The following is the official statement of the National Association of REALTORS® for the Ways and Means Hearing entitled, "TAX REFORM: WHAT IT MEANS FOR STATE AND LOCAL TAX AND FISCAL POLICY" held on March 19, 2013.

Attribution for this statement should be made to the National Association of REALTORS® or Gary Thomas, 2013 President of the National Association of REALTORS®.

Please feel free to contact me should you have any questions about this submission.

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STATEMENT OF THE NATIONAL ASSOCIATION OF REALTORS®

SUBMITTED FOR THE RECORD TO THE UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON WAYS AND MEANS

HEARING ON

TAX REFORM: WHAT IT MEANS FOR STATE AND LOCAL TAX AND FISCAL POLICY

MARCH 19, 2013

The NATIONAL ASSOCIATION OF REALTORS® (NAR) is America's largest trade association, with one million members. NAR represents a variety of real estate professionals engaged in all aspects of the residential and commercial real estate industries. Their activities include real estate sales and brokerage, property management, residential and commercial leasing and appraisal. A REALTOR®'s business 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.

As professionals who deal in the exchange of real property, REALTORS® are constantly aware of the balance between providing sufficient local services while not overburdening property owners with tax obligations. Most importantly REALTORS® believe that real estate should be subject to a single level of taxation.

Preserving the Deduction for State and Local Taxes

The income tax system of the United States has provided a deduction for state and local 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 recognizing the taxpayer's ability to pay.

Double Taxation. 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 fund essential government functions. 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). Federal tax law follows this same principle in connection with payments of taxes to other nations. Only in this case, 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.

Ability to Pay. While state and local taxes vary greatly, two aspects of them that do not vary 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 of 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.

Promoting Home Ownership

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. Our tax system has, from its inception, featured a deduction for real property taxes. The value of this deduction, along with the mortgage interest deduction, is deeply embedded in the price of a home. While economists agree that there is no accurate measure of the value of these embedded tax benefits, they all generally agree that the value of a particular home includes tax benefits.

The NATIONAL ASSOCIATION OF REALTORS® remains committed to preserving current law incentives for homeownership. Moreover, REALTORS® emphasize that there could not be a worse time for even considering changes to these incentives. With the housing market just recently beginning to show signs of life, and the housing finance system still staggering from the horrors of the market crash that began in 2007, we can see no benefit to tax law changes that could stymie the nascent housing recovery and put the brakes on one of our economy's major growth engines.

Moreover, real estate is the most widely-held category of assets that American families own, so changes to its tax treatment will have far-reaching consequences in the economy, as well as on the retirement prospects of homeowners. Any change that would erode the value of the tax incentives to homeownership could represent a net tax increase on a group of Americans that currently pays 80 to 90 percent of all federal income taxes.

Importance of the Real Property Tax Deduction

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 largest one 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).

<u>Answering the Critics</u>

Critics: Only a third of taxpayers itemize deductions. While it is true that in any particular year only about a third of individuals itemize deductions, this figure is a snapshot. Over the course of an owner's tenure in a home, an individual may itemize in the early years of homeownership, when the mortgage interest expense is high relative to the principal paid, but then not itemize in later years. Mortgages get paid off, other itemized deductions rise and fall, individuals down-size, divorces occur, a spouse dies or needs to simplify his or her living arrangements. These and other life events may convert itemizers into standard deduction taxpayers.

A survey conducted for NAR in 2011 by the Harris polling organization projected homeowners' understanding and utilization of the mortgage interest deduction. That survey showed that 54 percent of homeowners polled currently claimed the mortgage interest deduction, but an additional 16 percent had taken it in the past. Thus, over time, at least 70 percent of homeowners have claimed mortgage interest as an itemized deduction. Including in these figures the deduction for real property taxes only increases these percentages, since all homeowners pay property taxes.

Moreover, one can easily argue that those who utilize the standard deduction – both homeowners and renters – are actually receiving the benefit of the deduction for mortgage interest and for property taxes. This is because the standard deduction, which is a simplification measure added to the tax law by Congress in 1944, is based on a composite basket of typical deductions, including the mortgage interest deduction and the state and local taxes deduction. The legislative history clearly shows that Congress intended the standard deduction to be a proxy for allowable itemized deductions, both when it was adopted and when it has subsequently been increased. Thus, the notion that only those who itemize get the benefit of these homeowner incentive deductions is incorrect. In fact, those who claim the standard deduction actually receive a proportionally deeper subsidy than those who itemize. For example, a married couple's total state and local tax, mortgage interest, and charitable contributions might be $10,000. With the standard deduction currently at about $12,000, the standard deduction couple would be receiving tax benefits for $2,000 in expenditures they never made. If they were in the 28 percent bracket, that would amount to a $560 tax "freebie." ($2,000 excess x 28%).

Critics: The "wealthy" predominantly benefit from the real property tax deduction. 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, in 2012 three-quarters of the value of real property tax deductions 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.

Conclusion

The National Association of REALTORS® encourages the Committee to retain the federal deduction for state and local taxes in its effort to reform the federal income tax. Seventy-Five million homeowners pay property taxes and all of them, either through the standard deduction, or by itemizing their returns, avoid being taxed twice by government on the value of their most important asset.