GFRC Brief

Estimated Impact of the Cap on SALT Deductions at the Zip Code Level in Illinois

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22 February 2019

Executive Summary

In this report, data from Illinois' 2015 federal income tax filings are examined to estimate the impact of the new $10,000 cap on federal income tax deductions for certain state and local taxes (SALT) that was approved as part of a massive federal tax reform program, called the Tax Cuts and Jobs Act of 2017 (TCJA).

Following are the estimated impacts of the new cap if the cap had been in place in 2015:

- Approximately 15% (or 896,790) Illinois tax filers would have been affected in 2015
  - The actual number of affected filers in 2018, the first year when the TCJA went into effect, will most likely be larger because the estimates produced in this report are based on 2015 data, and the increase in the state's income tax rate from 3.75% to 4.95% in 2017 would most likely increase the number of affected filers;
- The estimated average reduction in income due to the new cap would have been 1.8% (or $2.6 billion) for filers with adjusted gross incomes (AGI) above $200,000 in 2015.
  - The estimates are the estimated impact of the SALT deduction cap only, not the net effects of the TCJA. The estimates are conservative since the increase in the state's income tax rate in 2017 increases both the number of affected filers and the amount of SALT deductions per filer in excess of the new $10,000 cap; and,

- The tax filers who would likely see their federal income tax liability increase due to the new cap are likely to be concentrated in the AGI brackets above $100,000 and in municipalities with high property values and high local tax rates.
    - Of the 1,229 zip codes in Illinois (data are available only by zip code, not by municipality), 45 have more than one-third of their filers who will most likely pay higher federal income tax due to the new $10,000 cap.
        - Of those 45 zip codes, 11 have more than half their filers who will most likely pay higher federal income taxes.
    - Of the 1,229 zip codes in Illinois, no taxpayer in 569 zip code areas will feel any financial effect of the $10,000 cap.

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This brief is the first of a series of reports prepared by UIC's Government Finance Research Center and supported by the Illinois Finance Authority which are designed to examine contemporary fiscal challenges in Illinois. The purpose of this relationship is to inform state fiscal policy discussions by bringing together teams of academic scholars to provide objective data analysis of critical public policy problems.

Estimated Impact of the Cap on SALT Deductions at the Zip Code Level in Illinois

The federal government allows taxpayers to deduct certain state and local taxes (SALT) through the federal income tax system. Under federal tax law, taxpayers are allowed to deduct state and local property taxes and general sales or income taxes from their federal taxable income. The SALT deduction decreases a taxpayer's federal taxable income, and thus reduces that taxpayer's ultimate federal tax liability. For example, if one federal income tax filer paid $15,000 in state and local property and income taxes and the marginal federal income tax rate is 22%, that filer can reduce federal income tax liability by $3,300.

The Tax Cuts and Jobs Act of 2017 (TCJA) places a $10,000 cap on itemizers' deductions of SALT from their taxable income.[1] The law still allows filers who choose to itemize deductions to subtract SALT from their federal taxable income within the $10,000 limit. This means that the state and local taxes paid in excess of $10,000 can no longer be deducted on a filer's federal income tax. While the provision will reduce federal tax expenditures, it will also affect some taxpayers because they will claim smaller amounts of taxes they pay to state and local governments. As a result, federal income tax liabilities will rise and after-tax incomes will shrink for those who itemize their taxes and have state and local tax payments above $10,000.

The impact of the new SALT deduction cap, however, is alleviated somewhat by two other provisions in the law. First, the new law raises the standard deductions for taxpayers. The standard deduction is now $12,000 for single filers, $18,000 for heads of household, and $24,000 for married individuals filing joint returns.[2] As a result of the increased standard deductions, some taxpayers will no longer itemize deductions and that change in behavior will eliminate the potential negative effects those taxpayers may have incurred from the new SALT deduction cap. In addition, the law enacts a slightly lower tax rate structure. For example, the highest marginal tax rate under the new law is reduced from 39.6% to 37%. These lower rates may also reduce the potential negative effects of the SALT deduction cap, particularly for taxpayers with high incomes.

The TCJA has received a great deal of attention from scholars and practitioners regarding how much it will affect taxpayers. Gordon (2018), for example, points out that the cap on the SALT deduction exacerbates the penalty for workers living in high cost, high productivity areas. Chernick (2018) and Reschovsky (2018) expect that the new tax law will reduce support for state income and local property taxes, and state and local governments will face

[1] Accessed on May 25, 2018 from https://www.congress.gov/bill/115th-congress/house-bill/1.
[2] The standard deduction for the tax year of 2017 was $6,350 for single filers, $9,350 for heads of household, and $12,700 for married individuals filling joint returns.

pressure to lower taxes or forgo tax increases, even in periods of economic recession. Reschovsky (2018) further anticipates that the tax law may induce some high-income taxpayers in higher-tax states to migrate to lower-tax states. According to a recent analysis from The Pew Charitable Trusts (Oliff and Samms 2018), the impact of the cap on SALT deductions could be far-reaching because federal income tax filers in 19 states who took the SALT deduction claimed more on average than the cap allows in 2015, the latest year for which data is available.

Given the substantial variation in the percentage of filers who claim the SALT deduction and the size of their deductions, the impact of the new cap will vary across communities. The SALT cap will increase federal income tax liabilities for certain federal income tax filers because under the new law they will not be allowed to claim a SALT deduction beyond the $10,000 limit. The more affluent and higher-tax communities will witness larger increases in federal tax liabilities.

Using a data set from the Internal Revenue Service (IRS), we estimate the impact of the SALT deduction cap on various communities in the state of Illinois. We estimate: A) the number of tax filers who are likely to be negatively impacted, and B) the magnitude of the impact on the incomes of tax filers who are likely to be negatively affected by the new cap. In addition to examining these issues for Illinois overall, we also examine them at the zip code level to understand the geographic variation in the impact of the SALT deduction cap.

The source of data is the IRS' Individual Income Tax ZIP Code Data for tax year 2015.[3] The data is based on administrative records of individual income tax returns (Forms 1040). The estimates for this study do not account for the recent increase in the Illinois' state income tax rate, which increased from 3.75% to 4.95% on July 1, 2017. As such, the estimates herein likely understate the impact of the capped SALT deduction because the amount of state and local income taxes Illinois taxpayers paid in 2015 was less than it will be in 2018, holding total incomes constant.

For the tax year 2015, the total number of federal income tax returns from the state of Illinois was 6,087,930, and about 32 percent (or 1,927,120) of those returns included itemized deductions. After excluding taxpayers who would most likely take the standard deduction under the new tax law, we estimate that 1,397,357 filers would continue to choose to itemize deductions.[4] In 2015, 1,874,240 filers claimed the SALT deduction, totaling $23.3 billion.[5] Under the new tax law, we estimate that 1,362,903 filers would still itemize and claim the SALT

[3] Accessed on October 15, 2018 from https://www.irs.gov/statistics/soi-tax-stats-individual-income-tax-statistics-zip-code-data-soi

[4] We first calculate the average itemized deduction amount per filer for each bracket of AGI. Then we exclude the filers who would switch from itemized deduction to standard deduction according to the filing status and the average itemized deduction amount. For example, married individuals filing joint returns would be excluded if the average itemized deduction is at or below $24,000; heads of household would be excluded if the average itemized deduction is at or below $18,000; and single filers would be excluded if the average itemized deduction is at or below $12,000.

[5] We focus only on the filers who itemize and claim SALT deduction. Filers who choose the alternative minimum tax are excluded from our estimates because they are not allowed to deduct SALT.

deduction.[6] The total SALT deductions would be reduced to $19.9 billion had the new, higher standard deductions been in effect in 2015.[7]

The IRS data are available for multiple levels of filers' adjusted gross income (AGI). We expect that the amount of SALT in excess of the new $10,000 cap will vary by level of AGI. To estimate how many tax filers will be impacted, we first divide the total amount of SALT deduction by the number of filers who would claim that deduction in order to calculate the average SALT deduction for each level of AGI.

As shown in Table 1, the average SALT deduction per filer rises with the level of AGI, and the amount of SALT deducted per filer that is in excess of the new $10,000 SALT deduction cap also increases for filers with higher AGIs. In particular, the average SALT deduction per filer is below $10,000 if the filer's AGI is under $100,000. We estimate that tax filers with AGI at or above $100,000 will possibly experience an increased federal tax liability due to the new SALT deduction cap.[8] As such, we estimate that approximately 15 percent of all 2015 Illinois tax fillers would be negatively impacted by the new SALT deduction cap.[9]

Table 1: The Average Excess of SALT Deductions – State of Illinois

Level of AGI	Number of filers who would deduct SALT	Average SALT deduction per filer	Average SALT deduction per filer in excess of the $10,000 cap
$1 ~ $25,000	79,514	$5,000	$0
$25,000 ~ $50,000	133,140	$5,200	$0
$50,000 ~ $75,000	143,596	$6,400	$0
$75,000 ~ $100,000	109,862	$8,100	$0
$100,000 ~ $200,000	617,410	$11,500	$1,500
$200,000 or more	279,380	$35,400	$25,400

Source: Author's computation

We expect that more filers in some communities will experience a higher federal tax liability than others due to substantial variation in the geographical distribution of high-income individuals in the state as well as variation in local tax rates. We therefore calculate the number

[6] We assume that the number of filers who would itemize SALT is reduced in the same proportion as the number of filers who would still choose itemized deduction under the new law.
[7] We assume that the amount of SALT deduction is reduced in the same proportion as the number of filers who would still itemize SALT under the new law.
[8] This is based on the statewide data of the average SALT deduction. The more detailed zip code level data indicate that, while the affected taxpayers still concentrate in the income brackets at or above $100,000, a few filers in the brackets lower than $100,000 will also be affected by the cap.
[9] We estimate the impact of the new SALT deduction cap using the 2015 tax data, and the actual number of tax filers that are impacted will likely vary for a variety of reasons including change in income and behavioral changes aimed at tax avoidance.

of filers whose federal tax liability would be increased by the SALT deduction cap for each zip code area in Illinois.

Table 2 provides information of the 50 zip codes that have the largest proportions of filers who would be affected by the SALT deduction cap. It shows the number of all federal income tax filers in each zip code, the number of filers that we estimate will have SALT deductions greater than $10,000 and therefore will be affected by the SALT deduction cap, and what percentage the negatively affected tax filers are of all tax filers in that zip code. For example, Table 2 shows that there are 3,910 tax filers in zip code 60022 in Glencoe, Cook County and we estimate that 2,500 or nearly 64 percent of them would have an average SALT payment exceeding $10,000, and therefore their federal tax liability would most likely increase under the new SALT deduction cap as compared with their federal tax liability in 2015 when the SALT deduction was not capped. The majority of taxpayers in 11 zip code areas (less than 1 percent of all zip codes in Illinois) would see higher federal income tax liabilities. These 11 zip code areas are located in just three Illinois counties: five zip code areas in Cook County (60022 in Glencoe, 60043 in Kenilworth, 60093 in Winnetka, 60091 in Wilmette, and 60558 in Western Springs), four in Lake County (60045 in Lake Forest, 60010 in Barrington, 60035 in Highland Park, and 60015 in Deerfield), and two in DuPage County (60184 in Wayne, and 60521 in Hinsdale).

Table 2: The Number and Percent of Affected Filers

Zip code	Municipality	County	Total number of filers	Number of filers whose federal tax liability would increase due to the SALT deduction cap	Percent of all filers whose federal tax liability would increase due to the SALT deduction cap
60022	Glencoe	Cook	3,910	2,500	63.9%
60184	Wayne	DuPage	1,220	758	62.1%
60045	Lake Forest	Lake	9,990	6,040	60.5%
60043	Kenilworth	Cook	1,220	730	59.8%
60093	Winnetka	Cook	9,560	5,580	58.4%
60010	Barrington	Lake	21,560	12,518	58.1%
60521	Hinsdale	DuPage	8,210	4,520	55.1%
60091	Wilmette	Cook	13,140	7,170	54.6%
60558	Western Springs	Cook	6,260	3,302	52.7%
60035	Highland Park	Lake	15,150	7,810	51.6%
60015	Deerfield	Lake	13,510	6,790	50.3%
60047	Lake Zurich	Lake	20,380	10,038	49.3%
60069	Lincolnshire	Lake	4,350	2,133	49.0%
60523	Oak Brook	DuPage	5,390	2,560	47.5%
60305	River Forest	Cook	5,250	2,450	46.7%
60564	Naperville	Will	19,450	8,944	46.0%
60026	Glenview	Cook	6,720	3,080	45.8%
60603	Chicago	Cook	1,400	640	45.7%
60175	Saint Charles	Kane	11,490	5,213	45.4%
60048	Libertyville	Lake	14,510	6,473	44.6%
60062	Northbrook	Cook	21,110	9,300	44.1%
60585	Plainfield	Will	10,030	4,247	42.3%
60044	Lake Bluff	Lake	4,980	2,050	41.2%
60134	Geneva	Kane	14,570	5,968	41.0%
60565	Naperville	DuPage	19,690	7,868	40.0%
60540	Naperville	DuPage	20,560	8,146	39.6%

60012	Crystal Lake	McHenry	5,300	2,031	38.3%
60192	Hoffman Estates	Cook	7,680	2,933	38.2%
60124	Elgin	Kane	10,610	3,989	37.6%
60554	Sugar Grove	Kane	5,900	2,202	37.3%
60137	Glen Ellyn	DuPage	18,870	6,986	37.0%
60068	Park Ridge	Cook	19,400	7,089	36.5%
60203	Evanston	Cook	2,240	810	36.2%
60422	Flossmoor	Cook	4,900	1,771	36.1%
60514	Clarendon Hills	DuPage	4,730	1,700	35.9%
60490	Bolingbrook	Will	9,700	3,478	35.9%
60611	Chicago	Cook	19,300	6,900	35.8%
60461	Olympia Fields	Cook	2,440	870	35.7%
60423	Frankfort	Will	15,680	5,464	34.8%
60067	Palatine	Cook	20,640	7,187	34.8%
60304	Oak Park	Cook	8,290	2,880	34.7%
61705	Bloomington	Mclean	6,400	2,220	34.7%
60025	Glenview	Cook	20,240	6,915	34.2%
60126	Elmhurst	DuPage	22,430	7,590	33.8%
60302	Oak Park	Cook	16,000	5,369	33.6%
60464	Palos Park	Cook	5,090	1,688	33.2%
60491	Homer Glen	Will	11,480	3,775	32.9%
60119	Elburn	Kane	5,080	1,660	32.7%
60089	Buffalo Grove	Lake	21,770	7,067	32.5%
60712	Lincolnwood	Cook	6,370	2,060	32.3%
	Illinois Total		**6,087,930**	**896,790**	**14.7%**

Source: Author's computations

Note: The table only includes the 50 zip codes that have the largest proportions of filers who would be affected by the cap on SALT deductions.

Appendix 1 provides the number and percentage of filers whose federal income tax liability would probably increase for all 1,229 zip codes in the file. It shows an uneven geographic impact of the SALT deduction cap. We estimate that some filers in 660 zip code areas in Illinois will be affected by the cap, whereas no taxpayer in the remaining 569 zip code areas will feel any financial effect. The 569 zip code areas that are not affected by the cap are mostly small communities—480 of them have less than 1,000 filers of federal income tax returns.

To further examine the impact of the cap, we estimate the extent to which the cap on SALT deduction will affect personal incomes. We follow a four-step approach to estimate the effects on the filers' income. First, the amount of 2015 SALT deductions that is in excess of the new $10,000 cap (the "excess SALT deductions") is determined for each AGI bracket. Second, we calculate a weighted average marginal tax rate for each level of AGI by multiplying the shares of different types of filers (single, head of household, and married filing jointly) and the corresponding marginal federal income tax rates in 2018. Third, we multiply the excess of SALT deductions and the weighted average marginal tax rate. This estimate would be the increased federal income tax liability or reduced personal income if the TCJA were effective in 2015. Last, we divide the reduced personal income by the total AGI of those who would be affected by the new cap to approximate the percent reduction in personal incomes of those filers due to the new cap provision.

Table 3 shows the estimated average percentage income that will likely be reduced by the new SALT deduction cap for the 50 zip codes with the greatest impact (the zip codes in Tables 2 and 3 are not identical as they measure different estimated impacts). For each of those 50 zip codes, Table 3 presents the number of filers in the top AGI bracket who would be impacted, the estimated total increase of their federal tax liability and the estimated percentage reduction of income as a result of the cap.[10] It should be noted that the estimated increase of federal tax liability and percentage reduction in income of tax filers are based on the assumption that the $10,000 SALT deduction cap had been in place in 2015. They are not the net effects of the TCJA. For example, the lower federal income tax rates may offset the negative impact of the cap. On the other hand, the increase of Illinois' income tax rate in the middle of 2017, which is not incorporated in the estimates, may counter the offsetting effects of the lower federal tax rates to a certain extent.

Therefore, the estimates in Table 3 are those only due to the SALT cap and do not incorporate the estimated effects of other elements of the TCJA. Holding all those elements constant, then, we estimate that the 470 tax filers residing in the 60606 zip code area in Chicago, Cook County with AGI above $200,000 would have to pay a total of $21.5 million additional federal income taxes than they paid in 2015, and such an increase in federal taxes would lead to an average of 4% reduction of their adjust gross income under the SALT deduction cap as compared with the tax year 2015 when the SALT deduction was not capped.

Table 3: Estimated Average Reduction in Income Due to SALT Deduction Cap

Zip code	Municipality	County	AGI bracket at $200,000 or more		
			Number of filers impacted	Estimated total increase of federal tax liability due to the cap	Estimated average percentage reduction in income due to the cap
60606	Chicago	Cook	470	$21,522,160	-4.0%
60604	Chicago	Cook	110	$7,212,040	-2.7%
60043	Kenilworth	Cook	510	$25,099,690	-2.6%
60184	Wayne	DuPage	290	$4,741,920	-2.5%
60601	Chicago	Cook	1,180	$24,462,000	-2.4%
60093	Winnetka	Cook	3,580	$116,968,200	-2.3%
60022	Glencoe	Cook	1,670	$51,283,110	-2.2%
60045	Lake Forest	Lake	3,550	$89,883,630	-2.2%
60035	Highland Park	Lake	3,870	$83,726,060	-2.2%
60305	River Forest	Cook	1,380	$18,633,940	-2.1%
60523	Oak Brook	DuPage	1,500	$27,697,090	-2.1%
60068	Park Ridge	Cook	2,980	$32,527,810	-2.1%
60603	Chicago	Cook	400	$11,314,600	-2.1%
60010	Barrington	Lake	5,490	$74,912,790	-2.1%
60521	Hinsdale	DuPage	2,910	$60,549,760	-2.1%
60015	Deerfield	Lake	3,430	$48,236,160	-2.0%
60514	Clarendon Hills	DuPage	1,020	$12,746,500	-2.0%
60091	Wilmette	Cook	3,920	$51,348,970	-2.0%
60558	Western Springs	Cook	1,790	$19,690,120	-2.0%
60302	Oak Park	Cook	2,420	$24,962,790	-2.0%

[10] Please see Appendix 2 for the estimated impacts on taxpayers residing in all 1,229 zip code areas in the file.

60069	Lincolnshire	Lake	940	$10,037,730	-2.0%
60527	Willowbrook	DuPage	2,320	$30,505,390	-2.0%
60047	Lake Zurich	Lake	4,220	$45,152,580	-2.0%
60067	Palatine	Cook	2,750	$27,601,670	-1.9%
60137	Glen Ellyn	DuPage	3,020	$30,032,160	-1.9%
60175	Saint Charles	Kane	2,310	$23,120,160	-1.9%
60012	Crystal Lake	McHenry	700	$5,358,340	-1.9%
60189	Wheaton	DuPage	2,110	$18,417,120	-1.9%
60201	Evanston	Cook	3,140	$30,088,030	-1.9%
60174	Saint Charles	Kane	1,360	$13,652,970	-1.9%
60525	La Grange	Cook	1,950	$16,259,650	-1.9%
60422	Flossmoor	Cook	590	$4,827,020	-1.9%
60546	Riverside	Cook	670	$5,312,460	-1.8%
60048	Libertyville	Lake	3,310	$34,241,970	-1.8%
60044	Lake Bluff	Lake	1,040	$13,298,910	-1.8%
60025	Glenview	Cook	3,180	$34,750,770	-1.8%
60062	Northbrook	Cook	4,340	$48,017,950	-1.8%
60119	Elburn	Kane	430	$2,968,880	-1.8%
60040	Highwood	Lake	130	$1,450,030	-1.8%
60564	Naperville	Will	4,010	$28,270,220	-1.8%
60464	Palos Park	Cook	700	$6,764,710	-1.8%
60134	Geneva	Kane	2,140	$14,615,000	-1.8%
60089	Buffalo Grove	Lake	2,200	$14,098,850	-1.7%
60026	Glenview	Cook	1,610	$16,611,150	-1.7%
60061	Vernon Hills	Lake	1,630	$11,099,630	-1.7%
60540	Naperville	DuPage	3,380	$30,315,540	-1.7%
60712	Lincolnwood	Cook	670	$7,651,970	-1.7%
60565	Naperville	DuPage	2,970	$19,765,400	-1.7%
60304	Oak Park	Cook	850	$4,450,290	-1.6%
60585	Plainfield	Will	1,210	$6,194,910	-1.5%
	Illinois		**279,380**	**$2,622,093,750**	**-1.8%**

Source: Author's computations
Notes:

a. Each percentage in the last column refers to the estimated reduction of income as percent of AGI of the filers who would be affected by the new tax law.
b. The table only includes the 50 zip codes that have the largest percentages of income reduction.

These estimates suggest that on average, the SALT deduction cap will not have a large impact on personal income overall, in Illinois. For the entire state, the estimated average reduction of income would be 1.8 percent of the adjusted gross income of the affected filers at the highest AGI bracket— $200,000 and more. For the affected filers in the top income bracket, only 15 zip code areas have greater than two percent average reduction in income, including nine in Cook County (60601, 60603, 60604 and 60606 in Chicago, 60043 in Kenilworth, 60093 in Winnetka, 60022 in Glencoe, 60305 in River Forest, and 60068 in Park Ridge), three in Lake County (60045 in Lake Forest, 60035 in Highland Park, and 60010 in Barrington), and three in DuPage County (60184 in Wayne, 60523 in Oak Brook, and 60521 in Hinsdale). Again, this is evidence of the varied geographic impact the SALT deduction cap is likely to have on Illinois tax filers. While the majority of taxpayers are not affected by the new SALT deduction cap, those who are impacted are likely to be concentrated in a few zip code areas.

Acronyms and Terms

- **Adjusted gross income (AGI).** AGI is a tax filer's total income that is subject to federal taxation.
- **Deductions.** Deductions reduce a tax filer's taxable income. A tax filer's AGI minus deductions (and exemptions) equals their taxable income. A tax filer can choose to itemize their deductions or take the standard deduction.
- **State and local taxes (SALT).** The SALT deduction is one of the deductions a tax filer can claim when itemizing deductions. The SALT deduction allows tax filers to reduce their taxable income (thus ultimately reduce their federal income tax liability) by state and local property taxes and general sales or income taxes they pay.

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