Luke Bell
Vice President of Governmental Affairs
3644 SW Burlingame Rd.
Topeka, KS 66611
(785)633-6649 (Cell)
Email: lbell@kansasrealtor.com

To: House Taxation Committee

Date: February 6, 2013

Subject: **HB 2110** – Opposing the Proposal to Increase the Income Tax Burden on Kansas Home Owners by "Decoupling" the Kansas State Income Tax Code from the Federal Income Tax Code through the Elimination of the Ability of Kansas Taxpayers to Claim the Mortgage Interest and State and Local Property Tax Deductions on Their State Income Tax Returns

Chairman Carlson and members of the House Taxation Committee, thank you for the opportunity to provide testimony today on behalf of the Kansas Association of REALTORS® in opposition to the current provisions of **HB 2110**, which would increase the income tax burden on Kansas home owners and destabilize the Kansas housing market through the elimination of the mortgage interest and state and local property tax deductions. Through the comments expressed herein, it is our hope to provide additional legal and public policy context to the discussion on this issue.

KAR is the state's largest professional trade association, representing nearly 8,000 members involved in both residential and commercial real estate and advocating on behalf of the state's 700,000 homeowners for over 90 years. REALTORS® serve an important role in the state's economy and are dedicated to working with our elected officials to create better communities by supporting economic development, a high quality of life and providing affordable housing opportunities while protecting the rights of private property owners.

As a starting point for this discussion, Kansas REALTORS® strongly support fundamental income tax reform that will provide meaningful tax relief and create economic development opportunities for Kansas families and businesses. However, Kansas REALTORS® believe that end result of any income tax reform efforts should be to reduce the tax burden on all Kansans and not simply shift the tax burden between different classes of taxpayers, including increasing the tax burden on Kansas home owners through the elimination of the mortgage interest and the state and local property tax deductions.

In fact, the Kansas Association of REALTORS® was one of the first statewide trade associations to publicly support the concept of phasing-in individual income tax reductions over time by using increased tax revenues over a baseline target to slowly ratchet down marginal individual income tax rates. In doing so, the Kansas Legislature would ensure that all Kansas taxpayers receive a proportionately equal reduction in their income tax burdens over time and that the tax burden is not simply shifted from one group of taxpayers to another.

Unfortunately, the proposals contained in **HB 2110** fundamentally stray from this simple concept and instead seek to provide income tax reductions for some Kansans by eliminating important tax relief provisions that over 383,000 other Kansans have enjoyed on the one hand for many decades and another 345,000 Kansans have enjoyed on the other hand for an entire century. If the Kansas Legislature approves the current language in **HB 2110**, then you will be effectively reversing a century's worth of housing and tax policy in this state and shifting the income tax burden increasingly on to the backs of middle-class Kansas home owners that are already burdened with some of the nation's highest property taxes.

In Section 2(c) of **HB 2110**, Governor Brownback has proposed to "decouple" the Kansas state income tax code from the federal income tax code and increase the income tax burden on middle-class Kansas home owners by eliminating their ability deduct their mortgage interest and property taxes from their adjusted gross income on their state income tax returns. During the 2012 Legislative Session, the Governor also proposed to eliminate the mortgage interest and property tax deductions, but this previous proposal also eliminated all other itemized deductions as well. For some unknown reason, this proposal was modified for this session to only single out and target for elimination those deductions that benefit middle-class Kansas home owners.

Under current law, a Kansas taxpayer calculates their federal adjusted gross income and has the ability to claim itemized deductions on their federal income tax return for various expenses such as home mortgage interest, charitable contributions, state and local property taxes, mortgage insurance premiums, child care expenses, student loan interest and many other standard expenses. When Kansas taxpayers complete their state income tax returns, the total amount of their federal itemized deductions is simply carried over to their state income tax returns from the federal returns and taxpayers are allowed to claim the full amount of federal itemized deductions on their state income tax returns with a few exceptions.

However, the Governor's income tax reform proposal would "decouple" the treatment of itemized deductions on state income tax returns from the federal income tax code, which would effectively prevent Kansas taxpayers from claiming the mortgage interest and state and local property tax deductions on their state income tax returns. Generally, REALTORS® believe that "decoupling" from the federal income tax code is an example of extremely poor public policy since this deprives Kansans of the tax benefits available to the citizens of other states and creates a competitive disadvantage and disincentive for certain economic activities to occur in this state compared to other states.

During the initial stages of the debate over this proposal, several comments have been made that the mortgage interest and state and local property tax deductions are an example of "special interest loopholes" and that "only wealthy taxpayers take advantage" of these two deductions that encourage and promote home ownership. However, we would respectfully beg to differ with these statements and assert that the nearly 384,000 home owners in this state who would see an increase in their income tax burden under this proposal are members of a "special interest group" or are guilty of manipulating the tax code for their special benefit.

In contrast, the mortgage interest deduction was originally created by Congress along with the creation of the first federal income tax code in 1913. As a result, there has never been a federal or state income tax code wherein home owners have not been allowed to deduct their mortgage interest from their adjusted gross income. If this proposal is successful in eliminating the mortgage interest deduction, then it will have done away with over a century's worth of tax policy encouraging home ownership and providing substantial income tax relief to home owners.

In direct contrast to any assertions that the mortgage interest and property tax deductions only reduce the income tax burden on "wealthy" or "higher-income" taxpayers, statistics taken from the 2011 Internal Revenue Service Income Tax data tables show that both the mortgage interest and property tax deductions are overwhelmingly claimed by middle-class taxpayers. In fact, over 318,000 (92.4%) of the 345,000 Kansas home owners who currently claim the mortgage interest deduction earn less than $200,000 per year, which is generally noted by political commentators as the dividing line between the middle-class and the "wealthy."

Moreover, over 225,000 (65.5%) Kansas home owners who currently claim the mortgage interest deduction earn less than $100,000 per year. Since nearly two-thirds of those Kansas who currently claim the mortgage interest deduction earn less than $100,000 per year and over 92% earn less than $200,000 per year, no one can legitimately attempt to argue that the mortgage interest deduction "predominantly benefits wealthy or higher-income taxpayers." In contrast, the overwhelming majority of Kansans who receive substantial income tax relief from the mortgage interest deduction are firmly in the middle-class.

According to the IRS, nearly 345,000 Kansas taxpayers will take advantage of the mortgage interest deduction this year to reduce their state income tax burden, which will deliver over $162.5 million in annual income tax relief to Kansas home owners. As a result, the average Kansas taxpayer who claims the mortgage interest deduction will have their individual income tax burden reduced by $432.50 in 2013. Although some have falsely tried to claim the mortgage interest deduction is "not a big deal" for Kansas taxpayers and provides an insignificant amount of income tax relief, I would respectfully beg to differ as $432.50 in income tax relief definitely qualifies as a substantial amount of money for most, if not all, Kansas state income taxpayers.

If the proposal to eliminate the mortgage interest deduction was not enough to significantly increase the income tax burden on middle-class Kansas home owners, then **HB 2110** would also increase the income tax burden by eliminating the ability of Kansas home owners to deduct their state and local property taxes on their state income tax returns. The state and local property tax deduction is intended to provide income tax relief to Kansas home owners to help offset the state's extremely high property tax burden.

If the current language in Section 2(c) of **HB 2110** is approved by the Kansas Legislature, then next year nearly 384,000 Kansas home owners will have their state income tax burden increased by a total of $68.5 million, or $133.54 for the average Kansas taxpayer who currently claims the property tax deduction. Again, several individuals have attempted to argue that the property tax deduction provides an insignificant amount of tax relief to Kansas home owners and that the deduction only benefits "wealthy" Kansans.

However, the statistics taken from the 2011 Internal Revenue Service Income Tax data tables show that nearly 352,000 (91.8%) of the 384,000 Kansas home owners who currently claim the property tax deduction earn less than $200,000 per year and over 250,000 (65.3%) home owners earn less than $100,000 per year. Again, the facts would show that these statements are misleading and that in fact predominantly middle-class home owners receive a reduction in their state income tax burdens from the property tax deduction.

If the Kansas Legislature approves the current language in **HB 2110** and both the mortgage interest and property tax deductions are eliminated, then the average middle-class Kansas home owner who currently claims both deductions on his or her state income tax return would be hit with a state income tax increase of $566 in 2013 over current law. Again, I would respectfully beg to differ that this is an "insignificant" amount of money for most, if not all, Kansas income taxpayers that currently claim both deductions.

Unfortunately, REALTORS® believe that eliminating the Kansas mortgage interest deduction will have an extremely negative effect on the Kansas housing market and economy. The negative effects associated with eliminating the Kansas mortgage interest deduction will only result in further damage to an economy and housing market that have been severely weakened by a nearly five-year long recession in the real estate, construction and development industries.

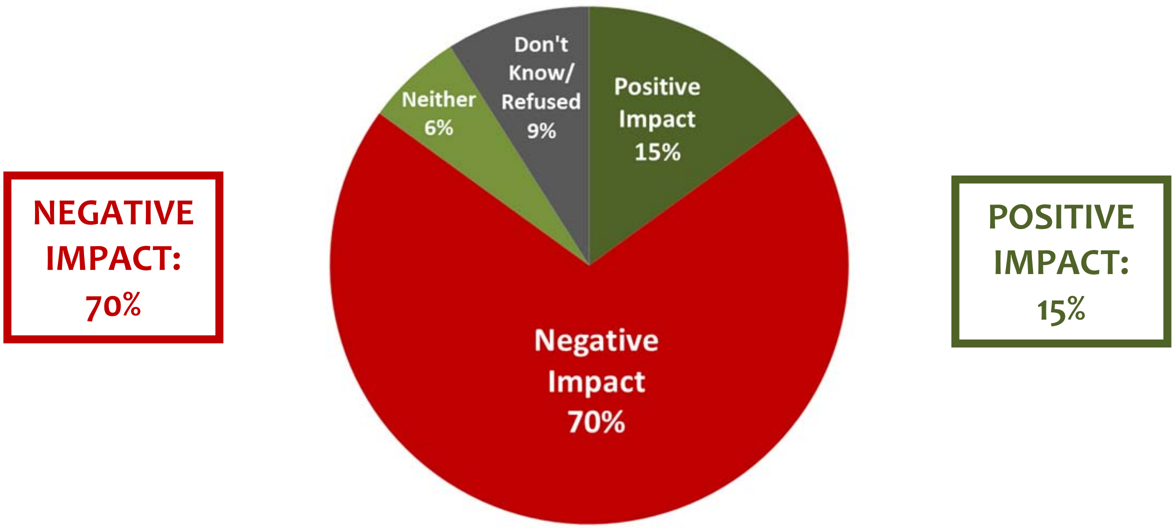
Each year, the construction, development and real estate industries generate approximately $16 billion in economic growth for the Kansas economy, which is around 12% of the state's total Gross State Product (GSP). The construction and real estate industries contribute the third-largest share to the state's GSP, coming in right behind the government and manufacturing sectors in terms of economic output and overall economic contributions to the Kansas economy.

From 2007 through 2011, the total number of home sales in Kansas declined from a peak of nearly 39,000 home sales in 2007 to around 28,000 home sales in 2011, which was a 28% reduction in just four years. Since every home sale is estimated to generate around $46,000 in additional economic benefits for the overall economy (construction labor, sales taxes on materials, etc.), this reduction in home sales has resulted in an estimated annual loss of nearly $554.0 million in economic output for the Kansas economy.

According to a statewide poll of 600 voters conducted late last year by a national polling firm, over 80% of Kansans believe that the availability of the home mortgage interest deduction is a factor in their decision whether to purchase a home in the current housing market. Nearly one-third (32%) said that the home mortgage interest deduction is a "big" or "huge" factor, while only 10% said it was "not a factor at all."

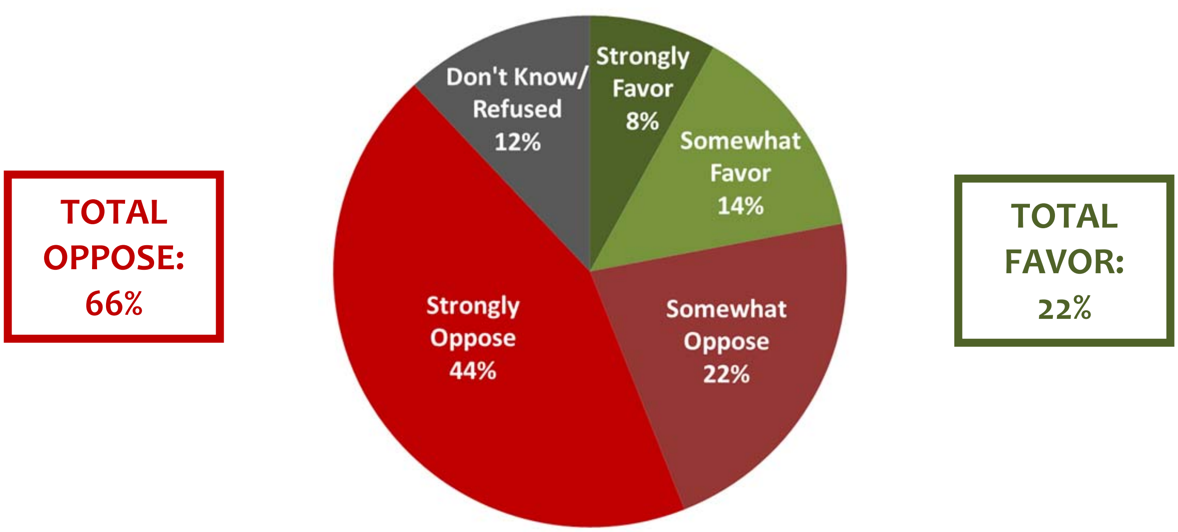
If the Kansas mortgage interest deduction is eliminated, it is clear that over 80% of Kansans would see this action as a disincentive to purchase a home in the current housing market. This would clearly cause a further deterioration in consumer confidence in the housing market and could lead to a new recession in the Kansas housing market, which would be damaging to the overall Kansas economy and would harm the very substantial portion of Kansans' household wealth in their home equity.

According to this same poll of Kansas voters, more than two-thirds (70%) of Kansans say that eliminating the home mortgage interest deduction would have a negative impact on the Kansas housing market and overall Kansas economy. As a result, it is clear that Kansans overwhelmingly believe that the elimination of the mortgage interest deduction would cause severe harm to the Kansas housing market and economy.

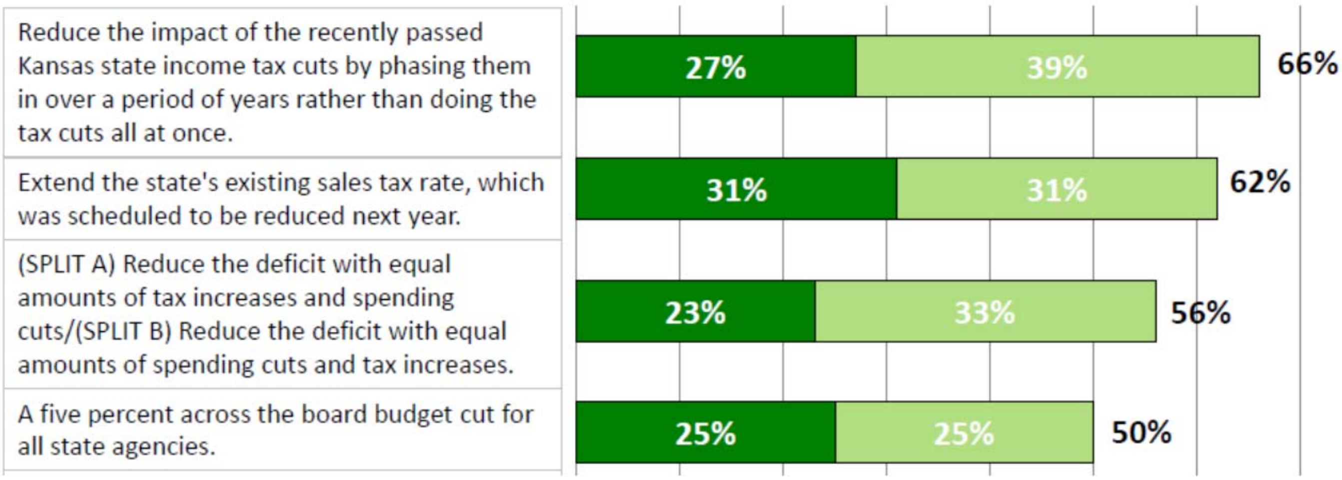


During this challenging housing market and struggling economy, REALTORS® firmly believe that now is not the time to undertake major changes in state's housing and tax policy that would cause catastrophic harm to the Kansas housing market and economy. Although the housing market is slowly recovering at this time, we believe that eliminating the mortgage interest and state and local property tax deductions at this time would result in an overall decrease in consumer confidence in the housing market and potentially a double-dip recession in the Kansas housing market.

When asked for their opinion on various proposals to close the state's $295 million state budget deficit, the most disliked proposal by far was the Governor's proposal to close the budget deficit by eliminating the ability of Kansans to claim the mortgage interest and property tax deductions on their state income tax returns. In fact, 66% of Kansans oppose this proposal to eliminate the mortgage interest and property tax deductions, with 44% of Kansans strongly opposed to this proposal compared to the only 22% of Kansans that were either strongly or only somewhat in favor of the proposal.



In contrast, the most popular options to close the state budget deficit was either to reduce the impact of the recently-passed Kansas state income tax cuts by phasing them in over a period of years with total support of 66%, extending the state's existing sales tax rate with total support of 62%, reducing the deficit with equal amount of spending cuts and tax increases with total support of 57% and cutting the state budget across the board with total support of 50%. As you can see, all three of these options were supported by two to three times more Kansans than the proposal to eliminate the mortgage interest and property tax deductions.



Having said that, Kansas REALTORS® are again supportive of making Kansas a zero-income tax state by phasing-in individual income tax reductions over time by using increased tax revenues over a baseline target to slowly ratchet down marginal individual income tax rates. In doing so, REALTORS® are not opposed to gradually phasing-out the mortgage interest and property tax deductions over the same time period if the following conditions are met in the enacted tax plan:

(1) the Kansas Legislature adopts binding language that commits the state to a phased-in reduction in the state's individual income tax rates using future state tax revenue growth;
(2) all other itemized deductions are phased-out over a similar time period and the mortgage interest and property tax deductions are not unfairly singled out for elimination;
(3) the total amount of itemized deductions that could be claimed in a given year by a Kansas state income taxpayer is established in a statutory formula and is directly proportional to the current top marginal income tax rate in effect in a given year compared to the top marginal income tax rate in the designated baseline year; and
(4) the total amount of itemized deductions that could be claimed in a given year would not only decrease with a decreasing top marginal income tax rate, but would also increase if the top marginal income tax rate were to be increased by the Kansas Legislature in a future tax year (up to a maximum of 100% of the itemized deductions that could be claimed in the baseline year established in the statute).

If enacted by the Kansas Legislature, such a compromise proposal would ensure that middle-class Kansas home owners do not lose the significant state income tax relief provided by the mortgage interest and property tax deductions completely in the absence of any real guarantee that the Kansas state income tax will be abolished or eliminated in future years. In addition, the enactment of such a proposal would provide a significant amount of increased tax revenue for the state in future years (roughly $50 to $60 million per year depending upon the reduction in rates and the determination of the baseline year) that could be used to make further reductions in the marginal individual income tax rates.

However, the current proposals contained in **HB 2110** fail to meet these conditions and are an example of very poor public policy for several reasons. First, any member of the Kansas Legislature who votes for **HB 2110** will be voting in favor of increasing the income tax burden on Kansas home owners by a total of nearly $1.04 billion from FY 2014 through FY 2018. Coupled with the over $1.5 billion increase in sales taxes and $553 million in "other revenue" contained in the legislation, the passage of **HB 2110** would increase the total tax burden on Kansans by $3.1 billion from FY 2014 through FY 2018.

In contrast, the current language of **HB 2110** contains several provisions that purport to decrease marginal income tax rates on selected groups of Kansas state income taxpayers beginning either in tax year 2014 for lower-income individuals and tax year 2017 for higher-income individuals. If these tax cuts are ultimately enacted by the Kansas Legislature and not modified in future legislative sessions (which is not absolutely guaranteed given the volatility of state income tax revenues and state spending), then the state's marginal income tax rates could be significantly reduced in future years.

Having said that, there is nothing in **HB 2110** that would make the proposed future income tax cuts absolutely binding and nothing would prohibit a future Governor or Kansas Legislature from either cancelling or reversing the proposed income tax cuts scheduled for future tax years. In fact, there is absolutely nothing that can be done in the legislation to completely bind future legislatures and **HB 2110** does not guarantee that the Kansas state income tax will ever be completely abolished or eliminated.

Each member of the Kansas Legislature that votes in favor of **HB 2110** will be voting to increase income and sales taxes on Kansans by roughly $3.1 billion from FY 2014 through FY 2018. In return, **HB 2110** does not actually eliminate the state's income tax and instead only contains the promise of future income tax reductions, which could be cancelled or reversed in future years to accommodate spending increases or orders to increase K-12 public education funding by the Kansas Supreme Court (which could require the state to spend up to $450 million per year from the state general fund within the next two years).

Effectively, a very large portion of any future income tax relief provided to Kansas state income taxpayers will be funded on the backs of income tax increases on middle-class Kansas home owners through the elimination of the mortgage interest and property tax deductions. Instead of providing broad and equal income tax relief to all Kansas state income taxpayers, **HB 2110** would instead simply shift the tax burden from one group to another group of state income taxpayers (namely middle-class Kansas home owners).

In closing, REALTORS® support fundamental income tax reform that will provide meaningful tax relief and create economic development opportunities for Kansas families and businesses. However, REALTORS® believe that the goal of income tax reform should be to reduce the tax burden on all Kansans and not simply shift the tax burden between different classes of taxpayers, including increasing the tax burden on Kansas homeowners through the elimination of the mortgage interest and property tax deductions.

Having said that, REALTORS® believe that there are other comprehensive income taxation reform proposals currently circulating in the Kansas Legislature that are worthy of serious consideration and support by the House Taxation Committee. For example, Kansas REALTORS® would be extremely supportive of any tax reform proposal that phased-out ALL itemized deductions over a period of years in proportion to a phased-in reduction in marginal income tax rates on Kansas state income taxpayers.

In doing so, the Kansas Legislature would ensure that the income tax burden is not increased on middle-class Kansas home owners by nearly $1.04 billion from FY 2014 through FY 2018 through the elimination of the mortgage interest and property tax deductions while not guaranteeing any real reduction in marginal income tax rates through the passage of **HB 2110**. Kansas home owners would only see a reduction in their ability to claim their mortgage interest and property tax deductions when marginal income tax rates were actually reduced by the Kansas Legislature rather than promised to be reduced at a future date as under **HB 2110**.

For all the foregoing reasons, we would urge the members of the House Taxation Committee to strongly oppose the provisions of **HB 2110** that would "decouple" the Kansas state income tax code from the federal income tax code by eliminating the ability of Kansans to claim the mortgage interest and property tax deductions on their state income tax returns. In doing so, we would urge the Kansas Legislature to do no further harm to the Kansas housing market and help prevent the tax burden from shifting to middle-class Kansas home owners.