

House Taxation Committee

Testimony on HB 2560

Kansas Society of Certified Public Accountants

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Two major elements of HB 2560 constitute a de-coupling of the Kansas tax statute from the Internal Revenue Code. Specifically, the bill provides for the exemption of small business income and the elimination of itemized deductions for all Kansas individual taxpayers. Historically, the Kansas Society of Certified Public Accountants (KSCPA) has opposed any proposed legislation de-coupling from the federal statute due to complexities created by the de-coupling.

It is important to be cognizant of the fact that the de-coupling of small business income and itemized deductions has no effect on the taxpayers' federal income tax return. The small business income will continue to be taxed for federal purposes and the itemized deductions will continue to be deductible for federal purposes.

On the surface it may appear as if the two measures being de-coupled in the proposed legislation will not create complexity. However, the exemption of small business income from taxation in the current bill has not addressed all of the tax issues created by the de-coupling measure. Specifically, the taxpayers' basis in pass-through entities (partnerships and subchapter S corporations) and basis in depreciable property held by small businesses will ultimately impact the taxation of gain when the partnership interest or subchapter S corporation stock is sold or when the underlying depreciable assets of the small business are sold.

At the request of the Kansas Department of Revenue, we have provided language to alleviate the issue with reference to the taxpayers' basis in partnership interests and subchapter S stock. However, the Department of Revenue does not support addressing the inconsistency with reference to the depreciable assets due to potential negative fiscal impact in future years.

As you consider HB 2560 we urge you to utilize the members of the KSCPA to answer your questions regarding the ramifications of the bill on specific individual taxpayer groups. While considering the bill, you must also keep the **BIG PICTURE** of the bill in focus and not necessarily focus solely on the positive or negative aspects of any particular provision in a vacuum.

While Kansas continues to impose an income tax, there will be arguments of inequity espoused by many parties if it appears that one party is realizing a benefit not realized by all. Under the bill, calendar year 2013 is the first year of implementation of the proposed changes. In 2013, all taxpayers receive a rate reduction and many taxpayers will lose either certain credits or deductions that they have been accustomed to receiving.

While 2013 is the initial year of the bill, the future benefit of tax reductions will continue to the vast majority of Kansas taxpayers with the lowering of income tax rates as state tax receipts increase in future years. Through the implementation of these future rate reductions, all Kansas taxpayers will see

additional reductions in their Kansas income tax liability. Ultimately, it is the plan that the Kansas income tax for individuals will be eliminated and the playing field will be level for all.

Statistics provided by the Kansas Department of Revenue for the 2009 tax year, the most recent year available, indicates that there were 1,361,873 individual income tax returns filed and out of this number, 416,403 itemized their deductions. Kansas taxpayers with adjusted gross income of \$50,000 or less totaled 900,752, 66% of the total and of these, 14% or 128,243 itemized deductions.

The elimination of itemized deductions for Kansas taxpayers will not necessarily result in an increase in their ultimate Kansas income tax due to the fact that the tax rates are being lowered and a standard deduction will be available.

Concern is being voiced by some parties regarding the loss of the itemized deductions as it relates to charitable contributions and the home mortgage interest. The concerns are legitimate, but it is important to put into financial context the magnitude of the Kansas income tax savings from these two deductions.

- The respective deduction is available only if the taxpayer itemizes deductions.
- The Kansas income tax brackets are being reduced to a two bracket system with 3% being the lower rate and 4.9% being the highest.

Accordingly, \$100 of deduction, whether it is the charitable contribution or the home mortgage interest deduction, will save the Kansas taxpayer from \$3.00 to \$4.90.

To illustrate further, I researched the December 2011 Kansas home sales and found that the median price of a home sold in the state of Kansas in December was \$126,000 and the interest rate for a 30 year fixed rate mortgage was 3.96% (Kansas Ass'n. of Realtors data). Based upon these amounts, a Kansas taxpayer buying a home at the median price and paying the stated interest rate would pay a maximum of \$4,989.60 of interest in the initial year of the mortgage. At an income tax rate of 4.9%, the Kansas income tax benefit from this deduction is \$244.49. To determine whether the taxpayer will pay more tax as a result of the loss of this deduction will depend upon the level of their standard deduction and the amount of the Kansas adjusted gross income.

As a conformity state with the federal tax statute, Kansas taxpayers will be impacted by conversations occurring in Washington, D.C. today. It is also the goal of our members of Congress to broaden the tax base and lower income tax rates for federal purposes. Items being considered in Washington also include disallowing and or limiting itemized deductions. As the federal government broadens its tax base through the elimination or limiting of itemized deductions, fewer Kansas taxpayers will be eligible to itemize their deductions for federal purposes, and accordingly for Kansas purposes.

In conclusion, the KSCPA is in favor of reducing taxes for everyone, in favor of reducing the complexity of our tax system in favor of growth and prosperity. But we are neutral overall, because we represent your full constituency and within that constituency there are winners and losers with the bill as proposed.