Tax Reform and Tax Hypocrisy

By: Andrew B. Wilson

Conservatives have long argued that taxes matter. Sure, they matter, progressives have countered – if all you care about is making the rich richer and doing nothing to help working people.

Witness an incredible turn of events:

We now hear the proudly progressive governors of California and New York howling in outrage at the removal of a substantial tax break for those at the highest level of income – the top 10 percent, and, especially, the top one percent.

Under the Tax Cut and Jobs Act that went into effect on Jan. 1, taxpayers may no longer count all of their state and local income tax payments, plus property taxes, as deductible expenses on their federal returns. The new law caps the deductibility of these state and local taxes (the so-called SALT deduction) at $10,000 per taxpayer. What follows is a rough calculation of how the cap will impact people at several different levels of income (focusing only on California, where local income taxes are not as important a factor as they are in New York, and disregarding property taxes).

Based on California income tax tables, a couple earning $150,000 in 2018 will owe $8,797 to the state of California – with the consolation of knowing that every cent will be deductible. The couple will save about $2,000 on their federal return.
A tipping point occurs at $164,000 in adjusted gross income. Exceeding that, a California couple filing jointly runs out of cap room and gets no further benefit from the SALT deduction.

The top one percent in California starts at about $500,000, according to the latest available data from the Internal Revenue Service. With that income, an entry-level couple in the one percent club will owe $41,347 to the state. Since all but $10,000 of the state tax is nondeductible under the new law, it has the effect of bumping up the adjusted gross income on their federal return by $31,347. Applying the top federal rate of 37 percent to that sum, the couple will owe an additional $11,598 to Uncle Sam.

The average income for families in the top one percent in California is $1.6 million, or more than three times the starting income. So how does the "average" ultra-rich family fare under the new tax regime? In 2018 it will owe $165,072 to the state – with a whopping $155,072 no longer counting as a deductible expense. Consequently, the family will take a hit of a little more than $57,000 in what it owes to Uncle Sam.

In a nutshell, the top one percent of filers in California are about to lose a huge tax break. No longer will they be able to reap one dollar in federal tax savings for every three or four dollars going to the state government.

No wonder the governors of the two states are worried. At 13.3 percent, California has the highest marginal income tax rate of all the states. New York State's top rate is 8.82 percent, and that jumps to 12.7 percent in New York City. Each state garners nearly 50 percent of its total income tax revenues from the top one percent of earners.

Who has compensated for the outsized deductions that the highly paid denizens of Hollywood, Silicon Valley, and Wall Street have been able to claim on their federal returns due to exceptionally high state and local taxes?

Taxpayers in low-tax states and less affluent regions have done so. In the process, they have helped to subsidize the growth in public spending that has occurred in Sacramento, Albany, and New York City.

The situation will soon change. In early 2019, when people file their local, state, and federal tax returns for the 2018 tax year, the cross-subsidies, of a reverse Robin Hood nature, will largely disappear.

At the same time, taxpayers outside the top ten percent of filers will appreciate the positive impact of a near doubling in the standard deduction – to $12,000 for individuals and to $24,000 for couples. According to the nonpartisan Tax Foundation in Washington, D.C., a married couple with two children and a combined adjusted income of $85,000 will reap a $2,254 tax savings in 2018 as a result of provisions in the new law.

So, what about the vociferous complaints coming from progressives, who say that the new law only serves to make the rich richer and does nothing to help working people?

But the tax tables tell an entirely different story.
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