The Daily Dish

The SALT Controversy

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The Wall Street Journal reports: “House passage of Democrats’ $2 trillion education, healthcare and climate package has inflamed an intraparty debate about whether the bill gives overly-generous tax benefits to high-income Americans. At the center of the dispute is the House plan to raise the $10,000 cap on the deduction for state and local taxes to $80,000 through 2030. A small but committed group of lawmakers from high-tax states like New York and New Jersey have for years insisted on repealing the $10,000 cap, which Republicans put into place as part of the 2017 tax law.” How should one think about the so-called SALT (state and local tax) provision?

The first aspect to consider is the efficiency of state and local public finance. Federal deductibility affects the “price” of state and local taxes. Specifically, if you can’t deduct, then the “tax price” of $1 of state and local taxes is $1. But if you can deduct, this price goes down. Suppose that your federal income tax rate is 50 percent and your state income tax rate is 10 percent. If you make another dollar, you pay 10 cents in state tax. You also owe federal tax, but you first get to deduct the state tax. Instead of paying 50 percent of $1, you pay 50 percent of 90 cents ($1 – $0.10); your federal tax is lowered from 50 cents to 45 cents. In effect, the federal tax code subsidizes 5 cents out of the 10 cents of tax.