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2019 Tax Filing Season (2018 Tax Year): Itemized Deductions

P.L. 115-97, often referred to as "The Tax Cuts and Jobs Act" (TCJA), temporarily changed some personal income tax deductions taxfilers will claim for tax years 2018 through 2026. This In Focus explains the changes made to itemized deductions in P.L. 115-97 and their potential impacts.

For more details about the changes enacted by P.L. 115-97, see CRS Report R45092, *The 2017 Tax Revision (P.L. 115-97): Comparison to 2017 Tax Law*, coordinated by Molly F. Sherlock and Donald J. Marples.

Summary of Current Law

Individual tax filers have the option to claim the standard deduction or itemize their tax deductions, typically choosing whichever provides the larger tax benefit. Itemized deductions are available for a diverse set of activities, such as mortgage interest, charitable giving, state and local sales or income taxes, real property taxes, and unreimbursed medical expenses. Itemized deductions are distinguished from "above-the-line" deductions (e.g., IRA contributions, student loan interest) that can be claimed regardless of whether a taxfiler itemizes or claims the standard deduction.

Comparison to Prior Law

Among some of the major changes in individual income taxes for 2018 are the increased standard deduction amounts. **Table 1** compares the standard deduction amounts that would have been in effect for 2018 pre-P.L. 115-97 and the actual amounts for 2018 under P.L. 115-97. As a result, more taxpayers will be better off claiming the standard deduction rather than itemizing.

Table 1. Standard Deduction Amounts, 2018

Filing Status	Under Pre-TCJA Law	Post-TCJA Current Law
Single (Unmarried)	$6,500	$12,000
Married Filing Jointly	$13,000	$24,000
Married Filing Separately	$6,500	$12,000
Head-of-Household	$9,550	$18,000

Source: IRS Rev. Proc. 2018-18, May 5, 2018, https://www.irs.gov/pub/irs-irbs/irb18-10.pdf; and IRS Rev. Proc. 2017-58, November 6, 2017, https://www.irs.gov/irb/2017-45_IRB.

These amounts, though, are permanently indexed for inflation using the "chained" Consumer Price Index (CPI) instead of the "unchained" or traditional CPI, pre-P.L. 115-97. Historically, the chained CPI has grown at a slower rate, because it allows for consumer substitutions in the prices of goods and services used to calculate inflation.

Because of the larger standard deduction and the limit or repeal of some itemized deductions, some taxfilers might be better off claiming the standard deduction in 2018 even if they itemized in the past.

Before 2018, taxfilers were allowed to claim an unlimited deduction for state and local income or sales taxes paid, as well as property taxes paid. In 2018, those deductions are limited to a combined amount of $10,000 per taxfiler, regardless of filing status.

Additionally, the deduction for mortgage interest was limited. In 2017, a homeowner was allowed an itemized deduction for the interest paid on the first $1 million of combined mortgage debt associated with a primary or secondary residence. A homeowner was also allowed to separately deduct the interest paid on the first $100,000 of home equity debt regardless of whether or not the taxpayer incurred the debt to finance costs associated with the home. Starting in 2018, the amount of interest that is deductible depends on when the mortgage debt was incurred. For mortgage debt incurred on or before December 15, 2017, the combined mortgage limit is $1 million. For mortgage debt incurred after December 15, 2017, the deduction is limited to the interest incurred on the first $750,000 of combined mortgage debt. Homeowners may still deduct interest on home equity loans, but the proceeds of that loan must be (or have been) used to improve the home (e.g., paying for a child's college is not allowed), and the taxpayer's total debt—including their home equity loan—must be below the applicable mortgage limit ($750,000 or $1 million). These limitations apply for taxable years 2018 through 2025. For more details, see CRS In Focus IF11063, *2019 Tax Filing Season: The Mortgage Interest Deduction*, by Mark P. Keightley.

Several other itemized deductions that affected narrower groups of taxfilers were also repealed beginning in 2018, such as deductions for: personal casualty losses—except for losses associated with federal disaster declarations—and all miscellaneous itemized deductions subject to the 2% of adjusted-gross-income (AGI) floor (including unreimbursed employee expenses). The floor for the medical expenses deduction, though, was temporarily reduced from 10% to 7.5% of AGI for 2017 and 2018.

The deduction for charitable contributions was basically unchanged, except for increasing the percentage of AGI that can be given as cash to qualifying organizations from 50% to 60%. Maximum cash donation limits to private foundations remain unchanged at 30% of AGI.

For high-income filers, the "Pease" limitation on itemized deductions was also repealed. This provision effectively acted like a surtax, triggered by income and not by the amount of deductions claimed.

Economic and Budgetary Impact of the Changes

Before P.L. 115-97, roughly one-third of taxfilers chose to itemize their deductions instead of claiming the standard deduction, according to historical IRS data. The rate of itemization increased with income.

As shown in **Table 2**, the Tax Policy Center estimated that 10.9% (19.3 million) taxfilers would itemize in 2018 compared to a projection of 26.4% (46.5 million) under prior law and that the rates of itemization within income classes will drop significantly except for taxfilers in the highest income classes.

Table 2. Percent of Itemizers Within Income Classes, Projected Pre- and Post-TCJA, 2018

Income Level (thousands of $)	Under Pre-TCJA Law (%)	Under Post-TCJA Current Law (%)
Less than $10	**	**
10-20	0.7	0.2
20-30	2.5	0.7
30-40	6.6	1.9
40-50	12.4	3.9
50-75	23.1	7.0
75-100	36.6	13.3
100-200	61.3	23.3
200-500	88.6	47.3
500-1,000	94.1	72.5
More than 1,000	92.5	82.1
All taxfilers	26.4	10.9

Source: Tax Policy Center, Table T18-0001, January 11, 2018, https://www.taxpolicycenter.org/model-estimates/impact-itemized-deductions-tax-cuts-and-jobs-act-jan-2018/t18-0001-impact-number.

Notes: ** indicates insufficient data. Income levels are valued in 2017 dollars.

The reduced rate of itemization projected under P.L. 115-97 has sparked debate as to whether activities that are encouraged by the deductions will also decrease. This concern has focused mostly on the deductions for charitable contributions and mortgage interest, as they are frequently claimed by itemizers and are more likely to be within the control of the taxfiler.

Although the deduction for charitable contributions was unchanged, fewer people could choose to give to charity or reduce the amount they give to charity if they cannot receive a tax benefit for that activity on the margins. The economic literature shows, however, that charitable giving is reasonably unaffected to tax incentives. Many individuals give because they enjoy the "warm glow" they receive from supporting such organizations or benefit indirectly from the activities funded by their donations. Some taxfiler strategies that have been discussed for maximizing tax benefits and supporting charitable organizations include "bunching" larger quantities of deductions in certain years (such that the sum of itemized deductions exceeds the standard deduction), possibly in conjunction with the use of donor-advised funds (DAFs). A taxpayer contributes to a DAF, taking a tax deduction in that year. The contributions to a DAF can grow tax-deferred if invested in an investment fund (which are structured like mutual funds, with various rates of return based the riskiness of the underlying portfolio). The DAF then deposits the contribution to the targeted, eligible 501(c)(3)s, typically according to the donor's preferences. In other words, bunching contributions intermediated through a DAF can provide benefits to taxfilers while still "smoothing out" cash flow to charities.

Economic studies indicate that the rate of itemization is unlikely to affect the decision to purchase a home but could affect the size of the mortgage taken out by a taxpayer. The decision to buy versus rent is a decision that is typically driven by more long-term concerns (e.g., job status, decision to start a family) rather than tax benefit. Once the decision to buy a home has been made, though, the ability to deduct interest on a mortgage could affect the amount of indebtedness that the taxfiler takes out on the margins. This could affect the prices of homes sold post-P.L. 115-97.

In contrast, limiting the deduction on state and local taxes (or the "SALT" cap, as it is commonly known) is typically beyond the short-term control of any given taxfiler. The $10,000 SALT cap is projected to affect a higher share of taxfilers in high-tax states and high-income taxfilers (generally) in states with income taxes. In the long term, though, some taxfilers might choose to live in certain areas with lower tax rates or negotiate for higher salaries to compensate for higher costs of living. These considerations will be made alongside other factors when deciding to live within a particular jurisdiction. State and local governments might also consider the limitation on this implicit federal subsidy as they consider the most appropriate tax rates they impose in a world post-P.L. 115-97.

The Joint Committee on Taxation estimated that increasing the standard deduction amounts would lose $720.4 billion over 10 years. In contrast, various limits and repeal of certain itemized deductions would raise $668.4 billion over 10 years, including the SALT cap, limiting the interest deduction for mortgage indebtedness to $750,000, repealing the deduction for home equity debt, repeal of non-declared disaster casualty losses, repeal of miscellaneous itemized deductions, and repeal of the Pease limitation.

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