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# Key Issues in Tax Reform: Itemized Tax Deductions

## Brief 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, unreimbursed employee business expenses, and extraordinary medical expenses. For high-income filers, a limit on itemized deductions ("Pease" limitation) might apply, but this provision actually is structured more like an income surtax since it is triggered by income and not by the amount of deductions claimed.

As shown in **Table 1**, 30% of all filers in the 2015 tax year chose to itemize. The average sum of itemized deductions among all filers was $28,214, but this total varied widely from one end of the income spectrum to the other.

**Table 1. Tax Data on Itemizers, Tax Year 2015**

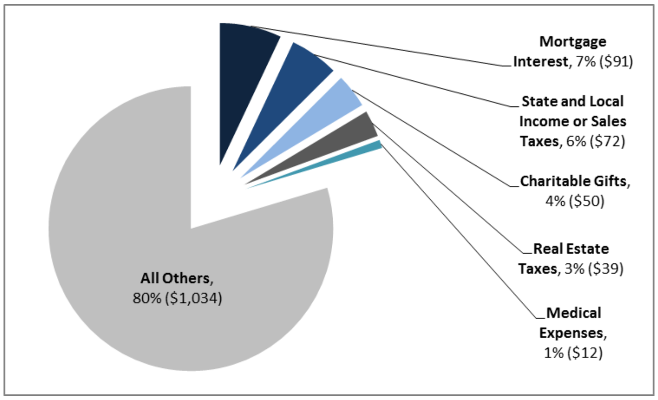
| Adjusted Gross Income (AGI) | Share of Tax Filers Who Itemize | Average Sum of Deductions Claimed per Itemizer |
|---|---|---|
| $1 to $19,999 | 5% | $15,596 |
| $20k to $49,999 | 17% | $16,115 |
| $50k to $99,999 | 44% | $19,199 |
| $100k to $199,999 | 76% | $25,517 |
| $200k to $499,999 | 94% | $43,427 |
| $500k to $1 million | 93% | $84,820 |
| $1 million + | 91% | $436,732 |
| ***All tax filers*** | ***30%*** | ***$28,214*** |

**Source:** CRS analysis of the Internal Revenue Service's Statistics of Income data, Tables 1.4 and 2.1, at https://www.irs.gov/uac/soi-tax-stats-individual-statistical-tables-by-size-of-adjusted-gross-income.

## Budgetary Issues Under Current Law

Some itemized deductions rank among the largest individual tax expenditures, or revenue losses compared to a broader baseline of income. Specifically, the deductions for mortgage interest, state and local taxes, and charitable contributions rank within the top 10 largest individual tax expenditures, according to estimates by the Joint Committee on Taxation (JCT). **Figure 1** indicates that the five largest itemized deductions, in terms of revenue loss, account for $264 billion (without interaction effects), or 20% of all individual tax expenditures, in FY2018.

**Figure 1. Itemized Deductions Estimated to Contribute Most to Revenue Losses ($ Bil.), FY2018**




**Source:** CRS analysis of JCT, *Estimates of Federal Tax Expenditures, For Fiscal Years 2016-2020*, 115th Congress, 1st session, January 3, 2017, JCX-3-17.

**Notes:** CRS tabulated the sum of all individual tax expenditures included in the JCT publication as $1,298 billion in FY2018. Numbers might not add to 100% due to rounding.

## The Tax Cuts and Jobs Act (TCJA; H.R. 1)

**Table 2** summarizes changes to select itemized deduction provisions proposed in the House and Senate versions of the TCJA. Both versions would repeal most itemized deductions or at least restrict them, relative to current law, beginning in 2018. The House version retains individual itemized deductions only for mortgage interest, state and local real property taxes (up to $10,000), and charitable contributions.

The House and Senate versions would also repeal personal exemptions, increase the standard deduction, and index the standard deduction to inflation using the Chained Consumer Price Index for all Urban Consumers (C-CPI-U) instead of the current unchained CPI-U. Under current law, the standard deduction in 2018 for married joint filers is $13,000 with a combined personal exemption of $8,300 (for a total of $21,300). Single filers can claim a standard deduction of $6,500 plus a personal exemption of $4,150 (for a total of $10,650). Within certain income limits, additional personal exemptions can be claimed for any dependents.

**Economic Issues.** From an economic perspective, itemized deductions target a mixed bag of economic activities. Some provisions encourage certain types of behavior (e.g., purchasing a mortgaged house, charitable giving), account for circumstances that reduce a filer's ability to pay taxes (e.g., extraordinary medical expenses, unreimbursed employee business expenses, casualty and theft losses), or subsidize state and local government spending (e.g., deduction for state and local nonbusiness taxes). Some of these activities could have positive or negative spillover effects that could affect assessments of their justification in the tax code. Alternatively, some of these benefits could be delivered through direct spending programs to reduce the complexity and enhance the progressivity of the tax code.

A broader argument can be made that itemized deductions are regressive, as most of the benefits of itemized deductions accrue to higher-income filers. Itemized deductions are typically claimed by one-third of individual filers, and most of these filers are middle- to higher-income. The provisions are structured as a deduction also means the tax benefit of an itemized deduction increases with one's top marginal tax rate.

Repeal or restriction of itemized deductions combined with an increase in the standard deduction will decrease the share of tax filers that itemize under the changes proposed in the TCJA. The Chief of Staff to the JCT testified during markup of the House version that the share of tax filers that itemize would decrease from 29% to 6% in 2018 under that proposal. Although both versions of the TCJA maintain deductions for mortgage interest and charitable giving, for example, only those with total itemized deductions exceeding the increased standard deduction will be motivated by the tax-based incentives to engage in further activity related to those provisions.

Changes to specific itemized deductions in both versions of the TCJA would have mixed distributional effects. Broad repeal of itemized deductions, particularly for state and local income taxes, and increasing the standard deduction would increase progressivity of the individual tax code.

Post-TCJA, the tax benefits from itemized deductions are likely to be even more concentrated in higher-income ranges. Middle and upper-middle income taxpayers will be less likely to itemize due to the higher standard deduction and the repeal and modification of other provisions.

**Budgetary Issues.** Limits on itemized deductions raise revenue by increasing the amount of income subject to taxation and potentially subjecting more income to higher marginal tax rates. In both versions of the TCJA, the revenue increase from limiting itemized deductions would be partially offset by more tax filers claiming the standard deduction. Indexing the standard deduction to the C-CPI-U will reduce budgetary costs over time because this chained index grows more slowly than the unchained CPI-U used under current law.

**Table 2.Changes to Select Provisions in the Tax Cuts and Jobs Act, Effective Tax Year 2018**

| Provision | House Version (H.R. 1) | **Modification to Senate Chairman's Mark** (All provisions except C-CPI-U indexation expire after 2025) |
|---|---|---|
| Standard deduction (2018 amounts by filing status) | $12,200 (S); $18,300 (HOH); $24,400 (MFJ) Indexed to C-CPI-U inflation beginning in 2020 | $12,000 (S); $18,000 (HOH); $24,000 (MFJ) Indexed to C-CPI-U inflation beginning in 2019 |
| "Pease" limitation | Repeal | Repeal |
| **Select itemized deductions** | | |
| State and local nonbusiness taxes | | |
| *–Income or sales, personal property* | Repeal | Repeal |
| *–Real estate* | Restrict deduction to $10k | Repeal |
| Mortgage interest | Restrict deduction to first $500,000 in indebtedness on primary residence and repeal deduction for home equity indebtedness | Maintain current law restriction to interest deduction on first $1m in mortgage indebtedness on primary or secondary residences but repeal deduction for home equity indebtedness |
| Charitable contributions | Maintain current law, with modifications | Maintain current law, with modifications |
| Medical expenses deduction | Repeal | Maintain current law restriction that costs are only deductible if they exceed 10% of adj. gross income |
| Personal casualty losses | Repeal. Preserve the an above-the-line deduction for certain casualty losses associated with special 2017 disaster legislation | Restrict deduction to casualty losses associated with certain disasters |

**Sources:** CRS summary of Tax Cuts and Jobs Act (H.R. 1) and JCT documents. See JCT, *Description of H.R. 1, The "Tax Cuts and Jobs Act",* JCX-50-17, November 9, 2017; *Description of the Chairman's Modification to the Chairman's Mark of the "Tax Cuts and Jobs Act",* JCX-56-17, November 14, 2017; and *Description of the Chairman's Mark of the "Tax Cuts and Jobs Act",* JCX-51-17, November 9, 2017.

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