SALT & The Local Tax Deduction Subsidy

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The State and Local Tax Deduction

- The state and local tax deduction cost the federal government over $100 billion in 2017 alone
  - The $10,000 cap significantly reduced the cost of the SALT deduction, but it is set to expire in 2026 and there are proposals to increase the cap sooner
- The state and local tax deduction benefits taxpayers in two related ways:
  - (1) It allows itemizing taxpayers, who are relatively wealthy, to reduce their federal taxes, and
  - (2) It acts as a subsidy from the federal government to states and localities by effectively giving taxpayers a discount on their state and local taxes

The *State* Tax Deduction

- The state and local tax deduction is two separate deductions, one for state taxes and one for local taxes
  - Pre-TCJA, approximately half of the SALT deduction was for state taxes and approximately half was for local taxes
- Debates surrounding the SALT deduction generally focus on the state-level (rather than local-level) effects of the deduction and it is often described as a subsidy for high-tax, blue states
  - However, states and localities have very different compositions and fund very different things, and the justifications for a deduction are therefore different for states versus localities

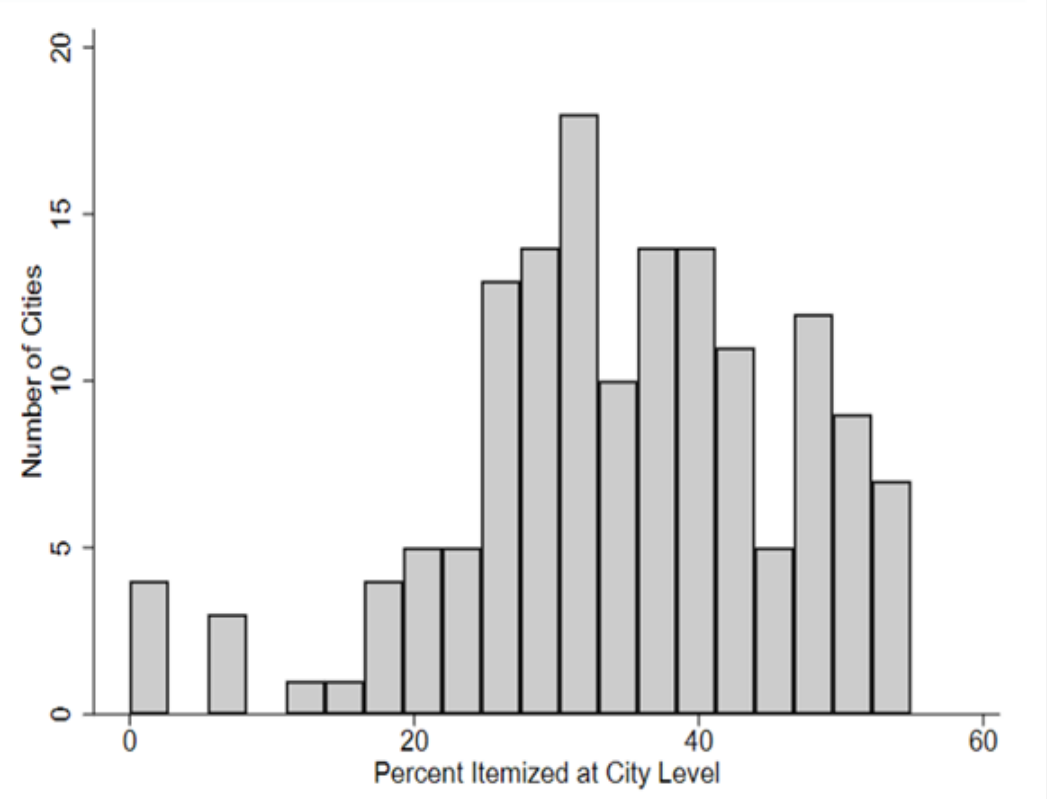
The *Local* Tax Deduction

- The local tax deduction *disproportionately subsidizes wealthy, economically segregated localities* because only the relatively wealthy can deduct their local taxes and benefit from the local tax deduction on their tax returns

Quantifying The *Local* Tax Deduction Subsidy

- The total subsidy received by a locality is driven by three factors:
  - (1) The concentration of itemizers in the locality,
    - Used IRS Statistics of Income (SOI) to determine the percentage of filers in each zip code who itemized
    - Merged the SOI with postal code data to aggregate zip codes to the local (school district, city, or county) level
  - (2) The amounts paid in local tax, and
    - Used property taxes as a proxy for local taxes
      - The SOI does not distinguish between state and local taxes
      - However, we know that deductible local taxes are primarily composed of local income taxes and real estate taxes
    - Thirty-seven states do not permit cities and counties to levy an income tax, so for those states the deductible local taxes paid should be almost exclusively local property taxes, which are available on the SOI
  - (3) The federal tax rate applicable to the itemizers
    - There are 4 filing statuses and 6 AGI buckets, so we have 24 potential "estimated tax rates for status"

Utah: Percentage of Tax Returns that Itemize



City	Percent Itemized
Herriman	51.68%
Draper	49.67%
Park City	49.09%
Springville	36.91%
Salt Lake City	32.90%
Brigham City	31.82%
West Valley	24.60%
Salina	23.36%
Helper	20.65%

Utah: Federal Subsidy Per Taxpayer for Local Taxes

City	SALT Subsidy per Itemizer
Park City	$1,564
Draper	$966
Herriman	$680
Salt Lake City	$783
Springville	$490
Brigham City	$439
West Valley	$422
Salina	$388
Helper	$369

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The Local Tax Deduction & Economic Segregation

- The fact that the local tax deduction disproportionately subsidizes wealthy, economically homogeneous localities means that the deduction rewards (and provides an incentive for) economic segregation
  - The $10,000 cap reduces the rewards of economic segregation but is certainly imperfect
- What about redistribution?
  - When there is a not a strong correlation between taxes paid and benefits received, then there is a strong argument that taxes should be deductible
  - State taxes are relatively redistributive
  - Local taxes are generally less redistributive. Local level redistribution occurs when:
    - a locality is less economically homogeneous (compare Scarsdale to NYC and LA County), and
    - when there is state-forced redistribution among localities