

A

CBO PAPER

FEBRUARY 2008

The Deductibility of State and Local Taxes

... see Pub. 529.

... nized
ns

... amount of each ex
next to line 27.
attach a stateme
amount of each e
line 27.

... amount of each ex
next to line 27.
attach a stateme
amount of each e
line 27.

... Gambling
tent of gambling
Form 1040, line 21.

... Casualty and theft losses of
income-producing property from Form
4684, lines 35 and 41b, or Form 4797, line
18a.

... Loss from other activities from
Schedule K-1 (Form 1065)

... Use the worksheet below to figure the
amount to enter on line 28 if the

... Deduction for repayment of amo
under a claim of right if \$3,000 or les

... Certain losses on nonfederally insured
institutions. For details, including limits
apply, see Pub. 529.

... Casualty and theft losses of property
ed in performing services as an employe
om Form 4684, lines 35 and 41b, or
797, line 18a.

... Deduction for repayment of amo
under a claim of right if \$3,000 or les

... Attach to Form 1040.

... See Instructions for Schedules A&B (Form 1040).

SCHEDULES A&B
(Form 1040)

Department of the Treasury
Internal Revenue Service (99)

Name(s) shown on Form 1040

Schedule A—Itemized Deductions
(Schedule B is on back)

▶ See Instructions for Schedules A&B (Form 1040).

Medical and Dental Expenses

1 Medical and dental expenses reimbursed or paid by others. 1

2 Enter amount from Form 1040, line 38 2

3 Multiply line 2 by 7.5% (.075). 3

4 Subtract line 3 from line 1. If line 3 is more than line 1, enter -0- 4

Taxes You Paid

5 State and local income taxes 5

6 Real estate taxes (see page A-3) 6

7 Personal property taxes 7

8 Other taxes. List type and amount ▶ 8

9 Add lines 5 through 8 9

Interest You Paid

10 Home mortgage interest and points reported to you on Form 1098 10

11 Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see page A-3 and show that person's name, identifying no., and address ▶ 11

12 Points not reported to you on Form 1098. See page A-4 for special rules 12

13 Investment interest. Attach Form 4952 if required. (See page A-4.) 13

14 Add lines 10 through 13 14

Gifts to Charity

15 Gifts by cash or check. If you made any gift of \$250 or more, see page A-5 15

16 Other than by cash or check. If any gift of \$250 or more, see page A-5. You must attach Form 8283 if over \$500 16

17 Carryover from prior year 17

18 Add lines 15 through 17 18

Casualty and Theft Losses

19 Casualty or theft loss(es). Attach Form 4684. (See page A-6) 19

20 Unreimbursed employee expenses—job travel, union dues, job education, etc. Attach Form 2106 or 2106-EZ if required. (See page A-6.) ▶ 20

21 Tax preparation fees. 21

22 Other expenses—investment, safe deposit box, etc. List type and amount ▶ 22

23 Add lines 20 through 22 23

24 Enter amount from Form 1040, line 38 24

25 Enter amount from line 24 by 2% (.02) 25

26 If line 25 is more than line 24, enter the difference. List type and amount ▶ 26

Other Miscellaneous Deductions

Line 27

Only the expenses listed next can be deducted on this line. List the type and amount of each expense next to line 27.

1. Enter the total of the amounts from lines 1 through 26. 27

2. Enter the total of the amounts from lines 1 through 26, minus the amount on line 27. 28

Itemized Deductions Worksheet

1. Enter the total of the amounts from lines 1 through 26. 27

2. Enter the total of the amounts from lines 1 through 26, minus the amount on line 27. 28

CAUTION Be sure your total gambling losses do not exceed the amount on line 27. Enter the amount on line 27 next to line 28.

3. Is the amount on line 2 less than the amount on line 1?
 No. Yes. Your deduction is the amount on line 28.

4. Multiply line 2 by 80% (.80)

5. Enter the amount from Form 1040, line 38

6. Enter \$150,500 (\$75,250 if married)

7. Is the amount on line 6 less than the amount on line 5?
 No. Yes. Your deduction is the amount on line 6.

8. Multiply line 7 by 3% (.03)

9. Enter the smaller of line 4 or line 8

10. Divide line 9 by 3

11. Subtract line 10 from line 9

12. Total itemized deductions. Subtract the amount on line 27 from line 11. 28



The Deductibility of State and Local Taxes

February 2008

Notes

Numbers in the text and tables may not add up to totals because of rounding.

Unless otherwise indicated, all years mentioned in this report are calendar years.

The Joint Committee on Taxation's estimates of the budgetary effects of the alternatives for changing state and local tax deductibility are calculated on a fiscal year basis.



Preface

Since the inception of the federal income tax in 1913, federal taxpayers have been allowed to deduct certain state and local taxes in calculating their taxable income. In its final report, in 2005, the President's Advisory Panel on Federal Tax Reform recommended elimination of the state and local tax deduction, which provides a federal subsidy for some of the taxes levied by state and local governments. That subsidy is of substantial personal benefit to residents of the states and localities that receive it, but it is not shared equally among all federal taxpayers. In addition, the individual alternative minimum tax (AMT) increasingly eliminates the benefit of the state and local tax deduction for many middle-class taxpayers.

This Congressional Budget Office (CBO) paper, which was prepared at the request of the Ranking Member of the Senate Budget Committee, examines the arguments for and against the state and local tax deduction; how the benefits from the deduction are distributed among different groups of taxpayers and different governments; how the deduction and the AMT interact; and how modifying or eliminating the deduction would affect the federal budget, the finances of state and local governments, and federal taxpayers. In accordance with CBO's mandate to provide objective, impartial analysis, the paper makes no recommendations.

Kristy Piccinini of CBO's Tax Analysis Division wrote the paper, under the supervision of Tom Woodward and Frank Sammartino. Juan Contreras, Robert Dennis, and Theresa Gullo of CBO commented on early drafts, as did Donald B. Marron, formerly of CBO. Jim Cilke, Karl Russo, and John Navratil of the Joint Committee on Taxation also commented on the paper. (The assistance of external reviewers implies no responsibility for the final product, however, which rests solely with CBO.)

Leah Mazade edited the paper, and Loretta Lettner proofread it. Maureen Costantino designed the cover and prepared the report for publication. Lenny Skutnik produced the printed copies, Linda Schimmel coordinated the print distribution, and Simone Thomas prepared the electronic version for CBO's Web site (www.cbo.gov).



Peter R. Orszag
Director

February 2008



Contents

<i>Summary</i>	<i>ix</i>
Background on the State and Local Tax Deduction	2
Rules Governing the State and Local Tax Deduction	2
Historical Perspectives	4
Interactive Effects	5
Current Issues in State and Local Tax Deductibility	5
Rationales for the State and Local Tax Deduction	5
Distribution of the Benefits from the Taxes-Paid Deduction	7
Analysis of Alternatives: Effects on State, Local, and Federal Governments	15
Description of the Alternatives and Their Cost	16
The Options' Interaction With the Alternative Minimum Tax	22
Distributional Analyses of Changes in Tax Liability in 2010 and 2011 Under the Options	23
Effects of Deductibility Options on Tax Liability and Tax Simplification, by Income	24
Effects of Deductibility Options on Tax Liability, by Region	32
Effects of Combining Deductibility Options with Changes in the Alternative Minimum Tax	33
Tables	
1. Estimated Cost of Federal Aid to State and Local Governments, by Aid Source	4
2. Sources of Revenue for State Governments, 2004	8
3. Sources of Revenue for Local Governments, by State, 2004	12
4. The Taxes-Paid Deduction, by Taxpayers' Adjusted Gross Income, 2004	16
5. Selected Measures of State and Local Tax Deductibility, 2004	18

Tables (Continued)

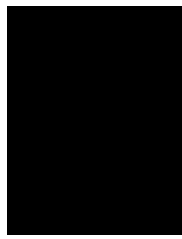
6.	Total Effects on Federal Revenues of Options for Changing the Taxes-Paid Deduction Assuming No Change in the Alternative Minimum Tax, by Fiscal Year	21
7.	Total Effects on Federal Revenues of Combining Options With Indexation of the Alternative Minimum Tax, by Fiscal Year	23
8.	Effects of Eliminating the Taxes-Paid Deduction, by Taxpayers' Adjusted Gross Income, Calendar Years 2010 and 2011	27
9.	Effects of Limiting the Taxes-Paid Deduction to 2 Percent of AGI, by Taxpayers' Adjusted Gross Income, Calendar Years 2010 and 2011	28
10.	Effects of Capping the Taxes-Paid Deduction, by Taxpayers' Adjusted Gross Income, Calendar Years 2010 and 2011	29
11.	Effects of Replacing the Taxes-Paid Deduction With a Credit of 15 Percent of Currently Deductible Taxes, by Taxpayers' Adjusted Gross Income, Calendar Years 2010 and 2011	30
12.	Effects of Restricting the Taxes-Paid Deduction to Real Estate Taxes, by Taxpayers' Adjusted Gross Income, Calendar Years 2010 and 2011	31
13.	Effects of Eliminating the Taxes-Paid Deduction and Indexing the AMT, by Taxpayers' Adjusted Gross Income, Calendar Years 2010 and 2011	36
14.	Effects of Limiting the Taxes-Paid Deduction to 2 Percent of AGI and Indexing the AMT, by Taxpayers' Adjusted Gross Income, Calendar Years 2010 and 2011	37
15.	Effects of Capping the Taxes-Paid Deduction and Indexing the AMT, by Taxpayers' Adjusted Gross Income, Calendar Years 2010 and 2011	38
16.	Effects of Replacing the Taxes-Paid Deduction with a Credit of 15 Percent of Currently Deductible Taxes and Indexing the AMT, by Taxpayers' Adjusted Gross Income, Calendar Years 2010 and 2011	39
17.	Effects of Restricting the Taxes-Paid Deduction to Real Estate Taxes and Indexing the AMT, by Taxpayers' Adjusted Gross Income, Calendar Years 2010 and 2011	40

Figures

1. Percentage of Taxpayers Who Itemized and Who Claimed the Taxes-Paid Deduction, 1985 to 2004 5
2. Types of Taxes Claimed Under the Taxes-Paid Deduction, 1993 to 2004 6
3. Federally Subsidized Shares of Tax Revenues in 2004, by State 14
4. Federally Subsidized Shares of Income in 2004, by State 15
5. Relative Shares of Adjusted Gross Income Deducted in 2004 Under the Taxes-Paid Deduction, by State 17
6. Shares of High-Income Taxpayers in 2004, by State 20
7. Increases in Average Tax Liability in 2010 and 2011 Under the Options for Changing the Taxes-Paid Deduction, by Census Division 32

Box

1. Data and Methods Used in the Analysis 3



Summary

Taxpayers who itemize deductions on their federal income tax returns may, with some limitations, deduct payments for certain state and local taxes from their reported income. About 35 percent of taxpayers opted to itemize deductions on their federal income tax returns in 2004, and nearly all of them claimed a deduction for the state and local taxes they paid. Income taxes (56 percent) and real estate taxes (36 percent) made up the majority of the state and local tax deductions claimed.

The “taxes-paid” deduction, which has been in place in some form since the inception of the modern federal income tax, not only benefits the taxpayers who claim it but also provides an indirect federal subsidy to the state and local governments that levy deductible taxes—because it decreases the net cost to taxpayers of paying those taxes. By lowering the net cost of certain state and local taxes, the taxes-paid deduction may encourage state and local governments to impose higher taxes and provide more services than they otherwise would.

Whether that indirect subsidy is an efficient use of federal resources depends on the nature of the benefits from any additional services. To the extent that state and local taxes are payments by residents of those jurisdictions for services that they themselves receive from their state and local governments, the rationale for a federal subsidy is weak. In contrast, if state and local taxes pay for services that have spillover benefits that are regional or national in nature, then a federal subsidy may be desirable to ensure that an adequate volume of such services is produced.

Some evidence suggests that state and local governments may respond to the taxes-paid deduction not by imposing higher taxes but by simply using deductible taxes in place of some nondeductible taxes. Deductible taxes measured as a share of states’ total revenues or as a percentage of their total income vary considerably among the states and do not appear to be related to the overall level of taxation.

In general, deductible taxes make up a larger share of the revenues of local governments than of state governments.

Higher-income households are more likely than low- or moderate-income households to benefit from the taxes-paid deduction. The probability that taxpayers will itemize (which is necessary to claim the taxes-paid deduction), the amount of state and local taxes paid, and the reduction in federal income taxes for each dollar of state and local taxes deducted all increase with income.

The state and local tax deduction reduced federal revenues by an estimated \$50 billion in fiscal year 2007. Over the next several years, scheduled changes to tax law and the interaction of the regular income tax and the alternative minimum tax (AMT) will change the number of taxpayers who claim the deduction and the associated loss of federal revenues.¹ The amount of that loss is projected to diminish through 2010, because more taxpayers will pay the AMT, which does not allow people to claim the taxes-paid deduction. The number of taxpayers subject to the AMT will rise because, unlike the regular income tax, the AMT is not indexed for inflation. Without changes in the tax code (such as the temporary increases in the AMT exemption level that have been enacted in recent years), more and more taxpayers will pay the AMT as their nominal income grows.

The scheduled expiration after 2010 of tax provisions enacted in 2001 and 2003 will boost income tax rates for many taxpayers, raising the value of the taxes-paid deduction for those who claim it and increasing the associated revenue loss for the federal government. With the higher

1. The AMT is a parallel income tax system with fewer exemptions, deductions, and tax rates than the regular income tax. Taxpayers potentially subject to the AMT must calculate their taxes under both the regular income tax and the AMT and pay the higher amount.

tax rates for the regular income tax, many taxpayers will move from the AMT back to the ordinary income tax—under which they are permitted to claim the state and local tax deduction. Those shifts will further increase the revenue loss from the taxes-paid deduction.

Legislation enacted during the past 50 years has for the most part tended to gradually limit the state and local tax deduction. The 2005 President’s Advisory Panel on Federal Tax Reform went further, recommending the complete elimination of the deduction. A major exception to the trend of gradual restriction occurred in 2004, however, when the American Jobs Creation Act reinstated the sales tax deduction (which the Tax Reform Act of 1986 had eliminated). The 2004 law allowed taxpayers to deduct either sales taxes or income taxes—but not both—in 2004 and 2005. Subsequent legislation extended that provision to 2006 and 2007. Without new legislation, taxpayers will not be able to deduct state and local sales taxes after 2007.

The Congressional Budget Office (CBO) analyzed five options for changing the taxes-paid deduction: eliminating the deduction, limiting the deduction to 2 percent of adjusted gross income (AGI), capping the deduction at \$5,000 in 2008 (and indexing the cap for inflation in subsequent years), replacing the deduction with a non-refundable tax credit equal to 15 percent of currently deductible taxes, and restricting the deduction to real estate taxes. Because the effects of any changes to the taxes-paid deduction would depend on what happens to the AMT in the future, CBO analyzed each of the options in two ways: under the assumption that current laws would remain in place and under the assumption that the AMT was indexed for inflation (specifically, that the AMT exemption amounts and tax brackets were permanently increased to their 2006 levels and were indexed for inflation thereafter). That analysis indicates that:

- Eliminating the taxes-paid deduction would remove the implicit federal subsidy for deductible state and local taxes and any incentive that state and local governments might have to raise revenues by using taxes that are deductible under the federal income tax rather than taxes that are not deductible. Eliminating the deduction would have the greatest impact, relative to income in those states, on residents of New York and residents of states in the Mid-Atlantic region, some states in New England, and states in the Far West.

If the taxes-paid deduction was changed without altering the AMT:

- Eliminating the deduction would increase federal revenues by an estimated \$748 billion during the 2008–2017 period.² Limiting the deduction to 2 percent of AGI, restricting it to real estate taxes, or capping it at \$5,000 would increase federal revenues by between \$442 billion and \$530 billion over the same period. Replacing the deduction with a 15 percent credit would increase federal revenues by \$165 billion over those 10 years.
- Most of the options would have the greatest impact on the 20 percent of taxpayers who had the highest income (roughly, taxpayers whose income was \$75,000 or more). Eliminating the taxes-paid deduction would increase taxes for 50 percent of those taxpayers in 2010 and for 73 percent in 2011. By comparison, among taxpayers whose income was between \$40,000 and \$75,000, eliminating the deduction would raise taxes for 41 percent.
- Eliminating the taxes-paid deduction would produce the largest decrease in average after-tax income for taxpayers with income of \$500,000 or more. For example, under that option, average after-tax income in 2010 would fall by 1.4 percent for taxpayers whose income was between \$500,000 and \$1 million and by 1.7 percent for taxpayers whose income was \$1 million or more. After-tax income for those groups would shrink even more in 2011, after the 2001 and 2003 tax provisions expired and regular tax rates increased.
- Compared with eliminating the deduction, limiting it to 2 percent of AGI or replacing it with a credit would result in a smaller drop in the average after-tax income of high-income taxpayers. Capping the deduction at \$5,000 would result in nearly the same decline as that from completely eliminating the deduction.
- Eliminating the deduction would have a small effect on the average after-tax income of taxpayers in the \$40,000-to-\$75,000 income group, resulting in a drop of 0.5 percent. Capping the deduction at \$5,000 or limiting it to real estate taxes would have almost no effect on those taxpayers’ after-tax income. By con-

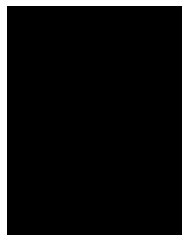
2. Estimates of the options’ effects on federal revenues were provided by the Joint Committee on Taxation.

trast, replacing the taxes-paid deduction with a non-refundable credit would increase their average after-tax income by a small amount.

- Under each of the five options that CBO analyzed, the change in after-tax income for taxpayers who pay the AMT would be quite different in 2011 from the change in 2010. For example, eliminating the taxes-paid deduction would decrease the average after-tax income of taxpayers whose income was between \$200,000 and \$500,000 by only 0.1 percent in 2010. Most taxpayers in that income range will pay the AMT in that year and thus will not be able to claim the taxes-paid deduction. In 2011, when provisions of the 2001 and 2003 laws are currently scheduled to expire, many taxpayers in the \$200,000-to-\$500,000 income range will move from the AMT to the ordinary income tax—under which they may claim the deduction. Eliminating the taxes-paid deduction would reduce the average after-tax income of taxpayers in that income range by 1.6 percent in 2011.

If the taxes-paid deduction was changed and the AMT was indexed for inflation:

- Eliminating the taxes-paid deduction in combination with indexing the AMT would increase federal revenues over the next 10 years, but the amount of the rise would be about 40 percent less than the gain that would occur with no change in the AMT. Under the assumption that the AMT is indexed for inflation, the options to limit the deduction to 2 percent of AGI, to cap it at \$5,000, or to restrict it to real estate taxes would reduce annual federal revenues in the 2008–2011 period but then increase them in the 2012–2017 period. Revenues would be higher over the entire 10-year period under those options plus indexation (compared with revenues under current law), but the increase would be 60 percent to roughly 80 percent less than what it would be with no change in the AMT. Replacing the taxes-paid deduction with a 15 percent credit in combination with indexing the AMT would lower federal revenues by an estimated \$330 billion from 2008 to 2017.
- Eliminating the taxes-paid deduction and indexing the AMT would increase average after-tax income in 2010 for taxpayers whose income was between \$75,000 and \$500,000. However, eliminating the deduction and indexing the AMT would reduce the average after-tax income of those taxpayers in 2011, when the provisions of the 2001 and 2003 tax acts would have expired.
- Combining indexation of the AMT with any of the options would limit the decline in average after-tax income for most income groups except for taxpayers who had income of \$500,000 or more. Relatively few taxpayers who have income in excess of \$500,000 pay the AMT and thus would not benefit from the tax's indexation.



The Deductibility of State and Local Taxes

The federal individual income tax allows taxpayers to claim a number of so-called tax preferences. Some take the form of exclusions and deductions that reduce taxpayers' taxable income, and some are credits that may reduce how much tax people owe. All of those preferences decrease the revenues that the federal government raises from a given set of statutory tax rates. Preferences benefit only taxpayers who meet certain eligibility criteria and may alter how those individuals behave toward the tax-preferred activity. They also raise issues of equity regarding otherwise similarly situated taxpayers who do not benefit from such tax-favored treatment.

One such preference is the deduction that the current tax code allows for certain state and local tax payments—those for real estate and personal property taxes along with either income or general sales taxes—subject to the limits that apply to all itemized deductions.¹ Deducting state and local taxes under the federal individual income tax subsidizes the revenue-raising activities of state and local governments as long as the revenues are raised through deductible taxes. Because taxpayers who claim the “taxes-paid” deduction may thereby reduce their federal tax liability, the “cost” to the itemizing taxpayer of an additional dollar of revenue raised through deductible state or local taxes is less than a dollar. If that lower cost for taxpayers encourages state and local governments to raise revenue from deductible sources, the reduction in

federal tax will constitute an indirect federal subsidy of eligible taxes at the state or local level.

One of the criteria for evaluating whether a federal subsidy is an efficient use of scarce federal resources is the national benefits that it provides. If the taxes-paid deduction encourages state and local governments to use deductible taxes to fund additional services that create spillover benefits to other regions of the country, then the deduction provides a benefit to the federal taxpayers who implicitly finance the preference. If the deduction does not prompt states or localities to change their behavior in that way, or if they use deductible taxes in place of non-deductible levies and do not offer additional services, then the deduction provides a federal subsidy to taxpayers that is not related to state and local services but to the amount of individuals' income and whether or not they choose to itemize on their tax returns.

During the past few decades, policymakers have limited the taxes-paid deduction on several occasions, and the 2005 President's Advisory Panel on Federal Tax Reform recommended its elimination.² That trend toward constraining the deduction was reversed during two recent Congresses, when the deduction was expanded. Changes in the treatment of state and local taxes under the individual income tax continue to be considered, in large part because of the way they would interact with the alternative minimum tax (AMT). The AMT is an additional method of computing tax liability that, unlike the ordinary income tax, does not allow the deduction of state and local taxes and is not indexed for inflation. Consequently, as more and more taxpayers become subject to the AMT as their income rises, fewer of them will benefit from the taxes-paid deduction. Indeed, the deduction is

1. The extension of the provision in the American Jobs Creation Act of 2004 that allows taxpayers to claim the deduction for general sales taxes in lieu of income taxes expired at the end of 2007. Because taxpayers tend to pay more in income taxes than they pay in sales taxes when both are levied, the sales tax deduction in place from 2004 to 2007 mainly affected residents of the states that levy general sales taxes but not general income taxes—that is, Florida, Nevada, South Dakota, Tennessee, Texas, Washington, and Wyoming. Alaska and New Hampshire levy neither general income taxes nor general sales taxes.

2. The panel's final report is available at www.taxreformpanel.gov/final-report/.

one of the tax preferences that the AMT was designed to constrain; it may thus be a candidate for restriction or elimination as lawmakers look for ways to replace the revenues that would be lost if the AMT was limited or repealed.

This Congressional Budget Office (CBO) paper discusses various issues surrounding the deduction of state and local taxes under the federal individual income tax. (Box 1 briefly describes the data and methods that CBO used in its analysis.) The report examines the deduction and discusses the underlying rationales for the preference and the criticisms leveled at it. The paper also describes the characteristics of taxpayers who claim the deduction and the geographical distribution of its benefits.

As part of its analysis, CBO presents various alternatives for limiting the deductibility of state and local taxes. Using estimates by the Joint Committee on Taxation (JCT) to illustrate how those constraints would affect federal revenues, CBO considers the alternatives both on their own and in the context of possible changes to the AMT. CBO also analyzes how those limits would affect the projected tax liability of various groups of taxpayers—groups based on both income and geography—in 2010 and 2011. By using those years, CBO’s estimates highlight the differences in liability related to deductibility under two conditions: when current law includes the tax provisions enacted since 2001 in their fully phased-in form (in 2010) and when it does not include them, because they have expired (in 2011).

Background on the State and Local Tax Deduction

The preference for state and local taxes is one of the largest tax expenditures in the individual income tax system; estimates by the Joint Committee on Taxation put its cost to the federal government in fiscal year 2007 at roughly \$51 billion.³ (Only the exclusion of pension contributions and earnings, the exclusion of employers’ contributions for health care, and the deduction of mortgage interest result in more forgone federal revenues.) The deductibility of state and local taxes, direct grants, and the ability to issue tax-exempt bonds are the primary types of federal subsidy provided to state and local governments. Direct grants are the largest in terms of the federal government’s costs; deductibility and tax-exempt

debt each make up less than one-tenth of the estimated amount that will be spent on direct aid in 2008 (see Table 1).⁴

After policymakers made substantial changes to the tax code in 1986 (discussed below), the number of taxpayers who itemized and claimed the taxes-paid deduction dropped (see Figure 1). In recent years, however, that number has risen. In 2004, the most recent year for which data were available, 35 percent of taxpayers itemized deductions, and virtually all of them claimed the taxes-paid deduction on their tax return. Most of the taxes claimed are income taxes (56 percent of the total in 2004) and real estate taxes (36 percent; see Figure 2 on page 6). Deductions for sales taxes, personal property taxes, and miscellaneous taxes each amounted to 5 percent or less of the total state and local taxes claimed.

Rules Governing the State and Local Tax Deduction

Under the rules for determining tax liability for 2007, taxpayers who itemize their deductions may choose to deduct either state or local income taxes or general sales taxes. (As noted earlier, however, beginning in 2008 only income taxes may be deducted.) Taxpayers who claim a deduction for sales taxes may deduct either the actual sales taxes they paid or, using tables that the Internal Revenue Service (IRS) provides, an estimated amount based on their income and the number of exemptions they claim. They may also deduct taxes based on the assessed value of real estate that they own and personal property

-
3. Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2007–2011*, JCS-3-07 (September 24, 2007). That estimate does not include any effects from recent legislation limiting the number of taxpayers subject to the AMT in calendar year 2007, which would tend to increase the size of the tax expenditure for the state and local tax deduction. JCT defines tax expenditures in the above document as “revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability” (p. 2). Tax expenditure estimates, unlike revenue estimates, do not presume that taxpayers will alter their behavior in response to changes in the tax code.
 4. Direct aid to states includes payments to individuals through federal programs administered by the states (such as the Temporary Assistance for Needy Families program and Medicaid). Those payments made up 64 percent of direct grants to states in 2007. For more information, see *Budget of the United States Government, Fiscal Year 2009: Analytical Perspectives*.

Box 1.**Data and Methods Used in the Analysis**

The Congressional Budget Office (CBO) used two data sets—one from the Bureau of the Census and the other from the Internal Revenue Service (IRS)—in its analysis of the taxes-paid (state and local tax) deduction. CBO obtained data on state and local tax revenues from the Census Bureau's survey of state and local government finances, which reports those revenues by various categories. The share of each type of tax collected was then calculated as a percentage of the government's total own-source revenues (in this report, all revenues not received from another government or from government-run utilities, liquor stores, or insurance trust funds); receipts from deductible taxes were reported as personal income tax, general sales tax, and property tax revenues. Data on the taxes-paid deduction in the federal individual income tax came from the IRS's Statistics of Income files.

As part of the analysis, the Joint Committee on Taxation (JCT) prepared estimates of the budgetary effects of five alternatives for changing the deduction: eliminating it, limiting it to a maximum of 2 percent

of adjusted gross income, capping the deduction at an indexed dollar amount, replacing the deduction with a credit for currently deductible taxes, and restricting the deduction to real estate taxes. JCT also estimated the budgetary effects of combining those options with changes to the alternative minimum tax (AMT)—specifically, permanently increasing the AMT exemption amounts and brackets to their 2006 levels and indexing them thereafter.

CBO calculated changes in average tax liability by income group and by region using its microsimulation tax model. It assumed that taxpayers would choose whether to take the standard deduction or to itemize on the basis of whichever method minimized their tax liability. In distributional estimates combining the options discussed in this paper with the AMT's indexation, CBO assumed that a taxpayer would choose to itemize deductions—even if those deductions did not exceed the standard deduction—if itemizing would limit his or her tax liability under the AMT.

that is not used for a business.⁵ The overall effect of those provisions is to reduce the tax liability of filers who pay state and local taxes and claim the deduction.

The taxes-paid deduction is subject to certain limits. First, the total allowable amount of a number of itemized deductions, including that for state and local taxes, may be reduced. For 2007, the reduction, which can be no more than 53-1/3 percent, is calculated by taking 2 percent of any amount that taxpayers' adjusted gross income, or AGI, exceeds a statutory threshold. The limit is scheduled to change several times in the next few years as the

tax provisions enacted since 2001 are fully phased in, by 2010, and then expire, in 2011.

Second, the AMT limits the benefits that taxpayers (and thus, indirectly, governments) receive from the deductibility of state and local taxes. Taxpayers must pay the larger of their liability under the AMT or under the individual income tax. In computing liability under the alternative tax, a taxpayer must include in taxable income several items that are deductible under the ordinary income tax and then subtract the statutory AMT exemption amount; the remaining income is taxed at one of two AMT rates. The largest preference that taxpayers must forgo under the AMT is the deduction for state and local taxes. Without further changes to the alternative tax, many taxpayers will lose the benefit of the taxes-paid deduction.

5. Taxes paid in connection with a business enterprise are deducted in arriving at the net income from the business.

Table 1.**Estimated Cost of Federal Aid to State and Local Governments, by Aid Source**

(Billions of dollars)

	2007	2008
Direct Grants ^a	443.8	466.6
Tax Expenditures		
Taxes-Paid Deduction ^b	50.7	43.9
Tax-Exempt Bonds	36.5	39.3

Sources: Congressional Budget Office based on *Budget of the United States Government, Fiscal Year 2009: Analytical Perspectives* (direct grants); and Joint Committee on Taxation, *Estimates of Federal Tax Expenditures, 2007–2011*, JCS-3-07 (September 24, 2007).

- The figure for 2008 is an estimate.
- The taxes-paid deduction allows taxpayers to deduct from their adjusted gross income some of the taxes they pay to state and local governments, including income or sales, real estate, and other taxes. The provision allowing sales taxes to be deducted expired at the end of 2007.

Historical Perspectives

The legislative history of the deduction for state and local taxes shows two markedly different patterns. During much of the time that the deduction has been in effect, lawmakers focused on clarifying or limiting the preference. Since 2001, though, legislation has expanded the allowable deduction and thus the subsidy provided to taxpayers and to state and local governments.

The taxes-paid preference dates from the enactment of the modern income tax. The Revenue Act of 1913 listed “all national, state, county, school, and municipal taxes paid within the year, not including those assessed against local benefits,” as one of various items that taxpayers could deduct in arriving at their taxable income. At the time, the law’s large exemption amounts meant that few people actually paid the income tax, so the preference’s administrative burden and the forgone revenues from the deduction were relatively small.

By the end of World War II, the proportion of the population who paid income taxes had grown dramatically, from about 5 percent when the tax was enacted to nearly 75 percent in 1944. To lessen the complexity of filing, the Congress introduced the standard deduction, which allowed taxpayers to eliminate the recordkeeping neces-

sary to claim any of the itemized deductions. Today, a substantial majority of taxpayers—in 2004, 65 percent—choose to use the standard deduction.

For the most part, legislation enacted during the past 50 years has gradually limited the taxes-paid deduction for those who choose to itemize and claim it. The Revenue Act of 1964 changed the treatment of state and local taxes so that only taxes specifically mentioned in the tax code—namely, taxes on real and personal property, as well as income, general sales, and motor fuels taxes—were deductible. Other legislation clarified the deduction for sales taxes as being limited to a retail tax imposed at a single rate on many classes of items. Because of the considerable recordkeeping necessary to claim a deduction for all of the sales taxes paid, taxpayers were given the option of using a general deduction amount based on their income and household size. A few years later, the Revenue Act of 1978 eliminated the deduction for taxes on motor fuel.

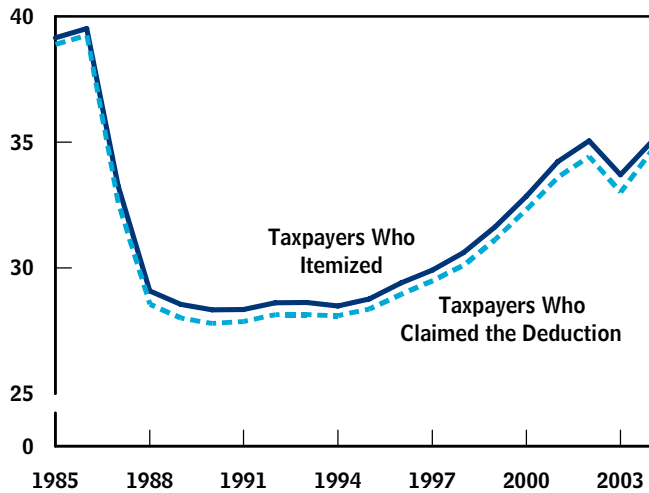
When policymakers discussed major tax reform in the 1980s, one of the many proposals they considered was the elimination of the state and local tax deduction. The Tax Reform Act of 1986, the outcome of those deliberations, repealed only the deduction for general sales taxes; that action came amid concerns about the deduction’s administrative burden for those who did not choose to use the IRS’s sales tax deduction tables and a perception that, for those who did use the tables, the deduction amount was insufficient. However, the American Jobs Creation Act of 2004 partially reinstated the sales tax deduction for 2004 and 2005, allowing taxpayers to choose to deduct either sales taxes (the documented amount they paid or a standardized amount based on their income and household size) or income taxes. Policymakers extended that provision for 2006 and 2007 in the Tax Relief and Health Care Act of 2006.

The Omnibus Budget Reconciliation Act of 1990 enacted a general limit on itemized deductions, which is often called the Pease provision, after Congressman Donald Pease, who proposed it. Under that limit, certain itemized deductions—including that for state and local taxes—were temporarily reduced by 3 percent of the amount that a taxpayer’s adjusted gross income exceeded an indexed threshold, with a maximum reduction of 80 percent of deductible expenses. In 1993, lawmakers made the limit permanent. However, one of the provisions of the Economic Growth and Tax Relief

Figure 1.

Percentage of Taxpayers Who Itemized and Who Claimed the Taxes-Paid Deduction, 1985 to 2004

(Percent)



Source: Congressional Budget Office based on data from the Internal Revenue Service's Statistics of Income file.

Note: The taxes-paid deduction allows taxpayers to deduct from their adjusted gross income some of the taxes they pay to state and local governments, including income or sales, real estate, and other taxes. The provision allowing sales taxes to be deducted expired at the end of 2007.

Reconciliation Act of 2001 (EGTRRA) phased out the Pease provision, reducing the limit by one-third for tax years 2006 and 2007 and two-thirds for 2008 and 2009, and then eliminating it for 2010. At the same time, the lower statutory tax rates that EGTRRA put in place reduced the tax benefit from the additional deductions. Because that law expires at the end of 2010, the general limit on itemized deductions will again apply in its original full form beginning in 2011.

Interactive Effects

Over the next several years, the interaction of inflation, economic growth, and existing provisions in the tax code will also affect the deductibility of state and local taxes. Inflation will increase the number of taxpayers who are affected by the AMT. Unlike the schedule of tax brackets and exemptions for the individual income tax, the brackets and exemptions for the AMT are not indexed for inflation. As a result, the growth of nominal income will cause more and more taxpayers to pay the alternative tax—which, as noted earlier, does not allow a deduction

for state and local taxes paid. Policymakers have enacted legislation that temporarily increases the AMT's exemption amounts, limiting the number of taxpayers subject to the tax. The most recent temporary increase, which was enacted in December 2007 and applies to 2007 tax liabilities, expired at the end of that calendar year.

Current Issues in State and Local Tax Deductibility

An informed discussion of possible changes to the deduction for state and local taxes requires an understanding of several key issues. First, how does deductibility affect a state or local government's incentive to tax or to provide public services? Second, how does the current composition of state and local government revenues affect the benefits those governments receive from deductibility? Third, how are the benefits from deductibility distributed among taxpayers?

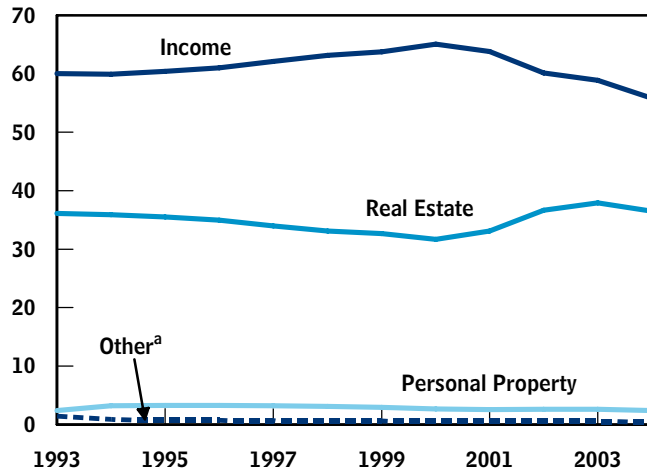
Rationales for the State and Local Tax Deduction

The desirability of a deduction for state and local taxes is closely related to the rationales for fiscal federalism—the systematic division of responsibilities among the federal, state, and local governments in terms of the services they provide to taxpayers. As a general principle, a number of public services are provided at the state and local—not at the federal—level for two reasons. First, smaller governmental units may perform many services more efficiently than larger units because they are better acquainted with the local circumstances in which those services are provided. Second, performing services locally permits greater variation in the type and number of them that can be provided, allowing such services to better satisfy the varying preferences of a diverse population.

That second point is key to understanding a common rationale for and a frequent criticism of the taxes-paid deduction. Under fiscal federalism, the variation permitted in the services that are provided may promote the population's general welfare with respect to certain kinds of services. For example, to better suit their preferences for street lights, parks, and even public safety, citizens may sort themselves into different communities that provide different amounts of those services. However, some services, such as public assistance and education, provide general benefits that are not easily restricted to those who have financed them and that "spill over" to people in other states and localities. A so-called free-rider problem results: Citizens can live in communities that do not

Figure 2.**Types of Taxes Claimed Under the Taxes-Paid Deduction, 1993 to 2004**

(Percentage of all taxes deducted)



Source: Congressional Budget Office based on data from the Internal Revenue Service's Statistics of Income file.

Note: The taxes-paid deduction allows taxpayers to deduct from their adjusted gross income some of the taxes they pay to state and local governments, including income or sales, real estate, and other taxes. The provision allowing sales taxes to be deducted expired at the end of 2007.

a. Includes sales taxes in 2004.

provide such services, and therefore avoid paying for them, but they may benefit from services provided by neighboring communities. Knowing that, state and local governments will tend to provide fewer of those services than they might otherwise.

Financing public goods with large spillover benefits at the federal level would avoid that free-rider problem and the associated underprovision of services by state and local governments. However, the public services that the respective levels of government provide do not break down neatly along those lines. In practice, state and local governments supply a number of services that have nationwide benefits and therefore might be thought of as principally federal in nature. The potential underprovision of such services can be offset if the federal government assists those governments financially, either through direct grants or subsidies.

For several reasons, a deduction for certain state and local taxes may not be the appropriate way to compensate state

and local governments for providing services that have national benefits. If deductible taxes are simply charges that cover the value of services desired by taxpayers who have efficiently chosen a particular local community, the rationale for subsidizing those different preferences at the federal level is weak—unless there are significant differences among localities in the cost of providing services. In fact, the original legislation enacting the federal income tax explicitly labeled as nondeductible local taxes paid in return for local benefits. Some deductible taxes, though, are clearly not charges for such benefits. State income taxes, for example, are generally considered to have a redistributive function, although the extent to which they redistribute income varies widely among the states and is small relative to the redistributive capacity of the federal income tax.

Another reason that the taxes-paid deduction may not offset the underprovision of services is that it may simply encourage state and local governments to use deductible taxes in place of nondeductible taxes (levies such as selective—rather than general—sales taxes) without increasing spending for the desired activities. If so, the subsidy does not effectively encourage those governments to provide services that generate national benefits. Some evidence exists to show that deductibility affects the mix of taxes that states and localities choose for financing their activities, but there is relatively little that suggests that deductibility actually increases spending for services.⁶

6. Martin S. Feldstein and Gilbert E. Metcalf ("The Effect of Federal Tax Deductibility on State and Local Taxes and Spending," *Journal of Political Economy*, vol. 95, no. 4, 1987, pp. 710–736) find that among a cross-section of states, deductibility raises the share of revenues that subsidized taxes make up but has no consistent effect on spending. Douglas Holtz-Eakin and Harvey S. Rosen ("Tax Deductibility and Municipal Budget Structure," in Rosen, ed., *The Fiscal Behavior of State and Local Governments: Selected Papers of Harvey S. Rosen*, Lyme, N.H., Elgar, 1997, pp. 43–72) document a similar effect, smaller but more precisely measured. Gilbert E. Metcalf ("Tax Exporting, Federal Deductibility, and State Tax Structure," *Journal of Policy Analysis and Management*, vol. 12, no. 1, 1993, pp. 109–126), using data on the states from 1980 to 1988, finds that the income tax share of taxes is sensitive to the subsidy from deductibility but the sales tax share is not. Holtz-Eakin and Rosen ("Federal Deductibility and Local Property Tax Rates," *Journal of Urban Economics*, vol. 27, no. 3, 1990, pp. 269–284) use a sample of municipal governments from 1976 to 1980 and find that deductibility increases local property tax rates.

Moreover, the deduction may spur state and local governments to provide services that are neither federal in nature nor targeted toward areas of national concern. The indirect nature of the subsidy means that its size and use are not subject to ongoing federal oversight. The lack of monitoring means that state and local governments can use the benefits thus conferred to finance any services they provide to local taxpayers, regardless of the nature of those services. As a result, the subsidy may interfere with the sorting mechanism that otherwise helps keep local public services at levels appropriate to their value to local taxpayers. Because of the subsidy, too many of those services may be supplied, and state and local governments may be bigger as a result.

Those competing factors—the federal government’s interest in assisting state and local governments to provide public services that have benefits beyond their borders and the possibility that such help generates an inefficiently large volume of local services—are the principal pro and con arguments associated with the deduction. Nevertheless, some other issues are also significant.

A common argument for allowing taxpayers to deduct state and local taxes is that of avoiding unfair double taxation. The contention is that resources claimed as taxes by state and local governments are not truly available to taxpayers and thus should not be considered part of the basis for federal taxation. In fact, that argument involves some of the same issues discussed earlier. If state and local taxes are benefit charges and reflect variations in the amount of local public services that taxpayers desire, then such taxes are a form of public consumption and therefore a fair basis for a levy that rests on the concept of people’s ability to pay. If state and local taxes finance services whose benefits spill over to other localities, then the federal subsidy, which has federal benefits, may be justified regardless of the double taxation issue.

Another argument for the taxes-paid deduction involves its effect on marginal tax rates (that is, the total rate on the last dollar of income). By reducing the combined federal, state, and local marginal tax rate on income, the deduction lessens the deterrents to earning income that are inherent in high tax rates. But that reduction in disincentive effects on the so-called individual margin (people’s choice between work and leisure) occurs by changing the incentives on another margin—either the state or local government’s marginal choice between types of taxes (deductible or nondeductible) or the kinds and

number of services the governments provide. Whether the combined changes ultimately lessen the overall disincentive effects of the tax code depends on the choices that individuals and governments make.

Distribution of the Benefits from the Taxes-Paid Deduction

How benefits from the deduction are distributed among states and localities depends on the structure of a government’s tax system and the characteristics of the taxpayers who provide revenue to that government. For example, a state or local government that finances its spending by using a larger share of taxes that are deductible under the federal individual income tax receives a larger subsidy through the deductibility provision than an otherwise identical government that finances its spending through a smaller share of deductible taxes. All else being equal, a state or local government whose taxpayers are more likely to itemize deductions also gains a greater benefit than a government whose taxpayers tend to claim the standard deduction.

Distribution of Benefits to State and Local Governments.

Revenue sources for state and local governments vary widely. For state governments in 2004, taxes made up about 50 percent of “own-source revenues” for all states.⁷ However, the share of an individual state’s own-source revenues coming from taxes (which include individual income, general sales, property, and other levies) ranged from a high of about 67 percent in Connecticut to just over 20 percent in Alaska (see Table 2).

How much of the tax share of states’ own-source revenues is eligible for federal subsidization through the taxes-paid preference? One measure of the subsidy is the share of all revenues collected by a state (or local) government from taxes that the Internal Revenue Code labels as deductible. That measure is an upper bound on the extent of the federal subsidy; taxpayers do not actually claim all types of legally deductible taxes on their returns—because not all taxpayers itemize and because for some taxpayers, the deduction is limited. In 2004, potentially deductible revenues were about 17 percent of states’ total own-source

7. In this report, own-source revenues are all revenues not received from another government or from government-run utilities, liquor stores, and insurance trust funds. Such charges as fees for education and hospitals make up most of the nontax portion of own-source revenues.

Table 2.
Sources of Revenue for State Governments, 2004

(Percent)

State	Share of Own-Source Revenues from: ^a					Share of Total Revenues from Federal Transfers	Potentially Deductible Taxes as a Share of:	
	Individual Income Tax	General Sales Tax	Property Tax	Other Taxes	Nontax Sources		Own-Source Revenues ^a	Income ^b
Alabama	15.3	12.9	1.5	18.1	52.2	29.1	16.8	2.0
Alaska	0	0	0.7	19.5	79.8	24.7	0.7	0.2
Arizona	13.8	28.1	2.1	13.4	42.6	27.7	15.8	1.6
Arkansas	16.6	21.1	5.1	12.0	45.2	28.3	21.7	3.1
California	20.3	14.7	1.2	11.5	52.3	19.9	21.4	3.0
Colorado	18.5	10.3	0	9.3	61.9	19.6	18.5	2.1
Connecticut	28.1	20.3	0	18.5	33.1	21.1	28.1	2.7
Delaware	16.8	0	0	34.3	48.8	17.9	16.8	2.6
District of Columbia	17.1	11.9	16.8	19.0	35.3	30.7	33.9	7.3
Florida	0	29.2	0.5	22.4	47.9	22.0	29.7	3.2
Georgia	26.6	19.1	0.3	10.7	43.3	26.0	26.8	2.6
Hawaii	17.7	28.8	0	11.8	41.6	19.8	17.7	2.8
Idaho	16.9	19.3	0	13.1	50.7	24.4	16.9	2.4
Illinois	15.9	15.3	0.1	21.0	47.7	21.3	16.1	1.6
Indiana	19.2	24.0	0	17.0	39.8	25.7	19.2	2.0
Iowa	17.3	14.3	0	14.5	54.0	25.5	17.3	2.1
Kansas	23.8	24.0	0.7	17.1	34.3	26.9	24.5	2.3
Kentucky	19.6	17.1	3.2	18.9	41.2	29.0	22.8	2.9
Louisiana	13.3	16.3	0.2	17.2	52.9	29.4	13.6	1.8
Maine	20.3	16.1	0.8	13.1	49.7	30.9	21.1	3.1
Maryland	24.0	12.3	2.2	17.6	43.8	21.9	26.2	2.6
Massachusetts	27.1	11.5	0	13.1	48.4	20.7	27.1	3.3
Michigan	13.9	18.7	4.9	16.0	46.5	24.1	18.8	2.5
Minnesota	24.5	17.4	2.6	18.6	36.8	20.9	27.1	3.4
Mississippi	10.7	25.0	0.4	15.5	48.4	34.1	11.1	1.5
Missouri	19.7	15.6	0.1	12.8	51.8	27.5	19.8	2.1

Continued

Table 2.**Continued**

(Percent)

State	Share of Own-Source Revenues from: ^a					Share of Total Revenues from Federal Transfers	Potentially Deductible Taxes as a Share of:	
	Individual Income Tax	General Sales Tax	Property Tax	Other Taxes	Nontax Sources		Own-Source Revenues ^a	Income ^b
Montana	16.2	0	4.9	22.3	56.6	31.1	21.1	3.1
Nebraska	20.9	25.7	0	14.7	38.7	28.4	21.0	2.2
Nevada	0	26.4	1.6	27.6	44.4	15.5	28.0	3.0
New Hampshire	1.2	0	11.0	32.4	55.4	23.6	12.2	1.2
New Jersey	18.0	15.3	0	17.8	48.8	17.8	18.1	2.0
New Mexico	12.2	17.5	0.6	18.1	51.6	29.1	12.8	2.1
New York	27.8	11.3	0	12.5	48.3	30.2	27.8	3.3
North Carolina	22.9	13.3	0	15.2	48.6	24.9	22.9	3.0
North Dakota	5.3	9.2	0	16.1	69.3	22.8	5.4	1.1
Ohio	14.1	12.8	0.1	9.5	63.5	18.9	14.2	2.5
Oklahoma	17.9	12.3	0	19.4	50.4	25.6	17.9	2.4
Oregon	21.0	0	0.1	8.9	70.0	16.9	21.1	3.9
Pennsylvania	13.6	14.4	0.1	18.9	53.0	21.9	13.7	1.8
Rhode Island	17.4	15.6	0	13.6	53.4	27.3	17.4	2.4
South Carolina	16.2	18.2	0.1	10.8	54.7	27.4	16.3	2.1
South Dakota	0	22.3	0	18.2	59.5	31.6	22.3	2.5
Tennessee	0.9	39.2	0	23.8	36.1	36.7	39.2	3.3
Texas	0	23.8	0	23.6	52.6	27.5	23.8	2.2
Utah	16.4	15.2	0	9.2	59.2	21.3	16.4	2.6
Vermont	14.4	8.6	15.0	21.1	40.9	30.5	29.4	4.4
Virginia	25.2	10.1	0.1	12.9	51.8	17.0	25.2	2.8
Washington	0	29.9	5.4	14.0	50.6	19.0	35.4	4.6
West Virginia	12.8	12.3	0	19.9	55.0	28.0	12.9	2.3
Wisconsin	18.8	14.0	0.4	12.1	54.7	19.0	19.2	3.0
Wyoming	0	14.8	4.5	28.9	51.8	37.5	19.3	3.5
All States	16.5	16.6	0.9	15.6	50.5	23.6	17.4	2.1

Source: Congressional Budget Office based on the Bureau of the Census's survey of state and local government finances.

a. All revenues not received from another government or from government-run utilities, liquor stores, or insurance trust funds. Charges such as fees for education and hospitals make up most of the nontax portion of own-source revenues.

b. Total personal income of all state residents.

revenues; shares ranged from a low near zero in Alaska to highs near 40 percent in Washington and Tennessee.⁸ Revenues from direct federal transfers—at just under 24 percent of revenues from all sources—made up a larger share of total state budgets than did potentially deductible taxes.

Although state governments tend to raise most of their tax revenues from income or sales taxes, local governments depend primarily on property taxes for revenues. About 38 percent of localities' total own-source revenues came from property taxes in 2004, although among the states, that percentage varied widely by local jurisdiction (see Table 3).⁹ By comparison with state governments, local governments tend to raise a larger share of their revenues from deductible sources because of their dependence on real estate taxes, which make up the majority of property tax revenues. The average local government raises about 40 percent of its own-source revenues from potentially deductible taxes, with a range of about 15 percent for localities in Alabama and Arkansas to approximately 75 percent for those in New Hampshire and New Jersey.

Using the share of revenues raised by deductible taxes to measure the benefits that state and local governments receive from the deductibility provision does not account for differences in the percentage of total state income that different governments receive as tax receipts. For example, a state government that collects a larger share of the total income of its residents in taxes receives a larger relative federal subsidy than a state government that has the

same share of deductible taxes in its revenue mix but a lower average tax burden. Potentially deductible taxes as a share of state and local governments' own-source revenues and as a share of the total income of state residents are fairly well correlated (see the last two columns of Tables 2 and 3).¹⁰ That correlation suggests that most of the variation in the subsidy among the states results from differences in the mix of taxes that the governments choose rather than from differences in their overall tax burdens.

Considering the states on a regional basis reveals a few general patterns, whether measuring the subsidy by the potentially deductible share of revenues or by taxpayers' total income. Both tend to be larger in the Northeastern states. States in the South and Southwest—with the exception of Florida and Texas, when the sales tax is included in potentially deductible taxes—tend to have relatively small subsidized shares by either measure (see Figures 3 and 4 on pages 14 and 15).

Yet the potentially deductible share of taxes overstates the actual federal subsidy because all taxes that are eligible for deduction are not actually deducted on individuals' tax returns. A more accurate measure of the potential subsidy to individual state and local governments would compare the amount of the taxes-paid deductions claimed by the jurisdictions' residents with the total revenues that were collected from those individuals. One problem with such an approach, though, is that in some cases, taxpayers pay state and local taxes to jurisdictions in which they do not reside. As a result, this type of comparison is unlikely to provide much useful information.

Comparing the share of income, sales, and real estate taxes deducted on a national basis avoids that issue and may shed some additional light on the relative subsidy to certain state and local governments. CBO estimates that in 2004, taxpayers claimed, on schedule A of Form 1040, more than 90 percent of both income and property tax payments that were eligible for deduction under the individual income tax—even though on two-thirds of

8. The potentially deductible share in 2004 is based on the tax code in that year; that is, general sales taxes are counted as potentially deductible in the states that do not have broad-based income taxes. The potentially deductible shares of own-source revenues for governments in states that did not have broad-based income taxes in 2004, calculated without sales taxes, are as follows: Florida, 0.5 percent; Nevada, 1.6 percent; South Dakota, zero; Tennessee, 0.9 percent; Texas, zero; Washington, 5.4 percent; and Wyoming, 4.5 percent. The exclusion of the sales tax substantially changes the position of those states in the distribution in Table 2, and that adjusted ranking may be a better measure of the actual geographical distribution of deductibility benefits in 2004 (because the number of taxpayers who actually claim a new deduction—that is, the provision for sales taxes, which was new in 2004—tends to be small at first, compared with the number who are eligible).

9. Census data on local governments were collected at the state level and are so reported.

10. Again, the inclusion or exclusion of sales tax revenues as potentially deductible has a large effect on the placement in the distribution of states that do not levy broad-based income taxes but do levy sales taxes. In 2004, the potentially deductible shares of income for the relevant state governments, calculated without sales taxes, were as follows: Florida, 0.05 percent; Nevada, 0.2 percent; South Dakota, zero; Tennessee, 0.08 percent; Texas, zero; Washington, 0.7 percent; and Wyoming, 0.8 percent.

returns, taxpayers did not itemize deductions. In contrast, of the general sales tax revenues estimated to be eligible for deduction under the federal tax, taxpayers claimed less than 10 percent.¹¹

Several factors in combination probably explain the low ratio of sales taxes deducted to sales taxes paid. First, few states impose sales taxes but not income taxes, so the share of the population for whom the sales tax deduction by default would be preferable to the income tax deduction is relatively small. Second, because sales taxes are less progressive than either income or real estate taxes and the likelihood of claiming the deduction rises with income, fewer taxpayers whose potential sales tax deduction is larger than their potential income tax deduction are likely to itemize. Third, as noted earlier, the amounts in the IRS's sales tax table may understate the actual amounts that individuals pay, but the cost to document those actual payments may be prohibitive. Finally, in 2004 the sales tax deduction had just been enacted and was temporary, which tended to make people less aware of it.

Distribution of Benefits to Taxpayers. Taxpayers who itemize do so in most cases because the value of their itemized deductions exceeds that of the standard deduction. Individuals who choose to itemize and deduct the state and local taxes they have paid decrease their federal tax liability by approximately the amount of their deductible state and local taxes multiplied by their marginal tax rate under the individual income tax. Because the likelihood of itemizing and the marginal tax rate increase with income, taxpayers who benefit from the taxes-paid deduction in its current form are concentrated in the upper part of the income distribution.

In 2004, slightly less than 35 percent of all taxpayers deducted state and local taxes they had paid, but whether a taxpayer claimed the deduction varied considerably

according to his or her income. Approximately 20 percent of taxpayers who had income of less than \$75,000 took the deduction, whereas more than 85 percent of taxpayers who had income above \$75,000 did so (see Table 4 on page 16). The latter group, who make up roughly the top 20 percent of filers by income, accounted for just over 70 percent of the value of all state and local tax deductions claimed, with an average of \$13,218 in deductible taxes per return claiming the deduction.¹² Within that group, taxpayers who had income between \$75,000 and \$100,000 were less likely than those whose income was higher to take the deduction, and the amount of the average deduction (before any phaseout) rose steadily with income.

Although the general limit on itemized deductions, as discussed earlier, restricts the benefit of the taxes-paid deduction for taxpayers whose adjusted gross income is above an indexed threshold (\$142,700 for joint filers in 2004), the benefit nevertheless increases with income because of the progressivity of federal income tax rates. (In general, under the current progressive individual income tax, the higher a taxpayer's income is, the higher will be his or her marginal tax rate and therefore the larger the reduction in federal tax liability gained from deducting an additional dollar of state or local tax.) CBO estimates that in 2004, approximately 80 percent of the tax benefit of the state and local deduction accrued to those whose income was above \$75,000 (see Table 4)—about the same proportion as the 78 percent share of total taxes paid by that group. Within that upper portion of the income distribution, taxpayers who had income between \$100,000 and \$200,000 received just under 30 percent of the total benefit from the deduction, and taxpayers who had income of more than \$1 million received slightly less than 16 percent of the benefit.

The standard deduction in the federal individual income tax does not vary by state. Thus, states whose average taxpayer income is high, relative to that in other states, will have more taxpayers whose other itemized deductions (which tend to rise with income) exceed the standard deduction—regardless of variation in the level of taxation

11. Those figures are necessarily approximations because the census data on state and local tax revenues do not distinguish between sales and property taxes that are paid by businesses and those that are paid by individuals. Consequently, CBO estimated the shares of those revenues paid by individuals by using data from Robert Cline, Tom Neubig, and Andrew Phillips, "Total State and Local Business Taxes: 50-State Estimates for Fiscal Year 2006" (February 2007), available at [www.ey.com/global/assets.nsf/US/Total_State_and_Local_Taxes_-_50_State_Estimates_2006/\\$file/TotalStateLocalTaxes2006.pdf](http://www.ey.com/global/assets.nsf/US/Total_State_and_Local_Taxes_-_50_State_Estimates_2006/$file/TotalStateLocalTaxes2006.pdf).

12. That average and all subsequent calculations concerning the taxes-paid deductions claimed refer to the amounts claimed on schedule A before adjustments for any applicable general limit on itemized deductions.

Table 3.**Sources of Revenue for Local Governments, by State, 2004**

(Percent)

State	Share of Own-Source Revenues from: ^a					Share of Total Revenues from Intergovernmental Transfers		Potentially Deductible Taxes as a Share of:	
	Individual Income Tax	General Sales Tax	Property Tax	Other Taxes	Nontax Sources	Federal	State	Own-Source Revenues ^a	Income ^b
Alabama	1.0	12.5	13.7	6.2	66.7	3.5	28.3	14.6	1.2
Alaska	0	7.6	41.4	3.7	47.3	7.6	28.2	49.0	4.3
Arizona	0	11.8	32.3	4.8	51.1	4.5	32.7	32.3	2.7
Arkansas	0.1	19.1	16.3	3.6	61.0	3.7	44.8	16.4	0.8
California	0	6.2	26.0	6.4	61.3	4.3	34.9	26.0	2.6
Colorado	0	15.0	31.4	3.7	50.0	3.3	22.4	31.4	2.8
Connecticut	0	0	72.3	1.4	26.3	2.9	26.5	72.3	4.3
Delaware	3.4	0	33.2	8.7	54.7	2.9	40.4	36.6	1.7
Florida	0	1.7	35.1	8.0	55.2	3.6	24.1	36.8	3.5
Georgia	0	9.8	34.9	5.0	50.3	2.7	27.9	34.9	2.9
Hawaii	0	0	46.2	15.5	38.2	10.4	9.1	46.2	1.8
Idaho	0	0	43.2	2.9	53.8	3.3	36.6	43.2	2.9
Illinois	0	2.5	45.4	6.8	45.3	5.3	25.0	45.4	4.0
Indiana	3.1	0	44.0	1.7	51.3	2.0	33.2	47.1	3.5
Iowa	0.8	6.0	46.1	2.1	45.0	3.7	31.3	46.9	3.5
Kansas	0	7.5	43.3	3.0	46.3	1.6	28.3	43.3	3.8
Kentucky	13.0	0.2	27.1	8.0	51.7	3.4	36.0	40.1	2.2
Louisiana	0	26.4	22.1	4.5	47.0	4.7	29.4	22.1	1.8
Maine	0	0	74.9	2.1	23.0	2.9	28.1	74.9	5.2
Maryland	20.0	0	36.8	9.6	33.6	4.9	23.8	56.7	3.9
Massachusetts	0	0	54.2	2.0	43.8	5.3	28.6	54.2	3.6
Michigan	2.1	0	43.4	2.0	52.4	3.9	42.1	45.6	3.2
Minnesota	0	0.5	34.6	2.5	62.4	4.1	41.7	34.6	2.3
Mississippi	0	0	35.7	2.8	61.5	4.6	38.2	35.7	2.6
Missouri	2.4	13.0	32.7	6.4	45.6	4.2	26.0	35.1	2.6
Montana	0	0	53.0	2.1	44.9	7.4	34.7	53.0	3.0
Nebraska	0	3.4	28.6	6.1	61.9	2.0	18.2	28.6	3.5
Nevada	0	3.5	31.1	15.7	49.8	3.4	33.4	34.6	2.8

Continued

Table 3.**Continued**

(Percent)

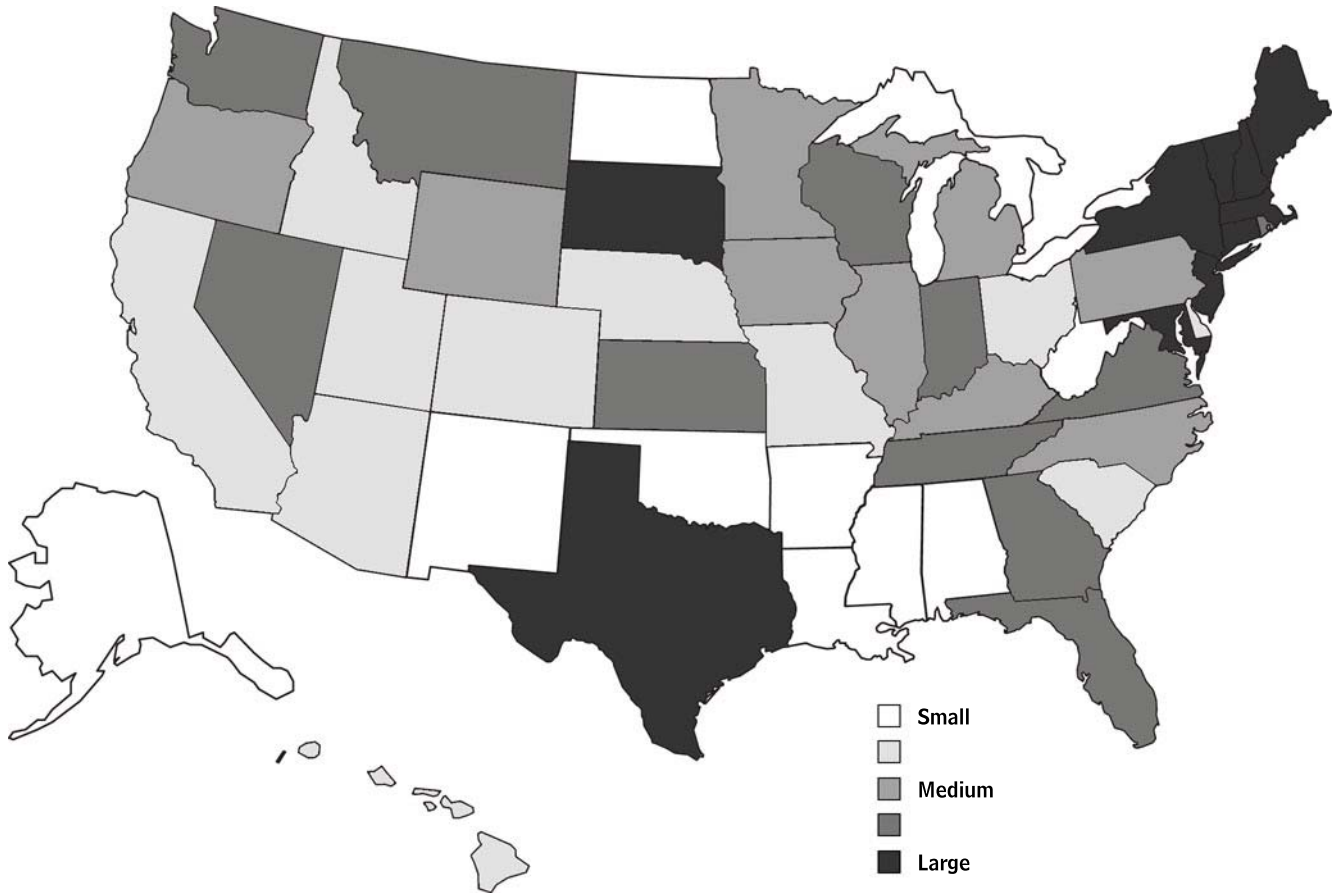
State	Share of Own-Source Revenues from: ^a					Share of Total Revenues from Intergovernmental Transfers		Potentially Deductible Taxes as a Share of:	
	Individual Income Tax	General Sales Tax	Property Tax	Other Taxes	Nontax Sources	Federal	State	Own-Source Revenues ^a	Income ^b
	New Hampshire	0	0	76.9	1.4	21.6	2.9	32.3	76.9
New Jersey	0	0	75.5	1.4	23.1	2.6	29.7	75.5	5.0
New Mexico	0	18.0	27.6	5.0	49.4	5.9	48.7	27.6	1.6
New York	6.8	10.3	35.9	8.7	38.3	3.3	29.6	42.7	5.2
North Carolina	0	8.1	32.4	3.0	56.5	2.9	33.8	32.4	2.4
North Dakota	0	5.3	48.5	2.1	44.1	6.3	31.9	48.5	3.1
Ohio	12.7	5.0	40.7	2.3	39.4	4.1	34.6	53.4	4.1
Oklahoma	0	19.2	26.5	3.0	51.3	3.4	33.3	26.5	1.7
Oregon	1.2	0	40.7	9.8	48.4	5.7	33.7	41.8	3.2
Pennsylvania	9.9	0.6	41.2	5.8	42.5	6.1	31.3	51.1	3.7
Rhode Island	0	0	74.1	1.5	24.4	3.9	28.3	74.1	4.8
South Carolina	0	1.2	39.6	6.1	53.1	2.9	28.1	39.6	3.2
South Dakota	0	12.5	43.8	2.9	40.7	6.2	22.9	56.3	3.9
Tennessee	0	7.0	20.3	3.4	69.4	3.3	19.5	27.2	2.7
Texas	0	6.0	46.1	3.5	44.4	3.4	22.9	52.1	4.6
Utah	0	8.0	30.9	6.0	55.1	5.1	27.4	30.9	2.6
Vermont	0	0.2	55.2	1.6	42.9	2.9	49.0	55.2	2.5
Virginia	0	5.1	43.7	12.3	38.8	3.6	30.6	43.7	2.8
Washington	0	7.2	25.8	6.9	60.1	3.8	28.6	33.0	2.9
West Virginia	0	0	41.5	10.3	48.1	4.3	40.6	41.5	2.1
Wisconsin	0	1.8	54.2	1.8	42.3	2.9	38.9	54.2	4.1
Wyoming	0	8.3	31.8	3.1	56.8	2.5	35.3	40.1	4.0
All States	2.3	5.7	37.6	5.7	48.6	4.1	30.4	39.9	3.4

Source: Congressional Budget Office based on the Bureau of the Census's survey of state and local government finances.

Note: The Bureau of the Census collects data on local government finances on a state-by-state basis.

a. All revenues not received from another government or from government-run utilities, liquor stores, or insurance trust funds. Charges such as fees for education and hospitals make up most of the nontax portion of own-source revenues.

b. Total personal income of all state residents.

Figure 3.**Federally Subsidized Shares of Tax Revenues in 2004, by State**

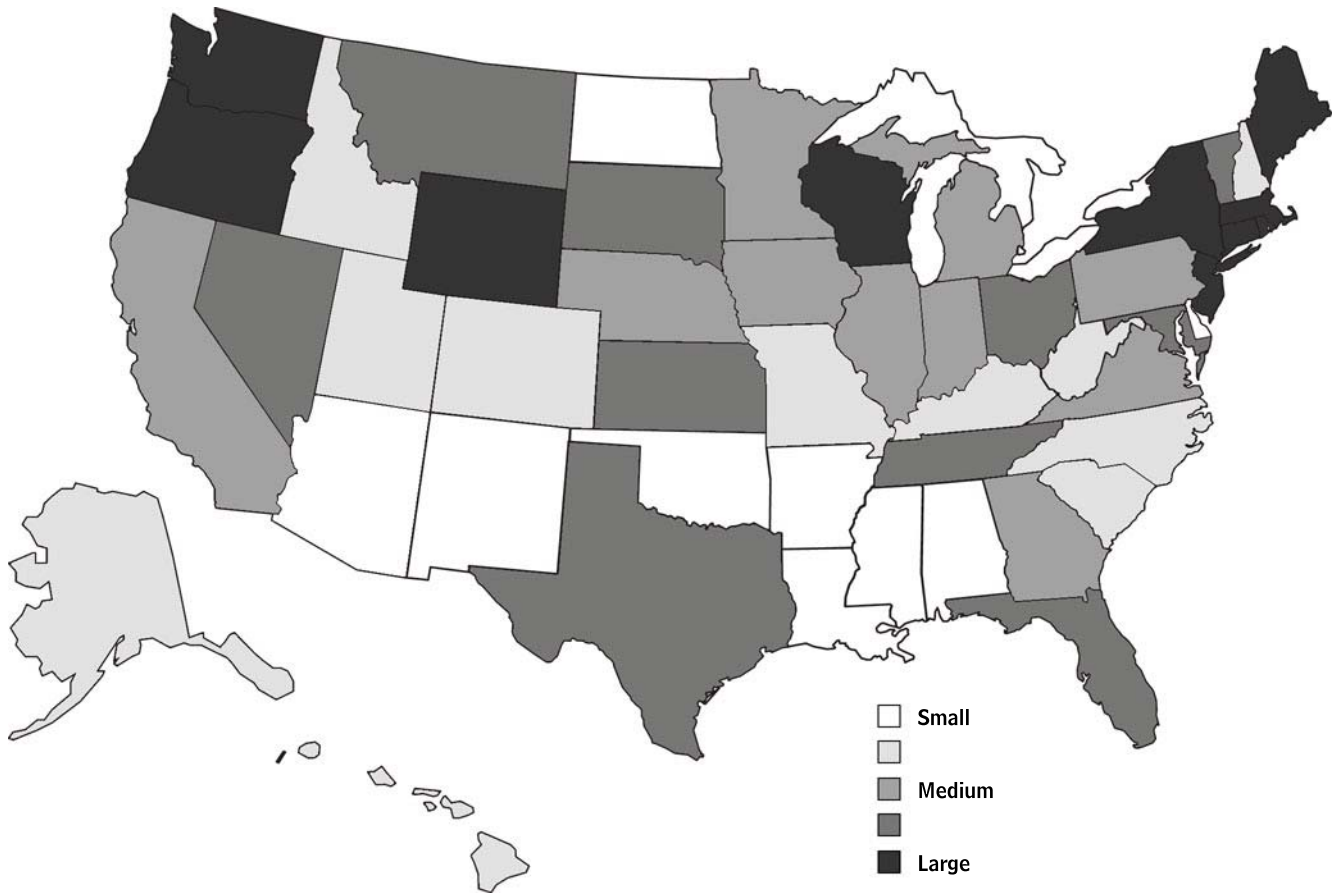
Source: Congressional Budget Office based on the Bureau of the Census's survey of state and local government finances.

Note: The five roughly equal categories group states by the percentages of combined state and local (own-source) tax revenues that were potentially deductible in 2004. (Own-source revenues are all those not received from another government or from government-run utilities, liquor stores, or insurance trust funds.)

among the states. The states in which taxpayers claim a relatively large share of all deductions are states that have large populations; in particular, they are states that have large populations of high-income, itemizing taxpayers. The taxpayers that claim the taxes-paid deduction are concentrated in New England, the Mid-Atlantic region, and the Far West. The South and Southwest have relatively smaller concentrations of such taxpayers—most likely because the largest states in those areas do not levy an income tax.

For taxpayers, one measure of the benefit that the taxes-paid deduction provides is how much the deduction reduces their income that is subject to taxation—specifically, the percentage deduction from AGI. CBO

estimated benefits by dividing the total deductions taken by residents of a state by the total AGI in that state, a calculation that allows states with different-sized populations and income to be compared more accurately (see Table 5 on page 18). Then, for ease of comparison, CBO divided those numbers by the national share of AGI deducted (the share for all states); as Table 5 shows, residents of states that have relative shares above 1 see a larger percentage deduction from AGI than the national average, and residents of states that have relative shares below 1 see a smaller percentage deduction. According to that measure of deductibility, taxpayers in the Mid-Atlantic region, southern New England, and the Far West benefit most from the deduction (see Figure 5 on page 17), a

Figure 4.**Federally Subsidized Shares of Income in 2004, by State**

Source: Congressional Budget Office based on the Bureau of the Census's survey of state and local government finances.

Note: The five roughly equal categories group states by the percentages of total state personal income that represent potentially deductible taxes.

geographic distribution that corresponds more closely to the distribution of high-income taxpayers among the states (see Figure 6 on page 20) than to the distribution of states that have high percentages of subsidized taxes.

The interaction between the presence of high-income taxpayers and state and local tax burdens also influences how the benefits from the taxes-paid deduction are distributed among the states. Although taxpayers in states that have a large percentage deduction from AGI tend to claim larger deductions at all income levels than do taxpayers in states that have a small deduction share, the ratio increases as income rises. That is, the difference between the claimed deductions of taxpayers in large-share states and small-share states is greatest for the

highest-income taxpayers. That finding implies that the benefits from deductibility are more closely related to the progressivity of state and local taxes than to their average level.

Analysis of Alternatives: Effects on State, Local, and Federal Governments

CBO analyzed several alternatives that would change the way the federal individual income tax treats the taxes paid to state and local governments: eliminating the taxes-paid deduction, setting a ceiling for the deduction at 2 percent of adjusted gross income, capping the allowable deduction at an indexed dollar amount, replacing the deduction with a nonrefundable tax credit for 15 percent of the

Table 4.**The Taxes-Paid Deduction, by Taxpayers' Adjusted Gross Income, 2004**

AGI Range (Dollars)	Percentage of All Taxpayers	Percentage of Taxpayers Taking the Taxes-Paid Deduction	Percentage of Total Deductions Claimed	Average Taxes-Paid Deduction per Return Claiming the Deduction (Dollars)	Percentage of Tax Benefits
All Income Categories					
0–10,000	18.5	3.8	0.7	2,647	0
10,000–20,000	17.6	10.5	1.8	2,665	0.3
20,000–40,000	24.6	24.7	6.6	3,032	3.4
40,000–75,000	21.9	53.3	19.8	4,708	15.7
75,000 or more	17.5	85.3	71.1	13,218	80.6
Highest Income Category					
75,000–100,000	7.7	78.2	14.8	6,779	14.2
100,000–200,000	7.5	90.1	25.1	10,358	29.5
200,000–500,000	1.8	94.2	13.6	22,324	13.6
500,000–1 million	0.3	91.8	5.5	49,952	7.5
1 million or more	0.2	91.2	12.2	201,899	15.9

Source: Congressional Budget Office based on data from the Internal Revenue Service's Statistics of Income file.

Note: The taxes-paid deduction allows taxpayers to deduct from their adjusted gross income some of the taxes they pay to state and local governments, including income or sales, real estate, and other taxes. The provision allowing sales taxes to be deducted expired at the end of 2007.

state and local taxes paid, and eliminating the deductibility of all taxes except those on real estate.¹³ Each option, if implemented, could cause state and local governments to change their tax structures in different ways and also affect taxpayers' filing behavior (for example, whether or not people itemize). In addition, all of the alternatives would substantially increase federal revenues during the 2008–2017 period. For most of the options (all except the credit), total revenues would still increase if the options were combined with changes that would limit the alternative minimum tax.

Description of the Alternatives and Their Cost

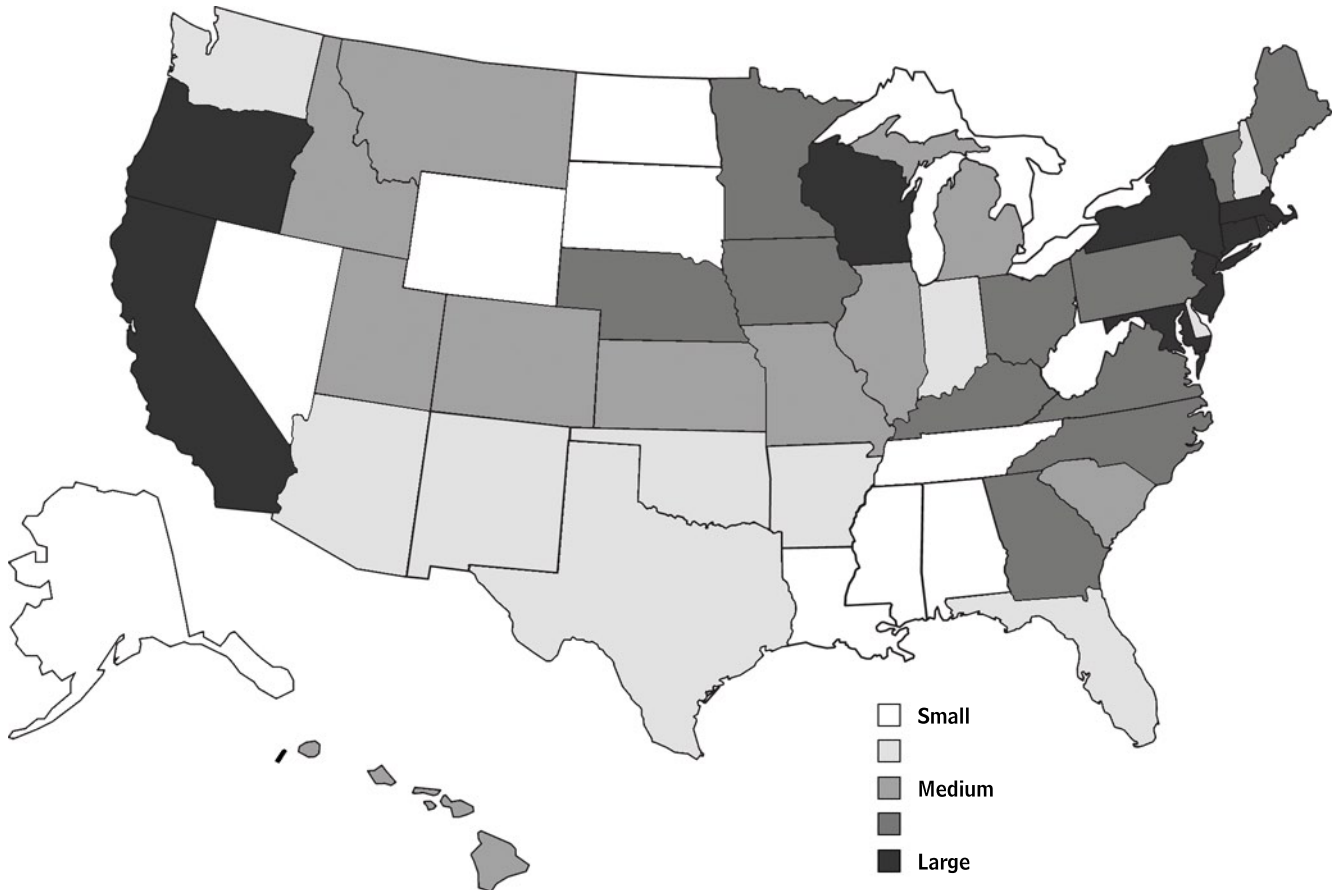
For each option that CBO analyzed, the Joint Committee on Taxation estimated the total effect, on a fiscal year basis, that the alternative would have on the federal budget. The estimates incorporate a full set of assumptions about the ways both taxpayers and governments might respond to the changes, including timing effects (revenues would be received at varying points after a change in law). All changes would be effective for calendar years that began after December 31, 2007. However, changes in tax rules are scheduled to occur within the next 10 years, including the expiration after 2010 of many of the tax provisions enacted in 2001 and 2003. As a result, JCT's estimates necessarily combine tax receipts collected under different tax regimes in fiscal years that bracket the changes in law that occur at the end of a calendar year.

The estimates discussed in this section incorporate the assumption that the exemption amounts for the AMT revert to their 2000 levels in tax year 2008 and remain there, as specified in current law. Under that assumption, approximately 30 million taxpayers would be subject to the AMT in 2010, CBO estimates.

13. Because the provision allowing the deduction of sales taxes in lieu of income taxes expired at the end of 2007, CBO's budget baseline, against which the Joint Committee on Taxation assessed the effects of the alternatives, does not include the sales tax deduction. (The baseline is a benchmark for measuring the budgetary effects of proposed changes in federal revenues or spending. The projections of budget authority, outlays, revenues, and the deficit or surplus that the baseline comprises are calculated according to rules set forth in the Balanced Budget and Emergency Deficit Control Act of 1985.)

Figure 5.

Relative Shares of Adjusted Gross Income Deducted in 2004 Under the Taxes-Paid Deduction, by State



Source: Congressional Budget Office based on data from the Internal Revenue Service's Statistics of Income file.

Note: The five roughly equal categories are based on the relative share, which is calculated by dividing the percentage deduction from AGI that state and local tax deductibility provides for taxpayers in each state by the national average.

Eliminate the Deduction of All State and Local Taxes. Of the five options, completely eliminating the deduction, which was recommended by the President's Tax Reform Panel, would generate the biggest rise in federal revenues. This alternative would also simplify the most returns (because more people would use the standard deduction) and would eliminate any subsidy-related effects on state and local governments' choices between different kinds of taxes that affect individuals.

If policymakers eliminated deductibility for all state and local taxes paid, revenues would rise by an estimated \$50 billion in fiscal year 2009 (see Table 6). The general limit on itemized deductions applies from 2011 onward under current law; however, the effects of the rise in mar-

ginal rates and other changes set to take place in that year with the expiration of EGTRRA would override the provision's effects and increase the revenue gain associated with eliminating the taxes-paid deduction. In 2012, that gain would rise to \$93 billion. Over the 2008–2017 period, eliminating deductibility would increase revenues by an estimated \$748 billion.

Limit the Deduction With a Ceiling on Adjusted Gross Income or a Cap on the Amount That Can Be Deducted.

These options would continue to provide some amount of subsidy for state and local governments and so would produce less of a boost in revenues for the federal government compared with the elimination alternative. The AGI ceiling and the cap would substantially weaken the

Table 5.**Selected Measures of State and Local Tax Deductibility, 2004**

	Percentage of Taxpayers Who Itemized	Percentage of Total Deductions Claimed	Average Taxes-Paid Deduction per Return Claiming the Deduction (Dollars)	Percentage of AGI Deducted	Ratio of Deduction Share to AGI Share
By State					
Alabama	31.7	0.7	4,039	3.0	0.569
Alaska	20.8	0.1	3,508	1.6	0.302
Arizona	37.1	1.3	5,312	4.1	0.760
Arkansas	25.7	0.4	5,757	3.6	0.672
California	39.6	17.3	10,292	7.0	1.302
Colorado	44.8	1.4	5,589	4.5	0.842
Connecticut	46.0	2.5	12,082	7.3	1.364
Delaware	29.3	0.2	6,541	3.6	0.677
District of Columbia	44.5	0.4	9,774	7.0	1.299
Florida	31.4	3.6	5,226	3.1	0.577
Georgia	38.5	2.6	6,549	5.3	0.983
Hawaii	38.4	0.4	6,122	4.7	0.870
Idaho	32.7	0.3	6,122	4.8	0.895
Illinois	34.8	4.1	7,411	4.8	0.901
Indiana	30.4	1.4	5,794	3.9	0.721
Iowa	34.4	0.8	6,387	5.1	0.951
Kansas	32.5	0.7	7,022	5.0	0.931
Kentucky	31.2	1.1	6,776	5.1	0.958
Louisiana	22.2	0.5	4,583	2.6	0.484
Maine	29.0	0.4	8,008	5.9	1.093
Maryland	48.3	3.0	8,724	7.1	1.326
Massachusetts	40.0	3.4	9,958	6.3	1.180
Michigan	35.4	2.9	6,692	5.0	0.926
Minnesota	41.4	2.1	7,717	5.9	1.100
Mississippi	21.6	0.3	4,584	2.8	0.520
Missouri	33.0	1.5	6,312	4.5	0.845
Montana	30.3	0.2	5,883	4.7	0.887
Nebraska	30.3	0.5	7,534	5.2	0.965
Nevada	40.0	0.6	4,664	3.0	0.569
New Hampshire	36.4	0.4	6,700	4.3	0.802
New Jersey	46.7	5.9	11,207	7.9	1.468
New Mexico	26.2	0.3	5,409	3.5	0.651
New York	38.4	12.0	13,109	8.3	1.557
North Carolina	37.0	2.6	6,998	5.6	1.047

Continued

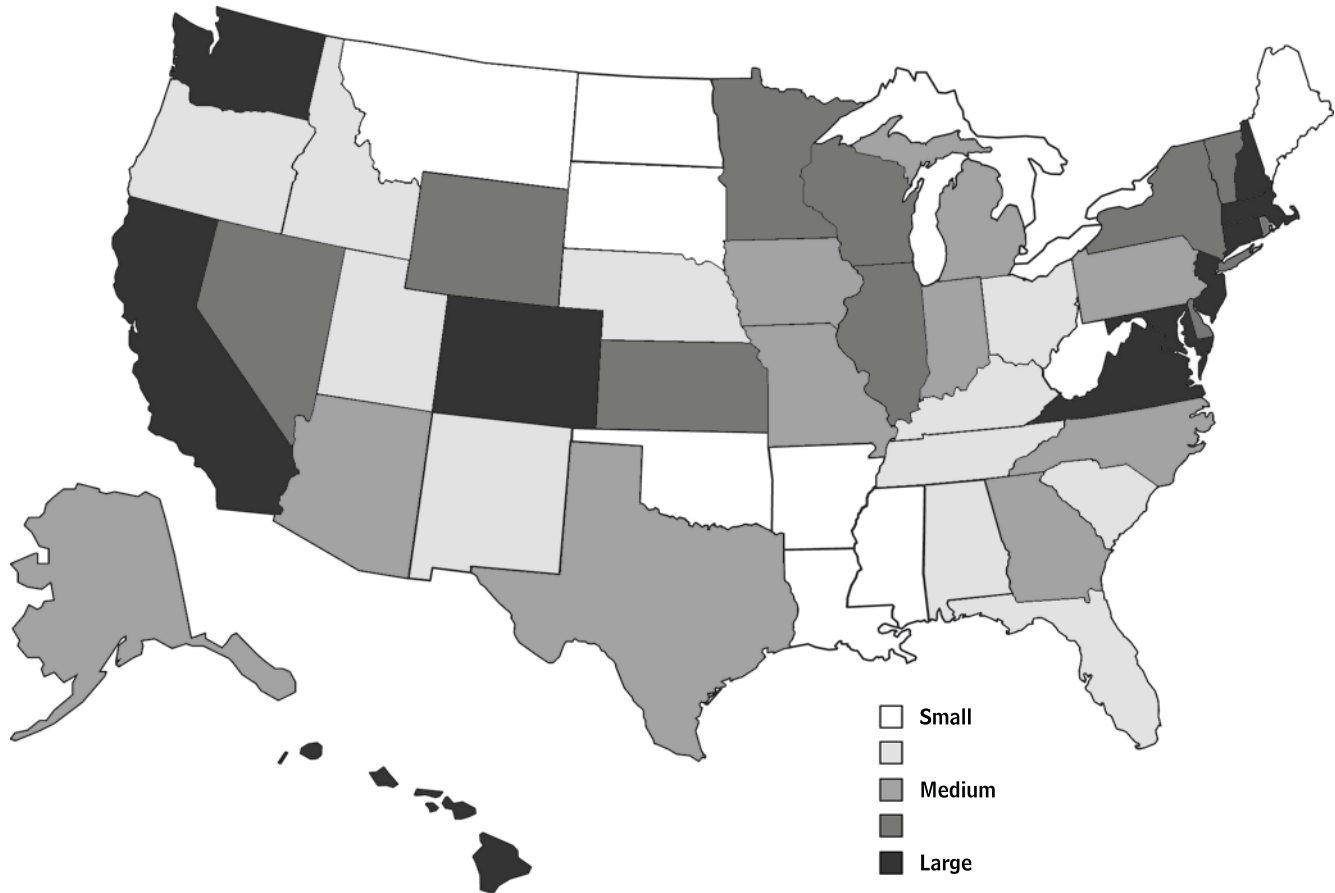
Table 5.**Continued**

	Percentage of Taxpayers Who Itemized	Percentage of Total Deductions Claimed	Average Taxes-Paid Deduction per Return Claiming the Deduction (Dollars)	Percentage of AGI Deducted	Ratio of Deduction Share to AGI Share
By State (Continued)					
North Dakota	22.6	0.1	4,796	2.7	0.500
Ohio	34.7	3.8	7,497	5.8	1.083
Oklahoma	32.1	0.7	5,421	4.2	0.780
Oregon	42.3	1.5	7,927	7.1	1.322
Pennsylvania	32.0	3.9	7,686	5.0	0.942
Rhode Island	38.1	0.5	9,838	7.2	1.337
South Carolina	29.2	0.9	6,096	4.5	0.834
South Dakota	15.9	0.1	3,523	1.4	0.267
Tennessee	24.8	0.7	3,838	2.2	0.402
Texas	25.3	3.8	5,939	3.1	0.570
Utah	41.1	0.6	5,447	5.0	0.931
Vermont	32.1	0.2	8,007	5.6	1.045
Virginia	41.4	3.0	7,522	5.4	1.007
Washington	36.5	1.4	5,113	3.2	0.603
West Virginia	18.2	0.2	5,894	2.9	0.538
Wisconsin	37.3	2.3	8,547	6.6	1.233
Wyoming	23.5	0.1	3,653	1.5	0.286
All States	35.2	100.0	6,767	5.4	1.000
By Census Division					
New England	39.6	7.5	10,054	6.4	1.202
Middle Atlantic	38.2	21.7	11,177	7.4	1.373
South Atlantic	36.0	16.7	6,721	4.7	0.883
East north central	34.6	14.5	7,232	5.2	0.966
East south central	27.7	2.7	4,784	3.2	0.594
West north central	34.2	5.8	6,890	5.0	0.932
West south central	25.7	5.5	5,692	3.2	0.589
Mountain	37.8	4.9	5,366	4.1	0.759
Pacific	39.1	20.7	9,275	6.4	1.186

Source: Congressional Budget Office based on data from the Internal Revenue Service's Statistics of Income file.

Notes: The taxes-paid deduction allows taxpayers to deduct from their adjusted gross income some of the taxes they pay to state and local governments, including income or sales, real estate, and other taxes. The provision allowing sales taxes to be deducted expired at the end of 2007.

AGI = adjusted gross income.

Figure 6.**Shares of High-Income Taxpayers in 2004, by State**

Source: Congressional Budget Office based on data from the Internal Revenue Service's Statistics of Income file.

Note: The five roughly equal categories group states by the percentages of taxpayers in the top 20 percent of the adjusted gross income distribution.

incentive of state and local governments to continue to use deductible taxes once taxpayers' liability exceeds those limits. Because average AGI varies by state, an AGI ceiling would subsidize states that had higher average income relatively more than would a cap on the deductible amount. Also, if high state and local taxes reflected a higher price for providing public goods rather than a preference for a particular amount of public consumption, then tying the amount of the deduction to a percentage of AGI would allow a larger subsidy for states and localities that had higher costs. Among taxpayers, the AGI ceiling would give higher-income filers a larger deduction and would preserve the support that the subsidy currently provides to more-progressive state and local taxes.

Capping the deduction at a specific dollar value that was then indexed for inflation would eliminate some of the variation in the use of the deduction by taxpayers in different states. A cap would affect more taxpayers in high-income and high-tax states than in states whose average income and tax burden were lower. Among taxpayers, the decrease in the benefit that deductibility provides would be greatest under a cap for those who could claim the largest deductions under the current system.

Restrictions on deductibility would have a commensurately smaller impact on federal revenues than would the elimination option. In 2009, limiting the deduction to 2 percent of AGI or implementing an indexed \$5,000 cap would boost revenues by \$35 billion or \$28 billion, respectively. As with the elimination alternative, the

Table 6.

Total Effects on Federal Revenues of Options for Changing the Taxes-Paid Deduction Assuming No Change in the Alternative Minimum Tax, by Fiscal Year

(Billions of dollars)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Total, 2008- 2017
Eliminate the Taxes-Paid Deduction	12.9	50.4	46.3	58.0	92.9	94.1	96.0	97.9	99.1	100.3	747.9
Limit the Deduction to 2 Percent of Adjusted Gross Income	9.0	34.7	31.0	39.8	67.5	67.8	68.9	70.0	70.6	71.1	530.2
Restrict the Deduction to Real Estate Taxes	8.4	32.5	29.1	36.4	57.4	57.9	59.0	60.2	61.2	62.2	464.4
Cap the Deduction at \$5,000 in 2008 and Index It Thereafter	7.3	28.2	26.1	33.9	55.3	55.9	57.1	58.2	59.3	60.3	441.6
Replace the Deduction with a 15 Percent Credit of Currently Deductible Taxes	1.1	3.9	2.8	8.2	22.3	23.1	24.2	25.4	26.5	27.4	165.0

Source: Joint Committee on Taxation.

Notes: JCT measured all effects of the options against the Congressional Budget Office's baseline projections for fiscal years 2008 to 2017.

The taxes-paid deduction allows taxpayers to deduct from their adjusted gross income some of the taxes they pay to state and local governments, including income or sales, real estate, and other taxes. The provision allowing sales taxes to be deducted expired at the end of 2007.

increase in revenues associated with those options would rise in 2012. In that year, limiting the deduction to 2 percent of AGI would add \$68 billion to revenues; capping the dollar amount would add \$55 billion.

Replace the Deduction with a Credit. A tax credit—for example, 15 percent of the taxes an individual pays that are deductible under current law—would preserve some federal subsidy for those taxes and therefore the incentive for states and localities to use them. The subsidy to state and local spending would continue to flow indirectly through the taxpayers that finance that spending but at a rate—the rate of the credit—that would not depend on what their marginal tax rate was or whether they itemized. For a taxpayer who did not itemize but had federal tax liability, the cost of an additional dollar of state or local government spending that was financed through creditable taxes would be roughly \$1 minus the credit rate (or \$1 minus 15 percent = 85 cents), compared with \$1 under the current taxes-paid deduction. For an itemizing taxpayer with federal tax liability, the cost of an additional dollar of spending through creditable taxes would

also be \$1 minus the rate of the credit (rather than \$1 minus the taxpayer's marginal tax rate, as is the case now).

Replacing the current deduction with a nonrefundable credit for 15 percent of taxes paid would generate the smallest federal revenue gain of all the options that CBO considered—\$4 billion in 2009, rising to \$22 billion in 2012.

Restrict the Deduction to Real Estate Taxes. This alternative would strengthen state and local governments' incentives to raise revenue from real estate taxes rather than from other types of taxes. Any change in law that eliminated deductibility for some taxes but left it in place for others would encourage state and local governments to alter their mix of taxes in response. However, if those governments did not respond to the changed incentives, continuing the real estate tax deduction and eliminating the others would cut the federal subsidy to state governments by much more than it would cut the federal subsidy to local governments. Real estate taxes are more likely than other types of subsidized taxes to correspond to localized

differences in benefits, affecting, for example, the quality of schools, which varies by school district. As a result, the taxes-paid deduction under this option would probably subsidize services that had few spillover benefits to other areas.

According to JCT, restricting the taxes-paid deduction to real estate taxes would increase federal revenues by \$33 billion in 2009 and by \$57 billion in 2012.

The Options' Interaction With the Alternative Minimum Tax

The preceding estimates incorporate the assumptions that current law continues to govern the AMT and a growing number of taxpayers become subject to that tax. In recent years, policymakers have enacted several laws, on a one- or two-year basis, to prevent such a rise in numbers. Because one of the largest tax preferences that the AMT eliminates is the deduction for state and local taxes, future legislative action that affected the AMT would have a substantial impact on the revenues to be gained from changes to the taxes-paid deduction. In particular, the fewer taxpayers that are subject to the AMT, the greater the impact on revenues of the taxes-paid deduction.

Interactive Effects of Combining the Elimination Alternative with a Change in the AMT. As one way to stop the continuing increase in the number of taxpayers subject to the AMT, policymakers could permanently boost the AMT's exemption and tax brackets and index them for inflation. By itself, indexing of the exemption and brackets from their 2006 levels would reduce revenues, relative to current law, by an estimated \$586 billion over the 2008–2017 period. If such a change was combined with the elimination of the taxes-paid deduction, the gain in revenues from eliminating the deduction would more than offset the loss in revenues from indexing the AMT, resulting in a net revenue gain of \$447 billion from 2008 to 2017.

In 2009, the first full fiscal year under the combined changes, the fall in revenues from the AMT would offset much of the increase from eliminating the state and local deduction, JCT estimates, leading to a rise in total revenues of \$15 billion (see Table 7). In 2010, the year in

which AMT revenues are projected to peak under current law, the revenues that would be lost if the AMT was indexed and the revenues that would be gained if the taxes-paid deduction was eliminated would combine for a relatively small change to revenues overall. In 2012, the first full year after the various tax provisions expire, the effect on revenues from the AMT's indexation would be substantially smaller (because more taxpayers would be subject to the ordinary income tax). Thus, the increase in revenues from eliminating the state and local tax deduction would be only partially offset by the AMT's indexation, generating a projected revenue gain of just under \$76 billion.

The rise in revenues from eliminating deductibility and the decline in revenues from indexing the AMT would each grow in nominal terms after 2012. However, because the loss in revenues from indexing the AMT would grow faster, the net gain in revenues from the combined changes would fall in each year after the peak in 2012.

Interactive Effects of Combining Any of the Other Alternatives With a Change in the AMT. Combining any of the other options with the AMT's indexation would substantially alter the total revenue effects of those proposals. Because the other options would generate smaller increases in revenues than that produced by eliminating the deduction, combining those options with changes to the AMT would generally produce revenue losses in the early years of the period and revenue gains in the later years.

Under options that applied weaker limits to deductibility (for example, an indexed cap), the decrease in revenues from the AMT's indexation would predominate in the years before 2011, when revenues from the tax would be high. The rise in federal tax receipts that the options would generate by partially eliminating deductibility for taxpayers at the high end of the income distribution would offset only a portion of the revenues lost when many taxpayers were removed from the AMT's rolls (as a result of indexation). After 2011, the revenues gained from limiting the deduction would more than offset the revenues lost from indexing the AMT. The one exception

Table 7.

Total Effects on Federal Revenues of Combining Options With Indexation of the Alternative Minimum Tax, by Fiscal Year

(Billions of dollars)

Effects of Indexing the AMT	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Total, 2008-2017
Without Options	-23.2	-62.4	-73.7	-62.7	-38.3	-46.1	-54.4	-63.6	-74.7	-87.1	-586.2
With Options											
Eliminate the taxes-paid deduction	-3.6	15.1	1.3	23.0	75.9	73.1	71.2	68.5	64.0	58.2	446.7
Limit the deduction to 2 percent of adjusted gross income	-8.7	-5.6	-20.0	-0.3	49.4	45.3	42.0	37.8	31.8	24.4	196.1
Restrict the deduction to real estate taxes	-10.4	-12.3	-27.2	-8.8	35.2	30.6	26.4	21.4	14.5	6.3	75.6
Cap the deduction at \$5,000 in 2008 and index it thereafter	-11.1	-14.9	-28.6	-10.0	34.7	30.5	26.8	22.1	15.7	8.0	73.2
Replace the deduction with a 15 percent credit of currently deductible taxes	-21.4	-55.8	-68.5	-50.4	-6.0	-11.6	-17.4	-24.1	-32.7	-42.6	-330.4

Source: Joint Committee on Taxation.

Notes: JCT measured all effects of the options against the Congressional Budget Office’s baseline projections for fiscal years 2008 to 2017.

The taxes-paid deduction allows taxpayers to deduct from their adjusted gross income some of the taxes they pay to state and local governments, including income or sales, real estate, and other taxes. The provision allowing sales taxes to be deducted expired at the end of 2007.

to that statement would be the credit option. Even after the scheduled expiration of the tax provisions at the end of 2010, the estimated overall effect on revenues of combining the credit with the AMT’s indexation would remain negative—because the gain in revenues from moving to a 15 percent credit would be too small to offset the cost of indexing the AMT, even in years for which relatively low revenues from the tax are projected.

Over the 2008–2017 period, JCT estimates, indexing the AMT and limiting the deduction to 2 percent of AGI, allowing the deduction only of real estate taxes, or capping the deduction at \$5,000 in 2008 (and indexing it thereafter) would increase revenues by about \$196 billion, \$76 billion, or \$73 billion, respectively (see Table 7). In contrast, replacing the deduction with a

15 percent credit would lower revenues by roughly \$330 billion. Changing some features of the options—for example, using a higher AGI ceiling, larger dollar cap, or lower credit rate—would alter the options’ effects. With such changes, policymakers could adjust the alternatives to more closely offset the loss in revenues that would result from indexing the AMT.

Distributional Analyses of Changes in Tax Liability in 2010 and 2011 Under the Options

The estimated changes in taxpayers’ calendar year tax liability that would occur under each of the options are not the same as the fiscal year revenue estimates discussed earlier, although they are measured against the same set of

baseline budget projections. The distributional estimates of tax liability do not incorporate any assumptions about when the federal government would receive the corresponding revenues. Most important, CBO's estimates of calendar year liability do not encompass all of the possible ways that taxpayers or state and local governments might respond to an option, although the estimates do incorporate assumptions about simple changes in filing behavior. CBO purposely ignored those broader issues to highlight the changes in the distributional impact of the options under the different tax regimes currently scheduled for 2010 and 2011—the years just before and after the scheduled expiration of the tax provisions in EGTRRA and other recent laws.

Effects of Deductibility Options on Tax Liability and Tax Simplification, by Income

For most of the alternatives, the effects on tax liability would be concentrated among taxpayers whose AGI was above \$75,000 (roughly the 20 percent of taxpayers with the highest income). Under 2010 tax law, taxpayers who had income of more than \$500,000 would have the largest declines in after-tax income (and the largest increases in tax liability). Unlike the other options, the credit option would reduce taxes for some taxpayers, generally those whose income put them in the bottom 80 percent of the income distribution. In 2011, the estimated impact of the alternatives would be similar to that in 2010 for most taxpayers, with the exception of those who had income between \$200,000 and \$500,000. As a group, those taxpayers would see particularly large declines in after-tax income in 2011 but little change in 2010—because the AMT prevents many of them from deducting state and local taxes in 2010.

All of the options would encourage at least some taxpayers to take the standard deduction instead of itemizing, thereby simplifying preparation of their tax returns. However, the AGI ceiling, dollar cap, and credit options would create some additional complexity in filing for those who continued to take the deduction or claim the credit.

Eliminate the State and Local Tax Deduction. Increases in tax liability under this alternative would be concentrated among taxpayers whose AGI was above \$75,000 in

2010—because those taxpayers are much more likely to claim the deduction in its current form than are taxpayers whose income is lower (see Table 8 on page 27). Taxpayers who had income of more than \$1 million would face the largest increase in liability under this option as well as the largest percentage decline in after-tax income. Nearly 80 percent of taxpayers whose income placed them in that top category would see their tax liability rise in 2010 if the taxes-paid deduction was eliminated.

Although the general limit on itemized deductions applies from 2011 on, its effects on liability would be smaller than the effects from the rise in marginal tax rates and other changes set to take place in 2011. As a result, the expiration of those tax provisions after 2010 would lead to an increase for all income groups in the average tax liability associated with eliminating the state and local tax deduction.

However, the difference in the effect of eliminating the deduction under 2010 law and eliminating it under 2011 law would be much larger for taxpayers whose income was above \$75,000—because they would be more likely than lower-income taxpayers to be affected by the expiration of the 2001 tax provisions. Within that higher-income group, the largest difference in the decrease in after-tax income from 2010 to 2011 under the elimination option would be for taxpayers whose AGI was between \$200,000 and \$500,000. Most of those taxpayers would be subject to the AMT in 2010, which would drastically limit the value of the taxes-paid deduction for them in that year. However, EGTRRA's expiration would shift most of them back to the ordinary income tax—under which they would benefit from the deduction if it was in place.

In 2011, taxpayers who had income of more than \$1 million would face the largest increase in average tax liability if the deduction was eliminated. However, in CBO's estimation, the largest percentage drop in after-tax income under this option would occur for taxpayers whose income was between \$500,000 and \$1 million. Among taxpayers whose income ranged from \$40,000 to \$75,000, about 40 percent would incur a larger tax liability. Nearly 80 percent of taxpayers who had income of more than \$100,000 would face such a hike.

In 2010 and 2011, about 7 percent and 8 percent of taxpayers, respectively, would switch from itemizing to using the standard deduction, CBO estimates. For almost all of those taxpayers, the loss of the taxes-paid deduction would be partially offset by the value of the standard deduction. For any taxpayer whose other itemized deductions totaled less than the standard deduction, a switch to claiming it would partially offset the loss of the taxes-paid deduction. CBO estimates that if state and local governments' tax policies did not change, about 15 percent of taxpayers in 2010 would see their total allowable deductions fall by the full amount that they would have claimed as their taxes-paid deduction. In 2011, about 19 percent would experience such a drop.¹⁴

Set a Ceiling on the Deduction. This alternative would lead to smaller increases in average tax liability for all income groups, relative to the elimination option, and would simplify fewer returns. In 2010, implementing a 2 percent AGI ceiling rather than completely eliminating the taxes-paid deduction would cut the projected increase in average new tax liability by about 40 percent for taxpayers with income above \$75,000 (see Table 9 on page 28). Compared with the percentage under the elimination alternative, the share of taxpayers who faced increased liability in 2010 under this option would be similar among taxpayers whose income was below \$75,000 but much smaller among taxpayers whose income was above that amount. In addition, an AGI ceiling would produce less variation, compared with eliminating the deduction, in the decline in after-tax income among the income classes above \$75,000. Notably, the AMT on its own would so limit the deduction for taxpayers whose income was between \$200,000 and \$500,000 that in 2010, there would be virtually no change in their after-tax income under the option of a 2 percent AGI ceiling on deductibility.

The same factors associated with the expiration of EGTRRA and other tax cuts and their interaction with

the AMT would apply under this alternative as well. Thus, the increases in average tax liability for most taxpayers claiming the deduction under a 2 percent AGI ceiling would be much larger in 2011 than in 2010. Also, among taxpayers with income above \$75,000, the percentage experiencing an increase in liability within each income subgroup would be more nearly equal in 2011 than in 2010—because in the earlier year, many taxpayers in the \$200,000–\$500,000 income range would have to pay the AMT.

Under the AGI ceiling option, more taxpayers than under the elimination alternative would continue to find it worthwhile to itemize. Thus, approximately 4 percent to 5 percent of taxpayers would switch to the standard deduction in 2010 and 2011, CBO estimates.

Set a Cap on the Deduction. Like an AGI ceiling, an indexed cap on the deduction would preserve some of the federal subsidy for certain state and local taxes. However, it would sever the close relationship between taxes paid and taxes deducted, decreasing the subsidy available to high-income filers by relatively more than would occur under the previous alternatives. Limiting the deduction to \$5,000 in 2008 and indexing that cap thereafter would increase projected tax liability in 2010 by much more for taxpayers whose income was above \$500,000 than it would for taxpayers whose income was below that amount (see Table 10 on page 29). Compared with previous options, taxpayers in the lower part of the above-\$75,000 group would face a smaller average tax increase because the amount of their claimed deductions would be more likely to fall below the cap. For the highest-income taxpayers, the percentage who would incur an increase in average liability would be larger under the cap than under the 2 percent AGI ceiling; in fact, the impact of this alternative on taxpayers whose income was more than \$500,000 would be similar to the impact under the elimination option.

In 2011, the increase in projected liability would be greater for all income groups than the increase in 2010. For taxpayers with income above \$500,000, the decline in after-tax income under the cap in this option would nearly equal the decline under the elimination alternative.

A cap of \$5,000 approximates the median taxes-paid deduction in 2004. As a result, in CBO's estimation, approximately half of the taxpayers who currently claim the deduction would still find it advantageous to claim

14. Eliminating the deduction would not boost tax liability for all itemizers. An additional 3 percent of taxpayers itemize but have no tax liability under current law or the elimination alternative. Also, in CBO's analysis, taxpayers whose itemized deductions exceed the standard deduction are considered itemizers, even if they are subject to the AMT under both current law and the elimination option. Those taxpayers would be unable to claim the deduction in either case and would be unaffected by its elimination. In 2010 and 2011, about 9 percent and 2.5 percent of taxpayers, respectively, would fall into that category.

the full value of the taxes they had paid. Fewer than 2 percent of taxpayers in any year would switch to the standard deduction under this option.

Replace the Deduction with a Credit of 15 Percent. The impact on the various income groups of replacing the state and local tax deduction with a nonrefundable credit (15 percent of the currently deductible taxes paid) differs substantially from the effects of the options discussed thus far. Because many taxpayers in roughly the bottom 80 percent of the income distribution do not claim the current deduction but could take a credit, that group under this option would have a slightly smaller average tax liability in 2010 (see Table 11 on page 30); however, just over 22 percent of taxpayers who had income between \$40,000 and \$75,000 would incur a larger liability. The increase in average tax liability would be small until taxpayers' income reached \$500,000; above that amount, the increase in liability would be more substantial. Yet although a majority of the taxpayers who had income above \$500,000 would face a tax increase, the percentage decline in after-tax income for that group would be smaller than under any of the other options.

Under this alternative, as under the others, the drop between 2010 and 2011 in the number of taxpayers who are projected to owe the AMT would lead to larger increases in average tax liability in 2011 for the 20 percent of taxpayers who had the highest income.

Compared with the number in 2010, more taxpayers in 2011 would see increases in tax liability, especially in the AMT-heavy \$200,000–\$500,000 income range. Nonetheless, the decline in after-tax income for the higher-income groups would be smaller under the credit option than under any of the other alternatives in 2011.

The small decrease in average tax liability for the bottom 80 percent of the income distribution would remain essentially the same in 2011 as it was in 2010. Those taxpayers would see little difference between the two years because they are unlikely to be affected by the expiration of the 2001 and 2003 tax provisions at the end of 2010.

Replacing the deduction with a credit would encourage some taxpayers to use the standard deduction instead of itemizing, although the number who would do so (an estimated 5 percent in 2010 and 7 percent in 2011) would be fewer than the number under the elimination alternative. In preparing its projections, CBO assumed that the credit would not be allowed under the AMT. Consequently, a small number of taxpayers (about 1.5 percent) who would not owe the alternative tax under current law but whose liability under the ordinary income tax would decrease under the credit option would be subject to the AMT if the credit was in place. However, the number of taxpayers newly subject to the AMT would be dwarfed by the large number who would claim the new credit under this alternative.

Restrict the Deduction to Real Estate Taxes. Because the share of total deductions attributable to real estate taxes drops with income, an option that allowed taxpayers to deduct only those taxes would cut the allowable deduction by relatively more for higher-income households than for lower-income ones. In 2010 under this option, taxpayers in roughly the bottom 80 percent of the income distribution would incur an increase in tax liability that would be less than half the increase incurred under the elimination alternative; taxpayers in the upper 20 percent would incur about two-thirds of the increase in liability projected under the elimination option (see Table 12 on page 31). The pattern of increases in tax liability for those with income above \$75,000 would be similar to that under the other options, with the exception of the credit. For taxpayers in the lower portion of the top 20 percent of the distribution, this option would generate larger increases in average tax liability than would the cap option but smaller increases than would the AGI ceiling. That order would be reversed for taxpayers in the highest-income group.

As with most of the other options, the rise in average tax liability under this alternative would be larger, and more taxpayers would incur increased liability, in 2011 than in 2010. Approximately 4 percent of taxpayers would find it more advantageous to take the standard deduction than to itemize.

Table 8.

Effects of Eliminating the Taxes-Paid Deduction, by Taxpayers' Adjusted Gross Income, Calendar Years 2010 and 2011

AGI Range (Dollars)	Average Change in Tax Liability (Dollars)	Percentage of Returns With Increased Liability	Percentage Change in After-Tax Income
Calendar Year 2010			
All Income Categories			
0–10,000	0	0.1	0
10,000–20,000	4	3.2	0
20,000–40,000	39	14.2	-0.1
40,000–75,000	248	41.3	-0.5
75,000 or more	1,057	50.1	-0.7
Highest Income Category ^a			
75,000–100,000	483	58.2	-0.6
100,000–200,000	454	50.3	-0.4
200,000–500,000	223	15.7	-0.1
500,000–1 million	7,086	73.7	-1.4
1 million or more	42,171	77.6	-1.7
Calendar Year 2011			
All Income Categories			
0–10,000	0	0.1	0
10,000–20,000	7	3.3	0
20,000–40,000	46	13.5	-0.2
40,000–75,000	276	41.1	-0.6
75,000 or more	2,142	72.7	-1.5
Highest Income Category ^a			
75,000–100,000	641	60.3	-0.8
100,000–200,000	1,465	78.4	-1.3
200,000–500,000	3,485	85.1	-1.6
500,000–1 million	13,369	87.9	-2.7
1 million or more	49,516	86.8	-2.3

Source: Congressional Budget Office.

Notes: Changes noted in the table are relative to current law.

The taxes-paid deduction allows taxpayers to deduct from their adjusted gross income some of the taxes they pay to state and local governments, including income or sales, real estate, and other taxes. The provision allowing sales taxes to be deducted expired at the end of 2007.

a. Roughly the 20 percent of taxpayers who have the highest income.

Table 9.

Effects of Limiting the Taxes-Paid Deduction to 2 Percent of AGI, by Taxpayers' Adjusted Gross Income, Calendar Years 2010 and 2011

AGI Range (Dollars)	Average Change in Tax Liability (Dollars)	Percentage of Returns With Increased Liability	Percentage Change in After-Tax Income
Calendar Year 2010			
All Income Categories			
0–10,000	0	0.1	0
10,000–20,000	4	2.9	0
20,000–40,000	31	13.2	-0.1
40,000–75,000	184	38.6	-0.4
75,000 or more	659	38.4	-0.4
Highest Income Category ^a			
75,000–100,000	323	50.3	-0.4
100,000–200,000	231	34.8	-0.2
200,000–500,000	99	8.7	0
500,000–1 million	4,266	56.1	-0.8
1 million or more	28,388	62.9	-1.1
Calendar Year 2011			
All Income Categories			
0–10,000	0	0.1	0
10,000–20,000	6	3.0	0
20,000–40,000	37	12.5	-0.1
40,000–75,000	206	38.7	-0.4
75,000 or more	1,518	65.0	-1.1
Highest Income Category ^a			
75,000–100,000	449	54.1	-0.6
100,000–200,000	996	70.8	-0.9
200,000–500,000	2,205	72.3	-1.0
500,000–1 million	10,005	78.1	-2.0
1 million or more	39,174	74.2	-1.8

Source: Congressional Budget Office.

Notes: Changes noted in the table are relative to current law.

The taxes-paid deduction allows taxpayers to deduct from their adjusted gross income some of the taxes they pay to state and local governments, including income or sales, real estate, and other taxes. The provision allowing sales taxes to be deducted expired at the end of 2007.

a. Roughly the 20 percent of taxpayers who have the highest income.

Table 10.

Effects of Capping the Taxes-Paid Deduction, by Taxpayers' Adjusted Gross Income, Calendar Years 2010 and 2011

AGI Range (Dollars)	Average Change in Tax Liability (Dollars)	Percentage of Returns With Increased Liability	Percentage Change in After-Tax Income
Calendar Year 2010			
All Income Categories			
0–10,000	0	0	0
10,000–20,000	0	0.2	0
20,000–40,000	1	1.8	0
40,000–75,000	29	11.4	-0.1
75,000 or more	683	20.3	-0.5
Highest Income Category ^a			
75,000–100,000	84	25.0	-0.1
100,000–200,000	85	15.7	-0.1
200,000–500,000	122	9.5	-0.1
500,000–1 million	5,992	68.2	-1.2
1 million or more	40,949	75.9	-1.6
Calendar Year 2011			
All Income Categories			
0–10,000	0	0	0
10,000–20,000	0	0.3	0
20,000–40,000	3	1.9	0
40,000–75,000	32	11.1	-0.1
75,000 or more	1,360	48.3	-1.0
Highest Income Category ^a			
75,000–100,000	136	28.4	-0.2
100,000–200,000	596	55.6	-0.5
200,000–500,000	2,297	70.9	-1.1
500,000–1 million	12,076	85.3	-2.5
1 million or more	48,588	85.6	-2.3

Source: Congressional Budget Office.

Notes: Changes noted in the table are relative to current law.

The taxes-paid deduction allows taxpayers to deduct from their adjusted gross income some of the taxes they pay to state and local governments, including income or sales, real estate, and other taxes. The provision allowing sales taxes to be deducted expired at the end of 2007.

a. Roughly the 20 percent of taxpayers who have the highest income.

Table 11.

Effects of Replacing the Taxes-Paid Deduction With a Credit of 15 Percent of Currently Deductible Taxes, by Taxpayers' Adjusted Gross Income, Calendar Years 2010 and 2011

AGI Range (Dollars)	Average Change in Tax Liability (Dollars)	Percentage of Returns With Increased Liability	Percentage Change in After-Tax Income
Calendar Year 2010			
All Income Categories			
0–10,000	-2	0	0
10,000–20,000	-28	0.3	0.2
20,000–40,000	-103	3.6	0.4
40,000–75,000	-96	22.6	0.2
75,000 or more	406	29.0	-0.3
Highest Income Category ^a			
75,000–100,000	68	37.0	-0.1
100,000–200,000	89	25.3	-0.1
200,000–500,000	92	9.1	0
500,000–1 million	3,081	56.4	-0.6
1 million or more	22,831	73.0	-0.9
Calendar Year 2011			
All Income Categories			
0–10,000	-2	0	0
10,000–20,000	-29	1.0	0.2
20,000–40,000	-99	5.5	0.4
40,000–75,000	-88	24.9	0.2
75,000 or more	865	57.0	-0.6
Highest Income Category ^a			
75,000–100,000	100	44.5	-0.1
100,000–200,000	485	63.3	-0.4
200,000–500,000	1,426	64.4	-0.7
500,000–1 million	7,628	81.9	-1.6
1 million or more	25,990	76.7	-1.2

Source: Congressional Budget Office.

Notes: Changes noted in the table are relative to current law.

The taxes-paid deduction allows taxpayers to deduct from their adjusted gross income some of the taxes they pay to state and local governments, including income or sales, real estate, and other taxes. The provision allowing sales taxes to be deducted expired at the end of 2007.

a. Roughly the 20 percent of taxpayers who have the highest income.

Table 12.**Effects of Restricting the Taxes-Paid Deduction to Real Estate Taxes, by Taxpayers' Adjusted Gross Income, Calendar Years 2010 and 2011**

AGI Range (Dollars)	Average Change in Tax Liability (Dollars)	Percentage of Returns With Increased Liability	Percentage Change in After-Tax Income
Calendar Year 2010			
All Income Categories			
0–10,000	0	0.1	0
10,000–20,000	1	1.9	0
20,000–40,000	13	10.8	0
40,000–75,000	117	34.6	-0.2
75,000 or more	702	34.0	-0.5
Highest Income Category ^a			
75,000–100,000	224	44.2	-0.3
100,000–200,000	174	29.8	-0.2
200,000–500,000	108	9.9	0
500,000–1 million	4,734	57.6	-0.9
1 million or more	36,728	69.9	-1.5
Calendar Year 2011			
All Income Categories			
0–10,000	0	0.1	0
10,000–20,000	1	1.9	0
20,000–40,000	13	10.2	0
40,000–75,000	129	34.4	-0.3
75,000 or more	1,372	57.5	-1.0
Highest Income Category ^a			
75,000–100,000	318	48.4	-0.4
100,000–200,000	759	62.1	-0.7
200,000–500,000	1,882	61.6	-0.9
500,000–1 million	10,003	78.1	-2.0
1 million or more	44,310	79.4	-2.1

Source: Congressional Budget Office.

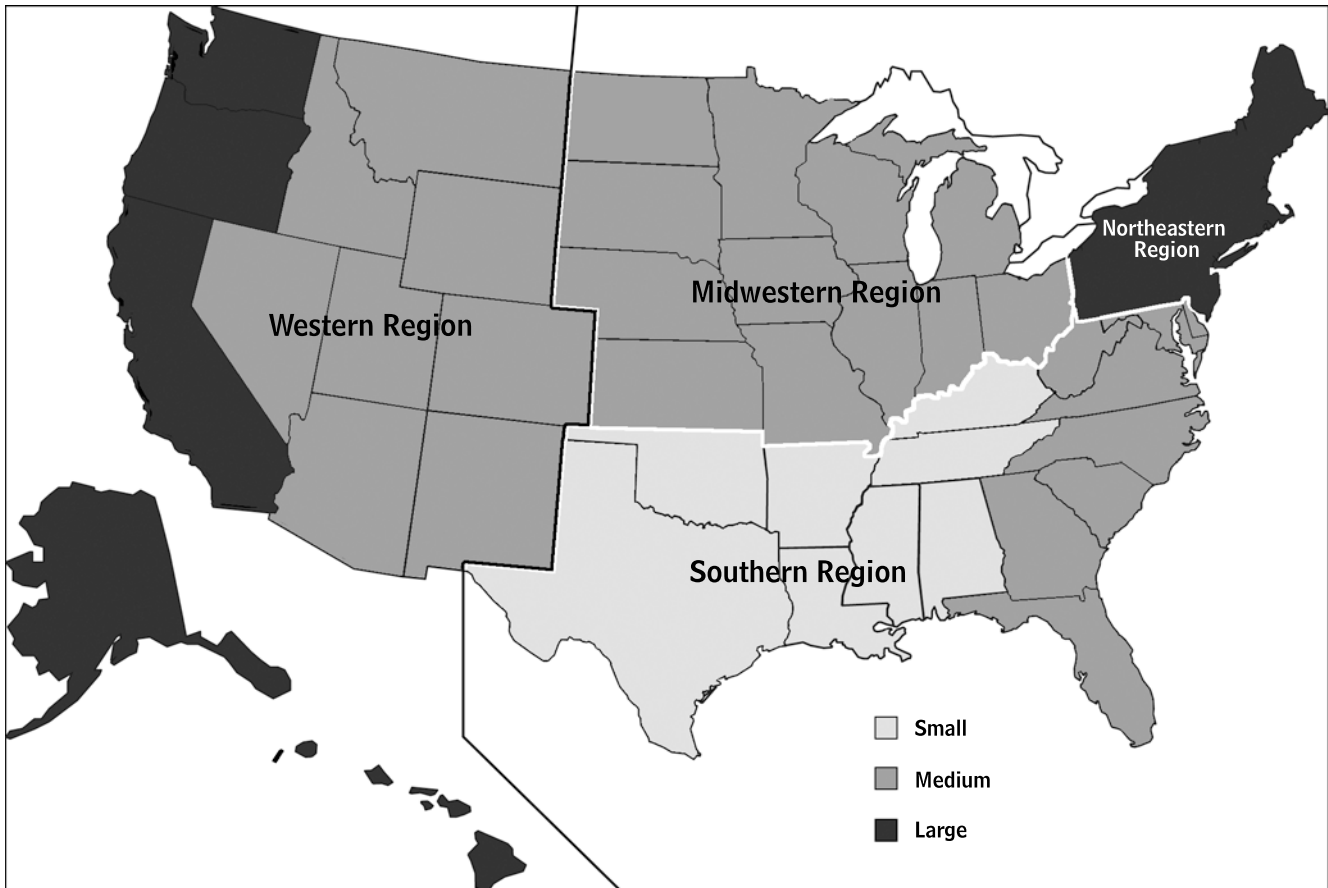
Notes: Changes noted in the table are relative to current law.

The taxes-paid deduction allows taxpayers to deduct from their adjusted gross income some of the taxes they pay to state and local governments, including income or sales, real estate, and other taxes. The provision allowing sales taxes to be deducted expired at the end of 2007.

a. Roughly the 20 percent of taxpayers who have the highest income.

Figure 7.

Increases in Average Tax Liability in 2010 and 2011 Under the Options for Changing the Taxes-Paid Deduction, by Census Division



Source: Congressional Budget Office.

Notes: The rankings in this figure apply to the effects in 2010 and 2011 of eliminating the taxes-paid deduction, limiting the deduction to 2 percent of adjusted gross income, capping the deduction at \$5,000 in 2008 and indexing it thereafter, replacing the deduction with a credit of 15 percent of currently deductible taxes, or restricting the deduction to real estate taxes. (The taxes-paid deduction allows taxpayers to deduct from their adjusted gross income some of the taxes they pay to state and local governments, including income or sales, real estate, and other taxes. The provision allowing sales taxes to be deducted expired at the end of 2007.)

The Northeastern Region comprises the New England and middle Atlantic census divisions, the Southern Region the south Atlantic and east and west south central divisions, the Midwestern Region the east and west north central divisions, and the Western Region the Pacific and mountain divisions.

Effects of Deductibility Options on Tax Liability, by Region

The regional differences in changes to average tax liability under the various deductibility alternatives would be much smaller than the differences among income classes, CBO estimates.¹⁵ The projected increase in liability that would result from altering the taxes-paid deduction would be greatest in the Mid-Atlantic, New England, and Pacific Coast regions under all of the options and in both

2010 and 2011 (see Figure 7). States in the Southeast, which receive relatively few benefits from the deduction,

15. CBO’s model of projected changes in tax liability is designed to generate representative outcomes on a national—not state-by-state—basis. Regional changes in average tax liability represent a compromise between understanding the geographical impact of the alternatives and the inability of the model to predict state-by-state changes.

would generally also face the smallest increase in liability. Although CBO found that the geographic areas that were the most and the least affected were the same under each of the different alternatives, the variation in outcomes among the areas would be greatest under the elimination option. The limits on deductibility that characterize the other options would tend to help equalize the benefits of the deduction among the regions, regardless of the differences among the areas in their average tax burdens.

Effects of Combining Deductibility Options with Changes in the Alternative Minimum Tax

All of the estimates of tax liability discussed above incorporate the assumption that in 2007, the exemption amounts for the alternative minimum tax revert to their 2000 levels and remain there. But indexing the AMT for inflation would change those amounts;¹⁶ they in turn would alter the distributional impact of projected changes in tax liability under the five deductibility options. Combining a change in deductibility with a change in the AMT would also affect both the number of taxpayers who itemized and the number subject to the alternative tax.

AMT Indexing and the Elimination Alternative. Under this combination scenario, taxpayers in the lower 80 percent of the income distribution would incur relatively small increases in average tax liability in 2010, CBO estimates (see Table 13 on page 36). Taxpayers in those income groups are rarely subject to the AMT, so indexing would create little reduction in their tax liability to offset the increase from eliminating deductibility.

For the 20 percent of taxpayers who had the highest income, average tax liability would fall overall, but within that group, changes in liability would vary considerably. Average tax liability would decline for taxpayers who had income of less than \$500,000; those with income between \$200,000 and \$500,000 would see the largest decline, and nearly all of that group would incur a smaller tax liability under the combined changes. Taxpayers who had income above that range would incur increases in liability similar to those incurred under the elimination option alone—because those taxpayers are generally unaffected by the AMT. (Under 2010 law, the AMT has a

bigger effect on taxpayers who have income between \$100,000 and \$500,000 than on those whose income is above \$500,000.) Overall, then, the decline in tax liability from indexing the AMT would more than offset the rise in liability from eliminating the taxes-paid deduction for taxpayers who had income ranging from \$75,000 to \$500,000.

In 2011, following expiration of the 2001 and later tax provisions, a large number of taxpayers will no longer be subject to the AMT. The average taxpayer in all income ranges would pay more tax under the elimination option combined with AMT indexation than he or she would pay under current law. But the increase in liability would be smaller than under the elimination alternative alone; moreover, roughly one-fifth of taxpayers who had income above \$75,000 would incur a smaller tax liability. The increase in liability would again be concentrated in the upper 20 percent of the income distribution; among taxpayers whose income was greater than \$100,000, 76 percent to 87 percent would see an increase.

For all taxpayers except those whose income was greater than \$500,000, the decline in after-tax income under the combination scenario would be smaller than under the elimination option alone. For the highest-income taxpayers, the decline in after-tax income under the combined changes would be essentially the same as the decline under the elimination alternative on its own.

If the taxes-paid deduction was eliminated and the AMT was indexed for inflation, almost 14 percent of taxpayers would no longer find it worthwhile to itemize their deductions in 2010, CBO estimates. Almost all taxpayers who were subject to the AMT and had income of less than \$200,000 would pay ordinary income tax instead—as would more than 90 percent of taxpayers who had income between \$200,000 and \$500,000. In 2011, under the combined changes, about 10 percent of taxpayers would no longer benefit from itemizing, and nearly all taxpayers whose income was below \$500,000 would no longer be subject to the alternative tax.

AMT Indexing and an AGI Ceiling. Combining a ceiling on deductibility of 2 percent of AGI with indexation of the AMT would create a pattern similar to that produced by combining the elimination alternative with indexation. Average tax liability in 2010 would increase very slightly for taxpayers in the bottom 80 percent of the income distribution and decrease more than it would

16. For its estimates that include indexing the AMT for inflation, CBO assumed that the AMT exemption amounts would be permanently raised to their 2006 levels and that both the tax's exemption amounts and brackets would be indexed thereafter.

under the indexation-elimination scenario for those in the top 20 percent (see Table 14 on page 37). Within that upper-income group, taxpayers who had income of less than \$500,000 would have larger declines in liability than they would under elimination and indexation combined, and taxpayers who had income of more than \$500,000 would face smaller increases. At every income level, fewer taxpayers than under the elimination-indexation scenario would incur an increase in liability, and more would see a drop.

In 2011, under the scenario combining an AGI ceiling with the AMT's indexation, average tax liability would rise for all income groups, but the increases would be smaller than those under the elimination alternative plus AMT change. Within the top 20 percent of the income distribution, the majority of taxpayers in most income groups would face increases, although a substantial minority who had income of less than \$500,000 would incur less tax liability than under the elimination-indexation scenario. Again, under the ceiling-indexation combination, almost all taxpayers whose income was below \$500,000 would owe ordinary income tax rather than the alternative tax.

AMT Indexing and a Cap on Deductibility. Combining an indexed cap on the deduction with indexation of the AMT would lead either to no change or to a fall in average tax liability in 2010 for income groups up to \$500,000 (see Table 15 on page 38). Because such a cap would only rarely limit the deduction for taxpayers at lower income levels, the effects of AMT indexation would predominate, and few taxpayers who had income of less than \$75,000 would incur increased liability. Taxpayers whose income was between \$75,000 and \$500,000 would have a smaller average liability under the changes, just as they would under the scenarios that combined indexation with the elimination or AGI ceiling alternatives. Yet even at those relatively high income levels, a cap would limit the deduction for relatively few taxpayers. The decline in liability associated with indexing the AMT would be larger than any increase from the cap, and most taxpayers in the upper-income ranges would not be subject to the AMT. Among individuals who had income of more than \$500,000, AMT indexation would have little effect on their overall tax burdens; however, those taxpayers would be more likely than those with lower income to have a deduction that would be limited by the cap.

In 2011, CBO estimates, the combination of a cap and the AMT's indexation would generate a decrease in average tax liability for taxpayers whose income was between \$20,000 and \$100,000. Taxpayers whose income was above that range would incur greater liability; for taxpayers at the highest income levels, the cap-indexation combination would produce increases in liability similar to those produced under the elimination option alone. Again, most taxpayers who had income in the range that is most often subject to the AMT would no longer have to pay the alternative tax if it was indexed, although the majority of those individuals would have greater tax liability.

AMT Indexing and a Tax Credit. Combining a credit and indexation would lower the average tax liability of taxpayers in the bottom 80 percent of the income distribution in 2010 (see Table 16 on page 39). Relatively few taxpayers in that group pay the AMT, so the effect of the taxes-paid credit would predominate; in addition, because many taxpayers in that group do not claim the deduction but could take the credit, many more taxpayers would see a drop in their liability than would see an increase. The pattern for taxpayers in the upper 20 percent of the income distribution would be similar to that under other combination scenarios. Taxpayers whose income was between \$75,000 and \$500,000 would incur a smaller average liability overall, mainly because the AMT's indexation would lower their taxes substantially. The 15 percent credit would be less likely to replace the full value of the deduction for taxpayers above that income range; however, they rarely pay the AMT and would not benefit from its indexation. As a result, their average tax liability would be larger under the combined changes than under current law.

In 2011, taxpayers whose income was less than \$75,000 would face a smaller average tax liability under this combination scenario, although some taxpayers, especially at the top of that range, would incur a rise in liability. For taxpayers with income above \$75,000, only those whose income was between \$75,000 and \$100,000 would experience a decline in liability. The increase in liability would be relatively small for taxpayers whose income put them just above that range, and most of those individuals would also benefit from not having to compute the alternative tax. After-tax income under this combination scenario would decline by more than 1 percent for taxpayers who had income of more than \$500,000.

AMT Indexing and Deductibility Restricted to Real Estate Taxes. Relatively few taxpayers who have income of less than \$75,000 are subject to the AMT, and for those individuals, property taxes account for the majority of state and local tax deductions that they claim. Consequently, in 2010, the combination scenario of indexing the AMT and restricting deductibility to real estate taxes would have little effect on the average liability of taxpayers in those income groups (see Table 17 on page 40). For taxpayers whose income placed them in the top 20 percent of the income distribution, the pattern would be similar to that found under the other options when combined with AMT indexation. Average tax liability would drop for taxpayers who had income of less than \$500,000, most of whom would no longer pay the alternative tax under indexation. In 2011, average tax liability would be virtually unchanged for taxpayers whose income was less than \$100,000, but it would be greater for all taxpayers

in higher income ranges. However, most taxpayers who would be subject to the AMT under current law would pay the ordinary income tax.

AMT Indexing and Regional Impact. The interaction between the alternatives and indexation of the AMT would lessen the already small differences among regions in increases in tax liability. The geographical distribution of such increases under the separate alternatives would remain the same if the AMT was indexed. However, because the regions that incur the largest increases in liability from eliminating or limiting the taxes-paid deduction are the same high-income regions most likely to be affected by the AMT, the regional differences in changes in average tax liability—including changes stemming from the AMT's indexation—would be considerably lessened.

Table 13.

Effects of Eliminating the Taxes-Paid Deduction and Indexing the AMT, by Taxpayers' Adjusted Gross Income, Calendar Years 2010 and 2011

AGI Range (Dollars)	Average Change in Tax Liability (Dollars)	Percentage of Returns With Change in Liability		Percentage Change in After-Tax Income	Percentage Change in AMT Returns
		Increase	Decrease		
Calendar Year 2010					
All Income Categories					
0–10,000	0	0.1	0.1	0	0
10,000–20,000	4	3.2	0.9	0	0
20,000–40,000	36	14.1	2.6	-0.1	-96.2
40,000–75,000	120	39.0	15.5	-0.2	-99.7
75,000 or more	-319	38.5	57.0	0.2	-97.6
Highest Income Category ^a					
75,000–100,000	-228	47.1	45.0	0.3	-99.7
100,000–200,000	-784	36.3	61.4	0.7	-99.5
200,000–500,000	-4,200	9.2	90.1	1.9	-93.3
500,000–1 million	6,744	72.6	18.5	-1.3	-65.1
1 million or more	42,101	77.6	9.6	-1.7	-38.5
Calendar Year 2011					
All Income Categories					
0–10,000	0	0.1	0.2	0	0
10,000–20,000	7	3.3	0.9	0	0
20,000–40,000	42	13.5	2.6	-0.1	-97.2
40,000–75,000	180	40.0	11.6	-0.4	-99.8
75,000 or more	1,849	69.5	16.7	-1.3	-98.8
Highest Income Category ^a					
75,000–100,000	349	55.8	22.3	-0.5	-99.9
100,000–200,000	1,238	76.0	13.4	-1.1	-99.6
200,000–500,000	2,875	81.6	15.3	-1.3	-97.9
500,000–1 million	13,224	87.3	5.4	-2.7	-62.6
1 million or more	49,489	86.6	4.2	-2.3	-53.2

Source: Congressional Budget Office.

Notes: Changes noted in the table are relative to current law.

The taxes-paid deduction allows taxpayers to deduct from their adjusted gross income some of the taxes they pay to state and local governments, including income or sales, real estate, and other taxes. The provision allowing sales taxes to be deducted expired at the end of 2007.

In its analysis, CBO increased the exemption amounts and brackets for the AMT (alternative minimum tax) to their 2006 levels and adjusted them for inflation thereafter.

a. Roughly the 20 percent of taxpayers who have the highest income.

Table 14.**Effects of Limiting the Taxes-Paid Deduction to 2 Percent of AGI and Indexing the AMT, by Taxpayers' Adjusted Gross Income, Calendar Years 2010 and 2011**

AGI Range (Dollars)	Average Change in Tax Liability (Dollars)	Percentage of Returns With Change in Liability		Percentage Change in After-Tax Income	Percentage Change in AMT Returns
		Increase	Decrease		
Calendar Year 2010					
All Income Categories					
0–10,000	0	0.1	0.1	-0.1	0
10,000–20,000	3	2.9	0.9	-0.1	0
20,000–40,000	27	13.2	2.9	-0.2	-96.2
40,000–75,000	58	36.8	16.3	-0.4	-99.7
75,000 or more	-946	30.5	63.2	0.2	-97.1
Highest Income Category ^a					
75,000–100,000	-381	42.4	47.8	0.1	-99.7
100,000–200,000	-1,206	25.8	70.4	0.6	-99.4
200,000–500,000	-5,466	3.2	95.4	2.0	-91.6
500,000–1 million	3,714	55.0	29.0	-1.1	-58.8
1 million or more	28,277	63.1	13.5	-1.6	-28.7
Calendar Year 2011					
All Income Categories					
0–10,000	0	0.1	0.2	-0.1	0
10,000–20,000	5	3.0	0.9	-0.1	0
20,000–40,000	32	12.5	2.9	-0.3	-97.2
40,000–75,000	109	37.9	12.3	-0.5	-99.8
75,000 or more	1,180	62.7	20.6	-1.3	-98.6
Highest Income Category ^a					
75,000–100,000	146	51.1	24.7	-0.6	-99.8
100,000–200,000	719	69.0	17.5	-1.1	-99.5
200,000–500,000	1,446	69.6	23.2	-1.1	-97.7
500,000–1 million	9,817	77.4	8.2	-2.4	-53.9
1 million or more	39,144	74.4	7.7	-2.4	-40.4

Source: Congressional Budget Office.

Notes: Changes noted in the table are relative to current law.

The taxes-paid deduction allows taxpayers to deduct from their adjusted gross income some of the taxes they pay to state and local governments, including income or sales, real estate, and other taxes. The provision allowing sales taxes to be deducted expired at the end of 2007.

In its analysis, CBO increased the exemption amounts and brackets for the AMT (alternative minimum tax) to their 2006 levels and adjusted them for inflation thereafter.

a. Roughly the 20 percent of taxpayers who have the highest income.

Table 15.**Effects of Capping the Taxes-Paid Deduction and Indexing the AMT, by Taxpayers' Adjusted Gross Income, Calendar Years 2010 and 2011**

AGI Range (Dollars)	Average Change in Tax Liability (Dollars)	Percentage of Returns With Change in Liability		Percentage Change in After-Tax Income	Percentage Change in AMT Returns
		Increase	Decrease		
Calendar Year 2010					
All Income Categories					
0–10,000	0	0	0.1	0	0
10,000–20,000	0	0.2	1.2	0	0
20,000–40,000	-2	1.8	5.2	0	-96.2
40,000–75,000	-106	11.1	23.6	0.2	-99.7
75,000 or more	-1,051	16.7	71.8	0.7	-97.2
Highest Income Category ^a					
75,000–100,000	-676	22.1	57.4	0.9	-99.7
100,000–200,000	-1,604	12.0	81.4	1.4	-99.3
200,000–500,000	-5,369	3.9	94.8	2.4	-92.2
500,000–1 million	5,576	67.2	22.1	-1.1	-62.6
1 million or more	40,870	76.1	10.1	-1.6	-37.1
Calendar Year 2011					
All Income Categories					
0–10,000	0	0	0.2	0	0
10,000–20,000	0	0.3	1.2	0	0
20,000–40,000	-1	1.8	4.9	0	-97.2
40,000–75,000	-73	10.9	19.5	0.1	-99.7
75,000 or more	946	47.0	27.7	-0.7	-98.7
Highest Income Category ^a					
75,000–100,000	-242	27.7	34.3	0.3	-99.8
100,000–200,000	220	54.3	24.8	-0.2	-99.5
200,000–500,000	1,531	68.3	24.7	-0.7	-97.7
500,000–1 million	11,912	84.7	6.2	-2.4	-59.1
1 million or more	48,563	85.6	4.5	-2.3	-51.1

Source: Congressional Budget Office.

Notes: Changes noted in the table are relative to current law.

The taxes-paid deduction allows taxpayers to deduct from their adjusted gross income some of the taxes they pay to state and local governments, including income or sales, real estate, and other taxes. The provision allowing sales taxes to be deducted expired at the end of 2007.

In its analysis, CBO increased the exemption amounts and brackets for the AMT (alternative minimum tax) to their 2006 levels and adjusted them for inflation thereafter.

a. Roughly the 20 percent of taxpayers who have the highest income.

Table 16.

Effects of Replacing the Taxes-Paid Deduction with a Credit of 15 Percent of Currently Deductible Taxes and Indexing the AMT, by Taxpayers' Adjusted Gross Income, Calendar Years 2010 and 2011

AGI Range (Dollars)	Average Change in Tax Liability (Dollars)	Percentage of Returns With Change in Liability		Percentage Change in After-Tax Income	Percentage Change in AMT Returns
		Increase	Decrease		
Calendar Year 2010					
All Income Categories					
0–10,000	-2	0	5.7	0	0
10,000–20,000	-28	0.3	33.2	0.2	0
20,000–40,000	-109	3.6	65.6	0.4	-84.2
40,000–75,000	-283	20.0	68.7	0.6	-99.1
75,000 or more	-1,757	18.9	78.7	1.2	-95.8
Highest Income Category ^a					
75,000–100,000	-933	24.9	71.0	1.2	-99.5
100,000–200,000	-1,996	15.1	83.8	1.7	-99.0
200,000–500,000	-6,628	2.7	96.6	3.0	-86.5
500,000–1 million	2,325	54.2	37.6	-0.4	-46.8
1 million or more	22,716	73.0	14.5	-0.9	-26.6
Calendar Year 2011					
All Income Categories					
0–10,000	-2	0	5.7	0	0
10,000–20,000	-30	1.0	33.1	0.2	0
20,000–40,000	-104	5.4	62.0	0.4	-93.9
40,000–75,000	-222	23.7	64.1	0.4	-99.7
75,000 or more	311	51.6	44.9	-0.2	-98.2
Highest Income Category ^a					
75,000–100,000	-356	38.9	55.6	0.5	-99.7
100,000–200,000	15	58.3	39.4	0	-99.3
200,000–500,000	119	56.8	41.9	-0.1	-97.0
500,000–1 million	7,380	81.1	13.4	-1.5	-43.5
1 million or more	25,940	76.7	15.1	-1.2	-23.4

Source: Congressional Budget Office.

Notes: Changes noted in the table are relative to current law.

The taxes-paid deduction allows taxpayers to deduct from their adjusted gross income some of the taxes they pay to state and local governments, including income or sales, real estate, and other taxes. The provision allowing sales taxes to be deducted expired at the end of 2007.

In its analysis, CBO increased the exemption amounts and brackets for the AMT (alternative minimum tax) to their 2006 levels and adjusted them for inflation thereafter.

a. Roughly the 20 percent of taxpayers who have the highest income.

Table 17.

Effects of Restricting the Taxes-Paid Deduction to Real Estate Taxes and Indexing the AMT, by Taxpayers' Adjusted Gross Income, Calendar Years 2010 and 2011

AGI Range (Dollars)	Average Change in Tax Liability (Dollars)	Percentage of Returns With Change in Liability		Percentage Change in After-Tax Income	Percentage Change in AMT Returns
		Increase	Decrease		
Calendar Year 2010					
All Income Categories					
0–10,000	0	0.1	0.1	0	0
10,000–20,000	1	1.9	1.0	0	0
20,000–40,000	9	10.8	3.2	0	-96.2
40,000–75,000	-12	32.8	17.0	0	-99.7
75,000 or more	-1,077	26.3	66.4	0.7	-96.6
Highest Income Category ^a					
75,000–100,000	-516	36.6	51.2	0.7	-99.7
100,000–200,000	-1,496	21.1	74.5	1.3	-99.2
200,000–500,000	-5,885	4.0	94.9	2.6	-89.5
500,000–1 million	4,133	56.4	29.4	-0.8	-55.3
1 million or more	36,636	69.9	11.8	-1.5	-32.9
Calendar Year 2011					
All Income Categories					
0–10,000	0	0.1	0.2	0	0
10,000–20,000	1	1.9	1.0	0	0
20,000–40,000	9	10.1	3.2	0	-97.2
40,000–75,000	29	33.5	13.1	-0.1	-99.8
75,000 or more	931	54.9	25.2	-0.7	-98.5
Highest Income Category ^a					
75,000–100,000	-26	45.2	27.6	0.0	-99.8
100,000–200,000	375	60.1	22.8	-0.3	-99.4
200,000–500,000	826	58.5	31.8	-0.4	-97.3
500,000–1 million	9,776	77.6	8.0	-2.0	-53.0
1 million or more	44,275	79.4	5.7	-2.1	-44.7

Source: Congressional Budget Office.

Notes: Changes noted in the table are relative to current law.

The taxes-paid deduction allows taxpayers to deduct from their adjusted gross income some of the taxes they pay to state and local governments, including income or sales, real estate, and other taxes. The provision allowing sales taxes to be deducted expired at the end of 2007.

In its analysis, CBO increased the exemption amounts and brackets for the AMT (alternative minimum tax) to their 2006 levels and adjusted them for inflation thereafter.

a. Roughly the 20 percent of taxpayers who have the highest income.