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In this article, Brooks argues that reformers who seek to limit itemized deductions should consider how those changes would affect the standard deduction, which he characterizes as a cobbled-together instrument serving contradictory purposes that is in dire need of reform.

The presidential candidates this campaign season are a diverse group with a wide range of tax policy proposals, but they agree unanimously about one thing: the need to limit itemized deductions. Sadly, however, none of their proposals tackles how limits on itemized deductions would affect the other side of the equation — the standard deduction — which is also very much in need of reform.

A close look at the standard deduction reveals that it has an incoherent structure, impedes more wide-ranging reform of itemized deductions, is a result of historical accident, and limits Congress's ability to provide relief for low-income taxpayers. A true zero bracket — not tied to itemized deductions — would be simpler and more logical. Moreover, itemized deductions could still be limited by using targeted floors, which would not be substantially more complicated than the current mishmash of floors and phaseouts.

Itemized Deduction Reform Proposals

The candidates' proposals for itemized deduction reform fall into two main camps. The Republican candidates propose to repeal some or all of the itemized deductions. For example, Sen. Ted Cruz, R-Texas, proposes to eliminate all deductions except those for charitable contributions and mortgage

interest.¹ Sen. Marco Rubio, R-Fla., had proposed to eliminate all deductions except those for charitable contributions and mortgage interest, which he would have limited to the interest on \$300,000 of acquisition indebtedness.² Jeb Bush had proposed to eliminate the deduction for state and local taxes, cap the remaining itemized deductions (other than the deduction for charitable contributions) at 2 percent of adjusted gross income, and eliminate the Pease phaseout.³ Donald Trump . . . well, it's not totally clear, but it sounds like he would accelerate the Pease phaseout for all itemized deductions other than charitable contributions and mortgage interest.⁴

On the Democratic side, both Hillary Clinton and Sen. Bernie Sanders, I-Vt., would cap the tax benefit of all itemized deductions at 28 percent of the expenditure.⁵ Sanders would also eliminate the Pease phaseout.⁶

There were similar proposals in the 2012 election. Obama proposed a 28 percent cap, like Clinton and Sanders.⁷ Romney proposed a dollar cap on itemized deductions of somewhere between \$17,000 and \$50,000.⁸

The two approaches are quite different, of course — elimination of some or all of the deductions versus limiting the value of the deduction for higher-income taxpayers. But the fact that the itemized deductions are an appealing target for tax reform is telling and is perhaps a sign of an opening for real reform. On the other hand, itemized deductions have been a target for reformers since at least Stanley Surrey, so we shouldn't get too excited just yet.

¹Tax Foundation, "Comparing the 2016 Presidential Tax Reform Proposals" (Feb. 24, 2016).

²*Id.*

³*Id.*

⁴*Id.*

⁵*Id.*

⁶*Id.*

⁷Richard Rubin, "Romney \$17,000 Deduction Limit Part of Three-Cap Concept," Bloomberg Business, Oct. 4, 2012.

⁸Stephen J. Entin, "Simulating the Economic Effects of Obama's Tax Plan," Tax Foundation, Nov. 1, 2012.

But if the itemized deductions make it onto the tax reform agenda in the next Congress, policymakers should remember that tinkering with the itemized deductions will also have real — and probably unwelcome — effects on the standard deduction. The standard deduction is already a cobbled-together instrument serving contradictory purposes, and big changes to the itemized deductions may just make it worse.

The Standard Deduction

The standard deduction plays two distinct roles. On one hand it is a simplified substitute for the itemized deductions. Those whose otherwise deductible expenses are not that large are relieved of the burden of record keeping and get a larger deduction to boot.⁹ At the same time, the standard deduction, together with the personal exemptions, operates as essentially a 0 percent tax bracket (or, equivalently, a flat exemption amount).¹⁰ For tax policy people, the latter role for the standard deduction is likely paramount, but the average taxpayer is more likely to see the standard deduction as just a substitute for the itemized deductions — that is, after all, how the tax code¹¹ and Form 1040 present it.

This structure for the standard deduction is well enough ingrained to be taken as a given, but let's pause for a second to think about how weird it is to tie together a zero bracket and the itemized deductions. How would we describe this policy combination? For a non-itemizer, by definition, the standard deduction exceeds the itemized deductions. So we could say that for non-itemizers, the “extra” amount by which the standard deduction exceeds the itemized deductions is the zero bracket amount, such that the zero bracket essentially phases out as itemized deductions grow, disappearing altogether when someone becomes an itemizer. But why is that the right way to make a zero bracket? Itemized deductions likely rise with income, but if we wanted a zero bracket to phase out with income, we could just do that.

Alternatively, we could say that the zero bracket *doesn't* phase out — conceptually, everyone gets a flat exemption — but that itemized deductions are allowed only to the extent they exceed the zero bracket amount. But that makes even less sense — why would the appropriate floor for itemized de-

ductions just happen to equal the zero bracket amount? And why is it appropriate to have a single floor for multiple deductions?

Finally, it is incoherent to say that the standard deduction does both of these things at the same time. If the standard deduction is a flat zero bracket amount plus a deduction floor, the zero bracket can't also be phasing out with income.

Therefore, all of the itemized deduction proposals imply the questions of what the standard deduction is supposed to do, how large it should be, and how it should relate to itemized deductions. But that's not what anyone appears to be asking. Those advocating for fewer itemized deductions are essentially also advocating for a larger zero bracket, but it's not clear that's what anyone actually intends. To put it another way, picking the “right” standard deduction amount requires calibrating two unrelated things — the appropriate size of the zero bracket and the appropriate number of itemizers. It would be very unlikely to satisfy both goals with a single number.

None of this is necessary. We can do this differently — indeed, we have done it differently before.

A Brief History of the Standard Deduction

The first standard deduction was introduced in 1944, after the income tax became a mass tax during World War II. That “optional standard deduction” was equal to 10 percent of AGI with a cap of \$500¹² (increased to \$1,000 in 1948¹³). The theory was that because itemized deductions rise with income, the standard deduction would give people a simplified alternative. Note that it would have been hard to describe this first standard deduction as a zero bracket or as part of a coherent progressive rate structure because its size *increased* with income, at least up to an income of \$10,000 (or around \$100,000 in today's dollars). It was designed instead to simplify tax calculation and record keeping for individuals new to paying the income tax.¹⁴

It wasn't until 20 years later, in 1964, that Congress decided to use the standard deduction to create an exemption amount. Congress added the “minimum standard deduction,” which began as

¹²Individual Income Tax Act of 1944, P.L. 78-315, section 9(a), 58 Stat. 231, 236.

¹³Revenue Act of 1948, P.L. 80-471, section 302(a), 62 Stat. 110, 114.

¹⁴The stated goals of the legislation were: “1. To relieve the great majority of taxpayers from the necessity of computing their income tax. 2. To reduce the number of tax computations. 3. To simplify the return form. 4. To decrease the number of persons required to file declarations of estimated tax. 5. To eliminate some of the difficulties and uncertainties in the making of estimates required for declarations.” H.R. Rep. No. 78-1365, at 1 (1944); *see also* S. Rep. No. 78-885, at 1 (1944) (same).

⁹John R. Brooks, “Doing Too Much: The Standard Deduction and the Conflict Between Progressivity and Simplification,” 2 *Colum. J. Tax L.* 203, 205 (2011).

¹⁰*Id.*

¹¹Section 63 says, in essence, itemizers should use itemized deductions to calculate taxable income, and non-itemizers should instead substitute the standard deduction.

\$200 plus \$100 for each dependent, while retaining the percentage standard deduction for those with higher AGI.¹⁵ Treasury considered simply raising the personal exemption amount as a way to provide relief for low-income taxpayers but ultimately decided that it would be too expensive to give the exemption to everyone.¹⁶ Using the standard deduction instead would target the relief only at those with a relatively low amount of itemized deductions — that is, those who were more likely to have low income.

Congress tightened up the design in 1969 by renaming the minimum standard deduction the “low income allowance” and explicitly tying the combination of the low-income allowance and the personal exemptions to the relevant poverty line.¹⁷ So, for example, a single taxpayer in 1969 had a low-income allowance of \$1,100 and a personal exemption of \$600, for a total of \$1,700 — which was precisely what the then-Department of Health, Education, and Welfare calculated as poverty-level income (with that level increasing roughly around \$600 per child).¹⁸ The low-income allowance was increased to \$1,300 in 1971¹⁹ and eventually to \$1,700 by 1975.²⁰

But the original percentage standard deduction still existed alongside this exemption. Indeed, the 1969 act also increased the standard deduction from 10 percent to 15 percent of AGI and increased the cap from its 1948 level of \$1,000 to \$2,000 (both changes phased in over three years).²¹ Further leg-

islation pushed the deduction percentage to 16 percent of AGI and the cap to \$2,400 by 1975.²²

Note the odd setup that existed as of 1975. The standard deduction had a floor of \$1,700 and a ceiling of \$2,400, and was 16 percent of AGI for those within that narrow \$700 range. Those with higher AGI or higher itemizable expenses just itemized instead. This is the sort of bizarrely complicated structure that can occur when trying to use a single policy instrument to manage both progressivity and simplification — but at least Congress tried.

Then in 1977, Congress effectively gave up and created our current flat standard deduction.²³ However, tax policy people of a specific age will remember that between 1977 and 1986, the standard deduction was not called the standard deduction. It was the zero bracket amount (ZBA).²⁴ To be clear, it operated just like our current standard deduction — and thus was not a great zero bracket at all — but the labeling is telling. Congress appeared to want the standard deduction to be an exemption amount, a zero bracket. But nonetheless, Congress maintained the historical connection of the ZBA to the itemized deductions, even though the original simplification purpose was largely superseded.

As a formal matter, the ZBA worked like a uniform exemption for everyone, and itemizers could deduct only the excess of their expenses above the ZBA.²⁵ Taxpayers who were not entitled to a full ZBA, such as dependents, had to add back their “unused zero bracket amount” to taxable income.²⁶ But the net effect was the same as a flat standard deduction. (Indeed, in its report on the 1977 act, the Senate Finance Committee switched back and forth between calling it a ZBA and a standard deduction, implying that they were not entirely sure what the policy was.²⁷) The change

¹⁵Revenue Act of 1964, P.L. 88-272, section 112(a), 78 Stat. 19, 23. The \$1,000 cap remained in place. The \$100 per dependent was in addition to the existing deductions for personal exemptions under section 151 (1964).

¹⁶See Treasury, 91st Cong., “Tax Reform Studies and Proposals,” pt. 2, at 127 (Joint Comm. Print 1969), reprinted in Bernard D. Reams Jr., ed., *22 Tax Reform — 1969: A Legislative History of the Tax Reform Act of 1969*, Doc. No. 102 (1991); see also President’s 1963 Tax Message: Hearings Before the H. Comm. on Ways and Means, 88th Cong. 15, 41-42, 195 (1963), reprinted in Reams, ed., *26 Internal Revenue Acts of the United States: Revenue Acts of 1953-1972 With Legislative Histories, Laws, and Congressional Documents*, pt. I (1985); Brooks, *supra* note 9, at 236 notes 166-167.

¹⁷Tax Reform Act of 1969, P.L. 91-172, section 802(a), 83 Stat. 487, 676-677.

¹⁸H.R. Rep. No. 91-413, at 205-206 (1969), reprinted in 1969-3 C.B. 200.

¹⁹Revenue Act of 1971, P.L. 92-178, section 203(a), 85 Stat. 497, 511.

²⁰Revenue Adjustment Act of 1975, P.L. 94-164, section 2(a)(1), 89 Stat. 970, 970-971.

²¹Tax Reform Act of 1969, P.L. 91-172, section 802(a), 83 Stat. 487, 676-677. In 1971 the scheduled increases to 15 percent of AGI and \$2,000 were accelerated from 1973 to 1972, among other relief provisions, to provide tax relief during an economic recession. See H.R. Rep. No. 92-533, at 7-8 (1971).

²²Revenue Adjustment Act of 1975, *supra* note 20.

²³Tax Reduction and Simplification Act of 1977, P.L. 95-30, section 102(a), 91 Stat. 126, 135-136.

²⁴See *id.*, section 102(a), 91 Stat. at 135; S. Rep. No. 95-66, at 51 (“Conversion of standard deduction into zero bracket amount and floor under itemized deductions.”).

²⁵The 1977 act redefined taxable income for individuals as “adjusted gross income (1) reduced by the sum of (a) the excess itemized deductions, and (b) the deductions for personal exemptions provided by section 151, and (2) increased (in the case of an individual for whom an unused zero bracket amount computation is provided by subsection (e)) by the unused zero bracket amount (if any).” Tax Reduction and Simplification Act of 1977, section 102(a), 91 Stat. at 135.

²⁶See *id.*

²⁷“The House bill eliminates the present minimum, percentage and maximum standard deductions and replaces them with what is, in effect, a flat standard deduction. . . . By incorporating the flat standard deduction in a zero rate bracket in the tax tables and rate schedules, the House bill eliminates the need for

(Footnote continued on next page.)

was intended to make computation simpler but ended up doing the opposite.²⁸ In the 1986 act, Congress went back to the deduction structure and reverted to the standard deduction terminology.²⁹ But it kept the same flat structure, which continues to be the model today.

In summary, the connection between itemized deductions and the zero bracket or exemption amount is, essentially, an accident of history. Policymakers saw the standard deduction in 1964 and 1969 as a convenient host upon which to graft a poverty-level exemption. Tying that exemption to itemized deductions ensured that the exemption would not be universal — that it would phase out for taxpayers with larger deductions — but that was pretty rough justice. The tinkering that went on after 1969 was all done to try to make the dual role of the standard deduction — progressivity and simplification — work better. But it ultimately led to the illogical state of affairs we have today.

The Zero Bracket Alternative

Suppose that we want the tax code to do two things: provide a large exemption so that poverty-level incomes go untaxed and simplify or otherwise limit the role of itemized deductions. Must we use a single instrument to achieve both? Of course not. Indeed, if we were writing a tax code from scratch, it's hard to imagine tying them together.

The large exemption could instead be simply that — a large exemption or a 0 percent tax bracket. If just a rate bracket, it would apply to everyone — which would also supply some relief for middle-income taxpayers — but that's certainly not necessary. If politics required the zero bracket to be unavailable for high-income taxpayers, it could instead phase out with AGI, much like the Pease phaseout now does for itemized deductions. The exemption would operate like a hidden marginal rate increase, but that's not the end of the world if the threshold for starting the phaseout is high enough. That said, it would be better to have a fixed zero bracket and make up for it with higher statutory rates if necessary.

Decoupling the zero bracket from the itemized deductions would allow Congress to make the zero bracket whatever size it wished. This could simplify policies for low-income-taxpayer relief, for example. Currently, if Congress simply increased the standard deduction, it would affect the application

the separate concept of the standard deduction in the Code and the subtraction of the standard deduction in computing tax liability." S. Rep. No. 95-66, at 50-51 (1977).

²⁸See Brooks, *supra* note 9, at 218.

²⁹Tax Reform Act of 1986, P.L. 99-514, section 102(a), 100 Stat. 2085, 2099.

of the itemized deductions. Fewer people would qualify for the deductions for charitable contributions or mortgage interest, for example. For tax reformers, that might not be a bad thing, but it's a different question, and one that would interest a lot of well-funded lobbying groups. This is perhaps one reason why additional relief has been provided mostly outside the standard deduction, through provisions like the expanded child tax credit (for those with children), the earned income tax credit (for those with jobs), and the American opportunity tax credit (for students). These programs of course target particular policy goals, but to the degree that they are also trying to provide general tax relief, they inevitably leave out important segments of the population. A larger zero bracket would be simpler, cleaner, and more equitable.

Itemized Deduction Floors

The catch with simply decoupling the zero bracket from the itemized deductions is that there would no longer be a floor for the itemized deductions. Everyone could potentially become an itemizer, instead of only the roughly one-third of taxpayers who itemize now.³⁰ No one wants that, least of all the people who advocate limiting the itemized deductions. But there is a simple answer here too: just have more floors or similar limitations.

Right now the standard deduction operates like a single large floor under the itemized deductions — only amounts that exceed that floor are deductible. But this is, of course, a very rough way to have a floor. It leads to strange results like making a charitable deduction contingent on the size of your mortgage or the rate of tax in your state. If, instead, each deduction had its own floor, the provisions would operate independently of one another, as they should.

Each itemized deduction has its own economics and logic (some better than others). Lumping them together with a single floor mixes policy apples and oranges. For example, if the policy reason for a charitable contribution deduction is to increase charitable giving, it would probably make sense to focus the subsidy on the marginal dollar. So perhaps only contributions above, say, 2 percent of AGI should be deductible. But if the policy reason for the extraordinary medical expense deduction is to recognize that paying for more than baseline medical care isn't really "consumption" in a Haig-Simons

³⁰See Justin Bryan, "Individual Income Tax Returns, 2011," Statistics of Income Bulletin, Fall 2013, at 9 (out of roughly 143 million returns, about 46 million, or 32 percent, claimed itemized deductions).

sense, as William Andrews has argued,³¹ perhaps only expenses above some flat floor pegged to average medical costs should be deductible. And maybe the mortgage interest deduction should be capped. And so on.

These are not new points, of course. Many have advocated precisely these reforms. David Schizer, in particular, has urged that we take an individualized approach to tax expenditures and their limitations, balancing the programmatic goals, excess burden, and distributional effects of each.³² Each deduction operates differently on each dimension, and we should not expect a single approach to be best for all of them. But when the standard deduction looms over them, the value of any particularized reform is pretty limited. Decoupling the zero bracket and the deduction floors could then make deduction floors and other limitations much more attractive policy levers for achieving public goals.

Complexity

Before you dismiss this idea as needlessly complicated, please remember that we're already using individualized floors. Casualty and theft losses are deductible only to the extent they exceed 10 percent of AGI.³³ Same for extraordinary medical expenses.³⁴ Miscellaneous itemized deductions have to exceed 2 percent of AGI.³⁵ And many suggest similar floors for the charitable contribution deduction or some limitation to the mortgage interest deduction.

Moreover, consider the *current* complexity associated with, say, an expense for the production of income deductible under section 212. A taxpayer has to first lump the expense together with other miscellaneous itemized deductions, see how much of that total exceeds 2 percent of AGI, take that net amount and lump it together with the other itemized deductions to see if they exceed the standard deduction, and then also handle the Pease phase-out, if applicable. Oh, and maybe just drop it out entirely if the taxpayer is subject to the alternative minimum tax. Yes, TurboTax (or the equivalent) handles most of the calculations, but at the time of the expense many people have to simply guess whether they will qualify for the deduction come April 15. Replacing this jury-rigged system with one in which each deduction stands on its own, even with a floor, would be much easier to grasp.

³¹William D. Andrews, "Personal Deductions in an Ideal Income Tax," 86 *Harv. L. Rev.* 309, 331-337 (1972).

³²David M. Schizer, "Limiting Tax Expenditures," 68 *Tax L. Rev.* ____ (coming 2016).

³³Section 165(h).

³⁴Section 213(a).

³⁵Section 67.

If each deduction had its own floor, Congress or Treasury could calibrate the floors to maintain roughly the same number of itemizers as we have now. Alternatively, Congress could be fine with some expansion of itemizing because in many cases a new itemizer might be itemizing only for a single expense, such as someone who donates heavily to charity but rents his home or someone who just wants to take the theft loss in a particularly bad year. A few more single-item itemizers around the edges should not be a huge burden on the IRS.

Nor should it be a huge burden on taxpayers. For itemizers, it would be no more complicated than the current scheme — they're already keeping track of expenses, and TurboTax generally does the rest. Indeed, some might even stop keeping track of expenses that don't exceed the floor (just as many itemizers already don't track medical expenses). New itemizers might track only one or two expenses. And electronic banking and tax preparation substantially ease the record-keeping and computational complexity. With just a few clicks many of the expenses could flow from a taxpayer's bank account to a tax form.

The largest relative burden may be on low-income and less sophisticated taxpayers who do not have access to electronic tools. But with floors in place, many wouldn't itemize anyway — and they would still get the larger zero bracket amount exemption. Moreover, the record keeping required for many expenses is minimal. Banks report mortgage interest on a single Form 1098, state tax payments are on Forms W-2 and will be calculated anyway for state tax purposes, and charities provide tax receipts. The combination of modern information reporting, electronic record keeping, and electronic tax preparation make compliance and calculation much simpler than they might have been in previous eras.

Conclusion

The itemized deductions are a perennial target for reform, and with good reason. But if itemized deduction reform actually gets going, policymakers should not forget the biggest deduction of them all.

The standard deduction is the largest exemption for most taxpayers and, together with the personal exemptions, makes up what is essentially a 0 percent tax bracket. But because of a combination of historical accident and political expedience, this zero bracket is intimately tied with itemized deductions in ways that make little sense, particularly because reasonable alternatives exist. Congress could simply create a single exemption or 0 percent tax bracket, coupled with floors or other limitations for the itemized deductions. This would rationalize a major portion of our individual income tax system with, at most, only an incremental increase in complexity.



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