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Subsidizing Economic Segregation Through the State and Local Tax Deduction

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Economic segregation has increased over the past half-century. The trend of rich localities getting richer while poor localities get poorer is particularly concerning because it limits upward mobility and perpetuates intergenerational income inequality. This Article makes the novel argument that the state and local tax deduction subsidizes economic segregation. It arrives at that conclusion by showing that the "local tax deduction" provides a greater subsidy, per capita, for wealthy, economically segregated localities because only those localities have a critical mass of wealthy taxpayers who claim the deduction. This allows wealthy localities, but not poor localities, to provide services at a cost less than face value to their residents. This Article argues that the deduction's subsidy for wealthy localities rewards and likely contributes to economic segregation because it provides an incentive for the wealthy to segregate into wealthy, subsidized localities over less segregated and less subsidized localities. This Article's analysis and arguments are particularly relevant in light of recent controversy surrounding the state and local tax deduction, including the new $10,000 limit on the deduction, efforts to circumvent this limitation, and congressional proposals to reform it.

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INTRODUCTION

Economic segregation—the uneven geographic distribution of income groups—has increased over the past half-century among households with children.[1] This trend is significant because economic segregation is both a cause and consequence of income inequality, which is higher now than at any time since the Great Depression,[2] and compounds intergenerational income inequality for those

1. *See* Kendra Bischoff & Sean F. Reardon, *Residential Segregation by Income, 1970-2009*, *in* DIVERSITY AND DISPARITIES: AMERICA ENTERS A NEW CENTURY 208, 209–10, 213 (John R. Logan ed., 2014) [hereinafter Bischoff & Reardon, *Residential Segregation by Income, 1970-2009*]; SEAN F. REARDON & KENDRA BISCHOFF, CTR. FOR EDUC. POL'Y ANALYSIS, THE CONTINUING INCREASE IN INCOME SEGREGATION, 2007–2012, at 1 (2016); Ann Owens, *Inequality in Children's Contexts: Income Segregation of Households with and Without Children*, 81 AM. SOCIO. REV. 549, 550 (2016) [hereinafter Owens, *Inequality in Children's Contexts*] ("Rising income segregation between neighborhoods is a story about families with children . . . ."); *infra* notes 34–35 and accompanying text.

2. *See* Emmanuel Saez & Gabriel Zucman, *Wealth Inequality in the United States Since 1913: Evidence from Capitalized Income Tax Data*, 131 Q.J. ECON. 519 (2016); Kathryn M. Neckerman

who live in predominately poor localities.[3] Scholars have studied the causes and effects of economic segregation, and the government has implemented programs aimed at decreasing economic segregation, but they have not considered an important way that federal tax policy subsidizes economic segregation. This Article fills a significant gap in the literature by exploring the relationship between economic segregation and the state and local tax deduction, one of the federal government's largest tax expenditures.[4] In doing so, it provides a new perspective that should cause policymakers and scholars to reconsider how they think about the deduction.

The state and local tax deduction allows taxpayers to deduct the state and local taxes they pay from their federal taxable income, thereby reducing their overall federal tax liability. The deduction costs the federal government approximately $100 billion each year.[5] The magnitude of the deduction has brought it to the center of political and academic debate, especially over the past three years. In order to fund tax cuts in other areas, the Tax Cuts and Jobs Act (TCJA) controversially placed a new, temporary $10,000 cap on the state and local tax deduction, which taxpayers

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& Florencia Torche, *Inequality: Causes and Consequences*, 33 ANN. REV. SOCIO. 335, 337–38 (2007) (discussing the causes and negative ramifications of income inequality).

3. *See infra* Part I; Raj Chetty, John N. Friedman, Nathaniel Hendren, Maggie R. Jones & Sonya R. Porter, *The Opportunity Atlas: Mapping the Childhood Roots of Social Mobility* (Nat'l Bureau of Econ. Rsch., Working Paper No. 25147, 2020), https://www.nber.org/system/files/working_papers/w25147/w25147.pdf [https://perma.cc/58UQ-CEUY] ("Children's outcomes vary sharply across nearby areas: for children with parents at the 25th percentile of the [national] income distribution, the standard deviation of mean household income at age 35 is $5,000 across tracts within counties."); Jonathan Rothwell, *The Neighborhood Effect: Localities and Upward Mobility*, BROOKINGS (Nov. 12, 2014), https://www.brookings.edu/blog/social-mobility-memos/2014/11/12/the-neighborhood-effect-localities-and-upward-mobility [https://perma.cc/NRN5-MLJG] ("[I]nequality is partly inherited via neighborhoods . . . ."); *see also* Emily Badger, *The One Thing Rich Parents Do for Their Kids that Makes All the Difference*, WASH. POST (May 10, 2016, 3:30 AM), https://www.washingtonpost.com/news/wonk/wp/2016/05/10/the-incredible-impact-of-rich-parents-fighting-to-live-by-the-very-best-schools/ [https://perma.cc/88PS-79SF] (quoting Ann Owens that "buying a neighborhood is probably one of the most important things you can do for your kid. . . . There's mixed evidence on whether buying all this other stuff matters, too. But buying a neighborhood basically provides huge advantages.").

4. A tax expenditure is a "provision of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability." Congressional Budget and Impoundment Control Act of 1974, 2 U.S.C. § 622(3) (2006). Scholars have debated the merits of tax expenditures as a tool of federal policy. *See, e.g.*, Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705 (1970); Lily L. Batchelder, Fred T. Goldberg, Jr. & Peter R. Orszag, *Efficiency and Tax Incentives: The Case for Refundable Tax Credits*, 59 STAN. L. REV. 23, 49 (2006).

5. *See* STAFF OF JOINT COMM. ON TAXATION, JCX-34-18, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2017–2021 (2018); *see also Briefing Book*, TAX POL'Y CTR., https://www.taxpolicycenter.org/briefing-book/what-are-largest-tax-expenditures [https://perma.cc/KC34-DZWH] (last visited Apr. 6, 2020) ("The cost of the deduction of state and local income, sales, and property taxes will decline from $100.9 billion in 2017 to only $21.2 billion in 2019 because of the increase in the standard deduction and because the tax deduction is [temporarily] limited to no more than $10,000 per tax return.").

had previously been able to deduct without limit.[6] This change is projected to raise approximately $668 billion in new taxes over ten years.[7] In response to this cap, certain states and localities unsuccessfully sued to attempt to restore the full deduction, and the House of Representatives has passed bills that would temporarily restore the deduction (though the bills are highly unlikely to pass in the Senate).[8]

Given the significance of and political contention surrounding the state and local tax deduction, much has been written about its effects and normative desirability.[9] This Article adds a significant new wrinkle to this longstanding and ongoing debate by making the novel argument that the local half of the deduction serves to subsidize economic segregation. This Article develops that argument by raising two separate, but related, questions about the relationship between economic segregation and the state and local tax deduction. First, how does economic segregation affect who, geographically and socioeconomically, is subsidized by the state and local tax deduction? Second, does the state and local tax deduction reward economic segregation, and if so, may the deduction serve as a contributing factor to the rise in economic segregation? This Article argues that the answer to each question is yes, which in turn has significance for how scholars and policymakers should think about how this expensive and important federal tax expenditure should be structured.

Starting with the first question, this Article argues that the *local* tax deduction, which accounts for approximately half of the state and local tax deduction, provides a greater subsidy, per capita, for wealthy, economically segregated localities than it

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6. *See* Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054 (2017); I.R.C. § 164(b)(6) (West 2007).

7. H.R. REP. NO. 115-466, at 684 (2017) (Conf. Rep.) (calculating the amount that the federal government would save as a result of the $10,000 ceiling and stating that the ceiling constitutes the "lion's share" of the $668 billion in tax expenditure savings). The remainder of the $1.5 trillion tax overhaul was funded by a combination of increased federal debt and dozens of other, smaller revenue-raising provisions, including new limitations on the deductibility of home mortgage interest.

8. *See* Vill. of Scarsdale v. Internal Revenue Serv., No. 1:2019cv06654 (S.D.N.Y. July 17, 2019) (Justia, Dockets & Filings); State v. Mnuchin, No. 1:18-cv-6427 (S.D.N.Y. July 17, 2019) (Justia, US Law); Restoring Tax Fairness for States and Localities Act, H.R. 5377, 116th Cong. (2019); Shahar Ziv, *Stimulus Update: Dems Cut $1.2 Trillion from Heroes Act: Propose $2.2 Trillion Stimulus Package*, FORBES (Sept. 29, 2020, 9:10 AM), https://www.forbes.com/sites/shaharziv/2020/09/29/stimulus-update-dems-cut-12-trillion-from-heroes-act-propose-22-trillion-stimulus-package/?sh=7ba84d8d57a9 [https://perma.cc/CBU2-8L4J].

9. For examples of literature that explore the debates surrounding the state and local tax deduction, but which do not address its relationship to economic segregation, see Ruth Mason, *Federalism and the Taxing Power*, 99 CALIF. L. REV. 975, 1021–23 (2011); Brian Galle, *Federal Fairness to State Taxpayers: Irrationality, Unfunded Mandates, and the "SALT" Deduction*, 106 MICH. L. REV. 805, 813 (2008); Julie Roin, *The Consequences of Undoing the Federal Income Tax*, 70 U. CHI. L. REV. 319, 332 (2003) ("A commonly expressed fear is that the elimination of the deduction for state and local taxes will reduce subordinate governments' ability to generate tax revenue."); Louis Kaplow, *Fiscal Federalism and the Deductibility of State and Local Taxes Under the Federal Income Tax*, 82 VA. L. REV. 413, 417, 484–90 (1996) (analyzing the effects of the state and local tax deduction as a subsidy); William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309, 366–67 (1972).

does for economically heterogeneous or less wealthy localities.[10] It supports this claim by showing how the deduction (i) predominantly benefits wealthy, itemizing taxpayers by allowing them to reduce the taxes they pay and (ii) acts as a subsidy from the federal government to localities because the deduction effectively gives taxpayers a discount on their local tax rates, allowing localities to charge higher taxes (and provide better goods and services) than they could in the absence of a deduction. It then asks the critical questions: Which localities are subsidized by the local tax deduction, and should they be? This Article argues that the local tax deduction disproportionately subsidizes wealthy, economically segregated localities because only the relatively wealthy can deduct their local taxes and benefit from the local tax deduction on their tax returns; therefore, only localities with a critical mass of relatively wealthy taxpayers can charge higher taxes (at the expense of all taxpayers) as a result of the deduction.[11] In contrast, taxpayers in poor localities, which are comprised primarily of non-itemizing taxpayers, pay full or close to full price for their local goods and services because poor localities receive little to no subsidy from the local tax deduction.

To illustrate the effect of the local tax deduction on wealthy localities, it is helpful to consider local schools, which are one of the most significant local tax expenditures.[12] There are certain schools where almost every parent claims the deduction and other schools where no, or very few, parents claim the deduction.[13] Wealthy localities, where most of the households claim the deduction, can charge higher taxes because each dollar charged costs the itemizing residents less than a dollar, and therefore wealthy localities receive a federal subsidy for their local

10. One reason this Article's insights about the local tax deduction have not been discussed in prior academic literature is that scholars and policy makers almost always discuss the state and local tax deduction as one deduction, and therefore have not separately analyzed the federal deduction for local taxes and the federal deduction for state taxes. In fact, it is so common to discuss the two halves of the deduction as one that it is often reduced to the acronym "SALT" deduction. *See, e.g.*, Galle, *supra* note 9; Kirk J. Stark, *Fiscal Federalism and Tax Progressivity: Should the Federal Income Tax Encourage State and Local Redistribution?*, 51 UCLA L. REV. 1389 (2004); Daniel Shaviro, *An Economic and Political Look at Federalism in Taxation*, 90 MICH. L. REV. 895 (1992); Bruce Bartlett, *The Deduction for State and Local Taxes*, N.Y. TIMES (Aug. 13, 2013, 12:01 AM), https://economix.blogs.nytimes.com/2013/08/13/the-deduction-for-state-and-local-taxes/?mtrref=www.google.com&assetType=REGIWALL [https://perma.cc/8LG2-NXWB] ("The federal deduction for state and local taxes, in the tax world often called the Salt deduction, is among the largest in the tax code . . . .").

11. *See infra* note 116 (discussing what constitutes a "critical mass" for purposes of this Article).

12. Economic segregation has significantly increased among households with children but has changed little among childless households, strongly indicating that the rise in economic segregation is a result of parents with school-age children "buying" better schools for their children. *See* Owens, *Inequality in Children's Contexts*, *supra* note 1.

13. *See* Richard Voith, *Does the Federal Tax Treatment of Housing Affect the Pattern of Metropolitan Development?*, BUS. REV., Feb. 1999, at 9 ("For a community composed of moderate-income residents who find it most advantageous to use the standard deduction, the local residents would pay the full $1 million for school funding [for a school to receive $1 million in school benefits].").

schools as a result of the deduction.[14] However, schools in localities where no or very few households claim the deduction receive little to no benefit from the deduction because those localities do not have a federal subsidy that allows them to charge taxes at a discounted rate in the way wealthy localities do.[15]

This Article asserts that the answer to the second question—whether the state and local tax deduction rewards or contributes to economic segregation—is that the local tax half of the state and local tax deduction certainly rewards, and likely contributes to, economic segregation.[16] By disproportionately subsidizing wealthy, economically segregated localities, the deduction rewards taxpayers for economic segregation, thereby creating an incentive for taxpayers to economically segregate. Although the subsidy created by the deduction is only one of many factors that go into the complicated calculation of where to live, the quality of local goods and services (and in particular, the quality of local schools), relative to their cost in taxes, undoubtedly goes into the calculation.[17] Therefore, the deduction, which lowers the cost of local goods and services for wealthy, economically segregated localities, changes the cost-benefit analysis in favor of those localities for those who can afford to choose to live there. If at least some taxpayers have responded to this incentive to choose a wealthy, economically segregated locality over another less economically segregated locality, then the local tax deduction has contributed, at least in some part, to the rise in economic segregation. Moreover, the deduction rewards those whose decisions are unaffected by the deduction but would choose to live in a wealthy locality even in the absence of the deduction.

To be clear, this Article does not purport to empirically explain how each locality in the United States works. Each locality is different in its economic composition and taxing and spending patterns, and there are therefore exceptions to any attempt to explain how and why localities behave like they do. The goal of this Article is to begin a discussion about the undertheorized local tax deduction and its relationship to economic segretation and income inequality. While this Article focuses on the theory behind the deduction and economic segregation, not on empirically proving a connection, there is anecdotal evidence to support a

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14. *Id.* ("In high-income communities, property tax deductibility lowers the cost of providing local amenities, such as schools and parks, that are financed by property taxes . . . .").

15. *Id.* ("For a community composed of moderate-income residents who find it most advantageous to use the standard deduction, the local residents would pay the full $1 million for school funding [for a school to receive $1 million in school benefits].").

16. This Article explains that there are two rewards for economic segregation—the reward explained in the text above and the reward that comes because when the wealthy live in wealthy, economically homogeneous localities, they are able to minimize the amount of redistribution from them to the less wealthy. *See infra* Section II.C.

17. *See* Shelly Hagan & Wei Lu, *These Are the Wealthiest Towns in the U.S.*, BLOOMBERG (Feb. 13, 2019, 7:03 AM), https://www.bloomberg.com/news/articles/2019-02-13/silicon-valley-suburb-snags-richest-spot-in-u-s-for-third-year [https://perma.cc/JR95-HGV7] (explaining that Scarsdale is the second wealthiest locality in the United States and quotes Scarsdale Mayor Dan Hochvert, a 40-year resident, "We moved here, as many did, because of the outstanding school system. . . . That's one of the primary drivers.").

connection.[18] Some of this ancedotal evidence arises from the effects of the recent and highly controversial $10,000 limit on the deductibility of state and local taxes.[19] A headline from the *Wall Street Journal* is telling: "Democrats and Affluent Suburbs Join to Fight Tax-Break Cap."[20] Scarsdale, the wealthiest locality in New York (with an average household income of $417,335) filed a lawsuit on July 17, 2019, challenging the validity of the cap.[21] The fact that New York's wealthiest locality funded and filed this lawsuit, in connection with the fact that New York's other wealthy localities and school districts have formed a coalition to overturn the effects of the $10,000 cap, indicates that wealthy localities have a larger stake in the deductibility of local taxes than other localities.[22] Comments by the residents of Scarsdale are also telling: "[T]he denial of [a deduction] disproportionately hits communities like mine,"[23] "These regulations will cause real harm for villages like Scarsdale,"[24] and "I worry that the changes to SALT are going to destroy our way of life . . . ."[25] Furthermore, there is some evidence that the $10,000 cap has reduced housing values in wealthy neighborhoods but has had no effect on housing values in poor neighborhoods, indicating that the deduction disproportionately subsidizes wealthy neighborhoods.[26]

Additional anecdotal evidence comes from wealthy communities that are part of larger, economically heterogeneous localities deciding to separate to form their own smaller, wealthy, economically homogenous cities and school districts.[27] This

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18. An empirical analysis of the magnitude of the deduction's subsidy for wealthy, economically segregated localities, and the related question of whether and to what extent the deduction has contributed to the rise in economic segregation among households with children, is beyond the scope of this Article. However, this Article lays the foundation and framework for future empirical scholarship to test its arguments and conclusions.

19. *See infra* Part III.

20. Richard Rubin, *Democrats and Affluent Suburbs Join to Fight Tax-Break Cap*, WALL ST. J. (June 25, 2019, 7:00 PM), https://www.wsj.com/articles/democrats-and-affluent-suburbs-join-to-fight-tax-break-cap-11561503637 [https://perma.cc/N8ML-QU4M].

21. *See* Vill. of Scarsdale v. Internal Revenue Serv., No. 1:2019cv06654 (S.D.N.Y. July 17, 2019) (Justia, Dockets & Filings); Hagan & Lu, *supra* note 17.

22. The coalition is comprised of New York's wealthiest and, generally, most economically segregated localities and school districts, including Scarsdale, Rye, Upper Brookeville, Pelham, Bronxville, North Castle, Lewisboro, and Bedford. *See* Lauren Loricchio, *States, Locality Sue to Overturn IRS SALT Regs*, 164 TAX NOTES FED. 590, 590 (2019).

23. *Id.* at 591 (quoting New York State Assembly member Amy Paulin).

24. *Id.*

25. *See* Jimmy Vielkind, *New York Towns Gearing Up to Fight IRS Ruling on Local Taxes*, WALL ST. J. (Sept. 30, 2018, 11:00 AM), https://www.wsj.com/articles/new-york-towns-gearing-up-to-fight-irs-ruling-on-local-taxes-1538319601 [https://perma.cc/QWG9-3QU3].

26. *See* Jim Tankersley, *The Trump Tax Cuts Were Supposed to Depress Housing Prices. They Haven't.*, N.Y. TIMES (Aug. 27, 2018), https://www.nytimes.com/2018/08/27/business/housing-prices-tax-law.html [https://perma.cc/7Z93-99QA] (finding that controlling for the other provisions of the TCJA, only the state and local tax deduction had an effect on housing prices, and noting that the changes are "contained to a few high-priced, highly taxed ZIP codes").

27. *See* Adam Harris, *The New Secession*, ATL. (May 20, 2019), https://www.theatlantic.com/education/archive/2019/05/resegregation-baton-rouge-public-schools/589381/ [https://perma.cc/

trend, which has "rapidly accelerated," allows the wealthy to economically segregate without physically moving and "isolates their property-tax dollars in a new district."[28] Because this form of economic segregation occurs by tax boundary drawing, not moving truck, it indicates that the benefits of living in an economically segregated locality, which are subsidized by the local tax deduction, are contributing to this trend.[29] Furthermore, even if each of these separations would have occurred independently of the subsidy created by the local tax deduction, the deduction nonetheless economically rewards, at the cost of all taxpayers, those who choose to engage in this form of economic segregation.

This Article concludes by exploring how its insights should influence debates about whether a deduction should exist, and if so, how it should be structured. It makes the previously unrecognized point that to understand whether a deduction for local taxes is merited, we need to look at the types of localities it subsidizes. It argues that, from a tax policy perspective, a deduction for local taxes is justified if it is shared with the less wealthy through redistribution (much like the charitable deduction),[30] which is often the case for taxpayers in large cities with economically diverse populations and taxpayers in states that require wealthy localities to share tax revenue with poorer localities.[31] However, where the subsidy created by the local tax deduction is captured primarily by those who receive a direct benefit for the taxes they pay, which occurs the most frequently in wealthy, economically segregated localities,[32] then the deduction is significantly less justified because taxpayers should not receive a deduction for what amounts to their own consumption (the same way they do not get a deduction for purchasing a car or clothes).[33] When looked at this way, the question of whether to allow and how to structure a deduction turns to the nature of the underlying localities the deduction subsidizes.

The time is ripe to consider how to better structure the local deduction in light of the recent tax reform's effect on the deduction. This Article provides a new perspective on the $10,000 cap on federal deductibility of state and local taxes and

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LPT7-68JN] (stating that the rate at which wealthy communities have separated to form their own school districts has "rapidly accelerated in the past two years").

28. *Id.*

29. *See supra* note 16.

30. *See infra* notes 119–20 and accompanying text (discussing tax policy justifications for deductibility).

31. *See infra* notes 127–30 and accompanying text.

32. For example, schools in wealthy neighborhoods often have more local tax funding than schools in poor neighborhoods, even after accounting for transfers from the state and federal government. *See infra* notes 73–74 and accompanying text; *see also* Ann Owens, Sean F. Reardon & Christopher Jencks, *Income Segregation Between Schools and School Districts*, 53 AM. EDUC. RSCH. J. 1159, 1161–62 (2016) [hereinafter *Income Segregation Between Schools and School Districts*] ("Income segregation thus implies variation in school funding between school districts. In many states, these inequalities are partially or wholly offset by state and federal funding, but there are still many states where funding remains correlated with local residents' income and property values.").

33. *See infra* note 120 (explaining why taxpayers should not get a deduction for consumption).

proposes new approaches to deductibility that may be better tax policy than the current limitation. These could include limiting deductibility of local taxes in wealthy, economically segregated localities or continuing to subsidize wealthy, economically segregated localities while increasing funding (perhaps in the form of a credit) for relatively poor and economically heterogeneous localities that have historically been less subsidized by the local tax deduction. Either of these options would reduce the tax incentive to economically segregate by leveling the tax playing field between localities.

This Article proceeds in three parts. Part I describes the rise in economic segregation in the United States and shows how economic segregation contributes to intergenerational income inequality. Part II makes the claim that the local tax deduction rewards the wealthy for segregating into wealthy localities by subsidizing wealthy, economically homogeneous localities, and argues that this reward has likely contributed to the rise in economic segregation. Part III analyzes the new $10,000 limit on the deductibility of state and local taxes and makes alternative proposals to reform the deduction in ways that would reduce the deduction's incentive for economic segregation.

I. ECONOMIC SEGREGATION IN THE UNITED STATES

Economic segregation—the uneven geographic distribution of income groups—creates wealthy localities with superior local goods and services and poorer localities with comparatively inferior local goods and services. Economic segregation has significant social and economic ramifications, including the perpetuation of intergenerational income inequality. This background on economic segregation provides the foundation for Part II, which explores the ways that the local tax deduction has incentivized and rewarded economic segregation.

A. Rising Economic Segregation

It is common knowledge that people choose to live in a particular area because of the cost of housing in that area. Economic segregation occurs because housing prices and rental costs vary but are usually clustered in localities, with high-cost housing generally more closely surrounded by other high-cost housing and low-cost housing generally more closely surrounded by other low-cost housing. Therefore, high-income families typically choose to live in localities with other high-income families, where they can afford housing, while low-income families typically live in localities with other low-income families, where they can afford housing.[34]

Economic segregation among localities, neighborhoods, and school districts has always existed, but it has increased markedly since 1970.[35] During that time, it

34. Bischoff & Reardon, *Residential Segregation by Income, 1970-2009*, *supra* note 1.

35. The social science literature, which is the primary source for measuring economic segregation, has taken several approaches to measuring economic segregation, with some using *neighborhoods* and others using school districts or census tracts. Although these studies take different

has become more common for the wealthy to live near the wealthy and for the poor to live near the poor,[36] and the percentage of the population living in the United States' poorest and wealthiest neighborhoods has more than doubled since 1970.[37] In other words, lower-income households have become more likely to live in localities with other low-income households, and higher-income households have become more likely to live in localities with other high-income households.[38]

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approaches to measuring economic segregation, overall, they show that economic segregation has increased since 1970 among households with children. Although no study has measured economic segregation by local taxing jurisdiction, in large part because the studies were not focused on the relationship between taxes and economic segregation, the fact that economic segregation has increased among school districts, which are often their own taxing jurisdictions, indicates that economic segregation has also increased among taxing jurisdictions. *See Income Segregation Between Schools and School Districts*, *supra* note 32 (finding that economic segregation has increased among school districts). Even if (i) economic segregation had only increased among the neighborhoods and school districts as measured by the social science literature, but not among local taxing jurisdictions (which seems highly unlikely), or (ii) all the studies showing an increase in economic segregation were incorrect (which also seems highly unlikely), the claims made in this Article in Parts II and III regarding the ways that the local tax deduction rewards economic segregation would remain correct. For other articles that find that economic segregation has increased over time, see Bischoff & Reardon, *Residential Segregation by Income, 1970-2009*, *supra* note 1, at 214 (finding that "overall income segregation increased by approximately 29 percent" from 1970 to 2010); SEAN F. REARDON & KENDRA BISCHOFF, GROWTH IN THE RESIDENTIAL SEGREGATION OF FAMILIES BY INCOME, 1970-2009 (2011) [hereinafter REARDON & BISCHOFF, GROWTH IN THE RESIDENTIAL SEGREGATION OF FAMILIES BY INCOME, 1970-2009] (measuring economic segregation by using U.S. Census data and the American Community Survey and comparing neighborhood median family income to metropolitan area median income); Tara Watson, *Inequality and the Measurement of Residential Segregation by Income in American Neighborhoods*, 55 REV. INCOME & WEALTH 820 (2009); Richard Fry & Paul Taylor, *The Rise of Residential Segregation by Income*, PEW RSCH. CTR. (Aug. 1, 2012), http://www.pewsocialtrends.org/2012/08/01/the-rise-of-residential-segregation-by-income/ [https://perma.cc/Q93A-4EPU] (using census tracks for 1980 to 2010 as a proxy for what constitutes a neighborhood and finding that residential segregation has increased since 1980). *But see* John R. Logan, Andrew Foster & Jun Ke, *The Uptick in Income Segregation: Real Trend or Random Sampling Variation?*, 124 AM. J. SOCIO. 185, 185 (2018) (discussing the ways that the census, which is the primary source of data used to calculate economic segregation, relies on a reduced sample size that may exaggerate the upward trend for the 2000s).

36. REARDON & BISCHOFF, GROWTH IN THE RESIDENTIAL SEGREGATION OF FAMILIES BY INCOME, 1970-2009, *supra* note 35, at abstract, 8 (defining affluent as those who make 1.5 times the median family income, and poor as those who make less than .67 times the median family income of a given metropolitan area, measuring the extent to which families in the top ten percent of earners lived in separate neighborhoods, and concluding "[a]s overall income inequality grew in the last four decades, high- and low-income families have become increasingly less likely to live near one another"); Fry & Taylor, *supra* note 35 (defining low-income households as those making less than two-thirds of the national median annual income, upper-income households as those making more than double the national median annual income, and finding that "28% of lower-income households in 2010 were located in a majority lower-income census tract, up from 23% in 1980, and that 18% of upper-income households were located in a majority upper-income census tract, up from 9% in 1980").

37. REARDON & BISCHOFF, GROWTH IN THE RESIDENTIAL SEGREGATION OF FAMILIES BY INCOME, 1970-2009, *supra* note 35, at 11 (showing that in 1970, approximately fifteen percent of families lived in neighborhoods that were classified as either wealthy or poor, and by 2007, thirty-one percent of families lived in such neighborhoods).

38. Lower-income households have not been put into this situation by choice. Lower-income households have more limited budgets than wealthier households and are, therefore, priced out of many localities, even though they typically spend a higher percentage of their income on housing costs. *See Affordable Housing*, HUD.GOV, https://www.hud.gov/program_offices/comm_planning/

Economic segregation is the most pronounced among the relatively wealthy, who are more segregated than lower-income families.[39] The increase in the number of wealthy localities has led to an increase in the number of localities that are composed almost exclusively of relatively wealthy families, and these localities almost always have superior local public goods and services.[40]

Why have the wealthy segregated themselves? One cause is the overall increase in income inequality.[41] In a world with no income inequality, there could be no economic segregation because every locality would have income homogeneity. But

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affordablehousing [https://web.archive.org/web/20200801195446/https://www.hud.gov/program_offices/comm_planning/affordablehousing/] (last visited Aug. 1, 2020) (reporting that "[a]n estimated 12 million renter and homeowner households now pay more than 50% of their annual incomes for housing"). In addition, because local amenities, including local public schools, are priced into housing costs, lower-income families are faced with different housing constraints than wealthier households and are unable to pay the same amounts for any given package of local amenities. *See* JONATHAN ROTHWELL, BROOKINGS, HOUSING COSTS, ZONING, AND ACCESS TO HIGH-SCORING SCHOOLS 1 (2012), https://brookings.edu/wp-content/uploads/2016/06/0419_school_inequality_rothwell.pdf [https://perma.cc/C4AS-Z89X] (reporting the standardized test scores for high- and low-income students and that "housing costs an average of 2.4 times as much, or nearly $11,000 more per year, near a high-scoring public school than near a low-scoring public school"); Watson, *supra* note 35, at 822. For example, while a wealthy household may choose between different size houses, each in good school districts, a lower-income family must often choose between safety, and proximity to employment, childcare, and public transportation. In many cases, a choice about safety may (logically) be a higher priority than living in a school district with higher rated schools. *See* Maya Wesby, *Why Rich Kids Become Rich Adults and Poor Kids Become Poor Adults*, WILSON Q. (Aug. 13, 2015), https://wilsonquarterly.com/stories/why-rich-kids-become-rich-adults-and-poor-kids-become-poor-adults/ [https://perma.cc/6SVG-H9EF] (noting that "where low-income families focus on immediate needs, such as food and transportation, rich families invest more on future-oriented purchases that will ensure their wellbeing").

39. REARDON & BISCHOFF, GROWTH IN THE RESIDENTIAL SEGREGATION OF FAMILIES BY INCOME, 1970-2009, *supra* note 35 at 1, 22 ("The affluent are more segregated from other Americans than the poor are. That is, high-income families are much less likely to live in neighborhoods with middle- and low-income families than low-income families are to live in neighborhoods with middle- and high-income families. This has been true for the last 40 years. . . . During the last four decades, the isolation of the rich has been consistently greater than the isolation of the poor.").

40. *See* Fry & Taylor, *supra* note 35 ("18% of upper-income households were located in a majority upper-income census tract, up from 9% in 1980."); *see also* Emily Gersema, *Neighborhood Segregation Is Driven by Income Inequality, Choice of School Districts*, USC NEWS (May 10, 2016), https://news.usc.edu/99804/neighborhood-segregation-is-driven-by-income-inequality-and-choice-of-school-districts-study-finds/ [https://perma.cc/J8TA-DKYS] (discussing the rise in economic segregation among families). The wealthiest of these neighborhoods have been referred to as "Super Zips." *See* CHARLES MURRAY, COMING APART: THE STATE OF WHITE AMERICA, 1960–2010 (2012); *see also* Ted Mellnik & Carol Morello, *Washington: A World Apart*, WASH. POST (Nov. 9, 2013), https://www.washingtonpost.com/sf/local/2013/11/09/washington-a-world-apart/?utm_term=.3a1a6e58ba57 [https://perma.cc/A7FC-PHMX] (explaining that "'Super Zips' . . . describe the country's most prosperous, highly educated demographic clusters. On average, they have a median household income of $120,000, and 7 in 10 adults have college degrees").

41. For articles discussing the correlation between rising economic segregation and rising income inequality, see Bischoff & Reardon, *Residential Segregation by Income, 1970-2009*, *supra* note 1, at 208 ("[W]e find that segregation has grown most rapidly in metropolitan areas characterized by growing income inequality, growing proportions of children, and increasing average educational attainment levels."); *see also* Fry & Taylor, *supra* note 35 (discussing the increase in income inequality and noting the increase in the number of upper- and lower-income census tracts).

as income inequality increases, the rich have become richer and the poor have become poorer.[42] Consequently, economic segregation has increased as wealthy localities have become wealthier and poorer localities have become poorer.[43] However, increasing income inequality appears to only account for a portion of the increase in economic segregation, with multiple studies concluding that economic segregation has increased since 1970 among households with children, even when controlling for increased income inequality.[44] Therefore, the increase in economic segregation seems to be due, at least in part, to an increase in the number of people choosing to move to localities that are relatively economically homogeneous.

A primary reason why the wealthy prefer homogenous localities is that they permit them to reduce economic redistribution, thereby allowing wealthy taxpayers to more directly benefit from the local taxes they pay.[45] In contrast, when the wealthy pay local taxes in an economically heterogeneous locality, at least a portion of their local taxes fund goods and services for less wealthy residents who do not pay enough taxes to fund the local goods and services they consume. The ways in which residents should be expected to sort into localities was famously modeled by Charles Tiebout, who argued that in a perfectly competitive scenario, there would be an equilibrium where people would sort into localities where the local goods and services exactly matched the residents' preferences.[46] The Tiebout model views each locality as a package of local public goods and services that residents pay for via local taxes. If the goods and services provided and taxes charged do not perfectly match a resident's preferences, then that resident will move to a locality that does. Although the Tiebout model relies on a number of assumptions that do not hold in the real world, including that there are no costs associated with moving between jurisdictions and that local public goods and tax burdens are the only factors people consider when deciding where to live, it is a widely cited and useful model for

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42. For articles documenting the rise in income inequality, see Saez & Zucman, *supra* note 2; Drew DeSilver, *U.S. Income Inequality, On Rise for Decades, Is Now Highest Since 1928*, PEW RSCH. CTR. (Dec. 5, 2013), http://www.pewresearch.org/fact-tank/2013/12/05/u-s-income-inequality-on-rise-for-decades-is-now-highest-since-1928/ [https://perma.cc/3LW7-Y7Z8].

43. *See* Watson, *supra* note 35, at 822 ("[A]s inequality rises, the rich will be more likely to outbid the poor for high-quality neighborhoods and the rich and poor will be less likely to live in close proximity."); Badger, *supra* note 3 ("[A]s income inequality has widened . . . the rich have more and more money to spend on the real estate arms race to get into wealthy neighborhoods, where everyone else is wealthy, too (and the same can be said of the local classrooms).").

44. In theory, increasing income inequality could be the sole reason for increased economic segregation. To illustrate, if income inequality increased, but no one moved, then there would still be increased economic segregation because the wealthy localities would, on average, become wealthier while the poor localities would, on average, become poorer. However, studies that control for increasing income inequality have concluded that the increase in income inequality is not the sole reason for the increase in economic segregation. *See* REARDON & BISCHOFF, GROWTH IN THE RESIDENTIAL SEGREGATION OF FAMILIES BY INCOME, 1970-2009, *supra* note 35, at 21 (controlling for increased income inequality and concluding that "[b]y any of the measures we examine, segregation of families by income has grown significantly in the last 40 years"); Watson, *supra* note 35 (showing that residential segregation increased independently of rising income inequality).

45. *See infra* Section II.C.

46. *See* Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956).

understanding individual's decisions about where to live. The Tiebout model also may help explain the phenomenon of increased economic segregation.[47] Since 1970, the United States has moved closer to a Tieboutian world where taxpayers, especially the wealthy, sort themselves into economically homogeneous localities where they are essentially purchasing local goods and services through their local taxes.[48]

Of course, households perceive and evaluate local goods, services, and taxes differently depending on their particular preferences. Each household weighs factors such as the tax rate, the attractiveness of the homes in an area, educational facilities, air quality, low crime, proximity to public transportation, local natural resources, and any number of other factors differently. Generally, localities with higher median housing costs generate higher tax revenue and therefore have better-funded schools, safer neighborhoods, and better local amenities, such as parks and other community facilities. Even though households weigh local goods and services differently, the fact that, collectively, wealthy households have increasingly chosen to move to wealthy, homogeneous localities indicates that wealthy households have an increased desire to live in localities with superior goods and services, or at least not to subsidize other less wealthy households.[49] By moving into wealthier and more segregated localities, these families are effectively purchasing the goods and services of those localities via local property taxes.[50]

Although it is impossible to know how each household came to choose the locality it lives in, there is one factor that appears to strongly influence households' decisions to sort into homogeneous localities more than any other: local public schools.[51] A recent study by Ann Owens shows that income segregation between neighborhoods is approximately twice as high among households with children as

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47. Although other factors, including preferences for proximity to work, proximity to family, characteristics of neighbors, etc., play a role in people's decisions regarding where to live, there are typically both wealthy and poor neighborhoods in the same greater metropolitan area that allow people to accommodate these non-income economic preferences. *See* Patrick Bayer & Robert McMillan, *Tiebout Sorting and Neighborhood Stratification*, 96 J. PUB. ECON. 1129 (2012) (showing that employment geography and commuting costs are factors that affect where people choose to live and serve to bring heterogeneous households together in the same neighborhoods).

48. *See* Bayer & McMillan, *supra* note 47.

49. *See* Steven N. Durlauf, *A Theory of Persistent Income Inequality*, 1 J. ECON. GROWTH 75, 75 (1996) (stating that the benefits of superior local public schools plus the sociological effects connected with living in wealthy neighborhoods has created "incentives for wealthier families to segregate themselves into economically homogeneous neighborhoods"); Patrick Bayer, Robert McMillan & Kim Rueben, *An Equilibrium Model of Sorting in an Urban Housing Market* (Nat'l Bureau of Econ. Rsch., Working Paper No. 10865, 2004), https://www.nber.org/system/files/working_papers/w10865/w10865.pdf [https://perma.cc/8L6T-LJMK] (showing that wealthy families are willing to pay higher housing prices in order to live in more homogeneous neighborhoods).

50. It is often said that you should buy the worst house in the best neighborhood. The rationale behind that adage is that living in the best neighborhood you can afford gives you access to the best local goods and services you can afford even though your home is cheaper than the surrounding homes.

51. *See* Bayer & McMillan, *supra* note 47, at 1142 (testing the factors that affect where people choose to live and showing that "highly educated households tend to locate in neighborhoods with better schools and lower crime . . . while the reverse is true for less-educated households . . . .").

it is for households without children, and that from 1990 to 2010, income segregation increased approximately twenty percent among households with children but changed little among households without children.[52] The result is that children face greater, and increasing, economic segregation compared to the overall population.[53] Studies have further confirmed that economic segregation has increased among school districts.[54] From these studies, it seems logical to conclude that wealthy families have not only chosen to spend their additional income on vacations or improvements to their existing home. Instead, the increase in income inequality has provided the means for wealthier households to spend more on their children, and one way they have done this is by moving to the best locality they can afford, along with other wealthy households, which has become easier to navigate as information regarding school quality has become more readily available.[55] To put this in Tiebout's terms, households with children who have been the economic beneficiaries of the rise in income inequality have used their additional income to "vote with their feet" and purchase superior education for their children by moving to wealthier, economically homogeneous school districts.[56]

52. Owens, *Inequality in Children's Contexts*, *supra* note 1, at 550 (examining census data from 100 major U.S. metropolitan areas and concluding that "[i]ncome segregation between neighborhoods is higher and increased by about 20 percent among families with children, but it changed little among childless households, who make up the majority of U.S. households").

53. In addition, wealthy families have increased their spending on young children while poor families have not. *See* Sabino Kornrich, *Inequalities in Parental Spending on Young Children: 1972 to 2010*, 2 AERA OPEN 1, 1 (2016) (finding that parents at the top of the income distribution (primarily those in the top two income deciles) increased their spending on young children from 1972 to 2010, while parents at the bottom of the income distribution did not); Sabino Kornrich & Frank Furstenberg, *Investing in Children: Changes in Parental Spending on Children, 1972–2007*, 50 DEMOGRAPHY 1, 20 (2013) ("Our findings also show that investment grew more unequal over the study period: parents near the top of the income distribution spent more in real dollars near the end of the 2000s than in the early 1970s, and the gap in spending between rich and poor grew.").

54. *See Income Segregation Between Schools and School Districts*, *supra* note 32.

55. *See* Owens, *Inequality in Children's Contexts*, *supra* note 1, at 549 ("Rising income inequality provided high-income households more resources, and parents used these resources to purchase housing in particular neighborhoods, with residential decisions structured, in part, by school district boundaries."); *see, e.g.*, Badger, *supra* note 3 (noting that most real estate sites list the grades for local schools next to each property listing making it easier "to make sure you're buying not only the best home, but also the public schools with the best standardized test scores").

56. Although the focus of this Article is segregation by income, racial segregation has been and continues to be an important issue. This Article will focus primarily on economic segregation because racial segregation is too complicated of an issue to tackle in an article that strives to cover the other issues that are the focus of this Article, and because this Article strives to discuss and propose policies that will reduce economic segregation, which would indirectly reduce racial segregation. For a further discussion of the interrelationship between racial and economic segregation, see Ann Owens, *Racial Residential Segregation of School-Age Children and Adults: The Role of Schooling as a Segregating Force*, 3 RUSSEL SAGE FOUND. J. SOC. SCI. 63 (2017); Fry & Taylor, *supra* note 35; REARDON & BISCHOFF, GROWTH IN THE RESIDENTIAL SEGREGATION OF FAMILIES BY INCOME, 1970-2009, *supra* note 35, at 23–24; Bischoff & Reardon, *Residential Segregation by Income, 1970-2009*, *supra* note 1, at 208 ("[W]e find clear evidence that income segregation has grown rapidly, particularly in the last decade and particularly among black and Hispanic families."); Will Dobbie & Roland G. Fryer, Jr., *Are High Quality Schools Enough to Increase Achievement Among the Poor? Evidence from the Harlem Children's Zone*, 3

B. Why Economic Segregation Matters

Economic segregation matters because it affects the distribution of resources and social networks in ways that accentuate advantages for the wealthy and compound disadvantages for the poor,[57] in particular because of the strong correlation between neighborhood average income and the quality of local public schools.[58] These advantages and disadvantages especially affect children, ensuring that the problem of income inequality compounds in future generations.[59] This Section analyzes these effects.

1. Distribution of Resources

One way economic segregation helps the rich grow richer and the poor grow poorer is through the unequal distribution of public and private resources. Because taxes fund local resources, and because wealthy localities have higher local tax revenues than poor localities, wealthy localities typically have better-funded schools, parks, and other community facilities.[60] In contrast, poor localities have lower tax revenues, and therefore typically have fewer and less well-funded community facilities. Therefore, income segregation results in a world where the wealthy have better access to well-funded local resources.

The residents of wealthy localities benefit from economic segregation because economic homogeneity allows wealthy households to fund public resources without

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AM. ECON. J. 158 (2011) (suggesting that reducing economic segregation can significantly reduce racial educational inequalities).

57. *See, e.g.*, Robert J. Sampson, *Moving and the Neighborhood Glass Ceiling*, 337 SCI. 1464 (2012) ("From Victorian London to present-day America, research has shown links between neighborhood poverty and outcomes such as crime, economic dependency, poor physical health, teenage pregnancy, and school dropout.").

58. *See* Rothwell, *supra* note 3.

59. The locality one grows up in has a significant influence on an individual's physical, social, educational, and economic outcome. *See, e.g.*, Raj Chetty, Nathaniel Hendren & Lawrence F. Katz, *The Effects of Exposure to Better Neighborhoods on Children: New Evidence from the Moving to Opportunity Experiment*, 106 AM. ECON. REV. 855, 899 (2016) [hereinafter Chetty et al., *Effects of Exposure*] (finding that young children who move to low-poverty areas "are more likely to attend college and have substantially higher incomes as adults" and "are less likely to become single parents themselves, suggesting that some of the benefits . . . will persist into the following generation"); Julia Burdick-Will, Jens Ludwig, Stephen W. Raudenbush, Robert J. Sampson, Lisa Sanbonmatsu & Patrick Sharkey, *Converging Evidence for Neighborhood Effects on Children's Test Scores: An Experimental, Quasi-Experimental, and Observational Comparison*, *in* WHITHER OPPORTUNITY? RISING INEQUALITY, SCHOOLS, AND CHILDREN'S LIFE CHANCES 255 (Greg J. Duncan & Richard J. Murnane eds., 2011); Patrick Sharkey & Jacob W. Faber, *Where, When, Why, and For Whom Do Residential Contexts Matter? Moving Away from the Dichotomous Understanding of Neighborhood Effects*, 40 ANN. REV. SOCIO. 559 (2014) (discussing the many disadvantages of growing up in poor neighborhoods); Tama Leventhal & Jeanne Brooks-Gunn, *The Neighborhoods They Live In: The Effects of Neighborhood Residence on Child and Adolescent Outcomes*, 126 PSYCH. BULL. 309 (2000) (reviewing the effects of neighborhood residence on child and adolescent well-being).

60. Approximately one-third of state revenue comes from the federal government, and approximately one-third of local revenue comes from state government. Therefore, the federal government indirectly subsidizes localities because it transfers revenue to states, which then transfer a portion of that federal tax revenue to localities.

subsidizing those resources for the poor.[61] When wealthy taxpayers live in localities that include both wealthy and poor residents, then the wealthy residents, who pay more in local property taxes than poor residents, subsidize local goods and services for poor residents. In contrast, when wealthy taxpayers live in wealthy, economically homogenous localities, the wealthy taxpayers avoid paying that subsidy (or at least pay a much smaller subsidy) and are therefore able to receive a more direct benefit from the local taxes they pay.[62]

Schools are the most important public resource that affect the economic outcomes for those living in a particular locality,[63] and approximately half of public revenue spent on primary and secondary education is generated through local taxes.[64] Although school choice policies somewhat weaken the link between the localities children live in and the schools they attend, most public school students attend their neighborhood public school.[65] Although social scientists have debated the extent to which a better education affects children's economic outcomes and the extent to which economic outcomes are affected by other factors,[66] there is a consensus that better education strongly correlates with higher incomes, higher social status, greater political participation and influence, and better health.[67] Because there is a strong correlation between school quality and neighborhood

61. *See* Durlauf, *supra* note 49, at 90 ("Wealthy families have an incentive to isolate themselves from the rest of the economy in order to provide the highest level of education for their children at the lowest cost.").

62. For further discussion of the economic rewards that the wealthy receive when they economically segregate, see *infra* Sections II.B–C.

63. A household has to move to a neighborhood with better schools in order to significantly impact its economic prospects, and moving to wealthier neighborhoods alone is insufficient to have a significant impact on household earnings. *See* Rothwell, *supra* note 3.

64. *See, e.g.*, MATTHEW M. CHINGOS & KRISTIN BLAGG, URB. INST., DO POOR KIDS GET THEIR FAIR SHARE OF SCHOOL FUNDING? 1 (2017), https://www.urban.org/sites/default/files/publication/90586/school_funding_brief_1.pdf [https://perma.cc/9CQX-W6A3] ("Local governments provided more than 80 percent of school funding in the 1920s, but they have been roughly equal partners with state governments since the 1970s."); Gladriel Shobe, *Disaggregating the State and Local Tax Deduction*, 35 VA. TAX REV. 327, 349 (2016) (showing that in 2009, $327 billion of the $598.1 billion spent on primary and secondary schools came from state government transfers).

65. *See* NAT'L CTR. FOR EDUC. STAT., U.S. DEP'T OF EDUC., NCES 2010-004, TRENDS IN THE USE OF SCHOOL CHOICE: 1993 TO 2007, at 7 (2010), https://nces.ed.gov/pubs2010/2010004.pdf [https://perma.cc/H2UU-2JPD] (finding that in 2007, seventy-three percent of public school students attended their neighborhood school).

66. *See, e.g.*, Rothwell, *supra* note 3, at 2–3.

67. *See* David Card, *The Causal Effect of Education on Earnings*, *in* 3A HANDBOOK OF LABOR ECONOMICS 1801 (Orley C. Ashenfelter & David Card eds., 1999); Jian Huang, Henriëtte Maassen van den Brink & Wim Groot, *A Meta-Analysis of the Effect of Education on Social Capital*, 28 ECON. EDUC. REV. 454 (2009); David M. Cutler & Adriana Lleras-Muney, *Education and Health: Evaluating Theories and Evidence*, *in* MAKING AMERICANS HEALTHIER: SOCIAL AND ECONOMIC POLICY AS HEALTH POLICY 29 (Robert F. Schoeni, James S. House, George A. Kaplan & Harold Pollack eds., 2008); Justine S. Hastings & Jeffrey M. Weinstein, *Information, School Choice, and Academic Achievement: Evidence from Two Experiments*, 123 Q.J. ECON. 1373 (2008) (finding that students who won the lottery to higher-scoring schools performed significantly better than had they not won the lottery for higher-scoring schools).

income,[68] wealthy neighborhoods typically have higher per pupil expenditures and higher average test scores.[69] Even though state governments generally ensure that each school receives a baseline of funding, individual schools can receive more than that baseline of funding through their local taxes. Therefore, wealthy localities, which almost always have higher property taxes than poor localities, can afford to exceed the baseline of funding and have better-funded schools than poor localities.[70]

In addition to the fact that wealthy localities have higher taxes that result in better-funded local amenities and services, wealthy localities may also have superior amenities and services for nontax reasons. Because the residents of wealthy localities usually have more political influence than those living in poorer localities, the residents of wealthy localities typically have a disproportionate influence on the distributions of both desirable (e.g., the location of county or state green spaces, libraries, etc.) and undesirable public goods (e.g., landfills, prisons, etc.).[71] As Reardon and Bischoff put it, "Segregation of affluence not only concentrates income and wealth in a small number of communities, but also concentrates social capital and political power."[72] Therefore, wealthy localities often have better local amenities and services for both tax revenue and political power reasons.

Turning to how the unequal distribution of resources negatively affects poor localities, localities with lower median household incomes have lower property taxes and therefore less funding for local services and amenities. The discrepancy in local tax revenue between wealthy and poor localities is important because of the myriad

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68. *See* Rothwell, *supra* note 3 ("We know school quality is highly correlated with neighborhood income, and experimental evidence shows that poor children have higher cognitive scores and lifetime earnings when they attend good schools. Interesting quasi-experimental evidence from the random assignment of refugees shows that those who grow up in better neighborhoods do better at school.").

69. *See, e.g.*, Danielle Kurtzleben, *Growing Up in a Poor Neighborhood Can Hold You Back in Life — Even if Your Parents Aren't Poor*, VOX (Nov. 13, 2014, 10:30 AM), https://www.vox.com/2014/11/13/7210781/the-difference-between-growing-up-in-a-poor-vs-a-rich-neighborhood [https://web.archive.org/web/20141115163419/https://www.vox.com/2014/11/13/7210781/the-difference-between-growing-up-in-a-poor-vs-a-rich-neighborhood] ("[S]chool quality is highly correlated with neighborhood income . . . ."); ROTHWELL, *supra* note 38 (reporting the standardized test scores for high- and low-income students).

70. Scarsdale, New York, provides a well-known example of well-funded local public schools and higher-than-average student test scores. *See infra* note 124 and accompanying text. Additional amounts spent, both by schools and parents, on wealthy children may help explain the widening achievement gap. *See* Sean F. Reardon, *The Widening Achievement Gap Between the Rich and the Poor: New Evidence and Possible Explanations*, *in* WHITHER OPPORTUNITY? RISING INEQUALITY, SCHOOLS, AND CHILDREN'S LIFE CHANCES 91 (2011); Kornrich, *supra* note 53, at 10 (noting that the increase in spending by wealthy parents "might offer at least a partial explanation for changes in the income-based achievement gap").

71. LARRY M. BARTELS, UNEQUAL DEMOCRACY: THE POLITICAL ECONOMY OF THE NEW GILDED AGE (2d ed. 2016); Thomas B. Edsall, Opinion, *How the Other Fifth Lives*, N.Y. TIMES (Apr. 27, 2016), https://nytimes.com/2016/04/27/opinion/campaign-stops/how-the-other-fifth-lives.html [https://perma.cc/BX4C-29PT] ("Political leverage is another factor separating the top 20 percent from the rest of America.").

72. *See* REARDON & BISCHOFF, *supra* note 1.

ways in which local amenities, and especially schools, affect the outcomes of those living in poor localities. Even though states use state tax revenue to subsidize poorer school districts, on average, poor school districts receive about $1,000, or seven percent, less per student than wealthy school districts.[73] The gap between poor and wealthy school districts widens to about $2,000, or sixteen percent, less per student because it costs school districts more to educate poorer students, so schools in poor localities face the double issue of less funding and higher costs.[74] These differences in resources add up, both in terms of total amounts spent and results achieved. For example, living in a poor neighborhood is associated with attending schools that have lower than average test scores, lower graduation rates, and reduced learning outcomes.[75] In contrast, moving to a lower-poverty neighborhood has a significant positive effect on the socioeconomic perspective of young children.[76] Poor localities also typically have higher crime rates, less funding for police and fire departments, lower quality health care facilities, fewer green spaces, and a dearth of other resources that are beneficial for children's development and upward mobility.[77]

Children who grow up in poor localities face a double disadvantage: not only do they have access to fewer public resources, they also typically grow up in families that do not have the private resources to compensate for the lack of public resources. This lack of resources has harmful psychological effects on children and other residents of poor localities,[78] and it is very likely that the effects of living in

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73. IVY MORGAN & ARY AMERIKANER, THE EDUC. TR., FUNDING GAPS: AN ANALYSIS OF SCHOOL FUNDING EQUITY ACROSS THE U.S. AND WITHIN EACH STATE 6 (2018), https://1k9gl1yevnfp2lpq1dhrqe17-wpengine.netdna-ssl.com/wp-content/uploads/2014/09/FundingGapReport_2018_FINAL.pdf [https://perma.cc/P6TK-8F2E].

74. *See id.* at 7; Thomas A. Downes & Thomas F. Pogue, *Adjusting School Aid Formulas for the Higher Cost of Educating Disadvantaged Students*, 47 NAT'L TAX J. 89, 94–107 (1994) (finding that disadvantaged students, including those who qualify for free or reduced price lunch, are more expensive for a school to educate); William Duncombe & John Yinger, *How Much More Does a Disadvantaged Student Cost?*, 24 ECON. EDUC. REV. 513 (2004) (developing models to price the increased cost of educating disadvantaged students).

75. *See* Robert J. Sampson, Patrick Sharkey & Stephen W. Raudenbush, *Durable Effects of Concentrated Disadvantage on Verbal Ability Among African-American Children*, 105 PROC. NAT'L ACAD. SCIS. 845 (2008), http://pnas.org/content/pnas/105/3/845.full.pdf [https://perma.cc/2JB6-PN94]; Geoffrey T. Wodtke, David J. Harding & Felix Elwert, *Neighborhood Effects in Temporal Perspective: The Impact of Long-Term Exposure to Concentrated Disadvantage on High School Graduation*, 76 AM. SOCIO. REV. 713 (2011).

76. *See* Chetty et al., *Effects of Exposure*, *supra* note 59 (finding that neighborhood poverty negatively affects children's development and that moving to a lower-poverty neighborhood had positive effects).

77. *See* WILLIAM JULIUS WILSON, THE TRULY DISADVANTAGED: THE INNER CITY, THE UNDERCLASS, AND PUBLIC POLICY (2012); Raj Chetty, Nathaniel Hendren, Patrick Kline & Emmanuel Saez, *Where Is the Land of Opportunity? The Geography of Intergenerational Mobility in the United States*, 129 Q.J. ECON. 1553 (2014) (finding that the areas that provide more local public goods and larger tax credits for low income families tend to have higher levels of upward mobility).

78. *See* Hirokazu Yoshikawa, J. Lawrence Aber & William R. Beardslee, *The Effects of Poverty on the Mental, Emotional, and Behavioral Health of Children and Youth Implications for Prevention*, 67 AM. PSYCH. 272 (2012).

localities with underfunded local schools, fewer green spaces, poorer homes, and so on have adverse effects that cannot be easily expressed or measured.[79]

2. Distribution of Social Networks

Economic segregation affects the distribution of social networks in ways that further amplify the benefits of being wealthy and the disadvantages of being poor. People, and especially children, are strongly affected by older mentors who serve as role models and provide information to the younger generation about educational and employment opportunities.[80] Since localities affect the composition of the mentors in a social network, localities affect the distribution of these mentors. People are also affected by their peers, and an individual's peers are generally those who live in the same locality. Mentor and peer group influences are significant because they are understood to have imitative effects, meaning that people tend to imitate the characteristics and behaviors of those with whom they spend time.

Social networks that include wealthy individuals benefit the wealthy, and in particular, wealthy children. Children who grow up in wealthy localities associate with mentors who generally have higher rates of employment, have a higher percentage of graduate degrees, and who are more involved in the community. Children in wealthy localities also associate with peers who have higher average test scores, which matters because of the effects social networks have on classroom composition and related effects.[81] To the extent a child's educational efforts and achievements have effects on her friends and peers, then the locality she grows up in affects her socioeconomic outcome. Studies have explored how children's peers affect their educational achievement and have shown a strong correlation between a child's educational achievement and the educational achievement of the child's peers.[82] For example, higher average test scores of peers in the same grade has a

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79. *See* Steven N. Durlauf, *The Memberships Theory of Poverty: The Role of Group Affiliations in Determining Socioeconomic Outcomes*, *in* UNDERSTANDING POVERTY 392, 392 (Sheldon H. Danziger & Robert H. Haveman eds., 2001).

80. Steven N. Durlauf, *Neighborhood Effects*, *in* 4 HANDBOOK OF REGIONAL AND URBAN ECONOMICS 2173, 2176–77 (J. Vernon Henderson & Jacques-François Thisse eds., 2004) (explaining that imitative effects stem from a combination of psychological factors, including a desire to be like others, interdependencies that cause certain information to be transmitted to others in the same social circle, and interdependencies that result in certain behaviors having higher or lower opportunity costs).

81. *See* ROTHWELL, *supra* note 38, at 1 ("Nationwide, the average low-income student attends a school that scores at the 42nd percentile on state exams, while the average middle/high-income student attends a school that scores at the 61st percentile on state exams."); Durlauf, *supra* note 79, at 393–94 (discussing the ways that the composition of an individual's peers and mentors affect socioeconomic outcomes).

82. *See, e.g.*, Durlauf, *supra* note 80, at 2177 ("[T]he relative desirability of staying in school is higher when adults in a community are college graduates or when one's peers are also staying in school."); KIRK JOHNSON, THE HERITAGE FOUND., NO. CDA00-06, THE PEER EFFECT ON ACADEMIC ACHIEVEMENT AMONG PUBLIC ELEMENTARY SCHOOL STUDENTS 1 (2000), https://www.heritage.org/education/report/the-peer-effect-academic-achievement-among-public-elementary-school-students [https://perma.cc/J544-LAM8] (concluding that peer effects are "a particularly strong influence in academic achievement" and that "[t]he peer effect is independent of other factors such as

positive effect on student performance.[83] Wealthy localities also typically have more community involvement, such as parent involvement in the classroom and neighbors' willingness to help children in the neighborhood, which also have a positive effect on children's long-term achievement.[84]

Does the fact that there are benefits from living in wealthy localities mean that adding poor students to the mix (for example, through busing) negatively affects the socioeconomic prospects of the wealthy students? There is not a clear consensus in the literature,[85] although it seems safe to conclude that it depends on how much the composition of the wealthy school changes. As one scholar stated, "Does one really think, for example, that adding two disadvantaged students to a school has the same average effect . . . as replacing 20% of the students with disadvantaged counterparts?"[86] The answer is obviously no, although scholars and policymakers have not determined the extent to which the different percentages affect schools or whether the effects are incremental or a cliff.

Switching the focus from wealthy localities to poor localities, a social network that is composed primarily of low-income households has negative effects, particularly on children. The isolation of the wealthy and poor presents a double-edged social problem. The isolation of the poor results in a lack of exposure to middle-class and wealthy role models. Because the characteristics of both the peers and mentors in children's neighborhoods has an effect on their outcomes,[87] this isolation contributes to social issues, higher rates of unemployment, and higher

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race, ethnicity, gender, income, and other background variables."); *see also* Vernon Henderson, Peter Mieszkowski & Yvon Sauvageau, *Peer Group Effects and Educational Production Functions*, 10 J. PUB. ECON. 97, 105–06 (1978) ("It is quite unlikely that the parents of more able students will be easily persuaded to sacrifice the achievement levels of their children in order to raise the performance of less able students . . . .").

83. Eric A. Hanushek, John F. Kain, Jacob M. Markman & Steven G. Rivkin, *Does Peer Ability Affect Student Achievement?*, 18 J. APPLIED ECONOMETRICS 527, 527 (2003) (showing that "peer achievement has a positive effect on achievement growth" and that "students through the school test score distribution appear to benefit from higher achieving schoolmates").

84. *See* Robert J. Sampson, Jeffrey D. Morenoff & Felton Earls, *Beyond Social Capital: Spatial Dynamics of Collective Efficacy for Children*, 64 AM. SOCIO. REV. 633 (1999) (analyzing the data produced by the Project on Human Development in Chicago Neighborhoods and evaluating how neighborhood members help one another); S. Wilder, *Effects of Parental Involvement on Academic Achievement: A Meta-Synthesis*, 66 EDUC. REV. 377 (2014); Claire Cain Miller, *Class Differences in Child-Rearing Are on the Rise*, N.Y. TIMES (Dec. 17, 2015), https://nytimes.com/2015/12/18/upshot/rich-children-and-poor-ones-are-raised-very-differently.html [https://perma.cc/4AUS-396X].

85. Some studies have shown that sending children from poor schools to schools in more affluent suburbs did not impact the test scores of the students who already attended the affluent schools. *E.g.* Joshua D. Angrist & Kevin Lang, *Does School Integration Generate Peer Effects? Evidence from Boston's Metco Program*, 94 AM. ECON. REV. 1613 (2004). However, as this Article has discussed, the composition of one's peers can affect socioeconomic outcomes. Thus, it seems that there must be a tipping point at which integration of low-performing students would affect the high-performing students, although the tipping point is likely difficult to impossible to measure.

86. Durlauf, *supra* note 79, at 414.

87. Watson, *supra* note 35, at 821.

dependency on government assistance.[88] The other edge of the sword comes from the isolation of the wealthy; because high-income households do not interact with low-income families, high-income households may be less inclined to directly or indirectly (e.g., through voting for programs to assist low-income families) support low-income families, which some speculate "may do as much harm to the poor as the concentration of poverty itself."[89]

3. Intergenerational Effects

Economic segregation itself perpetuates income inequality over time and across multiple generations by allowing the wealthy to segregate their resources from the poor, affecting the economic outcomes for both the children of wealthy localities and the children of poor localities.[90] Because economic segregation amplifies the benefits of being wealthy and the disadvantages of being poor, economic segregation is one of the reasons that one's income status at birth is strongly correlated to economic status in adulthood.[91] Neighborhoods have a substantial effect on children's social mobility and play a significant role in

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88. *See* WILSON, *supra* note 77, at 57 ("[I]n a neighborhood with a paucity of regularly employed families and with the overwhelming majority of families having spells of long-term joblessness, people experience a social isolation that excludes them from the job network system that permeates other neighborhoods . . . . Thus, in such neighborhoods the chances are overwhelming that children will seldom interact on a sustained basis with people who are employed . . . . A vicious cycle is perpetuated through the family, through the community, and through the schools.").

89. *See* REARDON & BISCHOFF, *supra* note 1, at 14 (stating that "it is increasingly unlikely that high-income families interact with middle- and low-income families, eroding some of the social empathy that might lead to support for broader public investment in social programs to help the poor and middle class").

90. *See* Jonathan T. Rothwell & Douglas S. Massey, *Geographic Effects on Intergenerational Income Mobility*, 91 ECON. GEOGRAPHY 83 (2015) (analyzing the relationship between regional and neighborhood conditions and intergenerational income mobility); Chetty et al., *supra* note 77 (exploring factors that correlate with upward mobility, including economic segregation); LINDA LEVINE, CONG. RSCH. SERV., R42400, THE U.S. INCOME DISTRIBUTION AND MOBILITY: TRENDS AND INTERNATIONAL COMPARISONS 14 (2012), www.fas.org/sgp/crs/misc/R42400.pdf ("[I]f the income of a child's parents was 30% higher than the average income of families in the parents' generation, then the child's income will be 15% above the average for his/her generation. In other words, in the United States, about 50% of the (dis)advantage of growing up in a (low) high income family may be inherited."); Daniel Aaronson & Bhashkar Mazumder, *Intergenerational Economic Mobility in the United States, 1940 to 2000*, 43 J. HUM. RES. 139 (2008); Bhashkar Mazumder, *The Apple Falls Even Closer to the Tree than We Thought: New and Revised Estimates of the Intergenerational Inheritance of Earnings*, *in* UNEQUAL CHANCES: FAMILY BACKGROUND AND ECONOMIC SUCCESS 80 (Samuel Bowles, Herbert Gintis & Melissa Osborne Groves eds., 2005); Russell W. Rumberger, *Education and the Reproduction of Economic Inequality in the United States: An Empirical Investigation*, 29 ECON. EDUC. REV. 246 (2010).

91. *See* Durlauf, *supra* note 49, at 75 ("Economic stratification combines with strong neighborhoodwide feedback effects to transmit economic status across generations, leading to persistent income inequality."); Chetty et al., *Effects of Exposure*, *supra* note 59, at 855 (finding that there were significant advantages for young children who moved to lower-poverty neighborhoods, but that moving to lower-poverty neighborhoods had little effect on adults' economic outcomes).

children's future earning potential.[92] In fact, every year of childhood spent in either a wealthy or poor neighborhood affects children's social mobility.[93] Although wealthy parents pass their wealth on to their children in other ways,[94] their choice to raise their children in wealthy neighborhoods should interest scholars and policymakers because Congress has the power to reduce the incentives for the wealthy to segregate into wealthy neighborhoods through sensible tax policy, as discussed later in this Article.[95] Doing so could reduce economic segregation and therefore increase intergenerational economic mobility.

Conversely, raising children in poor localities perpetuates the poverty cycle. Intergenerational income immobility—the extent to which income levels can change across multiple generations—is a persistent issue for those living in poor localities and policymakers hoping to effect change in those localities.[96] Neighborhoods with low median household incomes typically have a low percentage of college graduates, local public schools that receive the minimum baseline of funding, and higher crime. Children who grow up in these types of neighborhoods are less likely to interact with mentors who could teach them skills, provide them with information about neighborhood options, and inform them of educational paths and job opportunities.[97] Due to unequal distribution of local resources and social networks, both the high and low college attendance rates of the

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92. *See* Rothwell & Massey, *supra* note 90, at 96 (concluding that people in the bottom income quartile would have had a $500,000 higher lifetime household income if they had been raised in a top quartile neighborhood).

93. *See* David Leonhardt, Amanda Cox & Claire Cain Miller, *An Atlas of Upward Mobility Shows Paths Out of Poverty*, N.Y. TIMES: THE UPSHOT (May 4, 2015), https://nytimes.com/2015/05/04/upshot/an-atlas-of-upward-mobility-shows-paths-out-of-poverty.html [https://perma.cc/H5BW-6P4R] ("Every extra year of childhood spent in a better neighborhood seems to matter.").

94. Some of the other ways that wealthy parents give their children a leg up include providing them healthy lifestyles, directly passing on monetary wealth, and spending time with them. *See* STEVEN H. WOOLF, LAUDAN ARON, LISA DUBAY, SARAH H. SIMON, EMILY ZIMMERMAN & KIM X. LUK, URB. INST., HOW ARE INCOME AND WEALTH LINKED TO HEALTH AND LONGEVITY? 1 (2015), https://urban.org/sites/default/files/publication/49116/2000178-How-are-Income-and-Wealth-Linked-to-Health-and-Longevity.pdf [https://perma.cc/W39B-ZR9W] (discussing the relationship between income and why "Americans at all income levels are less healthy than those with incomes higher than their own"); Samuel Bowles & Herbert Gintis, *The Inheritance of Inequality*, 16 J. ECON. PERSPS. 3, 18 (2002) (discussing how parents pass money on to their children); Garey Ramey & Valerie A. Ramey, *The Rug Rat Race*, 41 BROOKINGS PAPERS ON ECON. ACTIVITY 129, 129 (2010) (modeling the ways that college-educated parents spend more time than non-college educated parents to help their children compete for college admissions); Jonathan Guryan, Erik Hurst & Melissa Kearney, *Parental Education and Parental Time with Children*, 22 J. ECON. PERSPS. 23, 44 (2008) (finding that parents with higher earnings spend more time with their children and noting that "the fact that they do so may have important implications for the intergenerational transmission of human capital"); *id.* at 23 (showing that college educated mothers spend approximately 4.5 more hours per week with their children than non-college educated mothers).

95. *See infra* Part III.

96. *See, e.g.*, Ann Owens & Susan Clampet-Lundquist, *Housing Mobility and the Intergenerational Durability of Neighborhood Poverty*, 39 J. URB. AFFS. 400, 401–02 (2017); Gary Solon, *Intergenerational Income Mobility in the United States*, 82 AM. ECON. REV. 393 (1992).

97. *See, e.g.*, WILSON, *supra* note 77; Owens & Clampet-Lundquist, *supra* note 96 (examining the many ways that neighborhood poverty continues from one generation to the next).

mentors in the communities will influence the college attendance rates and economic prospects of the children in the respective communities.[98] "One way to think about the poverty trap is that a community, if initially comprised of poor members, will remain poor across long time periods, even generations."[99]

II. SUBSIDIZING ECONOMIC SEGREGATION THROUGH THE LOCAL TAX DEDUCTION

This Part explores the relationship between economic segregation and the local tax deduction and argues that the local tax deduction has contributed to the rise in economic segregation, or at least has rewarded it. It first explains why only the relatively wealthy claim the deduction. It then describes how the deduction acts as a subsidy from the federal government to localities because it allows localities to charge higher taxes than they could in the absence of the deduction. It then asks a question that has gone unaddressed in the literature: Which localities does the local tax deduction subsidize? The answer is intuitive, important, and relevant to economic segregation, and supported by recent anecdotal and empirical evidence of the effects of tax reform.[100] This Part shows that the local tax deduction disproportionately subsidizes wealthy localities because only the relatively wealthy benefit from the deduction on their tax return. Therefore, only localities with a critical mass of relatively wealthy taxpayers can charge higher taxes (at the expense of the federal government) as a result of the deduction.[101] To the extent wealthy localities are economically homogenous (i.e., exclude the poor), and to the extent states do not force redistribution among localities, wealthy taxpayers are able to minimize redistribution of this subsidy to the poor. Therefore, the deduction certainly rewards and likely contributes to economic segregation, which, as established in Part I, has perverse effects on lower-income households, especially for the children in those households.

A. The Two Benefits Created by the State and Local Tax Deduction

The state and local tax deduction benefits taxpayers in two distinct ways. First, it allows itemizing taxpayers to *reduce their federal tax liability* on their federal tax return. Second, it acts as a *subsidy* for states and localities. Stated differently, the first

98. *See* Durlauf, *supra* note 80, at 2177.

99. *Id.* "Another definition of the poverty trap is a socially undesirable (in the sense of producing poverty across a community) collection of behaviors in which the behaviors are mutually reinforcing and so individually rational." *Id.* at 2178.

100. The recent $10,000 cap on the state and local tax deduction has reduced housing prices in wealthy neighborhoods but not in poor neighborhoods, indicating that the deduction acts as a subsidy primarily for wealthy neighborhoods. *See* Tankersley, *supra* note 26 ("In the top 10 percent of areas that make use of the SALT deduction, growth in home values have slowed by about 0.6 percentage points since the law took effect. At the median, growth has slowed by about 0.3 percentage points. The bottom 10 percent haven't seen any slowdown."); *see also supra* notes 21–25 and accompanying notes (discussing anecdotal evidence of the connection between economic segregation and the deduction).

101. *See infra* note 116 (discussing what constitutes a "critical mass" for purposes of this Article).

benefit is a "pay less in taxes" direct benefit for itemizing taxpayers while the second benefit is a "get more government services at a discount" indirect benefit. These two benefits are well understood, but the relationship between them and their effect on economic segregation has not been explored in the literature.

1. The Deduction Reduces Taxes for the Wealthy

The Internal Revenue Code (the Code) generally allows taxpayers to reduce their federal taxable income by amounts they pay in state and local taxes. However, this deduction is taken only by taxpayers who choose to itemize their deductions (i.e., reduce their taxable income by actual deductions) rather than take the standard deduction (i.e., reduce their taxable income by a set amount).[102] Because taxpayers only itemize their deductions, including the state and local tax deduction, when the total amount of their itemized deductions exceeds the standard deduction, only taxpayers who itemize get any benefit from the deduction on their tax return.

Unsurprisingly, the upper-middle class and the wealthy itemize at much higher rates than less wealthy taxpayers. Before the recent Tax Cuts and Jobs Act (TCJA), the details and effects of which are discussed in Part III, approximately thirty percent of taxpayers itemized their tax deductions.[103] More specifically, before the TCJA, ninety-two percent of households with adjusted gross incomes over $500,000 itemized, forty-six percent of households with adjusted gross incomes between $50,000 and $99,000 itemized, and only seven percent of households with adjusted gross incomes under $30,000 itemized.[104] These statistics show that before the TCJA, the upper-middle class and the wealthy were able to claim the deduction at a much higher rate than the relatively less wealthy. The TCJA doubled the standard deduction, which reduced the number of taxpayers who itemize to approximately twelve percent in 2018.[105] Starting in 2018, the percentage of middle-class taxpayers who claim the deduction dropped significantly because only the relatively wealthy

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102. 26 U.S.C. § 161. Both the standard and itemized deductions reduce a taxpayer's overall tax liability. The standard deduction is a preset deduction based on a taxpayer's taxable income, whereas the itemized deduction includes many individual deductions. The vast majority of taxpayers who itemize their tax deductions include the state and local tax deduction as one of their deductions. Examples of individual deductions, other than state and local tax, include home mortgage interest, medical expenses, and charitable contributions. *See* CHENXI LU, TAX POL'Y CTR., ITEMIZED DEDUCTIONS (2017), http://www.urban.org/sites/default/files/publication/87831/2001128-itemized-deductions.pdf [https://perma.cc/W67J-PQVF].

103. Because this Part focuses primarily on how the tax system has influenced economic segregation, the pre-TCJA law is more relevant to this Part than the new law. For further discussion of how tax reform affected the state and local tax deduction, see *infra* Part III. *See also* LU, *supra* note 102, at 3.

104. *See* LU, *supra* note 102, at 1–2.

105. *See* STAFF OF JOINT COMM. ON TAXATION, JCX-32R-18, TABLES RELATED TO THE FEDERAL TAX SYSTEM AS IN EFFECT 2017 THROUGH 2026 (2018). The 2017 tax reform also changed how the deduction works. Prior to 2018 (and starting again in 2025), taxpayers who itemized could fully deduct their state and local taxes, while under current law, taxpayers who itemize can to deduct up to $10,000 of their state and local taxes. *See infra* Part III.

earn enough to itemize their deductions under the new law.[106] Relatively wealthy taxpayers benefited from the state and local tax deduction at a higher rate than the middle class and the poor, and tax reform further skewed the demographics of taxpayers who claim the deduction toward the wealthiest taxpayers. Furthermore, even among those who do itemize, the deduction is worth more to the wealthiest of those taxpayers because an itemized deduction is worth as much as a taxpayer's marginal income tax rate.[107]

2. The Deduction is a Federal Subsidy for State and Local Governments

The state and local tax deduction also benefits taxpayers because it acts as a subsidy from the federal government to states and localities, which can pass that subsidy along to their residents. The deduction acts as a subsidy because it allows states and localities to charge higher tax rates than they could absent the deduction by reducing the cost of state and local taxes to taxpayers: for every dollar an itemizing taxpayer pays, she gets to reduce her federal tax liability by a portion of that dollar, which is effectively the same as the locality charging a lower tax rate.[108] This discount on state and local taxes increases taxpayers' tolerance for those taxes, and therefore states and localities can charge higher tax rates as a result of the state and local tax deduction.[109] In other words, the deduction acts as a subsidy from the federal government to states and localities because the deduction reduces the amount of federal taxes an individual pays while increasing the amount of state and local taxes that states and localities can charge.

Because the local tax deduction allows states and localities to charge higher taxes, it enables them to collect more revenue than they would without the deduction. To the extent states and localities use the additional revenue to provide more or higher-quality goods and services, the deduction allows states and localities to provide more goods and services than they could in the absence of the deduction.

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106. *See infra* Part III.

107. Some of the wealthiest taxpayers will be subject to the alternative minimum tax credit (AMT) because the state and local tax deduction is not deductible to the extent taxpayers are subject to the AMT. However, the 2017 tax reform scaled back the AMT so that it applies to far fewer taxpayers. H.R. REP. NO. 115-409, at 45–48 (2017) (Conf. Rep.).

108. This rationale presupposes that states and localities are able to raise their rates because itemizing taxpayers are aware that the deduction reduces their federal tax liability. *See* Gilbert E. Metcalf, *Assessing the Federal Deduction for State and Local Tax Payments*, 64 NAT'L TAX J. 565, 565–90 (2011) (finding that states and localities charge higher tax rates in response to the state and local tax deduction).

109. Some states impose property tax limits on their localities. *See* Ariel Jurow Kleiman, *Tax Limits and the Future of Local Democracy*, 133 HARV. L. REV. 1884, 1893 (2020). An interesting project would be to examine states that impose local property tax limitations to analyze whether wealthy localities charge up to the state limit more often than poorer localities.

B. Geographic and Demographic Distribution of the Deduction's Subsidy

The two benefits created by the state and local tax deduction have been the source of policy arguments both for and against the deduction.[110] Scholars have defended the deduction by arguing that the deduction subsidizes state and local goods that benefit the broader population, including the poor.[111] This Section pushes back on that argument by separately analyzing the federal deduction for state taxes and the federal deduction for taxes paid to "localities" (any substate taxing jurisdiction, such as cities, counties, towns, and special taxing jurisdictions), which this Article will refer to respectively as the "state tax deduction" and the "local tax deduction."[112] This Section argues that the subsidy created by the *local* tax deduction disproportionately subsidizes wealthy, economically segregated localities, which is significant because the state and local tax deduction, one of the largest tax expenditures, cost the federal government approximately $100.9 billion in 2017 alone,[113] approximately half of which was for local taxes.[114]

1. The "Local Tax Deduction": A Subsidy for Wealthy Localities

In order to understand how the deduction rewards economic segregation, it is essential first to ask where, demographically and geographically, the deduction's subsidy for state and local governments flows. This Section answers that question in terms of the *local* tax deduction by analyzing (i) which types of localities the local tax deduction subsidizes and (ii) whether those localities are able to capture that subsidy for their residents, or whether they are required to share it with others through redistribution.

The local tax deduction disproportionately subsidizes wealthy localities. Explaining this new and important insight requires building on the information explained above—that the deduction acts as a subsidy because when itemizing taxpayers effectively get a discount on their local taxes, they tolerate a higher tax

110. *See infra* Part III.

111. *See infra* notes 134–35.

112. The Author's prior work disaggregated the federal deduction for state taxes and the federal deduction for local taxes and separately analyzed whether either is justified from a tax policy perspective. It argued that there is a stronger relationship between local taxes paid and local benefits received than there is between state taxes paid and state benefits received, and that because of the comparatively close relationship between local taxes paid and benefits received, the exchange of local taxes and benefits looks more like consumption and therefore a deduction is less justified for local taxes than it is for state taxes. However, that work treated all localities the same and stopped short of examining which types of localities benefit from the deduction and how the local tax deduction subsidizes economic segregation. *See* Shobe, *supra* note 64, at 334; Gladriel Shobe, Opinion, *The GOP Gets a Big Part of Its Tax Plan Backward*, WASH. POST (Nov. 7, 2017), https://www.washingtonpost.com/opinions/the-gop-gets-a-big-part-of-its-tax-plan-backward/2017/11/07/63a7ad1e-c3f4-11e7-afe9-4f60b5a6c4a0_story.html [https://perma.cc/M3K3-NABQ].

113. *See supra* note 5 and accompanying text.

114. *See* Gladriel Shobe, *Ending the Local Tax Deduction*, 149 TAX NOTES FED. 955, 955–56 (2015) (estimating the local portion of the state and local deduction based on the Joint Committee on Taxation's estimates of tax expenditures combined with Census Bureau statistics, which separately indicates the percentage of each expenditure that comes from states and localities).

rate than they would in the absence of a deduction—and then taking that information a step further to show that only certain localities can raise their tax rates as a result of the deduction.[115] Importantly and intuitively, because only the relatively wealthy itemize their local taxes, only localities with a critical mass of relatively wealthy taxpayers can charge higher taxes as a result of the deduction.[116] Stated differently, poor taxpayers rarely itemize their local taxes,[117] so localities that are comprised primarily of poor residents receive little to no benefit from the deduction because those localities do not have a federal subsidy that allows them to charge local taxes at a discounted rate. Of course, the majority of localities are neither all wealthy nor all poor, so the extent to which any particular locality is subsidized by the local tax deduction will depend on that locality's unique circumstances. However, the local tax deduction clearly subsidizes wealthy localities far more frequently than it subsidizes poor localities, and therefore it disproportionately subsidizes wealthy localities' already superior local schools, parks, police departments, and so on, all at the expense of the nation as a whole.[118]

The local tax deduction's subsidy for wealthy localities would not be problematic from a tax policy perspective if the local goods and services purchased with that subsidy were redistributive.[119] However, to the extent wealthy taxpayers "get what they pay for" when they pay local taxes, the exchange of local taxes for local goods and services looks like "consumption," for which it is generally

115. *See supra* note 108 and accompanying text.

116. What constitutes a "critical mass" of wealthy, itemizing taxpayers depends on the percentage of households in a locality that are wealthy enough to claim the deduction and several other factors. If only one out of every 100 households in a locality claimed the deduction, then the deduction would be unlikely to act as a subsidy to that locality because the locality would be unlikely to be able to charge higher taxes to all 100 residents in light of the deduction being applicable only to one resident. However, if ninety-nine out of every 100 households in a locality claimed the deduction, then the locality would be much more likely to be able to raise its tax rates (and therefore generate additional tax revenue) because those taxes would be cheaper than face value to those ninety-nine residents. Of course many localities are comprised of a mix of both wealthy and poor residents, and whether and how much those localities can raise their taxes as a result of the local tax deduction would depend on other factors, including the residents' various income levels, effective tax rates, political influence, and desire for various local goods and services. But what is clear is that a locality with all itemizing taxpayers, which is inherently a wealthy locality, should tolerate a higher local tax rate than a locality with no itemizing taxpayers, which is inherently a poor locality.

117. *See* LU, *supra* note 102.

118. Tax scholars have made related arguments that when the federal government subsidizes states and localities, that subsidization results in an "oversupply" of state and local public goods and services. *See* Kaplow, *supra* note 9, at 487–90.

119. Many favor a federal deduction for state and local taxes when the relationship between taxes paid and benefits received is too attenuated to view the exchange as consumption and the revenue generated by the taxes benefits the broader population. *See* Galle, *supra* note 9, at 813; Kaplow, *supra* note 9, at 417; Charles R. Hulten & Robert M. Schwab, *A Haig-Simons-Tiebout Comprehensive Income Tax*, 44 NAT'L TAX J. 67, 68–71 (1991); Brookes D. Billman, Jr. & Noel B. Cunningham, *Nonbusiness State and Local Taxes: The Case for Deductibility*, 28 TAX NOTES FED. 1107, 1111–12 (1985). The federal tax deduction for charitable donations operates under a similar rationale: when taxpayers donate amounts to a Section 501(c)(3) organization, their deduction is reduced to the extent they receive a benefit in return.

acknowledged taxpayers should not get a deduction.[120] On the other hand, to the extent wealthy taxpayers fund local goods and services for poorer taxpayers, the local tax deduction redistributes benefits from the wealthy to the poor, for which a deduction is generally supported (much like with a charitable donation).[121] Therefore, whether taxpayers should receive a deduction for their local taxes turns on whether there is a close relationship between local taxes paid and local goods and services received or whether there is redistribution from the wealthy to the poor.

One factor in determining the closeness of the relationship between local taxes paid and local goods and services received, and therefore whether a deduction is justified, is whether the locality is economically homogenous. Because there are a multitude of taxing jurisdictions with their own unique demographic composition, this Section evaluates localities on a spectrum of economic homogeneity. At one end of the spectrum are wealthy, economically homogenous localities, and at the other are economically heterogeneous localities.[122] In between are a wide range of possible distributions, although typically, the smaller the locality, the more likely it is to fall on the economically homogenous end of the spectrum, and the larger the locality, the more likely it is to fall on the economically heterogeneous end of the spectrum.

In localities on the economically homogenous end of the spectrum, there is a close relationship between local taxes paid and local goods and services received. One well-known example of a wealthy, economically homogenous locality is Scarsdale, New York.[123] Although people are well aware that Scarsdale is comprised

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120. Under the Haig-Simons definition of taxable income—consumption plus savings—taxpayers should not receive a deduction for consumption, including purchases of public goods and services. Therefore, if the individuals who pay taxes are not the ones who receive the benefits funded by the taxes, then there is no exchange of taxes for benefits. In that case, there is no consumption and the tax paying individuals should be permitted to deduct the taxes. *See* HENRY C. SIMONS, PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY (1938); Robert Murray Haig, *The Concept of Income—Economic and Legal Aspects*, *in* THE FEDERAL INCOME TAX 1, 7 (Robert Murray Haig ed., 1921), *reprinted in* READINGS IN THE ECONOMICS OF TAXATION 54 (Richard A. Musgrave & Carl S. Shoup eds., 1959).

121. Scholars and policymakers generally agree that the marginal utility of public goods and services to the poor exceeds the marginal utility to the wealthy and that because the wealthy have a greater ability to pay, they should fund a higher percentage of public goods and services. Therefore, the tax code should be at least somewhat progressive. For further discussion of the duties of the wealthy to help the poor, see JOHN RAWLS, A THEORY OF JUSTICE (1971); Amartya Sen, *On Weights and Measures: Informational Constraints in Social Welfare Analysis*, 45 ECONOMETRICA 1539 (1977); Louis Kaplow, *A Fundamental Objection to Tax Equity Norms: A Call for Utilitarianism*, 48 NAT'L TAX J. 497 (1995).

122. Although it is also true that there is a close relationship between taxes paid and benefits received in poor, economically homogenous localities, those localities are not a focus of this Section because they receive little to no direct subsidy from the local tax deduction.

123. Elsa Brenner, *Houses Even Bigger, Scores Way Above Average*, N.Y. TIMES (May 18, 2008), https://nytimes.com/2008/05/18/realestate/18livi.html [https://perma.cc/6UX3-QAZB] (discussing the well-funded and high-quality Scarsdale schools and the high Scarsdale property taxes); David McKay Wilson, *Scarsdale Revaluation Hits High-End Homes Hardest*, LOHUD (Aug. 4, 2014,

primarily of wealthy residents and has excellent local goods and services, including exceptional local public schools, what has been generally overlooked is the fact that because Scarsdale is economically segregated and wealthy, its local schools are subsidized by the local tax deduction in ways that poor and economically heterogeneous local schools are not. Importantly, the primary reason that Scarsdale is economically homogenous, and therefore able to capture the local tax deduction's subsidy for its wealthy residents, is that its local taxing jurisdiction is small (essentially the town of Scarsdale itself). If Scarsdale were part of a larger substate taxing jurisdiction that included poor, neighboring areas, then the wealthy residents of Scarsdale would have to share their local tax revenue with poorer taxpayers and the relationship between local taxes paid and local benefits received would be more attenuated for the wealthy Scarsdale residents.[124] Even though most localities are not as wealthy and economically homogenous as Scarsdale, wealthy, economically homogeneous localities have become increasingly more common in recent years.[125]

On the other end of the spectrum lie economically heterogeneous localities, for which the relationship between local taxes paid and local benefits received is attenuated and for which a deduction for local taxes is therefore justified from a tax policy perspective. The larger a locality is, both in terms of size and population, the more likely it is to be economically heterogeneous and therefore redistributive.[126] Two examples of economically heterogeneous localities include Los Angeles County (LA) and New York City. Because LA and New York City each have a significant number of wealthy, middle-class, and poor taxpayers, benefits are redistributed from the wealthy, who fund a disproportionate share of the local tax

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10:41 AM), https://lohud.com/story/money/personal-finance/taxes/david-mckay-wilson/2014/08/02/scarsdale-wealthy-homeowners-rattled-revaluation/13532461/ [https://perma.cc/YMF5-FLG4] (discussing Scarsdale's high property taxes and stating that Scarsdale has "one of the nation's finest school districts").

124. *See Fault Lines*, EDBUILD, http://viz.edbuild.org/maps/2016/fault-lines/ [https://perma.cc/QVQ3-HVC4] (last visited Nov. 23, 2020) ("Because property taxes play such an important role in school funding, well-off communities have an interest in school district borders that fence off their own neighborhoods from lower-wealth areas and needier students—and most states' laws allow this kind of self-segregation."); *Fractured: The Breakdown of America's School Districts*, EDBUILD, https://staging.edbuild.org/content/fractured-2017#intro [https://perma.cc/6ZQQ-S2ZV] (last visited Nov. 23, 2020) ("When lenient secession policies are combined with funding systems rooted in local property taxes, it creates a structure in which communities are incentivized to close themselves off—one in which the better-off are rewarded for lesser participation, often without consideration for either the efficiency of the system or for the welfare of the children left behind.").

125. *See supra* Part I.

126. *See, e.g.*, CHINGOS & BLAGG, *supra* note 64 ("Florida and New York represent different ends of the spectrum. . . . New York has many school districts, most of which are relatively small, and Florida has 67 countywide districts (e.g., the entire Miami metropolitan area is a single district). . . . New York school districts are segregated by income, whereas Florida districts—mostly because of their size—are much more integrated. In New York, the average poor student attends school districts with poverty rates that are 40 percent higher than those nonpoor students attend. In Florida, the difference is only 6 percent."). For further discussion of ways in which localities are redistributive, see Clayton P. Gillette, *Local Redistribution, Living Wage Ordinances, and Judicial Intervention*, 101 NW. U. L. REV. 1057, 1060–65 (2007) (describing local redistributive programs in the United States).

revenue, to those who receive those localities' local goods and services, which include taxpayers from all income levels.

Another factor in determining the closeness of the relationship between local taxes paid and local goods and services received is whether the state in which the locality is located forces redistribution among that state's localities. In contrast to the type of redistribution described immediately above, which occurs *within* localities due to economic heterogeneity, this type of redistribution occurs *among* localities. To the extent a state forces wealthier localities to share their tax revenue with poorer localities, a deduction for those taxes is justified because the taxes paid by the residents of the wealthy localities are then redistributive (and not consumption). Because most local tax revenue funds the types of benefits that are consumed primarily by those living within the locality, such as elementary and secondary education, police and fire protection, and parks and recreation, without state intervention, there is unlikely to be any significant redistribution from one locality to another.[127] In particular, without state intervention, poor school districts would receive significantly less funding than wealthy school districts. Therefore, many states redistribute funding from wealthy to poor school districts, although whether poor school districts receive as much funding as wealthy localities varies significantly from state to state.[128] Across the United States, poor school districts spend about $1,000, or seven percent, less per student than wealthy school districts.[129] The funding gap widens to $2,000, or sixteen percent, after adjusting for the additional costs associated with educating low-income students.[130]

127. REARDON & BISCHOFF, *supra* note 1, at 14 ("[A]ny self-interested investment the rich make in their own communities has little chance of 'spilling over' to benefit middle- and low-income families."). A minimal amount of redistribution may occur naturally among localities (without state intervention) when, for example, a taxpayer from one locality uses the local park of another locality. Natural redistribution from one locality to another is often referred to as "spillovers." *See* Richard Briffault, *The Local Government Boundary Problem in Metropolitan Areas*, 48 STAN. L. REV. 1115, 1132–33 (1996) (discussing local governments and spillovers); *see also Annual Survey of State and Local Government Finances*, U.S. CENSUS BUREAU, https://www.census.gov/programs-surveys/gov-finances.html [https://perma.cc/P8XY-G7TJ] (last visited Oct. 12, 2020) (compiling annual datasets that show how localities spend their tax revenue).

128. *See* CHINGOS & BLAGG, *supra* note 64, at 1–2 ("Redistributing funding across districts is a natural role for states to play, as they have the capacity to collect taxes statewide and then apportion funding among local districts. . . . Currently, 35 states have a provision in their formula that provides additional funding to districts serving more low-income students. In theory, these provisions should make school funding more progressive by spending more money on students from low-income families. But this depends on how successful are states at counteracting local funding, which tends to be regressive."); Ivy Morgan & Ary Amerikaner, *Funding Gaps 2018: An Analysis of School Funding Equity Across the U.S. and Within Each State*, EDUC. TR. (Feb. 27, 2018), https://edtrust.org/resource/funding-gaps-2018/ [https://perma.cc/S5VT-CS5Y] ("There is, of course, great variation among states' school funding patterns. Nebraska stands out for its unfairness, spending nearly 25 percent less per pupil in districts serving the most students of color. And while in 14 states, districts that serve the most students of color receive substantially more money, in 14 other states, they receive substantially less."); *see also* EDBUILD, *supra* note 124 (providing interactive tools that show how each state funds its local schools and explaining the cost-sharing agreements states have with their local school districts).

129. MORGAN & AMERIKANER, *supra* note 73.

130. *Id.*

In sum, the local tax deduction disproportionately subsidizes wealthy localities (which have a critical mass of wealthy, itemizing taxpayers), *and* wealthy taxpayers who live in those wealthy, economically segregated localities can keep that subsidy for themselves due to minimal redistribution within economically homogenous localities. Therefore, unless a state forces redistribution among its localities, taxes paid to wealthy, economically homogenous localities resemble consumption due to the close relationship between taxes paid and benefits received. However, the local deduction benefits the wealthy who live in large, economically heterogeneous localities much less because more of their taxes are redistributed, and therefore a deduction for their local taxes is generally merited. In between are a number of more or less economically homogenous localities, for which a deduction is more or less justified depending on a particular locality's makeup. Because the wealthy often and increasingly live in exclusive, wealthy localities, the local tax deduction disproportionately and increasingly benefits wealthy localities and those who live in them.[131]

2. The "State Tax Deduction": Broad Distribution of Benefits

The state tax deduction is not the focus of this Article, but it provides a useful comparison point to the local tax deduction. Like the local tax deduction, the state tax deduction enables states to charge higher state taxes because it discounts state tax rates for itemizing taxpayers.[132] However, the state tax deduction is less controversial from a tax policy perspective because states are naturally economically heterogeneous due to their size, making it impossible for taxpayers to economically segregate at the state level. Therefore, when taxpayers pay state taxes, the benefits funded by those taxes broadly benefit all taxpayers in the state, including the poor.[133] Because state taxes are redistributive and the relationship between state taxes paid and state benefits received is attenuated, a deduction for state taxes is more justified from a tax policy perspective, which dictates that taxpayers should get a deduction when there is little to no relationship between taxes paid and benefits received.[134] Large local taxing jurisdictions like LA and New York City

131. An interesting project would be to create a map that geographically showed which households claimed the deduction. The map would illustrate how those who claim the deduction are tightly clustered in wealthy localities.

132. It also seems probable that states with higher concentrations of wealthy, itemizing taxpayers would be more likely to raise their tax rates as a result of the state tax deduction.

133. State taxes are relatively redistributive in nature because state taxes, which are paid primarily by wealthier taxpayers, disproportionately fund state goods and services that are for the benefit of the poor, such as funding poor school districts, state welfare programs, and healthcare for low-income residents. *See* Shobe, *supra* note 64, at 347–51; *Annual Survey of State and Local Government Finances*, *supra* note 127.

134. Scholars and policymakers generally support tax deductions for redistributive taxes because deductibility makes those who pay the taxes (but are not the beneficiaries of the public goods and services purchased by the taxes) less opposed to such taxes. *See* Yair Listokin & David M. Schizer, *I Like to Pay Taxes: Taxpayer Support for Government Spending and the Efficiency of the Tax System*, 66 TAX L. REV. 179, 180, 200, 212 (2013); Howard Chernick, *A Model of the Distributional Incidence of*

function more like states in this way, justifying a deduction for residents of those localities.

C. The Local Tax Deduction Rewards and Contributes to Economic Segregation

Does the state and local tax deduction reward economic segregation? If so, is the deduction a contributing factor to the rise in economic segregation among households with children? This Section argues that the answer to each of those questions is yes.

Economic segregation rewards the wealthy in two ways, the first of which is independent of the local tax deduction. This first reward exists because when the wealthy segregate into wealthy-only localities, they do not need to subsidize local goods and services for the less wealthy (and therefore they are more likely to "get what they pay for" in terms of local taxes).[135] Because economic segregation rewards wealthy taxpayers by allowing them to fund superior local goods and services without having to subsidize those goods and services for the less wealthy, there is an incentive for them to segregate from the poor that is independent of federal income tax considerations.[136] As economists have noted, "Wealthy families have an incentive to isolate themselves from the rest of the economy in order to provide the highest level of education for their children at the lowest cost."[137]

The local tax deduction creates a second reward for the wealthy to economically segregate from the poor by allowing the wealthy to receive *more* than what they pay in local taxes when they economically segregate, because, as discussed above, the local tax deduction disproportionately subsidizes wealthy, economically homogeneous localities.[138] When wealthy taxpayers choose to live in economically heterogeneous localities, they can still get the benefit of reducing their tax liability by itemizing their local taxes, but they lose the two rewards that come with

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State and Local Taxes, 20 PUB. FIN. Q. 572 (1992) (demonstrating that deductibility of state and local taxes increases the progressivity of state and local tax systems); Stark, *supra* note 10, at 1425 ("The overall effect of current law, therefore, is that the . . . state and local tax systems have been made more *progressive* (because of the incentive to shift the state and local tax burdens to high-income tax taxpayers).")

135. *See* Durlauf, *supra* note 49, at 75 (stating that the benefits of superior local public schools plus the sociological effects connected with living in wealthy neighborhoods has created "incentives for wealthier families to segregate themselves into economically homogeneous neighborhoods").

136. To illustrate, consider two localities, *A* and *B*, with very different economic compositions. Assume that locality *A* is composed half of wealthy residents who each paid $10,000 in local taxes and half poor residents who paid no local taxes. Assuming that locality *A* spent the same amount of local tax revenue on each resident, the resources purchased with the local taxes would be evenly distributed among the wealthy and poor residents, and the wealthy residents would receive only $5,000 of the benefit of the local taxes they paid to locality *A*. In contrast, locality *B* is composed entirely of wealthy residents who each paid $10,000 in local taxes. Assuming that locality *B* spent the same amount of local tax revenue on each resident, then each resident would receive $10,000 in local benefits. In other words, locality *A* redistributed tax revenue from the wealthy to the poor, but locality *B* did not because it was economically homogenous.

137. Durlauf, *supra* note 49, at 90.

138. *See supra* Section II.B.1.

economic segregation. There is a corresponding economic incentive for the poor to live in predominately wealthy localities because doing so would give them access to local goods and services that are subsidized by higher local taxes paid by the wealthy. However, due to zoning restrictions, the poor are typically priced out of wealthy localities and are therefore restricted in their ability to move into such localities.[139]

By rewarding taxpayers for economic segregation, the local tax deduction creates an incentive for taxpayers to economically segregate and has therefore likely contributed to economic segregation. Many factors go into the complicated calculation of where to live, and the quality of local goods and services, and especially the quality of local schools compared to their cost, goes into that calculation.[140] Because the local tax deduction allows relatively wealthy localities to provide better goods and services at a cheaper cost than they could in the absence of the deduction, the deduction changes the cost-benefit analysis in favor of those localities for those who can afford to choose to live there. To illustrate, if the deduction's federal subsidy allowed a wealthy locality to hire additional teachers and build better schools than an adjacent, less wealthy locality, and the quality of local schools was the deciding factor that caused a wealthy taxpayer to choose the wealthy locality over the less wealthy locality that did not benefit from the deduction, then the deduction contributed to that taxpayer's decision to economically segregate.[141] Of course, the first reward to economically segregate (the nontax benefit of low redistribution) also changes the cost-benefit analysis in favor of the wealthy locality. However, if the local tax deduction's additional reward to economically segregate

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139. *See* WILLIAM A. FISCHEL, THE HOMEVOTER HYPOTHESIS: HOW HOME VALUES INFLUENCE LOCAL GOVERNMENT TAXATION, SCHOOL FINANCE, AND LAND-USE POLICIES 218 (2001). Although government subsidized housing and housing vouchers could, in theory, ameliorate the issue, these housing policies have proven to be relatively ineffective at moving low-income households into wealthier localities. *See, e.g.*, Michelle D. Layser, *How Federal Tax Law Rewards Housing Segregation*, 93 IND. L.J. 915, 919 (2018) (arguing that "the federal tax law discourages integration through the low-income housing tax credit program and rewards White-flight and economic segregation through the mortgage interest deduction," which exacerbates "the enduring effects of past policies like redlining and exclusionary zoning, while also limiting the effectiveness of nontax federal programs intended to promote housing choice, such as the Section 8 tenant voucher program").

140. *See* Owens, *Inequality in Children's Contexts*, *supra* note 1, at 565–67.

141. The fact that many wealthy families choose to send their children to private school does not affect this Section's arguments. Typically, parents send their children to private school either for religious reasons, which are not particularly relevant to this Article, or because they live in a large metropolitan area with low-performing public schools. Jacob Davidson, *You'll Never Guess the City Where Private School Is the Most Common*, MONEY (Aug. 14, 2014), https://money.com/private-school-enrollment-cities-highest/ [https://perma.cc/VME8-XJAC]. Parents in large metropolitan areas almost always have the option of moving to a relatively nearby suburb with high-performing public schools. So even if parents choose to live in a city with low-performing public schools and send their children to private school, thereby funding public schools from which they receive no direct benefit from, the fact that there was almost certainly a wealthy, subsidized suburb within commuting distance went into their calculation of where to live. Even when the local tax deduction's subsidy does not move the line enough to cause private school households to move to the suburbs, it nonetheless moves the line, which affects taxpayers who are on the margin. *See also Private School Enrollment*, NAT'L CTR. FOR EDUC. STAT., http://nces.ed.gov/programs/coe/indicator_cgc.asp [https://perma.cc/6D8P-H52E] (May 2020) (noting that approximately ninety percent of children attend public school).

has caused at least some taxpayers to choose a wealthy, economically segregated locality over another less wealthy, less segregated locality, then the deduction has contributed, at least somewhat, to the rise in economic segregation among households with children.

Another way to analyze whether the deduction has contributed to the rise in economic segregation is to examine whether people sort into localities based on a locality's tax and benefit package. Taxpayer sorting based on localities' tax and benefit packages would strongly indicate that the deduction's reward for economic segregation can and has contributed to the rise in economic segregation. The Tiebout model discussed above posits that in a theoretical world with no obstacles to moving, people would choose where to live based exclusively on this tax and benefit combination.[142] Perfect sorting based on taxes and benefits is unrealistic because there are many obstacles to mobility, including the costs of physically moving, lack of information about which benefits taxes are purchasing, and many other noneconomic considerations that taxpayers consider when deciding where to live, such as family proximity.[143] Despite these obstacles to perfect sorting, certain households can and do sort based on one variable, as Part I established: households with children sort into wealthier localities at higher rates than any other group, presumably because this enables their children to attend better local schools.[144] This implies that local school quality is the key "purchase" that households with children make when choosing a locality's tax and benefit package.[145] The fact that certain households sort based on high-quality local schools indicates that the deduction's subsidy, which makes good schools even better, has contributed to economic segregation by amplifying the incentive for the wealthy to segregate.[146] Furthermore,

142. *See supra* Section I.A.

143. Ruth Mason, *Delegating Up: State Conformity with the Federal Tax Base*, 62 DUKE L.J. 1267, 1311 (2013); Shaviro, *supra* note 10, at 964 ("Exit often is costly."); *see* William W. Bratton & Joseph A. McCahery, *The New Economics of Jurisdictional Competition: Devolutionary Federalism in a Second-Best World*, 86 GEO. L.J. 201, 233–34 (1997) (discussing the implausibility of the Tiebout model due to costs associated with mobility). Even Tiebout himself characterized his theoretical model as "extreme." Tiebout, *supra* note 46, at 419–20.

144. *See supra* notes 52–54 and accompanying text. Households with children are generally able to access information about the quality of local schools either online or through their social networks. *See* FISCHEL, *supra* note 139, at 61. Although education for children of wealthy families is obviously important, schools in wealthier school districts are naturally able to raise more revenue through local taxes and are the least in need of a subsidy (that is not available to poor localities) from the federal government.

145. A significant determinant of whether taxes paid equal public goods and services received is whether taxpayers make a deliberate choice to live in localities that provide the taxpayer's preferred combination of taxes paid and public goods and services received. Because families with children choose to economically segregate into wealthier localities, thereby effectively purchasing higher quality education through their local taxes, the local taxes those families pay are a form of consumption, and therefore do not warrant a deduction.

146. For discussions of how high-quality schools affect housing prices, see David N. Figlio & Maurice E. Lucas, *What's in a Grade? School Report Cards and the Housing Market*, 94 AM. ECON. REV. 591 (2004); Sandra E. Black, *Do Better Schools Matter? Parental Valuation of Elementary Education*, 114 Q.J. ECON. 577 (1999); Jennifer Jellison Holme, *Buying Homes, Buying*

wealthy taxpayers have shown an ability to sort into wealthy school districts without even moving, as wealthy communities that are part of larger, economically heterogeneous localities have increasingly separated to form their own smaller, wealthy, economically segregated cities and school districts.[147]

This Article, which is focused on a theory behind the relationship between economic segregation and the local tax deduction, does not argue that the theory explains the behavior of all localities (which are each unique) and does not purport to empirically prove the existence of that relationship. However, as illustrated in the Introduction, there is anecdotal evidence to support this Article's claims regarding the relationship between economic segregation and the local tax deduction, including the reaction of Scarsdale and other ultra-wealthy localities to tax reform's recent, temporary $10,000 ceiling on the state and local tax deduction.[148] In addition, if the deduction does reward economic segregation by subsidizing wealthy localities, we would expect to see a premium for housing in those localities. One way to test whether the deduction creates a premium for homes located in wealthy localities would be to measure housing values with and without the deduction. Tax reform's temporary $10,000 limitation created an opportunity to conduct that test.[149] Economists who measured home values before and after the ceiling found that the $10,000 ceiling reduced home values in wealthy localities but not poor localities.[150] This implies that the local tax deduction rewards economic segregation by adding value to homes in wealthy localities, but not poor localities, and that therefore wealthy localities receive more of a benefit from the state and local tax deduction than less wealthy localities.[151]

The magnitude of the relationship between economic segregation and the local tax deduction is relevant to whether and how the government should act. As

Schools: School Choice and the Social Construction of School Quality, 72 HARV. EDUC. REV. 177, 185 (2002) (stating that high-quality schools have "driven up housing prices"); Wallace E. Oates, *The Effects of Property Taxes and Local Public Spending on Property Values: An Empirical Study of Tax Capitalization and the Tiebout Hypothesis*, 77 J. POL. ECON. 957, 966–67 (1969).

147. *See supra* notes 27–29 and accompanying text.

148. *See supra* notes 15–22 and accompanying text. For a discussion of tax reform and the $10,000 ceiling, see *infra* Part III.

149. Although the ceiling capped the deductibility for a taxpayer's combined state and local taxes at $10,000, the ceiling effectively limits the deductibility of local taxes to $10,000 minus state taxes. Because most wealthy taxpayers pay close to or more than $10,000 in state taxes alone, under the ceiling, there is no federal reward for wealthy taxpayers to live in localities that charge high local tax rates.

150. *See* Tankersley, *supra* note 26 (controlling for the other provisions of the TCJA, finding that only the state and local tax deduction had an effect on housing prices, and noting that the changes are "contained to a few high-priced, highly taxed ZIP codes").

151. Assuming the housing market is efficient, we would expect to see housing prices in subsidized localities reflect the federal subsidy, which initially seems to indicate that taxpayers cannot get more than what they pay for. For example, there is a premium for housing located near top scoring schools. *See supra* note 146. However, additional amounts a taxpayer pays for a home in a subsidized locality goes into the basis of the home, so the value of the subsidy generally remains with the taxpayer (thus enabling them to, in the long run, get more than what they pay for). On the other hand, due to the time value of money, the step up at death, etc., it seems likely they purchase some portion of their increased local goods and services through higher home prices.

explained above, there are two rewards for economic segregation, the first of which (minimizing redistribution) is independent of the local tax deduction.[152] If the wealthy segregate primarily to minimize redistribution, and not because of the better goods and services that are subsidized by the deduction, then while segregation may be a concerning trend, it is unlikely to be influenced by tax policy. It is impossible to completely disaggregate the effects of each reward since money is fungible and both rewards allow wealthy localities to provide better goods and services at a discount. However, even if the first reward is the primary reason for the increase in economic segregation among households with children, the federal government should not further reward the wealthy for segregating into wealthy-only localities.

III. REFORMING THE LOCAL DEDUCTION

One could criticize the wealthy for choosing to live in exclusive, wealthy localities, but that choice is entirely rational based on economic incentives that are created, in part, by the federal government.[153] This Part addresses several ways that Congress could level the tax playing field among localities, thereby reducing the local tax deduction's incentive to economically segregate.

A. Tax Reform's $10,000 Ceiling

Before the recent tax reform legislation, taxpayers who itemized could deduct the full amount of their state and local taxes, other than sales taxes, from their federal taxable income.[154] The TCJA, which was enacted in 2017 and took effect in 2018, added a $10,000 ceiling to the state and local tax deduction. Therefore, starting in 2018, taxpayers who pay more than $10,000 in state and local taxes receive no federal tax benefit for state and local taxes that exceed $10,000. The $10,000 ceiling is set to expire in 2025, barring any legislative changes, at which point it (and many other individual income tax provisions) will revert to the pre-2018 law.[155]

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152. People do not need to be aware of or understand either reward to respond to the rewards. If local goods and services, such as the local schools, are better as a result of homogeneity and the local tax deduction, and households choose a particular locality as a result of the locality's better local goods and services, then the choice to economically segregate is a result of either or both of the rewards, regardless of whether they are directly aware of either subsidy.

153. *See* Edsall, *supra* note 71 (quoting E-mail from Timothy Smeeding, Professor of Pub. Affs. & Econ., Univ. of Wis., to Thomas B. Edsall) ("The well-to-do are isolated from the day to day struggles of the middle class and below to provide these key services (health, education, job search and other opportunities) to aid the upward mobility of their children. But the upper middle class are happy to take advantage of tax subsidies for their own housing, preschool for their kids, and saving for college which benefit them.").

154. *See* Tax Cuts and Jobs Act, Pub. L. No. 115-97, § 11042, 131 Stat. 2054, 2085–86 (2017); I.R.C. § 164(b)(6). Sales taxes may be deducted in lieu of income taxes, although relatively few taxpayers do. *See SOI Tax Stats - Individual Income Tax Returns Publication 1304 (Complete Report)*, IRS, https://www.irs.gov/statistics/soi-tax-stats-individual-income-tax-returns-publication-1304-complete-report [https://perma.cc/4W7V-XD9C] (Sept. 3, 2020) (compiling statistics on returns with itemized deductions in Table 2.1).

155. President Trump and members of the Republican Party have proposed making these changes permanent, although it is unclear whether Congress will be able to garner enough votes to

The new $10,000 ceiling on the federal deduction for state and local taxes was and remains one of the most controversial provisions in the TCJA.[156] Capping the deduction is projected to raise approximately $668 billion over the next ten years and was one of the primary ways that the Republican Party funded tax reform's significant tax cuts (other than increasing the deficit).[157] These savings to the federal government come at the expense of taxpayers who used to receive a greater benefit from the deduction. States with high state and local taxes, which are primarily blue states, have remained vehemently opposed to the $10,000 ceiling and sued the federal government to overturn the effects of the ceiling.[158] These states "have viewed the ceiling as little short of a congressional declaration of war on blue states, and they have prepared to respond in kind."[159] Several tax scholars have also strongly opposed the deduction, although their arguments have focused primarily on technical workarounds to the deduction, not whether the deduction incentivizes economic segregation.[160]

Because blue states tend to have higher state and local taxes than red states, a higher percentage of blue-state taxpayers pay more than $10,000 in state and local taxes than red-state taxpayers, and therefore blue-state constituents were disproportionately affected by the $10,000 ceiling. Blue-state politicians unsurprisingly have sharply criticized the ceiling. They have attempted to create several workarounds designed to allow their residents to deduct more than $10,000 in state and local taxes despite the ceiling, and these attempts have garnered significant media and political attention. For example, New York enacted several workarounds, including expanding employers' options to convert employee wages to employer payroll taxes (which are not subject to a deductibility cap) and various credits against local property taxes for contributions to certain state charities.[161]

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revisit the ceiling on the state and local tax deduction before it sunsets. The reason why Congress was forced to make the changes temporary was because the TCJA was a reconciliation bill, which can make use of the "Byrd Rule." This rule allows congressional budget bills to avoid a filibuster in the Senate and instead receive a straight yes or no vote, effectively requiring only 51 votes instead of 60. It was necessary for Republicans to go through this process because Republicans held only 51 seats in the Senate.

156. Lawrence Zelenak, *SALT Ceiling Workarounds and Tax Shelters*, 89 TAX NOTES ST. 521, 521 (2018) ("The new $10,000 ceiling on the deduction for state and local taxes has been among the most widely publicized and controversial features of the Tax Cuts and Jobs Act (P.L. 115-97).").

157. *See supra* note 7.

158. *See supra* note 8.

159. Zelenak, *supra* note 156, at 521.

160. In particular, eight tax scholars co-authored an article arguing that the law supports a charitable contribution deduction for gifts that entitle them to a state tax credit. *See* David Gamage, Joseph Bankman, David Gamage, Jacob Goldin, Daniel Hemel, Darien Shanske, Kirk J. Stark, Dennis J. Ventry Jr. & Manoj Viswanathan, *State Responses to Federal Tax Reform: Charitable Tax Credits*, 159 TAX NOTES FED. 641 (2018).

161. *See* Zelenak, *supra* note 156 (discussing New York's proposed payroll tax and charitable contribution workarounds); Darla Mercado & Sarah O'Brien, *Blue States File Suit Against Federal Government Over SALT Caps*, CNBC (July 17, 2018, 4:15 PM), https://www.cnbc.com/2018/07/17/blue-states-file-suit-against-federal-government-over-new-tax-law.html [https://perma.cc/J3LP-C9KB].

Several other states have taken similar measures.[162] In response, Treasury issued regulations that limited the effectiveness of these workarounds by applying quid pro quo rules to charitable contributions made to states, effectively ending attempts to use ostensibly charitable contributions in order to deduct over $10,000 in state and local taxes.[163] Politicians continue to heavily debate the political issues surrounding the ceiling, but they have paid little attention to whether the ceiling is normatively desirable from a tax policy perspective.[164] Congress seems to have stumbled upon the $10,000 limitation for budgetary, rather than tax policy, reasons, and in fact, Congress originally proposed a deduction only for local taxes before relenting at the last minute and allowing a deduction for both state and local taxes.

This Part attempts to step back from the contentious politics of the state and local tax deduction and analyze what good tax policy would be with respect to the deduction in light of the deduction's effect on economic segregation discussed above. This Article shows that, while there are previously unmentioned merits to the ceiling compared to full deductibility, there are several aspects of the ceiling that are problematic from a tax policy perspective. Starting with the ceiling's merits, it reduces the economic reward for the wealthy to segregate into wealthy localities by drastically cutting the federal subsidy for wealthy localities.[165] This is supported by the fact that the ceiling has reduced housing values primarily in wealthy neighborhoods and has had no effect on housing values in poor neighborhoods, indicating that deduction primarily rewards wealthy neighborhoods and that the ceiling reduced that reward.[166] Therefore, deduction mitigates the economic segregation concerns raised in this Article.[167] Furthermore, because the ceiling is

162. *See* Bankman et al., *supra* note 160; Zelenak, *supra* note 156, at 521 (discussing the strategies taken by New Jersey and California).

163. *See, e.g.*, Contributions in Exchange for State or Local Tax Credits, 84 Fed. Reg. 27,513 (June 13, 2019).

164. *See* Martin A. Sullivan, *Economic Analysis: Repeal of SALT Deduction More About Politics than Policy*, 156 TAX NOTES FED. 137 (2017) (discussing why cutting the deduction was sensible from a tax policy perspective, but noting that political discussions surrounding the deduction focused on red-blue state interests and revenue issues).

165. Although there is not an ordering rule to the state and local tax deduction, in effect, the current deduction for local taxes is equal to $10,000 minus state taxes paid, which will approach zero dollars for most upper middle class and wealthy taxpayers. To illustrate, a relatively wealthy person will often exceed the $10,000 ceiling in state taxes alone, especially in relatively high-tax states, meaning that they effectively get no deduction for local taxes and that wealthy localities receive little to no federal tax subsidy from the local tax deduction. Therefore, the $10,000 ceiling will heavily impact those who live in wealthier localities, where taxpayers often exceed $10,000 in state taxes, but will have much less impact on middle-income localities and virtually no effect on poorer localities.

166. *See supra* note 100.

167. Even though the ceiling removes the federal subsidy for wealthy localities, it does not affect the other reward for economic segregation—those who live in wealthy-only localities are still economically rewarded by the fact that their local taxes do not subsidize the less wealthy. *See supra* Section II.C. However, the ceiling does mean that residents of wealthy localities are less likely to pay *less* than dollar-for-dollar for their local goods and services. To frame this in Tiebout-like terms, the ceiling makes it less likely that the wealthy can get more than what they pay for as a result of economic segregation. *See supra* notes 46–48 and accompanying text.

already enacted (albeit as a temporary tax provision) and efforts to make it permanent have already garnered some political support, making it permanent may be more politically feasible than many of the other ways to ameliorate the causes and effects of economic segregation.

The $10,000 ceiling is an imperfect tool for several reasons. For some taxpayers, it limits deductibility for state taxes, for which a deduction is generally considered "fair" and justified under a tax policy analysis.[168] Furthermore, limiting deductibility for state taxes could result in states raising less than the ideal amount of state tax revenue, including revenue for redistributive state spending for low-income school districts.[169] The ceiling also limits deductibility for certain local taxes that operate like state taxes—either due to the locality being large and heterogeneous or due to state-forced redistribution among localities—and which should therefore also be deductible.[170]

A further issue with the ceiling is that it allows for disparate treatment of taxpayers who pay the same aggregate amount of state and local taxes, but whose makeup of state versus local taxes varies. Taxpayers with a combination of low state taxes and high local taxes will personally benefit from the deduction more than a taxpayer with high state taxes and low local taxes. In the latter scenario, a higher percentage of that taxpayer's taxes will fund redistributive goods and services. To illustrate, assume Taxpayer *A* paid $8,000 in state taxes, from which she derived no direct benefit, and $2,000 in local taxes, from which she derived $2,000 in local goods and services.[171] Taxpayer *B* paid $1,000 in state taxes, from which she derived no direct benefit, and $9,000 in local taxes, from which she derived $9,000 in local goods and services. Both Taxpayer *A* and Taxpayer *B* can deduct their full $10,000

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168. *See supra* Section II.B; *supra* notes 120–21 and accompanying text (discussing tax policy justifications for deductibility and counterarguments against deductibility).

169. *See* Nora Gordon, Opinion, *How the Tax Bill Hurts the Poorest Schools*, N.Y. TIMES (Dec. 12, 2017), https://www.nytimes.com/2017/12/12/opinion/congress-tax-bill-education.html [https://perma.cc/H7T7-DZ29] ("State-level school spending is critical. Economic segregation across school districts means that some areas need an infusion of resources to have a chance at serving their students well, and states are the primary source of that infusion. Research shows that when states send more resources to their neediest districts, achievement levels in those districts rise."); Michael Leachman, *SALT "Compromise": Similar Harm to States as Full Repeal*, CTR. ON BUDGET & POL'Y PRIORITIES (Oct. 31, 2017, 11:45 AM), https://www.cbpp.org/blog/salt-compromise-similar-harm-to-states-as-full-repeal [https://perma.cc/FCU6-C9VD] ("[T]he deduction makes higher-income filers more willing to support state taxes, because they can reduce the federal taxes that they owe by deducting these state taxes. Repealing the deduction would make it harder for states—many of which already face serious budget strains—to raise sufficient revenues in the coming years to invest in high-quality education, infrastructure, and other priorities crucial to the nation's long-term economic prospects.").

170. *See supra* notes 127–31 and accompanying text.

171. This illustration is simplified in its assumption that Taxpayers *A* and *B* do not get back more or less than what they paid for with their local taxes. Although that assumption is unrealistic, it is generally true that local taxes are less redistributive than state taxes and that, therefore, taxpayers who pay a higher percentage of local taxes will generally receive more a benefit from their aggregate taxes than taxpayers who pay the same total amount of state and local taxes but who pay a higher percentage of those taxes as state taxes.

combined state and local taxes, but Taxpayer *B* is better off because she got back $7,000 more from her taxes than Taxpayer *A*. Although disparities exist in the tax treatment of taxpayers like Taxpayers *A* and *B*, the ceiling vastly reduces disparities in tax treatment because it limits such situations to a maximum of $10,000 differences.[172]

Although the ceiling removes the federally created incentive for localities to charge higher local taxes, the fact that the ceiling is temporary makes it difficult to predict how quickly and to what extent wealthy localities will respond by lowering (or otherwise choosing not to raise) their tax rates in connection with the ceiling's diminished federal subsidy.[173] However, this uncertainty does not affect the normative desirability of the cap. Wealthy localities that were previously subsidized, but which lost the vast majority of their subsidy due to the $10,000 ceiling, can choose to either keep their tax rate the same, thus forcing their residents who are subject to the ceiling to pay more for the same level of goods and services, or lower their tax rates and reduce the amount or quality of their local goods and services. Either way, the fact that residents of wealthy, economically homogenous localities now pay more for the same goods and services is not a problem from a tax policy perspective because the residents have the choice of moving to a locality that more closely matches their preferences or staying put and paying the unsubsidized amount for their local goods and services.

B. Improving the $10,000 Ceiling

Although the $10,000 ceiling reduces the federal subsidy available only to wealthy, homogeneous localities, other approaches would better achieve the goal of disincentivizing economic segregation.[174] One way to reform the deduction would involve allowing greater deductibility for state taxes than local taxes. Because state taxes are relatively redistributive, and therefore full deductibility is justifiable from a tax policy perspective, one alternative would be to allow full deductibility for state taxes.[175] Congress could keep this option relatively revenue neutral, which is often crucial for political reasons, by limiting deductibility for local taxes.[176] Alternatively,

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172. For example, absent the $10,000 ceiling, if Taxpayer *C* paid $1,000 in state taxes, from which she derived no direct benefit, and $39,000 in local taxes, from which she derived $40,000 in local goods and services, Taxpayer *C* would be significantly better off than both Taxpayers *A* and *B* because she would get $39,000 in local goods and services and would be paying for those goods and services with tax deductible dollars. Although the $10,000 ceiling still leaves Taxpayer *C* in a better position than Taxpayer *A*, it limits the discrepancy in tax treatment because Taxpayer *C* (appropriately) had to pay dollar-for-dollar for every local good and service beyond the combined $10,000 in state and local taxes.

173. Even if Congress makes the ceiling permanent, any effects on tax rates and economic segregation would be slow to be realized due to limitations on taxpayer mobility and the politics involved in changing tax rates.

174. Because the $10,000 ceiling was one of the primary ways that the TCJA funded tax reform's significant tax cuts, it seems likely that politically viable alternatives to the $10,000 ceiling must also raise revenue. Therefore, this Section focuses on alternatives to full deductibility.

175. *See supra* Section II.B.

176. *See supra* Section II.B.

the federal government could put a cap on the deductibility of local taxes but not state taxes or put a lower cap on local taxes than state taxes. The federal government could also allow greater or full deductibility for sales and income taxes, which are primarily charged by states, but cap deductibility for property taxes, which are primarily charged by localities.[177] There are endless iterations of these options, but generally, options that make state taxes comparatively more deductible than local taxes are better than the current $10,000 ceiling because they would reduce the federal subsidy that rewards economic segregation while maintaining the federal subsidy for state taxes. Although these options are likely an improvement on the current $10,000 ceiling, they are still less than ideal to the extent they limit deductibility for local taxes that are redistributive, either due to the locality being large and redistributive or due to state-forced redistribution among the localities.[178] In other words, making state taxes more deductible than local taxes is more targeted than the current $10,000 ceiling but is still an imperfectly blunt instrument; although it would reduce the subsidy for wealthy, homogenous localities, it would also reduce the subsidy for other localities for which a deduction is more justified.

A similar, but more targeted way to reform the deduction would be to allow for full (or greater) deductibility of state taxes but disallow or limit deductibility for local taxes based on whether the locality is economically segregated.[179] For example, Congress could reform the deduction to include a dissimilarity index that measured economic segregation within the local taxing jurisdiction and limit deductibility in proportion to the level of economic segregation. This option is ideal from a tax policy perspective because it adjusts for consumption by specifically targeting wealthy, homogenous localities, but its administrability is more complicated than other alternatives that do not explicitly account for actual levels of economic segregation.

A different approach would get rid of the local deduction altogether and replace it with a refundable credit for all taxpayers for local taxes paid, with the credit rate set at ten percent. Because ten percent is the lowest positive marginal rate, this alternative would equalize the subsidy between high- and low-income individuals. In addition, making the credit refundable would extend it to all

177. *But see* David Gamage & Darien Shanske, *The Future of SALT: A Broader Picture*, 88 TAX NOTES ST. 1275, 1277 (2018) (explaining that property taxes are more stable than other forms of state and local taxes, and therefore there are merits to keeping or expanding deductibility for property taxes).

178. Furthermore, there is the possibility that localities and states could redefine certain local taxes as state taxes, therefore circumventing the effectiveness of this type of reform.

179. If Congress limited deductibility for local taxes, thereby decreasing the federal subsidy for localities, residents of wealthy localities could respond by increasing their individual charitable donations to local charities and local schools. *See* ROB REICH, JUST GIVING: WHY PHILANTHROPY IS FAILING DEMOCRACY AND HOW IT CAN DO BETTER 87–89 (2018) (discussing how wealthy taxpayers make charitable contributions to wealthy schools). Although allowing a charitable deduction for donations to wealthy schools may be bad tax policy, the deduction for charitable organizations is outside the scope of this Article. Furthermore, making a donation to a charitable organization or local school does not reduce a taxpayer's local tax liability, and therefore should not affect policy decisions regarding the local tax deduction.

taxpayers, including low-income taxpayers, which would allow low-income localities to charge higher taxes, and therefore provide better goods and services, as a result of the credit.[180]

Even though each of these alternatives is likely better from a tax policy perspective than the current $10,000 ceiling, the history behind the ceiling shows why it would be politically difficult to limit or eliminate deductibility for local taxes while keeping deductibility for state taxes. During the tax reform debate, an early version of the Senate's bill included a full repeal of the deduction.[181] Congress considered this primarily for budgetary reasons and would have raised over $100 billion per year, but ultimately rejected it.[182] Another version of the bill would have reformed the deduction so that taxpayers could deduct up to $10,000 of their local property taxes, but not their state taxes.[183] Ultimately, Congress expanded the $10,000 ceiling to include all forms of state and local taxes. However, no version of the bill permitted taxpayers to deduct more of their state taxes than their local taxes. One explanation for this is pressure from powerful real estate lobbyists, who predicted that limiting deductibility for state and local taxes would cause housing prices to drop and strongly advocated against any ceiling on local tax deductibility.[184] Real estate lobbyists are strongly motivated to keep some form of deductibility for local property taxes but not for state taxes because the vast majority of local tax revenue comes from property taxes, which are tied to home value. States primarily raise revenue through income and sales taxes, which are not tied to home value. The fact that the powerful real estate lobby and high-tax jurisdictions have such a keen

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180. *See also* Gamage & Shanske, *supra* note 177, at 1277 (proposing several ways to reform the state and local tax deduction and arguing that making the deduction an above-the-line deduction or a credit would make it more progressive).

181. Alan Rappeport, *Dueling Tax Plans: Here's What the Senate and House Have to Resolve*, N.Y. TIMES (Dec. 1, 2017), https://www.nytimes.com/2017/12/01/business/dueling-tax-plans-heres-what-the-senate-and-house-have-to-resolve.html [https://perma.cc/R8LW-J5VA] (noting that the Senate version of the tax reform bill contained a full repeal of the state and local tax deduction while the House version contained a $10,000 limitation).

182. *See supra* note 5 and accompanying text (noting that in 2017 alone, the state and local tax deduction cost the federal government $100.9 billion).

183. Earlier versions of the TCJA would have allowed taxpayers to deduct up to $10,000 of their local property taxes only (as opposed to $10,000 of their state and local taxes). *See* Shobe, *supra* note 112; Rappeport, *supra* note 181.

184. Kelly Phillips Erb, *Realtors Predict Tax Bill Will Cause Housing Prices to Drop in Every State*, FORBES (Dec. 1, 2017, 1:07 PM), https://www.forbes.com/sites/kellyphillipserb/2017/12/01/realtors-predict-tax-bill-will-cause-housing-prices-to-drop-in-every-state/#209a41d630fb [https://perma.cc/3AMC-HSRQ] (discussing how the National Association of Realtors predicted that changes to the state and local tax deduction and the home mortgage interest deduction would cause housing prices to drop). Despite predictions that the tax bill would cause housing prices to drop, housing prices increased in the months after the TCJA was enacted. *See* Herbert Lash, *Pricey U.S. Home Sales Soar as Buyers Ignore New Tax Code*, REUTERS (Apr. 20, 2018, 4:04 AM), https://www.reuters.com/article/us-usa-property-tax-homes-analysis/pricey-u-s-home-sales-soar-as-buyers-ignore-new-tax-code-idUSKBN1HR1JN [https://web.archive.org/web/20180518121422/https://www.reuters.com/article/us-usa-property-tax-homes-analysis/pricey-u-s-home-sales-soar-as-buyers-ignore-new-tax-code-idUSKBN1HR1JN].

interest in deductibility for property taxes makes any proposal that would further limit deductibility for local taxes politically unlikely. Furthermore, because Congress needs to maintain the $10,000 ceiling in order to fund the other tax reform provisions and because there are no interest groups with strong interests in expanding deductibility for state taxes, expanding deductibility for state taxes is unlikely as well.[185] Although attaining good tax policy is difficult in light of political pressures surrounding the deduction, the current $10,000 ceiling on the state and local tax deduction is far from the best normative answer to what kinds of subnational taxes should be deductible, even if in many ways it is better policy than unlimited deductibility.[186]

CONCLUSION

Economic segregation is on the rise among households with children, increasing the economic disparities between wealthy and poor localities and compounding the causes and effects of intergenerational income inequality. The local tax deduction rewards, and likely contributes to, economic segregation because it disproportionately subsidizes wealthy localities, amplifying the incentive for the wealthy to segregate into wealthy, economically homogeneous localities. This insight has important tax policy implications for recent debates surrounding the deductibility of state and local taxes.

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185. *See* Joseph C. Mandarino, *Evaluation of Efforts to Combat the SALT Deduction Cap*, 87 TAX NOTES ST. 1061, 1061 (2018) (discussing the fact that it would be difficult to raise the $10,000 ceiling "without significant economic or political cost").

186. Other, non-tax ways to reduce economic segregation also face strong political barriers. Some of these options include removing restrictive zoning regulations, housing assistance and vouchers, school busing, and redrawing school district boundaries. For articles discussing how these policies can reduce economic segregation, see ROTHWELL, *supra* note 38, at 2 ("[L]imiting the development of inexpensive housing in affluent neighborhoods and jurisdictions fuels economic . . . segregation and contributes to significant differences in school performance across the metropolitan landscape."); Owens & Clampet-Lundquist, *supra* note 96, at 415 (noting that "housing assistance had long-lasting effects, shaping the intergenerational durability of neighborhood poverty"); Michael C. Lens & Paavo Monkkonen, *Do Strict Land Use Regulations Make Metropolitan Areas More Segregated by Income?*, 82 J. AM. PLAN. ASS'N 6, 7, 12 (2016). For articles that discuss the political unfeasibility of these options to decrease economic segregation, see Paul Sperry, *Obama's Last Act Is to Force Suburbs to Be Less White and Less Wealthy*, N.Y. POST (May 8, 2016, 7:30 AM), https://nypost.com/2016/05/08/obamas-last-act-is-to-force-suburbs-to-be-less-white-and-less-wealthy/ [https://perma.cc/QB5M-XBFA] (discussing how housing vouchers have been blamed for spreading crime to wealthy suburbs); Richard V. Reeves, *The Dangerous Separation of the American Upper Middle Class*, BROOKINGS (Sept. 3, 2015), https://brookings.edu/research/the-dangerous-separation-of-the-american-upper-middle-class/ [https://perma.cc/24UV-2UY3] ("Efforts to increase redistribution, or loosen licensing laws, or free up housing markets, or reform school admissions can all run into a solid wall of rational, self-interested upper class resistance.").