

ITEMIZED DEDUCTIONS

¶215 Deduction of State and Local Taxes by Individuals

NEW LAW EXPLAINED

Limitation of itemized deduction for certain income, property, and sales taxes.— The deduction for taxes paid or accrued by an individual during the tax year that are not directly connected with a trade or business, or with property held for the production of income, is limited for tax years beginning after December 31, 2017, and before January 1, 2026. Specifically, for tax years 2018 through 2025, an individual may claim an itemized deduction on Schedule A of Form 1040 of up to only \$10,000 (\$5,000 for married taxpayer filing a separate return) for: (1) state and local real property taxes; (2) state and local personal property taxes; and (3) state and local income taxes, as well as state and local sales taxes deducted in lieu of state and local income taxes (Code Sec. 164(b)(6), as added by the Tax Cuts and Jobs Act).

For purposes of applying the dollar limit above, if an individual prepays before 2018 a state or local income tax imposed for a tax year beginning after 2017, the payment is treated as paid on the last day of the tax year for which the tax is imposed (Code Sec. 164(b)(6), as amended by the 2017 Tax Cuts Act). Thus, an individual cannot claim an itemized deduction in 2017 on a prepayment of income tax for a future tax year in order to avoid the dollar limit for tax years 2018 through 2025 (Conference Report on H.R. 1, Tax Cuts and Jobs Act (H. Rept. 115-466)).

COMMENT

The prepayment restriction specifically applies to state or local income taxes, but not to state and local real or personal property taxes.

A taxpayer may still claim a deduction for foreign income taxes subject to the \$10,000/\$5,000 limit. However, no deduction is available for foreign real property taxes for tax years 2018 through 2025 (Code Sec. 164(b)(6), as amended by the 2017 Tax Cuts Act).

In the case of state and local real property and personal property taxes, a deduction is still allowed with no dollar limit if the taxes are paid or accrued in carrying on a trade or business, or on property held for the production of income. Thus, state and local property taxes may be deducted in computing an individual's Schedule C, Schedule E, or Schedule F of Form 1040. For example, an individual may deduct property taxes if the taxes are imposed on business or income producing assets such as residential rental property.

CAUTION

A deduction is still allowed for state and local income taxes if the taxpayer are paid or accrued in carrying on a trade or business, or on property held for the production of income. However, as written, the language of Code Sec. 164(b)(6) is that state and local income taxes are subject to the \$10,000/\$5,000 limit regardless of whether or not they are paid or accrued in a business or for the production of income.

COMMENT

The deduction for federal and state generation-skipping transfer (GST) taxes imposed on income distributions is not affected. An individual who received a income distribution from a GST trust and paid GST taxes on the distribution may continue to claim an itemized deduction for the taxes.

Effective date. The amendment made by this provision applies to tax years beginning after December 31, 2016 (Act Sec. 11042(b) of the Tax Cuts and Jobs Act).