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FEDERAL TAX DEDUCTIONS FOR STATE TAXES: A NEW CONTROVERSY

By Stephen L. Bakke  December 5, 2017



Here's what provoked me:

Are the high tax states now being subsidized by the federal taxpayers? That's the claim being made by most of the Republicans in Congress. However, the Republicans in states with high taxes and spending are siding with the Democrats on this one. Read on for a little insight into this controversy which is part of the current tax reform debate.

Here's my response:

Federal Tax Deductions for State Taxes: A New Controversy

State taxes now are deductible by individuals for federal filing purposes. That's one of the controversies in the developing tax reform legislation. It looks like there's a good chance this deduction will be eliminated in the final bill.

Individuals in high-tax states thereby pay less federal taxes than individuals with the same earnings but living in low tax states. That's why Republicans claim federal taxpayers are unfairly subsidizing high tax states. Democrats, and some republicans from high-tax states, argue the state isn't being subsidized as long as it otherwise pays more taxes than received back in federal programs.

The Republicans have the stronger argument in this case. If one doesn't want the federal government to subsidize high-tax states the deduction should be eliminated. If there are concerns of fairness, they should be dealt with in other ways – perhaps rethinking the tax and spend tendencies in those states.

Federal tax law shouldn't be such that it affects state tax policy. It shouldn't give states incentive to raise taxes by virtue of federal deductibility. State spending and taxing decisions should stand on their own merits.