

ITEMIZED DEDUCTION LIMITATION

Preston Brashers, Research Fellow
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TOPLINE: The One Big Beautiful Bill (OB3) changed the limitation on itemized deductions so that it only applies to taxpayers in the top income tax bracket.

BACKGROUND: The Pease Limitation was enacted in the early-1990s and reduced taxpayers' itemized deductions as their adjusted gross income (AGI) increased. For every \$100 the taxpayer's income rose above an upper-middle-income AGI threshold, the Pease Limitation reduced deductions by \$3. So, taxpayers in the limitation range were effectively taxed on \$103 of income for every additional \$100 they earned. The Pease Limitation was designed such that it would reduce taxpayers' itemized deductions by 80%, but no further.

The 2017 TCJA streamlined individual taxes by lowering tax rates and eliminating many itemized deductions *and* the Pease Limitation. However, the elimination of the Pease Limitation was temporary, and it was scheduled to return in 2026.

What OB3 Did:

- Replaced the Pease Limitation with a permanent new itemized deduction limitation in 2026.
 - The new limitation reduces taxpayers' itemized deductions if they are in the top tax bracket.
 - The limitation is $\frac{2}{37} \times$ the lesser of (a taxpayer's itemized deductions or the taxpayer's taxable income earned in the top tax bracket).

EXAMPLE:

Consider a single taxpayer with \$100,000 of itemized deductions.

- The top tax bracket (single) starts at \$640,600 of taxable income.
- Once the taxpayer reaches \$640,600 of taxable income, for every \$37 of additional income he earned, he would lose \$2 of itemized deductions.
- Once his income reaches \$740,600 (\$100,000 in the top bracket), his itemized deductions would be less than his top-tax-bracket income.
- Beyond that, he could earn more income without reducing itemized deductions, but he could only claim \$35 out of each additional \$37 in itemized deductions.

Why It Matters?

- Itemized deduction limitations that are income-based act like a higher marginal tax rate and discourage work.

Where Can I Find the Changes? OB3 Section [70111](#); [26 U.S.C. § 68](#).

BOTTOMLINE: The limitation is a hidden 39% tax bracket inside the 37% tax bracket.

