

Impact of Limiting the SALT Deduction on Connecticut

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January 17, 2018 | 2018-R-0028

Issue

Explain the new federal tax law's limit on the state and local tax (SALT) deduction. How does the limit impact Connecticut taxpayers and the state budget?

Summary

The SALT deduction allows federal income taxpayers to subtract from their income the amount they paid in certain state and local taxes during the tax year, thus reducing the amount of income that is subject to tax. The deduction may be claimed only as an itemized deduction, meaning that taxpayers who claim the standard deduction are not eligible for the SALT deduction. The new federal tax law caps the SALT deduction at \$10,000 (\$5,000 for married taxpayers filing separately). It also disallows prepayment in 2017 of state and local income taxes imposed in future tax years to avoid the new dollar limitation (26 U.S.C.A. § 164, as amended by P.L. 115-97, § 11042).

In 2015, 41% of the federal tax returns filed in Connecticut claimed an average SALT deduction of \$19,665, nearly double the \$10,000 limit. This puts Connecticut second among all states and the District of Columbia in the percentage of filers claiming the deduction and the average SALT deduction for 2015, according to a 2017 [study](#) prepared by the Government Finance Officers Association (GFOA).

The average SALT deduction across income levels in Connecticut varies widely, ranging from a low of \$5,652 for filers with incomes below \$25,000 to a high of \$329,026 for filers with incomes of \$1 million and greater (based on 2015 IRS data). Based on these averages, we estimate the

average additional tax due as a result of the SALT deduction cap to range from \$19 for filers with incomes between \$75,000 and \$100,000 to \$118,040 for filers with incomes of \$1 million and greater. However, this does not take into account that taxpayers who previously itemized their deductions may instead opt to claim the standard deduction, which nearly doubles under the new federal tax law. Doing so may reduce their overall tax liability, regardless of the SALT deduction cap.

The cap does not directly impact the state's income tax revenue because it is not incorporated into Connecticut income tax calculations.

SALT Deduction

The SALT deduction allows taxpayers to reduce their taxable income by the amount they paid in certain state and local taxes during the tax year. Under prior law, taxpayers could claim the deduction (with no dollar limit) for four types of nonbusiness taxes:

1. state, local, and foreign income taxes;
2. state, local, and foreign real property taxes;
3. state and local personal property taxes; and
4. state and local general sales taxes (which may be deducted in lieu of state and local income taxes).

For the 2018 to 2025 tax years, the new law limits the deduction to \$10,000 (\$5,000 for married taxpayers filing separately) for such taxes paid or accrued in the tax year (except that no deduction is available for foreign real property taxes for such years). Taxpayers may still claim a deduction with no dollar limit for state and local property taxes related to a business (e.g., property taxes paid for rental property) (26 U.S.C.A. § 164, as amended by P.L. 115-97, § 11042).

The new law also disallows prepayment in 2017 of state and local income taxes imposed for future tax years to avoid the new dollar limitation. Although the law does not refer to the prepayment of property taxes, the IRS has issued guidance that a deduction for the prepayment of such taxes in 2017 depends on whether the taxes were assessed prior to 2018 ([IRS News Release IR-2017-210](#)).

Taxpayer Impact

Number of Taxpayers Claiming the SALT Deduction

In 2015, the most recent year for which data is available, 41.3% of federal tax returns filed in Connecticut claimed the SALT deduction. As Table 1 shows, the average amount of the deduction was \$19,665 per return.

Table 1: SALT Deductions Claimed by CT Taxpayers in 2015

Total Number of CT Returns	1,761,060
No. and % Claiming the SALT Deduction	726,560 (41.3%)
Total Amount Claimed	\$14,287,651,000
Average SALT Deduction	\$19,665

Source: OLR calculation using 2015 IRS [Statistics of Income Division](#) data

Relative to other states and the District of Columbia, Connecticut ranks second in the percentage of filers claiming the deduction and the average SALT deduction in 2015, according to a 2017 [study](#) prepared by the GFOA. Table 2 shows the 15 jurisdictions with the highest percentage of filers using the SALT deduction and the average deduction (see page nine of the GFOA study for a complete list). As the table indicates, Maryland had the highest percentage of filers claiming the deduction (46%), followed by Connecticut (41%), New Jersey (41%), and the District of Columbia (40%). New York had the highest average deduction (\$22,169), followed by Connecticut (\$19,664), California (\$18,437), and New Jersey (\$17,850).

Table 2: Percentage of Filers Using the SALT Deduction and Average Deduction by Jurisdiction

State	% with SALT Deductions	Average SALT Deduction
Maryland	46%	\$12,931
Connecticut	41	19,664
New Jersey	41	17,850
District of Columbia	40	16,442
Virginia	37	11,288
Massachusetts	37	15,571
Oregon	36	12,616
Utah	35	8,291
Minnesota	35	12,954
New York	35	22,169
California	34	18,437
Georgia	33	9,158
Rhode Island	33	12,434
Colorado	32	9,017
Delaware	32	9,194

Source: [The Impact of Eliminating the State and Local Tax Deduction](#), GFOA, 2017

SALT Deduction by Income Level

Table 3 shows the distribution of Connecticut filers claiming the SALT deduction in 2015 by adjusted gross income (AGI). As it indicates, the majority of filers with AGIs over \$75,000 and nearly all filers with AGIs over \$200,000 claimed the deduction. The average SALT deduction claimed increases as AGI increases, from a low of \$5,652 for filers with AGIs below \$25,000 to a high of \$329,026 for filers with AGIs of \$1 million and greater.

Table 3: SALT Deduction Claimed by CT Taxpayers in 2015 by AGI

AGI	Number of SALT Deductions	% Claiming SALT Deduction	Total \$ Claimed (Thousands)	Average SALT Deduction
Under 25K	41,800	7.2%	\$236,256	\$5,652
25K to 50K	84,890	23.2	525,902	6,195
50K to 75K	116,360	48.3	926,599	7,963
75K to 100K	111,380	67.0	1,123,271	10,085
100K to 200K	245,610	88.3	3,630,498	14,782
200K to 500K	96,460	98.8	2,813,098	29,163
500K to 1M	18,700	99.0	1,287,711	68,862
1M+	11,380	99.0	3,744,316	329,026
All Filers	726,560	41.3%	\$14,287,651	\$19,665

Source: OLR calculations using 2015 IRS [Statistics of Income Division](#) data

Estimated Additional Tax Burden Due to SALT Deduction Cap

Based on the average SALT deductions claimed in 2015 across AGI levels, we estimated the average additional tax due as a result of the \$10,000 SALT deduction cap. Table 4 shows the analysis. It assumes that the excess amount over the \$10,000 limit will be taxed at the highest marginal tax rate for joint filers for each AGI bracket. As it shows, the estimated average additional tax ranges from \$19 for filers with AGIs between \$75,000 and \$100,000 to \$118,040 for filers with AGIs of \$1 million and greater.

Table 4: Estimated Additional Tax Burden Due to SALT Deduction Cap

AGI	Average SALT Deduction	Excess Over \$10,000 Limit	Top Marginal Tax Rate for Joint Filers	Estimated Average Amount of Additional Tax Due
75K to 100K	\$10,085	\$85	22%	\$19
100K to 200K	14,782	4,782	24	1,148
200K to 500K	29,163	19,163	35	6,707
500K to 1M	68,862	58,862	37	21,712
1M+	329,026	319,026	37	118,040

Source: OLR calculations

It is important to note that this analysis does not take into consideration that taxpayers generally have the option of using the standard deduction or itemizing their deductions on their tax returns. The standard deduction is a specific dollar amount, adjusted annually for inflation, that varies depending on a taxpayer's filing status (plus an additional amount for taxpayers who are age 65 or older or blind). For the 2018 to 2025 tax years, the new federal tax law nearly doubles the standard deduction to \$24,000 for joint filers, \$18,000 for head of household filers, and \$12,000 for all others, indexed for inflation. Thus, taxpayers who previously itemized their deductions, and thus claimed the SALT deduction, may opt to claim the standard deduction instead. Doing so may reduce their overall tax liability, regardless of the SALT deduction cap.

Budgetary Impact

The federal SALT deduction is not incorporated into Connecticut income tax calculations and, consequently, does not directly impact the state's income tax revenue.

As this [2016 OLR report](#) explains, the starting point for calculating taxable income subject to Connecticut's income tax is federal adjusted gross income (AGI). To calculate federal AGI, taxpayers list the total income they received for the tax year in specified categories. They then apply certain exemptions and deductions, which reduce the amount of income subject to tax. Exemptions and deductions can either be "above-the-line" or "below-the-line," meaning they are claimed before or after calculating AGI (i.e., the "line").

Federal "above-the-line" exemptions and deductions are generally incorporated into Connecticut income tax calculations because they are claimed before calculating federal AGI. They include deductions for educator expenses, health savings account contributions, and student loan interest. Alternatively, federal "below-the-line" exemptions and deductions are not included in Connecticut's state income tax calculation because they are claimed after calculating federal AGI. This includes the standard deduction and itemized deductions for SALT, medical expenses, home mortgage interest, and charitable gifts, among others.

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