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Feeling Salty

How Eliminating the State and Local Tax Deduction Will Force Taxpayers to Take Out Billions in Debt to Pay for Tax Cuts for the Wealthy

The current debate in the U.S. Congress over national tax policy is fundamentally a fight over whether most of us will sacrifice to pay for tax cuts for the wealthy and corporations. Wall Street and the wealthy have long been pushing for tax reform that will further redistribute wealth upward. One way to reach that goal is the elimination of state and local tax (SALT) deductions. Not only will this amount to a regressive redistribution of wealth—since it would effectively take money from all of us and give it to a small group of rich people—it will also be a handout to big banks and wealthy bondholders.

FIGURE 1: The Tax Impact of Eliminating the SALT Deduction[1]

Adjusted Gross Income	Number of Deductions	Total Deducted	Tax Rate	Additional Tax Burden
Under $25K	3,061,430	$10,715,857,000	15.0%	$1,607,378,550
$25K to $50K	6,563,670	$26,377,106,000	15.0%	$3,956,565,900
$50K to $75K	7,603,690	$41,818,805,000	15.0%	$6,272,820,750
$75K to $100K	6,903,290	$50,018,752,000	25.0%	$ 12,504,688,000
$100K to $200K	13,915,460	$154,484,401,000	28.0%	$ 43,255,632,280
$200K to $500K	5,065,480	$115,726,717,000	33.0%	$ 38,189,816,610
$500K to $1M	805,020	$43,921,403,000	39.6%	$ 17,392,875,588
Over $1M	400,420	$109,645,122,000	39.6%	$ 43,419,468,312
Total	**44,318,460**	**$552,708,163,000**		**$ 166,599,245,990**

Because eliminating the SALT deduction at the federal level will raise taxes on families, it will make it harder for state and local governments to maintain current tax rates. This will lead to declining tax revenues at the state and local levels, and force public officials to borrow money to fill budget shortfalls. This will allow Wall Street banks and law firms to collect issuance fees and bondholders to collect billions in interest payments while cities and states cut vital services and get mired in debt.

Currently, families may deduct the income, sales, and property taxes they pay to state and local governments from their federal taxes. This means that taxpayers do not have to pay federal taxes on the income they use to pay state and local taxes. The SALT deduction is intended as a subsidy for state and local governments, since it helps reduce opposition to state and local taxes. The Republican tax bill proposes to eliminate the federal tax deduction for state and local income and sales taxes for families and to limit it for property taxes.[2] The bill exempts most businesses from this change, which means they will continue to be able to use the SALT deduction.[3]

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This means that, if state and local taxes remain steady at their current levels, families will see their federal taxes go up if the SALT deduction is eliminated. According to a report by the Government Finance Officers Association, taxpayers deducted $552 billion in state and local taxes in 2015.[4] If this deduction had not existed in 2015, the ***additional tax burden on those families would have been an estimated $167 billion*** (See Figure 1).

If federal taxes suddenly spiked by $167 billion, it would put pressure on state and local governments to lower their tax rates to offset the increased expense for families. They will address this in one of three ways: they will cut spending on public services by a certain amount, force taxpayers to absorb some of the additional expense, and borrow the rest. Borrowing to close budget gaps is particularly problematic because it creates even more opportunities for the upward redistribution of wealth by forcing taxpayers to pay issuance fees and interest.

For example, a 2015 study by the Haas Institute for a Fair and Inclusive Society at UC Berkeley and the ReFund America Project that looked at issuance fees for 812 bond issuances from around the country found that the weighted average for issuance fees in the sample was 1.02% of the initial bond principal.[5] Based on that, if state and local governments decided to borrow the entire $167 billion to offset the impact of eliminating the SALT deduction, ***they would likely pay $1.7 billion in issuance fees*** to the banks that underwrite the bonds, and the other financial and legal firms involved in the process of issuing the bonds. That is another $1.7 billion that they will not be able to spend on public services like education and healthcare.

The issuance fees are just the tip of the iceberg. On a conventional 30-year, fixed-interest rate bond, the interest payments over the life of the bond are roughly equal to the original principal. That means that if state and local governments borrow $167 billion, ***they will likely have to pay another $167 billion or so in interest to bondholders.*** This $167 billion in interest would also come at the expense of public services. Most municipal bonds offer relatively modest returns, but are exempt from federal taxes. As a result, the bondholders that invest in municipal bonds are often wealthy individuals whose main interest in the bonds is to use them as a tax shelter. This means that if state and local governments were forced to take out $167 billion in additional debt, much of the interest from those bonds would go to wealthy individuals.

In reality, it is unlikely that the additional tax burden from eliminating the SALT deduction would have a one-to-one correlation with increased state and local government borrowing. As mentioned above, if the SALT deduction is eliminated and federal taxes shoot up by $167 billion, state and local governments are unlikely to borrow that entire amount to offset the expense for taxpayers. They will cut spending on public services by a certain amount, force taxpayers to absorb some of the additional expense, and borrow the rest. That said, they will likely be forced to borrow tens of billions of dollars, which result in a windfall for the Wall Street banks, law firms, and wealthy bondholders who would get to collect tens of billions in issuance fees and interest payments.

Not coincidentally, the executives of these financial and legal firms and the wealthy individuals who invest in municipal bonds are some of the same people who will be the prime beneficiaries of tax plans that prioritize the interests of Wall Street and the wealthy. After all, the proposal to eliminate the SALT deduction in the first place is intended to pay for tax cuts for those same wealthy individuals. Under this plan, instead of making them pay their fair share in taxes, we will be forcing state and local governments to borrow that money from the wealthy instead and pay them back with fees and interest—billions of dollars that would be better spent on public services.

About the Authors

Saqib Bhatti and **Carrie Sloan** are with the **ReFund America Project** (RAP) of the **Action Center on Race & the Economy** (ACRE). RAP tackles the structural problems in the municipal finance system that cost governments across the United States billions of dollars each year at the expense of public services. ACRE focuses on the role that the financial sector plays in driving racial and economic inequality. Bhatti and Sloan research the role of financial deals in contributing to public budget distress and work with policy experts, community leaders, and public officials to develop, advocate for, and implement solutions to save taxpayer dollars.

Endnotes

1 *The Impact of Eliminating the State and Local Tax Deduction.* Government Finance Officers Association. 2017. 7-8. http://www.gfoa.org/sites/default/files/GFOA_SALT_09202017.pdf

2 Qiu, Linda. "Take Claims About State and Local Tax Deductions With a Grain of Salt." *New York Times*. 03 Nov 2017. https://www.nytimes.com/2017/11/03/us/politics/fact-check-state-local-taxes-republican.html

3 Sahadi, Jeanne. "There's a loophole in GOP's plan to kill the state and local tax deduction." *CNN Money*. 07 Nov 2017. http://money.cnn.com/2017/11/07/news/economy/state-and-local-tax-deduction-loophole/index.html

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5 Joffe, Marc. *Doubly Bound: The Costs of Issuing Municipal Bonds*. Haas Institute for a Fair and Inclusive Society and ReFund America Project. 2015. 9-10. http://haasinstitute.berkeley.edu/sites/default/files/haasinstituterefundamerica_doublybound_cost_of_issuingbonds_publish.pdf