Changes in the Deductibility of State and Local Taxes: How to Respond?

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Acronyms Abound: TCJA and SALT

Before the law

- Most of the 30 percent of households that itemized deductions benefitted
- 10 percent of households with income less than $50,000
- 81 percent of households with income more than $100,000
- Cost of $96 billion in 2017 (TPC

TCJA

- Deductions for state and local income taxes capped at $10,000

Thanks to https://www.taxpolicycenter.org/briefing-book/how-does-deduction-state-and-local-taxes-work

How Do We Respond to This Change?

1. Why a SALT in the first place?
2. What are the state and local fiscal implications of this demise?
3. Should we mourn the (incomplete) demise?
4. Schemes for its resurrection
5. Is a resurrection desirable?

1. Why a SALT in the First Place?

- Avoid double taxation of income
- Protect state tax base from federal encroachment
- Has appeared, in ever-decreasing form, since advent of income tax
    - Revenue Act of 1862 allows state and local tax deductibility
    - Returns with permanent return of income tax in 1913
    - States' adoption of sales tax yields federal deductibility
    - 1944's introduction of standard deduction limits scope of SALT
    - 1986 TRA eliminates deductibility of sales taxes (CHECK!)

Thanks to http://www.taxhistory.org/thp/readings.nsf/ArtWeb/663D98E8EB142B3B852581C6005A9982?OpenDocument

2. Subnational Fiscal Implications of SALT's Demise

- DC definition of taxable income changes due to "rolling conformity" with federal definition
- District requires taxpayers to increase taxable income by SALT deduction
- Net impact of TCJA is to increase municipal tax collections
- Return it? spend it? and/or adopt a scheme to lower federal tax burden?

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For many states, this is in a context of historically low non-Medicaid spending

3. Should We Mourn SALT's Incomplete Demise?

Demise may

- Broaden base
- Decrease inequality
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- Equalize cost of sub-national taxation across modes

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But it might also

- Increase inequality
- Induce responses that complicate tax code
- Further penalize expensive, productive places

4. Schemes for Resurrection

1. Re-label taxes "charitable contributions" which remain deductible
2. Make income taxes employer-paid "payroll taxes" which remain deductible
3. Something extremely convoluted with pass-through business taxes

Empirical Aside: Where are the Low-Tax-State Law Professors?

A startlingly honest disclaimer from David: "As an upper-middle-income homeowner in a high tax state, I am undeniably a SALT beneficiary ... [with a] political/professional interest in SALT's revival."

- Can we look at the geographic distribution of authors of law review articles on these schemes?
- Do opinions change when the author moves?

5a. The Beauties of Resurrection

- Decreases cost of tax revenue for states
- Tax revenue is (sometimes) used for good things
- Can increase state and local spending on fundamental human capital investments

5b. The Downsides of Resurrection

- All schemes make tax code less transparent
- Tax payments solve public goods provision problem in a way that charitable contributions cannot
- Equating taxes and charitable contributions eats away at power of representative government to compel contributions for public goods