Aggregate Impact of Elimination of State and Local Tax (SALT) Deductions in California

The proposed tax reform would have wide ranging impacts on taxpayers and households throughout California. The proposed elimination of the state and local tax (SALT) deductions, without substantial marginal tax rate reductions or a larger increase in the standard deduction amounts, would increase the federal tax liability for many taxpayers, particularly those in California. While elements of the tax reform legislation may offset some of this increase, including eliminating the alternative minimum tax (AMT), increasing the standard deduction and lowering marginal tax rates for some filers, the elimination of SALT deductions would have disproportionate effects on the state. For many, particularly those with higher adjusted gross income (AGI) in high tax states such as California, the elimination of the SALT deductions will likely increase the federal tax liability.

Figure 1: California State SALT Deductions - 2015

Deduction Type	Number of Filers	Share of Total Filers	Deductions (Bil.)
Total Itemized Deductions	6,119,910	34.5%	$225.2
State and Local Income Taxes	5,002,300	28.2%	$79.9
State and Local Real Estate Taxes	4,817,470	27.1%	$28.3
State and Local Sales Taxes	963,560	5.4%	$1.5

Source: U.S. Internal Revenue Service

SALT Deductions in California

The potential elimination of the federal tax deduction for state and local taxes (SALT) would affect nearly 45 million Americans, approximately 30% of all federal tax filers, and disproportionately impact residents of California. In California, of the nearly 17.8 million tax filers, more than 6.1 million utilized itemized deductions. More than 5.0 million deducted state and local income taxes, more than 4.8 million deducted state and local property taxes, and nearly 1.0 million deducted state and local sales taxes.

Figure 2: State and Local Income Tax Deductions

County	Filers Using Itemized Deductions	Filers Using SALT Income Deductions	Average SALT Income Tax Deduction	County	Filers Using Itemized Deductions	Filers Using SALT Income Deductions	Average SALT Income Tax Deduction
California	**6,119,910**	**5,002,300**	**$15,977**	Orange	563,170	464,860	$16,813
Alameda	300,670	262,280	$14,945	Placer	82,680	67,620	$11,969
Alpine	160	90	$7,978	Plumas	2,580	1,780	$6,584
Amador	5,830	4,320	$7,092	Riverside	338,620	255,200	$7,159
Butte	25,690	20,030	$8,781	Sacramento	219,280	183,110	$8,350
Calaveras	7,730	5,570	$7,956	San Benito	9,460	7,760	$9,416
Colusa	2,090	1,690	$15,626	San Bernardino	276,870	212,080	$6,741
Contra Costa	242,150	204,430	$16,582	San Diego	527,630	429,700	$13,770
Del Norte	2,300	1,700	$6,684	San Francisco	189,020	172,670	$32,530
El Dorado	38,400	30,820	$11,733	San Joaquin	89,910	73,190	$8,132
Fresno	97,810	76,720	$9,686	San Luis Obispo	49,170	37,570	$10,701
Glenn	2,430	1,880	$11,116	San Mateo	169,470	148,790	$35,568
Humboldt	14,370	10,700	$7,796	Santa Barbara	62,900	49,630	$17,993
Imperial	12,910	10,210	$7,318	Santa Clara	395,690	353,630	$27,820
Inyo	2,250	1,820	$8,004	Santa Cruz	46,750	37,800	$15,594
Kern	94,680	75,810	$8,597	Shasta	22,220	16,880	$7,713
Kings	12,500	9,300	$8,136	Sierra	340	240	$5,775
Lake	6,590	4,670	$6,459	Siskiyou	4,390	3,090	$6,463
Lassen	2,740	2,110	$5,588	Solano	75,280	62,110	$7,580
Los Angeles	1,499,930	1,205,490	$16,552	Sonoma	90,720	71,050	$13,047
Madera	14,670	10,240	$8,508	Stanislaus	61,650	49,930	$8,591
Marin	67,660	56,810	$34,603	Sutter	11,170	8,710	$8,181
Mariposa	2,070	1,470	$6,299	Tehama	5,730	4,300	$7,505
Mendocino	9,930	7,030	$8,782	Trinity	1,160	770	$6,283
Merced	21,020	16,320	$8,310	Tulare	40,270	30,170	$8,475
Modoc	700	530	$7,362	Tuolumne	7,850	5,630	$7,445
Mono	1,780	1,390	$9,540	Ventura	151,320	123,100	$12,955
Monterey	53,360	41,150	$13,126	Yolo	29,970	25,740	$10,471
Napa	25,100	20,560	$19,252	Yuba	7,450	5,850	$5,249
Nevada	19,370	14,000	$10,553				

Source: U.S. Internal Revenue Service

Not only do a large number of Californians utilize SALT deductions, but the aggregate dollar value of deductions was also substantial. Total itemized deductions were more than $225.2 billion in 2015, of which nearly $110 billion were SALT deductions, as shown in Figure 1.

Figure 3: California Increased Tax Liability

Aggregate Deduction - State and Local Income Taxes	$79.9 Bil.
Aggregate Deduction - State and Local Real Estate Taxes	$28.3 Bil.
Effective Federal Tax Rate - 35%	x 35%
Increased Federal Tax Liabilities	$ 37.9 Bil.

Sources: U.S. Internal Revenue Service, RCG

Utilization of itemized deductions is relatively widespread throughout the state and, in the largest counties by population, a large share of filers benefit from SALT deductions, as shown in Figure 2. In Los Angeles County, more than 1.2 million tax filers claimed state and local income tax deductions in 2015 averaging more than $16,500 per filer. In Orange County, nearly 465,000 filers claimed an average of nearly $17,000. In the Inland Empire counties of Riverside and San Bernardino, nearly 470,000 tax filers claimed an average of nearly $7,000. In San Diego County, nearly 430,000 filers claimed deductions averaging nearly $14,000 per tax filer. In Santa Clara County, more than 350,000 tax filers utilized state and local income tax deductions with an average deduction of nearly $28,000. In San Francisco County, nearly 173,000 filers deducted an average of more than $32,500. In Alameda and Contra Costa counties, nearly 263,000 and 205,000 tax filers deducted an average of $15,000 and nearly $17,000, respectively. Finally in Sacramento County, more than 183,000 federal tax filers claimed an average of more than $8,000 in state and local income tax deductions.

The ability to deduct more than $108 billion for state and local income and real estate taxes for California residents reduced (assuming a 35% effective tax rate) federal tax liabilities by $37.9 billion, as shown in Figure 3. The elimination of the SALT deduction without other tax offsets would transfer this amount away from economic activity in California and throughout the country, and would instead be sent to the federal government.

Short-Run Impact of the Elimination of SALT Deductions on the California Economy

Isolating the effects of the elimination of SALT deductions by assuming no other tax liability offsets highlights the detrimental nature of this component of tax reform. The $37.9 billion increase in effective taxes for California taxpayers would directly reduce consumption throughout the state. For middle income and lower households that utilize SALT deductions, elimination of the deductibility of state and local taxes would cause a corresponding decrease in spending. For upper middle income households, the reduction in consumption could be nearly dollar for dollar given the high cost of living in many parts of California. For very high income households, the higher effective tax rates would likely marginally impact consumption.

If the entire $37.9 billion reduced consumption, using a conservative local multiplier effect of 2x to 3x, the reduction in consumption would be roughly 2%-3% of economic activity in the state. Utilizing these rough estimates, there would potentially be thousands of fewer jobs in the state and reduced local sales and property tax revenue for municipal and state governments.

(* Local multiplier assumes that each dollar spent generates two to three times the initial amount as local service industries generate sales, income and jobs.)

Long-Run Impact of the Elimination of SALT Deductions in California

Beyond the reduction in economic activity, the main long-term impact of the proposed end of the SALT deduction, even if offset in part by the lower marginal federal tax rates, is that California would become even more tax disadvantaged relative to other states. States with high state and local taxes are implicitly subsidized by the SALT deduction. Table 1 from the Tax Foundation shows that SALT deductions amounted to 7.9% of AGI in California. California and many of the municipalities in the state are already tax disadvantaged and the end of SALT deductions means the tax disadvantage is increased substantially.

The long-run impact of this worsening relative tax differential means that the tax motivated out-migration from California will accelerate. This means reduced jobs, tax revenue and public expenditures as households with the financial means and mobility to relocate are more likely to migrate to other states. Reduced income would decrease consumption activity and, at the margin, cause some residents to leave for lower cost states.

The elimination of state and local tax deductions is clearly harmful to California residents and the economy. This elimination of SALT deductions will increase the effective tax burden on households throughout the state, from coastal cities to inland regions, and may drive residents and businesses to relocate outside of California. The decreased economic activity will mean fewer jobs, less consumer spending and reduced state and local government receipts.

Table 1: SALT Deduction Shares and Value by State

State	AGI per Filer	Share of Itemizers	% of AGI	State Share
Alabama	$52,741	26.0%	2.8%	0.6%
Alaska	$67,212	22.2%	1.5%	0.1%
Arizona	$56,903	28.3%	3.5%	1.1%
Arkansas	$53,186	22.7%	3.7%	0.5%
California	**$73,938**	**33.9%**	**7.9%**	**19.6%**
Colorado	$70,342	32.6%	4.0%	1.4%
Connecticut	$93,806	41.2%	8.3%	2.6%
Delaware	$61,998	32.0%	4.5%	0.2%
Florida	$60,676	22.9%	2.6%	2.8%
Georgia	$57,899	32.7%	4.9%	2.4%
Hawaii	$58,209	29.2%	4.5%	0.3%
Idaho	$52,703	27.9%	4.4%	0.3%
Illinois	$69,186	32.4%	6.0%	5.0%
Indiana	$54,125	23.1%	3.5%	1.1%
Iowa	$59,559	29.2%	4.7%	0.8%
Kansas	$62,299	25.7%	3.8%	0.6%
Kentucky	$51,977	26.0%	4.7%	0.9%
Louisiana	$57,560	22.8%	2.6%	0.6%
Maine	$53,519	27.6%	5.6%	0.4%
Maryland	$72,746	45.2%	7.7%	3.2%
Massachusetts	$85,408	36.8%	6.3%	3.5%
Michigan	$56,937	26.5%	4.3%	2.2%
Minnesota	$68,649	35.0%	6.2%	2.2%
Mississippi	$46,639	22.9%	3.0%	0.3%
Missouri	$56,634	26.1%	4.3%	1.3%
Montana	$55,240	28.2%	4.5%	0.2%
Nebraska	$61,711	27.8%	4.8%	0.5%
Nevada	$58,745	24.6%	2.4%	0.4%
New Hampshire	$69,498	31.5%	4.3%	0.4%
New Jersey	$81,344	41.1%	8.7%	5.9%
New Mexico	$50,743	22.7%	3.1%	0.3%
New York	$79,268	34.2%	9.1%	13.3%
North Carolina	$56,385	29.1%	4.7%	2.2%
North Dakota	$73,499	17.7%	1.6%	0.1%
Ohio	$56,322	26.5%	4.7%	2.9%
Oklahoma	$59,450	24.0%	3.2%	0.6%
Oregon	$59,845	36.0%	7.0%	1.5%
Pennsylvania	$63,037	28.8%	4.9%	3.7%
Rhode Island	$62,296	32.9%	6.4%	0.4%
South Carolina	$52,434	27.0%	4.2%	0.9%
South Dakota	$60,690	17.3%	1.6%	0.1%
Tennessee	$54,997	20.0%	1.9%	0.6%
Texas	$67,253	23.0%	2.5%	3.9%
Utah	$60,792	35.4%	4.5%	0.7%
Vermont	$57,573	27.5%	5.6%	0.2%
Virginia	$72,151	37.2%	5.5%	3.0%
Washington	$73,010	30.4%	2.9%	1.4%
West Virginia	$50,401	17.1%	3.0%	0.2%
Wisconsin	$59,596	31.6%	6.0%	1.9%
Wyoming	$77,370	21.9%	1.6%	0.1%
District of Columbia	$88,430	39.4%	6.8%	0.4%

Source: Tax Foundation, 2014