

SALT SUBSTITUTE: EVALUATING IMPACTS OF TAX CHANGES

Tax Cuts and Jobs Act of 2017



- Signed into law on December 22 by President Trump, the Tax Cuts and Jobs Act:
 - ▣ Reduces most income tax rates for individuals and increases standard deduction
 - ▣ Repeals personal exemptions and limits some itemized deductions, including for state and local taxes (SALT)
 - ▣ Permanently reduces corporate taxes, replacing current structure (with top rate of 35%) with a single 21% rate
- CBO estimates law will increase deficit by nearly \$1.5 trillion over 10 years

SALT Debate



- New law caps SALT deduction, which previously was unlimited
 - ▣ Taxpayers allowed to deduct state and local income, sales and property taxes up to a total of \$10,000
 - ▣ The final language was a compromise
 - Early Republican framework called for eliminating SALT
 - Republicans from high-cost, high-tax states insisted at least partial preservation
 - ▣ Proponents for getting rid of the deduction say it disproportionately benefits high-earners
 - ▣ Opponents say ending SALT would burden states that rely on the provision as de facto subsidy (making it easier for states to raise taxes)

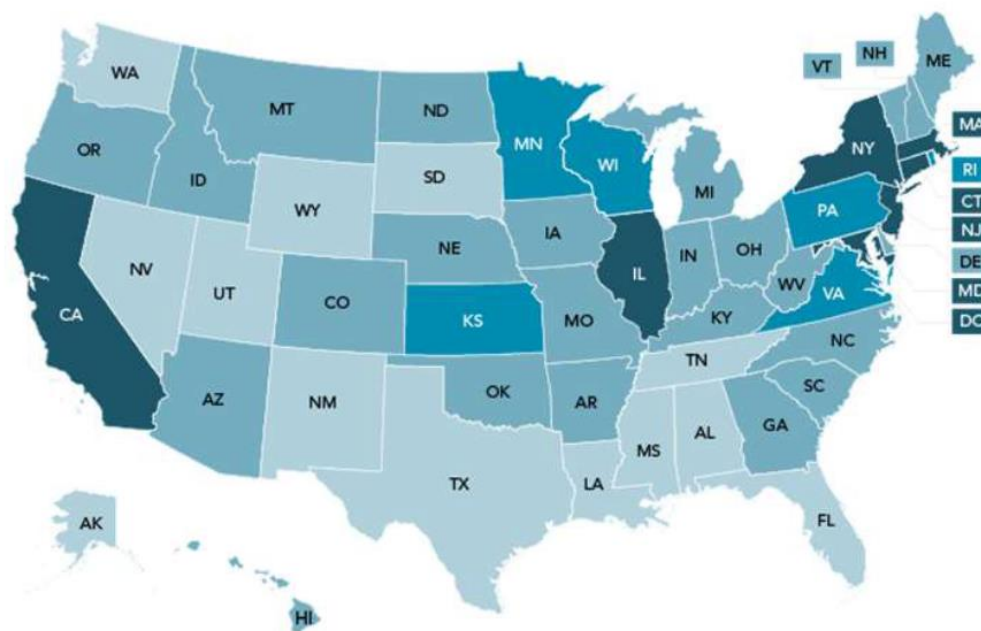
Sources: CNN Money, Vox, Tax Foundation

Regional Effects

Tax Policy Center estimated California and New York alone would have paid for 31% of the total tax increase if SALT had been eliminated.

FIGURE 2

Average Tax Increase from Repealing SALT



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0515-1).

Note: Average increase only among tax units with tax increase from repeal of the state and local tax deduction.

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Graphic: Tax Policy Center

State Response



- The changes are inspiring alternative approaches, so states can shield households from the effects
- Proposed workarounds:
 - ▣ Converting income tax to payroll tax
 - ▣ Giving taxpayers the option of making donations instead of paying taxes, so they can use the charitable deduction
- Even though high-tax states bear the brunt of the change, any state with an income tax might weigh alternative approaches

Is a Payroll Tax the Future?



- States could switch from individual income tax to employer-side payroll tax
 - ▣ Collect taxes from corporate payrolls instead of individuals
 - ▣ Companies would be able to take a deduction on the corporate tax
- New York Gov. Andrew Cuomo is weighing this option



NY Gov. Andrew Cuomo.
Photo credit: Diana Robinson,
Wikimedia Commons

Source: Reuters

Pros and Cons of Payroll Tax



- Advantages:
 - ▣ Itemizers regain deductibility of majority of their income
 - ▣ People taking standard deduction also receive deduction
 - ▣ Businesses could deduct payroll taxes from corporate taxes
- Potential complexities:
 - ▣ Jared Walczak, Senior Policy Analyst, Tax Foundation:
 - IRS could view this as companies remitting employees' individual tax - legal but not eligible for deductions
 - States with graduated-income taxes would face challenges designing graduated-payroll tax

Source: Tax Foundation

Modeling Scenarios

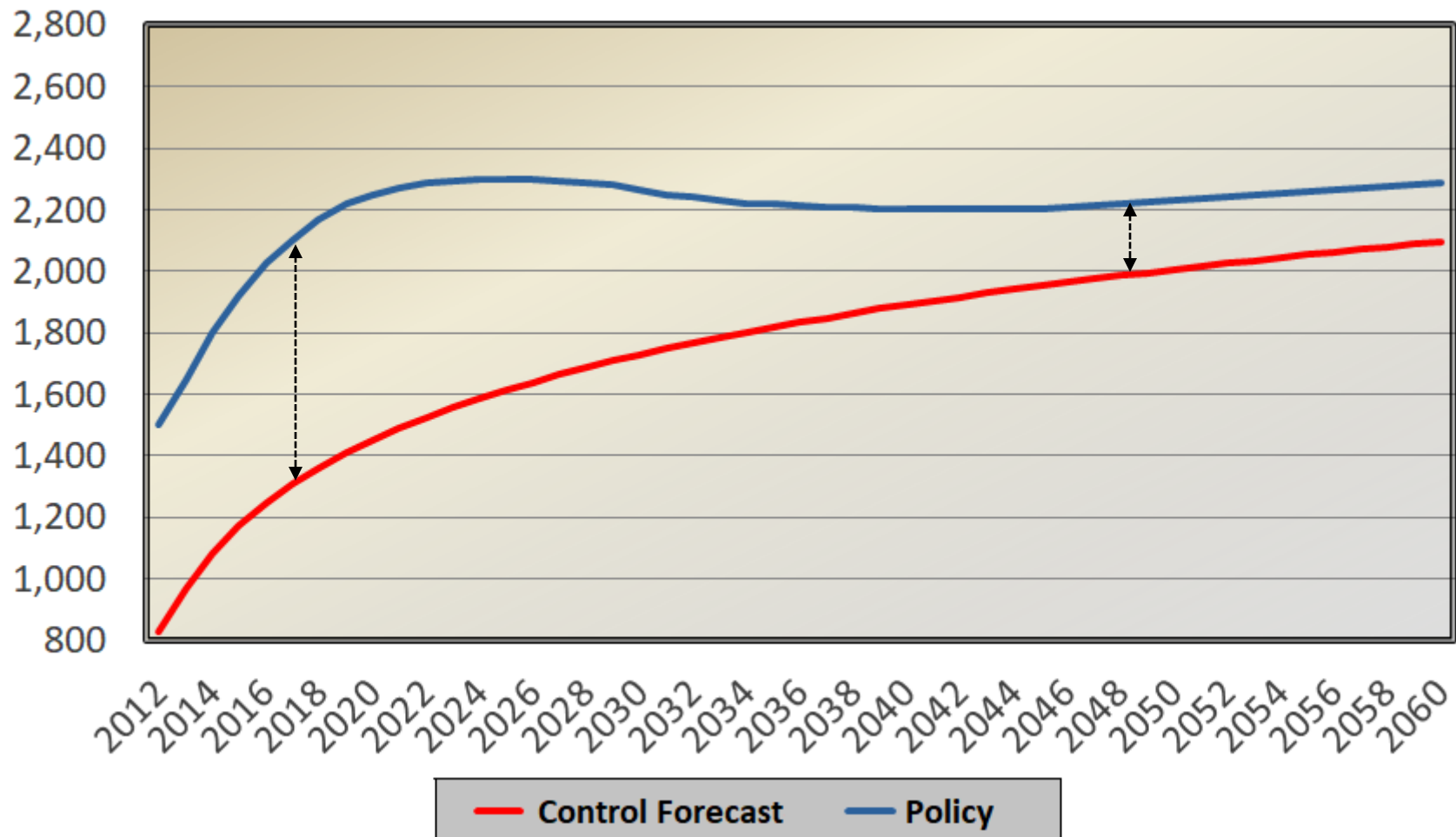


- Cap SALT Deductions at \$10,000
 - ▣ Effect on Taxpayers taking Itemized Deduction

- States Convert Wage/Salary Income Tax to Payroll Tax
 - ▣ Effect on Taxpayers taking Itemized Deduction
 - ▣ Effect on Taxpayers taking Standard Deduction
 - ▣ Effect on Businesses

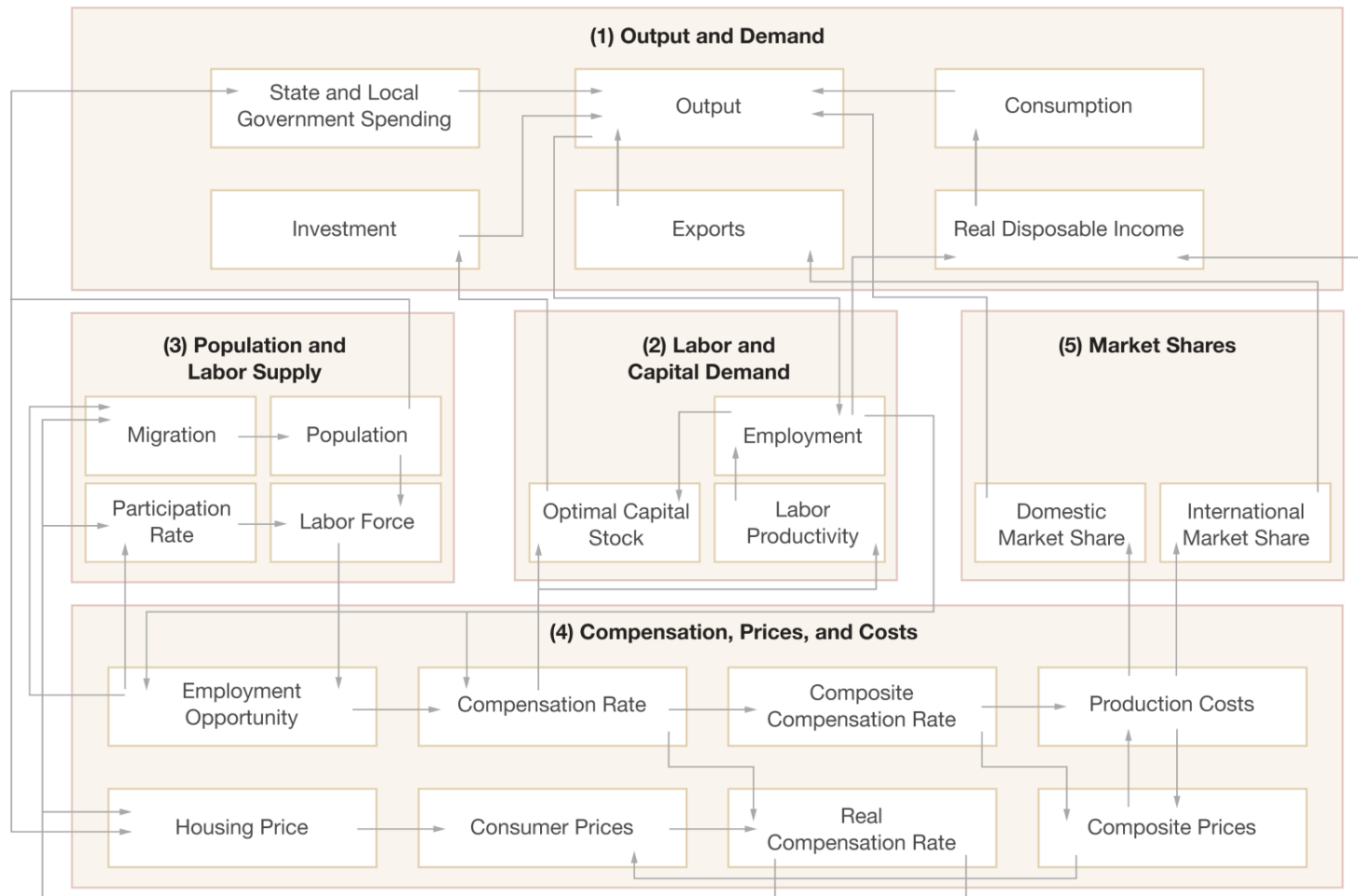
- Scope of Analysis: 50 states + D.C., 2018-2022

Model Framework



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Model Structure



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Cap SALT Deductions



□ Methodology, data sample (IRS)

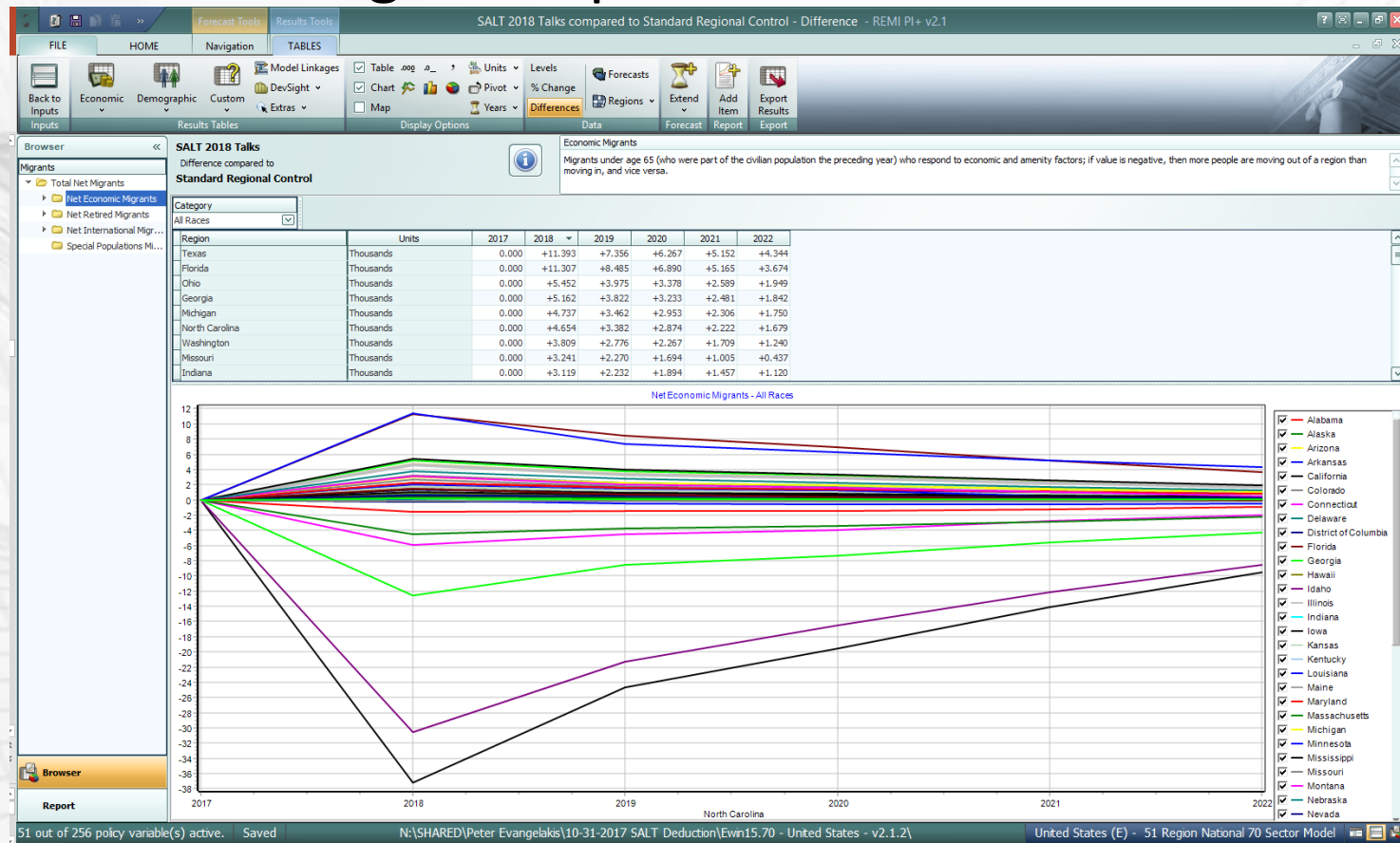
State	SALT Returns (Millions)	Total Deduction with \$10K Deduction (Billions)	Total SALT Deduction (Billions)	Difference in SALT Deduction (Billions)	Excess SALT Deduction (Billions)	Excess SALT Deduction, 20% Tax (Billions)
Alabama	0.52939	5.2939	2.981157	-2.312743	0	0
Alaska	0.07715	0.7715	0.3695	-0.402	0	0
Arizona	0.80141	8.0141	5.626575	-2.387525	0	0
Arkansas	0.27653	2.7653	2.438026	-0.327274	0	0
California	5.89631	58.9631	101.11201	42.148911	42.148911	8.4297822
Colorado	0.83032	8.3032	7.139648	-1.163552	0	0
Connecticut	0.71806	7.1806	13.599857	6.419257	6.419257	1.2838514
Delaware	0.14057	1.4057	1.237089	-0.168611	0	0
District of Columbia	0.13205	1.3205	2.040489	0.719989	0.719989	0.1439978

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Cap SALT Deductions



□ Economic migration patterns

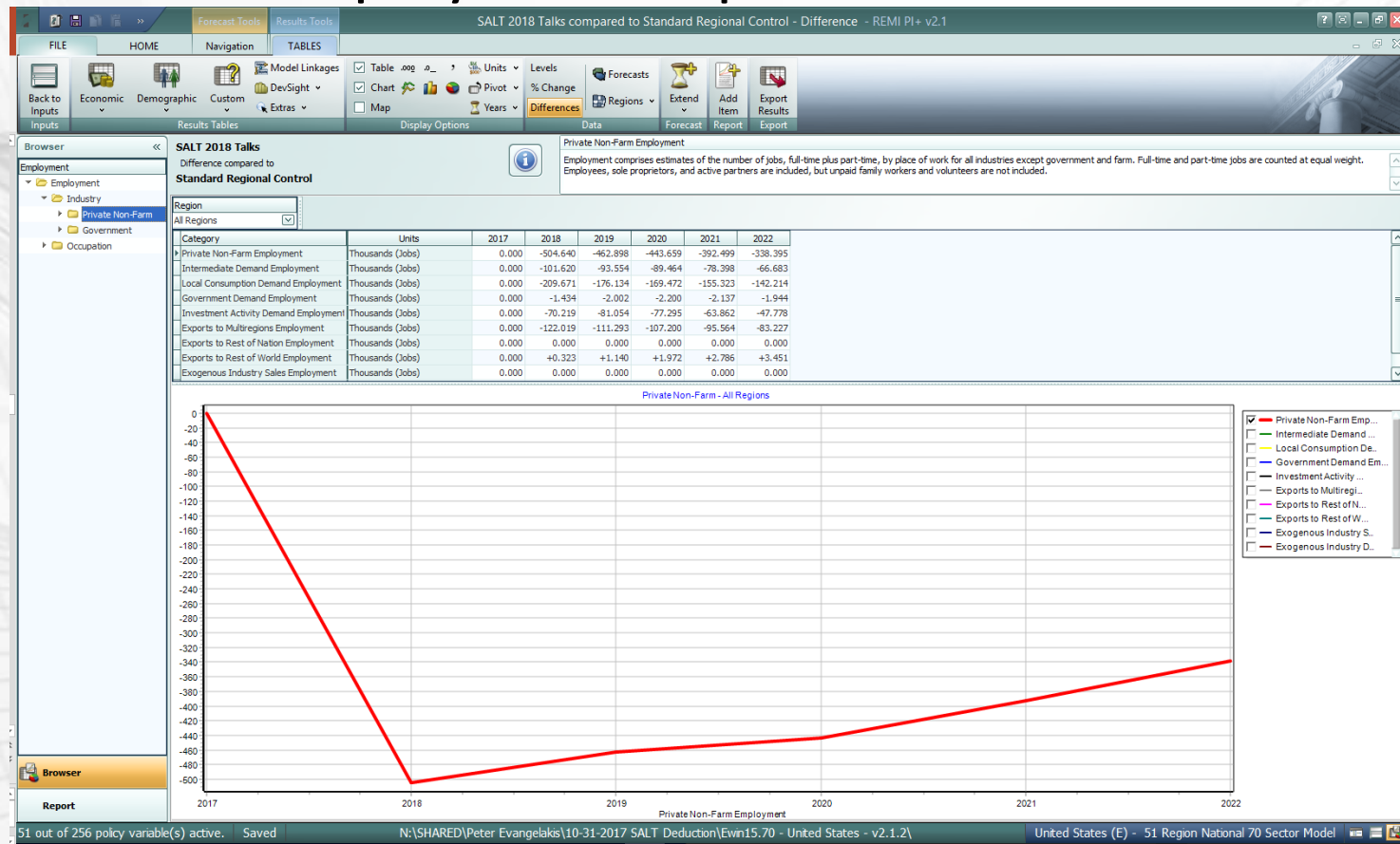


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Cap SALT Deductions



□ National employment impacts

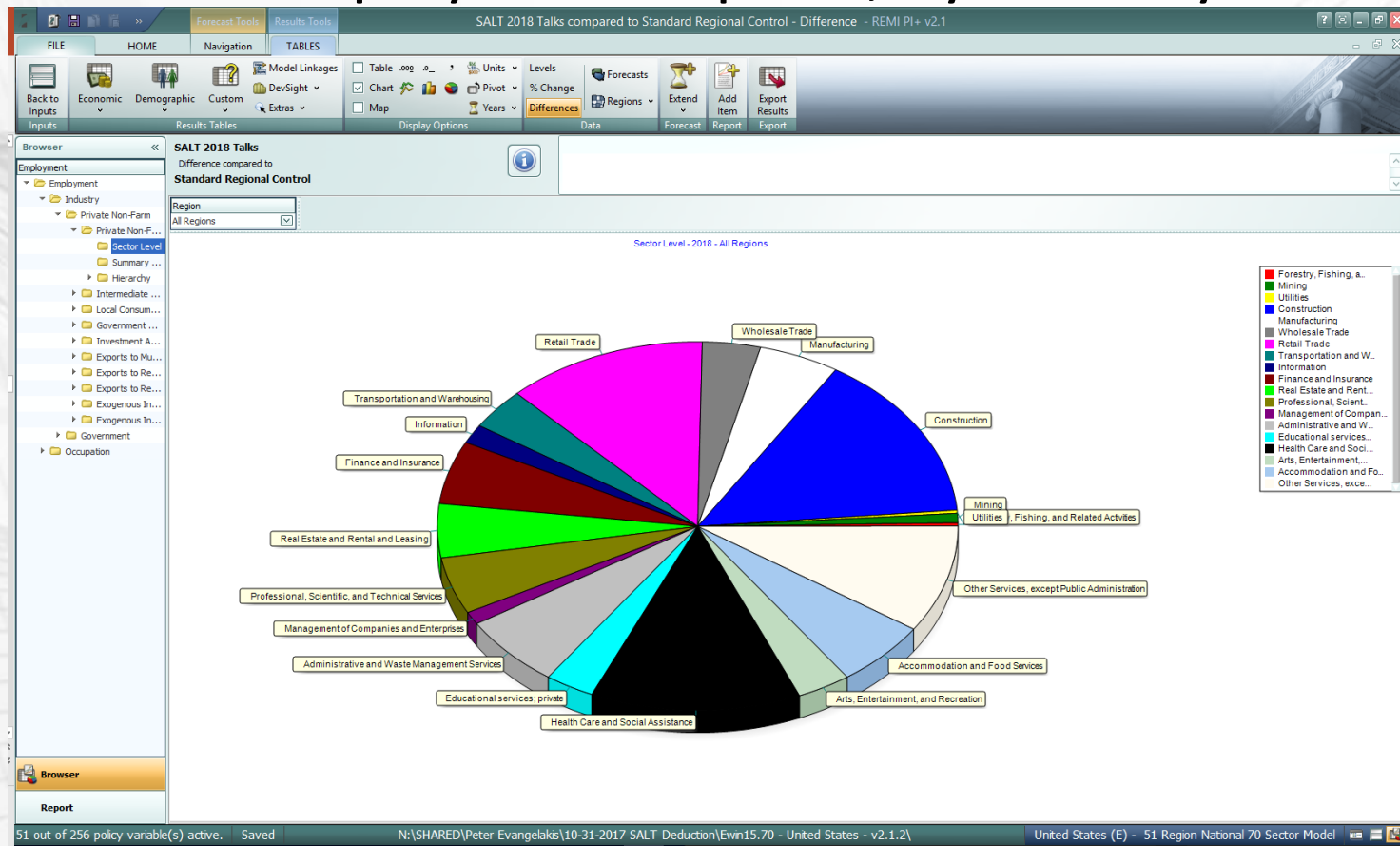


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Cap SALT Deductions



□ National employment impacts, by industry

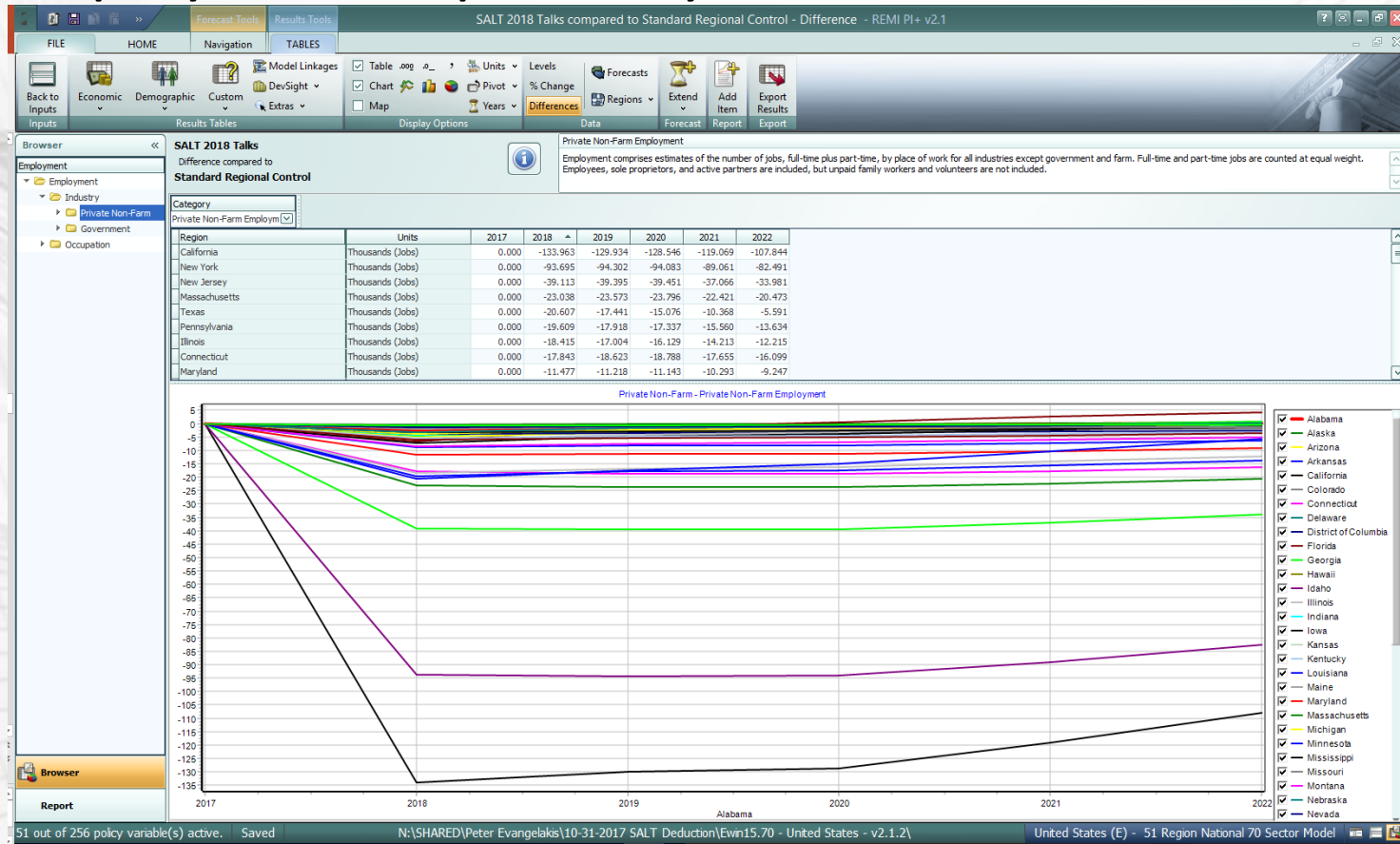


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Cap SALT Deductions



□ Employment impacts, by state

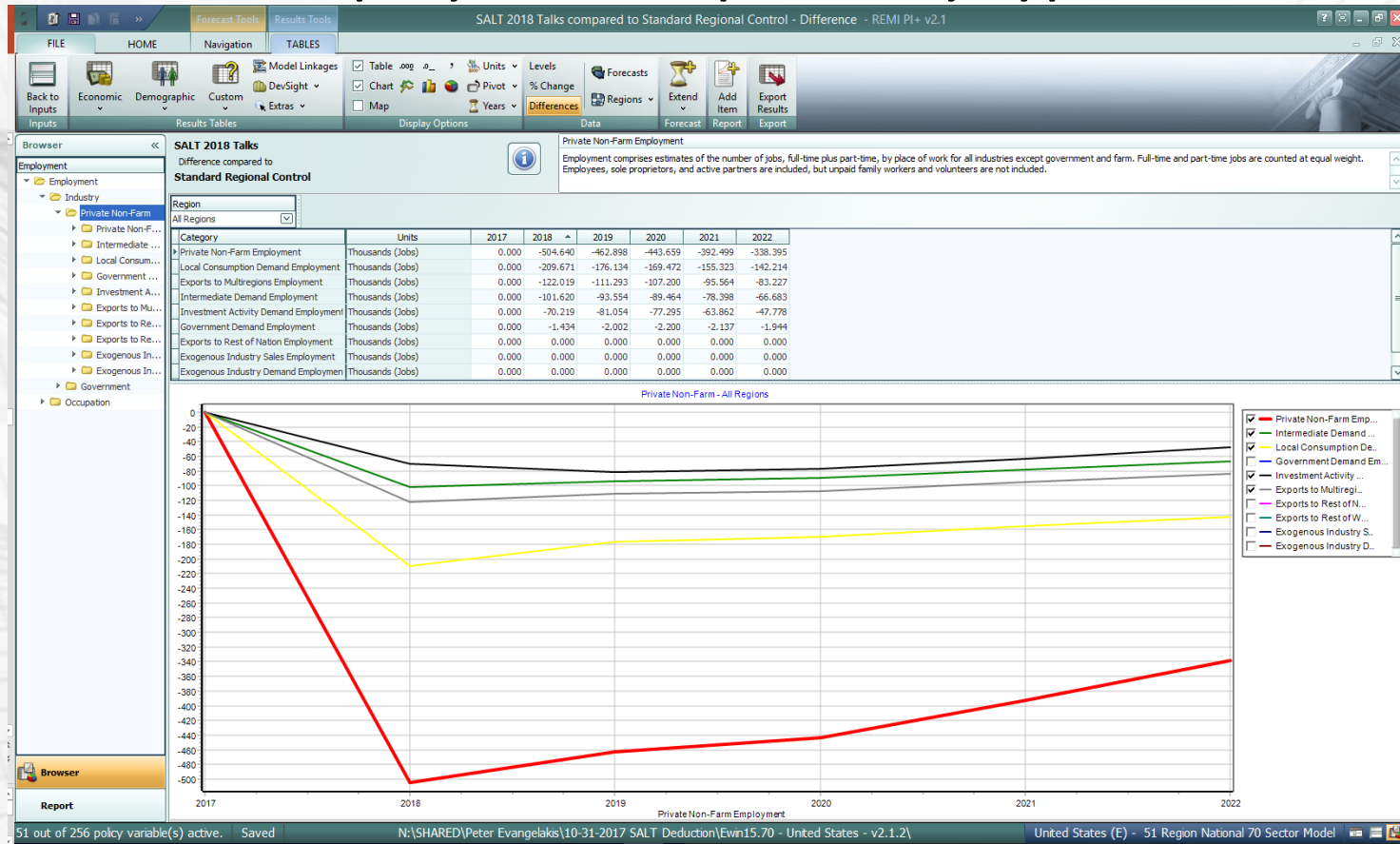


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Cap SALT Deductions



□ National employment impacts, by type

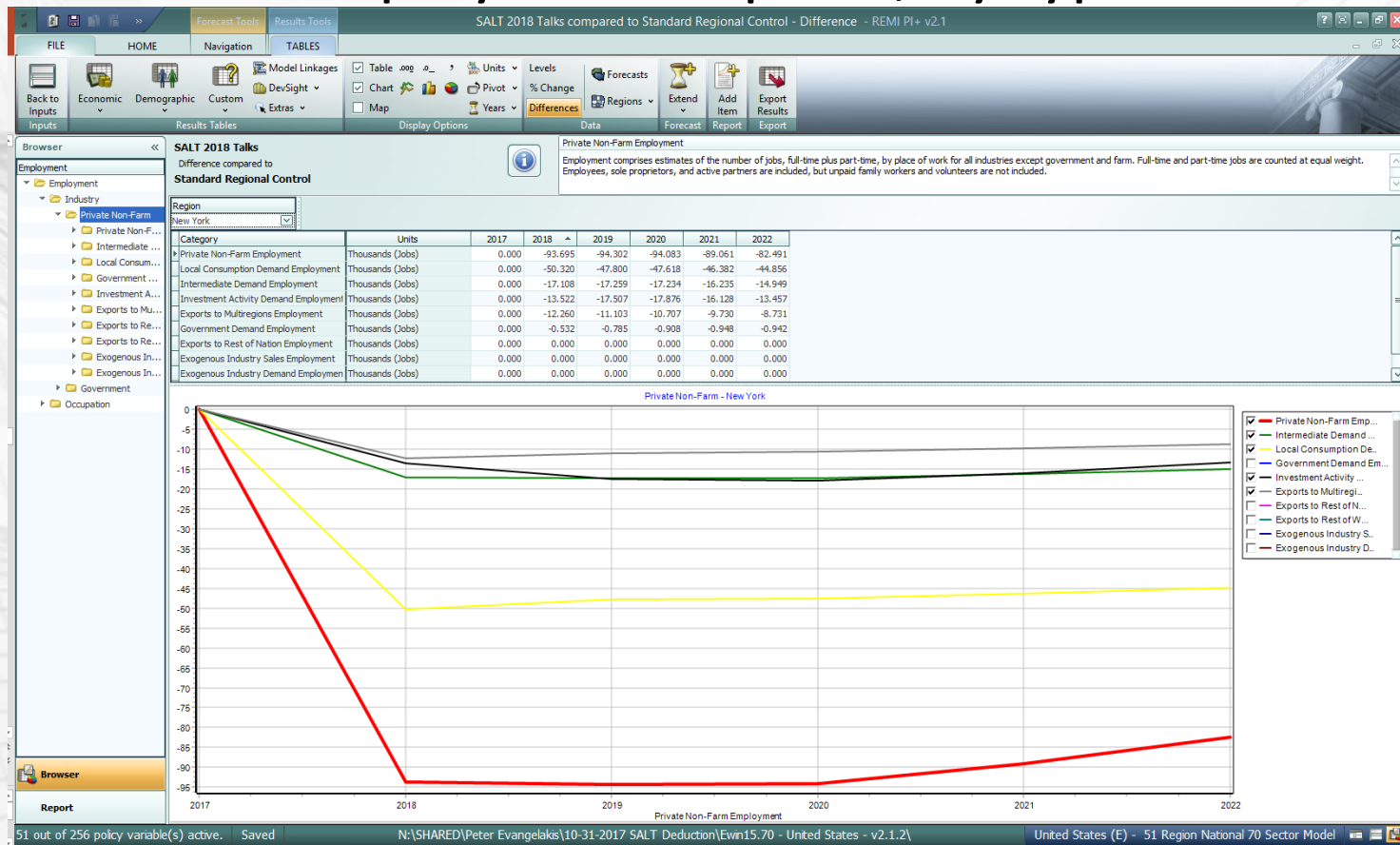


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Cap SALT Deductions



□ New York employment impacts, by type

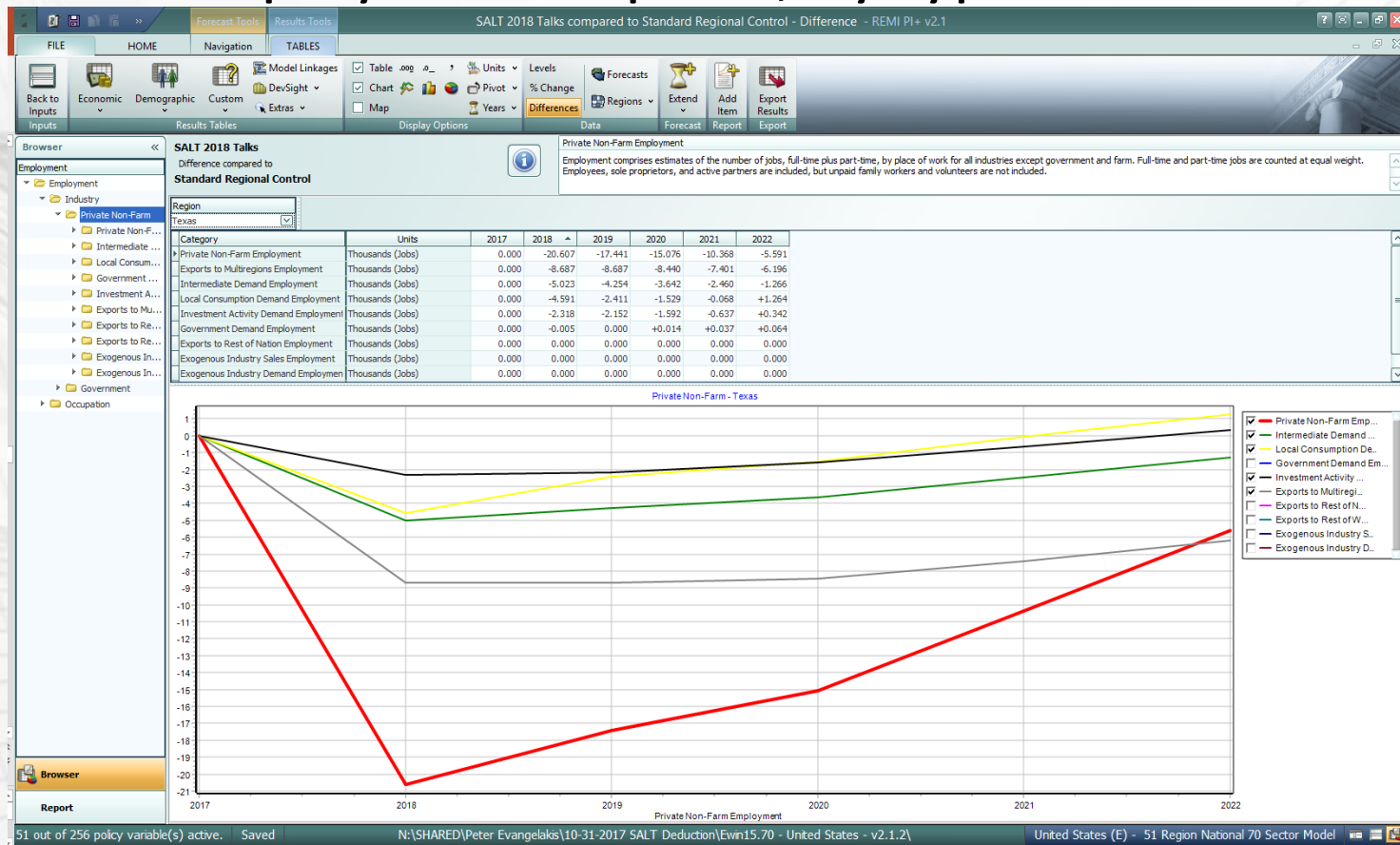


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Cap SALT Deductions



□ Texas employment impacts, by type

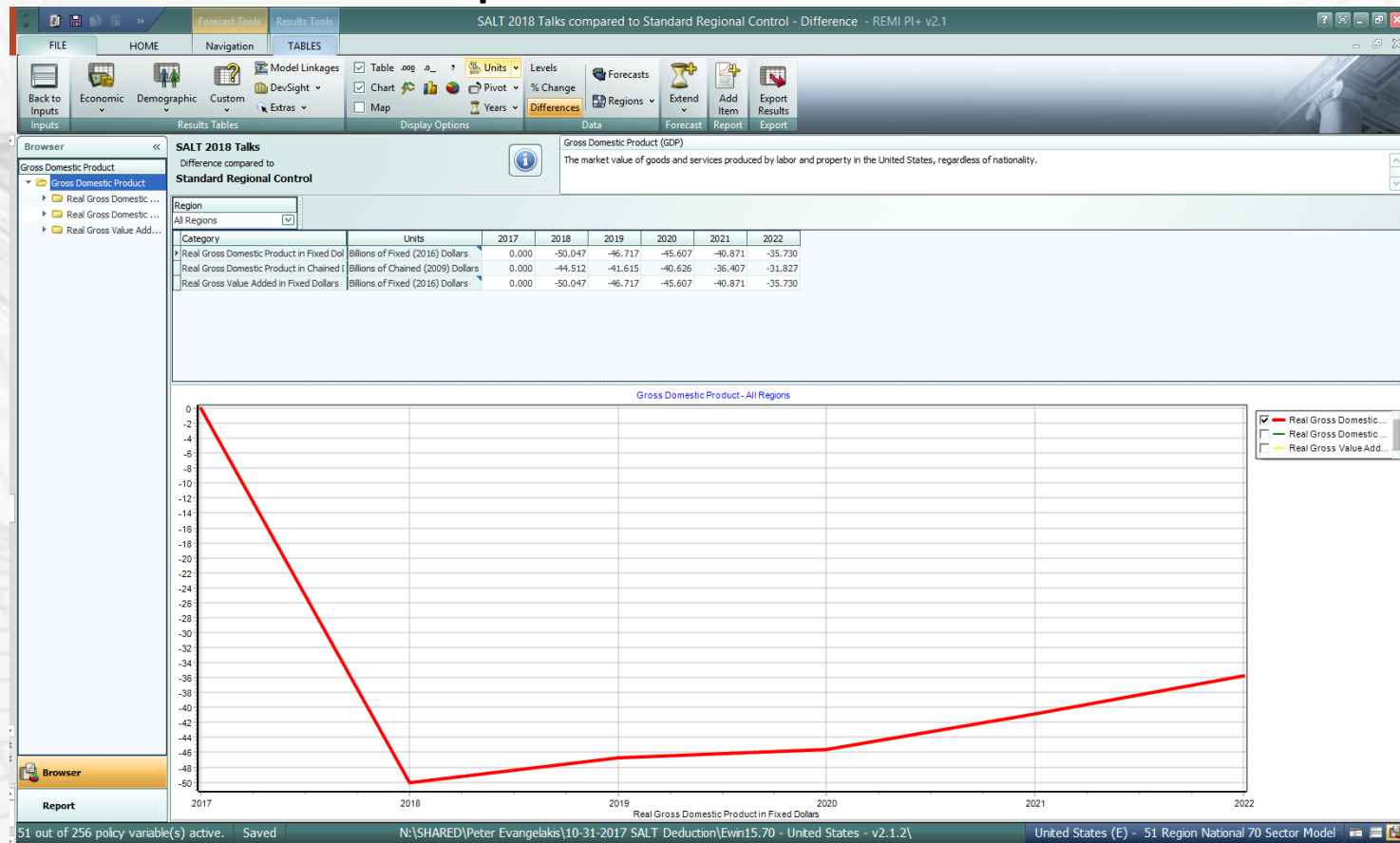


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Cap SALT Deductions



□ National GDP impacts

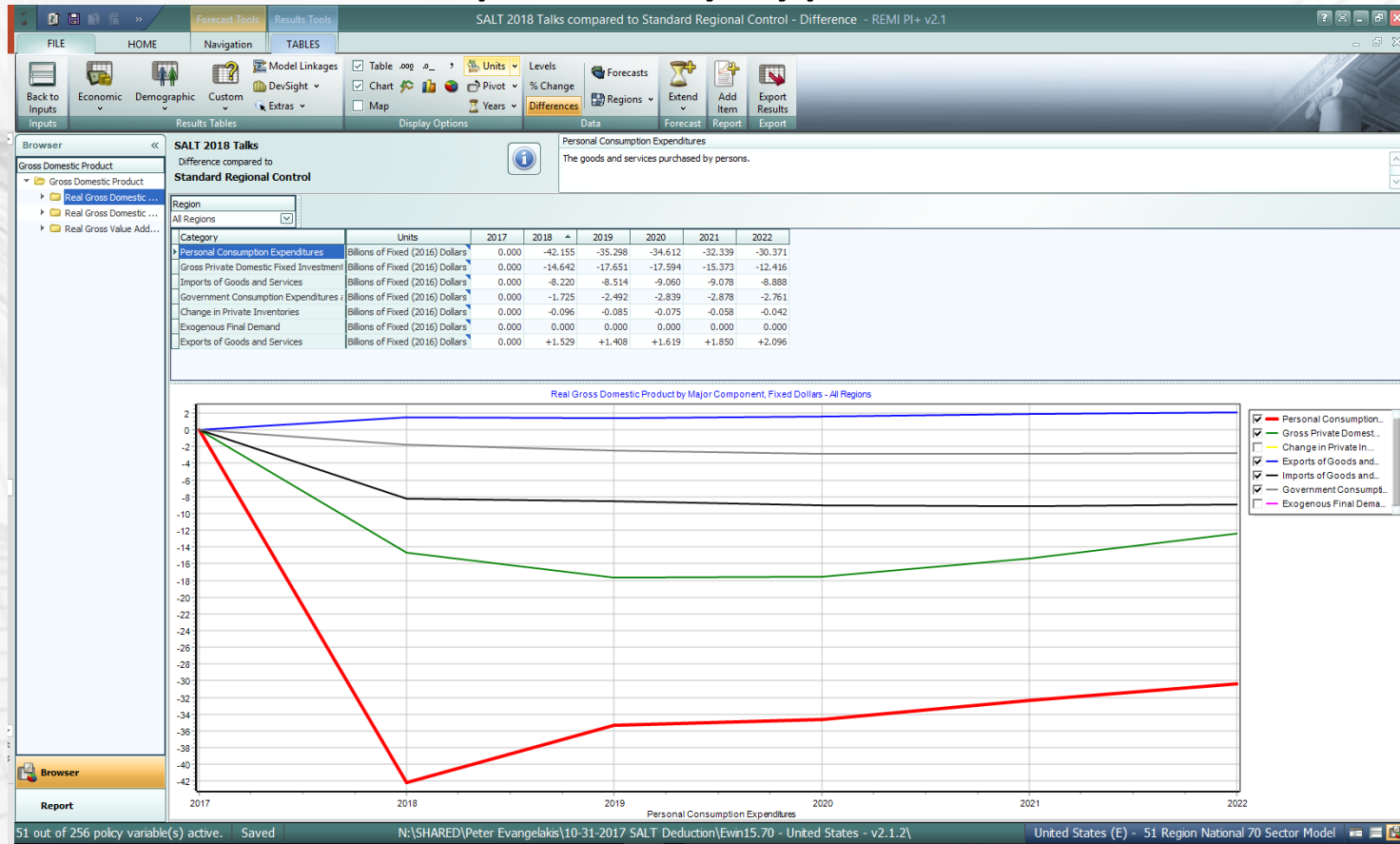


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Cap SALT Deductions



□ National GDP impacts, by type



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Payroll Tax: Itemized Deduction



- Methodology, data sample (IRS, Pew, REMI baseline)

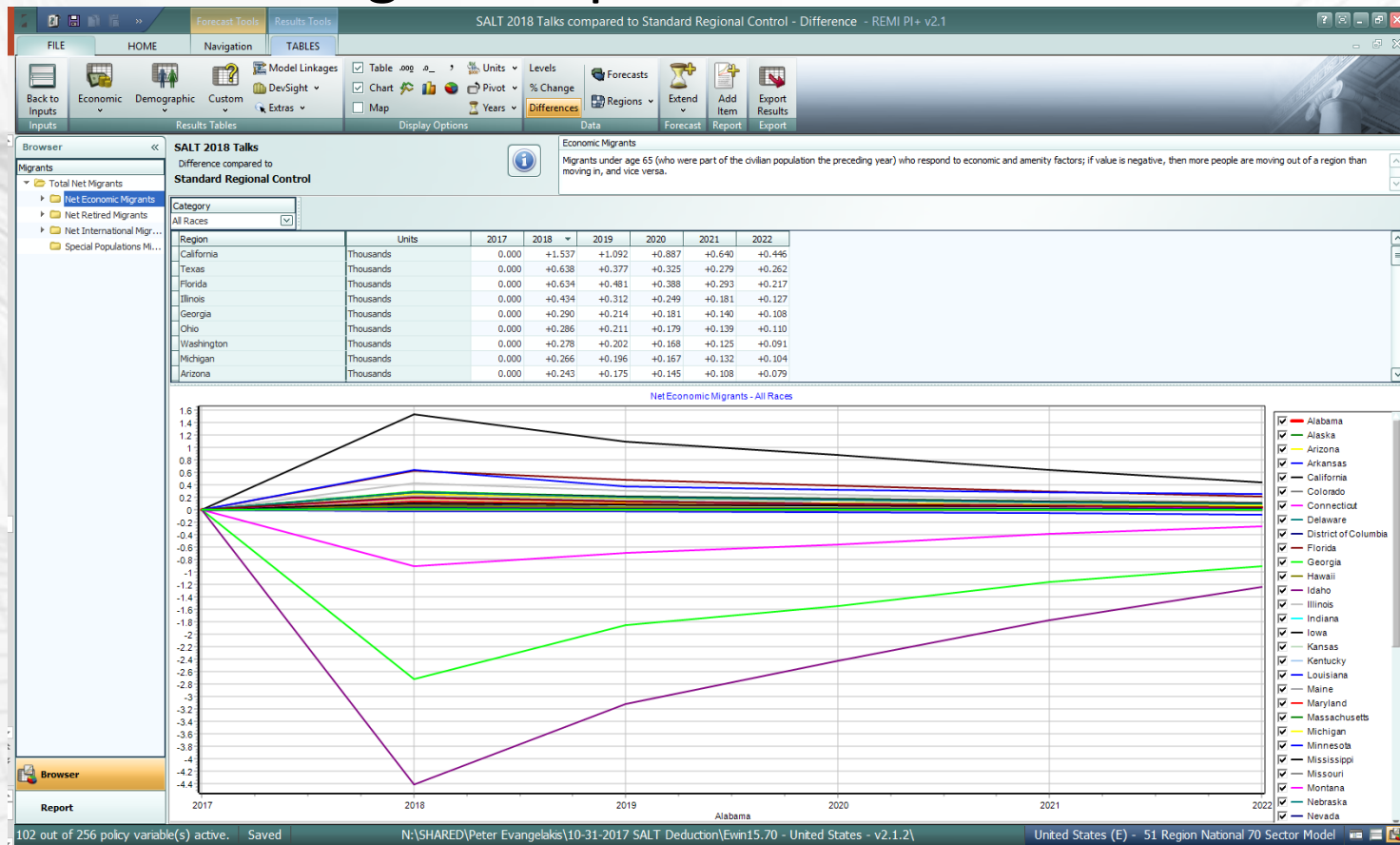
						Payroll: Decrease in Excess SALT Deduction, 20% Tax (Billions)
		Payroll:		Real Estate	Payroll:	
	Income Tax	Income Tax	Sales Tax	Tax	Total SALT	
	Component	Component	Component	Component	Deduction	
State	(Billions)	(Billions)	(Billions)	(Billions)	(Billions)	(Billions)
Alabama	2.23604339	0.78234726	0.12501447	0.62009913	1.52746086	0
Alaska	0	0	0.02610125	0.34339875	0.3695	0
Arizona	3.40041443	1.1897376	0.31305082	1.91310975	3.41589817	0
Arkansas	1.92308165	0.67284815	0.06882161	0.44612275	1.1877925	0
California	73.6542003	25.7701446	1.36486627	26.0929444	53.2279553	-8.4297822
Colorado	5.10637817	1.7866205	0.09279592	1.9404739	3.81989032	0
Connecticut	8.60789469	3.01173171	0.04549953	4.94646278	8.00369402	-1.1192326
Delaware	0.91401875	0.31979704	0	0.32307025	0.64286729	0
District of Columbia	1.67626414	0.58649159	0.00367013	0.36055474	0.95071646	-0.1439978

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Payroll Tax: Itemized Deduction



□ Economic migration patterns

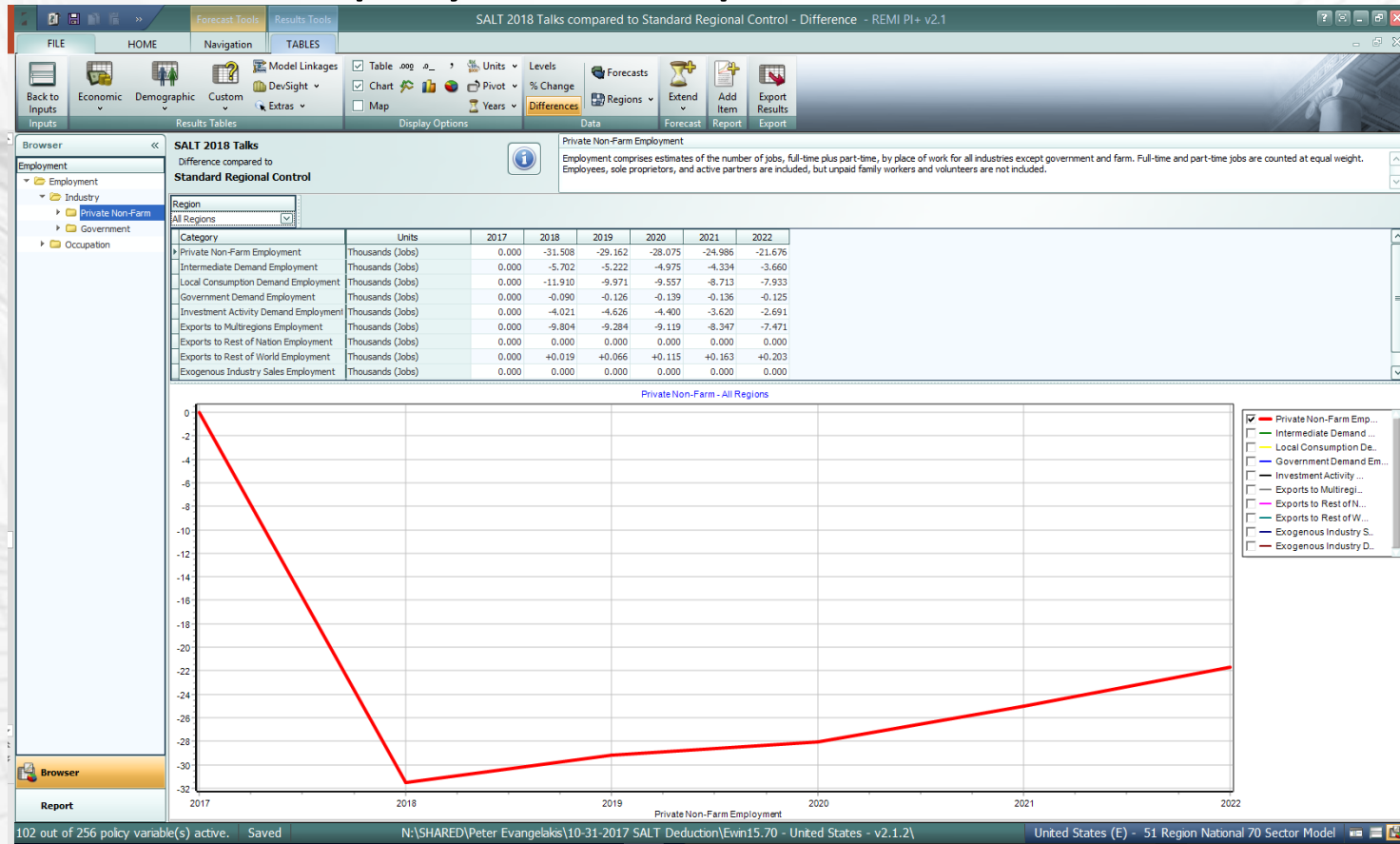


what does REMI say? *sm*

Payroll Tax: Itemized Deduction



□ National employment impacts

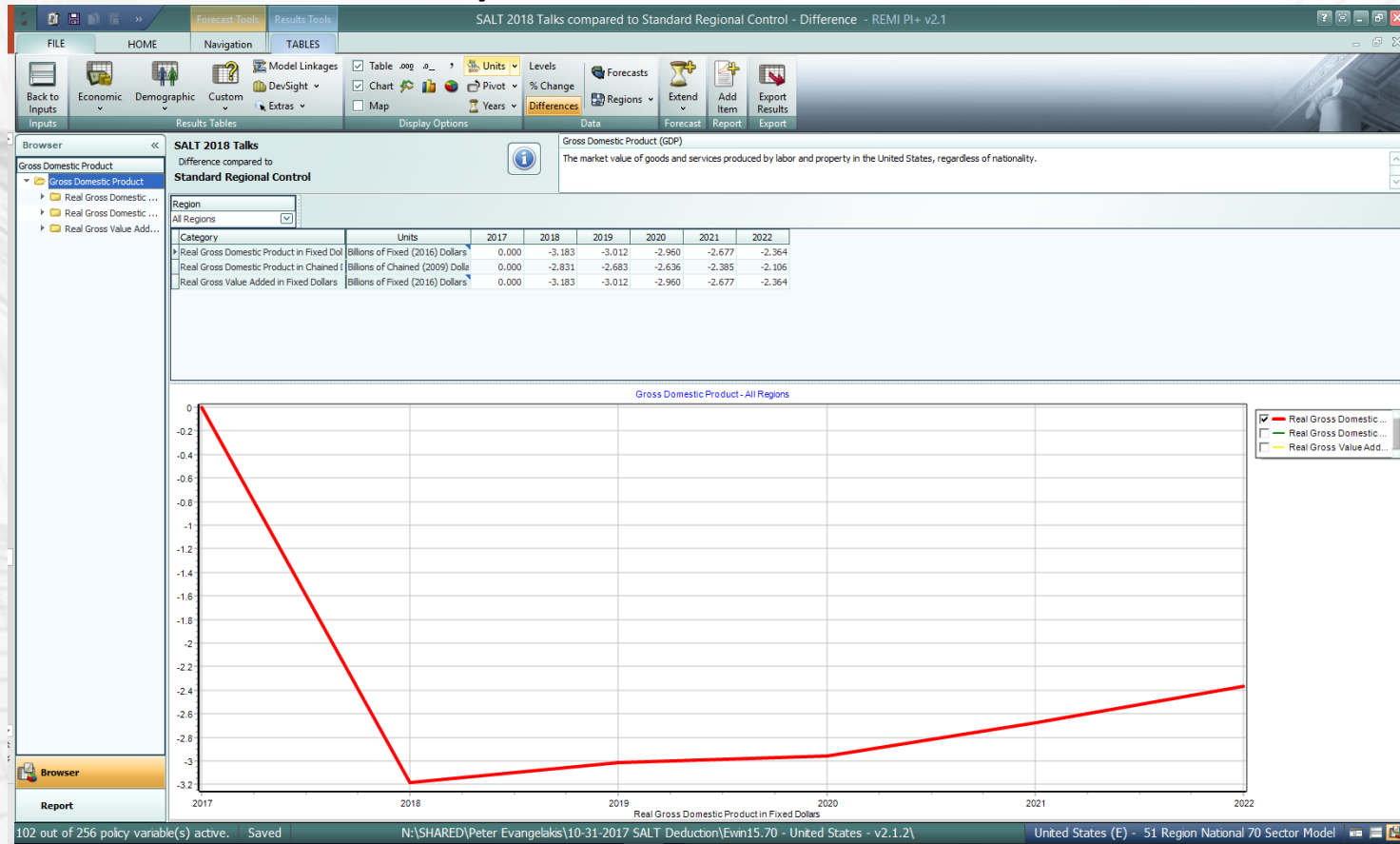


what does REMI say? sm

Payroll Tax: Itemized Deduction



□ National GDP impacts



what does REMI say? sm

Payroll Tax: Standard Deduction



- Methodology, data sample (IRS, Pew, REMI baseline)

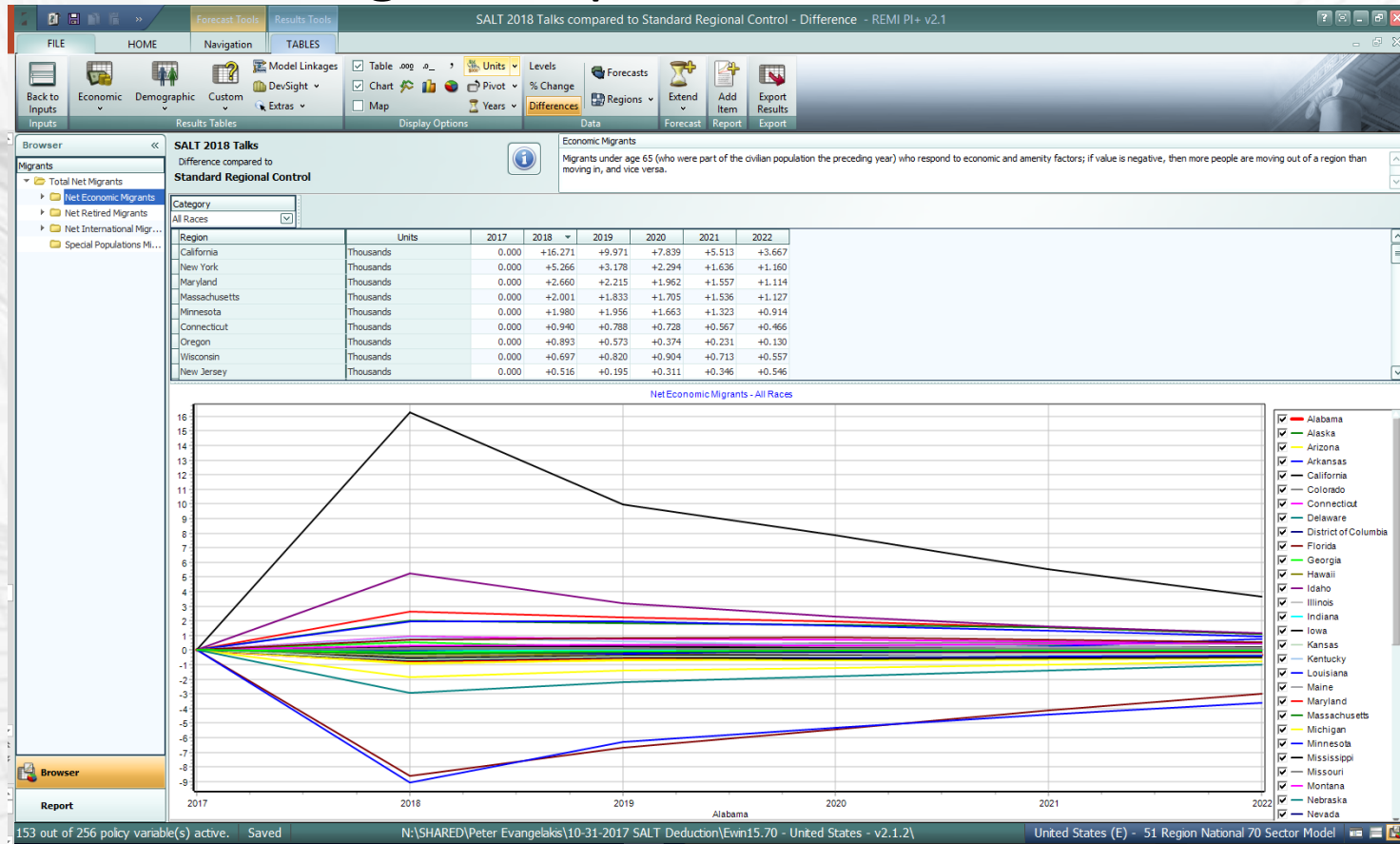
State	Income Tax Component (Billions)	State AGI (Billions)	Implied State Income Tax Rate	Standard Deduction Payroll Deduction, 15% Tax (Billions)
Alabama	2.236043394	107.9367	0.0345271	-0.1453696
Alaska	0	24.27239	0	0
Arizona	3.400414434	161.9286	0.0349991	-0.2210677
Arkansas	1.923081645	65.05434	0.0492686	-0.1250233
California	73.6542003	1287.368	0.095355	-4.7884056
Colorado	5.106378173	179.6006	0.0473864	-0.3319758
Connecticut	8.607894688	164.1109	0.0874195	-0.5596163
Delaware	0.914018751	27.51602	0.0553628	-0.0594222
District of Columbia	1.676264136	29.79659	0.0937615	-0.1089773

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Payroll Tax: Standard Deduction



□ Economic migration patterns

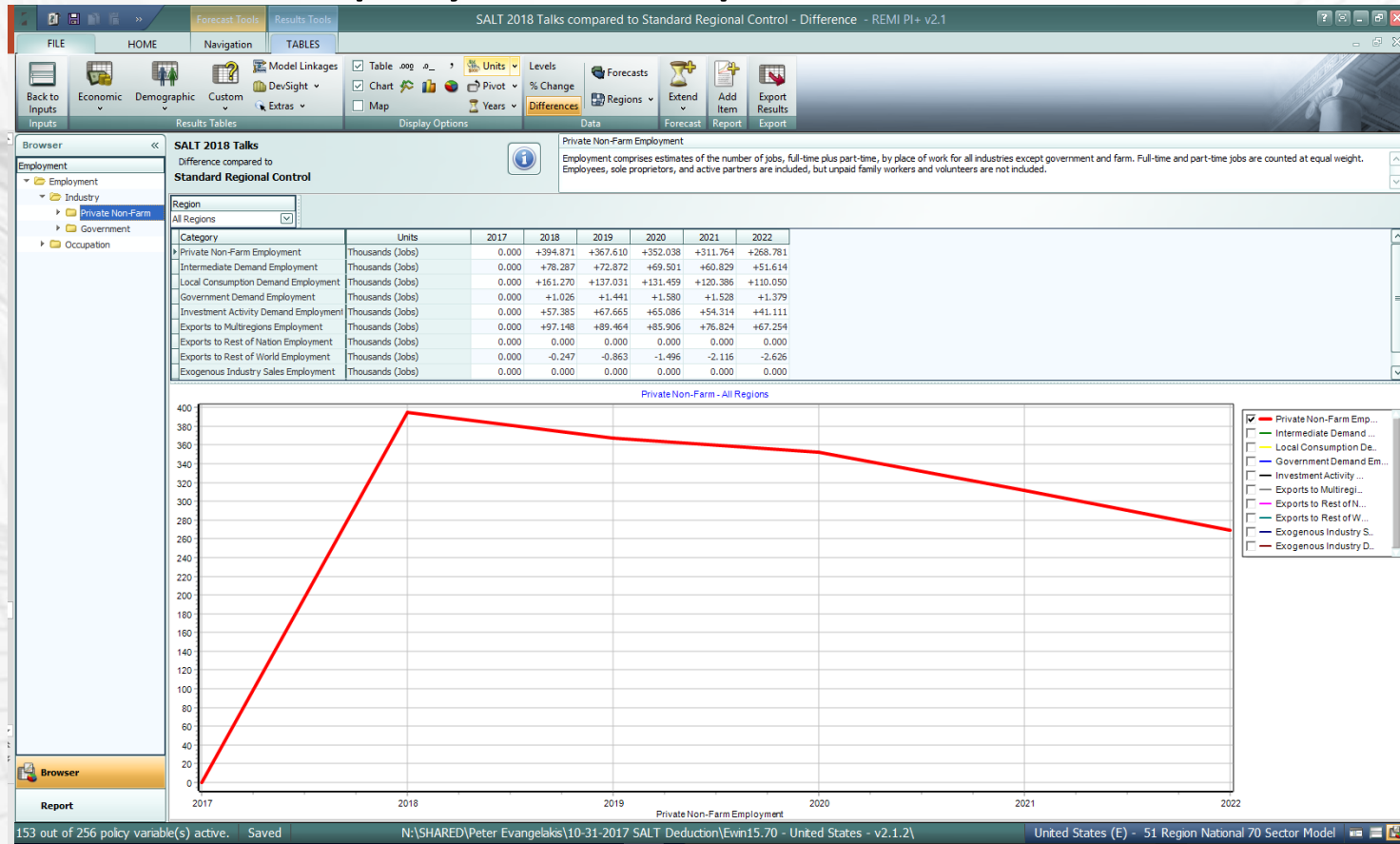


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Payroll Tax: Standard Deduction



□ National employment impacts

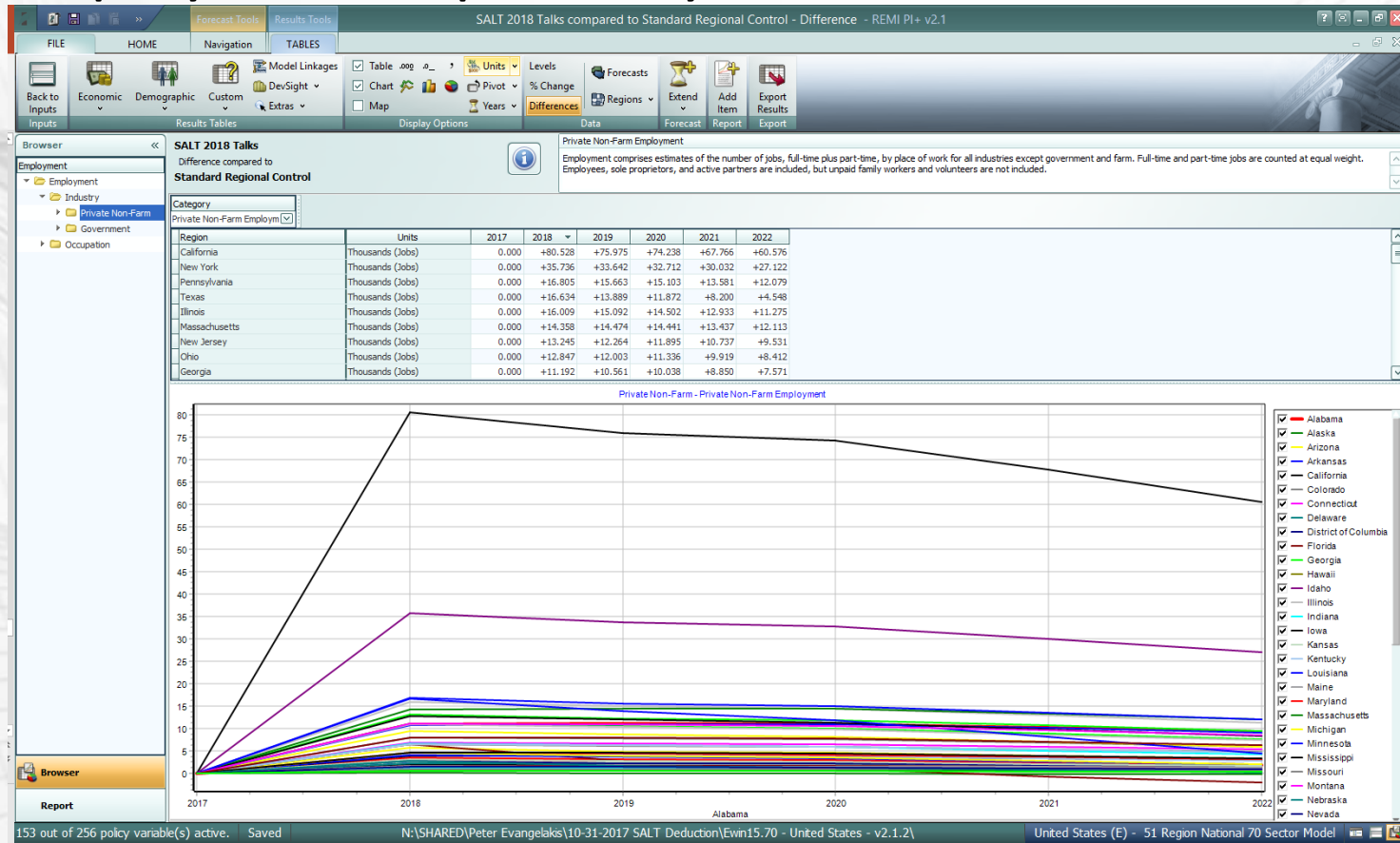


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Payroll Tax: Standard Deduction



□ Employment impacts, by state

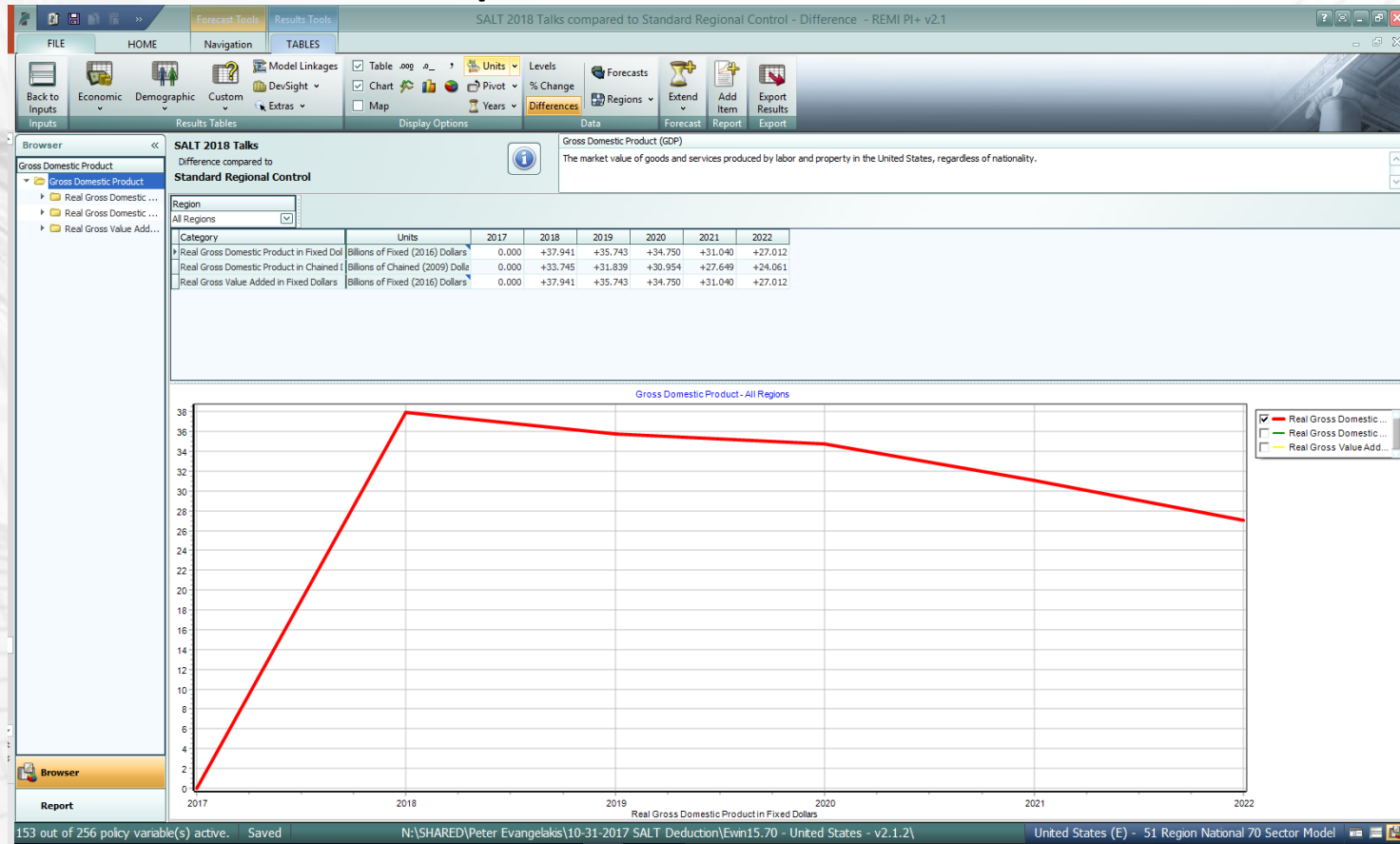


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Payroll Tax: Standard Deduction



□ National GDP impacts



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Payroll Tax: Businesses



- Methodology, data sample (IRS, Pew, REMI baseline)

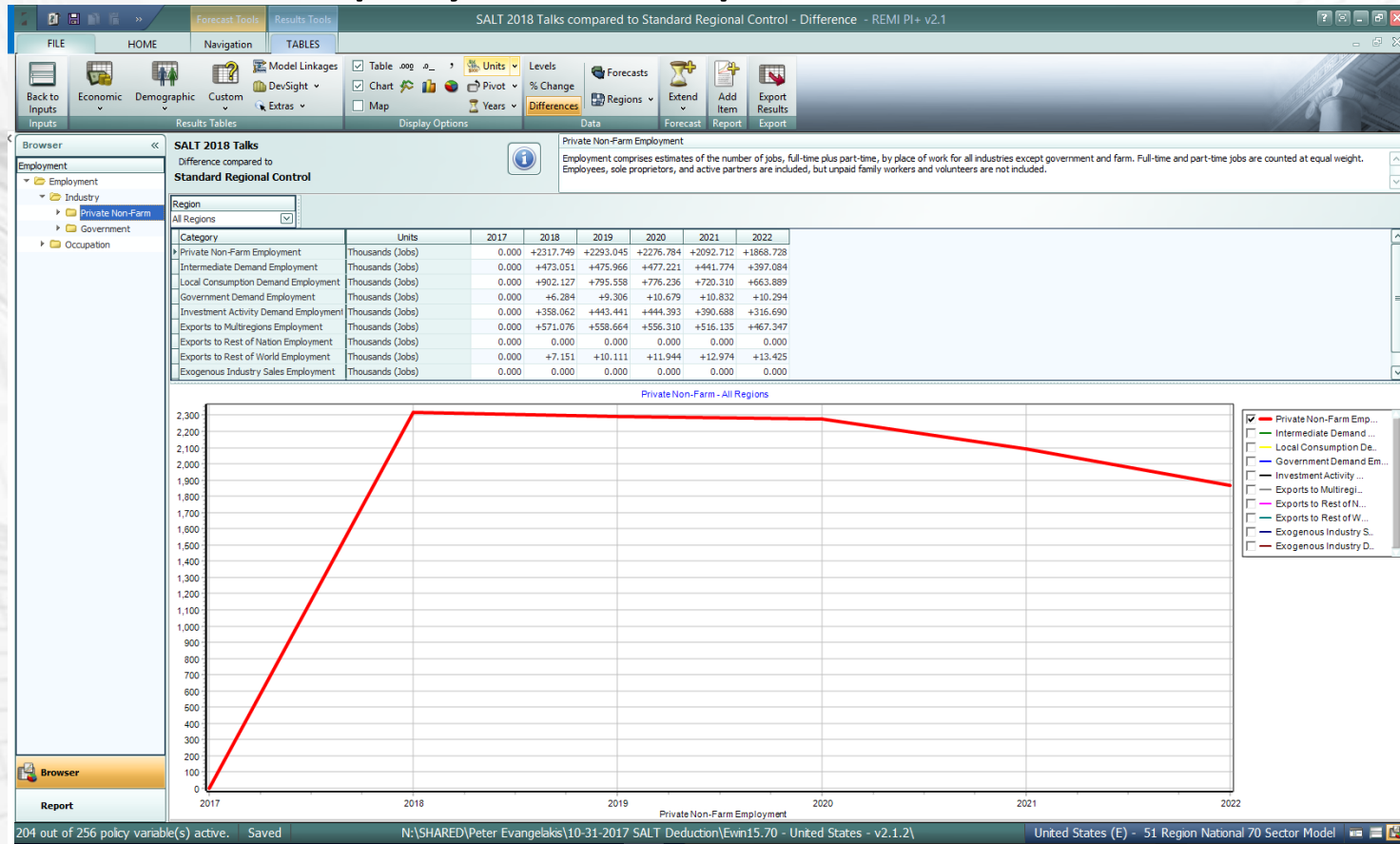
		Implied	Biz Payroll
		State	Deduction,
		Income Tax	21% Tax
		Rate	(Billions)
State	State AGI (Billions)		
Alabama	107.9367	0.0345271	-0.5087936
Alaska	24.27239	0	0
Arizona	161.9286	0.0349991	-0.7737369
Arkansas	65.05434	0.0492686	-0.4375817
California	1287.368	0.095355	-16.759419
Colorado	179.6006	0.0473864	-1.1619152
Connecticut	164.1109	0.0874195	-1.958657
Delaware	27.51602	0.0553628	-0.2079776
District of Columbia	29.79659	0.0937615	-0.3814204

what does **REMI** say? sm

Payroll Tax: Businesses



□ National employment impacts

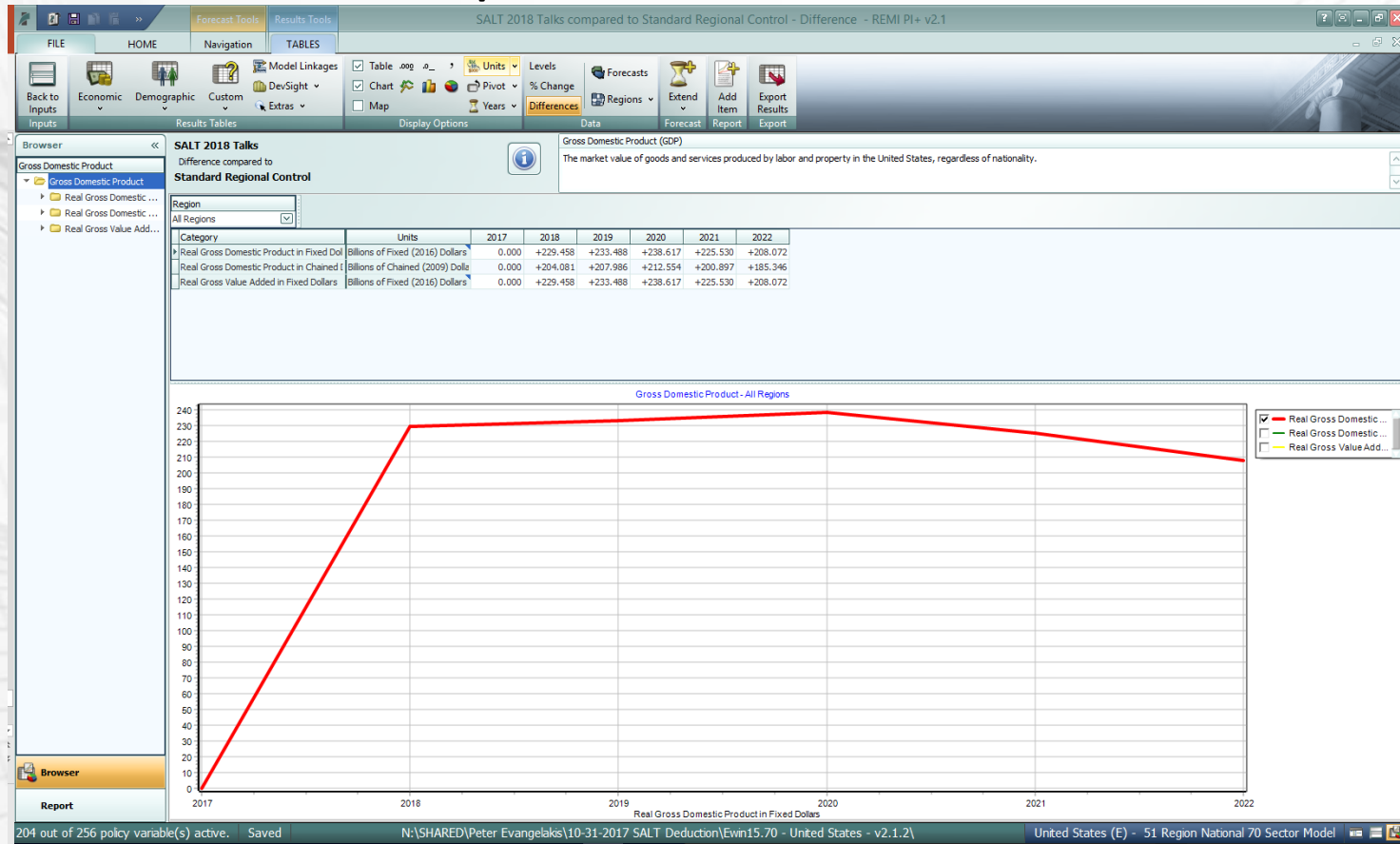


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Payroll Tax: Businesses



□ National GDP impacts



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Conclusion



- Only one piece of the puzzle
- In isolation, SALT cap shrinks national economy & generates migration from high- to low-tax states
- Switching to employer payroll tax (if possible):
 - Heavily dampens SALT cap impact
 - Generates additional benefits to states:
 - Those taking standard deduction get wage income deducted
 - Businesses can deduct payroll tax against federal corporate income tax
 - Benefit high-tax states more than low-tax, reverse migration