

Tax Expenditures for State and Local Tax Payments

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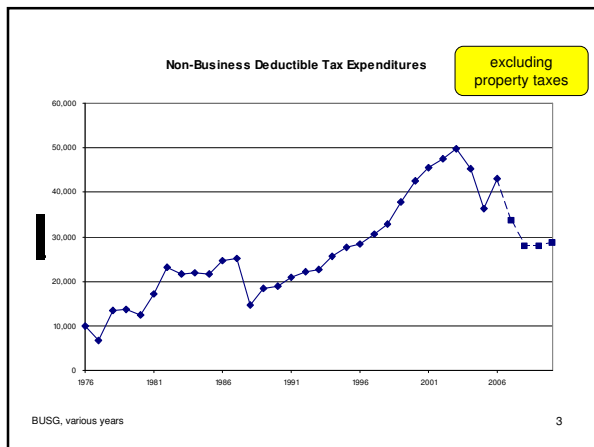
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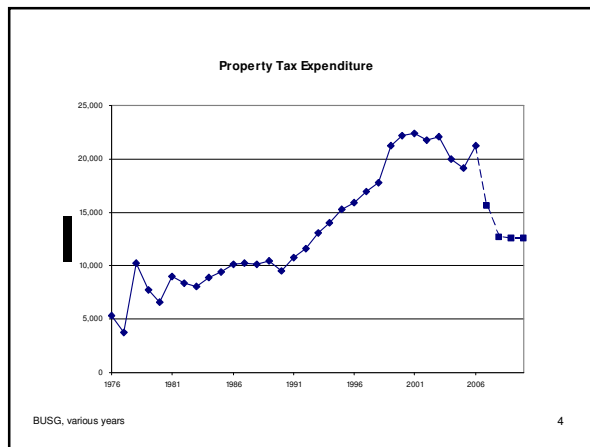
Outline

- How large is the reported tax expenditure for state/local tax deductions?
- How has it changed over time?
- How is it distributed across the population?
- Behavioral issues at the state & local level
- Econometric strategy

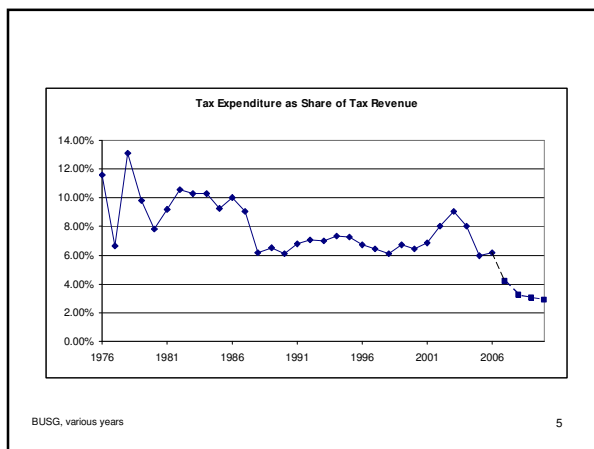
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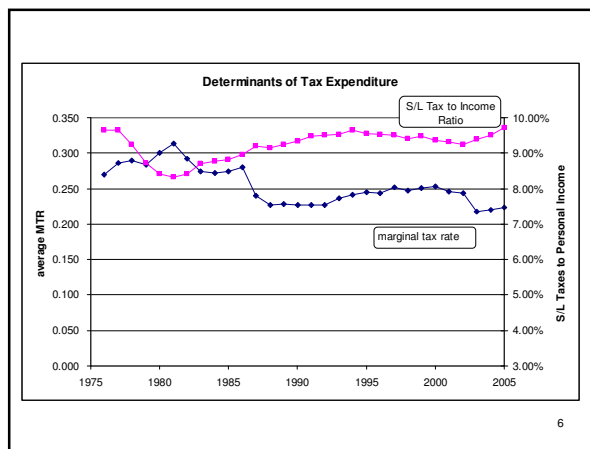
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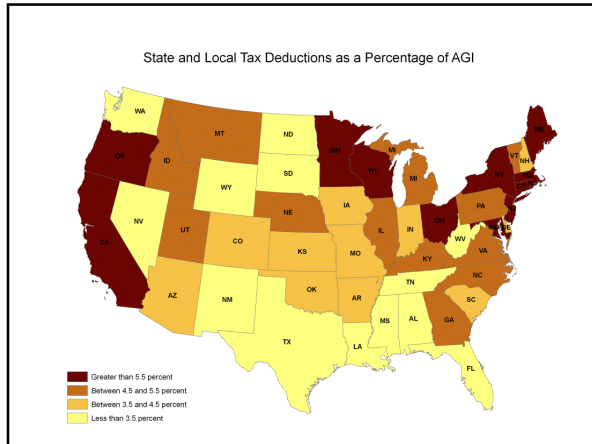
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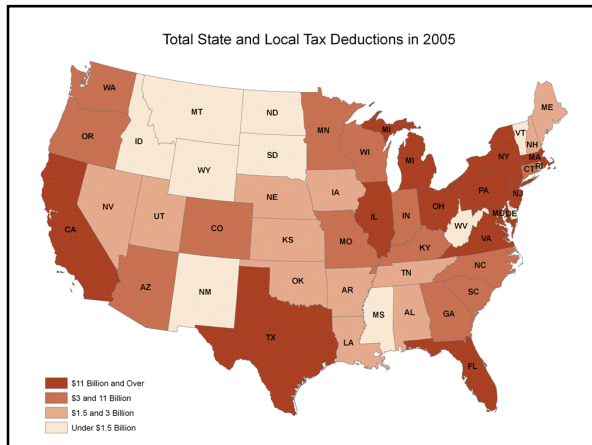
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Top States: By AGI Share

State	Income tax	Sales tax	Property tax	Total	Share of AGI
NEW YORK	32,171	520	14,750	47,441	8.6%
NEW JERSEY	12,036	255	11,220	23,512	8.3%
MARYLAND	9,131	52	3,435	12,619	7.4%
CONNECTICUT	5,699	68	3,764	9,530	7.2%
OREGON	4,136	8	1,677	5,820	7.2%
CALIFORNIA	45,920	1,963	20,710	68,594	7.1%
WISCONSIN	5,096	68	3,606	8,771	6.6%
RHODE ISLAND	971	19	723	1,713	6.5%
MASSACHUSETTS	8,141	51	4,859	13,051	6.3%
MINNESOTA	5,787	86	2,388	8,260	6.0%

IRS Data (2005) 8



Top States: By Amount

State	Income tax	Sales tax	Property tax	Total	Share of Aggregate Deductions
CALIFORNIA	45,920	1,963	20,710	68,594	18%
NEW YORK	32,171	520	14,750	47,441	12%
NEW JERSEY	12,036	255	11,220	23,512	6%
ILLINOIS	6,622	598	8,914	16,133	4%
PENNSYLVANIA	9,408	210	6,479	16,097	4%
TEXAS	858	3,669	10,502	15,028	4%
OHIO	9,987	175	4,581	14,743	4%
FLORIDA	2,066	3,062	9,437	14,566	4%
MASSACHUSETTS	8,141	51	4,859	13,051	3%
MARYLAND	9,131	52	3,435	12,619	3%

IRS Data (2005) 10

Distribution Across Income

Tax Expenditures by Income Class: 2005

Income Class	Real estate tax deduction				State and local income, sales, and personal property tax deduction			
	Returns	Amount	Per Return	Ratio to AGI (000)	Returns	Amount	Per Return	Ratio to AGI (000)
Below \$10,000	372	0	0	0.00	20	1	50	10.00
\$10,000 to \$20,000	864	30	35	2.31	447	25	56	3.73
\$20,000 to \$30,000	1,618	162	100	4.00	1,479	141	95	3.81
\$30,000 to \$40,000	2,414	350	145	4.14	2,696	378	140	4.01
\$40,000 to \$50,000	3,340	732	219	4.87	3,885	777	200	4.44
\$50,000 to \$75,000	8,534	2,929	343	5.49	10,113	3,300	326	5.22
\$75,000 to \$100,000	7,689	3,478	452	5.17	8,946	4,081	456	5.21
\$100,000 to \$200,000	12,356	9,646	781	5.20	13,401	13,387	999	6.66
\$200,000 and over	3,679	4,630	1,258	2.52	3,192	17,881	5,602	11.20
Total	40,866	21,957	537		44,178	39,969	905	

JCT (2006) 11

- ### Behavioral Issues
- Feldstein and Metcalf (1987) find that deductibility affects state and local choice of tax instruments.
 - Other papers: Holtz-Eakin and Rosen (1988), Inman (1989), Gade and Atkins (1990)
 - Sales Tax Puzzle: Metcalf (1992), Metcalf (1993), Izraeli and Kellman (2003)
 - Tax Progressivity: Bahl, Martinez-Vazquez, and Wallace (2005), Chernick (2005)
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Tax Price and Behavior

$$T_{it} = \beta P_{it} + X_{it}'\gamma + \alpha_i + \varepsilon_{it}$$

$$P_{it} = \pi_{it}(1 - m_{it}) + (1 - \pi_{it})(1) = 1 - \pi_{it}m_{it}$$

Elements of P_{it}
endogenous

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Implications for Tax Expenditures

- An elimination of tax deductibility may cause state and local governments to shift reliance to deductible business taxes
- Gain in revenue from eliminating personal deductibility offset by loss from increased business deductibility

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Econometric Plan

- Panel of Data on State Tax Shares: 1979 – 2003
- Tax prices: average and different percentiles
- Control for state socioeconomic characteristics and state fixed effects

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TAXSIM Data

- Tax price variable

$$P_{it} = 1 - \sum_j \omega_{ijt} \pi_{it} m_{ijt}$$

These are constructed as average values. I can also construct at given percentiles (e.g. 75th, 90th, 95th, etc.).

- IVs for endogeneity in itemization and tax bracket

$$P_{it}^0 = 1 - \sum_j \omega_{ijt} \pi_{it}(AGI_{ijt}, Dep_{ijt}) m_{ijt}^0$$

$$P_{it}^A = 1 - \sum_j \omega_{ijt} \pi_{it}(AGI_{ijt}, Dep_{ijt}) m_{it}(AGI_{ijt}, Dep_{ijt})$$

$$\pi_{it} = \sum_j \omega_{ijt} \pi_{it}(AGI_{ijt}, Dep_{ijt})$$

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IV Construction

National Distribution of Dependents: 1979 – 2003	
0	62%
1	16%
2	13%
3+	8%

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IV Construction

National AGI Break Points							
	1	2	3	4	5	6	7
1980	2,972	5,999	9,150	12,889	17,641	23,531	32,214
1985	4,034	7,841	11,843	16,664	22,619	30,820	42,356
1990	4,200	8,841	13,730	19,590	27,200	37,580	53,710
1995	4,943	10,130	15,520	22,060	30,810	43,200	62,850
2000	6,150	12,380	18,970	26,810	37,710	52,690	76,910
2003	6,624	13,130	19,980	28,340	39,110	55,010	80,640

High-income filers state id's are censored

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Questions of Interest

- How does the sensitivity of state tax shares to tax price affect estimate of tax expenditure?
- What is the impact on the estimated tax expenditure for possible changes to the deduction?
 - Cap deduction at some amount
 - Convert to a tax credit at fixed percentage
 - Other?
- Can we resolve the Sales Tax Puzzle with more recent data?

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