “Options for Changing the Tax Treatment of Charitable Giving,” May 2011, page 10. https://www.cbo.gov/publication/41452

13 For example, it is worth asking whether the deduction for charitable giving is even compatible with democratic principles. The majority of Americans can implement their vision for society through their elected government. The wealthy minority can implement their vision for society through their philanthropic endeavors. The charitable deduction shifts resources from the former to the latter.