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Budget Model

Policy Options: Eliminate Itemized Deductions

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Summary: We estimate the budgetary, economic and distributional effects of eliminating all Schedule-A itemized deductions starting on January 1st, 2021. We project that it would raise about $2.1 trillion of additional revenue on a conventional basis over the 10-year budget window and increase GDP by 2.3 percent by 2050. Families in the top 10 percent of the income distribution would bear 75 percent of the overall burden of this tax increase.

What are itemized deductions?

When taxpayers prepare their individual income tax returns, their gross income is first adjusted through above-the-line deductions[1] to arrive at an individual's Adjusted Gross Income (AGI). The majority of taxpayers[2] are then given the choice to either deduct a flat amount, known as the standard deduction, or deduct the sum of certain expenses, known as itemized deductions, from their AGI to arrive at their taxable income. Subject to various thresholds, common itemized deductions include state and local taxes, charitable contributions, mortgage interest and large out-of-pocket medical expenses. High-income taxpayers are more likely to itemize, with about 93% of returns with AGI of at least $500,000 electing to itemize their deductions in 2017.[3]

Current law:

For tax year 2019, the standard deduction is $12,200 for single taxpayers and $24,400 for married taxpayers filing jointly. If a filer chooses to itemize, certain limitations apply. Mostly notably, taxpayers cannot deduct more than $10,000 in state and local taxes and cannot deduct mortgage interest attributable to the portion of loans that exceeds $750,000. Some itemized deductions, such as medical and dental expenses, are allowed only if the expenditure exceeds a certain percentage of AGI.

The limitations on itemized deductions enacted under the 2017 tax law are scheduled to expire in 2026. The standard deduction will also return to its 2017 level, adjusted for inflation, in 2026. Together, these expirations will lead more filers to itemize in 2026 than in previous years.

Policy option:

We estimate a policy option that would eliminate all Schedule-A itemized deductions. All taxpayers would be required to take the standard deduction when computing taxable income. Notably, under this policy option, taxpayers would still be able to receive employer-based medical benefits on a pre-tax basis, as this expense does not appear in Schedule A and is not included in gross income. Above-the-line deductions would also remain unchanged.

This policy would remove certain distortions from the tax code. For example, debt-financed homeownership would no longer receive an implicit subsidy, and recent research suggests removing this tax expenditure would slightly reduce home prices.[4] Charitable contributions, which currently receive an average tax subsidy of about 16 cents per dollar of donation, would no longer receive preferential tax treatment, thereby lowering charitable giving, as discussed in our previous analysis.

Budget estimates:

On a conventional basis, PWBM estimates this policy would raise about $2.1 trillion over the period 2021 to 2030.

Table 1. Conventional Budget Estimate, FY2021-2030

Billions of Dollars, Change from Current-Law Baseline

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Policy	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2021-2030
Eliminate all itemized deductions	67	93	122	153	186	222	260	302	346	394	2,146

Economic effects:

Following scoring conventions, we assume that this additional revenue is used to pay down federal debt. A reduction in federal debt “crowds in” private capital formation, thereby potentially increasing the nation’s production output, as measured by Gross Domestic Product (GDP).

As shown in Table 2, we project that eliminating all itemized deductions would increase output by 2.3 percent by 2050. In the near term, highly productive workers experience an increase in the effective marginal tax rate and would thus cut back on labor supply (“hours worked”). On its own, this effect would reduce output. However, this effect is dominated in the long run as substantial debt reduction leads to a larger private capital stock. As the capital stock increases, wages and labor income increases, encouraging individuals to work more hours.

Table 2. Dynamic Macroeconomic Effects

Percent Change from Baseline

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Year	GDP	Capital stock	Labor income	Hours worked	Consumption
2030	0.1%	0.7%	0.1%	-0.2%	-0.1%
2040	0.8%	2.4%	0.8%	0.0%	0.0%
2050	2.3%	6.5%	2.3%	0.3%	0.4%

Note: Consistent with empirical evidence, the projections above assume that the U.S. economy is 40 percent open and 60 percent closed. Specifically, 40 percent of new government debt is purchased by foreigners.

Distributional analysis:

On a conventional basis, this policy would make the tax code more progressive. The overall burden of this tax increase would mostly be borne by higher-income families, with 75 percent of the increase tax falling on the top 10 percent of families. When certain elements of the 2017 tax law expire after 2025, the policy becomes slightly less progressive, with 65 percent of the costs falling on the top 10 percent. After-tax incomes for the top 1 percent would fall by about 2 percent, while tax liabilities for the median family would fall by 0.2 percent. Families with lower income would be largely unaffected by this policy change because they typically rely on the standard deduction.

Table 3. Distribution of Policy Change by Annual Income Categories in 2021, Relative to Current-Law Baseline

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Income group	Average tax change	Share with a tax increase	Percent change in after tax income	Share of tax change	Share of federal taxes paid	Change in share of federal taxes paid
Bottom quintile	$0	1%	0.0%	0%	0%	0.0%
Second quintile	$10	2%	0.0%	1%	1%	0.0%
Middle quintile	$80	8%	-0.2%	4%	8%	-0.1%
Fourth quintile	$295	17%	-0.4%	11%	17%	-0.2%
80-90%	$625	29%	-0.5%	10%	14%	-0.1%
90-95%	$1,345	44%	-0.7%	10%	11%	0.0%
95-99%	$2,930	55%	-1.0%	17%	18%	0.0%
99-99.9%	$12,760	68%	-1.5%	17%	15%	0.0%
Top 0.1%	$204,015	78%	-2.8%	31%	17%	0.5%

1. Above-the-line deductions include contributions to a traditional IRA, interest on student loans and contributions to a Health Savings Account. A list of applicable expenses can be found in Part II of Schedule 1 of the 1040 form. The 2019 version is available here. ↩

2. Not all taxpayers are eligible for the standard deduction. The criteria used to determine eligibility can be found on the Internal Revenue Service website here. ↩

3. Calculated from Internal Revenue Service, Statistics of Income, Table 1.2. “Table 1.2. All Returns: Adjusted Gross Income, Exemptions, Deductions and Tax Items, by Size of Adjusted Gross Income and by Marital Status, Tax Year 2017 (Filing Year 2018).” Available here. ↩

4. Sommer, Kamila, and Paul Sullivan. “Implications of U.S. Tax Policy for House Prices, Rents, and Homeownership.” *American Economic Review* 108, no. 2 (February 2018): 241–74. ↩