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Repealing "SALT" Cap Would Be Regressive and Proposed Offset Would Use up Needed Progressive Revenues

By Chuck Marr, Kathleen Bryant, and Michael Leachman

A bill from House Ways and Means Chairman Richard Neal and others would modify and then repeal for two years the 2017 tax law's cap on the federal deduction for state and local taxes (SALT) and offset the cost over ten years by returning the top individual tax rate to 39.6 percent. By itself, repealing the SALT cap would overwhelmingly benefit high-income households, since most low- and middle-income taxpayers don't face the SALT cap. In addition, paying for repeal by raising the top rate would use up a source of progressive revenue that would no longer be available to fund other, more critical priorities.

As a result, the Ways and Means bill would not address two central flaws of the 2017 tax law overall: its steep cost and its heavy tilt toward wealthy individuals and profitable corporations. Chairman Neal and the Ways and Means Committee have separately advanced legislation, the Economic Mobility Act, that would expand refundable tax credits to help low- and moderate-income families, as a down payment on beginning to restructure the 2017 law.[1] Given the steep cost of full repeal of the SALT cap, however, more modest proposals to modify the SALT cap offer a superior approach; such proposals can be designed to exempt the vast share of taxpayers from the cap and at far less cost.

The 2017 tax law imposed a $10,000 cap on the state and local taxes that filers can deduct on their federal tax returns. The Ways and Means bill would raise the cap in 2019, to $20,000 for married couples, and repeal it altogether in 2020 and 2021; the bill would offset the cost by reversing the 2017 tax law's reduction in the top income tax rate from 39.6 percent to 37 percent.[2]

- **Repealing the cap would be regressive and costly.** The top 1 percent of households would receive 56 percent of the benefit of repeal, and the top 5 percent of households would

[1] Chuck Marr, Yixuan Huang, and Vincent Palacios, "House Ways and Means Committee Legislation Would Expand EITC and Child Tax Credit," Center on Budget and Policy Priorities, updated July 2, 2019, https://www.cbpp.org/research/federal-tax/house-ways-and-means-committee-legislation-would-expand-eitc-and-child-tax.

[2] Joint Committee on Taxation, Table JCX-52-19, December 10, 2019, https://www.jct.gov/publications.html?func=startdown&id=5235. Increasing the top rate to 39.6 percent raises $191 billion over ten years, while the SALT provisions lose $185 billion.

receive over 80 percent of the benefit, while the *bottom* 80 percent of households would receive just 4 percent, according to the Tax Policy Center (TPC).[3] The cost of just the SALT provisions over ten years would be roughly $185 billion, according to Joint Committee on Taxation (JCT) estimates.[4] If repeal were later extended through 2025 (the last year the cap is in effect under current law), we estimate that the total cost would grow to nearly $600 billion.[5]

- **Few middle-income households would benefit.** The vast majority of households in the bottom 80 percent are unaffected by the SALT cap and thus would not benefit from its repeal. Fewer than 3 percent of households in the middle income quintile (those between roughly $51,000 and $88,000 in 2018), and fewer than 10 percent of households in the fourth quintile (those between roughly $88,000 and $157,000 in 2018), would receive any tax cut from repeal, according to TPC.[6]
- **Higher-income households affected by the cap would still receive a large *net tax cut* from the 2017 tax law overall.** Given the controversy around the SALT cap and the attention it has received, policymakers and many filers affected by the cap may mistakenly assume that affected filers fared poorly under the 2017 law. Both nationally and in affluent states, however, households in the 95th to 99th percentiles of the income spectrum — many of whom live in affluent suburbs and may feel targeted by the SALT cap — received the largest net tax cuts from the tax law, measured as a share of pre-tax income.[7]

To be sure, the Ways and Means bill would pay for a tax cut for high-income people with a tax increase on high-income people. But the resulting distribution of the 2017 law would remain largely unchanged: it would remain heavily tilted in favor of high-income people.[8] And a key source of progressive revenue — an increase in the top rate to 39.6 percent — would no longer be available to fund a range of pressing needs.

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[3] Tax Policy Center, TPC Table T18-0140, September 24, 2018, https://www.taxpolicycenter.org/model-estimates/repeal-10000-state-and-local-tax-salt-deduction-limitation-sep-2018/t18-0140-repeal. The cash income limits for each percentile class are as follows (in 2018 dollars): $25,700 for the bottom quintile, $50,500 for the second quintile, $88,000 for the third quintile; $157,000 for the fourth quintile; $326,900 for the next 15 percent, and $773,200 for the next 4 percent. Households earning above $773,200 are in the top 1 percent. Figures are expressed in 2017 dollars in the TPC table but in 2018 dollars in this paper.

[4] JCT Table JCX-52-19.

[5] CBPP calculations based on JCT and TPC estimates. JCT Table JCX-52-19; Tax Policy Center, Table T18-0143, September 24, 2018, https://www.taxpolicycenter.org/model-estimates/repeal-10000-state-and-local-tax-salt-deduction-limitation-sep-2018/repeal-10000.

[6] TPC Table T18-0140.

[7] Steve Wamhoff, Meg Wiehe, and Matthew Gardner, "The Final Trump-GOP Tax Plan: National and 50-State Estimates for 2019 & 2027," Institute on Taxation and Economic Policy, December 16, 2017, https://itep.org/finalgop-trumpbill/.

[8] Chuck Marr, Brendan Duke, and Chye-Ching Huang, "New Tax Law is Fundamentally Flawed and Will Require Basic Restructuring," Center on Budget and Policy Priorities, updated August 14, 2018, https://www.cbpp.org/research/federal-tax/new-tax-law-is-fundamentally-flawed-and-will-require-basic-restructuring.

More modest modifications to the SALT cap are available, such as raising the cap — for example, to $20,000 for all filers[9] — or exempting taxpayers with incomes below a level such as $200,000 or $250,000 from the cap.

Repealing Cap Would Be Costly and Give the Biggest Benefit to Top 1 Percent

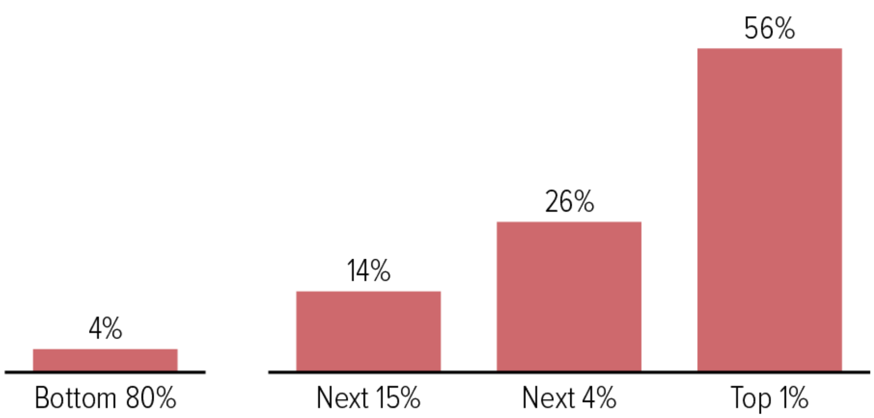
The 2017 tax law imposed a $10,000 cap on the allowable state and local tax deductions for both single filers and married couples. The cap is scheduled to expire in 2025, along with the law's other individual income-tax provisions. The Ways and Means bill would raise the cap for married couples to $20,000 for 2019 and then repeal the cap for all filers in 2020 and 2021.

Repealing the cap would be very regressive, raising average after-tax incomes by 2 percent for the top 1 percent of households but by just 0.02 percent for the bottom 80 percent of households.[10] More than half of the benefit would flow to those in the top 1 percent; over 80 percent of the benefit would flow to the top 5 percent. (See Figure 1.)

FIGURE 1

Benefits of SALT Cap Repeal Would Flow Heavily to the Top

Share of tax cut by income group, 2018



Note: The 2017 tax law capped the amount of state and local taxes (SALT) that filers can deduct from their federal taxes at $10,000.

Source: Tax Policy Center Table T18-0140

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[9] We offer this as an example because it is one of the proposals for which we have estimates on its cost and impact, from the Institute on Taxation and Economic Policy. See footnote 23.

[10] Repealing the SALT cap would provide only a negligible benefit for the bottom 80 percent of households because only a small share of them have deductions large enough for them to itemize rather than take the standard deduction. Table T18-0140.

Relatively Few Middle-Income People Would Benefit From Repeal

All taxpayers can choose between taking the standard deduction and itemizing their deductions, such as for SALT, mortgage interest, and charitable giving. If their deductions' combined value exceeds the standard deduction, they typically itemize.

Most middle-income households took the standard deduction even before the 2017 tax law. And because that law doubled the standard deduction — to $24,000 for married filers and $12,000 for single filers — even fewer taxpayers itemize now, independent of the effects of the SALT cap.[11] Specifically, married filers who previously had itemized deductions totaling between $12,000 and $24,000 now are likely to use the standard deduction.

Consider, for example, a married couple with no children and $100,000 in income that previously claimed itemized deductions of $22,900, including $11,900 in state and local taxes.[12] In 2018, the SALT deduction was capped at $10,000, but the cap didn't affect this couple. Because the new $24,000 standard deduction exceeds the $22,900 in itemized deductions that the couple would claim *without* the SALT cap, the couple would continue claiming the standard deduction if the SALT cap is repealed.

Relatively few middle-income taxpayers consequently would benefit from repealing the SALT cap. *Only 2.9 percent of households in the middle quintile would receive any tax cut*, according to the Tax Policy Center.[13] (See Figure 2.) Fewer than 1 percent of households in the bottom two quintiles would benefit.[14] Even in the fourth quintile, only 10 percent of households would benefit.

The impact of repeal in specific states would vary because their tax codes differ. But in *no* state does the SALT cap affect more than 10 percent of households in the middle quintile, according to analysis by the Institute on Taxation and Economic Policy (ITEP).[15] The cap affects a larger share of households in the fourth quintile, but even in New Jersey, the state with the largest such share, two-thirds of households in the fourth quintile are unaffected.[16] This is why alternative approaches can be crafted that would exempt most of the taxpayers affected by the cap at much lower cost.

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[11] "Fewer Taxpayers Might Itemize Due to Tax Reform, IRS Says," Tax Notes, November 21, 2018, https://www.taxnotes.com/tax-notes-today/individual-income-taxation/fewer-taxpayers-might-itemize-due-tax-reform-irs-says/2018/11/26/28mfz; Tax Policy Center Table T18-0002, January 11, 2018, https://www.taxpolicycenter.org/model-estimates/impact-itemized-deductions-tax-cuts-and-jobs-act-jan-2018/t18-0002-impact-number; Joint Committee on Taxation Table JCX-32-18, April 23, 2018, https://www.jct.gov/publications.html?id=5091&func=startdown.

[12] Analysis of data from the National Taxpayer Advocate's reports to Congress, 2016. These figures are imputed based on the average deductions in 2016 for households in Connecticut with adjusted gross incomes in the $75,000-$100,000 and $100,000-$150,000 ranges.

[13] TPC Table T18-0140.

[14] *Ibid.*

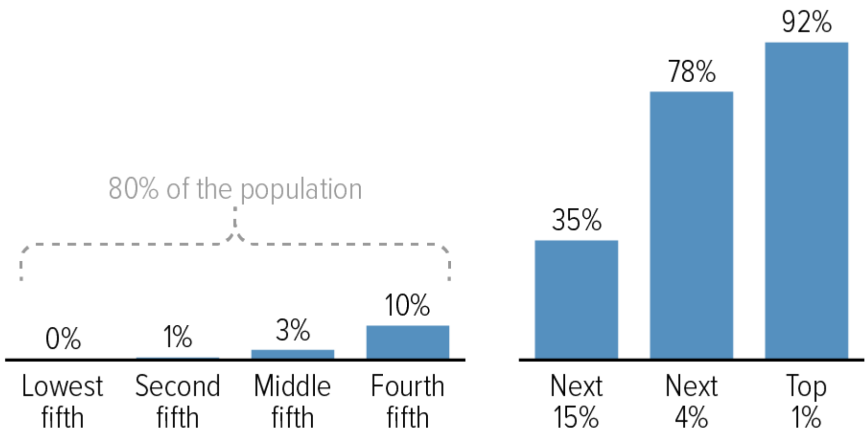
[15] Unpublished figures from Steve Wamhoff, Institute on Taxation and Economic Policy, 2019.

[16] *Ibid.*

FIGURE 2

Vast Majority of Americans Would Receive No Benefit From SALT Cap Repeal

Share of households receiving *any* benefit from repeal, 2018



Note: The 2017 tax law capped the amount of state and local taxes (SALT) that filers can deduct from their federal taxes at $10,000.

Source: Tax Policy Center Table T18-0140

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Affluent Households Were Biggest Winners From 2017 Law, Despite SALT Cap

In high-income, high-tax states, the SALT cap typically affects about 9 in 10 households in the 95th to 99th percentiles.[17] Even so, these households received the largest net tax cut from the 2017 tax law (measured as a share of income). Nationally, the tax cut from the 2017 law amounts to 3.5 percent of pre-tax income for those in the 95th to 99th percentiles, on average, as compared to 2.7 percent of pre-tax income for the top 1 percent of households (and 1.3 percent of pre-tax income for the bottom 60 percent), according to ITEP.[18]

The same pattern holds in the states most affected by the SALT cap. In New York, for example, households in the 95th to 99th percentiles received a tax cut worth 3.0 percent of their pre-tax income, on average. This is double the average for all filers in the state and the highest percentage for any New York income group that ITEP examined.[19]

Two key reasons help explain why these households received such large tax cuts from the 2017 law despite the SALT cap. First, the law lowered income tax rates across many of the seven tax brackets. Second, the law substantially scaled back the individual alternative minimum tax (AMT) in

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[17] *Ibid.*

[18] TPC finds similar results when measuring tax cuts as a share of *after*-tax income. ITEP numbers are used for this analysis because ITEP provides state data, while TPC does not. Wamhoff, Wiehe, and Gardner, 2017.

[19] *Ibid.*

ways that made the AMT much less likely to affect taxpayers in the 95th to 99th percentiles. Specifically, it raised the amount of income that is exempt from the AMT for a married couple from $86,200 to $109,400 in 2018. And it dramatically increased the income level above which the exemption begins to phase out, from $164,100 to $1 million for a married couple in 2018.[20]

The AMT is a parallel tax system that requires households to calculate their tax liabilities under a different set of rules. It is designed to ensure that higher-income people who take large deductions pay at least a minimum level of tax, and does so by not allowing taxpayers to deduct certain items like SALT or miscellaneous business expenses when calculating their AMT liability. Before the 2017 tax law, 80 percent of tax filers who had to pay the AMT had incomes between $200,000 and $1 million.[21] Under the 2017 law, many fewer households in that income range will owe the AMT and those that do will owe less AMT tax.

Unlike middle-income households, many of these higher-income households will likely continue itemizing their deductions, so the law's higher standard deduction won't shield them from the effects of the SALT cap; the cap is likely to reduce their overall itemized deductions and thus increase their taxable income. But that income faces lower tax rates due to the 2017 law, and these households typically owe *much less* in AMT or none at all — factors that more than offset the SALT cap for most of these households.

Impact on State and Local Budgets Unclear

The SALT cap could make it harder for some states and localities to raise revenues from progressive tax sources if it reduces support for state and local taxes on the part of higher-income filers who can no longer deduct all their state income tax and local property tax payments. On the other hand, the 2017 tax law overall was so skewed to the top that it may spur some states and localities to raise *more* revenue from high-income residents to help pay for better schools and other investments that can expand opportunity. Since the 2017 law took effect, for example, New Jersey has raised income taxes for households with incomes over $5 million, New York has extended an existing millionaires' tax, and Connecticut, New York, and Washington state have adopted or expanded a real estate transfer tax on high-value homes (often referred to as a "mansion tax").[22]

Some also may worry that the SALT cap will encourage wealthy people to leave high-income states by effectively raising their state and local taxes. The empirical evidence, however, does not support that view. Most research finds that state and local personal income tax levels have an

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[20] Before the 2017 tax law's enactment, the AMT exemption amount in 2018 was scheduled to be $86,200 for married filers, and the exemption phase-out threshold was scheduled to be $164,100. As noted in the text, the 2017 law increased the exemption amount and the exemption phase-out threshold in 2018, to $109,400 and $1 million, respectively. Both of these new levels will be adjusted for inflation in future years.

[21] Internal Revenue Service Statistics of Income Table 1.4, 2016, https://www.irs.gov/statistics/soi-tax-stats-individual-statistical-tables-by-size-of-adjusted-gross-income.

[22] For more on mansion taxes see Michael Leachman and Samantha Waxman, "State 'Mansion Taxes' on Very Expensive Homes," Center on Budget and Policy Priorities, updated October 1, 2019, https://www.cbpp.org/research/state-budget-and-tax/state-mansion-taxes-on-very-expensive-homes. For more on millionaires' taxes, see Wesley Tharpe, Millionaires' Taxes a Smart Way for States to Invest in Their Future," Center on Budget and Policy Priorities, February 7, 2019, https://www.cbpp.org/blog/millionaires-taxes-a-smart-way-for-states-to-invest-in-their-future.

insignificant impact on economic growth and that income-tax increases cause only a small number of high-income residents to move.[23]

Using Progressive Offsets for SALT Repeal Would Sacrifice Future Opportunity

The Ways and Means bill would pay for repealing the SALT cap by returning the top income tax rate to 39.6 percent. This approach is preferable to not paying for repeal or doing so in a regressive way, and proponents may note that this makes the proposal essentially neutral from a distributional perspective. But that would miss an important point: *every dollar of progressive revenue used to offset SALT cap repeal would then be unavailable to meet national priorities,* and in particular, to improve the economic standing of low- and middle-income people.

The 2017 tax law was heavily tilted towards high-income households, with the top 1 percent (and the next 4 percent) of households receiving average tax cuts more than twice as large as the bottom 60 percent, measured as a share of pre-tax income.[24] Working households in the bottom 60 percent of the income distribution have faced decades of low or stagnant wage growth even as income at the top has surged and inequality widened substantially; the 2017 tax law exacerbated these trends.

The 2017 law also deprives the Treasury of needed revenue. Even though the economy is near full employment, federal revenues will total just 16.3 percent of gross domestic product (GDP) in 2019, according to the Congressional Budget Office, well below the 18.4 percent average over the past four decades for this point in the economic cycle.[25]

Using a progressive offset to pay for repeal of the SALT cap would leave the 2017 law's fundamental flaws — its overall tilt to the top and its large cost — essentially unaddressed.

Less Costly Alternatives Would Significantly Reduce Cap's Reach

Alternative approaches to addressing concerns about the SALT cap are available that would be much less costly and would remove a significant share of taxpayers from the SALT cap, particularly households not at or near the top of the income ladder. For instance, the cap could be retained but

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23 See Michael Leachman and Michael Mazerov, "State Personal Income Tax Cuts: Still a Poor Strategy for Economic Growth," Center on Budget and Policy Priorities, updated May 14, 2015, https://www.cbpp.org/research/state-budget-and-tax/state-personal-income-tax-cuts-still-a-poor-strategy-for-economic; Michael Mazerov, "Millionaire Tax Flight Myth Debunked — Again," Center on Budget and Policy Priorities, May 26, 2016, https://www.cbpp.org/blog/millionaire-tax-flight-myth-debunked-again; Michael Mazerov, "State Taxes Have a Negligible Impact on Americans' Interstate Moves," Center on Budget and Policy Priorities, revised May 21, 2014, https://www.cbpp.org/research/state-budget-and-tax/state-taxes-have-a-negligible-impact-on-americans-interstate-moves.

24 Wamhoff, Wiehe, and Gardner, 2017.

25 Congressional Budget Office, "Monthly Budget Review: Summary for FY 2019," November 7, 2019, https://www.cbo.gov/system/files/2019-11/55824-CBO-MBR-FY19.pdf; Paul Van de Water, "2017 Tax Law Heightens Need for More Revenues," Center on Budget and Policy Priorities, November 15, 2018, https://www.cbpp.org/research/federal-tax/2017-tax-law-heightens-need-for-more-revenues.

at a higher amount (as the Ways and Means bill does in the first year), or policymakers could simply exempt taxpayers below a given income level from the cap.[26]

Doubling the current $10,000 cap to $20,000 for all taxpayers, for example, would cost roughly one-quarter as much as full repeal, ITEP estimates, while cutting the number of taxpayers facing the cap by more than half, from 9 percent nationally to 4 percent.

All taxpayers who now face the cap would benefit under this alternative, and the higher exemption amount would remove the cap entirely for most otherwise-affected middle-income households. The share of households in the fourth quintile facing the cap nationally would fall from 6 percent to just 1 percent. (The share of households in the 95th-99th percentiles facing the cap would fall from 68 percent to 50 percent, while the share of households in the top 1 percent facing the cap would fall from 91 percent to 84 percent.)

The same pattern would apply in high-income, high-tax states. In New Jersey, for example, 10 percent of households in the middle quintile and 32 percent in the fourth quintile now face the cap. If the cap were raised to $20,000, those figures would fall sharply to just 1 percent and 7 percent of such households, respectively, ITEP estimates. And while virtually all New Jersey taxpayers in the top 1 percent would still face the cap, they would benefit from the higher cap amount.

A second alternative approach would exempt from the SALT cap all taxpayers with adjusted gross income below a prescribed income level, such as $250,000. The limit on the SALT deduction would then be phased in for taxpayers with income between $250,000 and, for example, $350,000. Households with incomes above $350,000 still would face the $10,000 cap, as under current law.

This option would cost roughly one-fifth as much as full repeal, ITEP estimates. It would cost even less than the first alternative described above, while removing more taxpayers from the SALT cap. Nationally, the share of taxpayers facing the cap would fall from 9 percent to just 3 percent. In a high-income state such as New York, the share would fall from 15 percent to 5 percent — and would fall close to zero for households in the bottom 80 percent. Even in the 80th-95th percentiles, only 5 percent of households would face the cap.

These two alternatives are among the many ways to modify the SALT cap that would be preferable to full repeal.

[26] The cap would be phased in above this exemption level to avoid a cliff. All figures in this section on the impact of these alternative proposals are unpublished figures from Steve Wamhoff, Institute on Taxation and Economic Policy, 2019. Note: the Ways and Means proposal would double the cap just for married couples, whereas ITEP analyzed doubling it for both singles and married couples. All unpublished figures are calculated for 2020.