



April 12, 2013

The Honorable Dave Camp
Chairman
Committee on Ways and Means
House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

The Honorable Sander Levin
Ranking Member
Committee on Ways and Means
House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Chairman Camp and Ranking Member Levin:

NAIOP, the Commercial Real Estate Development Association, is the leading organization for developers, owners, investors, and related professionals in office, industrial and mixed-use real estate, with 15,000 members and 48 local chapters throughout the United States. We thank you for the opportunity to provide comments and recommendations on the important issue of comprehensive tax reform, on behalf of our members in the commercial real estate industry.

Commercial real estate development and construction is critical to the strength of our national economy, with direct construction spending and related economic impacts generating a significant financial contribution to state and local economies. During the construction phase, new commercial projects provide jobs. Even after completion, however, commercial buildings continue to add to the productive capacity of their communities. The outlays that support the operations of new buildings are ongoing sources of economic vitality which accumulate over the life span of commercial buildings. Our financial institutions hold trillions of dollars in commercial real estate-



related debt, magnifying the importance of the continued economic health and vitality of the industry to the overall economy.

Because of the enormous role that commercial real estate plays in our economy, the task of simplifying and streamlining our overly complicated tax code will have far-reaching implications for the industry and our nation. If done correctly, tax policy changes that are part of a comprehensive rewriting of the tax code and are based on good tax policy reasons could lead to greater capital formation, encourage entrepreneurship, and provide stability and predictability for investors. However, prior tax reform efforts have damaged our industry because changes were made without proper consideration for adequate transitions to a new regime. The 1986 Tax Reform Act created severe economic dislocations in the real estate sector, adversely affected our financial institutions, and had a negative impact on many sectors of our economy.

In order to ensure that your efforts at comprehensive tax reform result in a tax code that promotes economic growth and encourages entrepreneurship, while maintaining a strong commercial real estate sector, we respectfully suggest the following broad, governing principles:

- Entrepreneurship and responsible risk-taking should be encouraged to ensure continued vitality in our markets. Our tax code should maintain a differential and lower rate for capital gains that rewards these activities;
- Tax provisions, to the extent possible, should be a *permanent* part of the tax code, and not be dependent on short-term, congressional reauthorizations. This will provide stability and predictability for both investors and owners, allowing them to plan for the long-term;



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- Tax policy provisions should be assessed and changes made to existing laws because such actions are the right tax policy over the long-term, not for short-term budgetary reasons or to offset the costs of other changes;
- Tax reform changes should take into account existing investment relationships and the impact of these changes on business entities, and provide fair and adequate transition periods designed to minimize economic dislocation. The impact of tax policy changes should be prospective, not retroactive, to the extent possible.

We believe adhering to these principles will result in rational changes to our tax code that achieves your goals of added simplicity, predictability and fairness, without causing unintended or unfair harm.

Specifically regarding certain provisions and matters affecting the commercial real estate industry, we provide the following recommendations:

Carried Interests, also known as “promoted interests” or “promotes”, have been a feature of the commercial real estate development industry for many years. In many real estate development partnerships, carried interest compensation – which is not guaranteed income but in fact is dependent on the ultimate success of the real estate development venture -- is provided to a general partner by the investors in the venture. Such compensation exceeds the proportionate share of the capital invested by the general partner, and is provided to align the interests of the general partner with the investors. A carried interest is designed to ensure that all partners benefit in the long-term success of the project. Carried interest compensation has been treated as a capital gain, and taxed at lower capital gains rates.



In the real estate context, carried interests have not been controversial. However, proposals have been offered to change the tax treatment of carried interests from their current capital gains to ordinary income, taxable at higher rates, reflecting the belief that many who receive carried interests are not taking risks but in fact performing services.

In fact, a general partner in a real estate venture is at risk for not only capital contributions to the partnership, but also for all partnership liabilities, such as environmental contamination and lawsuits, and often guarantees construction completion and payment of debts. Moreover, a carried interest in a real estate venture is far from guaranteed income, and should not be compared to guaranteed salary taxable at ordinary income rates. Real estate development also involves a capital asset, which remains in the community, making ongoing contributions to the economy. For these reasons, we believe carried interests are more like capital gains than ordinary income.

Changing the tax treatment of carried interests would have a retroactive impact and disrupt the existing investment relationship between many entrepreneurs and their capital finance partners. While it is reasonable to expect an entrepreneur to be prepared for changing tax rates, it is unfair to change the *character* of income and apply that retroactively to existing partnerships that have undertaken long-term development ventures. We remain opposed to proposals to tax carried interest at ordinary income rates because we believe this will adversely impact the flow of capital to real estate deals.

Leasehold Improvement Depreciation (also known as tenant improvement depreciation) is the ability to deduct the cost of the customized improvements a building owner makes to a rental space to configure it for a tenant's needs. The



current code provides for a 39-year depreciation period, but temporary provisions repeatedly passed by Congress (“tax extenders”) have provided for 15-year depreciation for qualified leasehold improvements.

Clearly, leasehold and tenant improvements do not last for nearly four decades. In fact, they characteristically last five to ten years across all commercial sectors, or the average length of a lease term. The 15-year depreciation period more closely and accurately reflects economic reality. Longer depreciation periods result in higher capital costs for building owners, creating disincentives to upgrade and modernize the space for their tenants. In 2011, leasehold improvement outlays of more than \$15.5 billion added nearly \$45 billion to the U.S. economy, and supported nearly 342,000 jobs.

Fifteen-year qualified leasehold improvement depreciation should be made a permanent feature of the tax code, which will provide the industry with the stability and predictability needed to encourage these capital improvements.

Brownfields Remediation Expensing allows for the expenses incurred in the cleanup of a brownfield site to be immediately expensed by a developer. The development of these sites is of critical importance to the economic prosperity and revitalization of many communities. This provision has enjoyed strong bipartisan support because it helps bring currently underutilized or unproductive properties into productive use. As a consequence, continuation of this policy adds to the overall economic productivity of our nation.



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The brownfields remediation expensing tax provision has in the past been renewed on a temporary basis, included in "tax extenders" legislation, but has since expired and not been renewed. We suggest that brownfields expensing be reauthorized and included as permanent feature of the tax code.

Thank you for the opportunity to offer our recommendations on comprehensive tax reform. Please be assured that as you go forward in your efforts toward a simpler, fairer tax code that promotes economic growth, NAIOP will continue to work with you and the members and staff of the Ways and Means Committee to ensure that future tax policy remains supportive of the economic health of the commercial real estate industry.

Sincerely,

A handwritten signature in black ink that reads "Thomas J. Bisacchino". The signature is fluid and cursive, with a long horizontal stroke at the end.

Thomas J. Bisacchino
President and CEO