Itemized Tax Deductions for Individuals: Data Analysis

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February 12, 2014

Congressional Research Service
7-5700
www.crs.gov
R43012

CRS Report for Congress
Prepared for Members and Committees of Congress

Summary

Reforming or limiting itemized tax deductions for individuals has gained the interest of policymakers as one way to increase federal tax revenue, increase the share of taxes paid by higher-income tax filers, simplify the tax code, or reduce incentives that might lead to inefficient economic behavior. However, limits on deductions could cause adverse economic effects or changes in the distributional burden of the federal income tax code. This report is intended to identify who claims itemized deductions, for how much, and for which provisions?

This report analyzes data to inform the policy debate about reforming itemized tax deductions for individuals. In 2011, 32% of all tax filers chose to itemize their deductions rather than claim the standard deduction. In addition, the data indicate that both the share of tax filers who itemize their deductions and the amount claimed by each tax filer as adjusted gross income (AGI) increases. AGI is the basic measure of income under the federal income tax and is the income measurement before itemized deductions and personal exemptions are taken into account. Although higher-income tax filers are more likely to itemize their deductions and claim a larger amount of itemized deductions than lower-income tax filers, the majority of itemizers (63.6%) have incomes below $100,000, and 90.3% of itemizers have an AGI below $200,000.

Tax filers in different income ranges tend to claim different itemized deductions. In 2011, tax filers in higher income ranges claimed deductions for charitable gifts, state and local taxes, and real estate property taxes at higher rates than tax filers in lower income ranges. For example, the deduction for charitable gifts was claimed by 45% of tax filers with an AGI between $50,000 and $100,000, whereas it was claimed by 75% to 94% of tax filers with an AGI above $100,000. Deductions for state and local taxes and the deduction for charitable gifts comprise a larger share of itemized deductions as income rises.

The four largest itemized deductions are estimated to account for 17.8% ($195.7 billion) of the approximately $1.1 trillion in tax expenditures in FY2014. These deductions are for home mortgage interest, state and local taxes, charitable gifts, and real estate taxes.

These findings have several implications for policy options that would seek to reform or limit itemized tax deductions. First, efforts to target limits on itemized tax deductions toward higher-income tax filers are limited in the amount of revenue that can possibly be raised. Although higher-income tax filers claim a larger average amount of deductions, these tax filers make up a small share of itemizers.

Second, the structure of a limit on itemized deductions could affect which deductions a tax filer might claim. Although a limit based on a percentage reduction in the overall tax benefits of itemized deductions would not change the relative choice of deduction claims, limits based a flat-dollar value cap likely would alter deduction claims and possibly tax filer behavior. This could happen if a tax filer has deductions that exceed a flat-dollar value cap, because the tax filer must make a decision about which deductions to actually claim. Even if a tax filer cannot claim a tax deduction for a particular activity, the tax filer might still engage in the activity for other reasons (although possibly to a lesser extent).

Third, the structure of a limit on itemized deductions also has an effect on its ability to raise revenue. Limiting deductions might raise the taxable income of some individuals, thereby pushing them into a higher marginal tax bracket, and tax a higher share of their income at that

higher marginal tax rate. However, certain combinations of deduction limits may shift some tax filers to claim the standard deduction instead of itemizing. In this case, the revenue increase by limiting itemized deduction would be partially offset by more tax filers claiming the standard deduction.

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Introduction

Reforming or limiting itemized tax deductions for individuals has gained the interest of policymakers as one way to increase federal tax revenue, increase the share of taxes paid by higher-income tax filers, simplify the tax code, or reduce incentives that might lead to inefficient economic behavior. However, limits on deductions, in the views of some, would have adverse economic effects or changes in the distributional burden of the federal income tax code. Discussions about itemized tax deduction reform are informed by scrutiny of tax filer data.

This report analyzes the most recently available public data from the Internal Revenue Service's (IRS's) Statistics of Income (SOI) to provide an overview of who claims itemized deductions, what they claim them for, and the amount in deductions claimed. In addition, the revenue loss associated with several of the larger deductions is presented using data obtained from the Joint Committee on Taxation's (JCT) tax expenditure estimates. This report concludes with a brief discussion of the implications of various policy options to reform or limit itemized deductions. More in-depth discussion on options for reforming itemized tax deductions, as a whole or individually, can be found in other CRS reports.[1]

An Overview of Itemized Tax Deductions

Individual income tax filers have the option to claim either a standard deduction or the sum of their itemized deductions on the federal income tax Form 1040. The *standard deduction* is a fixed amount, based on filing status, available to all taxpayers. Alternatively, tax filers may claim *itemized deductions*. Tax filers who itemize must list each item separately on their tax returns and be able to provide documentation in the event of an IRS audit that the expenditures have been made. Whichever deduction a tax filer claims—standard or itemized—the deduction amount is subtracted from adjusted gross income (AGI) in the process of determining taxable income.[2] AGI is the basic measure of income under the federal income tax and is the income measurement before itemized deductions and personal exemptions are taken into account.

Generally, only individuals with aggregate itemized deductions greater than the standard deduction find it worthwhile to itemize.[3] The tax benefit of choosing to itemize is the amount that their itemized deductions exceed the standard deduction multiplied by their top marginal income tax rate.

[1] For example, see CRS Report R43079, *Restrictions on Itemized Tax Deductions: Policy Options and Analysis*, by Jane G. Gravelle and Sean LowryCRS Report R42435, *The Challenge of Individual Income Tax Reform: An Economic Analysis of Tax Base Broadening*, by Jane G. Gravelle and Thomas L. Hungerford.

[2] For more information on how tax deductions reduce taxable income, see CRS Report R42872, *Tax Deductions for Individuals: A Summary*, by Sean Lowry.

[3] Although this is generally the case, the Government Accountability Office (GAO) estimated that about 510,000 tax filers (representing about 0.1% of all individual taxes paid) in 1998 overpaid their taxes by claiming the standard deduction, even though they could have itemized their deductions for a greater tax benefit. GAO did not determine the reasons why tax filers might have done this. See U.S. General Accounting Office, *Tax Deductions: Further Estimates of Taxpayers Who May Have Overpaid Federal Taxes by Not Itemizing*, GAO-02-509, March 2002, at http://www.gao.gov/new.items/d02509.pdf.

Some itemized deductions can only be claimed if they meet or exceed minimum threshold amounts (also known as a floor) to simplify tax administration and compliance. Floors usually come in the form of a limit based on a percentage of AGI. For example, eligible extraordinary medical and dental expenses must amount to 10% of AGI in order to claim an itemized deduction in 2013; total expenses less than this floor are not eligible for an itemized deduction.

In addition, some itemized deductions are subject to a cap (also known as a ceiling) in benefits or eligibility. Caps are meant to reduce the extent that tax provisions can distort economic behavior, limit revenue losses, or reduce the availability of the deduction to higher-income tax filers. For example, the itemized deduction for home mortgage interest can only be claimed for the value of interest payments made on the first $1 million of mortgage debt.

Analysis of Tax Data

This section of the report uses publicly available tax data from the IRS to provide a profile of itemizers and some insight into trends among various itemized deduction provisions. Itemized deductions are often grouped together in broader discussions of tax policy, in part because they are grouped together on the tax Form 1040.[4] But, itemized deductions exist for a variety of reasons and are designed in ways such that they target (or exclude) certain types of tax filers. Analysis of data on these deductions can inform these discussions over reforming one or more itemized deduction provisions. Specifically, the data analysis in this report intends to identify who claims itemized deductions, for how much, and for which provisions?

This analysis might be relevant to the 113th Congress, as there has been growing congressional interest in reforming or limiting itemized tax deductions for individuals. Some see reforming itemized tax deductions as one way to increase federal tax revenue (and possibly contribute to deficit reduction), increase the share of taxes paid by higher-income tax filers, simplify the tax code, or reduce incentives that might lead to inefficient economic behavior.

Who Claims Itemized Tax Deductions?

In 2011, 32% of all tax filers chose to itemize their deductions rather than claim the standard deduction.[5] Of this 32% of tax filers, a greater share of higher-income individuals chose to itemize their deductions compared with lower-income individuals. **Table 1** shows the share of tax filers who chose to itemize their deductions and the average sum of those deductions in 2011 by AGI.

Higher-income tax filers chose to itemize their deductions more often than lower-income tax filers in 2011. As shown in **Table 1**, the share of tax filers who chose to itemize in higher-income ranges above $200,000 remained virtually the same (over 90%), although the average sum of itemized deductions claimed increased substantially. For taxpayers with an AGI above $200,000, the share that itemized ranged from 94% to 98% and the average sum of itemized deductions claimed per itemizer ranged from $39,470 to $441,719. In contrast, 84% of tax filers with an AGI

4 This report analyzes 2011 data, which are the most recently available public data from the IRS.

5 CRS analysis of the Internal Revenue Service's Statistics of Income 2011 Data,Tables 1.4 and 2.1, at http://www.irs.gov/uac/SOI-Tax-Stats—Individual-Statistical-Tables-by-Size-of-Adjusted-Gross-Income.

between $100,000 and $200,000 chose to itemize their deductions in 2011, with an average of $27,075 in deductions claimed. Six percent of tax filers with an AGI less than $20,000 chose to itemize their deductions in 2011, with an average of $15,227 in deductions claimed.

Table 1. Share of Tax Filers Claiming Itemized Tax Deductions and Average Deduction Claimed, by Adjusted Gross Income (AGI), 2011

Adjusted Gross Income	Number of Itemizers	Share of Tax Filers Who Itemized	Average Sum of Itemized Deductions Claimed Per Itemizer
$1 to $20k	2,902,737	6%	$15,227
$20k to $50k	9,650,874	22%	$15,469
$50k to $100k	16,892,129	55%	$19,441
$100k to $200k	12,348,754	84%	$27,075
$200k to $250k	1,601,935	94%	$39,470
$250k to $500k	2,023,910	96%	$54,942
$500k to $1million	578,811	97%	$99,629
+$1million	294,685	98%	$441,719

Source: CRS analysis of the Internal Revenue Service's Statistics of Income 2011 Data, Tables 1.4 and 2.1, at http://www.irs.gov/uac/SOI-Tax-Stats—Individual-Statistical-Tables-by-Size-of-Adjusted-Gross-Income.

What is the Value of an Itemized Tax Deduction?

Two key concepts are important in understanding the value of itemized deductions for tax filers: the progressive structure of the federal income tax and *statutory* versus *effective* tax rates. First, not all income is taxed at the same tax rate, at the federal level. As income increases through various ranges, or brackets, it is taxed at graduated rates. Second, the maximum statutory tax rate a tax filer faces is not necessarily the same as the actual, or effective, tax rate the tax filer pay on his or her income. Statutory tax rates are set in law, and form the basis of the progressive federal income tax structure. However, tax provisions that reduce taxable income (e.g., deductions and exemptions) might also reduce the tax filer's effective tax rate, if they are large enough to put the tax filer in a lower statutory marginal (top) tax rate. A simple calculation of the effective tax rate is the amount of taxes paid, or final tax liability, divided by adjusted gross income (AGI). For this reason, the effective tax rate is also often referred to as the average tax rate.

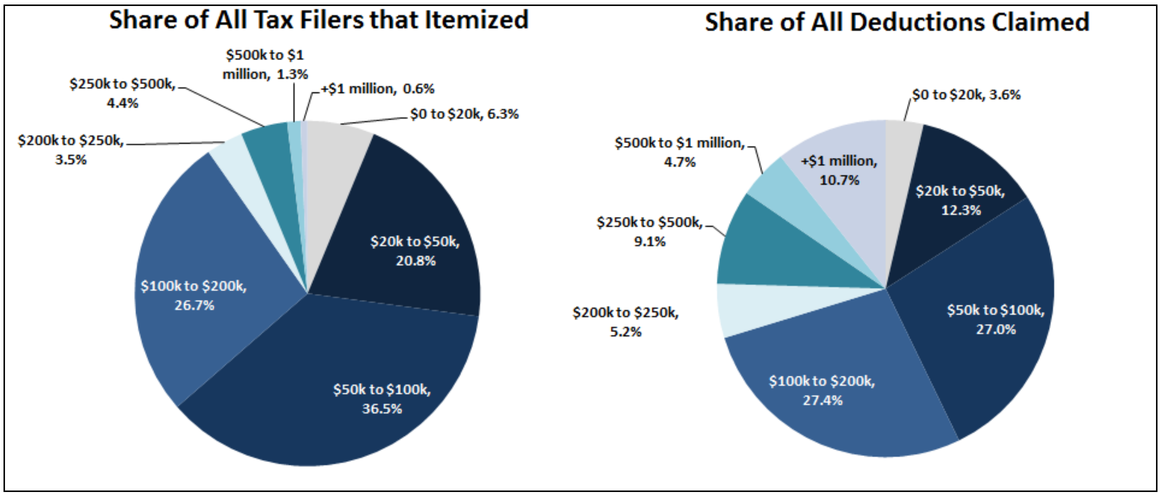
For example, an itemizer in a 25% tax bracket that claims a $4,000 deduction in state and local income taxes owes $1,000 ($4,000*0.25) less in federal income taxes, than if the tax filer did not claim the deduction. In other words, the value of any given itemized tax deduction is equal to the deduction amount claimed times a tax filer's statutory income tax rate. If the tax value of the deduction is large enough to put the tax filer into a different, lower tax bracket, then the value of the deduction could be less for the tax filer because a share of the income earned is taxed at a lower tax rate. For behavioral effects, however, it is the value of the last increment of deduction that is valued at the tax filer's marginal tax rate that is most likely capable of determining to what extent the individual participates in the behavior (or participates at all).

For more information of these tax calculations, see CRS Report R42872, *Tax Deductions for Individuals: A Summary*, by Sean Lowry and CRS Report RL30110, *Federal Individual Income Tax Terms: An Explanation*, by Mark P. Keightley.

Figure 1 shows the distribution, by AGI, of total itemizers and total itemized deduction claimed in 2011. Although higher-income tax filers both tend to itemize at higher rates and claim a larger average total of itemized deductions, the majority of itemizers (63.6%) have incomes below $100,000, and 90.3% of itemizers have an AGI below $200,000.

Compared with the distribution of itemizers, the distribution of total itemized deduction claim values are more evenly distributed across income ranges. As shown in **Figure 1**, a majority (57.2%) of total itemized deduction claims (amounts, in dollars) were made by tax filers with an AGI greater than $100,000. Although tax filers with an AGI more than $1 million comprised 0.6% of itemizers they claimed 10.7% of all itemized tax deductions in 2011. Similarly, tax filers with an AGI between $500,000 and $1 million accounted for 1.3% of itemizers, but they claimed 4.7% of all itemized deduction. Tax filers with an AGI between $50,000 and $100,000 accounted for 36.5% of all itemizers, but they claimed 27.0% of all itemized deductions.

Figure 1. Shares of Tax Itemizers and Itemized Deductions Claimed, by Adjusted Gross Income (AGI), 2011



Source: CRS analysis of the Internal Revenue Service's Statistics of Income 2011 Data, Tables 1.4 and 2.1, at http://www.irs.gov/uac/SOI-Tax-Stats—Individual-Statistical-Tables-by-Size-of-Adjusted-Gross-Income.

Analysis of Selected Deductions

Another way to analyze tax data on itemized deductions is to look at selected deductions. By analyzing data on selected deductions, it becomes apparent that there is wide variation in who claims a specific itemized deduction. For example, selected deductions tend to benefit different types of itemizers, based on their income. In addition to differences in the income of the itemizer, the variation in itemized deduction claims can also be explained, in part, by the structure of certain provisions (e.g., floors or ceilings that are designed to limit claims).

Tax filers in different income ranges tend to claim different itemized deductions. **Table 2** shows the average amount claimed in 2011 for selected deductions and the share of total tax filers who itemized in each income class that claimed a particular deduction.[6] Tax filers in higher-income ranges claimed deductions for charitable gifts, state and local taxes, and real estate property taxes at higher rates than tax filers in lower-income ranges. For example, the deduction for charitable gifts was claimed by 45% of tax filers with an AGI between $50,000 and $100,000; 75% of tax filers with an AGI between $100,000 and $200,000; and more than 88% of tax filers in each of

[6] All reported claim amounts in this report are tallied before limits were applied. In 2011, a deduction for medical expenses must have been in excess of 7.5% of AGI. A deduction for unreimbursed employee business expenses, when combined with all other "miscellaneous deductions," must have been in excess of 2% of AGI.

the income ranges over $200,000. Fewer tax filers in the highest income group (with an AGI greater than $1 million) than in the $100,000-$1 million income groups claimed the home mortgage interest deduction, possibly due to a greater ability for some individuals to pay for home purchases with cash (i.e., they did not have a mortgage).[7] Few tax filers, in general, claimed the deduction for extraordinary medical and dental expenses—particularly at the highest income ranges. The 7.5% of AGI floor required to claim the deduction in 2011 limited the amount of taxpayers that could be eligible for this provision.[8]

Table 2. Average Amount Claimed by Tax Filers for Various Tax Deductions, 2011

(share of total tax filers in each income group claiming each itemized deduction)

Adjusted Gross Income (AGI)	Home Mortgage Interest	Charitable Gifts	State & Local Taxes	Real Estate Taxes	Medical Expenses	Unreimbursed Employee Business Expenses
$0 to $20k	$7,569 (3%)	$1,634 (4%)	$770 (5%)	$2,991 (5%)	$8,494 (4%)	$5,071 (1%)
$20k to $50k	$7,314 (15%)	$2,281 (15%)	$1,500 (20%)	$2,815 (17%)	$7,247 (8%)	$5,487 (7%)
$50k to $100k	$8,645 (44%)	$2,877 (45%)	$3,208 (53%)	$3,319 (48%)	$7,532 (12%)	$5,069 (20%)
$100k to $200k	$11,370 (71%)	$3,886 (75%)	$6,304 (82%)	$4,713 (78%)	$10,526 (8%)	$4,866 (29%)
$200k to $250k	$15,444 (78%)	$5,726 (87%)	$11,526 (93%)	$6,901 (88%)	$18,884 (4%)	$5,971 (24%)
$250k to $500k	$18,790 (77%)	$8,917 (89%)	$18,168 (95%)	$9,020 (90%)	$30,133 (2%)	$6,528 (18%)
$500k to $1million	$23,568 (72%)	$18,152 (92%)	$40,502 (96%)	$13,870 (91%)	$65,714 (1%)	$9,896 (12%)
+$1million	$27,373 (62%)	$134,390 (94%)	$203,853 (97%)	$26,329 (92%)	$126,198 (<1%)	$28,696 (7%)

Source: CRS analysis of the Internal Revenue Service's Statistics of Income 2011 Data, Tables 1.4 and 2.1, at http://www.irs.gov/uac/SOI-Tax-Stats—Individual-Statistical-Tables-by-Size-of-Adjusted-Gross-Income.

Notes: Claim amounts are as reported before limits were applied. See footnote 6.

Average tax deduction values indicate which provisions have the largest effects in reducing different tax filers' taxable incomes. The deduction for state and local taxes was the largest average deduction amount claimed for any deduction by tax filers with an AGI above $500,000 (aside from the infrequent instance where a tax filer claimed the itemized deduction for extraordinary medical expenses). In contrast, the mortgage interest deduction was, on average, the

[7] In addition, the deduction for home mortgage interest is limited to interest on the first $1 million of mortgage debt. For more information on the home mortgage interest deduction, see CRS Report R41596, *The Mortgage Interest and Property Tax Deductions: Analysis and Options*, by Mark P. Keightley. On the other hand, higher-income individuals might prefer taking a mortgage out on their house rather than paying in cash if they believe that they can invest the money that they would otherwise use to pay their house off at a higher rate of return than the cost of the interest on the mortgage.

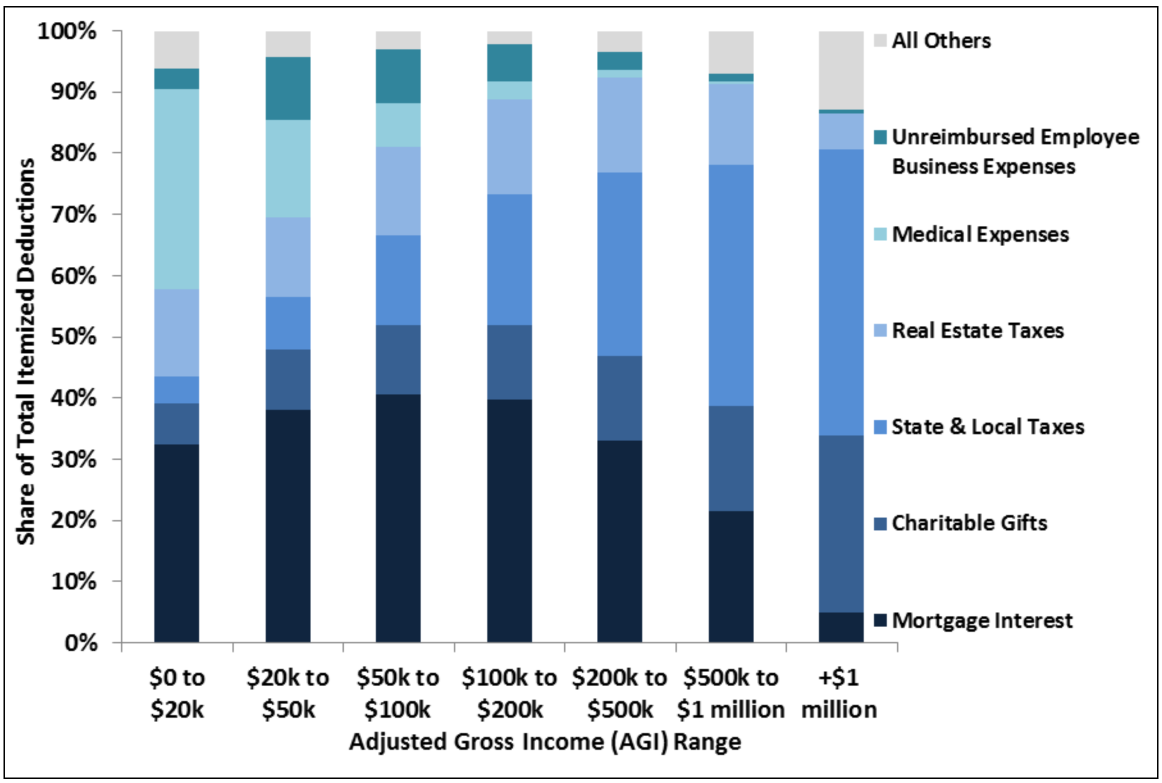
[8] The floor required to claim the deduction for extraordinary medical and dental expenses is 10% of AGI for tax years 2013 and beyond. See CRS Report R42872, *Tax Deductions for Individuals: A Summary*, by Sean Lowry.

largest single deduction, by amount, claimed by tax filers with an AGI less than $500,000 (aside from the medical expenses deduction). The average deduction for charitable gifts also increases sharply for tax filers with an AGI of $1 million or above. The average amount of the charitable gift deduction claimed by tax filers with an AGI between $500,000 and $1 million was $18,152. In contrast, the average amount of the charitable gift deduction for tax filers with an AGI more than $1 million was $134,390 in 2011.

Figure 2 shows the distribution of various deductions claimed across income groups. These data illustrate several trends.

- The home mortgage interest deduction made up the largest share of total itemized deduction claims for itemizers with an AGI between $20,000 and $250,000.
- The largest share of total itemized deduction claims for tax filers with an AGI more than $250,000 was composed of the deduction for state and local taxes.
- The deductions for state and local taxes and charitable contributions composed a larger share of total deductions claimed as income rise.

Figure 2. Distribution of Itemized Deductions Claimed, by Adjusted Gross Income (AGI), 2011



Source: CRS analysis of the Internal Revenue Service's Statistics of Income 2011 Data, Table 2.1, at http://www.irs.gov/uac/SOI-Tax-Stats—Individual-Statistical-Tables-by-Size-of-Adjusted-Gross-Income.

Notes: Claim amounts are as reported before limits were applied. See footnote 6.

Table 3 shows the amounts claimed for certain itemized deductions as a share of the total income of itemizers. Generally, the share of total itemized deductions claimed as a share of AGI decreases as income increases.[9] Total claims for the deduction for home mortgage interest comprised the largest share of AGI among all itemizers for any single deduction. The deduction for state and local sales or income taxes was the only deduction where the total claims as a share of AGI were higher for itemizers with over $1 million in AGI than for any other income range.

Table 3. Amount of Itemized Deductions Claimed as a Share of the Adjusted Gross Income (AGI) of Itemizers, 2011

Adjusted Gross Income	Home Mortgage Interest	State & Local Taxes	Charitable Gifts	Real Estate Taxes	All Itemized Deductions
$0 to $20k	35.0%	5.5%	7.8%	18.3%	125.4%
$20k to $50k	14.0%	3.9%	3.7%	6.1%	42.7%
$50k to $100k	9.4%	4.2%	2.6%	3.9%	26.4%
$100k to $200k	7.2%	4.6%	2.1%	3.2%	19.9%
$200k to $250k	5.7%	5.1%	2.0%	2.9%	17.8%
$250k to $500k	4.5%	5.4%	2.1%	2.5%	16.4%
$500k to $1million	2.6%	5.9%	2.1%	1.9%	14.7%
+$1million	0.5%	6.4%	2.8%	0.8%	13.9%
All Itemizers	6.4%	5.0%	2.4%	3.1%	21.5%

Source: CRS analysis of the Internal Revenue Service's Statistics of Income 2011 Data, Table 2.1, at http://www.irs.gov/uac/SOI-Tax-Stats—Individual-Statistical-Tables-by-Size-of-Adjusted-Gross-Income.

Notes: Claim amounts are as reported before limits were applied. See footnote 6.

Which Itemized Deductions Contribute Most to Revenue Loss?

Some itemized deductions are classified as tax expenditures, or losses in federal tax revenue. **Table 4** shows the Joint Committee on Taxation (JCT) estimates for the top five itemized deductions that are expected, under current law, to contribute most to annual tax expenditures in FY2014. Tax expenditures are defined under the Congressional Budget and Impoundment Control Act of 1974 (P.L. 93-344) as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability."

The five itemized deductions that contribute most to tax expenditures in FY2014 are estimated to account for 18.8% ($208.1 billion) of the approximately $1.11 trillion in individual tax expenditures.[10] As shown in **Table 4**, the home mortgage interest deduction, which is estimated to

[9] Itemized deduction claims as a share of AGI were greater than 100% for the lowest AGI range because statutory adjustments (e.g., losses and other above-the-line deductions) lowered AGI below gross income levels.

[10] These calculations do not assume a change in tax filer behavior in response to interactive changes to one or more (continued...)

account for 6.5% ($71.1 billion) of annual tax expenditures in FY2014, is the largest tax expenditure claimed by tax filers. The mortgage interest deduction is also the fourth largest individual tax expenditure overall.[11] The deduction for state and local taxes is estimated to account for 4.7% ($51.8 billion) of FY2014 tax expenditures, followed by charitable gifts (3.9%), property taxes (2.6%), and medical and dental expenses (1.1%) above the 10% of AGI limit for 2014.

Table 4. Itemized Tax Deductions Estimated to Contribute Most to Revenue Losses in FY2014

Deduction Provision	Tax Expenditure Estimate in FY2014, (in billions of dollars)	Share of All Individual Tax Expenditures in FY2014[a]
Mortgage Interest Deduction	$71.7	6.5%
State & Local Income or Sales Taxes	$51.8	4.7%
Charitable Gifts	$43.6	3.9%
Real Estate Taxes	$28.6	2.6%
Medical Expenses	$12.4	1.1%

Source: CRS analysis of Joint Committee on Taxation (JCT), Estimates of Federal Tax Expenditures, For Fiscal Years 2012-2017, 113th Congress, 1st session, February 1, 2013, JCS-1-13 (Washington: GPO, 2013).

a. Based on the JCT publication, above, individual tax expenditures are estimated to be $1,109.3 billion and corporate tax expenditures are estimated to be $119.7 billion ($1,229 billion total) in FY2014. JCT does not provide a value for provisions that are estimated to be less than JCT's *de-minimus* amount of $50 million in revenue losses for FY2013 to FY2017. These calculations do not assume a change in tax filer behavior in response to interactive changes to one or more provisions.

Policy Implications

Congress might consider policies limiting itemized deductions.[12] Some view these limits as one way to increase federal revenue, increase the progressive structure of the federal income tax code, simplify the tax code, or reduce economic distortions in the tax code.[13] When a tax filer loses the

(...continued)

provisions. For example, elimination of the top five largest tax expenditures would lead to an estimated revenue gain in FY2014 less than $208.1 billion because some taxpayers might claim the standardized deduction rather than itemize their deductions.

[11] The largest individual tax expenditure overall is the exclusion of employer contributions for health care, health insurance premiums, and long-term care insurance premiums at $143.0 billion for FY2014. See Joint Committee on Taxation (JCT), Estimates of Federal Tax Expenditures, For Fiscal Years 2012-2017, 113th Congress, 1st session, February 1, 2013, JCS-1-13 (Washington: GPO, 2013).

[12] There is an income-triggered "limitation" on the value of itemized deductions (called "Pease," after Rep. Donald Pease who initially sponsored the legislative provision) for tax years 2013 and beyond. For tax filers affected by Pease, the total of certain itemized deductions is reduced by 3% of the amount of AGI exceeding the threshold. The total reduction, however, cannot be greater than 80% of the deductions. However, the Pease limit is triggered by income, not amount of deductions claimed, and is effectively an additive tax rate rather than a limit on itemized deductions. For more information, see CRS Report R42872, *Tax Deductions for Individuals: A Summary*, by Sean Lowry.

[13] Some say that itemized deductions should be limited because they distort economic behavior, by providing individuals with tax incentives to engage in activities that would otherwise be viewed as inefficient.

ability to take deductions, then their taxable income increases (absent other behavioral changes). Others seek to limit itemized deductions to increase progressivity in the tax code, where tax filers with higher incomes pay a larger share of their income in taxes than those with less income.

Arguments against broad limits to itemized deductions vary. The economic effects of limiting itemized tax deductions might be undesirable for some.[14] Those who are willing to accept the economic consequences of limits on itemized tax deductions might argue for reform of individual provisions, rather than broader limits, because the rationale for itemized deductions varies. For example, some might find the deduction for charitable contributions desirable but not the deduction for state and local income taxes.[15]

Others argue that higher-income tax filers already provide most of the revenue collected through the individual federal income tax, and might oppose further efforts to increase the progressivity of the federal income tax code. These concerns might arise because some high-income individuals are also small business owners, and higher taxation on their income (and, in turn, their business's profits), might have a negative effect on job creation.[16]

Some proposals to reform or limit itemized deductions include a flat, dollar-value cap on total deductions; a percentage limit on the value of deductions; converting deductions into credits, and various others.[17] Although this report does not assess these policies in depth, it does provides insights from the data analysis on itemized tax deductions that might be useful for informing the debate concerning reform options.

First, efforts to target limits on itemized tax deductions toward higher-income tax filers are restricted in the amount of revenue that can possibly be raised. During the 2012 presidential campaign, a flat-dollar value cap was suggested as one possible way to increase federal tax revenue. However, to avoid increasing the taxable income of most households, the dollar-value cap on total deductions would need to be set high enough that it will not be lower than the average deduction values for those in the middle or lower portion of the income distribution of tax filers. For example, **Table 1** suggests that a flat-cap of $25,000 would affect the average itemizer with an AGI above $100,000. However, estimates show that higher caps have more limited ability to raise revenue.[18] As **Figure 1** and **Table 1** show, there are fewer itemizers at top of the income distribution.

[14] For more detailed analysis, see CRS Report R43079, *Restrictions on Itemized Tax Deductions: Policy Options and Analysis*, by Jane G. Gravelle and Sean Lowry.

[15] However, eliminating deductions for one type of activity but not another might lead to unequal treatment of similar activities. For an example of how this might relate to deductions for charitable giving and the deduction for state and local taxes (SALT), see Martin A. Sullivan, "Economic Analysis: Why the SALT Deduction Is Always Under Attack," *Tax Notes*, December 17, 2012.

[16] For more information, see CRS Report R41392, *Small Business and the Expiration of the 2001 Tax Rate Reductions: Economic Issues*, by Jane G. Gravelle and Sean Lowry. The authors of this report estimate that between 2%-3% of small businesses were subject to the top marginal income tax rates in 2012.

[17] For a sample of policy options to limit itemized deductions, see Tax Policy Center (TPC), "Options to Repeal or Limit Itemized Deductions," at http://www.taxpolicycenter.org/taxtopics/Limit-Itemized-Deductions.cfm; Office of Management and Budget, *Fiscal Year 2013 Budget of the U.S. Government*, p.39, at http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/budget.pdf; Martin Feldstein, Daniel Feenberg, and Maya MacGuineas, *Capping Individual Tax Expenditure Benefits*, National Bureau of Economic Research, Working Paper 16921, April 2011, at http://papers.nber.org/papers/w16921.

[18] Prior to the permanent changes in marginal tax rates in the American Taxpayer Relief Act of 2012 (ATRA; P.L. 112-240), the TPC estimated a cap of $25,000 could raise between $1.18 trillion and $1.3 trillion in revenue over 10 years, (continued...)

Second, the form of a limit on itemized deductions might affect which deductions a tax filer might claim. If a tax filer potentially has deductions that exceed a flat-dollar value cap, then the tax filer must choose which deductions to actually claim. **Table 2** provides some estimates of which deductions may "fill" up a taxpayer's cap, if that cap is based on a flat dollar amount, whereas **Table 3** provides estimates under a limit in the form of a share of AGI.

A reduction in the tax benefits derived from activities eligible for tax deduction can possibly affect tax filer behavior. Deductible activities that are more easily adjustable in the short run (e.g., charitable giving) could be reduced after enactment of a limit on deductions in order to claim deductions from activities that are more difficult to adjust or plan for in the short-run (e.g., state and local taxes, or extraordinary medical expenses).[19] Over time, tax filers might adjust their behavior to accommodate for limits in itemized deductions (e.g., renting a residence might be more preferable for some, if they can no longer deduct the interest costs of their mortgage). However, a tax filer might still engage in particular activities for other reasons (although possibly to a lesser extent) even if the tax filer no longer can obtain a tax benefit from doing so.[20] **Figure 2** shows what share of a tax filer's itemized deductions are composed of tax-deductible behaviors that are relatively more difficult to adjust in the short run versus behaviors that are relatively easier to adjust in the short run.

In contrast, limits that are not tied to fixed, dollar-values could be structured in a way that does not cause a tradeoff in choosing which tax-deductible activity to claim. For example, these limits could be capped based on a share of the tax filer's income. Although these limits would be less likely to cause a tradeoff between tax-deductible activities, they may reduce the tax-beneficial value of these activities. By reducing the value of those activities (in terms of tax liability), a tax filer might choose to claim a smaller value of deductions related to a certain activity (based on the behavioral response for each activity).

Third, the extent to which a limit on itemized deductions increases revenue depends on its structure. Limits on itemized deductions increase the amount of income of itemizers that is subject to taxation, thereby increasing revenue. Limiting deductions might raise the taxable income of some individuals, thereby pushing them into a higher marginal tax bracket, and tax a higher share of their income at a higher marginal tax rate.[21] Certain combinations of deduction

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(...continued)

relative to a current law baseline and current policy baseline, respectively. In contrast, TPC estimated that a flat-cap of $50,000 could raise between $727 billion and $749 billion in revenue over 10 years. See Tax Policy Center, "T12-0273—Options to Repeal or Limit Itemized Deductions; Impact on Tax Revenue, 2013-2022," October 17, 2012, at http://www.taxpolicycenter.org/taxtopics/Limit-Itemized-Deductions.cfm.

[19] See Martin A. Sullivan, "Deduction Caps: The Next AMT?," *Tax Notes*, December 10, 2012.

[20] For example, some researchers argue that charitable gifts result in "consumption" benefits or "warm glow" for the giver, such as social recognition and personal satisfaction. Those tax filers who are more motivated by these consumption benefits might be less responsive to changes in tax preferences for charitable giving. See Roger Colinvaux, Brian Galle, and Eugene Steuerle, *Evaluating the Charitable Deduction and Proposed Reforms*, Urban Institute, June 2012, p. 9, at http://www.urban.org/UploadedPDF/412586-Evaluating-the-Charitable-Deduction-and-Proposed-Reforms.pdf. For analysis and estimates of the behavioral responses of charitable giving to itemized deduction caps, see CRS Report R40518, *Charitable Contributions: The Itemized Deduction Cap and Other FY2011 Budget Options*, by Jane G. Gravelle and Donald J. Marples.

[21] The effect of limiting (or repeal) of certain tax deductions on revenue would depend on how a proposal is structured. For more information see Leonard E. Burman, Christopher Geissler, and Eric J. Toder, "How Big Are Total Individual Tax Expenditures, and Who Benefits From Them," *American Economic Review*, Papers and Proceedings of the One Hundred Twentieth Annual Meeting of the American Economic Association, vol. 98, no. 2 (May 2008), pp. 79-83.

limits may shift some tax filers to claim the standard deduction instead of itemizing. In this case, the revenue increase by limiting itemized deduction would be partially offset by more tax filers claiming the standard deduction.

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