

Will Democrats Pound SALT?

Proposing to abolish the state and local tax deduction is the best GOP reform hope.

By Donald L. Luskin

After a humbling loss in Tuesday's special election in Georgia, Democrats may be wondering if they ought to stop demonizing President Trump and instead work with him to kick-start economic growth.

An often overlooked but critical feature of Mr. Trump's tax-reform proposal gives Democrats the perfect opportunity to meet him at the bargaining table. When Mr. Trump introduced "the biggest individual and business tax cut in American history," he said he would "eliminate targeted tax breaks"—including the federal deduction for state and local taxes. Also known as the SALT deduction, this \$100 billion annual tax break to state and local governments has been on the books since 1913, even surviving Reagan tax reform. But this time, threatening the federal deduction may seal a tax deal for the GOP. Here's why:

First, it's hard for Democrats to argue that the tax reductions in Mr. Trump's plan are budget-busters when killing the SALT deduction would add \$1.3 trillion to federal coffers over a decade, according to the nonpartisan Tax Policy Center. That would pay for a lot of personal and business tax cuts, even without factoring in the faster growth that could pay for those cuts over time.

Second, Democrats can't say Mr. Trump's plan isn't real reform. The SALT deduction is a distortive subsidy to states. It encourages them to raise taxes, because voters can deduct those higher taxes from their federal tax bill.

Third, there's little in this for red states, because they generally have lower tax rates to begin with. Therefore, according to the Internal Revenue Service, blue states with higher tax rates receive about two-thirds of this break. In fact, half of the \$100 billion tax break goes to six deep-blue states: California, Illinois, Maryland, Massachusetts, New Jersey and New York. Democrats in favor of preserving the SALT deduction are simply self-interested.

Fourth, eliminating the SALT deduction makes it harder for Democrats to label the Trump tax reforms "a sop to the rich." It mainly applies to higher-earning taxpayers who itemize deductions, so the richest 20% of taxpayers get 14 times the benefit from it enjoyed by the poorest 20%, according to the Congressional Budget Office.

What scares Democrats most, however, is that the GOP can take away the SALT deduction—and achieve anything on taxes—without a single Democratic vote in the Congress.

To be sure, there are Republican legislators in blue states who might not like the idea of being the collateral damage of reform. Initially a couple GOP representatives expressed qualms, but

they understand this is a bargaining maneuver. Even so, the stakes are more daunting for the Democrats: Losing the SALT deduction begins a slippery slope toward losing more subsidies.

To spur growth, President Trump's main goal is to lower income and business tax rates. But putting the SALT deduction on the chopping block gives him the leverage he needs to force Democrats to work with him.

There's really only one kind of help Mr. Trump needs. Under Senate rules currently, a tax-reform bill could be passed with 52 GOP votes (or as few as 50, with Vice President Pence casting the tie-breaker). But if the bill isn't revenue-neutral and increases the forecast deficit, it would have to expire automatically after 10 years or so. Ideally, tax reform would be permanent, allowing businesses and individuals to make long-term plans. But that would take a filibuster-proof 60 votes. This is where the SALT deduction becomes Mr. Trump's chief bargaining chip: Republicans could offer to keep the SALT deduction, in exchange for eight yea votes from the Democrats.

There are 10 Democratic senators who face re-election in 2018 in states Mr. Trump carried last November. Three of them— Heidi Heitkamp of North Dakota, Joe Manchin of West Virginia and Joe Donnelly of Indiana—voted with the GOP majority to confirm Neil Gorsuch to the Supreme Court, risking their party's disfavor. They might also be inclined to support Mr. Trump's tax reforms—and five more could easily join them when they realize their seeming defection could win them votes in a tough midterm election.

Surely this is what Mr. Trump meant in his speech in Iowa on Wednesday, when he challenged Democrats to help on tax reform: "If we had even a little Democrat support . . . we'd be willing to change it and make it even better."

But the GOP wins either way. If they make no deal with the Democrats, tax cuts may not be permanent, but they can be even bigger thanks to the revenue from abolishing the SALT deduction. And a 10-year automatic expiration of reform leaves a lot of time to come up with eight votes.

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