Itemized deductions allow tax filers to reduce the amount of personal income tax they owe by reducing the amount of income on which they’re taxed. There are about a dozen such special deductions at the federal level, and many states allow filers to use most or all of these federal deductions at the state-level. Some states have additional, state-level deductions. Twenty-six states closely follow federal itemizing rules, while another five states, and the District of Columbia, follow these rules but limit their use in one way or another. If these thirty-one states all repealed their state-level itemized deductions, they could gain over $7 billion in revenue.

These tax law changes can also be structured so that the large majority of new revenue is collected from upper-income households, producing not only additional revenue for the state but also making the state’s tax system fairer.

WAYS TO DO IT

REPEAL ITEMIZED DEDUCTIONS AND INCREASE THE STANDARD DEDUCTION

Currently, 31 states allow itemized deductions. Since most tax filers who itemize are higher income, repealing itemized deductions would gather new revenue from those who could afford to pay a bit more. In some states, however, low and moderate income filers also use itemized deductions, because the alternative — the state standard deduction — is so low. For these states, simply raising the value of their standard deduction would shield lower-income filers from the impact of reforms to itemized deductions.

PLACE A CAP ON ITEMIZED DEDUCTIONS

In most states, filers who itemize their deductions do not have a limit on how much they can deduct. Capping the total value of deductions a filer can claim cuts the tax losses the state will sustain on behalf of high income filers, who are the filers most likely to exceed such a cap.

TURN DEDUCTIONS INTO CREDITS AND INCREASE THE STANDARD DEDUCTION

Turning itemized deductions into tax credits also can function to limit total revenue losses, delivering new state revenue that is derived primarily from high-income filers. This approach can provide small tax cuts to many lower- and middle-income households. Another positive feature of this approach is that tax credits can offer the same dollar-value benefit to every household that claims the credit, regardless of income level. The dollar-value of itemized deductions, by contrast, depends on a filer’s tax rate, with high-income households receiving much larger tax reductions.

PHASEOUT ITEMIZED DEDUCTIONS ABOVE A CERTAIN INCOME THRESHOLD

A phaseout reduces the total amount a tax filer can claim in itemized deductions as their income increases. While this approach is not as effective as those outlined above, it nevertheless is capable of raising tens of millions of dollars in new state revenue.

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TALKING POINTS: STATE REVENUE STRATEGIES

Taxes are the way we pay for the many important things we do together through our governments. The common goal of the tax reform proposals presented on the Investing in the Future website is to generate revenue sufficient to pay for schools and universities, roads and bridges, subways and buses, police and fire departments, libraries and parks, and so much more.

Any proposal to generate new tax revenue, however, necessarily raises a number of important questions: How will these tax changes affect the state’s economy? How will the changes affect family budgets? How can proponents facilitate a thoughtful and constructive public discussion of the proposals at hand? Below is an overview of responses to each of these questions – greater detail can be found on the Background Basics page of the Investing in the Future website.

TAXES & THE ECONOMY

The evidence strongly indicates that when appropriate investments are paid for with well-structured tax increases they result in significant positive net impacts to a state’s economy, particularly over the long term.

- Raising taxes on high-income households = substantial net tax revenue gains
- Raising taxes on high-income households does not lead to substantial migration out-of-state
- States with higher tax levels do NOT have weaker economies than low-tax states
- Better educated workforce = higher wage economy

FAIRNESS

In every state in the U.S., low and middle-income households pay more of their income in combined state-and-local taxes than high-income households do. It is reasonable, therefore, that efforts to raise more revenue for education and other public investments would seek to collect that new revenue from high-income households. This would bring the tax levels of high-income households closer to the levels paid by other households.

The goal of tax reform is to generate adequate revenue to pay for essential government functions, and to raise that revenue in a fair way.

TALKING ABOUT TAXES AND GOVERNMENT

Thirty years of determined anti-tax/anti-government messaging has undermined the general public’s belief in the essential, positive role that government plays in our daily lives. The fact is, we do many great things – large and small - for our communities, working together through our federal, state and local governments. Telling this positive story is essential, just as it is essential to offer a positive, aspirational vision of the future:

- Help people imagine how their communities can benefit from increased investment in schools, roads, libraries, public safety and more.
- Remind people of the direct connection between these public goods and the taxes we all pay.
- Focus discussion on overall public benefit and revenue gains of a particular tax proposal rather than an extensive debate on the minor details of a given plan.
- Remember to stay positive and inclusive and to focus on the big picture: Tax reform is a tool that will help people realize the aspirational visions they have for their communities.

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