

Vermont Legislative Joint Fiscal Office

1 Baldwin Street • Montpelier, VT 05633-5701 • (802) 828-2295 • Fax: (802) 828-2483

ISSUE BRIEF

Prepared by Sara Teachout
Revised January 2015

Deductibility of State and Local Income and Sales Taxes

State and local income and sales taxes are part of an individual income taxpayer's federal itemized deductions (Schedule A, Line 5). A taxpayer who claims a standard deduction does not benefit from the deductibility of these taxes. Other taxes which may be deducted, but are not included in this analysis are real estate taxes, personal property taxes, income taxes paid to a foreign country, war profits or excess profits taxes, generation skipping-transfer taxes, and environmental taxes. The federal government allows these types of deductions to ease the burden of taxes paid to state and local governments. Taxpayers who itemize get part of their state and local tax liability offset by the federal deduction.

Approximately one-third of Vermont taxpayers file itemized deductions. There are no local income taxes in Vermont and only a few communities have local sales taxes, therefore, almost all of the deduction taken by resident taxpayers is for income taxes. Out-of-state filers may claim sales taxes or local income taxes as part of their deduction. Because this is a federal deduction, the taxes deducted by Vermont taxpayers may have been paid to any state.

Vermont Taxation

The starting point for calculation of the Vermont personal income tax is federal taxable income. Therefore, unless modified by Vermont, all of the federal adjustments prior to reaching this point on the tax return, including all itemized deductions, are passed-through to Vermont taxpayers. Beginning in tax year 2009, Vermont began requiring taxpayers to add-back the value of the state and local tax deduction claimed at the federal level greater than \$5,000.

Treatment in Other States

Of the 43 states with an income tax and the District of Columbia the majority do not allow this deduction for state income taxes. There are a few that do allow the state and local income tax deduction. Four states allow the pass through of the entire federal amount of the state and local tax deduction (Arizona, Louisiana, North Dakota, and Ohio) Three states, Vermont (\$5,000 cap), Hawaii (AGI Cap) and Georgia (state taxes only) limit the deduction. A few states offer the state-level deduction for local taxes only (Alabama, Arkansas, Kentucky, and Utah).

Arguments for State and Local Tax Deductions (federal and state level)

- Proponents see the federal deduction as a means of aiding state and local government budgets by reducing the price of state and local government goods. At the state level, the local tax deduction is an additional benefit to local government, and to the itemizer.
- The deductibility of state and local taxes serves to level the playing field among higher and lower taxing states.

Arguments Against State and Local Tax Deductions (federal and state level)

- Opponents argue that it would be more efficient to provide direct federal assistance than allow these deductions.
- Taxpayers in higher taxing states receive more federal tax savings through deductibility, thereby reducing their total federal, state, and local tax liability relatively more than for those taxpayers in lower taxing states.
- Most of the policy reasons for this deduction are related to national issues, not state issues.
- Taxpayers who file itemized deductions tend to be higher-income and this policy lowers the overall progressivity of the federal-state-local tax system.

TY 2011 Average Amount of Itemized Deductions by AGI Class

AGI Income Class	# of Filers	Medical Deductions	State & Local Income Tax		Real Estate Tax	Home Mortgage Interest	Charitable Contributions	Other Deductions	Federal Average TOTAL	Vermont Average TOTAL
			Federal State/Local Income Tax	Vermont State/Local Income Tax						
Under 25,000	8,365	8,867	773	40	3,268	7,456	1,363	3,563	15,264	15,106
25,000 - 49,999	16,729	7,576	1,528	268	3,174	6,870	1,570	5,030	14,521	14,226
50,000 - 74,999	18,958	8,274	2,215	922	3,750	7,560	1,837	5,046	16,459	16,366
75,000 - 99,999	16,637	8,129	3,172	1,820	4,526	8,260	2,138	4,849	18,786	18,625
100,000 - 124,999	11,834	10,096	4,474	3,223	5,370	8,377	2,390	5,105	21,191	20,730
125,000 - 149,999	6,772	11,850	5,980	4,204	6,222	8,807	2,769	6,051	24,394	23,067
150,000 - 199,999	6,354	14,966	8,443	4,595	7,312	9,809	3,649	6,639	29,692	26,083
200,000 - 299,999	4,063	24,190	13,865	4,762	9,037	11,667	6,024	10,223	41,163	32,169
300,000 - 499,999	1,915	40,716	23,399	4,789	11,205	14,540	9,961	16,609	60,555	42,052
500,000 - 999,999	816	64,980	48,818	4,851	14,702	18,088	19,637	31,032	104,411	60,618
1,000,000 +	325	43,167	198,318	4,946	22,077	45,533	131,360	83,258	403,248	209,906
Average for ALL	92,768	8,805	5,205	2,825	4,967	8,440	3,386	5,987	22,629	20,273

TY 2011 Standard Deduction	
MFJ	11,600
HOH	8,500
Single	5,800

Note: The S&L Income Tax Deduction was capped beginning in TY09.