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STATEMENT

ON BEHALF OF THE

NATIONAL ASSOCIATION OF REALTORS®

SUBMITTED TO:

UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON WAYS AND MEANS

TAX REFORM WORKING GROUP ON REAL ESTATE

APRIL 15, 2013

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EQUAL HOUSING OPPORTUNITY

About THE NATIONAL ASSOCIATION OF REALTORS®

The NATIONAL ASSOCIATION OF REALTORS® (NAR) is a trade association that represents a variety of real estate professionals engaged in activities including real estate sales and brokerage, property management, residential and commercial leasing and appraisal. NAR has one million members, almost all of whom are members in their personal capacity and not as corporate entities. The business model of REALTORS® is a highly personal, hands-on, face-to-face model, focused on a family's fundamental needs for shelter. Real estate investment and operations provide locations where the commerce that drives the economy is conducted.

NAR Principles for Tax Reform

If one were designing a tax system for the first time, one might come up with something that is remarkably different from what we have today. But we're not starting from scratch, particularly in the context of housing. Some provisions in the tax code, such as the deductions for mortgage interest and state and local taxes paid, have been part of the federal tax code since the income tax was introduced 100 years ago. Thus, the values of such tax benefits are both directly and indirectly embedded in the price of a home. While economists agree that there is no accurate measure of the value of those embedded tax benefits, they all generally agree that the value of a particular home includes tax benefits.

Real estate is the most widely-held category of assets that American families own, and for many Americans, the largest portion of their family's net worth, despite the price declines of the Great Recession. Therefore, while NAR agrees that reform and revision to different portions of the individual tax code may be warranted, we remain committed to preserving the current law incentives for homeownership and real estate investment.

NAR believes that individual tax rates should be as low as possible while still providing for a balanced fiscal policy. NAR further believes that there should be a meaningful differential between the rates paid on ordinary income and capital gains on investments. However, NAR does not endorse a particular rate, nor does it believe that long established provisions in the code should be changed or eliminated solely to lower marginal rates. When Congress last undertook major tax reform in 1986, it eliminated a large swath of tax provisions, including major real estate provisions, in order to lower rates, only to increase those rates just five years later in 1991. Most of the eliminated tax provisions never returned and in the case of real estate, a major recession followed. Congress must be mindful that eliminating widely-used and simple tax provisions can have harsh and dangerous unintended consequences, particularly if the sole purpose of eliminating non-abusive provisions is to obtain a particular marginal tax rate. NAR also notes that American homeowners now pay between 80 and 90 percent of all federal income taxes. Congress should avoid further raising taxes on homeowners in a quest for additional revenue while federal spending is at record highs. Congress must first look to reduce spending in order to get our nation's fiscal house in order.

Homeownership and American Culture

Policymakers should not dismiss or underestimate Americans' passion for homeownership, notwithstanding the most recent economic crisis. Calling homeownership the "American Dream" is not a mere slogan, but rather a bedrock value. Owning a piece of property has been central to

American values since Plymouth and Jamestown. Homes are the foundation of our culture, the place where families eat and learn together, the basis for community life. The cottage with a picket fence is an iconic part of our heritage.

Research has consistently shown the importance of the housing sector to the economy and the long-term social and financial benefits to individual homeowners. The economic benefits of the housing market and homeownership are immense and well documented. The housing sector directly accounted for approximately 15 percent of total economic activity in 2012. Household real estate holdings totaled $17.7 trillion in the last quarter of 2012. After subtracting mortgage liabilities, net real estate household equity totaled $8.2 trillion.

In addition to tangible financial benefits, homeownership brings substantial social benefits for families, communities, and the country as a whole. These benefits include increased education achievement and civic participation, better physical and mental health, and lower crime rates.

The tax system does not "cause" homeownership. People buy homes to satisfy many social, family and personal goals. The tax system *facilitates* ownership. The tax system supports homeownership by making it more affordable. While it is true that only about one-third of taxpayers itemize deductions in any particular year, it is also true that, over time, substantially more than one third of taxpayers receive the direct benefit of the mortgage interest deduction. Over time, mortgages get paid off, other new homeowners enter the market and family tax circumstances change. Individuals who utilize the mortgage interest deduction (MID) in the years right after a home purchase are, over time, likely to switch to the standard deduction.

Arguably, the standard deduction gives non-itemizing taxpayers a "better" answer than utilizing the mortgage interest deduction, so it is not clear that non-itemizers have been put at a disadvantage. Indeed, in *proportional* terms, the standard deduction can be characterized as a *deeper* subsidy than itemizing taxpayers receive because the standard deduction ($12,200 for married couples filing jointly in 2013) likely represents an amount that is significantly larger than the couple's total itemized deductions. In essence, the standard deduction, for many, becomes "free" money.

When academics talk about the MID and refer to it as an expenditure, they are speaking in the language of macroeconomics. In reality, the billions of tax dollars they see as an expenditure are the individual savings of millions of families. Every time homeowners make a mortgage payment, even in today's market, they are generally creating non-cash wealth. Many of our seasoned REALTORS® describe their satisfaction in helping a family secure its first house and then a larger home(s) for raising families. The most satisfying of a long-term series of transactions is helping a couple buy its last house *without a mortgage*. Those couples are able to make this "last" purchase because ownership over a long term of years has resulted in savings sufficient to meet their needs.

The federal policy choice to support homeownership has been in the Internal Revenue Code since its inception. We see no valid reason to undermine that basic decision. Indeed, we believe that the only *viable* tax system is one that would continue to nurture homeownership.

Current State of the Housing Market

In 2012 the Census Bureau estimated that there were nearly 133 million housing units in the United States. The vast majority of these housing units—nearly 115 million—are occupied by households while the remaining 18 million are vacant for a variety of reasons[1]. Since 1965, the homeownership rate has fluctuated between 63 and 69 percent, and in 2012 was 65 percent. That translates to 75 million owner-occupied households and roughly 40 million renter households.

In any given year, a good number of households are in transition. In 2012, 4.66 million existing homes and an additional 370,000 new homes were sold for a total of 5 million properties for which ownership transitioned. While all homeowners interact with the tax code, the transition of ownership leads to additional tax interactions. Measured by sales activity, the housing market has recovered substantially but not fully since the housing and economic crisis. Total sales in 2012 for new and existing properties exceeded 5 million whereas from 1999 to 2008 existing home sales alone exceeded 5 million every year, in spite of the fact that there were 5 to 10 million fewer households. In addition to additional tax considerations as a result of a transition of ownership, research shows that additional economic activity is generated, making a healthy housing market a foundation of economic health. For example, the Harvard Joint Center for Housing Studies reports that 60 percent of owner-occupant purchasers made improvements averaging $11,100, and investor purchasers spent more per unit on average[2].

Homeownership is often referred to as the American Dream, and the realization of this dream takes some time. A strong correlation between the homeownership rate and age of the household head is the result—the older the head of household, the more likely the household is to own a home. Further, the median or typical age of a first-time home buyer in the US was 31 in 2012 and has ranged between 30 and 32 for the last decade[3]. Because homeownership delivers current consumption value—it provides shelter—and investment value, roughly 90 percent of home buyers finance their home purchase, and younger buyers are more likely to finance the home purchase. These trends are long-standing and were little-affected by the recession.

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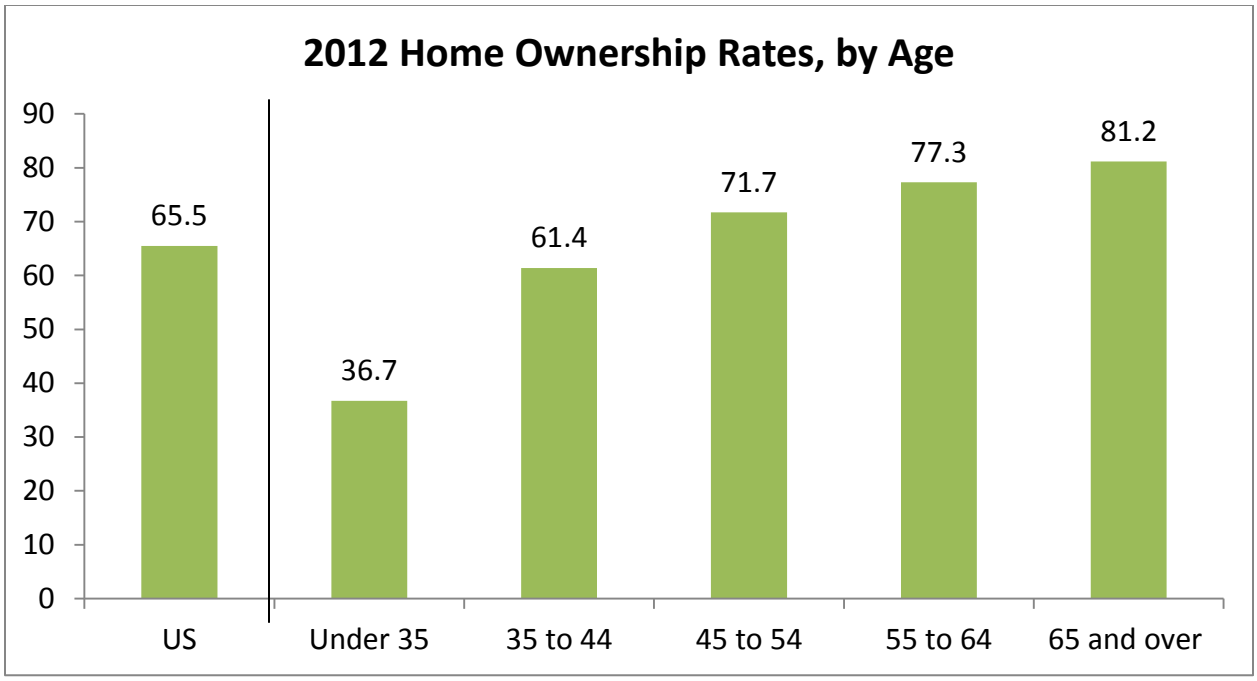
[1] Roughly a third of these vacant properties are in some form of transition or being marketed for transition and a quarter are seasonal properties not intended for year-round occupancy. Census Bureau, 2012 Housing Vacancy Survey

[2] Harvard Joint Center for Housing Studies. *The US Housing Stock: Ready for Renewal.* January 23, 2013. http://www.jchs.harvard.edu/research/publications/us-housing-stock-ready-renewal

[3] National Association of Realtors. *Profile of Home Buyers and Sellers,* various years.



Source: Census Bureau

Residential Real Estate Tax Provisions

There are a number of tax provisions that affect residential real estate in one form or another. These range from relatively small temporary provisions to major provisions of the tax code utilized by millions of taxpayers. While NAR generally supports tax provisions that encourage sustainable homeownership and that incentivize investment and improvement of real estate, we will focus here on the most prominent and widely used provisions for individual homeowners.

The Mortgage Interest Deduction

The deduction for mortgage interest paid has been part of the federal income tax code since its inception in 1913. Despite a century of additions, modifications, deletions, and overhauls of the tax code, Congress has left the mortgage interest deduction in place. Current law allows a homeowner to deduct the interest on up to $1 million in total acquisition debt for a principal residence and a second, non-rental, home. Homeowners are also allowed to deduct the interest on up to $100,000 in home equity debt.

Prior to 1986 there was no limit on the amount of home mortgage interest that could be deducted. The Tax Reform Act of 1986 imposed the first limitation on the MID, allowing it for allocable debt used to purchase, construct or improve a designated primary residence and one additional residence (Second home).

The Omnibus Budget Reconciliation Act of 1987 further limited the deduction to interest allocable to up to $1 million in acquisition debt. This limit is not adjusted for inflation. Factoring in the impact of inflation, the value of the cap has eroded by half since 1987; in 2013 dollars, the original cap would be equal to just over $2 million today had it been indexed.

Who Benefits from the Mortgage Interest Deduction?

The mortgage interest deduction (MID) is often criticized on two fronts – that it favors wealthier taxpayers at the expense of those with more modest incomes, and that it benefits only those relatively few taxpayers who are eligible to itemize their deductions. Since taxpayers who itemize are often those with higher incomes, these criticisms are related.

In 2010, the tax year for which the most complete data are available, 36.7 million tax filers claimed a deduction for mortgage interest. There are many ways to frame this number in context, and the conclusions drawn about the importance of the mortgage interest deduction (MID) are strongly affected.

Tax filers claiming the MID account for only 25 percent of the total number of tax returns filed; however, returns claiming the MID represent roughly half of owner-occupied households and roughly three-quarters of home-owners whose homes are mortgaged[4]. How can these statements all be true? When examining the question of who benefits from the mortgage interest deduction, it is helpful to keep in mind that households are not the same thing as tax-units and multiple tax filers can and do come from the same household. In 2011, for example, there were roughly 114 million households and 145.6 million individual income tax returns or more than 30 million tax returns filed by those in a household with another tax filer[5]. Further, the MID would only apply directly to the tax situations of the 75 million home owners and more specifically to the roughly 50 million homeowners nationally who have a mortgage or other debt on their residence. The tables below detail these shares by state which vary due to state differences in homeownership rates, incidence of mortgage debt, and the incidence of other itemized deductions. In some states, more than 90 percent of the target population of homeowners with a mortgage claims the MID.

By income, we see that the MID is valuable to households across the spectrum. 63 percent of those claiming the MID in 2010 earned less than $100,000 and 91 percent earned less than $200,000 in Adjusted Gross Income[6]. Breaking down the benefits of the MID by age, we see further evidence of the lifetime it takes to achieve the American Dream. Roughly half of those claiming the MID and half of the amount claimed went to households under the age of 45[7].

Some claim that since the economic downturn has reduced interest rates, we should look at data from the economically stronger years preceding the recession. Fair enough. A look at 2007 indicates a very similar finding. Eighty-two percent of the value of the MID in 2007 went to those making under $200,000, and this group represented 91 percent of all tax filers that year.

Furthermore, it is important to realize that MID utilization data offer just a snapshot in time. Over the course of an owner's tenure in a home, an individual may itemize in the early years of homeownership, when the interest expense is high relative to the principal paid, but then not itemize

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[4] National Association of REALTORS® Calculations of IRS and Census Bureau data.

[5] Taking households that do not file taxes into account would push this number up while taking into account taxes filed for those who are deceased would decrease this figure. Filing for the economic stimulus boosted the number of returns filed in 2007 vs 2006 or 2008 by roughly 15 million while roughly 2.5 million individuals passed away in 2011.

[6] National Association of REALTORS® calculations of IRS data.

[7] Jeff Curry and Jonathan Dent, "Individual Income Tax Returns, by Age of Primary Taxpayer, Tax Years 1997 and 2007," Statistics of Income (SOI) Bulletin, Spring 2011.

in later years. Mortgages get paid off, other non-MID deductions rise and fall, individuals down-size, divorces occur, a spouse dies or needs to simplify living arrangements. These and other life events may convert itemizers into standard deduction taxpayers. Thus, in any given year, we may not see the full contingent of homeowners who use the MID.

Taking a longer view shows the real picture. Of the nearly 76 million homeowners in 2007, 62 percent had a mortgage on their home. However, about 85 percent of homeowners took out a mortgage when they purchased the home. Of course, many taxpayers eventually pay off their mortgages. Only a fourth of homeowners with heads of household age 65 and over have a mortgage. Of households that still had one in 2007, almost 90 percent claimed the MID. NAR estimates that over 70 percent of homeowners will utilize the MID over their lifetimes, regardless of whether they own or rent a home in a particular year. This greatly exceeds the 37 percent of households that claimed the MID in 2007.

Mortgage Interest Deduction Claimers as a Share of Various Target Groups

	MID Claimers as a Share of		
	Tax Filers	Home Owners	Mortgaged Home Owners
UNITED STATES	25.5%	49.0%	72.9%
ALABAMA	22.4%	37.0%	60.8%
ALASKA	21.7%	49.9%	72.1%
ARIZONA	28.0%	50.1%	71.6%
ARKANSAS	18.8%	30.6%	53.0%
CALIFORNIA	27.4%	66.1%	88.1%
COLORADO	32.8%	60.1%	79.7%
CONNECTICUT	34.3%	64.1%	89.7%
DELAWARE	30.6%	54.6%	76.7%
DISTRICT OF COLUMBIA	25.3%	76.1%	98.7%
FLORIDA	19.4%	39.0%	61.1%
GEORGIA	27.2%	54.2%	76.2%
HAWAII	23.3%	59.0%	87.1%
IDAHO	27.4%	45.2%	65.8%
ILLINOIS	27.5%	51.6%	74.7%
INDIANA	22.8%	39.1%	55.8%
IOWA	24.4%	38.6%	61.8%
KANSAS	24.1%	42.0%	65.6%
KENTUCKY	23.9%	38.4%	61.8%
LOUISIANA	17.8%	31.0%	55.5%
MAINE	25.7%	40.5%	62.2%
MARYLAND	36.8%	71.9%	94.0%
MASSACHUSETTS	31.4%	64.2%	88.9%
MICHIGAN	26.0%	43.3%	65.6%
MINNESOTA	32.7%	54.9%	77.9%
MISSISSIPPI	17.2%	29.3%	53.6%
MISSOURI	24.9%	41.3%	62.7%
MONTANA	23.4%	39.7%	67.2%
NEBRASKA	23.8%	41.9%	65.7%
NEVADA	24.6%	55.0%	72.3%
NEW HAMPSHIRE	30.3%	54.5%	78.3%
NEW JERSEY	32.1%	65.4%	92.0%
NEW MEXICO	21.0%	36.8%	60.5%
NEW YORK	23.0%	54.7%	84.2%
NORTH CAROLINA	28.2%	48.0%	71.5%
NORTH DAKOTA	15.0%	26.5%	49.6%
OHIO	25.6%	45.0%	66.2%
OKLAHOMA	20.1%	33.0%	54.7%
OREGON	31.4%	58.1%	83.1%
PENNSYLVANIA	24.8%	43.9%	70.0%
RHODE ISLAND	29.7%	61.9%	84.8%
SOUTH CAROLINA	24.8%	42.0%	66.8%
SOUTH DAKOTA	15.5%	28.2%	48.2%
TENNESSEE	19.5%	33.4%	53.2%
TEXAS	19.9%	39.3%	62.8%
UTAH	32.6%	60.1%	80.9%
VERMONT	24.4%	42.9%	64.0%
VIRGINIA	33.2%	61.1%	84.9%
WASHINGTON	30.2%	58.2%	80.3%
WEST VIRGINIA	15.0%	21.2%	42.7%
WISCONSIN	29.3%	51.3%	75.5%
WYOMING	20.2%	36.0%	59.8%

The Enigma of the Standard Deduction

While it is true that a taxpayer must itemize in order to claim the mortgage interest deduction, it is not true that who do not itemize get no value from the MID. In order to appreciate this conundrum, one must look at the history of our modern tax system. In 1913, Congress and the President enacted the income tax. The original tax law provided for both a deduction for interest paid and for state and local taxes paid (including for property taxes). These two deductions, plus the deduction for charitable contributions, which was added to the tax law in 1917, together comprise the great majority of itemized deductions that are claimed each year.

For many years, the tax law provided that taxpayers who paid interest, state and local taxes, and/or made charitable contributions, could take a deduction for them. A few other deductions, such as for casualty and theft losses or for medical expenses, were also allowed. However, in order to qualify for these deductions, taxpayers actually had to incur these expenses and keep track of them.

This changed in 1944, when Congress decided to simplify the tax law by providing for the standard deduction. Legislative history (both original and subsequent) shows that the standard deduction was based on a composite basket of typical deductions that taxpayers claimed, including the MID, taxes paid, charitable contributions made, and so forth. The simplification came about by Congress deeming that all individuals were to receive a certain amount of generic deductions, represented by the standard deduction. Taxpayers claiming the standard deduction did not need to prove that any amounts were actually paid in order to take the standard deduction. Congress simply designated that all taxpayers could claim the standard deduction whether they made the deductible expenditures or not.

In enacting the standard deduction, Congress did not modify the deductions themselves. Rather, taxpayers who paid deductible expenditures in excess of the standard deduction were allowed to claim the actual amounts as what was (from then on) called itemized deductions. Taxpayers with deductions totaling an amount below the standard deduction threshold could simply claim the standard amount and not worry about even keeping track of what was actually paid. This represented a huge step toward simplifying the lives of millions of American taxpayers.

What is often not recognized today is that the standard deduction represents a tax giveaway for virtually all taxpayers who claim it. This is because if a taxpayer has deductions in excess of the standard deduction, he or she may claim the higher amount. But those who have actual deductions less than the standard are given the benefit of the standard deduction amount whether or not they actually incurred the expenses. Thus, the giveaway equals a range of as much as the standard deduction for taxpayers who have absolutely no deductions, on the high end, to as little as $1 for taxpayers whose actual deductions come just $1 short of the standard deduction amount, on the low end.

For example, assume a married couple's actual amounts for state and local tax, mortgage interest, and charitable contributions for 2013 total $12,000. With the standard deduction for a couple currently at $12,200, this family would be receiving an extra tax deduction for $200 in expenditures they never made. If they were in the 28 percent bracket, this would amount to a $56 tax "freebie" ($200 excess x 28%). Suppose another couple had just $2,000 of state and local taxes, but no mortgage interest and no charitable contributions. This family would also get to take the standard

deduction of $12,200, for a subsidy of $10,200 ($12,200-$2,000), which would be worth $2,856, assuming they were also in the 28 percent tax bracket ($10,200 x 28%).

The point is that whether a taxpayer is being subsidized a little bit (as with the first couple), or a lot (as with the second couple), or not at all (as with the case of a couple who has enough deductions to itemize), each couple is benefitting from the mortgage interest deduction. Just because the standard deduction does not specifically indicate which portion of it is attributable to the mortgage interest deduction (or any other deduction), does not mean that the MID is not part of the benefit being given.

When Congress first established the standard deduction in 1944, more than 82 percent of taxpayers were able to utilize this simplification tool, meaning that just 18 percent itemized. According to the Joint Committee on Taxation (JCT), by 1969 this proportion had dropped to 58 percent. In explaining the reason for Congress increasing the standard deduction in the Tax Reform Act of 1969, JCT stated that since 1944, "higher medical costs, higher interest rates, higher State and local taxes, increased homeownership, and more expensive homes have made it advantageous for more and more taxpayers to shift over to itemized deductions."

Thus, it is clear that even though no specific portion of the standard deduction is tied to the MID, Congress crafted the standard deduction to be a proxy for allowable deductions (i.e., itemized deductions), including the MID, and when the underlying amount of these deductions increase, Congress has believed that it is appropriate for the standard deduction to also increase. It is also clear that Congress intended that very few people would have to itemize (18 percent in 1944) and when this proportion was eroded by inflation and other factors, Congress increased the standard deduction to keep it closer to its original percentage.

Arguments that the mortgage interest deduction benefits only those who itemize simply do not hold water.

The Real Property Tax Deduction

The income tax system of the United States has provided a deduction for state and local taxes, including property taxes, since its inception. To do otherwise would violate two fundamental and widely accepted principles of good tax policy – the avoidance of double taxation and the need to recognize the taxpayer's ability to pay.

Taxes paid at the state and local levels to benefit the general public are in nature and purpose similar to the federal income tax in that they both fund essential government services. Therefore, allowing a deduction for these state and local taxes for federal income tax purposes is essential to avoiding double taxation on the same income (or a tax on a tax). Our federal tax law follows this same principle in connection with the payment of taxes to other nations. In the case of foreign taxes, however, the law goes even further and provides taxpayers with a choice of claiming a deduction for foreign taxes paid, or taking a credit, which is a dollar-for-dollar reduction in tax owed.

While state and local taxes vary greatly, two aspects of them that do not change are that they are ubiquitous throughout the nation, in one form or another, and they are largely involuntary. It is true that we can exercise some degree of choice over how much we pay in state and local taxes by

deciding where we live and what we buy. However, avoiding these levies altogether is not a practical option. Obviously, paying taxes to state and local governments leaves taxpayers without the income used to pay the taxes. The extraction of state and local taxes is tantamount to the money never being earned by the taxpayer in the first place. Our tax system recognizes this fact by providing a deduction for the payment of these taxes.

Eliminating the deduction for state and local taxes would fly in the face of these fundamental tax policy principles that have been ingrained in our income tax law from its beginnings.

Along with other state and local taxes, the Internal Revenue Code has provided a deduction for real property taxes paid since its enactment in 1913. To be deductible, a real property tax must be levied for the general public welfare. Thus, taxes paid for local improvements such as sidewalks and similar betterments that directly benefit the property are not deductible.

For homeowners, real property taxes represent an unending obligation, at least as long as they own their homes. The other major deduction for most homeowners, the mortgage interest deduction, does not continue after the mortgage is paid off, and it usually diminishes as the mortgage is being paid. Property taxes, on the other hand, often increase over the years, as assessments on property increase and as local governments increase their levy rates. For these reasons, the deduction for real estate property taxes is often the one most-claimed by homeowners. In fact, more taxpayers claim the real property tax deduction than claim the deduction for mortgage interest (in 2010, 41.1 million wrote off real property taxes while 36.7 million deducted mortgage interest).

As with the mortgage interest deduction, critics sometimes claim that the deduction for property taxes is misguided because it gives the lion's share of its benefit to the wealthy and little to the rest of us. However, this is just not the case.

Much of this criticism is centered on the fact that taxpayers must itemize in order to take the deduction. As discussed above (please see The Enigma of the Standard Deduction), taxpayers who claim the standard deduction also benefit from the property tax deduction.

Further, because real property taxes are assessed based on property values, one would expect the deduction to be much more utilized at higher incomes. Moreover, most local governments grant real property tax relief to lower-income taxpayers.

Surprisingly, however, 75 percent of the value of real property tax deductions in 2012 went to taxpayers with incomes of less than $200,000, according to an estimate prepared by the staff of the Joint Committee on Taxation. The typical real estate tax deduction beneficiary has an adjusted gross income slightly less than $81,000.

In addition, the tax law already includes a provision designed to limit the tax benefit of the real property tax deduction to the "wealthy." Specifically, the deduction is disallowed for purposes of the alternative minimum tax.

Estimated Tax Savings by State from Mortgage Interest and Property Tax Deductions at a 25% Marginal Rate

	Average MID Claim	Estimated Tax Savings	Average Real Estate Tax Claim	Estimated Tax Savings
UNITED STATES	10,640	2,660	4,232	1,058
ALABAMA	8,610	2,153	1,286	321
ALASKA	11,120	2,780	3,943	986
ARIZONA	11,282	2,820	2,458	615
ARKANSAS	7,764	1,941	1,589	397
CALIFORNIA	15,755	3,939	4,788	1,197
COLORADO	11,746	2,936	2,404	601
CONNECTICUT	10,970	2,742	6,707	1,677
DELAWARE	10,811	2,703	2,266	567
DISTRICT OF COLUMBIA	14,976	3,744	3,853	963
FLORIDA	11,163	2,791	4,202	1,051
GEORGIA	9,590	2,398	2,931	733
HAWAII	14,955	3,739	1,920	480
IDAHO	9,461	2,365	2,017	504
ILLINOIS	9,969	2,492	5,909	1,477
INDIANA	7,757	1,939	2,043	511
IOWA	7,177	1,794	2,814	704
KANSAS	7,846	1,961	3,053	763
KENTUCKY	7,553	1,888	2,005	501
LOUISIANA	9,009	2,252	1,812	453
MAINE	8,297	2,074	3,580	895
MARYLAND	12,448	3,112	4,141	1,035
MASSACHUSETTS	11,366	2,842	5,116	1,279
MICHIGAN	8,324	2,081	3,567	892
MINNESOTA	9,757	2,439	3,251	813
MISSISSIPPI	7,649	1,912	1,756	439
MISSOURI	8,332	2,083	2,627	657
MONTANA	8,973	2,243	2,416	604
NEBRASKA	7,479	1,870	3,635	909
NEVADA	12,192	3,048	2,828	707
NEW HAMPSHIRE	10,206	2,551	6,329	1,582
NEW JERSEY	11,411	2,853	8,944	2,236
NEW MEXICO	9,858	2,465	2,239	560
NEW YORK	10,639	2,660	7,346	1,836
NORTH CAROLINA	9,050	2,262	2,493	623
NORTH DAKOTA	7,920	1,980	3,241	810
OHIO	7,551	1,888	3,488	872
OKLAHOMA	7,645	1,911	2,119	530
OREGON	10,533	2,633	3,382	846
PENNSYLVANIA	8,835	2,209	4,434	1,108
RHODE ISLAND	9,626	2,407	4,851	1,213
SOUTH CAROLINA	9,021	2,255	1,815	454
SOUTH DAKOTA	8,580	2,145	3,230	807
TENNESSEE	9,419	2,355	2,371	593
TEXAS	9,109	2,277	5,199	1,300
UTAH	10,204	2,551	2,085	521
VERMONT	8,502	2,125	4,980	1,245
VIRGINIA	12,591	3,148	3,524	881
WASHINGTON	12,615	3,154	3,865	966
WEST VIRGINIA	8,132	2,033	1,458	364
WISCONSIN	7,793	1,948	4,406	1,101
WYOMING	10,392	2,598	2,242	560

NAR calculations based on IRS Data

Proposals to Eliminate or Modify Itemized Deductions

Over the past several years different plans have emerged proposing the reduction, modification, or complete elimination of itemized deductions. Each of these proposals would limit the value of the deduction and/or have a negative impact on the value of housing. In many cases, the largest impact would be felt by middle-class families, not necessarily by the individuals or families categorized by the media as "the rich." The following is an examination of each of these proposals.

Capping Itemized Deductions

Two proposals have repeatedly been floated to cap the value of all itemized deductions. The first is a proposal made each year in President Obama's budget to cap itemized deductions for upper-income taxpayers at 28 percent. As itemized deductions follow taxpayers' top marginal rate, this would have the effect of lessening the value of all itemized deductions for individuals in the 33 percent, 35 percent and 39.6 percent brackets. It is important to note that many of these taxpayers have already had the value of their deductions limited by the reinstatement of the complex and burdensome "Pease" limitation that now applies to individuals with adjusted gross income above $250,000 ($300,000 for couples) as part of the American Taxpayer Relief Act of 2012.

The 28 percent cap focuses on the tax filer's income, rather than the total dollar amount of itemized deductions. This proposal adds, rather than removes, complexity from the tax code and would be hard to plan for. An individual, particularly one who owns a business or who is self-employed, may be in different tax brackets from year to year. These individuals have a particularly difficult time estimating their incomes and tax liability, particularly in today's uncertain economic and legislative climate. They do not need added burdens of complexity or unanticipated tax increases. A reduction in the mortgage interest deduction (MID) would further complicate their family finances.

Some will say that putting a limitation on the deductions of upper income taxpayers would cause no harm for those in lower brackets. However, when reduced tax benefits reduce the value of a home, the value of all homes decreases. A collapse or reduction in home values at the top end of the market causes downward pressure on all other homes. That is, when the value of my neighbor's house declines, then the value of my house declines, as well.

The second proposal to cap itemized deductions comes in the form of a hard dollar cap on all itemized deductions. Most prominently proposed by Republican nominee Mitt Romney during the 2012 Presidential election, a dollar cap would disallow deductions above a certain dollar figure regardless of income.

As the cap is not based on income, but rather the amount of deductions claimed, this proposal would potentially raise taxes on Americans of all income levels regardless of where the dollar amount of the cap was set. For example, if the cap on total deductions were set at $25,000, households with cash incomes as low as $30,000 would be impacted, according to the Tax Policy Center (TPC). TPC further estimates that 35 percent of households with cash incomes between $100,000 and $200,000 would see a tax increase averaging almost $2,500 if itemized deductions were capped at $25,000.

Not only does a dollar cap affect taxpayers of all income levels, it penalizes those who live in areas with higher housing costs or higher state and local taxes. Taxpayers living in these areas have somewhat "fixed" deduction costs when it comes to their mortgage and tax levels. Their property tax levels are directly tied to the value of their property and the local tax rate. While, in theory, they can pay down their mortgage amount and reduce their interest paid if they have the financial ability to do so, neither the mortgage nor the tax amount paid are discretionary, as is a charitable donation. Therefore, while it is widely viewed that charities would take the biggest hit from a dollar cap on total itemized deductions, one could argue the biggest losers would be younger families living in high cost housing markets who have both larger mortgage interest payments and high state and local tax bills. Their tax increase would be the most pronounced and painful, despite the idea that a dollar deduction cap is designed to simply make "the rich" pay their fair share.

If a dollar cap were implemented on itemized deductions, no matter the dollar amount, more and more taxpayers would be subject to it if Congress failed to index that amount for inflation. This would create the same kind of tax nightmare that came about as a result of the Alternative Minimum Tax, as more and more middle class taxpayers became subject to the cap as home values and taxes paid rose, simply because of inflation. After spending years trying to exempt most middle class taxpayers from the AMT, it would seem odd Congress would choose to proactively introduce another one. A dollar cap further ads one more layer of complexity to the tax code and seems a rather blunt instrument to raise revenue.

Converting the Mortgage Interest Deduction to a Tax Credit

Many economists have traditionally favored tax credits over tax deductions because tax credits provide more benefit to those in lower tax brackets. This ignores the reality that, in a progressive tax system like ours, an individual in the 15 percent bracket receives only 15 cents of tax reduction for each dollar of interest deducted, while an individual in the 35 percent bracket receives a tax benefit of 35 cents on the dollar. The mathematics of this assertion are correct, but asymmetrical: The tax benefit analysis of a deduction ignores the balance between tax rates and individual income taxation. An individual in the 15 percent bracket pays only 15 cents of tax on the dollar, while an individual in the 35 percent bracket pays tax of 35 cents on the dollar. Thus, tax rates balance, rather than distort, the value of deductions.

In 2005, President Bush's tax reform advisory council proposed converting the deduction to a 15 percent non-refundable tax credit. The Simpson-Bowles Commission proposed a 12 percent non-refundable tax credit along with its proposals to eliminate the deduction for second homes and cap the total deduction at $500,000. Others have proposed credits of different amounts and with different limitations on the total amount of mortgage debt that could be claimed or the number of homes. In order to more carefully weigh the pros and cons of converting the deduction to a credit, NAR commissioned outside research in 2005 to study the effects of such a conversion.

While the conclusions are now somewhat dated, they present a striking contrast with the 12 percent or even 15 percent credit proposals. In 2005, NAR asked its consultants to design a revenue-neutral tax credit based on data then currently available. (Revenue-neutral was intended as a design under which the total amount of the tax expenditure associated with mortgage interest was neither increased nor decreased.) That analysis showed that in 2005, a revenue-neutral rate for a credit

would have been 22 percent – markedly more beneficial to taxpayers than a 12 percent or 15 percent credit.

The amount of the credit percentage would greatly affect the amount of winners and losers in any conversion. However, different studies have consistently shown that the tax increases for the losers would be far greater than the tax savings experienced by the winners. Furthermore, a conversion to a credit would upend 100 years of established tax law. The effects that drastic of a change would have on consumers and the real estate markets is unknowable. In this case we think Congress would be well advised to adopt the mantra of "do no harm."

Eliminating the Deduction for Second Homes

Several recent proposals for tax reform, including Bowles-Simpson, have included a proposal to eliminate the deduction for second homes. Critics of the second home deduction argue that it primarily benefits rich owners of expensive vacation homes in resort areas like Aspen or Cape Cod. In reality those taxpayers are not the beneficiaries of the deduction.

When a Second Home is not a "Second Home"

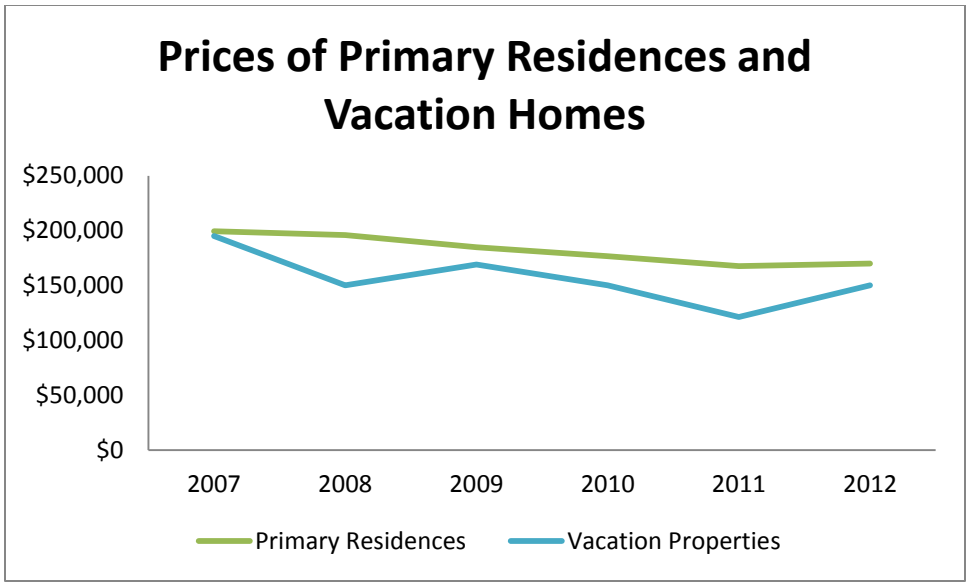
One overlooked reason for the code allowing a deduction for mortgage interest paid on a second home in a tax year is the most fundamental part of residential real estate: buying and selling. If a family has a mortgage on their primary residence, and then sells that residence in order to purchase another home in the same tax year, they have owned two homes in that year. Removing the deduction for second homes would only allow the family to deduct the interest for one of those residences and essentially introduce a tax on moving. Families move for many different reasons: more space for a growing family, downsizing once the kids are gone, economic challenges, or a new job. NAR estimates that as many as three million households take part in a move that would qualify them for a "second home" deduction in a tax year even though none of those families would consider themselves second home owners.

Second homes are both geographically concentrated and diverse

While the image conjured up by critics of a second home is a multi-million dollar property in a tony resort area, most of those homes are bought with cash. In reality, second homes nationally have a lower median sales price than principal residences.

(It is important to note that for the discussion of second homes we are referring to the traditional definition of a vacation home used for recreational purposes by the owner. Homes rented for more than 14 days in a tax year are considered rental properties and subject to different tax rules.)

Every year NAR conducts an Investment and Vacation Home Buyers Survey. Over the past decade, the median price of a second home has always trailed the median price of a principal residence. Moreover, the median price of a second home has decreased over the past decade. In 2003, the median price of a second home was $190,000. Medians for second homes peaked in 2004 at $204,100. Currently, the median price of a second home is $150,000 – nearly 25 percent less than it was at the top of the 2004 market.



National Association of REALTORS® Investment and Vacation Homebuyers Survey

The tax returns of second home owners show that more than half – 54 percent -- are in income classes below $200,000. In fact, the largest single category of second home owners is in the $100,000 - $200,000 AGI range. NAR data show that in 2012 the median income of a second homebuyer was $92,100. While that income level is above the national median, it is not the definition of "rich" that lawmakers targeted in recent tax debates.

NAR's second-home survey also shows that the age of second-home purchasers is increasing. After remaining flat (at around age 45) during the period 2004 – 2008, the median age of second home buyers in 2012 was creeping toward 50, suggesting that owning a second home is as much a retirement strategy as it is a recreation proposition. In fact, NAR research shows that 27 percent of second home purchasers in 2012 listed their top reason for purchase was to use the property as a principal residence in the future.

Finally, NAR has compiled data identifying all US counties in which more than 10 percent of the housing stock is second homes. Currently, about 900 of the nation's 3068 counties (roughly 30 percent) fall into this group. In some counties with very small populations, second homes can represent about 40 percent of the housing stock. In Meagher County, Montana, for example, the population is only 1,891 people, but second homes represent 42 percent of the housing stock. That area is doubtlessly dependent on the jobs and property taxes generated by those second homes.

Thus, about 30 percent of US counties have a stake in retention of the mortgage interest deduction for second homes. Those properties generate valuable jobs and property and sales taxes for the communities. To eliminate the MID for second homes would have at least as dramatic an impact on those communities as it would the taxpayer/owners themselves. Congress needs to carefully consider the economic impact on these communities, often located in rural areas with little other economic resources vs. the amount of revenue that could be raised from eliminating the deduction for second homes. The decline in home values and economic activity in those areas where the

economy is driven by second homeowners could very well eclipse the small amount of revenue that could be gained by increasing taxes on these homeowners.

Reducing the Amount of Qualified Mortgage Debt

Another proposal to "raise revenue" is to lower the cap on the amount of acquisition debt eligible for the mortgage interest deduction from $1 million to $500,000. As previously discussed, the $1 million limitation was put in place in 1987 and is not indexed for inflation. Consequently the value of the MID has eroded by roughly half in 25 years.

Critics of the MID argue that lowering the limitation to $500,000 would affect a relatively small number of wealthy taxpayers. In fact, research conducted on behalf of NAR shows that individuals in every adjusted gross income (AGI) class, even as low as $10,000, have mortgage debt in excess of $500,000. Those in the lower income ranges likely include those who are self-employed with minimal income after expenses, those who are business owners with significant losses or retired individuals with other tax-exempt income. No matter what the income category, however, reducing the cap would make their economic positions worse, particularly where there have been losses.

Further findings from research conducted for NAR shows over half of the taxpayers impacted by imposing a $500,000 cap on MID have AGI below $200,000.

Among those who itemize and claim MID, the AGI classes below $100,000 comprise 56 percent of all tax returns. These are primarily working families. Moreover, the AGI classes below $200,000 represent almost 90 percent of all itemized returns. Thus, the overwhelming majority of tax returns with MID are certainly NOT in so-called "Warren Buffett" territory.

Notably, taxpayers with AGI above $200,000 have far more resources with which to reduce their mortgage debt than do those with AGI of less than $200,000. Ironically, a $500,000 cap thus becomes less punitive for very high income taxpayers than it would be for working families – even fairly well-compensated ones with AGI around $200,000. These families have more constraints on their liquidity and cash flow than the very high income families.

A $500,000 cap has wildly divergent geographic implications. The burden of the cap would be disproportionately borne by taxpayers in high costs areas, even though they might not be categorized as "rich" and even though they may have fairly modest homes. Those living in high cost areas pay a disproportionately larger amount of their after tax income toward housing than do taxpayers in other parts of the country. Eliminating part of the MID for them would exacerbate that disparity and in fact make home ownership even less affordable for many families. Some have proposed addressing this geographic issue by tying the limits of the MID to area housing prices in a way similar to formulas used to calculate loan limits for the Federal Housing Administration (FHA). NAR would resist any effort to make the cap on the MID contingent on the taxpayer's place of residence. Such a change would impose significant complexity on what is currently a very simple provision.

Additional Residential Real Estate Provisions

In addition to the deductions for mortgage interest and property taxes paid, there are two other tax provisions that have a large impact on a family's ability to sell their home. One of these provisions is permanent and should be preserved while the other is temporary and should be made permanent.

Capital Gains Exclusion for Sale of a Principal Residence

Prior to 1997, the tax rules that governed the sale of a principal residence were complex and largely ignored (Section 1034 of the Internal Revenue Code). The general rule was that there was no recognition of gain, so long as the seller purchased a home of the same or greater value within a specified time. (This was a particular disadvantage to individuals who relocated from a high cost area to a lower cost area.) The deferred gain from the sale reduced the basis of the new home. Other elaborate rules required taxpayers to track the adjusted basis of the homes they owned so that, in the event that they did not purchase a replacement home (or purchased a replacement home of lesser value), the gain on that sale became taxable, as measured from the adjusted basis. Few taxpayers had adequate understanding of the law or sufficient records to enable them to comply with these rules.

In 1997, the Clinton Administration, without input from NAR or others in the housing industry, proposed a complete overhaul and simplification of these rules. Rather than require elaborate basis computations on multiple residences over a term of many years, the new rule simply permitted the seller to exclude up to $250,000 ($500,000 on a joint return) of the gain on the sale. Any excess above these amounts would be currently taxable at the capital gains rate for the year of sale. The reinvestment rules were eliminated, so taxpayers gained mobility and flexibility. The exclusion gives them the ability to downsize, buy more than one property, purchase a non-real estate asset or do anything they choose with the proceeds of the sale. The exclusion is restricted to the sale of only a principal residence, and certain qualifications must be satisfied in order to receive the benefit of the exclusion. As with the MID, the $250,000 and $500,000 amounts are not indexed for inflation.

Some have suggested reducing the amount of the exclusion on the rationale that home values have declined so the amount of excludable gain should decline, as well. NAR rejects this reasoning. In fact, homeowners have a very justifiable claim that they made a major contribution to any appreciation in their home, and so should be allowed to retain what, for many, would be the full value of that appreciation.

No data is publicly available that allows either NAR or its consultants to evaluate the impact of possible changes to these rules. No public IRS records present information about Forms 1099 that are filed for home sale transactions, and no capital gains data are separately presented to show the amount of taxable gain reported on homes sales in a particular year. In addition, there is no way to ascertain the value of unrecognized gain that has accumulated in homes that are not currently on the market. Finally, long-term holders are far more likely to have larger appreciation amounts and so should not be penalized for that long tenure.

We note that this provision is among the most taxpayer-friendly sections in the entire Code. When enacted, it was a substantial simplification from prior law. It allows a great deal of flexibility in the

financial planning for families. Notably, the gain on the sale of a principal residence is a significant factor in the retirement savings plan of many older Americans. They anticipate downsizing and then using the remaining proceeds to supplement any retirement income they have. Prior law penalized individuals over age 55 by limiting an exclusion to just once in a lifetime. Today's rules reflect far more accurately the homeownership patterns over a lifetime. The exclusion functions as a sort of "Housing Roth IRA" in that the gains made over long periods (in many cases with improvements made from after-tax dollars) are free of tax at the time of sale. At a time when policymakers are contemplating changes to entitlement programs and Americans are struggling to save more for retirement, Congress should continue to recognize the important role the principal residence exclusion plays in supplementing retirement savings. NAR urges Congress to retain the exclusion at current levels or secure its importance for future generations of homeowners by indexing it for inflation.

Cancellation of Mortgage Indebtedness for Principal Residence

Under general tax principles, when a lender cancels a portion or all of a debt, including mortgage debt, the borrower is required to recognize the forgiven amount as income and pay tax on it at ordinary income rates. An exception is provided for some mortgage debt that was or will be forgiven between January 1, 2007 and December 31, 2013. When this relief was initially considered in 2007, the Ways and Means Committee reported it as a permanent provision. The final version, however, was temporary and in place only through December 31, 2009. That date was extended through December 2012 as part of the flurry of legislation enacted at the height of the 2008 financial crisis. The American Taxpayer Relief Act of 2012 subsequently extended the expiration date to December 31, 2013.

While the volume of short sales and foreclosures has receded from record highs, there are still a significant number of families struggling to keep up with their mortgage payments and banks are still working to conduct loan modifications as a result.

NAR believes the tax code should not discourage homeowners from trying to take proactive steps to avoid foreclosure by taxing them on phantom income, especially when the federal government has devoted considerable resources to help modify mortgages and lessen the impacts of foreclosure.

We urge Congress to make mortgage cancellation relief a permanent provision.

Additional Views on Proposed Tax Systems – The Flat Tax and The Fair Tax

While we recognize the prospect of converting the entire tax code to a completely new system of taxation is not necessarily the goal of the Committee, we do wish to briefly note our views on the proposed Flat Tax and Fair Tax models to indicate our passion about them.

NAR aggressively opposed the flat tax as it was proposed in 1995 by then-Representative Dick Armey (R-TX) and later during the 1996 Presidential primary campaign of Steve Forbes. The Armey-Forbes flat tax, based on the so-called Hall-Rabushka model, would have repealed all deductions, including the mortgage interest deduction and state and local tax deductions.

Our internal research and the research of outside experts consistently has shown that *an overnight or even a phased loss of these deductions would cause the value of existing housing to fall by as much as 25 percent. The average loss of value would be 15 percent. This is simply unacceptable, particularly because our research also has shown that this loss of value is never fully recouped.*

Under current law, no federal-level tax applies to the purchase of a house. Thus, we would oppose any new, transaction-type tax on the sale or purchase of a house. We have no formal position on the system set forth in the National Retail Sales Tax ("The Fair Tax"), but we are dismayed that the sales tax rate of that model would likely range between 30 percent and 45 percent of the price on a tax-exclusive basis.

We are unable to imagine how buyers, sellers or housing markets could bear the burden of The Fair Tax. We question whether prudent lenders would or should finance the sales tax cost, as a long-term financing mechanism would almost certainly require mortgages that would exceed either the fair-market value or the after-tax value of the home.

If a home that had been subject to the sales tax were sold before the sales tax liability had been extinguished (which we believe would be the general case), the owner would likely realize no cash, as the outstanding tax and mortgage liabilities could easily use up most or all of the proceeds from the sale. Short sales would be epidemic. Thus, a tax on home purchase is ill-advised.

Commercial Real Estate Tax Provisions

Commercial real estate is a significant driver of our economy. Commercial real estate values are often more sensitive to tax changes than those of residential real estate simply because of the complex structure of commercial real estate deals and in the sheer dollar amounts involved to build, develop and operate commercial buildings. Dramatic changes to the tax code in 1986 for commercial real estate sparked a major decline in real estate values. NAR urges Congress to look carefully at the lessons learned from the way changes were made in 1986, often without adequate transition. It should be a warning to tread carefully before considering any major changes to existing commercial real estate provisions.

Depreciation of Leasehold Improvements

Until 2004, the Internal Revenue Code required that depreciation of leasehold or tenant improvements (TI) be taken over the statutory life of the building structure itself – 39 years – rather than over the economic life of the improvements. In 2004, legislation was enacted that temporarily reduced this 39-year depreciation period for TI to 15 years, a period more reflective of the true economic life of TI in the modern commercial real estate market. Since then, the provision has expired several times, but each time has been extended by Congress for short periods.

The latest extension of the shorter 15-year depreciation schedule for qualified leasehold improvements expired at the end of 2011, and the law reverted to the 39-year depreciation schedule.

Fortunately, the 15-year depreciation period was extended to December 31, 2013, on a retroactive basis by H.R. 8, The American Taxpayer Relief Act of 2012, (the "Fiscal Cliff" legislation), which was signed into law on January 2nd by President Obama.

Congress has recognized over and again that requiring property owners to amortize the costs of tenant improvements over a recovery period that has no relation to the economic life of the assets makes no sense. Such treatment artificially depresses rates of return. Correcting the depreciation rules and the tenant improvement amortization rules allows upgrades for technology and modernization to be more economically feasible. These types of improvements assure that nonresidential buildings will be adequately maintained and remain technologically current. Updated and well-maintained properties are more readily bought and sold, spurring economic growth.

Longer depreciation periods for TI result in longer recovery times and less of a return on investment for building owners, creating disincentives for them to upgrade and modernize space for their tenants.

Constant renewal of expiring tax provisions in annual tax extenders legislation has become more controversial and over the years has become politically more difficult, despite most of the provisions enjoying broad bipartisan support. Having to each year extend 15-year qualified leasehold improvement depreciation creates needless uncertainty for the commercial real estate sector, and hinders our nation's economic recovery.

NAR supports efforts to establish a permanent rule that more accurately reflects the depreciable lives of buildings and to conform amortization periods for tenant improvements more closely to the term of the lease. NAR supports the 15-year recovery period, but urges Congress to enact an even shorter term.

Taxation of Carried Interests

Many partnerships (including real estate partnerships) are organized with general partners, who contribute their expertise (and, in some cases, capital) and limited partners who contribute capital in the form of money and/or property to the enterprise. Generally, any profits of the partnership are divided among the limited partners. A common practice, however, is to provide additional incentive for the general partner to perform well by sharing some of the profits above a certain "hurdle" rate with him or her through a "carried interest," even when the general partner contributed little or no capital to the enterprise. The general partner's profits interest is "carried" with the property until the property is sold, which can be a number of years after the enterprise is formed and limited partners have received profit distributions.

During the time the property is held, the general partner receives compensation through management fees that are taxed as ordinary income. The limited partners can receive both ordinary income from operations and capital gains from any profits generated during the year. When the property is sold, the limited partners receive their profits distribution (the earnings on the capital they invested) as capital gains. If the venture is successful, the general partner then also receives the value of any carried interest as capital gains income.

The carried interest provision is not a specific provision of the tax law that was enacted in order to provide an incentive or tax benefit to general partners who receive carried interests. Rather, it is an integral product of the flexibility Congress imbued in the tax rules for partnerships more than 50 years ago. Under partnership taxation, each partner contributes his or her unique assets, and the

partners have great flexibility to divide the gains in any way they deem appropriate. The current tax treatment of carried interests is based on the established partnership tax principle that partners are taxed based on their share of partnership income (ordinary or capital gains), rather than based on the character of the partner (general or limited) to whom the income is allocated. The partnership structure has been a huge success, giving investors and entrepreneurs in many industries the tools to create and grow businesses, build shopping centers, found technology companies, and create millions of jobs.

It is unclear how much revenue could be generated by changing the taxation of carried interests. Some tax policy experts believe that talented entrepreneurs would simply find other ways to structure new ventures to avoid the higher tax. Others argue that some deals that now make economic sense would simply not be done in the future, since a higher tax would increase the hurdle rate of return. Moreover, Congress itself seems torn on how to approach the issue, with some proponents of changing the tax rules urging that certain industries, such as real estate and venture capital, be exempt from the change. Such an approach would likely reduce any possible revenue raised by a significant amount. Other policy makers argue that the change should be made prospective only, which would also likely reduce any new revenue by a large amount.

NAR believes that the current-law treatment of carried interests helps better align real estate managers' interests with those of investors and has played an important role in economic development and job creation. Changing the tax treatment to increase the rate of tax on general partners would decrease potential rates of return on successful ventures and raise the hurdle rate, resulting in fewer ventures being funded, and less economic growth and job creation.

Depreciation of Buildings

Depreciation is the loss in value of an asset, such as a building, over time due to wear and tear from usage, physical deterioration, obsolescence, and age. The cost of producing or acquiring an income-producing property can be recovered over the useful life of the asset which is determined by the tax law. Current law provides that residential income property must be depreciated over a 27.5 year period using straight line depreciation. Commercial income property must be depreciated over 39 years using straight line depreciation. Straight line depreciation stipulates that an asset be depreciated by equal amounts each year over its useful life.

Current depreciation lives are too long. The current law depreciation lives were arbitrarily selected for political and revenue reasons and do not reflect the economic life of structures. The 27.5- and 39-year cost recovery periods for real property should be shortened.

Studies by Treasury, Congress, and the real estate industry have repeatedly concluded that the current tax depreciation lives for both non-residential structures and for residential structures are too long – exceeding the actual useful lives of such properties (physical wear and tear as well as technological obsolescence).

A more realistic rate of return on depreciable assets would make real estate a more attractive investment. Policymakers should reduce the period over which non-residential and residential structures are depreciated to between 22 - 24 years, which would enhance economic growth and create jobs.

Conclusion

NAR would like to thank the Committee for its open and collaborative process as it seeks to reform our Nation's tax code. In order to devise a fairer and simpler tax code, the input of stakeholders at all levels is imperative to avoid unintended consequences.

The residential and commercial real estate industries in America are large drivers of the economy. The Nation has been led out of four of the last six recessions by a recovery in the housing market and it appears that housing is poised to lead us to yet another economic recovery. Commercial real estate adds value to the places that we work, conduct commerce, and play.

Despite the price declines, foreclosures, and economic hardship that has befallen our housing market in the past five years, Americans remain committed to the principles of homeownership. They continue to hold the vast majority of their personal wealth in their homes. They continue to believe that ownership of real property is part of the American Dream that was envisioned from the very beginning by our Founders. That is why even high numbers of those who rent consistently support tax incentives for home ownership. Congress should continue to support these same ideals as it seeks to reform the tax code.