D.C. Tax Revision Commission Policy Options

Policy Option #14: Conform Itemized Deduction Limitation to Federal

MEMORANDUM

Proposal: Conform D.C.'s limitation of itemized deductions to the federal limitation
Tax Type: Income
Origin: Mayor Gray/Robert Buschman
Commission Goal: Simplicity

Current Law

D.C. limits itemized deductions of higher-income taxpayers by phasing them out as income increases. A taxpayer who earns more than $200,000 in adjusted gross income (AGI) must reduce her itemized deductions by 5% of every dollar she earns over $200,000. (Note: The income level is $100,000 for married taxpayers filing separately.) For example, if a taxpayer has $350,000 in AGI she loses $7,500 of her itemized deductions.

The federal government also limits itemized deductions. Itemized deductions are reduced beginning at $300,000 for joint filers, $275,000 for head of household, $250,000 for individuals and $150,000 in the case of a married individual filing a separate return. The federal limitation is 3% of income above the threshold. The federal limit cannot reduce taxpayer's total deductions by more than 80%.

The D.C. limitation was added in 2011 after the federal limitation was completely eliminated in 2010 (it was gradually phased out over 10 years as a part of the Bush tax cuts). But the American Tax Relief Act of 2012 reinstituted the federal limit. As a result, when both laws are applicable in 2014, a D.C. taxpayer's itemized deductions are reduced *both* by the federal government and D.C. For example, the D.C. taxpayer with $350,000 (if filing as a married couple) will first have to reduce her itemized deductions by $1,500 (federal phase out) and then subtract another $7,500 from that *already reduced number* to comply with the D.C. limitation.

Proposed Change

Repeal the D.C. limitation and conform to the new federal limitation. A D.C. taxpayer's itemized deductions would only be decreased by the federal limitation. This is how the limitation worked prior to the repeal of the federal limitation and creation of the D.C. limitation.

Reason for Change

D.C. created its limitation of itemized deductions to replace the federal elimination of the limitation. With the reinstatement of the federal limitation, D.C. now double-counts some reductions and imposes extra compliance burdens (both limits must be calculated).

Pros

- D.C. taxpayers would not be “hit twice” by a federal and local limitation of itemized deductions.
- Would simplify the D.C. individual income tax.

Cons

- Removing the D.C. limitation on itemized deductions would lose tax revenue.

Revenue Impact

The Office of Revenue Analysis estimates that in the first year of implementation repealing the D.C. limitation on itemized deductions would lose $29,799,046 in tax revenue.