The U.S. Tax Cuts and Jobs Act, which became law in December 2017, included a $10,000 cap on the deductibility of state and local taxes from federal taxes, the so-called “SALT deduction.” Prior to the 2018 tax year, there was no cap on the deductibility of state and local income, property and other taxes. Nationwide, the SALT deduction is used by around 30 percent of all taxpayers — a greater usage rate than the mortgage interest deduction (21 percent) or the charitable-giving deduction (15 percent), according to the Government Finance Officers Association.

In 2017, as the federal legislation was being debated, the GFOA issued a report about the potential impact on taxpayers. One of its findings: The effects would vary considerably from one state to the next. In the Midwest, for example, 35 percent of taxpaying units (individuals or families) in Minnesota used the SALT deduction in tax year 2015, compared to 17 percent in South Dakota (see table for all Midwest states). The average deduction was greater than $10,000 in six of the region’s states: Illinois, Iowa, Minnesota, Nebraska, Ohio and Wisconsin.

If individuals end up paying higher federal income taxes because of the loss of the SALT deduction (other changes in the tax bill, such as increased standardized deductions, may counter some of that loss), state and local governments with higher taxes may face pressure from taxpayers to lower rates. Some of the states most affected by this change in federal tax law have mounted a legal challenge to it. New York, New Jersey, Connecticut and Maryland filed suit in federal district court in July 2018. These states based their case on the 10th and 16th amendments to the U.S. Constitution, which address federalism and federal taxing powers. They also argue that by limiting the SALT deduction, which would increase taxes for certain taxpayers in higher-tax states, the federal government is trying to force states to reduce their spending.

Other states have attempted to find a way to offer taxpayers extra charitable deductions (which are not capped in the federal law) for certain donations, or to characterize certain taxes paid as charitable contributions. In California, then-Gov. Jerry Brown vetoed a bill, SB 539, that would have significantly increased tax credits for individuals who donate to a state financial aid program for low-income students. The idea was that these tax credits could have then been claimed by individuals as a charitable contribution on their federal tax returns. In August, however, the Internal Revenue Service announced a new rule to prevent these types of state work-arounds of the SALT limit.

Other states have responded by decoupling their tax code from the federal tax code, thus ensuring that taxpayers can take the full SALT deduction on their state returns.
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