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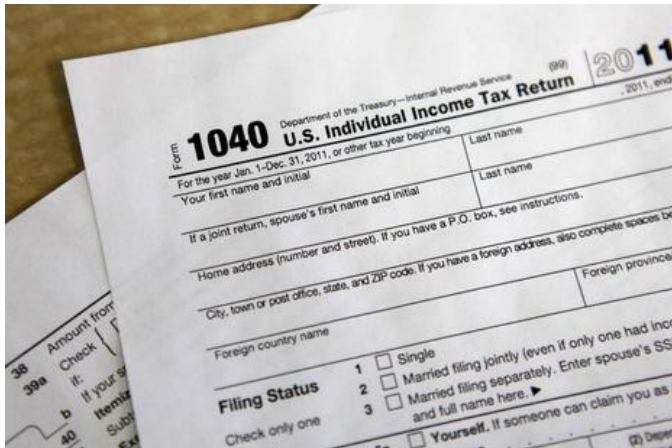
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Nathan B. Oman: A tax hike liberals and conservatives should both like

By Nathan B. Oman , For the Deseret News

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Under current law, everyone gets a deduction on their federal taxes for any state taxes that they pay. (Jacquelyn Martin, Associated Press)

The topple over the fiscal cliff has been averted, but the country's fiscal woes are far from solved. Indeed, while the deal between the president and congressional Republicans increased the top federal tax rate to 39.6 percent, Obama has already indicated that he will be looking for further tax increases. Let me suggest one that he ought to consider pushing: Capping the deduction for state taxes.

It's a tax hike that ought to appeal to liberals and conservatives alike.

Under current law, everyone gets a deduction on their federal taxes for any state taxes that they pay. Utah's income tax rate, for example, is 5 percent. California's top tax rate, on the other hand, is more than double that. Because of the federal deduction, Utahns pay federal taxes on more of their income than do Californians and thus face a higher effective federal tax rate.

Capping the deduction should appeal to liberals. First, it closes a loophole that allows citizens to avoid paying taxes at the currently prescribed rates. Second, it is a deduction claimed by virtually every taxpayer and thus — unlike symbolic fights over things like the carried interest deduction for hedge fund managers — could generate serious revenue. Third, it is progressive. A cap would allow low income tax payers to take the deduction. Only high earners would be hit with higher taxes. Fourth, it would increase equality by reducing the different effective federal tax rates faced by otherwise similar citizens under current law.

Conservatives should also support capping the deduction. First, the group that is likely to be hit hardest by the cap would be wealthy liberals. Right now, for example, Steven Spielberg and other Hollywood moguls that funded the Obama campaign can deduct the full amount of the their high California taxes. Second, the cap won't hit residents of conservative states, who already face higher effective federal tax rates, nearly as hard. Capping the deduction, for example, will have no impact at all on Sarah Palin's taxes. (Alaska has no income tax.) If, as liberals insist, the health of the republic depends on raising taxes, then they ought to capitalize on the political potential of conservative schadenfreude.

Finally, capping the deduction on state taxes is good policy. The deduction is a de facto federal subsidy for high-tax state governments. For example, the liberal citizens of Obama's home state of Hawaii, which has a top rate of 11 percent, do not pay for the full cost of their own government. This is because their higher state taxes allow them to avoid some of their federal taxes. This offsets part of

the cost of state government.

The central problem with American politics is that voters want the benefits of a generous state while paying only the taxes required by a much smaller government. So long as Americans live in the illusion that they can have both big government and low taxes, the fiscal outlook is bleak. There are two ways of forcing voters to awake to reality: We can either increase taxes to fund the government we want or we can reduce government to a level commensurate with the taxes we are willing to pay.

Right now citizens of big government, high-tax states do not face the full consequences of their own decisions. This is because we lower their federal tax bill to compensate for their higher state tax bill. Capping the deduction for state taxes would begin forcing voters to decide if they really want all of the government that they are giving themselves. It's a choice that all Americans need to begin facing seriously.

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