NAR Issue Brief
Understanding Pease Limitations

What are "Pease limitations?"
The provision is named after Congressman Don Pease from Ohio who originated the idea in the 1980's. In general, Pease is a tax on adjusted gross income (AGI) where the total incremental tax is limited to no more than 80% of itemized deductions. Few taxpayers will be affected by the itemized deduction cap. The Pease limitations were first enacted in 1990. The provision was phased out starting in 2006 and eliminated in 2010 as part of the 2001 tax cuts. Pease was reinstated at higher income levels in the deal struck by Congress to avert the fiscal cliff at the end of 2012. The provision raises the effective tax rate of affected taxpayers by reducing the amount of their total allowable itemized deductions.

Who is affected by Pease Limitations?

- Individuals with more than $250,000 Adjusted Gross Income (AGI)
- Head of Household filers with more than $275,000 AGI
- Married Couples Filing Jointly with more than $300,000 AGI
- ***No taxpayer below these income levels will be affected by Pease.***
- The thresholds have been increased over previous law and indexed for inflation.

Using IRS data, NAR estimates that Pease will partially limit the itemized deductions taken by approximately 2% of all homeowners or on 1% of all taxpayers.

What does this mean for the Mortgage Interest Deduction?
The Mortgage Interest Deduction, along with the deduction for property taxes, is included in the list of itemized deductions limited by Pease. While this provision will only affect a small number of total homeowners, it is the first time Congress has affirmatively taken steps to limit itemized deductions in 20 years.

How does Pease work?
Pease uses a formula to reduce the affected taxpayer's total itemized deductions by 3% for every dollar of AGI they earn over the applicable income threshold. **Under the formula, a taxpayer cannot lose more than 80% of their total itemized deductions.** Because itemized deductions tend to rise with income, NAR estimates that most taxpayers affected by Pease will not hit the 80% cap. Those most limited by Pease will be extremely high income filers who do not have many itemized deductions.

What is the actual Pease formula?
(Total Itemized Deductions)-(Amount of income above threshold x .03)=Total allowable itemized deductions

What is the net result?
By disallowing a percentage of total itemized deductions, the filer's taxable income is increased, thereby raising their effective tax rate. The total increase in the effective rate will depend on the filer's marginal tax rate. At the highest marginal rate, Pease will add roughly 1.2% to a filer's total tax liability.

See page two for examples of how the Pease formula would affect different taxpayers

Example one: Married Couple Filing Jointly

Mike and Cindy are married filing jointly and have $350,000 adjusted gross income and $75,000 in total itemized deductions. Their AGI is $50,000 above the Pease Threshold. Their allowable itemized deductions under Pease are calculated as follows:

Amount of Income above $300,000 (350-300)	Multiply by .03	Total Disallowance	Total Itemized Deductions	Subtract Total Disallowance (75,000-1500)	Total Itemized Deductions Still Allowed Under Pease
$50,000	**$50,000 x .03 =**	**$1,500**	**$75,000**	**$1,500**	**$73,500**

In this example Mike and Cindy's total itemized deductions are reduced by 2%.

Example two: Married Couple Filing Jointly

Jim and Mary are married filing jointly and have $500,000 adjusted gross income and $100,000 in total itemized deductions. Their AGI is $200,000 above the Pease Threshold. Their allowable itemized deductions under Pease are calculated as follows:

Amount of Income above $300,000 (500-300)	Multiply by .03	Total Disallowance	Total Itemized Deductions	Subtract Total Disallowance (100-6)	Total Itemized Deductions Still Allowed Under Pease
$200,000	**$200,000 x .03 =**	**$6,000**	**$100,000**	**$6,000**	**$94,000**

In this example Jim and Mary's total itemized deductions are reduced by 6%.

Example three: Individual Filer

Tom is a single filer with $1.25 million dollars AGI and $200,000 in total itemized deductions. Tom's AGI is one million dollars above the Pease Threshold for individual filers. His allowable itemized deductions are calculated as follows:

Amount of Income above $250,000 (1,250,000-250)	Multiply by .03	Total Disallowance	Total Itemized Deductions	Subtract Total Disallowance (200-30)	Total Itemized Deductions Still Allowed Under Pease
$1,000,000	$1,000,000 x .03 =	$30,000	$200,000	$30,000	$170,000

In this example Tom's total itemized deductions are reduced by 15%.