AMERICANS AGAINST DOUBLE TAXATION

A coalition to preserve state and local tax deductions

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Consequences of the Brady Partial Elimination of SALT

A Backgrounder

The new Brady tax plan would eliminate deductions for personal income and sales taxes, and preserve the property tax deduction. This not only affects the tax liability for individuals and families, but also will adversely affect their communities and public services. With the loss of deductibility for income and sales taxes, states and local governments will face pressure to cut funding for public services including education, health care and public safety – which these taxes support. Over time, this could cause state and local governments to rely more on – and raise – property taxes to fund essential services.

This backgrounder describes some of the key consequences of the Brady plan's impact on state and local public services and communities across the country, including:

1. State and local governments will be under increasing pressure to reduce income and sales taxes once they are no longer deductible;
2. Because most states rely on income and/or sales taxes for their revenues, the Brady plan could reduce state funding for education, health care, infrastructure and public safety;
3. By permitting a deduction only for property taxes, the Brady plan dictates winners and losers among states as each state and local government relies on a different mix of income, property and sales taxes to fund its operations and services;
4. Most significantly, taxpayers living in communities that rely on local property taxes will not escape the adverse impacts of the Brady plan. This is because states fund a large portion of public services provided in local communities – 46% of public education and nearly all health and public welfare services are state funded – and most states depend primarily on income and sales taxes to support these services.

These impacts are discussed in greater depth below:

- **The Brady plan will affect state and local governments and their taxpayers differently because these governments rely on a different mix of revenue sources to support public services and infrastructure. States that rely on income and sales taxes may be hardest hit.**

  Except for a brief period following the 1986 Tax Reform Act when sales taxes were not deductible, the decision to favor one tax over others in the Brady proposal is novel and consequential. For more than 100 years, federal law has provided deductions for all personal state and local taxes including income, property and sales taxes. By taking the rare step of favoring the property tax, the Brady plan will pressure state and local governments to reduce income and sales taxes that will no longer be deductible, and rely more heavily on property taxes. But not all states will see the same impacts. According to the Tax Foundation (Table 1), seven states have no individual income tax and thus could fare better than others that rely on it. Texas, for instance, has no income tax and a greater reliance on property taxes - 40.4% compared to the national average of 31.3% - and is likely to fare better than most states that are more income tax dependent.

- **Even taxpayers living in communities that rely on local property taxes could be hit hard by the Brady proposal, because states provide substantial financial support for public services and infrastructure and generally do not rely on property taxes.**

  Many vital public services in communities across the country are supported substantially through state funding. Thus, taxpayers living in communities that are property tax dependent would still be hurt by the elimination of deductions for income and sales taxes in the Brady plan, and the subsequent reduction in state support for education, health care and other services. Data from the National Center for Education Statistics (Table 1) reports that states finance 46% of public elementary and secondary education on average, and this state funding percentage is even higher in certain states – for instance, California 57%, Connecticut 61%, Minnesota and New Mexico 70%. Thus, by disadvantaging income and sales taxes that account for two-thirds of all state revenue nationwide (see table 8), the Brady plan will significantly impair the ability of many states to support public education. And, that's not all. The second largest category of state spending is on health care and public welfare, including Medicaid. Because 91% of all state and local direct spending for these services is at the state level, all communities could see reductions in these programs following the elimination of deductions for state income and sales taxes that support them.

- **The Brady Plan Intrudes on State and Local Governments' Rights**

  State and local governments and their finance systems existed long before the federal government established the first federal income tax in 1913. Recognizing the importance of state and local government and wishing not to intrude on their rights and financing, the framers of the first federal tax form included SALT as one of six deductions. SALT also was included on the emergency civil war tax imposed in 1862. For more than 100 years, the federal government has protected our fiscal federalism and protected taxpayers from double taxation by continuing to permit the SALT deduction. Moreover, by allowing deductions for all state and local taxes, federal policymakers also respected the rights of states and their localities to choose the mix of revenue sources that best suited them.

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The consequences of the Brady plan are historic and far-reaching. Taxpayers who have already paid mandatory taxes to state and local governments would also have to pay federal taxes on those monies. This federal intrusion into state and local government tax policies would undermine the independent authority of state and local fiscal decisions. And, with these changes, statewide support for education, health care, public safety and infrastructure – all of which depend on state government financing to some degree – could be adversely affected. Finally, the federal government's overreach could dictate winners and losers among states and their taxpayers based on nothing more than their decisions to finance their governments using the mix of revenue sources they deemed most appropriate.