

The State and Local Tax Deduction and Fiscal Federalism

by Alex Zhang



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In this article, Zhang argues that the Tax Cuts and Jobs Act's limit on the state and local tax deduction undermined the deduction's effectiveness, thus underscoring the inherent defects and obstacles in advancing federalism with a tax measure.

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I. Introduction

Enacted in a highly polarized political environment, the Tax Cuts and Jobs Act¹ is a major revision to the U.S. tax code.² Among other things,

the TCJA lowered the corporate income tax rate to 21 percent;³ overhauled the international tax rules by imposing, for example, a 10.5 percent tax on global intangible low-taxed income;⁴ and moved the U.S. tax system toward consumption taxation by means of immediate expensing for some and accelerated depreciation for others.⁵ Political responses to the enactment of the TCJA frequently fell on the extremes. In the House, while then-Minority Leader Nancy Pelosi, D-Calif., described the tax bill as “simply theft — monumental, brazen theft from the American middle class and from every person who aspires to reach it,” then-Speaker Paul Ryan characterized the bill as giving the people of this country their money back.⁶ In the Senate, the tax bill passed with a 51-48 vote, with no Democrat supporting it and no Republican voting against it.⁷

Among the TCJA's many reforms, perhaps none was more controversial and polarizing than limiting the state and local tax deduction to \$10,000.⁸ Because higher-tax jurisdictions, whose residents take more SALT deductions, tend to be more liberal-leaning, limiting the SALT deduction to \$10,000 was widely seen as the Republican Party's rebuke to Democratic states and voters. In

³ Section 13001, 131 Stat. at 2096 (codified at IRC section 11).

⁴ Section 14201, 131 Stat. at 2288 (codified at IRC section 951A). Since the corporate tax rate is 21 percent, and IRC section 250 allows a 50 percent deduction, the effective tax rate on GILTI is 10.5 percent. Starting in 2026, the TCJA will reduce the 50 percent deduction to 37.5 percent, resulting in an effective tax rate of 13.125 percent on GILTI. Section 250(a)(3)(B).

⁵ See, for example, section 168(k), which permits 100 percent bonus depreciation for some property (in general, property with a life of shorter than 20 years) through 2022, with bonus depreciation percentage then phased out; and section 179, which permits small businesses to deduct immediately the cost of some tangible business property, up to \$1 million per year.

⁶ Thomas Kaplan and Alan Rappeport, “Republican Tax Bill Passes Senate in 51-48 Vote,” *The New York Times*, Dec. 19, 2017.

⁷ *Id.*

⁸ Section 11042, 131 Stat. at 2085 (codified as amended at IRC section 164).

¹ An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, P.L. 115-97, 131 Stat. 2054 (2017) (codified in scattered sections of U.S. Code title 26).

² See, e.g., Michael J. Graetz, “Foreword — The 2017 Tax Cuts: How Polarized Politics Produced Precarious Policy,” 2018 *Yale L.J. Forum* 315, 315 (2018).

the House, the TCJA passed with no Democratic support but with the defection of 12 Republican representatives, 11 of whom were from New York, New Jersey, and California, whose constituents might see their tax bills rise despite a federal tax cut.⁹ From the Republican perspective, the House Ways and Means report identified two main justifications for limiting SALT deductions: “scaling back existing tax incentives, including the deduction for State and local taxes, makes the system simpler and fairer for all families and individuals, and allows for lower tax rates.”¹⁰ The committee’s stated twofold aim — (horizontal) equity and enabling a regime of lower federal tax rates — mirrors the recommendations articulated by various conservative think tanks immediately before the TCJA’s enactment. The Heritage Foundation, for example, criticized the distributional impact of the SALT deduction and argued that it “resulted in federal taxpayers in low-tax, low-debt states subsidizing taxpayers in high-tax, high-debt states.”¹¹ Eliminating the deduction would then “end the subsidy for bad state economic policies . . . and allow for a revenue-neutral and distribution-neutral reduction of up to 16.4 percent in federal tax rates.”¹² Democrats, on the other hand, denounced the limit on SALT deductions as a “deliberate attack on those ‘states that overwhelmingly voted against Donald Trump.’”¹³ Media outlets noted that the states most affected by the limit — the

ones with the highest average SALT deductions per household — voted for Hillary Clinton in 2016 with high margins.¹⁴ New York Gov. Andrew Cuomo (D), for example, vehemently criticized the TCJA’s limit on SALT deductions as an “economic missile” directed at his state, “an attempt to hurt Democratic states,” and “totally repugnant and hypocritical of the fundamental conservative ideology which [Republicans] preach — the limited federal government, respect [sic] state rights.”¹⁵ After the bill passed in the Senate, Minority Leader Charles E. Schumer, D-N.Y., vowed that the 2017 tax legislation “will be an anchor around the ankles of every Republican.”¹⁶

Even after the dust settled, high-tax states particularly those on the East Coast — continued the fight against the limit on SALT deductions in extraordinary ways. In July 2018 Connecticut, Maryland, New Jersey, and New York filed a lawsuit in federal court, arguing that the limit on SALT deductions violated the 10th Amendment and exceeded Congress’s taxing power.¹⁷ In addition to litigation, high-tax states attempted practical workarounds of the TCJA limit. New York, for example, considered allowing taxpayers to transfer to state-government-controlled entities funds that would be fully deductible as charitable contributions. The state would then grant a credit equal to the transferred amount to offset the taxpayer’s state tax liability.¹⁸ Beyond the charitable contribution workaround, New York also tried to circumvent the TCJA limit by converting the income tax into a payroll tax that

⁹ Sarah Almukhtar et al., “How Each House Member Voted on the Tax Bill,” *The New York Times*, Dec. 19, 2017.

¹⁰ H.R. Rep. No. 115-409, at 165 (2017). Of course, it is hard to see why limiting SALT deductions to \$10,000 would aid simplicity — after all, the deduction remains on the tax form, and taxpayers would still look at the state and local taxes that they have paid before determining how much (either the total amount that they have paid or the TCJA maximum of \$10,000) to deduct.

¹¹ Rachel Greszler, Kevin Dayaratna, and Michael Sargent, “Why Tax Reform Should Eliminate State and Local Tax Deductions,” Heritage Foundation, at 2 (Oct. 16, 2017). This argument — that SALT deductions result in low-tax states subsidizing high-tax states — ignores the uneven distribution of federal expenditures across states. SALT deductions, before the TCJA’s limit, may indeed contribute to an inflated marginal tax rate (like any other tax expenditure), but this “subsidy” takes place against the background of enormous imbalance in federal expenditures, which tend to favor low-tax jurisdictions. Part of the purpose of this article is to examine how much SALT deductions, as a tax expenditure, make up for this imbalance, which we can see as high-tax jurisdictions subsidizing low-tax jurisdictions through uneven distribution of federal spending. See *infra* Section III.B.

¹² *Id.* at 1.

¹³ Sasha Abramsky, “The GOP Tax Bill Was a Deliberate Attack on Blue States — and California Plans to Fight Back,” *The Nation*, Jan. 6, 2018.

¹⁴ See, e.g., Alicia Parlapiano and K.K. Rebecca Lai, “Among the Tax Bill’s Biggest Losers: High-Income, Blue State Taxpayers,” *The New York Times*, Dec. 5, 2017; and Carolyn Y. Johnson, Reuben Fischer-Baum, and Aaron Williams, “Blue States Will Be Hit Hardest by GOP Tax Plan’s Limits on Deductions,” *The Washington Post*, Nov. 3, 2017.

¹⁵ Jesse McKinley, “New York and New Jersey File Suit Against Trump Tax Plan,” *The New York Times*, July 17, 2018.

¹⁶ Kaplan and Rapoport, *supra* note 6. Schumer’s predictions turned out to be accurate: In the 2018 midterm elections, congressional districts with high SALT deductions disproportionately voted for Democrats, who picked up 14 seats among the 50 districts with the highest percentage of tax returns claiming SALT deductions. See Noah Zwiefel, “Did SALT-y Voters Punish Republicans in 2018?” Urban-Brookings Tax Policy Center (Oct. 8, 2019).

¹⁷ Complaint and Demand for Jury Trial, *New York v. Mnuchin*, 18-CV-6427 (JPO), 2019 WL 4805709 (S.D.N.Y. Sept. 30, 2019).

¹⁸ Rapoport and Jim Tankersley, “I.R.S. Warns States Not to Circumvent State and Local Tax Cap,” *The New York Times*, May 23, 2018.

employers can deduct from their employees' federal tax bill.¹⁹

As of today, neither litigation nor the practical workarounds have succeeded.²⁰ In 2018 the IRS promulgated a notice informing taxpayers that it would invoke the substance-over-form doctrine and decline to characterize the transferred funds as charitable contributions.²¹ In 2019 a federal district court granted the federal government's motion to dismiss the four states' constitutional challenge to the TCJA cap on SALT deductions.²² In dismissing the lawsuit, the court acknowledged that the cap is "in some ways unprecedented" and that an uncapped deduction for state income and property (albeit not sales) taxes has been "a mainstay of the federal income tax since that tax's earliest inception."²³ Nevertheless, the court held that the TCJA cap does not violate the 10th Amendment, since the states "remain free to exercise their tax power however they wish," and the lone fact that a piece of legislation "affects the decisional landscape within which states must choose how to exercise their own sovereign authority" does not "render[] the law an unconstitutional infringement of state power."²⁴ Regarding the states' argument that the TCJA cap coerces the states into changing their tax policies to align with the federal government's preferences, the court noted that Article I of the Constitution²⁵ "permits Congress to enact a tax that does not 'fall[] equally or proportionately on each State,' as long as the tax 'operates with the same force and effect in every place.'"²⁶ In response to the court's decision, Cuomo declared that the state would consider appealing, as "this policy is unprecedented, unlawful, punitive and politically motivated — and it must be stopped."²⁷

The legal challenge, however, is unlikely to succeed. After all, Congress has limited SALT deductions in the past by the (admittedly less explicit) means of the alternative minimum tax,²⁸ and it is unclear how the TCJA cap is different in a constitutionally relevant way.²⁹

Thus, much of the recent debate on SALT deductions has focused on the political nature of the TCJA cap, with liberal-leaning (often high-tax) states denouncing it as an unfair attack and conservative-leaning (often low-tax) states characterizing it as a reform for the sake of equity and lower marginal tax rates. Given the polarized political environment, this is perhaps unsurprising. But missing from this debate is the (critical) function that SALT deductions have so far fulfilled in our constitutional system of federalism.³⁰ All the way from the founding era, a central tenet of federalism posits that state and local governments must maintain their ability to tax (and therefore to spend, in accordance with the preferences and priorities of the local communities).³¹ An intense object of debate leading up to the ratification of the Constitution concerned the broad taxing power granted to the federal government under Article I, and more precisely, whether state and local governments could continue to raise revenue after the federal government chose to exercise its taxing power.³² The Revenue Act of 1862³³ — the first federal

²⁸ Section 55.

²⁹ See also Casselman, *supra* note 27.

³⁰ See also Kirk J. Stark, "Fiscal Federalism and Tax Progressivity: Should the Federal Income Tax Encourage State and Local Redistribution?" 51 *UCLA L. Rev.* 1389, 1396 (2004) ("One of the principal features of American fiscal federalism is the federal income tax deduction allowed for taxes paid to state and local governments.").

³¹ See Julie Roin, "The Consequences of Undoing the Federal Income Tax," 70 *U. Chi. L. Rev.* 319, 332 (2003) (explaining the common fear that "the elimination of the deduction for state and local taxes will reduce subordinate governments' ability to generate tax revenue").

³² Compare *The Federalist* No. 31 (Alexander Hamilton) (describing and rejecting as speculative the fear that "all the resources of taxation might by degrees become the subjects of federal monopoly, to the entire exclusion and destruction of the State governments") with *The Anti-Federalist* No. 6 (Brutus) (observing that if taxpayers could not afford to pay a federal tax and a state tax, they would forgo paying the state tax because of the supremacy clause, with the result that "the respective state governments will not have the power to raise one shilling in any way, but by the permission of the Congress").

³³ An Act to Provide Internal Revenue to Support the Government and to Pay Interest on the Public Debt, section 91, 12 Stat. 432, 473-74 (1862) ("[A]ll other national, state, and local taxes, lawfully assessed upon the property or other sources of income of any person . . . shall be first deducted from the gains, profits, or income.").

¹⁹ *Id.*

²⁰ See also Eric Rasmusen, "Getting Around the State and Local Tax Deduction Limit," SSRN Working Paper (Jan. 9, 2018).

²¹ IRS Notice 2018-54, "Guidance on Certain Payments Made in Exchange for State and Local Tax Credits."

²² *New York v. Mnuchin*, 2019 WL 4805709.

²³ *Id.* *12.

²⁴ *Id.* *13.

²⁵ U.S. Const. Art. I, section 8.

²⁶ *New York v. Mnuchin*, 2019 WL 4805709, at *15 (quoting *United States v. Ptasynski*, 462 U.S. 74, 82, 103 (1983)).

²⁷ Ben Casselman, "Tax Law's Cap on State and Local Deductions Is Upheld by Court," *The New York Times*, Sept. 30, 2019.

personal income tax, enacted at the height of the Civil War — allowed deductions for state and local taxes out of a desire to preserve taxable resources for state governments.³⁴ The last time Congress (together with the Reagan administration) seriously considered eliminating the SALT deduction was during the 1986 tax reform.³⁵ Despite political pressure and substantial academic commentary,³⁶ the 1986 Tax Reform Act kept intact the deduction for state and local income and property taxes and repealed only the deduction for state sales taxes.³⁷ This decision was at least partially motivated by the recognition that fully eliminating the SALT deduction would impair state and local government's ability to raise revenue and provide services.³⁸

Today, perhaps even more so than earlier, maintaining a system of federalism requires preserving state and local governments' ability to tax and spend — the power to tax, after all, is an important (some might argue, necessary) component of sovereignty. The federal government spends more than \$3 trillion in the states every year³⁹ — more than the total expenditures of all states and localities combined⁴⁰ — and the distribution of federal expenditures is highly uneven among states and localities.⁴¹ Delaware, for example, can expect to receive only 68 cents of federal spending for each \$1 it pays into the federal

treasury, while New Mexico or West Virginia can expect \$3.52 of federal spending for each \$1.⁴² The continued existence of federalism, under which each state or locality can provide services and effectuate policy in accordance with local preferences, requires mitigating this vast imbalance in federal expenditures.

This article examines the SALT deduction as a mechanism of fiscal federalism by analyzing the effect of the deduction, calculated as tax expenditures by state, on the imbalance of federal expenditures. I take seriously the idea that the SALT deduction constitutes a form of federal subsidy to the states, and a subsidy that naturally benefits states that impose heavier tax burdens on their residents.⁴³ At the same time, the imbalance of federal expenditures generally (although not perfectly) leans in favor of low-tax jurisdictions, which benefit less from the subsidy of SALT deduction but more from federal spending in general. This article argues that, on the whole, the SALT deduction was an effective, albeit imperfect, means of mitigating the imbalance of federal expenditures before the 2017 tax legislation. The TCJA's limit on the SALT deduction vastly undermined this effectiveness, while underscoring the inherent defects and obstacles in advancing federalism with a tax measure.

To this end, Section II of this article briefly reviews and situates it within previous scholarship. Section III presents the data and analysis for the imbalance of federal expenditures and the estimated effect of the SALT deduction, before and after the 2017 tax legislation, on this imbalance. The last section concludes and briefly discusses some of the shortcomings in effectuating federalism with the SALT deduction.

II. Literature Review

This part situates this article's main arguments within two strands of previous scholarship: the deductibility of SALT and the broader relationship between taxation and federalism.

³⁴ See 37 *Congressional Globe* 1194 (Mar. 12, 1862) (statement of House Ways and Means Committee member Justin Morill) ("It is a question of vital importance to [the several states] that the General Government should not absorb all their taxable resources.").

³⁵ See, e.g., U.S. Treasury Department, *Tax Reform for Fairness, Simplicity and Economic Growth* 78 (1984).

³⁶ See, e.g., Nonna A. Noto and Dennis Zimmerman, "Limiting State-Local Tax Deductibility: Effects Among the States," 37 *Nat'l Tax J.* 539, 546 (1984) (recommending imposing a percentage AGI floor as a way of limiting SALT deduction).

³⁷ See Tax Reform Act of 1986, P.L. 99-514, section 134, 100 Stat. 2085, 2116. In 2004 Congress reintroduced the deduction for state sales taxes, although taxpayers must choose between deducting income taxes or sales taxes. See American Jobs Creation Act, P.L. 108-357, 118 Stat. 1418 (2004).

³⁸ Stark, *supra* note 30, at 1405 (noting the recognition that "eliminating the deduction would raise the tax price of public goods for itemizing taxpayers, thereby reducing their demand for state and local government services and 'impairing cities' ability to provide public services" (quoting U.S. Conference of Mayors)).

³⁹ See *infra* Section III.A.

⁴⁰ In 2016 state and local governments spent approximately \$2.9 trillion, roughly equally divided between the states and the local governments. See Urban Institute, "State and Local Finance Initiative."

⁴¹ See *infra* Section III.A.

⁴² See *infra* Table 1.

⁴³ See, e.g., Greszler, Dayaratna, and Sargent, *supra* note 11; William B. Barker, "The Tax Cuts and Jobs Act of 2017: The SALT Deduction, Tax Competition, and Double Taxation," 56 *San Diego L. Rev.* 73, 100 (2018) ("The SALT deduction supports state taxation by providing a subsidy for a state's own source revenue.").

First, much has been written about whether state and local taxes should in fact be deductible in the federal income tax regime. Opponents of deductibility have made a wide range of theoretical and practical arguments.⁴⁴ The most prominent one relies on the Haig-Simons intuition that an income tax system should include in its base both consumption and savings — since state and local taxes are generally collected to provide benefits to the resident taxpayers, they should not be deductible like any other items of ordinary consumption.⁴⁵ In other words, the merely mechanical fact that state and local governments function as intermediate providers does not render the distributed benefits a deductible expense — fire stations or public education are services that taxpayers cannot deduct (if they have to pay for them). Deductibility, by reducing the costs of providing local services, might indeed encourage overprovision of purely local services that do not have positive spillover effects.⁴⁶ Progressivity of the federal income tax rates also implies that the SALT deduction is an upside-down subsidy that favors higher-income households — the AMT mitigates, but does not fully eliminate, this

regressivity.⁴⁷ Opponents of the SALT deduction also argue that it engenders inequities in the federal income tax: Lower-tax jurisdictions, in effect, subsidize higher-tax jurisdictions, leading to an uneven distribution in the provision of local services. Further, the deduction results in the federal government's imposition of much higher tax rates in order to collect the same amount of revenue.⁴⁸

Scholars favoring SALT deductibility have put forth an equally wide range of arguments. The earlier approaches focus on horizontal equity — if taxpayers in two different jurisdictions receive the same pretax income but must pay differing amounts of state and local taxes, then it seems inequitable to subject them to the same federal tax liability.⁴⁹ The equity-based argument for deductibility has also found some support in recent behavioral-law-and-economics scholarship: Taking into account both the imperfect rationality of taxpayers and federalism concerns, professor Brian Galle argues, on equity grounds, that at least *some* state and local taxes should be deductible (for example, when state benefits and burdens are not correlated because of taxpayers' cognitive biases).⁵⁰ In response to the arguments regarding the regressivity of the SALT deduction, scholars have noted the progressive nature of state and local tax

⁴⁴ See generally Daniel Hemel, "Easy on the SALT: A Qualified Defense of the Deduction for State and Local Taxes," Coase-Sandor Working Paper Series in Law & Economics (Oct. 28, 2017) (providing a survey of arguments urging the repeal of the SALT deduction).

⁴⁵ See Louis Kaplow, "Fiscal Federalism and the Deductibility of State and Local Taxes Under the Federal Income Tax," 82 *Va. L. Rev.* 413, 417 ("Commentators increasingly agree that an important factor bearing on the appropriateness of deductibility is whether individuals' state and local tax payments are closely related to the public services that individuals receive. . . . The simplest argument against deductibility — that state and local taxes equal benefits received — is stronger in principle than most arguments favoring deductibility.").

⁴⁶ See Stark, *supra* note 30, at 1393 ("For every dollar of state or local taxes that is deductible for federal income tax purposes, the taxpayer, in effect, receives a rebate from the federal government. This rebate . . . reduces the tax price that local residents face for public goods provided by state and local governments."); and Frank Sammartino and Kim Rueben, "Revisiting the State and Local Tax Deduction," Urban-Brookings Tax Policy Center, at 7 (Mar. 31, 2016) (the SALT deduction "can also distort choices about the level of subnational government spending, and rather than encouraging state and local governments to provide services that generate national benefits, it may only encourage subnational governments to spend more on strictly local goods and services").

⁴⁷ See, e.g., Stark, *supra* note 30, at 1433 ("As currently structured, this SALT deduction is a highly regressive federal subsidy."); and Gladriel Shobe, "Disaggregating the State and Local Tax Deduction," 35 *Va. Tax Rev.* 327, 375 (surveying the traditional argument that "state and local tax deduction disproportionately benefits the wealthy because the wealthy pay more in taxes and are therefore able to deduct more, and because the federal itemization regime makes it so that most low earners receive no benefit from itemization").

⁴⁸ See, e.g., Greszler, Dayaratna, and Sargent, *supra* note 11 (arguing that elimination of the SALT deduction can fund up to a 16 percent reduction in federal taxes); and Adam Michel, "The SALT Cap Is Fair Treatment for States and Congressional Districts," Heritage Foundation (Aug. 29, 2018) ("The SALT deduction should be fully repealed. The write-off is an unfair federal subsidy for high-income taxpayers in high-tax states.").

⁴⁹ See, e.g., Linda M. Beale, "Congress Fiddles While Middle America Burns: Amending the AMT (and Regular Tax)," 6 *Fl. Tax Rev.* 811, 862 (2004) ("Taxpayers who live in states with low property taxes and no state income taxes usually will enjoy their full income after federal taxes, while taxpayers who live in a state with high property taxes and high state income taxes often will pay tax on the income that is paid to the state due to the AMT. This appears, at least at first glance, as an inequity between taxpayers based on pure geographical happenstance." (footnote omitted)).

⁵⁰ See Brian Galle, "Federal Fairness to State Taxpayers: Irrationality, Unfunded Mandate, and the 'SALT' Deduction," 106 *Mich. L. Rev.* 805, 851 (2008) ("Where once it was said that paying SALT is simply a freely chosen consumption choice, such that no deduction could ever be justified, there now is at least a possibility that, depending on empirical findings, some deduction could be warranted.").

itself, which generally imposes higher marginal tax rates on higher brackets of income — indeed, the very regressivity of the SALT deduction may encourage progressivity in state and local taxation, because those jurisdictions can impose higher tax rates on high earners, who receive federal subsidies in the form of deductions.⁵¹ (For the sake of clarity, it is important to note that SALT deductions may function as two forms of subsidies: *First*, the state and local governments receive a federal subsidy that finances state and local taxation — the thought is that state and local governments can extract \$100 of tax revenue that costs, for example, only \$80 to the local taxpayers;⁵² and *second*, assuming that taxpayers receive some benefits from state and local expenditures that are roughly proportional to their state and local tax burdens, the taxpayers receive a federal subsidy that finances their “purchase” of public goods — for example, fire services and public education.⁵³) More recently, scholars have advanced more qualified defenses of deductibility. Some have disaggregated the SALT deduction, contending that state taxes should be deductible while local taxes should not.⁵⁴ Others have suggested that the SALT deduction be allowed at least insofar as the revenues fund educational and healthcare expenditures, and to the extent that allowing a charitable contribution deduction while repealing the SALT deduction would distort the collective financing of public goods.⁵⁵

Second, various scholars have recently challenged the idea that state and local taxation (in its current form) contributes positively to our constitutional system of federalism. According to conventional wisdom, state and local taxation creates risks for discrimination against interstate

commerce and export of tax burden to out-of-state residents. But these risks are mitigated by a variety of factors, including that (1) state and local governments tend to be more responsive to voters, so preserving their ability to tax increases democratic accountability in a tax regime;⁵⁶ (2) market forces and benefits of reciprocity impede tax exporting;⁵⁷ and (3) taxpayers can always leave if they are unsatisfied with their state and local taxes.⁵⁸ In an influential article, professor Daniel Shavero argues that these traditional assumptions are inaccurate, and that states’ taxing authority should be confined to “the determination of tax rates, not the precise contours of the tax bases to which they apply these rates.”⁵⁹ While Shavero emphasizes that he does not wholly reject federalism in taxation, he says the balance is askew — states and localities now have more control over taxation than efficiency would allow, because the costs of tax decentralization exceed the benefits.⁶⁰ More recent scholarship has focused on “vertical externalities,” which take place when state and local tax policies “inflict costs on the federal government, at the expense of national welfare.”⁶¹ Such “tax cannibalization,” to which the SALT deduction contributes, gives “the federal government [] a large and direct stake in state government tax policy decisions.”⁶²

This article fits into previous scholarship in two ways. First, by showing that the SALT deduction, calculated as tax expenditures by state, ameliorates the imbalance of federal expenditures, the article supplies an additional rationale for SALT deductibility. As philosophers have pointed out, justice in taxation cannot be separated from justice in expenditure.⁶³ Previous scholarship has focused

⁵¹ See Stark, *supra* note 30, at 1394.

⁵² The precise cost would, of course, depend on the average effective (federal) marginal tax rate of the local taxpayers; if the rate is 20 percent, for example, then for every \$100 of state and local taxes they pay, the true cost — taking into account the \$100 SALT deduction and the resultant \$20 savings in federal tax liability — is \$80.

⁵³ See also Kaplow, *supra* note 45, at 420-430.

⁵⁴ See Shobe, *supra* note 47, at 327 (“[T]he arguments for the deduction apply more strongly to states while the arguments against the deduction apply more strongly to localities.”). Of course, this distinction is a matter of degrees rather than nature. A more precise demarcation for deductibility of state, compared with local, taxes would depend on whether (and the extent to which) state and local taxpayers make use of, for example, public education (usually financed through local property taxes) or Medicaid (usually financed by the states with some federal support).

⁵⁵ See Hemel, *supra* note 44, at 3-4.

⁵⁶ See Larry D. Kramer, “Putting the Politics Back Into the Political Safeguards of Federalism,” 100 *Colum. L. Rev.* 215, 222 (2000); and Michael W. McConnell, “Federalism: Evaluating the Founders’ Design,” 54 *U. Chi. L. Rev.* 1484, 1493 (1987).

⁵⁷ See Charles E. McLure Jr., “Tax Exporting and the Commerce Clause,” *Fiscal Federalism and the Taxation of Natural Resources* 169 (1983).

⁵⁸ See Charles M. Tiebout, “A Pure Theory of Local Expenditures,” 64 *J. Pol. Econ.* 416 (1956).

⁵⁹ Daniel Shavero, “An Economic and Political Look at Federalism in Taxation,” 90 *Mich. L. Rev.* 895, 897 (1992).

⁶⁰ *Id.*

⁶¹ See David Gamage and Darien Shanske, “Tax Cannibalization and Fiscal Federalism in the United States,” 111 *N.W. L. Rev.* 295, 298 (2017).

⁶² *Id.* at 301.

⁶³ See Liam Murphy and Thomas Nagel, *The Myth of Ownership: Taxes and Justice* 25 (2002).

on the SALT deduction purely as a tax measure, without considering how it relates to (and pales in comparison to) the vast imbalance in federal expenditures. Second, by showing that the SALT deduction only imperfectly makes up for this imbalance — and that the TCJA has exacerbated this imperfection — the article suggests that there are inherent limits to using a tax measure to effectuate federalism.

III. SALT Deduction and the Imbalance of Federal Expenditures

This part is divided into three sections. Section A presents the data for federal expenditures for fiscal 2017, which shows a highly uneven distribution across states, especially when we consider each state's contribution to federal tax revenue. Section B presents the data and analysis for the SALT deduction's effectiveness in mitigating this uneven distribution before the TCJA's limit. Section C examines the TCJA's impact.

A. The Uneven Distribution of Federal Spending

Table 1 illustrates the imbalance of federal expenditures across states in fiscal 2017. As indicated in the table, column A shows the federal tax revenues by state, including business income, individual income, employment, estate, gift, and excise taxes (though individual income taxes constitute the vast majority of the federal tax revenues for most states).⁶⁴ Column B shows the federal government's spending in the states, including direct payments for individuals (for example, through the Social Security or Medicare programs), federal grants for state and local governments, federal procurement contracts, and wages for federal workers.⁶⁵ Column C shows the per capita federal expenditure by state.⁶⁶ Column D shows the overall balance of federal tax revenue

and federal expenditure, while column E shows the per capita balance. Column F, lastly, shows the ratio of federal expenditure to revenue by state. Amounts in columns A, B, and D are in millions of dollars.

As Table 1 demonstrates, the distribution of federal expenditures is highly uneven among the states, especially when we consider the federal tax revenue that comes from each state. First, even if we look only at federal spending and remove Virginia and Maryland from consideration (since these two states — home to many federal agencies — receive an abnormally large amount of federal funds), per capita federal expenditures still range from \$7,701 to \$17,554. This implies that Alaska is receiving 2.28 times as much in federal expenditures per capita as Utah, and that outlier states can expect to receive approximately 50 percent more in federal spending than median states.

Second, when we take into account each state's contribution to federal tax revenue, framing the uneven distribution as an imbalance between what the state contributes to the federal treasury (column A) and what the state receives from federal spending (column B), the results are even more striking. While 37 states receive surpluses (that is, they receive more federal money than they generate), 13 states suffer from deficits (that is, they receive less federal money than they generate). Many of the surpluses and deficits are substantial: On a per capita basis, 13 states can expect to receive over \$5,000 more in federal expenditures than they put into the federal treasury, while four states must put \$5,000 more into the federal treasury than they receive in federal expenditures. Three of these four states — Connecticut, Massachusetts, and New Jersey — are traditionally regarded as high-tax jurisdictions and take some of the highest per capita SALT deductions. These states can expect to get about 70 cents back from the federal government for each \$1 they put in. In contrast, 11 states can expect to get \$2 or more back from the federal government for each \$1 they put in.⁶⁷

⁶⁴ Data for column A comes from the IRS. See IRS, "Gross Collections, by Type of Tax and State, Fiscal Year 2017."

⁶⁵ Data for column B comes from Laura Schultz and Michelle Cummings, "Giving or Getting? New York's Balance of Payments With the Federal Government: 2019 Report," Rockefeller Institute of Government (Jan. 8, 2019). The U.S. Census Bureau used to collect data on federal expenditures, but think tanks have undertaken this task (using the same method as the Census Bureau) after the federal government stopped funding the project.

⁶⁶ Population estimates for 2017 come from the Census Bureau. See U.S. Census Bureau, "State Population Totals and Components of Change 2010-2019."

⁶⁷ These states are Alabama, Alaska, Hawaii, Kentucky, Maine, Mississippi, Montana, New Mexico, South Carolina, Virginia, and West Virginia. None of these states, except Virginia (again, because many federal agencies and offices are located there), are traditionally regarded as high-tax states.

Table 1. Distribution of Federal Revenues in FY 2017

State	A Federal Tax Revenue	B Federal Expenditures	C Per Capita Expenditure	D Balance of Federal Payments	E Per Capita Balance	F Ratio of Expenditure to Revenue
Alabama	26,584	65,751	13,487	39,167	8,034	2.473
Alaska	5,400	12,986	17,554	7,586	10,254	2.405
Arizona	43,928	82,812	11,748	38,884	5,516	1.885
Arkansas	32,458	35,129	11,698	2,671	889	1.082
California	440,475	436,092	11,069	-4,383	-111	0.990
Colorado	56,742	57,458	10,231	716	127	1.013
Connecticut	57,540	41,129	11,508	-16,411	-4,592	0.715
Delaware	17,081	11,546	12,064	-5,535	-5,784	0.676
Florida	192,869	237,654	11,329	44,785	2,135	1.232
Georgia	94,277	104,541	10,039	10,264	986	1.109
Hawaii	9,415	19,929	13,993	10,514	7,382	2.117
Idaho	10,386	17,451	10,152	7,065	4,110	1.680
Illinois	162,326	131,755	10,304	-30,571	-2,391	0.812
Indiana	58,941	67,780	10,177	8,839	1,327	1.150
Iowa	24,642	29,919	9,517	5,277	1,679	1.214
Kansas	25,563	31,297	10,752	5,734	1,970	1.224
Kentucky	35,127	70,808	15,898	35,681	8,011	2.016
Louisiana	42,725	52,011	11,135	9,286	1,988	1.217
Maine	8,083	17,438	13,062	9,355	7,007	2.157
Maryland	71,247	105,055	17,437	33,808	5,611	1.475
Massachusetts	112,996	78,730	11,471	-34,266	-4,993	0.697
Michigan	82,676	108,359	10,861	25,683	2,574	1.311
Minnesota	104,430	64,402	11,566	-40,028	-7,189	0.617
Mississippi	11,741	37,755	12,629	26,014	8,701	3.216
Missouri	71,921	72,271	11,831	350	57	1.005
Montana	6,080	12,233	11,616	6,153	5,842	2.012
Nebraska	25,450	17,736	9,249	-7,714	-4,023	0.697
Nevada	21,571	28,671	9,646	7,100	2,389	1.329
New Hampshire	12,138	14,993	11,108	2,855	2,115	1.235
New Jersey	143,835	97,682	10,990	-46,153	-5,192	0.679
New Mexico	8,979	31,669	15,128	22,690	10,839	3.527

Table 1. Distribution of Federal Revenues in FY 2017 (*Continued*)

State	A Federal Tax Revenue	B Federal Expenditures	C Per Capita Expenditure	D Balance of Federal Payments	E Per Capita Balance	F Ratio of Expenditure to Revenue
New York	268,354	220,622	11,262	-47,732	-2,436	0.822
North Carolina	82,856	113,081	11,010	30,225	2,943	1.365
North Dakota	6,640	7,889	10,447	1,249	1,654	1.188
Ohio	142,086	125,689	10,776	-16,397	-1,406	0.885
Oklahoma	27,113	45,057	11,457	17,944	4,563	1.662
Oregon	32,346	45,676	11,015	13,330	3,215	1.412
Pennsylvania	139,797	155,850	12,185	16,053	1,255	1.115
Rhode Island	14,917	12,593	11,920	-2,324	-2,200	0.844
South Carolina	26,636	59,740	11,898	33,104	6,593	2.243
South Dakota	7,873	9,250	10,592	1,377	1,577	1.175
Tennessee	69,069	76,278	11,370	7,209	1,075	1.104
Texas	270,955	268,985	9,497	-1,970	-70	0.993
Utah	22,486	23,896	7,701	1,410	454	1.063
Vermont	4,423	7,976	12,771	3,553	5,689	1.803
Virginia	87,184	176,785	20,884	89,601	10,585	2.028
Washington	85,876	80,524	10,844	-5,352	-721	0.938
West Virginia	6,980	24,554	13,513	17,574	9,671	3.518
Wisconsin	53,089	55,411	9,567	2,322	401	1.044
Wyoming	4,394	7,121	12,300	2,727	4,711	1.621

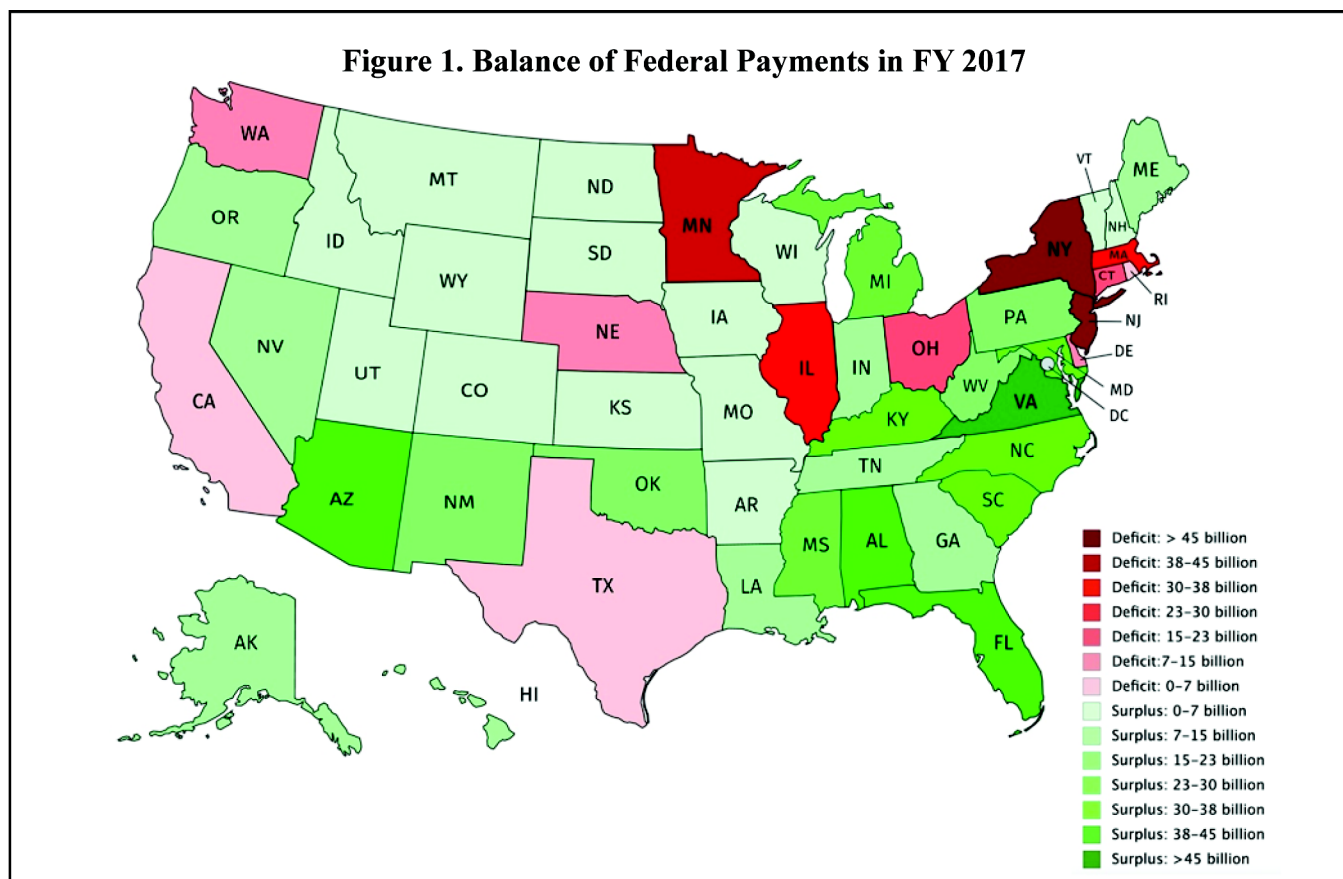
Many other high-tax states, including Illinois and New York, also have large deficits, both total and per capita. California, on the other hand, is somewhat of an outlier: While traditionally regarded a high-tax state, its federal tax revenue roughly equals federal expenditures, resulting in a rough balance of federal payments. But it is also important to note that the federal government runs a substantial deficit, reaching \$666 billion in fiscal 2017.⁶⁸ This high federal deficit implies that the average state should receive a significant surplus in its balance of federal payments rather than receive neither a surplus nor a deficit. In

fiscal 2017 the federal government received approximately \$3.37 trillion in tax revenue from the states and spent approximately \$3.71 trillion in expenditures in the states.⁶⁹ This means that the average state should run a ratio of expenditure to revenue of 1.1 instead of 1, and that the average person in the 50 states should receive a (per capita) balance of federal payments of \$1,044 instead of \$0. As a result, California's (and any other deficit state's) balance of federal payments is in fact a larger deficit than Table 1 alone would seem to suggest.

Many states have protested this enormous imbalance in federal payments. New York, for

⁶⁸ See U.S. Treasury Department, "Final Monthly Treasury Statement of Receipts and Outlays of the United States Government for Fiscal Year 2017 Through September 30, 2017, and Other Periods."

⁶⁹ See *supra* Table 1.



example, has declared that although many states benefit from positive balances with the federal government, it “remains the single largest net contributor to the federal government of all states.”⁷⁰ Since New York taxpayers “remain an outsized supporter of federal spending programs,” Congress should consider mitigating this imbalance of federal payments.⁷¹ This enormous imbalance — with Connecticut taxpayers receiving 72 cents back for each dollar they put in, and South Carolina taxpayers receiving \$2.24 back for each dollar they put in — is unlikely to be sustainable. In the long run, the imbalance will likely result in consistent and severe underfunding of local services and public goods in deficit states, though, as the next section argues, the SALT deduction mitigated this impact until at least 2017.

Figure 1 illustrates the total balance of federal payments among the states: Red represents deficit whereas green represents surplus, and the darker the color, the larger the magnitude of the deficit or surplus.

B. SALT Deduction as Tax Expenditure

This section presents the data and analysis of the federal government’s SALT deduction tax expenditures by state. A methodological note first: The Congressional Budget Act defines tax expenditures 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.”⁷² I calculate the SALT tax expenditure from data collected by the IRS Statistics of Income

⁷⁰ See Schultz and Cummings, *supra* note 65, at 3 (letter from Robert F. Mujica, director of the budget of New York state).

⁷¹ See *id.*

⁷² The Congressional Budget Act of 1974, P.L. 93-344, section 3(3).

division, which provides state-by-state data, broken up by adjusted gross income levels, on state income tax, sales tax, real estate tax, and personal property tax deductions.⁷³ I use the Urban-Brookings Tax Policy Center's data on the distribution of taxpayers by marginal tax rates⁷⁴ to estimate the average marginal tax rates for each AGI level, and then estimate the SALT deduction tax expenditure for each state by adding up the forgone revenue (SALT deductions * estimated average marginal tax rate) from each AGI group for each state. I also take into account the effect of the AMT, under which specific taxpayers would not be able to deduct state and local taxes, in calculating the SALT deduction tax expenditures for high-income households.⁷⁵ In estimating the effect of the AMT, I use the data provided by the Tax Policy Center, which reports the percentage of filers subject to the AMT by state and by AGI.⁷⁶ For example, 22 percent of New York residents with AGI of greater than \$1 million are subject to the AMT, whereas only 14.5 percent of Texas residents with AGI of greater than \$1 million are subject to it (this difference can likely be attributed to the fact that the average income of New Yorkers with AGI of greater than \$1 million is much higher than that of Texas residents in the same income group — that is, New York has more multimillionaires and billionaires than Texas). In any event, being subject to the AMT means that the taxpayer's ability to take some itemized deductions, such as the SALT deduction, is limited, and I take this effect into account in calculating the SALT tax expenditures by state.⁷⁷

In other words, I generally adopt the Joint Committee on Taxation's method of measuring tax expenditures as "the difference between tax liability under present law and the tax liability that would result from a recomputation of tax without benefit of

the tax expenditure provision."⁷⁸ In my calculations, I do not consider the behavioral consequences that may follow a repeal of the tax expenditure provision in question or the interdependent nature of related tax expenditure provisions.⁷⁹ Therefore, while the figures below may represent the federal government's subsidies to the states,⁸⁰ they do not represent accurate measures of federal revenue gain if the SALT deduction were to be completely eliminated.

Table 2 illustrates the effect of the SALT deduction, calculated as tax expenditures, on the imbalance of federal payments across states. Columns A and B show, respectively, the total and per capita balances of federal payments without considering the SALT deduction tax expenditure. Columns C and D show, respectively, the total and per capita SALT deduction tax expenditures for each state. Columns E and F show, respectively, the total and per capita balances of federal payments taking the SALT deduction tax expenditure into account. Columns G and H show, respectively, the ratio of federal expenditures to federal tax revenue, with and without considering the SALT deduction tax expenditure. Amounts in columns A, C, and E are in millions of dollars.

⁷³ See IRS, "SOI Tax Stats — Historical Tables" (updated Sept. 3, 2020).

⁷⁴ See Urban-Brookings Tax Policy Center, "Percent of Tax Filers by Marginal Tax Rates" (Oct. 8, 2019).

⁷⁵ See Rosanne Altshuler and Robert Dietz, "Reconsidering Tax Expenditure Estimation," 64 *Nat'l Tax J.* 459, 471-475 (2011) (describing the effect of the AMT on estimating tax expenditures).

⁷⁶ See Urban-Brookings Tax Policy Center, "AMT by State and by AGI" (Nov. 25, 2019).

⁷⁷ It is worth noting that the TCJA significantly reformed the AMT so that most taxpayers will not be subject to it from 2018-2025. In 2026, however, the AMT will spring back to life unless Congress extends the TCJA change.

⁷⁸ See Joint Committee on Taxation, "Estimates of Federal Tax Expenditures for Fiscal Years 2018-2022," at 13 (Oct. 4, 2018).

⁷⁹ See U.S. Treasury Office of Tax Analysis, Tax Expenditures for Fiscal Year 2020, at 1 (Oct. 19, 2018).

⁸⁰ As noted in Section II, the SALT deduction can be framed as two forms of subsidies. See *supra* text accompanying notes 52-53.

Table 2. Effect of SALT Deduction in FY 2017

State	A Balance of Federal Payments (Without SALT)	B Per Capita Balance	C SALT Tax Expenditure	D Per Capita SALT Expenditure	E Balance of Federal Payments (With SALT)	F Per Capita Balance (With SALT)	G Ratio Without SALT	H Ratio With SALT
Alabama	39,167	8,034	777	159	39,944	8,193	2.47	2.50
Alaska	7,586	10,254	95	128	7,681	10,383	2.40	2.42
Arizona	38,884	5,516	1,601	227	40,485	5,743	1.89	1.92
Arkansas	2,671	889	594	198	3,264	1,087	1.08	1.1
California	-4,383	-111	25,813	655	21,430	544	0.99	1.05
Colorado	716	127	1,995	355	2,710	483	1.01	1.05
Connecticut	-16,411	-4,592	3,205	897	-13,207	-3,695	0.71	0.77
Delaware	-5,535	-5,784	303	316	-5,233	-5,467	0.68	0.69
Florida	44,785	2,135	4,558	217	49,343	2,352	1.23	1.26
Georgia	10,264	986	3,179	305	13,443	1,291	1.11	1.14
Hawaii	10,514	7,382	448	315	10,962	7,697	2.12	2.16
Idaho	7,065	4,110	453	264	7,518	4,374	1.68	1.72
Illinois	-30,571	-2,391	5,597	438	-24,974	-1,953	0.81	0.85
Indiana	8,839	1,327	1,473	221	10,312	1,548	1.15	1.17
Iowa	5,277	1,679	1,004	319	6,280	1,998	1.21	1.25
Kansas	5,734	1,970	808	277	6,541	2,247	1.22	1.26
Kentucky	35,681	8,011	1,082	243	36,763	8,254	2.02	2.05
Louisiana	9,286	1,988	781	167	10,067	2,155	1.22	1.24
Maine	9,355	7,007	407	305	9,761	7,312	2.16	2.21
Maryland	33,808	5,611	3,608	599	37,416	6,210	1.47	1.53
Massachusetts	-34,266	-4,993	4,435	646	-29,832	-4,347	0.70	0.74
Michigan	25,683	2,574	2,868	287	28,551	2,862	1.31	1.35
Minnesota	-40,028	-7,189	2,757	495	-37,270	-6,693	0.62	0.64
Mississippi	26,014	8,701	413	138	26,427	8,839	3.22	3.25
Missouri	350	57	1,667	273	2,017	330	1.00	1.03
Montana	6,153	5,842	300	285	6,453	6,128	2.01	2.06
Nebraska	-7,714	-4,023	613	320	-7,101	-3,703	0.70	0.72
Nevada	7,100	2,389	593	200	7,693	2,588	1.33	1.36
New Hampshire	2,855	2,115	505	374	3,359	2,489	1.24	1.28
New Jersey	-46,153	-5,192	6,827	768	-39,326	-4,424	0.68	0.73

Table 2. Effect of SALT Deduction in FY 2017 (Continued)

State	A Balance of Federal Payments (Without SALT)	B Per Capita Balance	C SALT Tax Expenditure	D Per Capita SALT Expenditure	E Balance of Federal Payments (With SALT)	F Per Capita Balance (With SALT)	G Ratio Without SALT	H Ratio With SALT
New Mexico	22,690	10,839	338	161	23,028	11,000	3.53	3.56
New York	-47,732	-2,436	16,883	862	-30,848	-1,575	0.82	0.89
North Carolina	30,225	2,943	2,717	265	32,942	3,207	1.36	1.40
North Dakota	1,249	1,654	115	153	1,364	1,806	1.19	1.21
Ohio	-16,397	-1,406	3,211	275	-13,186	-1,130	0.88	0.91
Oklahoma	17,944	4,563	701	178	18,645	4,741	1.66	1.69
Oregon	13,330	3,215	1,850	446	15,180	3,661	1.41	1.47
Pennsylvania	16,053	1,255	4,399	344	20,452	1,599	1.11	1.15
Rhode Island	-2,324	-2,200	455	431	-1,869	-1,769	0.84	0.87
South Carolina	33,104	6,593	1,145	228	34,249	6,821	2.24	2.29
South Dakota	1,377	1,577	117	134	1,494	1,711	1.17	1.19
Tennessee	7,209	1,075	830	124	8,038	1,198	1.10	1.12
Texas	-1,970	-70	6,069	214	4,099	145	0.99	1.02
Utah	1,410	454	953	307	2,363	761	1.06	1.11
Vermont	3,553	5,689	220	352	3,773	6,041	1.80	1.85
Virginia	89,601	10,585	3,696	437	93,297	11,021	2.03	2.07
Washington	-5,352	-721	2,068	278	-3,284	-442	0.94	0.96
West Virginia	17,574	9,671	265	146	17,839	9,817	3.52	3.56
Wisconsin	2,322	401	2,229	385	4,551	786	1.04	1.09
Wyoming	2,727	4,711	101	175	2,829	4,886	1.62	1.64

As Table 2 demonstrates, the SALT deduction effectively but imperfectly mitigates the uneven distribution of federal expenditures and the imbalance of federal payments among states. On an absolute scale, SALT deduction tax expenditures make up a substantial portion of the states' deficits in federal payments. For the 13 states that contribute more to federal revenue than they receive in federal spending, their total deficit in federal payments amounts to \$259 billion. SALT deduction tax expenditures bring that figure down to \$180 billion — a 31 percent decrease in the total deficit amount. For some

states, the SALT deduction tax expenditure turns their deficit in federal payments into a surplus: In 2017 California, for example, contributed over \$4 billion more in federal tax revenue than it received in federal spending. When we take SALT tax expenditure into account, however, California ends up having a surplus in federal payments amounting to about \$20 billion. For other states, SALT tax expenditure does not turn their deficits into surpluses, but it at least mitigates their deficit. New York, for example, contributed over \$47 billion more in federal tax revenue than it received in federal spending. When we take SALT

tax expenditure into account, however, New York's deficit goes down to about \$30 billion. This result is not surprising: Given the uneven distribution of federal spending and the imbalance of federal payments,⁸¹ deficit states must rely more on their own tax revenue to provide local benefits and services. The higher state and local tax burdens imposed on the residents of those states then result in higher SALT deductions and SALT tax expenditures.

Of course, SALT tax expenditures also add to the (in some cases, already large) surpluses of states that receive high amounts of federal spending relative to their contributions to federal tax revenue. But these increases in surpluses are much smaller than the reductions in deficits. For the 37 states that received more in federal spending than they contributed to federal revenue, their total surplus in federal payments amounts to \$598 billion. SALT deduction tax expenditures bring that figure up to \$640 billion — an increase of about \$42 billion, or 7 percent. Compare this with the effect of SALT deduction tax expenditure on the deficit states: SALT reduces their deficit from \$259 billion to \$180 billion — a reduction of about \$79 billion, or 31 percent. In other words, 13 deficit states in 2017 received 65 percent of the SALT tax expenditures, whereas the 37 surplus states received only 35 percent of the SALT tax expenditures. Also, if we use a more accurate baseline (not the break-even baseline, but the baseline of the median state in its balance of federal payments), this difference becomes even more prominent. The 25 states with below-median per capita balances of federal payments received roughly \$95 billion, or 79 percent, of the total SALT tax expenditures, whereas the 25 states with above-median per capita balances of federal payments received only \$26 billion, or 21 percent, of the total SALT tax expenditures. Again, this result is not surprising: Surplus states or states with above-median balances of federal payments do not need to rely as heavily on state and local taxation in order to provide local services and public goods. The lighter tax burden that residents of these states

face translates into lower SALT deductions and lower SALT tax expenditures.

Figure 2 illustrates the total balance of federal payments among the states after taking SALT deductions into account as tax expenditures.

C. TCJA's Limit on SALT Deductions

Table 3 shows the estimated effect of the TCJA's limit on SALT deductions (\$10,000). Column A shows the SALT tax expenditures by state before the limit. Column B shows the estimated SALT tax expenditures by state after the limit. I estimate the effect of the TCJA limit on SALT deductions conservatively⁸² — whenever the average amount of SALT deductions taken within an AGI group exceeds \$10,000, I assign the highest possible deduction per return (\$10,000) to that group and estimate the tax expenditure based on the highest possible deduction amount that the group can take given the limit. In practice, therefore, the effect of the TCJA limit will be much more pronounced: The SALT deductions that taxpayers actually will take are likely much smaller than the highest possible amount. Column C shows the percentage change in SALT tax expenditures caused by the TCJA limit. Columns D and E, respectively, show the total and per capita balance of federal payments by state in 2017. Columns F and G, respectively, show the estimated total and per capita balance of federal payments by state after taking the TCJA limit into account. Amounts in columns A, B, D, and F are in millions of dollars.

⁸¹ See *supra* Table 1.

⁸² Because the TCJA raised the standard deduction (to \$12,000 for single filers, \$18,000 for heads of household, and \$24,000 for joint filers), it is also more likely that taxpayers will take the standard deduction rather than make itemized deductions. See section 63(c)(7).

WA OR ID MT ND SD MN NE WI MI OH PA NY CT RI NJ DE MD DC MA ME VT NH

CA NV UT CO KS OK TX NM AZ WY IA MO AR LA MS AL GA SC NC VA WV KY TN

AK HI

Legend:

- Deficit: > 45 billion
- Deficit: 38-45 billion
- Deficit: 30-38 billion
- Deficit: 23-30 billion
- Deficit: 15-23 billion
- Deficit: 7-15 billion
- Deficit: 0-7 billion
- Surplus: 0-7 billion
- Surplus: 7-15 billion
- Surplus: 15-23 billion
- Surplus: 23-30 billion
- Surplus: 30-38 billion
- Surplus: 38-45 billion
- Surplus: >45 billion

Table 3. Table 3. Estimated Effect of the TCJA Cap

State	A SALT Tax Expend. 2017	B Est. TCJA SALT Tax Expend.	C Percentage Change	D Balance of Payments With SALT	E Per Capita Balance	F Balance After TCJA Limit	G Per Capita Balance After TCJA
Alabama	777	645	-17.1%	39,944	8,193	39,812	8,166
Alaska	95	90	-5.1%	7,681	10,383	7,676	10,376
Arizona	1,601	1,239	-22.6%	40,485	5,743	40,123	5,692
Arkansas	594	424	-28.7%	3,264	1,087	3,094	1,030
California	25,813	13,607	-47.3%	21,430	544	9,224	234
Colorado	1,995	1,516	-24.0%	2,710	483	2,232	397
Connecticut	3,205	1,647	-48.6%	-13,207	-3,695	-14,764	-4,131
Delaware	303	254	-16.2%	-5,233	-5,467	-5,282	-5,519
Florida	4,558	3,461	-24.1%	49,343	2,352	48,245	2,300
Georgia	3,179	2,409	-24.2%	13,443	1,291	12,673	1,217
Hawaii	448	365	-18.5%	10,962	7,697	10,879	7,639
Idaho	453	355	-21.7%	7,518	4,374	7,420	4,316
Illinois	5,597	4,265	-23.8%	-24,974	-1,953	-26,306	-2,057

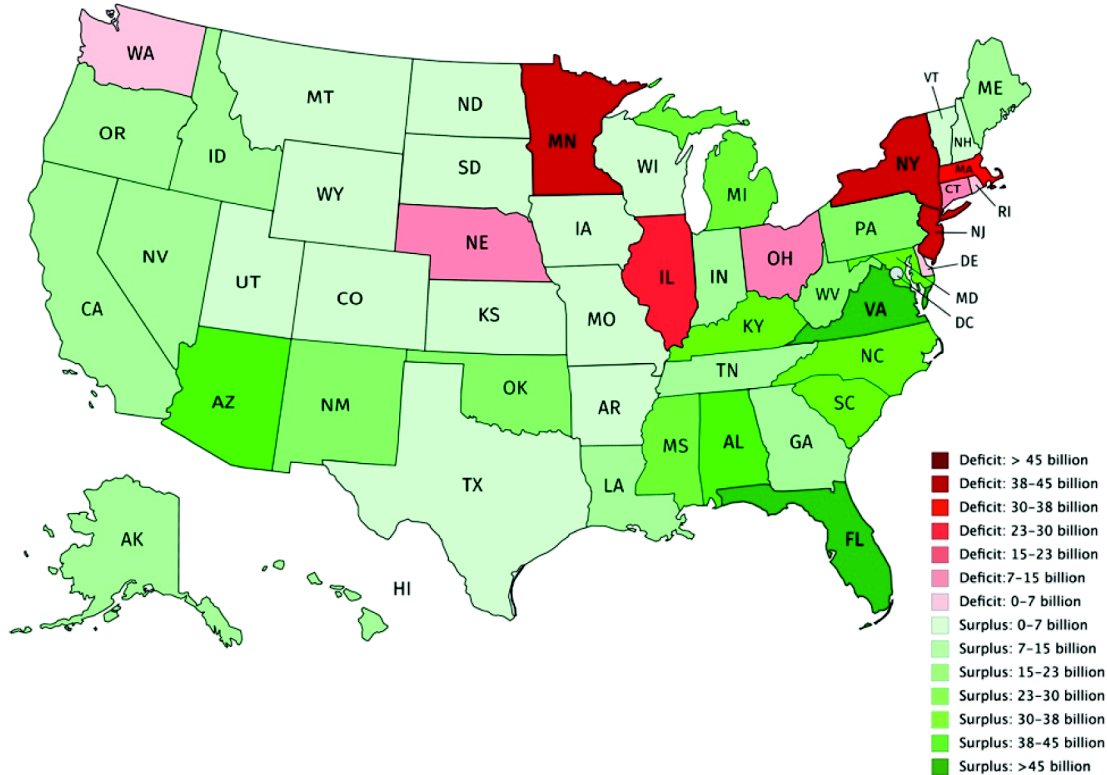
Table 3. Table 3. Estimated Effect of the TCJA Cap (*Continued*)

State	A SALT Tax Expend. 2017	B Est. TCJA SALT Tax Expend.	C Percentage Change	D Balance of Payments With SALT	E Per Capita Balance	F Balance After TCJA Limit	G Per Capita Balance After TCJA
Indiana	1,473	1,171	-20.5%	10,312	1,548	10,010	1,503
Iowa	1,004	851	-15.2%	6,280	1,998	6,128	1,949
Kansas	808	629	-22.1%	6,541	2,247	6,363	2,186
Kentucky	1,082	918	-15.1%	36,763	8,254	36,599	8,217
Louisiana	781	614	-21.4%	10,067	2,155	9,900	2,120
Maine	407	357	-12.2%	9,761	7,312	9,712	7,275
Maryland	3,608	2,639	-26.8%	37,416	6,210	36,448	6,049
Massachusetts	4,435	2,954	-33.4%	-29,832	-4,347	-31,312	-4,562
Michigan	2,868	2,304	-19.7%	28,551	2,862	27,987	2,805
Minnesota	2,757	1,999	-27.5%	-37,270	-6,693	-38,029	-6,830
Mississippi	413	352	-14.6%	26,427	8,839	26,367	8,819
Missouri	1,667	1,280	-23.2%	2,017	330	1,630	267
Montana	300	245	-18.3%	6,453	6,128	6,398	6,076
Nebraska	613	514	-16.1%	-7,101	-3,703	-7,200	-3,755
Nevada	593	449	-24.3%	7,693	2,588	7,549	2,540
New Hampshire	505	454	-10.0%	3,359	2,489	3,309	2,451
New Jersey	6,827	4,152	-39.2%	-39,326	-4,424	-42,001	-4,725
New Mexico	338	294	-13.0%	23,028	11,000	22,984	10,979
New York	16,883	7,447	-55.9%	-30,848	-1,575	-40,285	-2,056
North Carolina	2,717	2,193	-19.3%	32,942	3,207	32,418	3,156
North Dakota	115	98	-15.5%	1,364	1,806	1,346	1,783
Ohio	3,211	2,706	-15.7%	-13,186	-1,130	-13,691	-1,174
Oklahoma	701	567	-19.1%	18,645	4,741	18,511	4,707
Oregon	1,850	1,407	-24.0%	15,180	3,661	14,737	3,554
Pennsylvania	4,399	3,620	-17.7%	20,452	1,599	19,673	1,538
Rhode Island	455	365	-19.8%	-1,869	-1,769	-1,959	-1,854
South Carolina	1,145	971	-15.2%	34,249	6,821	34,075	6,786
South Dakota	117	106	-9.8%	1,494	1,711	1,483	1,698
Tennessee	830	739	-10.9%	8,038	1,198	7,948	1,185
Texas	6,069	5,466	-9.9%	4,099	145	3,496	123
Utah	953	745	-21.8%	2,363	761	2,156	695
Vermont	220	192	-12.8%	3,773	6,041	3,745	5,996

Table 3. Table 3. Estimated Effect of the TCJA Cap (Continued)

State	A SALT Tax Expend. 2017	B Est. TCJA SALT Tax Expend.	C Percentage Change	D Balance of Payments With SALT	E Per Capita Balance	F Balance After TCJA Limit	G Per Capita Balance After TCJA
Virginia	3,696	2,956	-20.0%	93,297	11,021	92,557	10,934
Washington	2,068	1,994	-3.6%	-3,284	-442	-3,357	-452
West Virginia	265	229	-13.6%	17,839	9,817	17,803	9,798
Wisconsin	2,229	1,842	-17.4%	4,551	786	4,164	719
Wyoming	101	69	-32.3%	2,829	4,886	2,796	4,829

Figure 3. Balance of Federal Payments With TCJA-Limited SALT Deduction



As Table 3 shows, the TCJA limit substantially impairs the effectiveness of the SALT deduction in mitigating the imbalance of federal payments. Unsurprisingly, the states with some of the largest deficits in federal payments can expect the largest decreases in SALT tax expenditures: California, Connecticut, New Jersey, and New York all face reductions of 40 percent or more in SALT deduction tax expenditures when the TCJA limit kicks in. New York in particular is estimated to see its SALT tax expenditure shrink by more than half

(55.9 percent), from approximately \$16.9 billion to \$7.4 billion, resulting in a 32 percent increase in its deficit in federal payments. California — another high-tax jurisdiction suffering from a deficit in federal payments — is estimated to see the largest decrease in SALT deduction tax expenditure, from \$25.8 billion to \$13.6 billion.

Figure 3 illustrates the total balance of federal payments among the states after taking SALT deductions into account as tax expenditures and estimating the impact of the TCJA.

IV. Conclusion

In addition to impairing the SALT deduction's effectiveness in mitigating the balance of federal payments, the TCJA limit illustrates at least two inherent shortcomings in using the SALT deduction to effectuate federalism. First, the SALT deduction simply is highly regressive: Before the TCJA limit, only 19 percent of SALT deduction tax expenditures were distributed to households with an AGI of lower than \$100,000, even though this AGI group constitutes the vast majority of American households. Eighty-one percent of SALT deduction tax expenditures therefore benefited households with more than \$100,000 of AGI — a small minority of American households. The TCJA's SALT limit, while it was probably intended to punish high-tax jurisdictions, will likely mitigate this regressivity. In general, households with AGIs of lower than \$100,000 are not substantially affected by the TCJA's limit, while the SALT deduction tax expenditure for households with AGIs of higher than \$100,000 will plummet by at least 35 to 40 percent. This means that after the TCJA limit, households with AGIs of lower than \$100,000 are likely to see their share of SALT deduction tax expenditures rise from 19 percent to 37 percent.

Second, because federal expenditures are so unevenly distributed, it is unrealistic to expect SALT deductions to close the gap between deficit and surplus states. Even before the TCJA limit, SALT deduction tax expenditures still leave high-tax states such as Connecticut, Massachusetts, New Jersey, and New York running large deficits in federal payments in the billions of dollars. The TCJA limit has exacerbated this shortcoming.

Therefore, a much better way of preserving federalism in taxation is for the federal government to adopt a more balanced approach to appropriations and expenditures. Given regional differences, it is not necessary that each state receives the exact same amount of federal spending — but the current state of highly uneven distribution of federal spending is not sustainable. Given polarized politics,⁸³ it is unlikely that Congress or the executive branch

can reform federal expenditures in such an effective way. Before that happens, then, SALT deductions still have some role to play in our system of federalism.

Appendix

This appendix reproduces the three figures from Section III together with a map of how Americans voted in the 2016 presidential election.⁸⁴ The connection between political preference and balance of federal payments is striking: Republican-leaning states tend to run high surpluses with the federal government, whereas Democratic-leaning states tend to run high deficits with the federal government. Two of the notable exceptions are Virginia and Maryland, which are anomalies — their surpluses come primarily from the large number of federal agencies present in those two states.

⁸³ See *infra* Appendix.

⁸⁴ See "Presidential Election Results: Donald J. Trump Wins, *The New York Times*, Aug. 9, 2017.

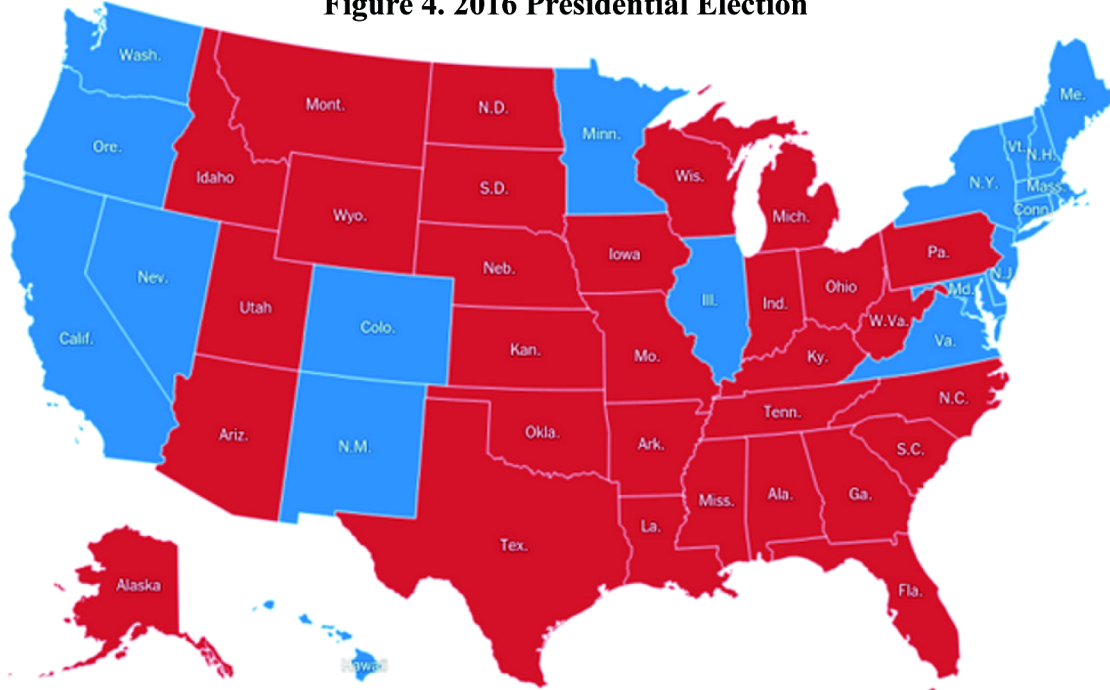
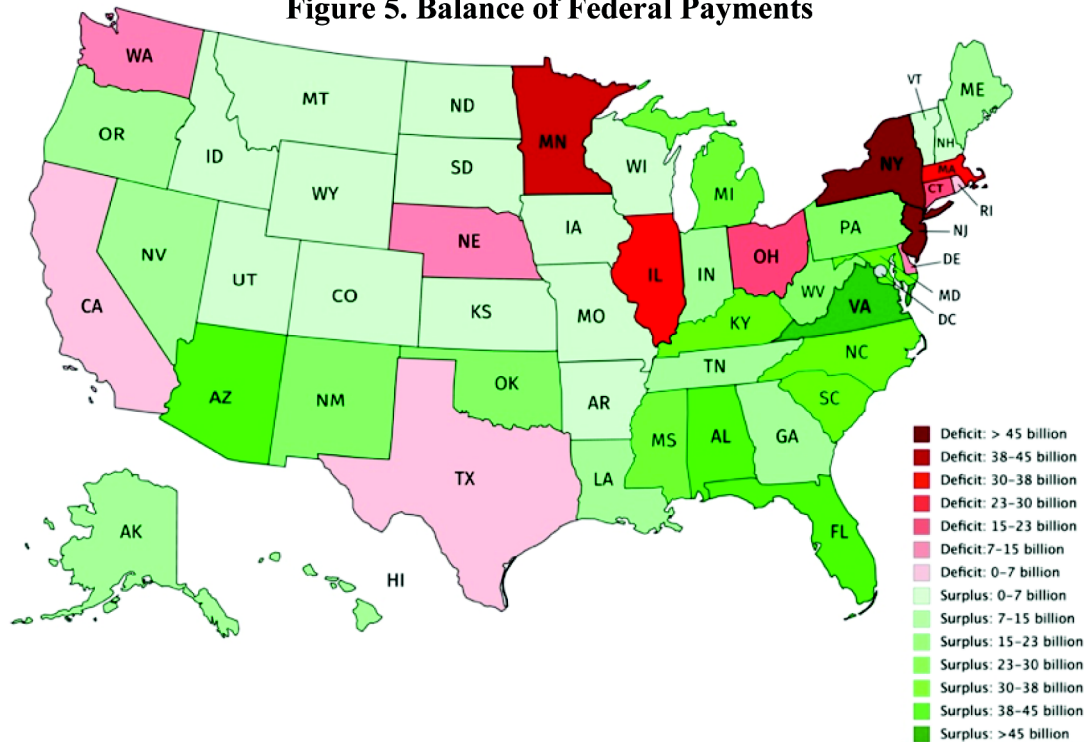
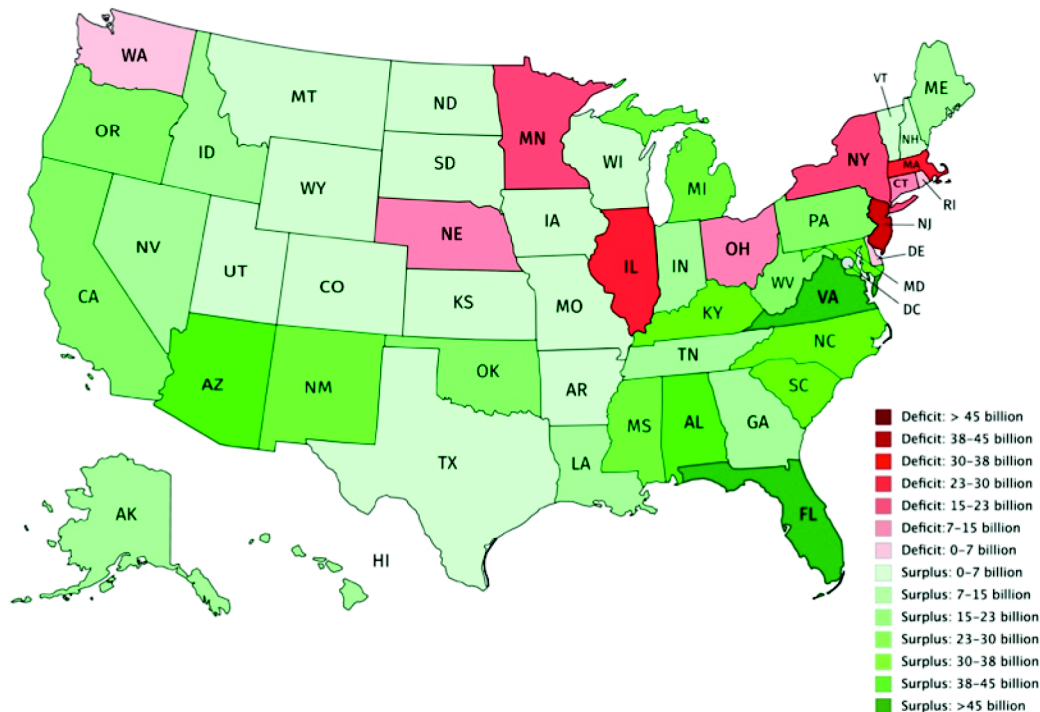
Figure 4. 2016 Presidential Election**Figure 5. Balance of Federal Payments**

Figure 6. Balance of Federal Payments Accounting for SALT Deductions as Tax Expenditure**Figure 7. Balance of Federal Payments After TCJA Cap**