The Real Estate Roundtable

April 15, 2013

The Honorable Sam Johnson
1211 Longworth House Office Building
Washington, DC 20515

The Honorable Bill Pascrell, Jr.
2370 Rayburn House Office Building
Washington, DC 20515

Dear Representatives Johnson and Pascrell:

I want to thank you for the opportunity to present The Real Estate Roundtable's priorities on tax policies to you on April 12. We appreciate the tremendous efforts that you, your Ways and Means colleagues, and staff are devoting to gather information from diverse stakeholders on the complex issues surrounding comprehensive tax reform. We hope you will continue to use The Real Estate Roundtable as a resource as you continue to examine tax issues and code provisions that affect the real estate sector.

To follow-up from our meeting, I have attached for the working group record the written presentation that we provided to you, and I wanted to briefly summarize several of the priorities that we discussed with suggested solutions to further our joint interests in pro-growth tax reform:

- ***Previous tax reform provides lessons***. As much as we welcome a simpler, more rational tax code — and any associated improvements in U.S. competitiveness abroad — we continue to urge that comprehensive tax restructuring be undertaken with caution, given the potential for tremendous economic dislocation. As history illustrates, the unintended consequences of tax reform can be disastrous for individual business sectors and the economy as a whole. A case in point is the 1986 Tax Reform Act, which included in a major change in the taxation of real estate investment applicable to existing investments, not just on a going forward basis. This "retroactive" tax reform had a tremendous destabilizing effect on commercial real estate values, financial institutions, the federal government and local tax bases.

  Proposed Solution:

  ✓ Do not apply tax increases to existing investments.

- ***Encourage greater foreign investment in U.S. real estate.*** The Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA") discourages investment in U.S. real property to the detriment of the overall economy. FIRPTA imposes a U.S. tax on gain realized by a foreign investor on the disposition of an "interest" in U.S. real property. FIRPTA establishes a discriminatory tax regime on foreign investment that unfairly singles-out real estate compared to other asset classes (*e.g.,* stocks and bonds) which do not face this tax.

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Proposed Solution:

- ✓ Repeal FIRPTA in its entirety.
- ✓ At a minimum, enact H.R. 2989 from last Congress, the "Real Estate Jobs and Investment Act" (co-sponsored by Reps. Brady and Crowley; companion legislation at S. 1616) which would increase to 10% the percentage ownership without FIRPTA that a foreign investor may hold in a publicly traded REIT, and repeal IRS Notice 2007-55 relating to the taxation of liquidating distributions; as well as, enact the Administration's recent budget proposal to tax all foreign tax exempt pension plans in the same manner that US tax exempt pension plans are taxed on their US real estate investments.

- ➢ ***Depreciation schedules for buildings and leasehold improvements should reflect the useful lives of these structures and tenants' investments in them.*** Studies by Treasury, Congress and the real estate industry have concluded that the tax code's current depreciable lives for non-residential commercial properties (39 years) and residential properties (27.5 years) – exceeds the economic and technological useful lives of these buildings. Similarly, the depreciable period for tenant improvements – which is currently at 15 years, but is scheduled to expire at the end of 2013 and revert to 39 years – does not reflect business reality insofar as the duration of commercial leases is typically in the 7-10 year range.

Proposed Solutions:

- ✓ 25 years should be the depreciation period for non-residential structures; 20 years for residential.
- ✓ Ideally, the depreciation period for tenant improvements should be tied to the duration of a lease. As a proxy, 15 years should be the depreciation period for tenant improvements.
- ✓ These depreciation periods should be made permanent.

- ➢ ***Encourage greater energy efficiency in commercial and larger multifamily buildings.*** An "all of the above" national energy policy should consider tax incentives that do not only encourage energy *creation* (such as by oil, gas, wind, solar, etc.,) but energy *savings.* Dollar for dollar, Congress gets more "bang for the buck" with investments to spur building efficiency projects that avoid energy use, compared to more expensive projects that develop new energy sources. The existing tax deduction for energy efficient commercial and large multifamily buildings – at Section 179D of the tax code – should be extended and reformed to truly encourage retrofit projects that upgrade existing buildings (805 of existing buildings are estimated to still be in use in 2030).

Proposed Solution:

- ✓ Enact S. 3591 from last Congress, the "Commercial Building Modernization Act".

- ***<u>Acknowledge the true risks and "sweat equity" of real estate partnerships when considering carried interest proposals.</u>*** Carried interest has been used in the commercial real estate industry for several decades as an investment model for rewarding the general partner in small and large real estate business ventures, for taking on the risks and liabilities associated with real estate projects – such as navigating the unpredictable land development and assemblage process, litigation, environmental concerns, operational shortfalls, construction delays and loan guaranties. These kinds of investment risks – not borne by other market participants such as hedge fund managers – should be rewarded and encouraged. Taxing all types of carried interest as "ordinary income" will discourage entrepreneurial risk-taking by real estate partnerships, and thereby drive significant investment dollars out of the U.S. economy.

  Proposed Solution:

  - ✓ If Congress makes changes to the carried interest partnership tax rules it should recognize real estate's unique risk profile and long-term investment horizon. And, to preserve property values and equity among the partners, any change enacted should not be retroactive to existing partnerships investments, and the rules applicable to family limited partnerships should not be discriminatory.

- ***<u>Restore marketplace fairness by requiring on-line retailers to collect sales taxes, like "brick and mortar" stores do.</u>*** It is estimated that, in 2013, $23 billion in uncollected sales tax revenues were lost by state and local governments because on-line retailers failed to collect sales taxes. A "sale is a sale" regardless of whether the purchase take place on Main Street, at shopping centers, over the Internet or with a smart phone. Tax fairness in our 21st century marketplace accordingly requires that on-line retailers must collect sales taxes just like regular "mom-and-pop" and other stores.

  Proposed Solution:

  - ✓ Enact S. 336, the Marketplace Fairness Act (30 bipartisan co-sponsors).

Thank you again for the opportunity to present real estate's perspective on these important issues. We look forward to continuing our productive dialogues in the months ahead as Congress continues to study proposals for comprehensive tax reform.

Sincerely,

Jeffrey D. DeBoer
President and Chief Executive Officer

cc: The Honorable Dave Camp
The Honorable Sander Levin
Mr. Frank G. Creamer, Jr.