ITEMIZING ON STATE AND FEDERAL TAX INCOME RETURNS: IT'S (NOW MORE) COMPLICATED

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A taxpayer's decision to itemize deductions or to claim the standard deduction on their income tax return is often framed as a simple calculation: Claim the greater of the two so as to minimize tax liability. But in states that require taxpayers to use the same status on their state income tax return as on their federal return, this general rule can produce conflicting results if taxpayers examine liability separately on their federal and state returns. Itemized deductions might be greater than the standard deduction on a state income tax return, but the reverse could be true on a federal return. Recent federal law changes have further complicated the choice. When the federal standard deduction was nearly doubled beginning in 2018, many more taxpayers found a conflict between the best itemization scenario on federal and state income tax returns. Those taxpayers must now calculate their federal and state income taxes under both scenarios if they want to minimize their combined state and federal income tax liability. Many taxpayers in states that link federal and state itemization choices are affected. In Maryland, for example, more than 200,000 taxpayers could benefit by itemizing on their federal returns when that may not be the obvious choice. In this brief, I examine the links between federal and state itemization decisions and explore the implications of relaxing state rules requiring that state itemization choices match federal ones.

Relatively few federal taxpayers itemize deductions on their income tax returns under current law, and those who do tend to have very high incomes. Almost three-quarters of the households itemizing federal deductions under current law have incomes in excess of $100,000.[1] Tax filers with low or moderate incomes who itemize often have a specific large deduction (such as high medical expenses) that makes itemizing more beneficial than claiming the standard deduction. In some cases, however, it makese sense for lower-income filers to itemize deductions on their federal returns even though their itemized deductions are less than the standard deduction. In states that only allow itemizing on state income tax returns when itemizing on federal returns, itemizing in these cases can sometimes allow a taxpayer to lower their state tax bill. By itemizing on both the federal and state returns, some taxpayers can reduce their state income tax liability by more than their increase in federal income tax liability. A combination of certain demographic and income characteristics combined with a particular state's tax rules can lead to this counterintuitive result.

For example, take a single person living in Maryland with $75,000 in wage income who is filing an income tax return for tax year 2019 (table 1). Assume she has itemized deductions that are slightly less than the $12,200 federal standard deduction. Because her itemized deductions are less than $12,200, she would owe less federal tax if she claimed the standard deduction. But because Maryland's standard deduction ($2,250) is significantly lower than the federal standard deduction, she could owe less state income tax if she were to itemize deductions on her state income tax return. As in a number of other states, Maryland only allows filers to itemize deductions on their state returns if they itemize deductions on their federal return. Thus, for this taxpayer, itemizing and paying $91 more in federal taxes is the right choice because doing so means she can decrease her state and local income taxes by $353.[2] On net, she would be $262 better off by itemizing deductions on both her federal and state returns.

TABLE 1

Example of the Advantage of Itemizing Deductions For a Single Maryland Resident in 2019

	Standard deduction	Itemized deductions	Change from itemizing
Federal tax calculation			
Income	75,000	75,000	
- Standard deduction	12,200	--	
- Itemized deductions for state income taxes	--	4,985	
- Other itemized deductions	--	6,800	
= Taxable income	62,800	63,215	
Federal income tax liability	9,675	9,766	91
State tax calculation			
Income	75,000	75,000	
- Standard deduction	2,250	--	
- Other itemized deductions	--	6,800	
- Personal exemption	3,200	3,200	
= Taxable income	69,550	65,000	
Maryland income tax liability	5,338	4,985	-353
Combined federal and state tax liability	15,013	14,751	-262

Source: Author calculations.

Notes: State and local income taxes are only deductible on federal returns. Maryland income tax liability includes local income tax at an assumed rate of 3 percent.

Refundable state tax credits can also affect taxpayers' itemization decisions. Some state refundable credits, such as Maryland's Child and Dependent Care Tax Credit and New York's Empire State Child Credit, are tied to the federal calculation of income tax liability before federal tax credits reduce the total. Most low-income families have little or no federal tax liability before credits and would therefore be ineligible for these state refundable credits. To become eligible, some of these taxpayers could choose to itemize on their federal return despite relatively small potential itemized deductions. Itemizing on their federal return would increase their federal tax liability before credits and make them eligible for the refundable state tax credits. Notably, this decision in many cases would not affect their bottom-line federal tax liability because credits such as the federal dependent care credit or federal child tax credit would offset the increase in tax before credits. (See appendix A for examples of low-income taxpayers itemizing deductions to take advantage of state refundable credits).

Although it is easy to construct examples where itemizing on federal returns reduces state tax liability, in practice it can be quite difficult for taxpayers to know which itemizing decision will minimize their combined federal and state tax liability. When preparing their taxes (or having them prepared), taxpayers first completely fill out their federal returns before starting their state returns, and they may focus solely on minimizing federal taxes, unaware of how those choices affect their state liability. At least one commercial tax preparation program that can calculate federal and state taxes simultaneously does not automatically select the tax-minimizing strategy in cases like these. A user can manipulate the software to produce the tax-minimizing strategy, but doing so is often not straightforward. Although differences in tax-minimizing strategy have always existed, these tensions became stronger after passage of the Tax Cuts and Jobs Act of 2017 (TCJA).

HOW THE TAX CUTS AND JOBS ACT CHANGED THE INCENTIVES TO ITEMIZE DEDUCTIONS

The TCJA made several significant changes to federal law that affect the incentives for itemizing deductions on federal and state tax returns. Most importantly, the law nearly doubled the federal standard deduction (from $6,500 to $12,000 for single filers in the law's first year).[3] It also limited certain itemized deductions by capping the federal deduction for state and local taxes at $10,000 per year, limiting mortgage interest deductions, and eliminating the deductions for casualty losses and miscellaneous expenses.[4] Because of those changes, the Tax Policy Center estimates that the number of taxpayers claiming itemized deductions on their federal returns in 2018 was less than half of what it would have been if the TCJA were not in place.[5] However, although many taxpayers found it beneficial to switch from itemized deductions to the standard deduction, certain taxpayers in some states may find it better to continue to itemize at the federal level even though their federal itemized deductions are now less than the standard deduction.

To illustrate how the TCJA changed incentives to itemize, we simulated itemizing choices for Maryland taxpayers in 2019 using the Tax Policy Center's State Income Tax Model. The model captures the interactions between federal tax law and each state's income tax system for a sample of households. The sample can be reweighted to be representative of each state's population. The model iterates between state and federal calculations to capture interactions between federal and state tax systems.[6] To understand the incentives for itemizing deductions, the model can make alternative assumptions about how taxpayers make their itemizing decision: It can base the decision to itemize solely on federal income taxes or it can allow taxpayers to consider the impact on both federal and state (and local) income taxes. For this analysis, we assumed that taxpayers would choose whether to itemize so as to minimize their combined federal and state and local income tax liability.

To examine the TCJA impact on the itemization decision, we also calculated what the income tax liabilities and itemization choices would be under the pre-TCJA rules. For example, the federal standard deduction for a taxpayer using the single filing status was $12,200 in 2019 but would have been only $6,600 in that year if the TCJA increase had not been enacted. Similarly, the limit on state and local taxes was not in place before the TCJA was passed.

We estimate that about 915,000 Maryland taxpayers could have benefited from itemizing deductions on their federal tax return in 2019 (table 2). That is, for these taxpayers, choosing to itemize on their federal return (and thus also on their state return) would create the lowest combined income tax liability. Roughly a quarter of these taxpayers (237,000) would benefit from itemizing on their federal income tax returns even though their federal itemized deductions were less than the federal standard deduction, because doing so would allow them to itemize on their state returns and reduce their state income taxes. For those taxpayers, the average decrease in state income taxes from itemizing deductions on their state return ($837) outweighed the average increase in federal income taxes ($392) from itemizing rather than claiming the standard deduction.

TABLE 2

TCJA's Effect on Maryland Itemizers in 2019

	Current law	Without TCJA changes
Number of federal itemizers in Maryland (thousands)	916	1,559
Taxpayers who would benefit from itemizing even when federal itemized deductions are below the federal standard deduction:		
Share of federal itemizers (percent)	26	1
Average reduction in federal taxes from itemizing (dollars)	392	2
Average reduction in state taxes from itemizing (dollars)	-837	-7
Average net benefit from itemizing (dollars)	-445	-5

Source: TPC State Income Tax Model
Notes: State tax includes an assumed Maryland local income tax rate of 3 percent. The simulations without the Tax Cuts and Jobs ACT (TCJA) account for the cap on state and local tax deductions and the change in the federal standard deduction.

Without the TCJA's changes to standard and itemized deductions, the number of Maryland taxpayers itemizing on their federal tax return would have been 70 percent larger. But very fewer taxpayers with itemized deductions under the old rules would have had incentives to itemize deductions when their itemized deductions were below the federal standard deduction: only 19,000 (1 percent) of those itemizing under the old rules. Before the TCJA, the incentives for itemizing were also smaller because the differences between the Maryland and federal standard deductions were much smaller. For these taxpayers, the net benefit of itemizing before the TCJA was only $5 on average.

The large increase in the number of taxpayers itemizing on federal returns when deductions are less than the standard deductions results primarily from the TCJA's increase in the standard deduction. The TCJA introduced a large discrepancy between the federal and state standard deductions in Maryland and some other states, and this made taxpayers more likely to want to itemize on federal returns when their potential itemized deductions were less than the standard deduction. Although the TCJA's $10,000 annual cap on state and local deductions also affected these incentives, most taxpayers affected by that cap would have federal itemized deductions greater than the standard deduction and would already be itemizing based on their federal returns alone.[7]

RELAXING CONSTRAINTS ON STATE ITEMIZING OPTIONS

Some states require that taxpayers make the same decision about whether to itemize deductions or claim the standard deduction on their state income tax returns as on their federal returns. Among the 44 states with a personal income tax in 2018, 5 required that the state itemization status match the federal status (table 3). Another 5 required taxpayers to claim the standard deduction on state returns if they claimed the federal one but allowed them a choice if they itemized on the federal return. Fifteen allowed taxpayers to choose any combination of itemizing or taking the standard deduction. The remaining states did not offer itemized deductions for state tax returns.

TABLE 3

State Links to Federal Itemizing Choice, 2018

Itemization choice must match federal choice					
District of Columbia	Georgia	New Mexico	Oklahoma	Virginia	
State return must claim standard deduction if claiming federal standard deduction					
Kansas	Maine	Maryland	Missouri	Nebraska	
No link between federal and state itemizing decision					
Alabama	Arkansas	Arizona	California	Delaware	Hawaii
Idaho	Iowa	Kentucky	Minnesota	Mississippi	Montana
New York	North Carolina	Oregon			
No state itemized deductions					
Colorado	Connecticut	Indiana	Illinois	Lousiana	Massachusettes
Michigan	New Hampshire	New Jersey	North Dakota	Ohio	Pennsylvania
Rhode Island	South Carolina	Tennessee	Utah	Vermont	West Virginia
Wisconsin					

Source: TPC State Tax model.
Notes: Colorado, North Dakota and South Carolina use federal taxable income. Wisconsin offers a credit for certain deductions.

Heavy reliance on the federal government takes a degree of autonomy away from states. If states automatically conform to federal rule changes, they may experience changes that are inconsistent with state values or revenue needs. But many states conform to federal tax rules to simplify recordkeeping and compliance for taxpayers and to reduce administrative costs for state tax authorities. If, for example, taxpayers claim the federal standard deduction because it is larger than their potential itemized deductions, they will generally still come out ahead even though they cannot itemize on state returns where the standard deductions are lower because in most cases, lower federal taxes from claiming the standard deduction will more than offset the higher state taxes from not being able to itemize. In this case, the state following the federal government saves the taxpayer from keeping track of potential itemized deductions and taking the time to calculate taxes with and without itemizing on their state and federal returns. Linking state itemized deductions to federal ones also reduces the enforcement requirements for state tax authorities as they can rely, to some extent, on federal checks of itemized deductions. If a state allows taxpayers who claim the standard deduction on federal returns to itemize on state returns, it would not be able to rely on federal compliance measures to verify itemized deductions.

On the other hand, one could argue that taxpayers should get to choose whichever itemization status minimizes their state tax liability. Because most taxpayers already rely on tax preparation software or professional preparers, it is unclear how much of an additional compliance burden would arise from allowing separate federal and state itemization choices. As a matter of fairness, it would be desirable for state taxpayers in similar situations be treated the same without regard to their federal itemization choice. But despite the increasing incentives to delink following the passage of the TCJA, no states to date have relaxed the requirements between federal and state optimization choices. The potential loss in revenue may be one factor preventing states from implementing such changes.

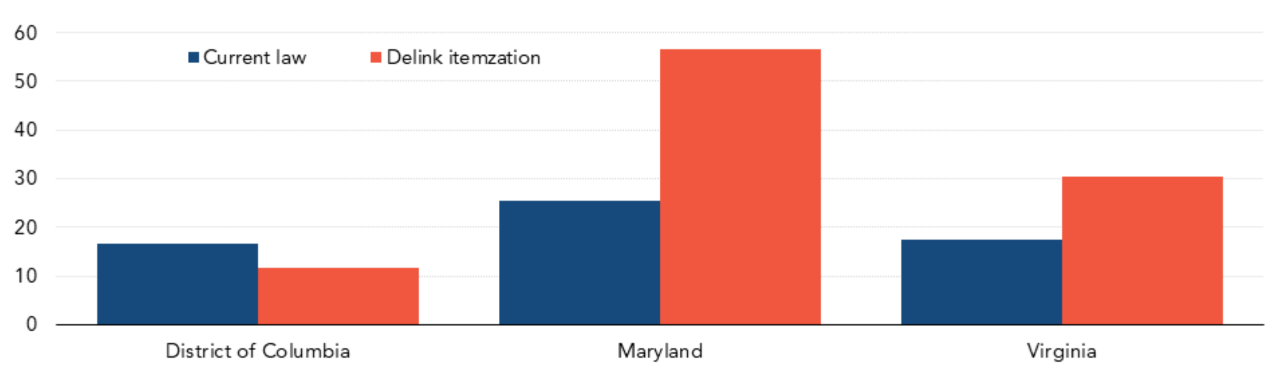
To see how much these links matter, we consider the impact of relaxing the constraints on state itemizing choices for three jurisdictions in the Washington, DC, metropolitan area for tax year 2019. Maryland, Virginia, and the District of Columbia all constrain state itemization choices based on what taxpayers did on their federal returns, but because of differences in these jurisdictions' standard deductions, the impact can vary greatly. The District of Columbia and Virginia require that the state itemization status match the taxpayer's federal return; Maryland requires that the status be identical only when the taxpayer claims the standard deduction on the federal return. The impact of relaxing these restrictions varies and depends on the nature of the links and other factors such as the magnitude of the standard deduction in each jurisdiction. Like the previous simulations looking at the impact of the TCJA, these simulations are based on the assumption that taxpayers choose an itemization status to minimize their combined federal and state income tax liability. (For results under an alternative assumption, see appendix B).

Change in Number of Itemizers

The Tax Policy Center's State Tax Model estimates that eliminating the constraints on itemizing would slightly reduce the number of itemizers in the District of Columbia (Figure 1). Because the District and federal standard deductions were identical in 2019 (table 4), the incentives to itemize are generally the same on District and federal returns. But the incentives are not completely aligned, because allowable itemized deductions in the District are less than federal itemized deductions. As is the case in almost all states, District income taxes can only be claimed as an itemized deduction on federal returns.[8] Under current law, a small number of taxpayers itemize deductions on both their federal and District returns even though their potential District itemized deductions are less than the District's standard deduction. For those taxpayers, paying the small additional District tax is worthwhile because the reduction in federal income taxes from itemizing is much larger. If the links between the District and federal itemization status were eliminated, those taxpayers could reduce District taxes by switching to the District standard deduction. In contrast, eliminating the constraints on itemizing would more than double the share of taxpayers itemizing deductions on Maryland state income tax returns in 2019, from roughly 25 percent to over 50 percent. Virginia would see a smaller increase in the share of itemizers, from about 18 percent under current law to about 30 percent if the itemization links were relaxed. The change in Virginia is smaller than the change in Maryland primarily beause the standard deductions in Virgina are larger than in Maryland. Given the option to delink their itemization decisions, some taxpayers in Maryland and Virginia who previously itemized on federal returns under current law would instead switch to the standard deduction (figure 2). These are taxpayers for whom the value of federal itemized deductions was just below the federal standard deduction. They were itemizing because the small additional federal tax from itemizing was offset by the reduction in tax from itemizing on state returns. If the link between federal and state itemization were removed, they would switch to taking the standard deduction to slightly reduce their federal taxes. The opposite would happen in the District, which would see a slight increase in the share of taxpayers itemizing on their federal returns.

FIGURE 1

Option for Allowing Separate State and Federal Itemizing Choices: State Itemizers as a Share of All Tax Units



Source: Tax Policy Center State Tax Model.

TABLE 4

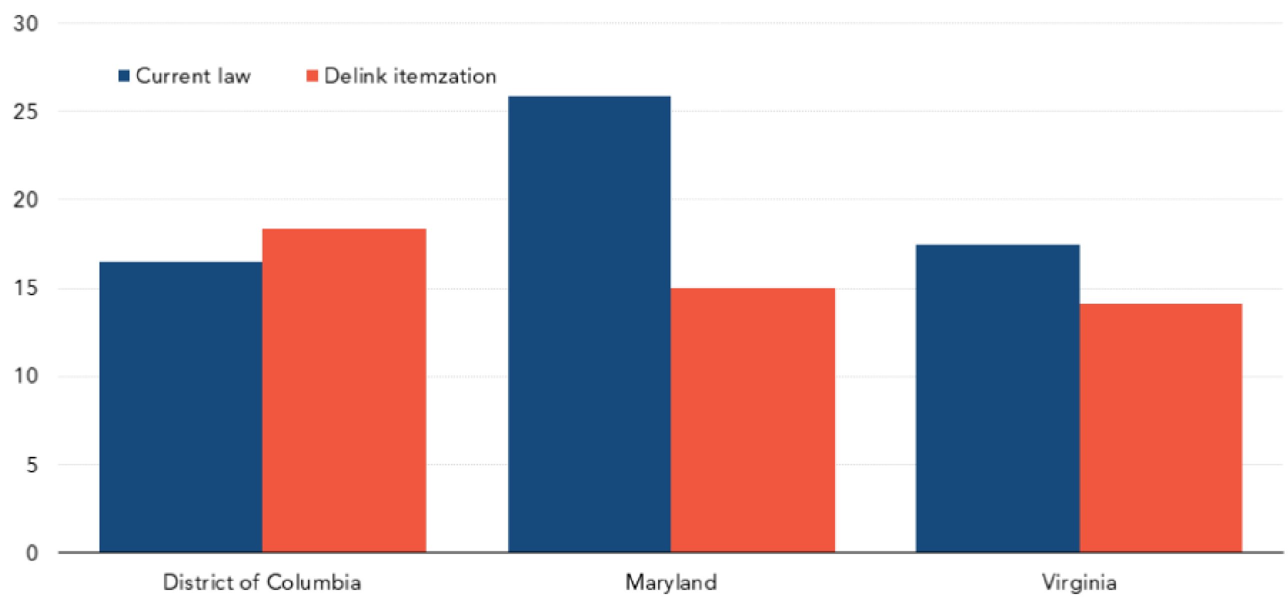
2019 Standard Deductions by Filing Status

	Single	Joint	Head of household
District of Columbia	12,200	24,400	18,350
Maryland	2,250	4,550	4,550
Virginia	4,500	9,000	4,500
Federal	12,200	24,400	18,350
Federal pre-TCJA	6,600	13,200	9,700

Source: Tax Policy Center State Income Tax Model.
Note: The Maryland standard deduction is calculated as a percent of adjusted gross income with minimum and maximum values. The value reported is the maximum standard deduction.

FIGURE 2

Option for Allowing Separate State and Federal Itemizing Choices: Federal Itemizers as a Share of All Tax Units



Source: Tax Policy Center State Tax Model.

Effect on Households

Less than 10 percent of tax units in the District of Columbia would see a decline in their combined federal and state income taxes if itemization choices were delinked. In contrast, 43 percent of tax units in Maryland would benefit from the change (table 5). Two groups could benefit from this change: First, taxpayers who currently claim the federal standard deduction and were required to also claim the standard deduction on their state returns. Among that group, taxpayers with state itemized deductions in excess of the state standard deduction would now be able to itemize on state returns to reduce their taxes. The second group benefiting from delinking are taxpayers who only itemize on federal returns because it allows them to itemize on state returns. That group would be able to switch to the federal standard deduction under the proposal and reduce their federal taxes. The average tax decrease for those who benefit would be about $500 in the District and about $800 in Maryland. Compared with Maryland, the benefit in Virginia (roughly $300) is lower because the standard deduction in Virginia is higher and because income tax rates in Virginia are significantly lower than the combined state and local income tax rates in Maryland.

TABLE 5

Delinking Federal and State Itemization Choice: Tax Units with a Tax Decrease, 2019

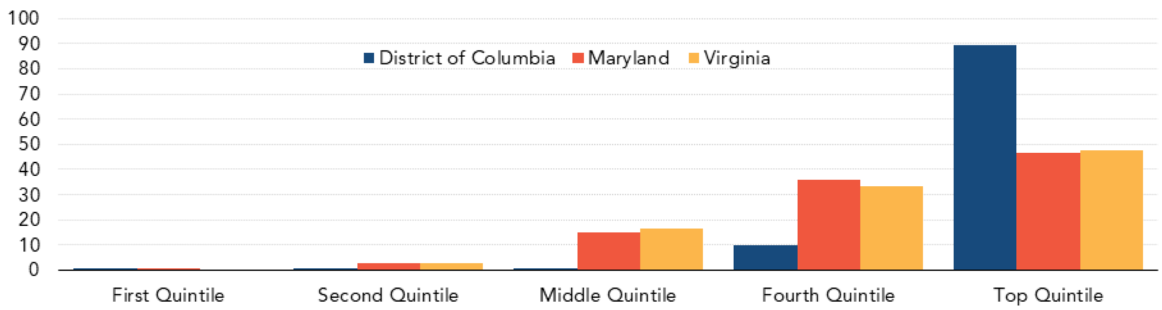
Jurisdiction	Percent of all tax units	Average tax decrease
District of Columbia	7	477
Maryland	43	796
Virginia	17	284

Source: Tax Policy Center State Income Tax Model.

Higher-income taxpayers, who are more likely to itemize in general, would benefit most from the change (figure 3). In Maryland and Virginia, more than 80 percent of the net tax change would accrue to taxpayers in the top two income quintiles, with 47 percent of the tax change in Maryland and 48 percent in Virginia going to the top income quintile. In the District, almost 90 percent of the reduction in taxes would go to the top quintile.

FIGURE 3

Option for Allowing Separate State and Federal Itemizing Choices: Share of Net Reduction in Federal and State Taxes 2019



Source: Tax Policy Center State Tax Model.
Note: Taxpayers are ranked by their place in the national distribution of federal adjusted gross income.

Revenue Impact

Delinking the itemization decision between state and federal returns would not have a large impact on jurisdiction revenues in the District of Columbia or Virginia (table 6). In Maryland, however, the revenue loss would be more significant. The District of Columbia would lose less than 0.5 percent of total income tax revenues, and Virginia would lose just under 1 percent. Maryland, on the other hand, would lose more more than 3.5 percent of its annual income tax revenues. In all three jurisdictions, however, the reduction in revenues could prove significant given current state budget constraints. (The revenue loss could be mitigated by offsetting increases in tax rates.) The size of the revenue loss for each jurisdiction is related to the differences between the federal standard deduction and the standard deduction in each jurisdiction. For example, for a married couple, the federal standard deduction was $24,400 in 2019. The District's standard deduction for married couples was identical to the federal standard deduction in 2019, while Virginia's was $9,000 and Maryland's only $4,550. Among the three jurisdictions, taxpayers with sufficient itemized deductions in Maryland had the most to gain if the state were to relax the requirement for itemizing on Maryland returns.

TABLE 6

Percent Change in Income Tax Revenue from Delinking Federal and State Itemization Choice, 2019

Jurisdiction	State revenue	Federal revenue	Federal + state revenue
District of Columbia	-0.3	--*	-0.1
Maryland	-3.6	-0.2	-1.3
Virginia	-0.9	-0.1	-0.3

Source: Tax Policy Center State Income Tax Model.
Note: * = between 0 and -.05 percent

The amount of federal income tax paid by residents in the three jurisdictions would also decline slightly were the itemizing rules delinked. Federal income taxes would decline 0.2 percent in Maryland, 0.1 percent in Virginia, and less than 0.05 percent in the District of Columbia. Federal income taxes would decline because those taxpayers currently choosing to itemize on their federal return solely because of the effect on their state return would no longer have to make the less optimal federal decision. Without a link between federal and state itemizing, taxpayers could save a few dollars on their federal taxes by claiming the federal standard deduction while continuing to itemize on their state returns.

APPENDIX A: STATE REFUNDABLE CREDITS CAN AFFECT THE DECISION TO ITEMIZE DEDUCTIONS

In some states, eligibility for refundable tax credits is based in part on certain definitions of federal tax liability. For some low-income taxpayers in those states, itemizing deductions on federal returns can be advantageous even when those itemized deductions would be below the federal standard deduction. Itemizing deductions can allow those taxpayers to claim state refundable tax credits that would otherwise be unavailable if they were to claim the federal standard deduction. New York's Empire State Child Credit and Maryland's Child and Dependent Care Tax Credit are two examples of refundable credits for which it can make sense for some low-income filers to itemize federal deductions. We don't know how many low-income taxpayers currently itemize to take advantage of state refundable credits.

For example, a single parent in New York with three children might be able to increase her Empire State Child Credit by itemizing deductions. If we assume that this parent earns $15,000 and all three children are eligible for the federal child credit, her net state tax liability would be lower if she itemizes on her federal return (table A-1). A portion of the Empire State Child Credit is based on a taxpayer's federal tax liability before subtracting the federal child and earned income tax credits. In this example, the taxpayer has no tax liability before those two credits if she claims the federal standard deduction. But if she itemizes deductions (and claims no itemized deductions), her federal taxable income will be higher and her income tax liability before those two credits will be $1,523. The taxpayer's bottom-line federal income tax liability is unchanged because that increase in tax is completely offset by the nonrefundable portion of the federal child tax credit. Whether she itemizes or not, this taxpayer will receive a net payment from the federal government of $8,432. But by itemizing on her federal return, the taxpayer can now claim a larger Empire State Child Credit. The bottom line is this taxpayer would be almost $400 better off by itemizing on her federal income tax return. However it is not clear how widespread this practice is.

TABLE A-1

Interaction between Itemizing Deductions and State Refundable Credits

New York Single Parent with Three Children, 2019

	Standard deduction	Itemize deductions	Change from itemizing	
Federal tax calculation				
Wage income	15,000	15,000		
- Standard deduction	18,350	--		
- Itemized Deductions	--	0		
= Taxable income	0	15,000		
Tax before credits	0	1,523	1,523	
- Non-refundable child tax credit	0	1,523		
- Refundable child and earned income credits	8,432	8,432		
= Federal income tax liability	-8,432	-8,432	0	
State tax calculation				
Wage income	15,000	15,000		
- Standard deduction	18,350	11,200		
- Itemized deductions	--	--		
- Exemption for dependents	3,000	3,000		
= Taxable income	0	800		
Tax before credits	0	33		
- Non-refundable credits (NY household credit)	0	105		
= Tax after non-refundable credits	0	0		
- Refundable earned income credit	1,935	1,935		
- Refundable empire state credit	594	990	396	
= New York income tax liability	-2,529	-2,925		
Combined federal and state tax liability	-10,961	-11,357	-396	*

Source: Author calculations.

Note: * Negative number indicates the taxpayer owes no tax and will receive a payment from the government of the negative amount.

If the same taxpayer instead lived in Maryland and had $3,000 in child care expenses, she would not be able to take advantage of Maryland's refundable Child and Dependent Care Tax Credit unless she itemized deductions on her federal return. The Maryland credit is based on the dependent care credit claimed on federal returns. If she were to claim the standard deduction on her federal return, she would be ineligible for the federal credit because a taxpayer can only claim a federal dependent care credit to the extent that he or she has federal tax liability before credits (table A-2). However, if our Maryland taxpayer were to itemize, she would have positive tax before credits and be able to claim the federal dependent care credit, rendering her eligible to claim the state credit of $336 and making her better off by that amount.

TABLE A-2

Interaction between Itemizing Deductions and State Refundable Credits

Maryland Single Parent with Three Children, 2019

	Standard deduction	Itemize deductions	Change from itemizing
Federal tax calculation			
Wage income	15,000	15,000	
- Standard deduction	18,350	--	
- Itemized deductions	--	0	
= Taxable income	0	15,000	
Tax before credits	0	1,523	
- Dependent care credit	0	1,050	1,050
- Non-refundable child tax credit	0	473	
- Refundable child and earned income credits	8,432	8,432	
= Federal income tax liability	-8,432 *	-8,432 *	0
State tax calculation			
Wage income	15,000	15,000	
- Child care expense	3,000	3,000	
- Standard deduction	3,050	--	
- Itemized deductions	--	0	
- Personal exemptions	12,800	12,800	
= Taxable income	0	0	
Tax before credits	0	0	
- Refundable earned income credit	1,836	1,836	
- Refundable child and dependent care tax credit	0	336	336
= Maryland income tax liability	-1,836 *	-2,172 *	
Combined federal and state tax liability	-10,268 *	-10,604 *	-336 *

Source: Author calculations.

Note: * Negative number indicates the taxpayer owes no tax and will receive a payment from the government of the negative amount.

APPENDIX B: AN ALTERNATIVE ASSUMPTION ABOUT HOW TAXPAYERS MAKE THEIR ITEMIZATION DECISION

The simulations for delinking the itemization connections in the District of Columbia, Maryland, and Virginia were based on the assumption that taxpayers would choose an itemization status that would minimize their combined federal and state tax liability. But given the complexities of the calculations and the order in which taxpayers complete their tax returns (federal returns first), in this appendix we present results under the alternative assumption that taxpayers choose based on minimizing only their federal tax liability. We examine the impact of the alternative assumption on the number of itemizers and the assumption's distributional and revenue effects.

If taxpayers were only concerned with minimizing federal tax liability, fewer taxpayers in Maryland and Virginia would itemize on state returns than if they were to consider both federal and state taxes (table B-1). The share of filers itemizing under current law would be 7 percentage points smaller in Maryland and 3 percentage points smaller in Virginia. The taxpayers switching to the standard deduction under this alternative assumption would see some reduction in federal taxes, but it would be at the expense of a bigger increase in their state income taxes. In contrast, under the alternative assumption, the District of Columbia would see an increase the share of taxpayers itemizing by 2 percentage points. Some taxpayers in the District of Columbia have itemized deductions just slightly above the standard deduction. On District returns, where they are unable to claim the state income tax deduction, their potential itemized deductions could be significantly below the standard deduction. When minimizing combined federal and state taxes, these taxpayers might choose to claim the federal standard deduction, which would allow them to claim more savings in state income taxes than they would lose in additional federal taxes. If instead these taxpayers focused only on minimizing federal taxes, a larger percentage would choose to itemize. Federal tax liabilities would be lower and state liabilities higher under the alternative assumption. The percentage of itemizers under the proposal to delink the itemization decision is nearly the same in all three jurisdictions.

TABLE B-1

Share of State Returns Itemizing Deductions, 2019

	Minimize total liability	Minimize federal liability	Difference
Current law			
District of Columbia	16.5	18.9	2.4
Maryland	25.5	18.8	-6.7
Virginia	17.5	14.1	-3.4
Delink federal and state itemizing			
District of Columbia	11.6	11.6	0.0
Maryland	56.6	56.5	-0.1
Virginia	30.3	30.3	0.0

Source: Tax Policy Center State Income Tax Model

The share of the tax benefit from delinking going to the top income classes is very similar under the alternative assumption about how taxpayers choose to itemize (table B-2). Under both assumptions, households in Maryland and Virginia with incomes in the top 40 percent of the income distribution would see over 80 percent of the net reduction in federal and state taxes. For the District, the share of the net tax reduction is over 85 percent for households in the top income group under both assumptions.

TABLE B-2

Share of Net Tax Reduction from Delinking Itemizing Decision, 2019

for Households Ranked by The National Distribution of Adjusted Gross Income

	District of Columbia	Maryland	Virginia
Minimize combined federal and state taxes			
First quintile	0	0	0
Second quintile	0	3	3
Middle quintile	1	15	16
Fourth quintile	10	36	33
Top quintile	89	47	48
Minimize federal taxes			
First quintile	0	0	0
Second quintile	0	3	3
Middle quintile	1	15	17
Fourth quintile	12	35	34
Top quintile	87	47	47

Source: Tax Policy Center State Income Tax Model

The percentage reduction in state revenue (table B-3) under the alternative assumption of minimizing federal income tax liability would be larger in all three jurisdictions, with the difference being less than 1 percentage point in each case.

TABLE B-3

Percent Change in State Tax Liabilities from Delinking Itemization Status, 2019

	Minimize total liability	Minimize federal liability	Difference
District of Columbia	-0.3	-0.6	-0.3
Maryland	-3.6	-4.5	-0.9
Virginia	-0.9	-1.5	-0.6

Source: Tax Policy Center State Income Tax Model

NOTES

[1] "T18-0001 – Impact on the Number of Itemizers of H.R.1, the Tax Cuts and Jobs Act (TCJA), by Expanded Cash Income Level, 2018," Tax Policy Center, January 11, 2018, https://www.taxpolicycenter.org/model-estimates/impact-itemized-deductions-tax-cuts-and-jobs-act-jan-2018/t18-0001-impact-number.

[2] The estimates for Maryland throughout the paper include local income taxes. In Maryland, the local income tax rate varies by locality and ranges from 1.75 percent to 3.2 percent. The median rate across localities and the effective rate on taxable income for all Marylanders is very close to 3.0 percent, which is the rate used in the examples and simulations.

[3] The increase in the standard deduction alone reduced the number of federal itemizers in Maryland by about 530,000 while the combined effect of the higher federal standard deduction and the cap on state and locat tax deductions reduced the number of itemizers by about an additional 110,000.

[4] Taxpayers may still claim a deduction for casualty losses attributable to certain major federally declared disasters. For more details on the TCJA changes to itemized deductions, see "How did the TCJA change the standard deduction and itemized deductions?" Tax Policy Center Briefing Book, accessed November 11, 2020, https://www.taxpolicycenter.org/briefing-book/how-did-tcja-change-standard-deduction-and-itemized-deductions.

[5] "T18-0001 – Impact on the Number of Itemizers of H.R.1, the Tax Cuts and Jobs Act (TCJA), by Expanded Cash Income Level, 2018," Tax Policy Center, January 11, 2018, https://www.taxpolicycenter.org/model-estimates/impact-itemized-deductions-tax-cuts-and-jobs-act-jan-2018/t18-0001-impact-number.

[6] For example, many state systems rely on calculations from the federal return such as adjusted gross income, taxable income, various credits, and whether the taxpayer has itemized deductions. Federal tax calculations, in turn, depend on state tax systems for those who itemize because of the deduction for state income taxes paid.

[7] The federal cap on state tax deductions did not have a large impact on state itemized deductions, because tax deductions are generally smaller on state returns (almost all exclude state income taxes) and because the federal limit does not apply to state tax deductions in many states. California and New York, for example, do not allow a deduction for state income taxes paid on state returns and have no cap on the deduction for property taxes.

[8] Of the 44 states with an income tax in 2019, only 3 (Arizona, Georgia, and Louisiana) allow taxpayers to deduct state income taxes paid as an itemized deduction on state returns.

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