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To: House Taxation Committee

Date: February 9, 2012

Subject: **HB 2560** – Opposition to Any Proposals Seeking to "Decouple" the Kansas State Income tax Code from the Federal Income Tax Code and Eliminate the Ability of Kansas Taxpayers to Claim Federal Itemized Deductions Such as the Mortgage Interest Deduction and State and Local Property Tax Deduction on State Income Tax Returns

Chairman Carlson and members of the House Taxation Committee, thank you for the opportunity to testify today on behalf of the Kansas Association of REALTORS® in opposition to proposals seeking to "decouple" the Kansas state income tax code from the federal income tax code and eliminate the ability of Kansas taxpayers to claim federal itemized deductions such as the mortgage interest deduction and state and local property tax deduction on their state income tax returns. 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 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, sustainable communities and providing affordable housing opportunities, while protecting the rights of private property owners.

Last month, Kansas Governor Sam Brownback laid out a comprehensive income tax reform proposal that would gradually eliminate Kansas income taxes over a period of time and cap the future growth in spending from the state general fund (SGF). As part of this proposal, Governor Brownback proposed to create, in his words, a "fairer, flatter and simpler" income tax system in Kansas through the elimination of various income tax credits, deductions and exemptions.

As a starting point for this discussion, 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 deduction and the state and local property tax deduction.

Unfortunately, the Governor has also proposed to "decouple" the Kansas state income tax code from the federal income tax code by eliminating the ability of Kansans to claim federal itemized deductions on their state income tax returns. The list of potentially affected itemized deductions includes the mortgage interest, state and local property tax, charitable contribution, mortgage insurance premium and many other important tax deductions.

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.

However, a portion of 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 itemized deductions on their state income tax returns. Generally, we believe that "decoupling" from the federal income tax code is 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 in the state compared to other states.

During initial stages of this debate, several comments have been made that the mortgage interest, state and local property tax, charitable contribution and mortgage insurance premium deductions are "special interest" loopholes and an example of "social engineering" in the income tax code that manipulate tax policy and reward special interest groups at the expense of other taxpayers. However, we would beg to respectfully differ with any statements that would assert that the 417,000 homeowners in this state who currently receive substantial tax breaks due to the mortgage interest deduction are members of a "special interest" group or are guilty of manipulating of 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 where homeowners have not been allowed to deduct their mortgage interest from their adjusted gross income. If any proposals currently under discussion in front of the Kansas Legislature are successful in eliminating the mortgage interest deduction, then they will have reversed nearly 100 years of tax policy encouraging homeownership and providing substantial tax relief to homeowners.

Currently, over 417,000 Kansas taxpayers take advantage of the home mortgage interest deduction on an annual basis to reduce their state income tax burden, thereby delivering over $162 million in annual income tax relief to Kansas homeowners. The average Kansas taxpayer receives nearly $390 a year in tax relief from the home mortgage interest deduction, but the amount of tax relief received by homeowners is much higher in certain parts of the state with higher housing prices.

Tax Benefits of the Kansas Mortgage Interest Deduction*

Mortgage Debt	Amount of Deduction	Current Kansas State Income Tax Benefit
$300,000	$15,000	$968.00
$250,000	$12,500	$807.00
$200,000	$10,000	$646.00
$150,000	$7,500	$484.00
$100,000	$5,000	$323.00

* Examples assume a homeowner with a five percent mortgage rate who pays the highest income tax rate of 6.45 percent.

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.

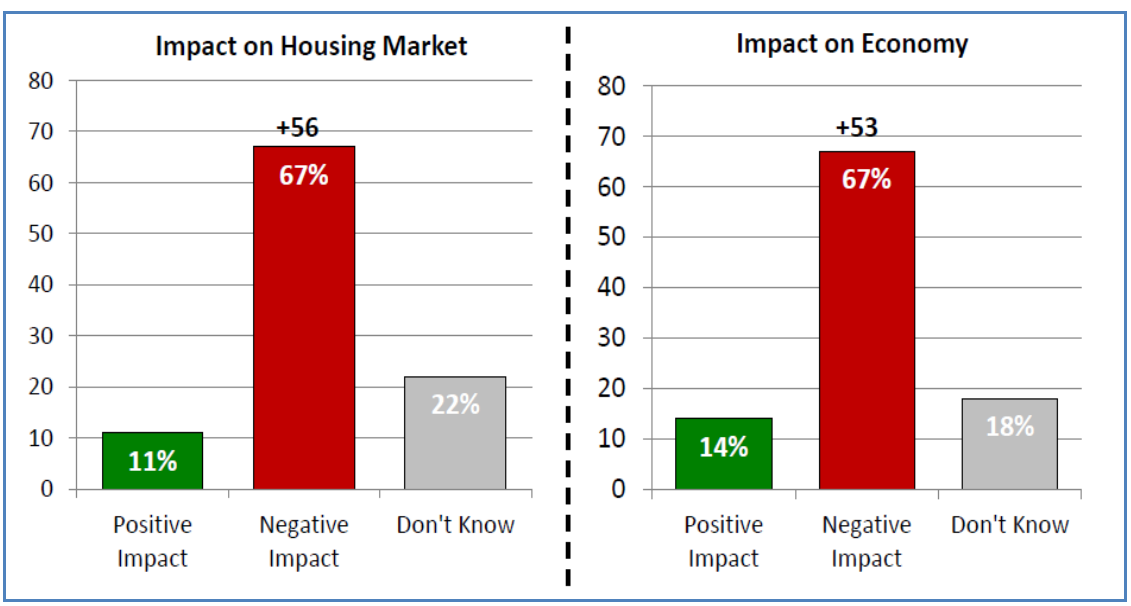
Each year, the construction, development and real estate industries generate approximately $17 billion in economic growth for the Kansas economy, which is around 13% of the state's total Gross State Product (GSP). The construction and real estate industries contribute the third-largest share to the state's 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 this year, which is 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 registered voters conducted earlier this month, 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. More than one quarter (28%) said that the home mortgage interest deduction is a "big" or "huge" factor, while only 11 percent say it is not a factor at all.

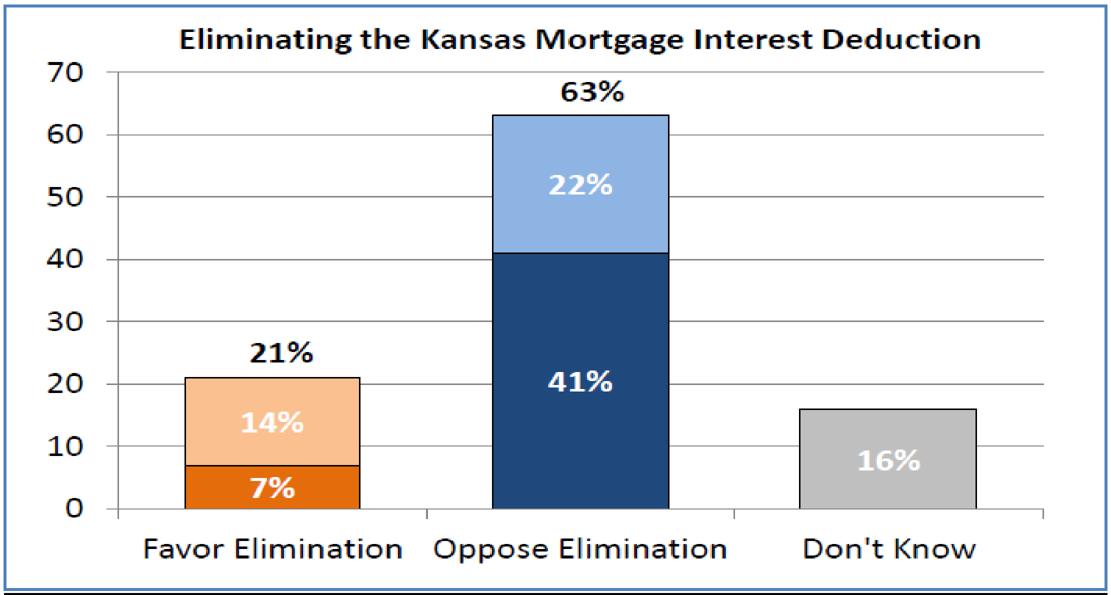
If the Kansas mortgage interest deduction is eliminated, it is clear that over 80% of Kansans would see this action as a disincentive to purchase a home in the current housing market. This would clearly cause a further deterioration in consumer confidence in the housing market and cause a further decline 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 the same poll of Kansas registered voters, more than two-thirds (67%) 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 believe that the elimination of the mortgage interest deduction would cause severe harm to the Kansas housing market and economy.

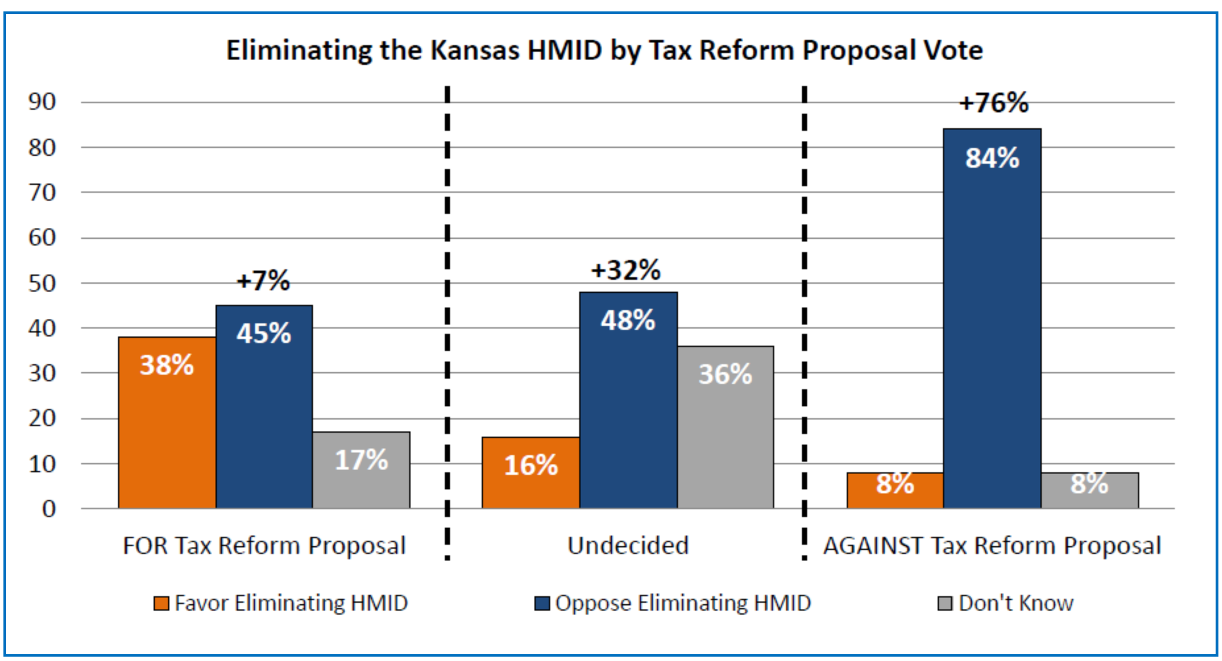


During this challenging housing market and struggling economy, REALTORS® firmly believe that now is not the time to undertake major changes in state tax policy that would cause catastrophic harm to the Kansas housing market and economy. Although the housing market is slowly recovering at this time, we believe that eliminating the mortgage interest deduction and other important itemized 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.

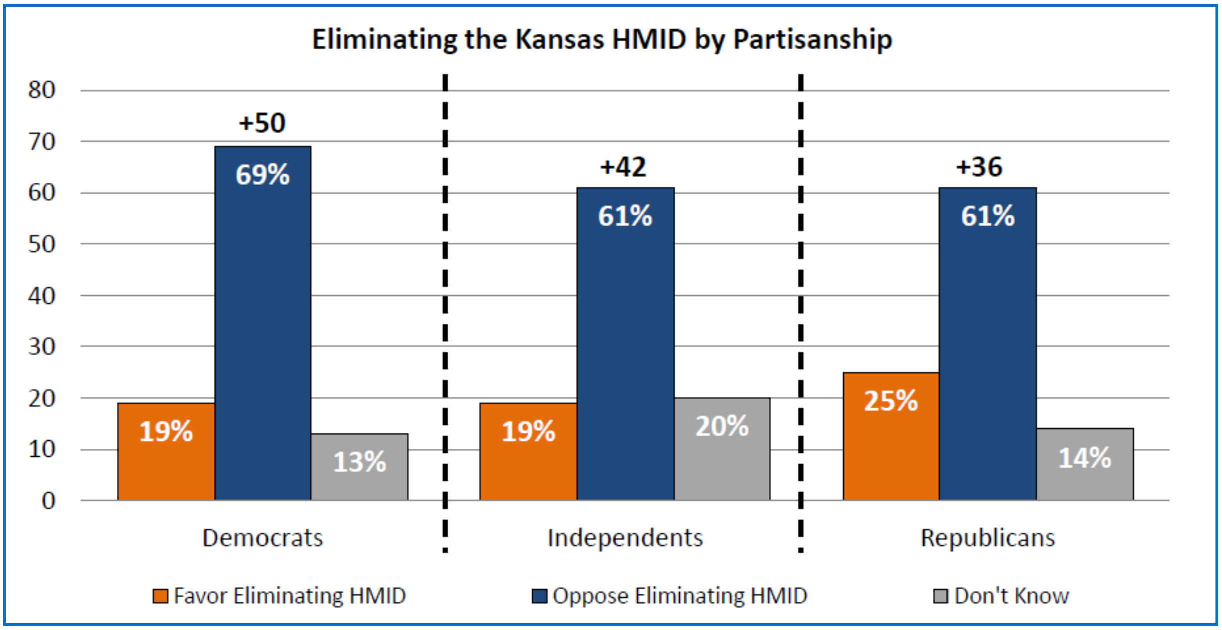
After hearing a brief description of the Governor's plan to cut state income tax rates with revenue generated from the elimination of various credits, deductions and exemptions, 63 percent of Kansans oppose eliminating the mortgage interest deduction as part of a bigger plan to cut state income taxes. Opposition to the plan is intense with 41 percent "strongly" opposed to the plan compared to only 14 percent of Kansans that strongly support the plan.



According to the same poll, even the minority of Kansans that are in favor of the Governor's overall income tax proposal (40%) oppose eliminating the mortgage interest deduction to help provided revenue for the proposal. Plurality support for maintaining the mortgage interest deduction is constant across all groups of Kansans who have taken a position on the Governor's income tax reform proposal.



In addition, there is overwhelming support for maintaining the Kansas mortgage interest deduction among Kansans of all political persuasions and groups. As you can see below, an overwhelming majority of Kansans in every political category support maintaining the Kansas mortgage interest deduction.



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 deduction.

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, the members of the Kansas House Republican leadership have issued a comprehensive income taxation reform proposal that retains all of the positive aspects of Governor Brownback's income tax reform proposal, while preserving the ability of Kansas taxpayers to claim federal itemized deductions on their state income tax returns.

In moving forward, the Kansas Association of REALTORS® will strongly support any comprehensive income tax reform proposal that provides meaningful tax relief by reducing the overall tax burden on all Kansas families, while not shifting the tax burden between different classes of taxpayers by eliminating the ability of Kansans to claim federal itemized deductions. Accordingly, REALTORS® strongly support the comprehensive income taxation reform proposal introduced by the Kansas House Republican leadership.

For all the foregoing reasons, we would urge the members of the House Taxation Committee to strongly oppose the provisions of **HB 2560** that would "decouple" the Kansas state income tax code from the federal income tax code by eliminating the ability of Kansans to claim federal itemized 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 Kansas homeowners.