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IN FOCUS

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2019 Tax Filing Season (2018 Tax Year): The State and Local Tax Deduction

Certain taxpayers can reduce their taxable income—and ultimately their federal income tax liability—by claiming the deduction for state and local taxes (SALT) they have paid. Recent changes to the SALT deduction made by the 2017 tax revision, often referred to as the "Tax Cuts and Jobs Act" (P.L. 115-97), have stimulated public discussion of the tax, its incidence, and potential responses from state and local governments. This In Focus summarizes current law and policy issues; a more extended discussion of the SALT deduction can be found in CRS Report RL32781, *Federal Deductibility of State and Local Taxes*.

Summary of Current Law

Taxpayers may deduct state and local taxes paid from income when calculating their federal income tax liability. Individual taxpayers must itemize deductions (rather than use the standard deduction) on their income tax return to claim the SALT deduction. The tax savings from the deduction on state and local taxes paid is equal to the taxpayer's marginal tax rate multiplied by the size of the deduction, though may be limited by a cap on the total amounts that can be deducted in certain years (see below). Income taxes, sales taxes (claimed in lieu of income taxes), personal property taxes, and real property taxes are all eligible to be claimed under the SALT deduction.

For tax years 2018 through 2025, SALT deduction claims for taxes paid not in the carrying on of a trade or business may not exceed $10,000, and payments for foreign real property taxes are not eligible for the deduction. SALT deduction amounts for taxes paid in the carrying on of a trade or business are not limited. Under current law the cap on SALT deductions not related to the carrying on of a trade or business is scheduled to be eliminated after 2025, and foreign real property taxes are to be eligible for the deduction in those years.

Comparison to Prior Law

There was no limit to the deduction amounts available for the SALT deduction before 2018. No distinction was made for whether taxes were paid in the carrying on of a trade or business, though business payments made toward sales and property taxes were removed from calculations of business economic income. Foreign real property taxes were eligible for the SALT deduction before tax year 2018. The rate of deductions available were reduced for taxpayers with adjusted gross income above certain thresholds ($313,800 for married taxpayers filing jointly and $261,500 for single filers in 2017).

P.L. 115-97 also increased the value of the standard deduction, making it more appealing to taxpayers and thereby reducing the proportion of taxpayers that itemize their deductions (and are eligible to claim the SALT deduction). That change combined with the new restrictions on payments eligible for the SALT deduction is expected to substantially reduce the number of SALT deduction claims in tax years 2018 through 2025. The Joint Committee on Taxation (JCT) estimates that 16.6 million SALT deduction claims will be made for the 2018 tax year, well under half the number of claims reported by the IRS for tax year 2016 (43.2 million).

Economic and Budgetary Impact of Changes

The SALT deduction effectively reduces the after-tax cost of state and local public services. That reduction not only benefits the taxpayers claiming the deduction (whose after-tax incomes increase) but also state and local governments, whose residents are willing to pay higher taxes than they would with no deduction. Restrictions on the SALT deduction such as those enacted by P.L. 115-97 may therefore provide state and local governments with incentive to either reduce the taxes they levy (and subsequently services they provide) or to modify their tax structure to be more reliant on other taxes with federal tax preferences.

Amounts claimed from the SALT deduction are directly dependent upon taxable income. Since the federal income tax rate regime is progressive (where the rate of tax increases with income), a tax deduction, in contrast to a tax credit, favors taxpayers in higher-income tax brackets because the value of benefits (aside from those restricted by the cap on overall benefits) is directly proportional to a taxpayer's marginal income tax rate.

Table 1 shows JCT's forecasted number of SALT deduction claimants and amounts claimed by income level in tax year 2018. Under those projections households with incomes less than $75,000 will represent under 10% of the households claiming the SALT deduction in tax year 2018, and more than half of amounts claimed will be by households with income exceeding $200,000.

Table 1. Projected Distribution of SALT Deduction Claims by Income Level, Tax Year 2018

(Returns in thousands, amounts in millions of dollars)

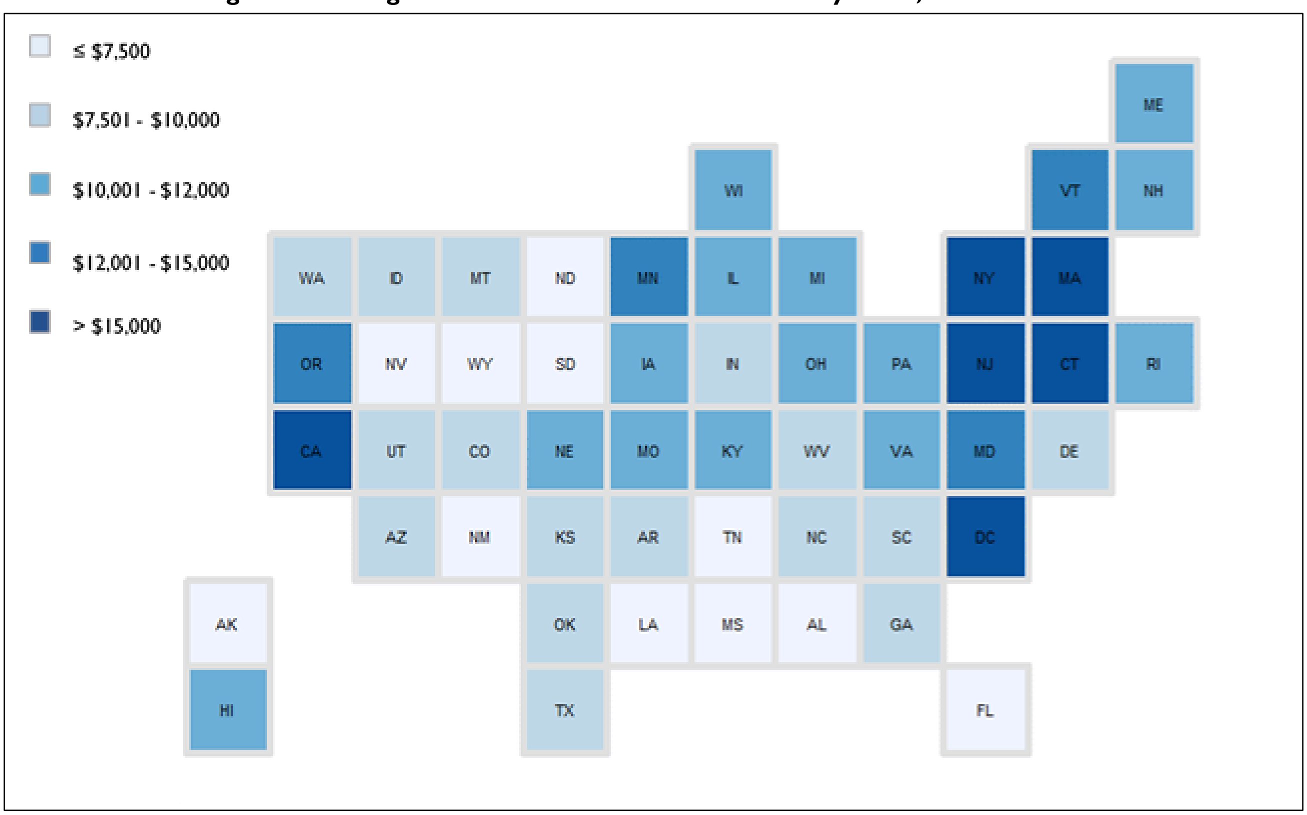
Income	Returns (thousands)	Amount (millions)
< $10K	5	<0.5
$10K-$20K	40	5
$20K-$30K	104	22
$30K-$40K	211	61
$40K-$50K	410	123
$50K-$75K	1,800	823
$75K-$100K	2,281	1,716
$100K-$200K	6,385	6,884
> $200K	5,342	10,573
Total	**16,577**	**20,208**

Source: Joint Committee on Taxation report JCX-81-18.

The value of the state and local tax deduction (and the effect of the changes enacted through P.L. 115-97) varies significantly across taxpayers, as income levels and other factors that may influence federal rates of tax itemization will also affect the relative benefit of the SALT deduction to a given household. A February 2019 Treasury Inspector General report estimated that 11 million taxpayers would have been subject to the $10,000 cap had it been effective for tax year 2017, though many of those households may claim the larger standard deduction for the 2018 tax year.

Localities with higher state and local tax rates are also likely to have more taxpayers whose SALT deductions are limited by the $10,000 cap on nonbusiness tax payments. **Figure 1** shows the average SALT deduction claimed per resident across select states in tax year 2016 (before the cap took effect). The average taxpayer claiming a SALT deduction in New York claimed a deduction that was more than four times greater than the deduction claimed by a SALT claimant in Alaska. The $10,000 limitation is therefore likely to affect a much greater share of taxpayers in New York than it will for Alaskan taxpayers.

Figure 1. Average Amount Deducted Per Claimant By State, Tax Year 2016



Source: Internal Revenue Service, SOI Historic Table 2.

Notes: Claims made before the $10,000 limitation on nonbusiness deductions took effect. States listed using their postal abbreviations.

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