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Reforming “Itemized Deduction” Tax Break Could Save States Billions, Make State Tax Systems Less Unfair

Itemized deductions cost more than 30 states billions of dollars in income tax revenue annually while undermining the fairness of state tax systems, a new report shows. Moreover, federal tax changes enacted during the presidency of George W. Bush have gradually made itemized deductions even more unfair and expensive over the last five years, automatically passing tax cuts onto states’ wealthiest residents even as state governments face unprecedented budget challenges. Itemized deduction reform could play a positive role in making state tax systems fairer and more sustainable.

A new report from the Institute on Taxation and Economic Policy, [*“Writing Off” Tax Giveaways: How States Can Help Balance Their Budgets by Reforming or Repealing Itemized Deductions*](#) presents estimates of the yield and tax fairness impact of five approaches to itemized deduction reform in the states, each of which would raise significant revenue to fund vital public services and make state tax systems less unfair.

Itemized deductions were designed to help defray a wide variety of personal expenditures that affect a taxpayer’s ability to pay taxes, including charitable contributions, extraordinary medical expenses, mortgage interest payments and state and local taxes. Yet, the deductions undermine the fairness of state tax systems: low-income families receive virtually no benefit from these deductions, and the biggest benefits are reserved for the upper-income families who arguably need them the least.

“No lawmaker would ever devise a spending program to encourage homeownership that gave the biggest checks to the richest taxpayers, while entirely excluding low-income families,” noted ITEP State Tax Policy Director Meg Wiehe. “Yet itemized deductions have exactly that effect.”

The most comprehensive reform approach available to states is simply to repeal all itemized deductions and ensure that most middle- and low-income families are held harmless by simultaneously increasing the basic standard deduction available to all families, a step taken this year by the Rhode Island legislature. The report presents four additional reform options, most of which have been enacted in some form in a number of states: capping the total value of itemized deductions, converting itemized deductions to credits, enacting stand-alone phaseouts, and decoupling from the recent federal tax changes.

Wiehe noted, “In the current fiscal and economic climate, state policymakers can ill afford to maintain these costly and unfair tax breaks in their current form. By enacting sensible itemized deduction reforms, lawmakers can prevent federally-imposed tax cuts for the wealthiest few from affecting their own budget—and can raise substantial revenues to fund needed public investments.”