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Federal Deductibility of State and Local Taxes

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Summary

Under current law, taxpayers who itemize can deduct state and local real estate taxes, personal property taxes, income taxes, and sales taxes (in lieu of income taxes) from federal income when calculating taxable income. The federal deduction for state and local taxes (the SALT deduction) shifts the burden for part of these state and local taxes to the federal government through lower tax collections. Theory would suggest that taxpayers are willing to accept higher state and local tax collections under this system because their federal tax deduction mitigates the net effect of such increases. In addition, there is some evidence that state and local governments rely more on these deductible taxes than on nondeductible taxes and fees for services. SALT deduction benefits are disproportionately claimed by high-income taxpayers and taxpayers in areas with high state and local tax rates.

The 2017 tax revision (commonly referred to as the Tax Cuts and Jobs Act, TCJA; P.L. 115-97) made a number of changes to the SALT deduction. Most notably, the TCJA established a limit, or "SALT cap," on the amounts claimed as SALT deductions for tax years 2018 through 2025. The SALT cap is $5,000 for married taxpayers filing separately and $10,000 for all other taxpayers.

The changes enacted in the TCJA have considerably affected SALT deduction activity since 2018 and will continue to do so through 2025, when most individual TCJA provisions are scheduled to expire. The increased value of the standard deduction, roughly doubling from its pre-TCJA value for tax years 2018 through 2025, along with the reduced availability of SALT and other itemized deductions, have both reduced the number of taxpayers claiming the SALT deduction and the average amount claimed per deduction. The SALT deduction changes enacted through the TCJA are currently scheduled to expire after tax year 2025.

Recent Congresses and administrations have considered a variety of changes to the SALT deduction in recent years, including making the SALT cap permanent, raising and extending the SALT cap, eliminating SALT deduction claims for sales taxes, and capping the effect of SALT deductions on tax liability. Limiting the SALT deduction could result in state and local public spending declines, as the SALT deduction effectively makes the federal government "pay for" a portion of state and local taxes. The magnitude of any such decline would be uncertain. Limiting the SALT deduction would also shift some of the federal tax burden away from taxpayers in low-tax states and low-income taxpayers to taxpayers in high-tax states and high-income taxpayers. Expanding SALT deduction benefits would have the opposite effect, placing a greater burden on low-income taxpayers and taxpayers in low-tax states.

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Introduction

Federal deductibility of state and local taxes (the "SALT deduction") is one of the principal ways federal, state, and local tax systems interact. Generally, individual taxpayers who itemize deductions are allowed to deduct real and personal property taxes, state and local income taxes, and sales taxes (in lieu of income taxes) paid from federal taxable income.

The 2017 tax revision (commonly referred to as the Tax Cuts and Jobs Act, TCJA; P.L. 115-97) made a number of changes to the SALT deduction. Most notably, the TCJA established a limit, or "SALT cap," on the amounts claimed as SALT deductions for tax years 2018 through 2025. The SALT cap is $5,000 for married taxpayers filing separately and $10,000 for all other taxpayers.

The changes enacted in the TCJA affect SALT deduction activity in tax years 2018 through 2025. The increased value of the standard deduction, roughly doubling from its pre-TCJA value for tax years 2018 through 2025, along with the reduced availability of SALT and other itemized deductions, have reduced both the number of SALT deduction claimants and the average amount claimed per return. The SALT deduction changes enacted through the TCJA are set to expire after tax year 2025 under current law.

This report summarizes the history of the SALT deduction, reviews each type of eligible state and local tax, and briefly discusses SALT deduction issues of potential interest to Congress.

Overview

Generally, taxpayers may deduct certain state and local taxes paid from income. Individual taxpayers must itemize deductions, rather than use the standard deduction, on their income tax return to claim the deduction for state and local taxes paid. Business taxpayers, in contrast, may deduct state and local taxes as a cost of doing business.

The federal tax savings from the deduction equals the taxpayer's marginal tax rate multiplied by the size of the deduction. Because the federal income tax rate regime is progressive and high-income filers are more likely to itemize, an itemized deduction favors taxpayers in higher income tax brackets.[1] For example, the Joint Committee on Taxation (JCT) projects that 87% of all benefits from the deduction of state and local taxes paid will accrue to individuals with adjusted gross incomes greater than $100,000 in calendar year 2025.[2]

The SALT deduction allows state and local governments to levy more taxes than they otherwise could as it effectively offsets some of any tax increase. This system represents a form of transfer, however indirect, from the federal government to state and local governments. By limiting the deduction's benefits, the SALT cap increases the cost (or "price") of state and local taxes for affected taxpayers. For example, an itemizing taxpayer with a 35% marginal tax rate and $12,000 in eligible SALT payments, the true net price of those taxes after accounting for the federal SALT deduction but without a SALT cap, is $7,800 (or $12,000*[1-0.35]). With the same tax situation but a $10,000 SALT limitation, the cost of those taxes to the taxpayer rises to $8,500 (or $2,000 + $10,000*[1-0.35]). Research has found that state and local governments respond to changes in the SALT deduction with shifts in their own tax and spending practices.[3]

[1] A progressive tax is one in which the rate of tax increases with income.

[2] Joint Committee on Taxation, "Background on the Itemized Deduction for State and Local Taxes," June 2019, JCX-35-19, available at https://www.jct.gov/publications/2019/jcx-35-19/.

[3] Bradley Heim and Yulianti Abbas, "Does Federal Deductibility Affect State and Local Revenue Sources?" *National Tax Journal*, vo. 68, no. 1 (2015), p. 33.

History

The deduction from federal income for state and local taxes paid originates from the Revenue Act of 1913, which included a provision that allowed the deduction for "all national, State, county, school and municipal taxes paid within the year, not including those assessed against local benefits."[4] State sales taxes, however, were not introduced until 1932, and a deduction for those taxes for individuals was not explicitly stated in the tax code until passage of the Revenue Act of 1942 (P.L. 77-753). The deductibility provision was frequently modified over the years, including the introduction of the standard deduction in lieu of itemizing deductions in 1944, but significant revision did not occur until 1964 with enactment of the Revenue Act of 1964 (P.L. 88-272).

Before the 1964 act, a deduction was allowed for all state and local taxes paid or incurred within the taxable year except those taxes explicitly excluded. After the 1964 act, only taxes explicitly mentioned were deductible. Included in the list of deductible taxes were state and local taxes on real and personal property; income; general sales; and the sale of gasoline, diesel fuel, and other motor fuels. A new subsection in the 1964 act spelled out the test for deductibility of general sales taxes. First, the tax must be a sales tax (a tax on retail sales) and second, it must be general, that is, imposed at one rate on the sales of a wide range of classes of items. "Items" could refer either to commodities or services.

The deductibility provision remained largely unchanged until the deduction for sales taxes was repealed by the Tax Reform Act of 1986 (TRA 1986, P.L. 99-514). One of the primary goals of TRA 1986 was to broaden the base of the federal income tax. Eliminating the deduction for all state and local taxes paid was one of the policy options considered to broaden the tax base. The final version of TRA 1986 repealed the deduction for general sales taxes but preserved the deduction for ad valorem property taxes and income taxes. The Joint Committee on Taxation summary of TRA 1986 suggested that Congress chose to repeal the sales tax deduction and not income or property taxes, because:

- only general sales taxes were deductible and not selective sales taxes (e.g., tobacco and alcohol taxes), which created economic inefficiencies arising from individuals changing consumption patterns in response to differential taxation;
- the deduction was not allowed for taxes paid at the wholesale level (and passed forward to the consumer), thus creating additional inequities and inefficiencies;
- the sales tax deduction was administratively burdensome for taxpayers who chose to collect receipts to justify sales tax deduction claims; and
- the alternative sales tax deduction tables – which calculated the amount of sales taxes that could be a deduction as a function of basic filer characteristics – generated by the Internal Revenue Service (IRS) did not accurately reflect individual consumption patterns, thereby diminishing the equitability of the tax policy.[5]

The American Jobs Creation Act of 2004 (AJCA 2004, P.L. 108-357) reinstated deductible sales tax *in lieu of* income taxes.[6] This meant taxpayers had the option of deducting either their state

[4] The 16th Amendment allowed for the taxation of income without regard to apportionment among the states. With the new constitutional authority, Congress passed The Revenue Act of 1913, initiating the current federal income tax.

[5] For more on the 1986 Act, see U.S. Congress, Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986 (H.R.3838 , 99th Congress;* P.L. 99-514*)*, 100th Cong., 1st sess., JCS-10-87 (Washington: GPO, 1987), pp. 47-48.

[6] IRS Publication 600, *Optional Sales Tax Tables*, provides an explanation of the new sales tax deduction.

and local sales taxes or income taxes, in contrast to the "in addition to" treatment in pre-TRA 1986 tax law. The concerns noted above still held. A secondary concern—presented during the debate before the repeal of sales tax deductibility in 1986—that states would alter their tax structures in response to the elimination of sales tax deductibility, would not arise. The AJCA 2004 sales tax deductibility provision expired after the 2005 tax year, but was extended on multiple occasions: through 2007 by the Tax Relief and Health Care Act of 2006 (P.L. 109-432); through the 2009 tax year by the Emergency Economic Stabilization Act of 2008 (P.L. 110-343); through the 2011 tax year by The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312); through the 2013 tax year by The American Taxpayer Relief Act (P.L. 112-240); and through the 2014 tax year by the Tax Increase Prevention Act of 2014 (P.L. 113-295). The Consolidated Appropriations Act, 2016 (P.L. 114-113) permanently incorporated the deduction of state and local sales taxes in lieu of state and local income taxes into the tax code.

The TCJA established a temporary limit, or "SALT cap," on annual SALT deduction claims for tax years 2018 through 2025. In each of those years, the limit was set to $5,000 for married individuals filing separately and $10,000 for all other taxpayers. By limiting the amount of the SALT deduction, the SALT cap increases the tax liability of certain taxpayers, which increases federal tax revenues relative to what otherwise would have been collected. The SALT cap's effect on tax liability varies significantly with taxpayer income and with state and local tax rates. For more detailed information on the SALT cap, see CRS Report R46246, *The SALT Cap: Overview and Analysis*. The TCJA also prohibited SALT deduction claims on taxes paid on foreign real property for tax years 2018 through 2025.

The TCJA made a number of other changes to the tax code with indirect effects on SALT deduction activity. Most notably, it roughly doubled the value of the standard deduction, which reduced the number of itemizers who are therefore eligible to claim a SALT deduction. The TCJA also limited the value of several other itemized deductions, which further discourages itemized filing and reduces SALT deduction eligibility. As with the direct SALT changes, these indirect modifications are effective for tax years 2018-2025 only.

Following enactment of the TCJA, several state governments changed their tax codes to lower their residents' SALT cap exposure. For example, certain states enacted laws that provided taxpayers a credit against state taxes for "charitable donations" to state entities. The IRS subsequently issued a final ruling that eliminated the ability of such laws to reduce exposure to the SALT cap.[7]

Other state actions to provide a so-called "pass-through work around" were determined to be more effective in reducing SALT cap exposure. The SALT cap does not limit SALT deductions associated with the carrying on of a trade or business, and so taxpayers whose SALT tax payments are associated with pass-through business income (including income from S corporations and partnerships) may not be subject to the SALT cap in the same manner as other individual income tax payments.[8] Certain state governments have adjusted for this activity by enacting laws that levy or raise taxes on the *pass-through business entity itself* that are offset (holding total tax rates constant) by tax reductions or tax credits applied to individual income liability for *pass-through business members subject to the tax increase*.

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[7] U.S. Department of the Treasury, "Treasury Issues Final Regulations on Charitable Contributions and State and Local Tax Credits," press release, June 11, 2019, available at https://home.treasury.gov/news/press-releases/sm705.

[8] An S corporation is a corporation that elects to pass corporate income, losses, deductions, and credits through to their shareholders. C corporations, in contrast, form legal business entities that are taxed separately from their owners. The SALT cap would apply to state and local *corporate income taxes* which are paid by non-pass-through businesses.

IRS regulations issued in November 2020 clarified that pass-through entity businesses may claim SALT deductions in states where the tax burden is shifted from individual owners to the business entity, essentially excluding such income from the $10,000 limitation for affected individual owners.[9] A 2024 review of state activity indicates that 36 of the 41 states with pass-through entity income taxes had enacted legislation limiting the SALT cap exposure of such tax payments.[10]

Major Components

Table 1 tracks the percentage of returns with itemized deductions and various SALT deductions from 1986 through 2021. 1986 tax return data reflects the last year that taxpayers could claim both income and sales taxes paid, with the latter tax being included on 97 percent of all returns with a SALT deduction. More taxpayers would claim a sales tax deduction because all but five states imposed a sales tax and, in contrast to property taxes, paying the tax is not conditioned on owning property, real or personal. The elimination of the sales tax option in TRA86 is reflected in the 2003 data, which also saw a small decline in the overall share of tax returns with any SALT deduction claimed. 2017 tax returns included the reinstatement of a sales tax deduction but only *in lieu of* income taxes, which is why returns in both 2017 and 2021 have shares of income tax claims (74%) and sales tax claims (24%) that combine to represent almost all SALT claimants.

Table 1. Itemization and SALT Deduction Claim Shares, Selected Years

Category	1986	2003	2017	2021
% of All Filers With Itemized Deductions	40	34	31	9
% of Itemizers With Any SALT Deduction Claim	99	98	99	99
% of SALT Deduction Claimants With Claims For…				
Real Estate Taxes	81	89	84	87
Personal Property Taxes	28	46	43	39
Income Taxes	82	83	74	74
Sales Taxes	97	0	24	24
Other Taxes	23	7	6	6

Source: U.S. Department of the Treasury, Internal Revenue Service, Statistics of Income Division, *Individual Income Tax Returns, various years*, Publication 1304.

As shown in **Table 1**, far fewer taxpayers itemized deductions after lawmakers enacted the TCJA—9 percent in 2021 versus 31 percent in 2017. This shift was caused both by an increase in the appeal of the standard deduction, which the TCJA roughly doubled for tax years 2018 to 2025, and an overall decline in the net appeal of itemized deductions, included the imposition of the SALT cap over the same timeframe. As in earlier years, nearly all (99%) of returns with itemized deductions included SALT deductions in 2021, and the share of claims across tax types was broadly similar to the distribution in 2017.

Table 2 shows the estimated effects of nonbusiness SALT deductions on federal revenues from FY2023 through FY2027. The projections highlight the effect of the TCJA tax changes on the

[9] U.S. Treasury, Internal Revenue Service, "Forthcoming regulations regarding the deductibility of payments by partnerships and S corporations for certain state and local income taxes," November 9, 2020, Notice 2020-75.

[10] American Institute of Certified Public Accountants, "State Pass-Through Entity (PTE) Level Approach," May 1, 2024, available at https://us.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/56175896-pte-map.pdf.

SALT deduction. The estimated revenue loss attributable to SALT deduction claims in FY2027, the first full year following expiration of relevant TCJA provisions, is $187.8 billion, more than eight times the estimated effect in FY2025, the last full year the TCJA changes are effective.

Table 2. Estimate of Federal Tax Expenditure for Nonbusiness State and Local Tax Deduction, FY2023-FY2027

(in $ billions)

	FY2023	FY2024	FY2025	FY2026	FY2027	Total
Deduction of nonbusiness state and local government taxes	21.1	21.7	22.5	139.1	187.8	392.1

Source: U.S. Congress, Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2023-2027*, joint committee print, JCX-59-23, 118th Congress (Washington: GPO, 2023).

Deduction for Real Estate Property Taxes

Ad valorem property taxes (taxes levied as a percentage of assessed value) qualify for the SALT deduction.[11] For example, an itemizing individual who owns a home with an assessed value of $100,000 and who pays a 1% property tax can deduct the $1,000 in taxes paid from his or her adjusted gross income. If this taxpayer is in the 24% marginal tax bracket, taking $1,000 out of taxable income reduces taxes by $240 ($1,000 multiplied by 24%).[12]

P.L. 110-289 included a provision that allowed non-itemizers to deduct up to $500 ($1,000 for joint filers) of property taxes paid. The special deduction was first available for the 2008 tax year and was extended through 2009 by P.L. 110-343. This special deduction has since expired.

In most cases, both the taxpayer's tax bracket and home value increase with income. Thus, higher-income taxpayers in higher tax brackets can generally deduct more than low-income taxpayers can.

Analysis

Approximately 87% of itemizing taxpayers claimed a real estate property tax deduction in 2021.[13] Property taxes are a major source of local government revenue, making their deductibility a substantial transfer from the federal government to localities. State governments, in contrast, depend less on property tax revenue than income and sales taxes. Nationally, property taxes comprised 48% ($610 billion in 2021) of all local government general own-source revenue and 1% ($20 billion in 2021) of all state government general own-source revenue.[14]

About 17% of the combined $630 billion in property taxes collected by state and local governments in 2021 was deducted by individual taxpayers who itemized on their federal income

[11] There are two types of property taxes, real estate (e.g., owner-occupied housing) and personal (e.g., cars and boats). The focus of this report is the real estate property tax. For ease of exposition, the modifier "real estate" is not used for the remainder of the report.

[12] Marginal tax rates are sometimes referred to as tax brackets. There are currently seven individual income tax brackets: 10%, 12%, 22%, 24%, 32%, 35%, and 37%.

[13] CRS calculations based on U.S. Department of the Treasury, Internal Revenue Service, Statistics of Income Division, "Individual Income Tax Returns 2021," Publication 1304, October 2023.

[14] U.S. Census Bureau, *State and Local Government Finances: 2021*, the data are available at https://www.census.gov/data/datasets/2021/econ/local/public-use-datasets.html, accessed March 26, 2024. The property tax in the census data includes both real estate property taxes and personal property taxes.

tax returns or by businesses as a business expense.[15] In 2021, $100 billion of real estate property taxes paid were claimed as itemized deductions on individual federal income tax returns.[16] Personal property taxes, such as annual car taxes (based on the value of the car), generated $4 billion in deductions in 2021.[17] The amount collected and the amount deducted differ for several reasons. About 9% of taxpayers itemize on individual returns, and the SALT cap limits the deductible amount for filers who do itemize. Additionally, businesses (including landlords) pay a large share of property taxes, which would not appear as itemized deductions on individual income tax returns.[18]

In theory, if the property tax paid deduction were eliminated taxpayers would reduce their level of housing consumption, and thus their property tax bill would also change. This shift would likely be gradual, as housing consumption choices are not as responsive as other expenditures to changes in after-tax price given the relatively illiquid nature of housing assets. As noted earlier, state and local governments may lower tax rates and shift to other revenue sources if the relative tax price of raising revenue through property taxes increases. Local governments would have more at stake than state governments because the real property tax is primarily a local source of revenue. Across taxpayers, high-income property owners in states with relatively high local property values (and taxes) would likely see the greatest increase in total tax burden if property tax deductibility were repealed.

Deduction for Income Taxes

As with property taxes, the federal deduction for state and local income taxes is equal to the taxpayer's individual tax rate multiplied by the amount of state and local income tax paid.[19] The income tax is a source of revenue primarily for states, not local jurisdictions. In 2021, state and local governments collected $545 billion in individual income taxes, with state collections accounting for 92% of that total ($504 billion).[20] Deductions claimed on federal income tax forms for both state and local income taxes in the 2021 tax year totaled $251 billion.[21] The difference between what was collected and what was claimed on federal returns stems from taxpayers who did not itemize, individuals who were not required to file federal returns, and the SALT cap limitation on federal tax deductions claimed.

In December 2010, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312) extended the sales tax deduction option through 2011, and the American Taxpayer Relief Act of 2012 (ATRA; P.L. 112-240) again extended the provision

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[15] Ibid. Department of the Treasury, Internal Revenue Service, "Individual Income Tax Returns Line Item Estimates, 2021" Rev. 10-2021, at http://www.irs.gov/pub/irs-soi/21inlinecount.pdf.

[16] Ibid.

[17] Ibid.

[18] U.S. Department of the Treasury, Internal Revenue Service, Statistics of Income Division, "Individual Income Tax Returns, various years," Publication 1304.

[19] In some states, taxpayers may also deduct federal income taxes from income when calculating state taxable income. The reciprocal deduction, however, for federal income taxes is practiced only in six states. Partial or limited deductibility is available in an additional three states. Because few states offer the reciprocal deduction for federal income taxes paid, the focus here is limited to the deductibility of state income taxes when calculating federal taxable income.

[20] U.S. Census Bureau, 2021 Census of Government: State & Local Finances, the data are available at https://www.census.gov/govs/local/, accessed May 2, 2017.

[21] Department of the Treasury, Internal Revenue Service, "Individual Income Tax Returns Line Item Estimates, 2021" Rev. 10-2021, at http://www.irs.gov/pub/irs-soi/14inlinecount.pdf.

through 2013. The Tax Increase Prevention Act of 2014 (P.L. 113-295) extended the sales tax deduction through the 2014 tax year. The Consolidated Appropriations Act, 2016 (P.L. 114-113) permanently extended the deduction of state and local sales taxes in lieu of state and local income taxes.

Analysis

74% of taxpayers that itemized their deductions included a claim for state and local income taxes paid in 2021. The deduction for state and local income taxes affects the distributional burden of both state and federal taxes. First, the deduction could increase the progressivity of *state taxes* if it causes states to rely more on income tax, which is progressive relative to sales taxes. The cost of the deduction for high-rate taxpayers is effectively "exported" to all federal taxpayers. A state that collects a relatively larger share of revenue through high state income tax brackets would be most effective at exporting a portion of its state tax burden to all federal taxpayers.

The exported tax burden then falls on all federal taxpayers, including those who do not itemize deductions and thus do not benefit from the SALT deduction. During the period when sales taxes were not deductible, this group included taxpayers in states with no income taxes, who were less likely to itemize. Taxpayers in these states bore a relatively higher tax burden than taxpayers in states with an income tax. Letting individuals deduct state and local sales taxes in lieu of income taxes had partially muted this shift in tax burden.

Deduction for Sales and Use Taxes[22]

Explanation

The deduction for state and local sales taxes was temporarily reinstated in 2004 with enactment of the AJCA. This provision was extended a number of times before being made permanent by the Consolidated Appropriations Act, 2016. Unlike the pre-TRA 1986 deduction, the most recent version allowed for a deduction of sales taxes *in lieu of*, as opposed to *in addition to,* income taxes. Taxpayers who itemized could choose between reporting actual sales tax paid, verified with receipts indicating sales taxes paid, or an estimated amount from tables provided by the IRS.[23] The table amounts do not include the sales taxes paid for cars, motorcycles, boats, aircraft, or a home, and local sales taxes paid. Taxpayers may add taxes paid for these items to the table amount. Taxpayers are asked to calculate the ratio of the local sales tax rate to the state sales tax rate, and then multiply the result by the table amount to arrive at an estimate of local sales taxes paid. The estimated local sales taxes paid are then added to the state sales taxes paid table amount.

The American Recovery and Reinvestment Act (ARRA, P.L. 111-5) included a special deduction for the sales tax and excise tax paid on new vehicle purchases through 2009. This deduction was available only for those taxpayers that chose not to claim a deduction for general sales taxes paid. Thus, both non-itemizers and itemizers claiming a state or local income tax deduction could take this special deduction. The law limited the dollar value of the deduction in two ways. First, only sales and excise taxes paid on the first $49,500 of the purchase price qualified. Second, the

[22] A use tax is a tax on the use of a product. In the early years of the sales tax, states began with general sales then added the use tax. The intent of the use tax is to capture the sales tax due on purchases made out-of-state yet used in-state. Eventually, states adopting a sales tax included the use tax in the enacting legislation.

[23] See IRS publication 600.

deduction phased out for taxpayers with adjusted gross income between $125,000 and $135,000 (for joint filers the phase-out range was $250,000 to $260,000).

Analysis

Allowing the deduction for state and local sales taxes in lieu of income taxes likely diminishes the progressivity of the SALT deduction and the federal tax system more generally. Household consumption tends to change less across levels of ability to pay than does household income, as the vast majority of total saving (or income less consumption) is generated by those with higher incomes. Consumption taxes, therefore, are more likely to place a higher burden on lower-income households than are similarly constructed income taxes.[24] The gradual reduction in allowable itemized deductions for wealthy taxpayers in effect before 2018 and the alternative minimum tax (AMT) limited the benefit at the highest end of the income distribution.

The percentage of 2021 itemizing taxpayers that included claims for sales taxes (24%) and other taxes (6%) were considerably lower than comparable rates for property and income taxes. States without an income tax rely more on sales and property taxes than do states with an income tax. As a result, itemizers in states without an income tax could deduct proportionately more of their state and local taxes than taxpayers in states with both an income and sales tax. As shown in **Table 3**, in states without an income tax, state and local governments rely on sales and property taxes for 75% of total tax revenue: those tax sources account for only 48% of revenue in other states.

Table 3. Type of Tax Revenue by State Income Tax Category, 2021

	Type of tax revenue as percent of total state and local tax revenue		
Type of tax	**Income tax states and DC**	**Non-income tax states[a]**	**All states**
Total	100%	100%	100%
Property tax	28%	38%	30%
General sales	20%	37%	23%
Individual income	31%	<1%	26%
Corporate income	5%	2%	5%
Other taxes	16%	23%	17%

Source: CRS calculations based on Census Bureau data for 2021.

a. Includes AK, FL, NH, NV, SD, TN, TX, WA, and WY. The income tax percentage is positive for states without an income tax because New Hampshire, Tennessee, and Washington levy an income tax on certain dividend and interest income (or capital income).

The differential treatment of states based on the reliance on the income tax was likely unintended. Nevertheless, taxpayers in states without an income tax receive considerably more benefit from the sales tax deduction option relative to taxpayers in states with an income tax.

Distribution of Activity

The breadth of economic activity that contributes to SALT deductions can lead to a number of distributional patterns that may be of interest to Congress. This section briefly discusses the distribution of the SALT deduction across states and localities and across taxpayer income levels.

[24] For further discussions, see Auerbach, Alan J., "The Choice Between Income and Consumption Taxes: A Primer," NBER Working Paper 12307, 2006, available at https://www.nber.org/papers/w12307.

Other distributional measures of potential interest to Congress include deduction activity across taxpayer filing statuses, homeownership categories, and family size.

By State and Locality

A taxpayer's potential SALT deduction is directly linked to the level of taxes imposed in their state and local jurisdiction: higher tax rates lead to increased state and local taxes paid and thus greater potential SALT deduction claims. The contribution of state tax levels to SALT deduction activity has generated considerable attention.[25] Local tax rates also contribute to SALT deduction exposure, however, with cities and other high-density areas generally levying more per capita taxes than more rural areas.[26]

The direct and indirect SALT deduction changes provided through the TCJA therefore had different levels and types of effects across state and local tax jurisdictions. The SALT cap's limitation on nonbusiness SALT deduction claims affects more people in high tax jurisdictions, as those areas are more likely to have taxpayers with SALT payments exceeding the cap level. While SALT deduction claims are generally more concentrated among high-income taxpayers (discussed below), high tax jurisdictions are also more likely to have middle- and low-income taxpayers affected by the SALT cap, since it would take less income and consumption to reach the cap in those areas.[27]

Table 4 provides average SALT deduction tax claims for 2017 (the last year before TCJA changes became effective) and 2021 across state and local tax levels. The table shows a notable difference in high- and low-tax activity both before and after the TCJA changes took place. Taxpayers in the five states with the highest combined tax burden were a bit less than twice as likely to claim a SALT deduction than taxpayers in the five states with the lowest tax burden in both tax years 2017 and 2021. The discrepancy in amounts claimed through the SALT deduction following the TCJA was more notable, however. The average SALT deduction claimed in the five highest tax burden states dropped by about $12,500 ($21,500 to $9,000), as compared to a decline of only $500 in the five lowest tax burden states ($7,400 to $6,900).

Table 4. Deduction Activity by State and Local Tax Level, 2017 and 2021

(deduction amounts in nominal dollars)

Tax Level	5 Highest Tax States	5 Lowest Tax States	All states
2017			
% of All Returns with (Itemized) SALT Deductions	38%	24%	31%
Average SALT Deduction ($ thousands)	21.5	7.4	13.4
2021			
% of All Returns with (Itemized) SALT Deductions	13%	7%	9%
Average SALT Deduction ($ thousands)	9.0	6.9	8.2

Source: U.S. Census Bureau and Internal Revenue Service. CRS calculations.

25 Cochrane, Emily and Alan Rappeport, "Democrats Hope to Doff 'SALT' Cap," *The New York Times*, November 3, 2021.

26 Gordon, Tracy, "The Price We Pay for Capping the SALT Deduction," *TaxVox*, Tax Policy Center, February 15, 2018.

27 CRS Report R46246, *The SALT Cap: Overview and Analysis*, by Grant A. Driessen and Joseph S. Hughes.

Notes: State and local tax levels were measured as a function per capita state and local tax collections. Highest tax states were: (1) Connecticut, the District of Columbia, Hawaii, New Jersey, and New York in 2017; and (2) California, Connecticut, the District of Columbia, New Jersey, and New York in 2021. Lowest tax states were: (1) Alabama, Mississippi, Oklahoma, South Carolina, and Tennessee in 2017; and (2) Alabama, Alaska, Florida, South Carolina, and Tennessee in 2021. Amounts deducted must be multiplied by the taxpayer's marginal tax rate to calculate the effect on total tax liability.

By Income Level

The benefits of the SALT deduction generally accrue to higher-income taxpayers. This pattern is a product of:

(1) higher incomes directly leading to more state and local income taxes, and being correlated with higher sales and property tax payments stemming from greater consumption;

(2) high-income taxpayers itemizing more than other taxpayers to take advantage of other itemized deductions to which they disproportionately benefit; and

(3) taxpayers with higher incomes being subject to higher marginal tax rates, so each dollar deducted from tax liability results in greater tax savings.

As a result, the SALT deduction changes in the TCJA likely have larger effects on high-income taxpayers than on low-income households. The larger direct exposure to income taxes and indirect exposure to consumption taxes for high-income taxpayers means that population is disproportionately likely to have nonbusiness SALT deduction claims that are constrained by the SALT cap. That and other TCJA changes, moreover, will likely have a greater effect on overall itemization rates for high-income taxpayers more generally.

Table 5 shows SALT deduction claims in tax years 2017 and 2021 (before and after the TCJA became effective) across taxpayers grouped by adjusted gross income (AGI). SALT deduction claim rates were 53 percentage points lower for taxpayers with more than $200,000 in AGI in 2021 (93%) than they were in 2017 (40%). The comparable drop was 13 percentage points (16% versus 3%) for taxpayers with AGI below $75,000. The TCJA also had an outsized effect on deduction amounts claimed for high income taxpayers, which dropped by about $34,200 across those years ($44,000 versus $9,800). The average claim amount actually increased in 2021 ($5,700) relative to 2017 ($4,800) for taxpayers with less than $75,000 in AGI: that change is likely attributable to relatively high deduction amounts for the taxpayers that "still" itemized in 2021, rather than any increase in deduction claims attributable to the TCJA for that taxpayer group.

Table 5. Deduction Activity by Taxpayer Adjusted Gross Income, 2017 and 2021

(deduction amounts in nominal dollars)

Adjusted Gross Income	<$75K	$75K-$200K	>$200K	All Returns
2017				
% of All Returns with (Itemized) SALT Deductions	16%	66%	93%	31%
Average SALT Deduction Amount ($ thousands)	4.8	10.2	44.0	13.4
2021				
% of All Returns with (Itemized) SALT Deductions	3%	17%	40%	9%
Average SALT Deduction Amount ($ thousands)	5.7	8.4	9.8	8.2

Source: U.S. Department of the Treasury, Internal Revenue Service, Statistics of Income Division, *Individual Income Tax Returns, various years*, Publication 1304.

Notes: Amounts deducted must be multiplied by the taxpayer's marginal tax rate to calculate the effect on total tax liability.

Related Policy Options

Federal policymakers have considered many changes to the SALT deduction in recent years. Below are brief summaries of several broad types of proposals, along with relevant legislation or Administration detail when applicable.

General TCJA Extension

A number of proposals, including H.R. 976 and S. 1226 in the 118th Congress, would extend much or all of the TCJA provisions that are scheduled to expire under current law, including the increase in the value of the standard deduction and the imposition of a SALT cap on nonbusiness taxes.

An extension of elements of the TCJA with direct and indirect effects on the SALT deduction would likely lead to a continuation of the aforementioned patterns in SALT deduction activity that have taken place since tax year 2018 (when those changes became effective). Those changes would likely lead to a decrease in lost revenues attributable to the SALT deduction, as can be seen in the pattern of revenue losses before and after such changes expire in the JCT estimate provided in **Table 2**. A comprehensive extension of expiring TCJA provisions, however, is estimated to substantially increase deficits in coming years. A May 2024 estimate from the Congressional Budget Office and JCT projected that extending all expiring TCJA provisions would increase FY2025-FY2034 deficits by a combined $4.6 trillion.[28]

Raise and Extend SALT Cap

Recent Congresses have also considered proposals that would both: (1) extend the SALT cap into 2026 and/or future years; and (2) increase the value of the SALT cap, either before the cap's current expiration, into future years, or both. In the 117th Congress, for instance, the version of H.R. 5376 that passed the House in November 2021 included a provision that would extend the SALT cap through 2031 and increase the cap value to $72,500 for tax years 2021 through 2031. This provision was not included in the version of H.R. 5376 that was enacted as P.L. 117-69.

Raising the level of the SALT cap for years where the cap is already effective under current law would reduce federal revenues in those years. This change is due to an increase in the number of taxpayers claiming a SALT deduction and the average amounts claimed, as taxpayers limited by the current law cap would be able to claim greater amounts through the SALT deduction. Some taxpayers who would claim the standard deduction under current law may choose to itemize under such proposals. The higher cap level would likely disproportionately help middle- and low-income taxpayers that are limited by the current law SALT cap, as taxpayers in those income groups would be less likely to have SALT deduction claims in excess of the new cap, relative to higher-income taxpayers.

[28] Congressional Budget Office, "Budgetary Outcomes Under Alternative Assumptions About Spending and Revenues," Table 2, May 2024, available at https://www.cbo.gov/system/files/2024-05/60114-Budgetary-Outcomes.pdf.

Extending the SALT cap at a raised value for years where there is no cap under current law would likely increase federal revenues in those years, as it would reduce both the number of SALT deduction claims (and itemizing taxpayers) and the average amount claimed for the SALT deduction. The new cap would have a disproportionate effect on higher income taxpayers relative to the current cap, as a higher cap level would affect less middle- and low-income taxpayers.

The Congressional Budget Office estimated that the SALT deduction provision in the November 2021 House-passed version of H.R. 5376 would have been roughly budget-neutral over the ten-year budget baseline, raising revenues by a combined $15 billion from FY2022-FY2031.[29] Future proposals that raise and extend the SALT cap could either increase or decrease future deficits depending on when the change takes effect and the new cap level.

Modify SALT Cap Changes Across Filing Statuses

The SALT cap in the TCJA is set to $5,000 for a married person filing separately and $10,000 for all other filers, including single filers, married individuals filing jointly, head of household filers, and married surviving spouses. This creates a "marriage penalty" for single or head of household filers, who can deduct a combined $20,000 if they remain unmarried but can only deduct $10,000 should they marry and file jointly.

Following TCJA enactment, a number of legislative proposals have been discussed that would include modifications to the way the SALT cap changes across these three filing statuses. Examples of such introduced legislation in the118th Congress include:

> (1) H.R. 339, which would increase the cap to $20,000 for joint filers and to $10,000 for married persons filing separately (the $10,000 cap for other filers would remain unchanged); and
>
> (2) H.R. 2660, which includes a 2023 cap increase to $30,000 for joint filers and to $15,000 for all other filers.[30]

Such changes to the SALT cap across filing statuses would likely result in shifts in itemization rates, SALT deduction rates, and SALT deduction amounts claimed among affected groups, with the direction and magnitude of the changes dependent on the specific nature of each proposal.

Eliminate Sales and Use Tax Deductibility

Congress may also consider proposals to repeal the option to include sales taxes in lieu of income taxes for the SALT deduction, as was federal law for tax years 1986 through 2004. Such a proposal would increase federal revenues—as seen in **Table 1**, 24 percent of SALT deduction claims included a claim for sales taxes paid in both tax years 2021 and 2017 (before and after the TCJA became effective).

The effect of such a proposal would likely be larger in states with no income tax (for which general sales taxes comprised 37% of their tax base in 2021, as shown in **Table 3**) than it would be for other states (for which general sales taxes represented 20% of their 2021 tax base). The share of filers who itemize would likely decrease, as the standard deduction would become relatively more attractive to affected taxpayers.

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[29] Joint Committee on Taxation, "Estimated Budget Effects of the Revenue Provisions of Title XIII – Committee on Ways and Means, of H.R. 5376, the "Build Back Better Act," as Passed by the House of Representatives," JCX-46-21, November 21, p.5, available at https://www.jct.gov/publications/2021/jcx-46-21/.

[30] The legislation would index 2024 and 2025 cap values to inflation.

Restrict SALT Deduction Effects on Tax Liability

President Obama's FY2016 budget plan proposed limiting the tax rate at which itemized deductions would reduce tax liability. This proposal would have reduced the value of the deduction for state and local taxes at 28% multiplied by the amount of the taxes paid for those taxpayers whose marginal income tax rate exceeded 28%.[31] Under current law, the value of an itemized deduction is the taxpayer's marginal tax rate multiplied by the amount of the taxes paid. The Obama Administration's proposal would have reduced the value of the deduction for upper income individuals. For the 2024 tax year, the proposal would have affected taxpayers in the three highest individual marginal income tax rates (32%, 35%, and 37%). The proposal would have had no effect on 2024 taxpayers in the bottom four tax brackets (with incomes below $201,050 for married couples filing jointly or $100,525 for single filers).

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[31] The interaction with the AMT would further reduce the value of the deductions that are preference items under the AMT such as the deduction for state and local taxes.