

Establishing a Cap on Itemized Deductions

Individuals filing their taxes can reduce the amount of their income that is taxable by taking deductions. Filers can choose to take the standard deduction, or to itemize. The standard deduction was raised from \$6,000 to \$12,000 for single filers and from \$12,000 to \$24,000 for joint filers in 2017 as part of the Tax Cuts and Jobs Act (TCJA). If taxpayers have qualifying expenses that are more than \$12,000 or \$24,000, they can itemize those expenses to further reduce their taxable income. Prior to TCJA, around a third of Colorado taxpayers claimed itemized deductions. Since TCJA, that number has fallen to around 10 percent.

Limits on itemized deductions – as opposed to eliminating or limiting specific tax expenditures – have been around for decades. The most prominent of these – the Pease Limitation – was first introduced to Congress in 1991. The Pease Limitation required taxpayers with adjusted gross income (AGI) above a certain threshold to reduce certain itemized deductions by 3% of every dollar of their taxable income. The Pease Limitation did not apply to medical expense, interest investment expense, casualty and theft loss, and gambling loss deductions. Twenty-three states either do not allow for itemized deductions or apply broad limitations to itemized deductions. Almost every state applies various limitations to various itemized deductions.

The Tax Cuts and Jobs Act of 2017 (TCJA) eliminated the Pease Limitation, allowing taxpayers to take an unlimited amount of itemized deductions from their adjusted gross income at the federal level. Since Colorado’s tax code automatically conforms to the federal tax code, this means that since 2018, Colorado taxpayers have also been able to claim an unlimited amount of itemized deductions from their state income taxes.

One way to fairly address unlimited itemized deductions in Colorado would be to impose a limitation on itemized deductions for taxpayers making more than \$400,000 a year; for example, \$30,000 for taxpayers filing individually, or \$60,000 for taxpayers filing jointly. This kind of limit would only affect 0.4% of all taxpayers and more closely conform Colorado law with other states. A limitation of this nature would allow the vast majority of Coloradans to use all of their itemized deductions to reduce their state tax liability.

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