NATIONAL WOMEN'S LAW CENTER
EXPANDING THE POSSIBILITIES

Financing Vital Investments and Improving Tax Fairness: Limit Tax Benefits of Itemized Deductions for Wealthiest Taxpayers

Under current law, taxpayers are allowed to reduce their taxable income by claiming the standard deduction or itemized deductions for certain expenses, including mortgage interest, charitable contributions, property taxes and state income taxes. Deductions are subtracted from income before tax is calculated and can reduce the applicable tax rate – the higher the tax bracket, the bigger the tax benefit from a deduction

- For example, a wealthy taxpayer in the current top tax bracket, 35%, who makes a $1,000 charitable contribution gets a tax saving of $350 from the itemized deduction (35% times $1,000). A middle-income taxpayer in the 15% tax bracket who makes the same $1,000 contribution gets a tax saving of $150.

President Obama's proposal would limit the value of itemized deductions for high-income taxpayers to 28%, starting in 2011. This would raise $267 billion in revenue over 10 years that could help pay for health care reform and other vital investments. The proposal would:

- Limit the tax subsidies the wealthiest taxpayers get from itemized deductions to 28%. For example, someone in the 35% bracket who makes a $1,000 charitable contribution would get a tax benefit of $280 rather than $350 – an amount that still exceeds the tax benefit available to someone in the 10%, 15%, or 25% tax bracket *for the same contribution*.

- The proposed change, applicable only to couples with income of at least $250,000 and individuals with income of at least $200,000, would affect less than 1.2% of U.S. households – people in the top two tax brackets who itemize deductions. And, because households with incomes *far* above $250,000 take the largest deductions, the effects would be concentrated among the very, very wealthy, according to an analysis by the Center on Budget and Policy Priorities.

The proposal promotes tax fairness and raises revenues that could help finance health care reform or other vital investments. Contrary to charges by some critics, the proposal would have little effect on charitable giving, small businesses, or housing.

An analysis by the Center on Budget and Policy Priorities, citing work by the Urban Institute-Brookings Institution Tax Policy Center, shows that criticisms of the proposal are overblown:

- *Charitable Giving*: Studies show that any decline in charitable giving as a result of the proposal would likely be very small: about 1.3% based on the current top tax rate. (If the top tax rate increased, the decline in charitable giving would be about 2%.) Only a

portion of charitable contributions, about 62%, comes from those who itemize deductions, and only 18% of those contributions come from the 1.2% of taxpayers in the top brackets who would be affected by the proposal. And, according to fund-raising experts, research has repeatedly found that tax incentives are at the bottom of the list of reasons that major donors give for making gifts to charities.

- *Small Business*: Just 1.9% of small business filers are in the top tax brackets, according to an estimate by the Tax Policy Center. (And, this estimate likely overstates the impact of the proposals, because it defines as "small businesses" taxpayers who do not operate a small business but get any amount of income from rents, farms, and partnerships.)

- *Housing:* Limiting the itemized deduction for mortgage interest to 28% would have a very limited impact on home purchases, because this proposal would only affect households with incomes above $250,000. Even for this group, the proposal is unlikely to affect their decision whether to buy a home, since they will still receive a substantial tax subsidy.