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April 15, 2013

Congressman Sam Johnson
US House of Representatives
Washington, DC 20515

Congressman Bill Pascrell
US House of Representatives
Washington, DC 20515

Dear Representatives Johnson and Pascrell,

On behalf of the International Council of Shopping Centers (ICSC), I would like to thank you for your efforts to consider potential reforms to the tax code related to the real estate industry. Founded in 1957, ICSC is the premier global trade association of the shopping center industry. We represent more than 50,000 shopping center owners, retailers, developers, managers, marketing specialists, investors, professional service providers and brokers, as well as academics and public officials.

ICSC and our members have significant concerns about potential changes to the tax treatment of pass-through entities generally and the tax items that particularly impact real estate such as capital gain rates, carried interest taxation, FIRPTA reform, and §1031 like-kind exchanges. In particular our members are concerned about the impact on raising capital through harming the after-tax return on investment and crowding out or disadvantaging investment in retail real estate as compared to other investment opportunities. Significant changes in any of these areas could cause unintended consequences to the industry, the financial institutions that are invested in real estate and the economy as a whole. The stability of existing jobs and future employment growth is at high risk because of the negative implications these proposed changes could have. As I am sure you are aware, the 1986 Tax Reform Act was extremely detrimental to the commercial real estate industry. It is ICSC's hope that significant attention will be focused on making sure that the unintended consequences of the 1986 Act are not repeated, and our membership is actively participating in the debate to help make sure that changes to the tax code do not disproportionately impact our industry.

Under current law, ICSC's members are typically not subject to corporate taxes, since they are generally organized as pass-throughs or as Real Estate Investment Trusts ("REITs".) As a result, much of their income is taxed at the lower capital gains rate. Up to this point, the stated goal of tax reform has been to lower corporate tax rates by broadening the taxable base. Because the real estate industry would not directly benefit from lower corporate tax rates, the reform could materially harm real estate, reminiscent of the collapse that occurred after the 1986 Tax Reform Act. Thus if there is any base broadening affecting real estate it is imperative to offset it with lower individual tax rates while maintaining capital gains rate preferences that encourage long-term investments like real estate. Additionally, we believe that there should be significant attention given to transition rules and a limit on the potential for retroactive impacts of changes to the tax code.

Business Interest Deduction

The retail real estate industry practices efficient capital redeployment that relies on a combination of debt and equity financing for both initial acquisitions and refinancing of existing properties to untie funds for new equity investments. Thus, any limitation to the deduction of business interest expense would have a very significant impact on the real estate industry.

Carried Interest

ICSC is very interested in maintaining the current tax treatment for carried interest for a general partner in a real estate partnership. The carried interest model has been used in real estate partnerships for more than 50 years as a way for investing partners to recognize the non-capital risk absorbed by the general partners such as personal recourse on debt and specific business liabilities such as unforeseen environmental remediation or construction cost overruns.

The ramifications of a change in character of carried interest income (i.e. capital vs. ordinary) and/or the tax rate applicable to carried interest for real estate partners would be significant. In addition to higher rates on future value growth, this tax change would be a retroactive tax increase since it would apply to built-in gains earned *before* enactment but recognized *after* enactment. Further, the legislation would have the effect of accelerating certain gains when the partnership distributes property to the service partner and also have the effect of suspended service partner deductions relating to the carried interest.

Depreciation

For several years ICSC has advocated for depreciation schedules which are more in line with market practices for replacing certain building components such as roofs and for updating retail space to reflect consumers' expectations and government regulations. We strongly believe that depreciation schedules should more closely reflect market practices than they have in the past.

§1031

The §1031 tax-free like-kind exchange rules are a critical component in the efficient deployment of capital by allowing retail real estate owners to provide economic development in a restricted capital market. For decades, §1031 has enabled individual investors and businesses of all sizes to utilize their capital more efficiently by deferring the capital gains and depreciation recapture taxes on sales of certain assets that are replaced via an exchange with property that is considered like-kind. Like-kind exchanges are an integral part of the operations of retail real estate related businesses and are particularly important to REITs who would otherwise be forced to distribute taxable income to maintain REIT qualification or may trigger gain that may subject it to tax protection obligations.

Development Incentives

In addition to the specific areas mentioned above, we would like to point out the importance of current law related to development incentives on jobs and economic development. Many development projects would not be viable without programs such as the New Markets Tax Credit, the historic rehabilitation tax credit, and tax-exempt state and local bonds.

Phantom Income

We are supportive of changes to the tax on income related to the cancellation of debt that were included in the financial products draft. In recent years, the tax on income attributable to debt cancellation (i.e. phantom income) has been particularly hard on our membership.

FIRPTA

We are supportive of current efforts to reform the current FIRPTA rules that greatly inhibit foreign investment in U.S. real estate. FIRPTA serves to materially limit needed capital for U.S. real estate, which is truly a global investment. It serves to needlessly complicate and inappropriately penalize investors at a time when the U.S. should be encouraging investment.

Rewrite Section 118(a)

For several years, ICSC has been advocating for a re-write of Section 118(a) of the Internal Revenue Code. Currently, Section 118(a) provides that "[i]n the case of a corporation, gross income does not include any contribution to the capital of the taxpayer." Because the literal language of Section 118(a) is limited to corporations, corporations that receive capital contributions from non-owners are subject to non-recognition treatment, whereas the current position of the IRS is that partnerships are subject to tax upon the receipt of identical capital contributions. The limitation of non-recognition treatment under Section 118(a) to corporations results in disparate treatment of partnerships without any policy justification. During conversations with staff of the Joint Committee on Taxation and the staff of the Ways and Means Committee, a recommendation has been made for a broader re-write of Section 118(a) concepts that would not be dependent on whether the recipient is a corporation or a partnership. This change would bring the tax code in line with common law principles on this matter and would provide equitable treatment to corporations, pass-throughs and sole proprietorships that receive a contribution from an entity that does not have an ownership stake.

Conclusion

While we see many areas of apprehension along with areas of opportunity, we are most concerned about how certain changes to the tax code may impact our industry when combined. For instance, an across the board increase to capital gains rates alone would be detrimental to the retail real estate industry, but combining this change with other modifications of the tax code such as §1031 exchanges, could be disastrous.

Once again, thank you for your careful deliberation of the potential impact of tax reform on the retail real estate industry and we look forward to working with you as the process to reform the tax code moves forward.

Sincerely,

Jennifer Platt
International Council of Shopping Centers
Vice President, Federal Operations