Limit the deductions higher-income households can claim on tax returns to 28 percent ($584 billion), or to 15 percent ($1.2 trillion)

The Idea: Wealthy households use itemized tax deductions to reduce their tax bills each year. If Congress were to limit the amount of the deductions that higher-income households can use to reduce from their tax bills to 28 percent of their overall income, the country could raise $584 billion[6] in revenues over the next 10 years while increasing tax fairness. But, limiting the amount of itemized deductions to 15 percent would bring in $1.2 trillion[7] over 10 years.

The Rationale: When filing a tax return, a household may subtract, or deduct, some expenses (including gifts to charity and state and local taxes) from the income on which they must pay federal taxes. These itemized deductions essentially shield a certain amount of income from taxation, thus lowering the taxes owed (assuming the total deductions are worth more than the standard deduction). But because of the graduated tax rates, the more money you make and the higher your tax rate, the more beneficial itemized deductions become. Capping the amount of itemized deductions allowed would increase tax fairness.

For example, if a middle-income family earning $65,000 contributed $100 to a favorite charity or church, the family would save $15 from its tax bill. But a family earning enough to be in the 35 percent tax bracket could save $35 of every $100 given to the charity or church of its choice.

Take the largest itemized deduction that most people take: the home mortgage deduction. The table below shows that a family in the 15 percent tax bracket (with an income of $65,000) paying $10,000 a year in interest on their mortgage would be able to shield $10,000 of income from taxation, providing them with $1,500 in subsidy (15 percent of $10,000). A wealthy family paying the 35 percent tax rate paying the same mortgage interest of $10,000 would receive $3,500 in subsidy. But wealthy people generally have bigger homes and larger mortgages. For a wealthy family, mortgage interest of $40,000 would net $14,000 in tax subsidies.

The upside-down effect of the mortgage interest deduction

	Middle-income household	High-income household
Income	$65,000	$500,000
Tax bracket	15 percent	35 percent
Mortgage interest paid	$10,000	$40,000
Current value of subsidy for mortgage interest	$1,500 (15 percent of interest paid)	$14,000 (35 percent of interest paid)
Value of subsidy for mortgage interest under Obama proposal on itemized deductions	$1,500 (15 percent)	$11,200 (28 percent)

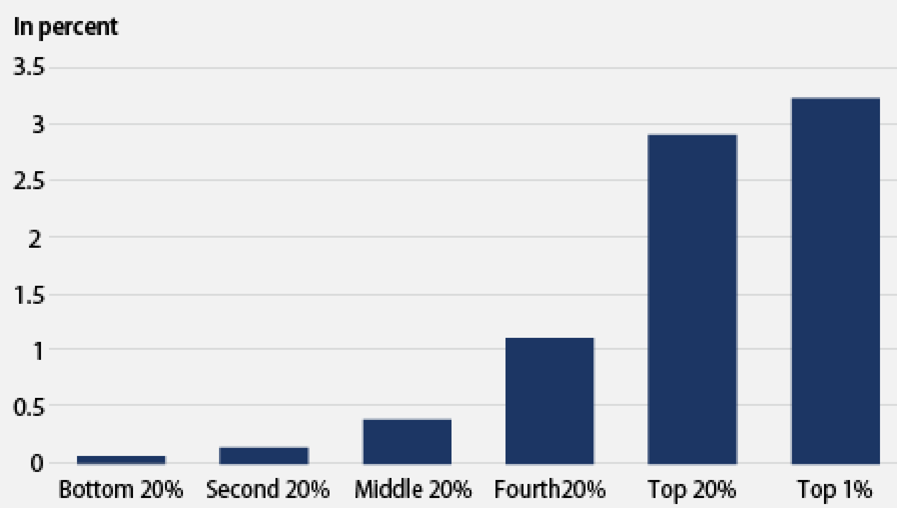
Chart: Center for American Progress

The result is that higher-income households receive a larger benefit from itemizing their income taxes. At the same time, this policy costs the U.S. Treasury significant amounts of lost revenue each year.

FIGURE 2

The upside-down effect of itemized deductions

Percent increase in after-tax income from itemized deductions



Source: http://www.urban.org/UploadedPDF/1001234_tax_expenditures.pdf (table 2, with interactive effects).

Chart: Center for American Progress

Support for the idea: The president has proposed capping the value of itemized deductions for high-income families at 28 percent. The Office of Management and Budget (OMB) estimates that this would raise about $584 billion in revenue over the next ten years. Tougher limits on itemized deductions would result in even greater savings. A plan that would limit itemized deductions to 15 percent would bring in $1.2 trillion in additional revenue over the next ten years.

Of the plans reviewed for this revenue project, the following proposed either limiting itemized deductions or eliminating them altogether: Our Fiscal Security's (Economic Policy Institute, Demos, and The Century Foundation) *Investing in America's Economy*, Center for American Progress' *Budgeting for Growth*, Esquire's *Commission to Balance the Federal Budget*, the Institute for America's Future *Citizens' Commission*, President Obama's *2012 budget* and *Living within Our Means*, Rep. Mike Quigley's *Reinventing Government*, Andy Stern's *21st Century Plan*, Stephen Pearlstein's *Deficit Reduction Op-Ed*, the Bipartisan Policy Center's *Restoring America's Future*, the National Commission on Fiscal Responsibility's *Moment of Truth*, and the Congressional Progressive Caucus' *People's Budget*.

[6] *President Obama's Fiscal Year 2013 Budget*, OMB, Summary Tables, pg. 220.
[7] *Reducing the Deficit: Spending and Revenue Options*, Congressional Budget Office, pg. 151-2.