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IN FOCUS

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Selected Issues in Tax Reform: The Deduction for State and Local Taxes

Members of Congress are currently debating legislative options related to the deduction for state and local taxes paid (or SALT deduction), which is among the largest tax expenditures in the federal income tax system. P.L. 115-97 (often referred to as the Tax Cuts and Jobs Act, TCJA) both directly and indirectly changed the SALT deduction, most notably by limiting the amount of nonbusiness taxes that can be claimed under the deduction (the "SALT cap") and roughly doubling the standard deduction. Those changes are scheduled to expire after the 2025 tax year. This In Focus summarizes the deduction and briefly examines policy issues that may be relevant to SALT reform. For more extensive analysis of the SALT deduction, see CRS Report RL32781, *Federal Deductibility of State and Local Taxes*.

Summary and Legislative Background

All individual taxpayers who itemize their deductions (rather than claiming the standard deduction) may claim a SALT deduction when filing a federal tax return. Business taxpayers, in contrast, may deduct state and local taxes as a cost of doing business. Qualifying taxpayers may claim deductions for state and local real estate taxes, personal property taxes, and either income taxes or sales taxes when calculating taxable federal income. As with all deductions, the savings to individual taxpayers equals the taxpayer's marginal tax rate multiplied by the amount of the deduction.

The SALT deduction was established by the Revenue Act of 1913 and subsequently modified on many occasions. Changes in the decades prior to enactment of the TCJA include repeal of the deduction for sales taxes by the Tax Reform Act of 1986 (P.L. 99-514), temporary instatement of a deduction for sales taxes *in lieu of* income taxes by the American Jobs Creation Act of 2004 (AJCA 2004, P.L. 108-357), and permanent incorporation of the sales taxes deduction in lieu of income taxes by the Consolidated Appropriations Act, 2016 (P.L. 114-113).

The TCJA reformed both the SALT deduction and other tax deductions in ways that affected SALT uptake. These changes included (1) limiting SALT deduction claims to $10,000 (or $5,000 for married taxpayers filing separately) for any taxes not paid in the carrying on of a trade or business; (2) prohibiting claims for foreign real property taxes; (3) roughly doubling the value of the standard deduction; and (4) reducing the value of other itemized deductions. All of those changes are effective for tax years 2018 through 2025, reverting to prior law in tax year 2026.

The changes in the TCJA reduced both the share of taxpayers claiming a SALT deduction and the average amount deducted, as seen in **Table 1**. In tax year 2022, 9% of tax returns claimed a SALT deduction, less than one-third of the comparable total in 2017 (31%), the last year before the TCJA changes took effect. The average SALT deduction decreased by a little more than $5,000 over those years.

Table 1. SALT Deduction Claims and Value by Year

Tax Year	% of Returns with Deduction	Average Claim
2017	31%	$13,400
2022	9%	$8,100

Source: Internal Revenue Service, CRS calculations.
Note: Claim amounts rounded to nearest hundred.

The TCJA's effects on SALT deduction activity were dampened in many states by a so-called "pass-through workaround" that was deemed permissible by a 2020 regulation from the Internal Revenue Service. As the SALT cap does not apply to taxes paid in the carrying on of a trade or business, taxpayers whose state and local 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 taxpayers.

Certain state governments have adjusted for this activity by enacting laws that levy or raise state taxes on the *pass-through business entity itself* that are exactly offset (holding total tax rates constant) by federal tax reductions or tax credits applied to individual income liability for *pass-through business members subject to the tax increase*, thereby taxing business activity and excluding such income from the $10,000 limitation for affected individual owners.

More generally, the SALT deduction allows state and local governments to levy higher taxes, as the federal government effectively offsets part of taxpayers' higher state and local tax burdens. By limiting the deduction, the SALT cap increases the net cost of state and local taxes for affected taxpayers. Without a SALT cap, for example, a taxpayer with $30,000 of eligible state and local tax payments and a 37% marginal tax rate could have reduced their tax liability by $11,100 ($30,000 x 0.37) through the SALT deduction. In 2025, that same activity would reduce tax liability by $3,700 if subject to a $10,000 SALT cap ($10,000 x 0.37).

All else equal, the SALT deduction is more valuable in states with higher taxes. Taxpayers in high-tax states were more likely than those in low-tax states to claim a SALT deduction both before and after the TCJA took effect, as shown in **Table 2**. The drop in the average amount claimed after the TCJA, however, was more pronounced in the five highest-tax states (declining from $21,500 in 2017 to $8,900 in 2022) than in the five lowest-tax states (declining from $7,400 to $6,800).

Table 2. SALT Deduction Activity in Highest- and Lowest-Tax States by Year

State Tax Type	% of Returns with Deduction	Average Claim ($K)
Tax Year 2017		
5 Highest-Tax States (CT, DC, HI, NJ, NY)	38%	$21,500
5 Lowest-Tax States (AL, MS, OK, SC, TN)	24%	$7,400
Tax Year 2022		
5 Highest-Tax States (CA, CT, DC, HI, NY)	13%	$8,900
5 Lowest-Tax States (AL, AK, DE, FL, TN)	7%	$6,800

Source: Census Bureau, Internal Revenue Service, and CRS calculations.

Notes: Claims amounts rounded to nearest hundred. States were classified as "highest-tax" or "lowest-tax" based on their shares of per capita state and local collections of SALT-eligible taxes.

The SALT deduction disproportionately benefits filers with higher incomes, who tend to (1) be more likely to itemize their taxes and thus claim the deduction; (2) have higher eligible state and local tax payments; and (3) reap greater benefits from deductions by virtue of being in higher marginal tax brackets.

Table 3. SALT Deduction Activity by Adjusted Gross Income (AGI) Level and Year

AGI	% of Returns with Deduction	Average Claim ($K)
Tax Year 2017		
<$75K	16%	$4,800
$75K<$200K	66%	$10,200
$200K and above	93%	$44,000
Tax Year 2022		
<$75K	3%	$5,600
$75K<$200K	16%	$8,400
$200K and above	38%	$9,600

Source: Internal Revenue Service. CRS calculations.

Note: Claim amounts rounded to nearest hundred.

Table 3 shows SALT deduction activity in tax years 2017 and 2022 by category of adjusted gross income (AGI). The share of taxpayers with AGI above $200,000 claiming a SALT deduction fell from 93% in 2017 to 38% in 2021, and the average amount claimed fell by more than $34,000 (from $44,000 to $9,600). In those same years, the share of SALT claims among filers with less than $75,000 in AGI fell from 16% to 3%, and the average amount claimed rose by a bit less than $1,000 (from $4,800 to $5,600).

Policy Considerations and Reform Proposals

The TCJA's direct changes to the SALT deduction, the increased value of the standard deduction, and changes to other itemized deductions are scheduled to expire after tax year 2025. Those expirations are projected to significantly increase the federal cost of the SALT deduction, as shown in **Table 4**. The Joint Committee on Taxation projects that the SALT deduction will reduce individual income tax revenues by $208.5 billion in FY2028, nearly 10 times the FY2024 reduction ($21.7 billion).

Table 4. Projected Revenue Losses Attributable to SALT Deduction, FY2024-FY2028

(in billions of nominal dollars)

Fiscal Year	Revenue Reduction
FY2024	$21.7
FY2025	$22.6
FY2026	$144.7
FY2027	$197.1
FY2028	$208.5

Source: Joint Committee on Taxation, JCX 48-24, December 2024.

There have been many proposals in recent Congresses to modify the SALT deduction, including those that would have

- extended most or all expiring TCJA provisions, including H.R. 976 and S. 1226 in the 118th Congress;
- raised and extended the SALT cap into future years, including H.R. 5376, that passed the House in November 2021;
- modified the SALT cap to increase its value to low-income filers and decrease its value to high-income filers, including H.R. 1326 from the 118th Congress; and
- eliminated the so-called marriage penalty that provides for the same SALT cap for single filers and joint filers, including H.R. 339 and H.R. 2660 from the 118th Congress.

Other recently discussed SALT changes include prohibiting the pass-through workaround, excluding sales taxes from the deduction, and limiting the rate at which all itemized deductions can reduce tax liability.

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