



International Council of Shopping Centers

**UNITED STATES
HOUSE OF REPRESENTATIVES**

COMMITTEE ON SMALL BUSINESS

**“Expiring Tax Incentives
and the Needs of Small Businesses”**

**STATEMENT OF
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THE KILDUFF COMPANY
ON BEHALF OF
THE INTERNATIONAL COUNCIL
OF SHOPPING CENTERS**

**1539 LONGWORTH HOUSE OFFICE
BUILDING**

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Thank you Chairwoman Velazquez and Ranking Member Chabot for conducting today's hearing on "Expiring Tax Incentives and the Needs of Small Businesses."

My name is Larry Kilduff. I am the Chairman of the Environmental Policy Committee and recent past Central Division Government Relations Co-Chair of the International Council of Shopping Centers ("ICSC"). I am also the president and founder of The Kilduff Company, a national retail development and consulting firm in Mequon, Wisconsin.

The Kilduff Company participates in development and consulting projects in all retail marketplaces. However, our passion and specialty is urban redevelopment and revitalization. We have made an indelible mark on neighborhoods throughout the United States by applying our unique talents and philosophy to assist communities and individual developers in their economic renovation efforts.

Founded in 1957, ICSC is the premier global trade association for the shopping center industry. Its more than 75,000 members in over 90 countries include shopping center owners, developers, managers, marketing specialists, investors, lenders, retailers and other professionals as well as academics and public officials.

I am appearing today on behalf of ICSC and its members who have been significantly impacted because the so-called tax "extenders" legislation continues to languish. This legislation contains a number of tax provisions that expired at the end of 2007 or are set to expire at the end of 2008.

In particular, ICSC supports immediate extensions of the 15-year depreciation for leasehold improvements, brownfields expensing, the new markets tax credit (“NMTC”) and a number of energy tax incentive provisions.

Fifteen-Year Depreciation for Leasehold Improvements

Prior to 1981, building owners could recover the costs of leasehold improvements over the term of the lease to the tenant. This reflected the fact that leasehold improvements for one tenant are rarely suitable for another. In 1981, a single depreciation life of 15 years was established for all buildings and all improvements made within. Later, the recovery period for all non-residential real property, including leasehold improvements, was increased to 39 years. This is clearly not a reasonable depreciation schedule for leasehold improvements. The American Jobs Creation Act of 2004 recognized this and provided for a temporary reduction in the depreciation period for the leasehold improvements from 39 years to 15 years, which better reflects the actual life of such improvements. ICSC believes that 15 years is a reasonable schedule for the depreciation of leasehold improvements and should be made permanent.

One of the most important obligations of shopping center owners is providing modern, efficient and environmentally-sound retail space for their tenants and the public. Owners must periodically refurbish and replace (usually every 5 to 10 years) many components of their buildings, including internal walls, partitions, lighting, plumbing, flooring and communication outlets, in order to meet the specific needs of their tenants and to comply with ever-changing government regulations. The 15-year depreciation period for such leasehold improvements more closely reflects the actual life of these improvements in light of market practices.

For example, in Alaska I know of a family-owned shopping center currently considering whether or not to move forward with an expansion of the center. The improvements to this property would lead to considerable associated economic activity, construction jobs, and investment in the local economy. However, the decision to make this investment at this time has to make economic sense. A 39-year depreciation schedule for the eventual leasehold improvements just does not make sense to this small developer, whereas the 15-year depreciation schedule that is more in line with the usefulness of the improvements will allow this project to move forward. The margin on this investment is so thin, that the depreciation schedule is a factor holding-up this expansion. Real business decisions are being made, and small businesses will not take on the risk associated with these investments without certainty about the tax consequences.

Brownfields Remediation Expensing

As a small developer who focuses on urban and suburban projects I have wrestled with more than my share of environmentally contaminated properties and have developed a great deal of experience with contaminated property cleanup and brownfields remediation programs.

Just as my example in Alaska shows the need for extending the expedited leasehold depreciation schedule, small businesses also need Section 179 expensing to be extended now. It is often a very expensive endeavor to clean-up a brownfields site. A small real estate business has to raise or contribute those funds upfront. A larger company may have the cash flow to float the investment, but a small guy does not. Being able to deduct legitimate business expenses each year is vital to small businesses with – by definition – small capitalization. This expensing provision is key to the economic decision making of small businesses.

Currently, I am involved in the early due-diligence stages of a 40 acre urban infill development in Kenosha, Wisconsin. The parcel is adjacent to a landfill that has been active for over 30 years. The degree of contamination is unknown, but the decision to acquire and clean this site will depend upon our ability to quantify the cost and the risk involved. The ability to utilize Section 179 brownfields remediation expensing is a large part of that decision-making process. If the project is not economically feasible, the City of Kenosha will lose a significant Senior Housing and multifamily residential development as well as the recreational area and projected increase in property tax increment of \$80 million at completion.

The Section 179 brownfields remediation expensing provision allows property developers to deduct the expenses of brownfields cleanups rather than require them to be treated as a capital improvement. In my opinion, it is inappropriate for the expenses associated with the mandated cleanup of previously contaminated real property to be charged as capital improvement costs and I strongly believe that expensing of brownfields cleanup costs should be made permanent. Until this provision can be made permanent, ICSC will continue to push for the temporary extension of brownfields remediation expensing as a key component to brownfields cleanup across the country.

The New Markets Tax Credit

The NMTC provides a tax credit to encourage private capital investment in eligible low-income communities. Thus, the credit encourages private investment in community development.

Indeed, the credit encourages new investment in the underserved areas that would not occur in the absence of these credits.

The NMTC plays an important role in redeveloping and revitalizing economically distressed communities. Therefore, it is imperative that the credit be extended, as these communities are already experiencing the impact of the recent economic downturn. Without an extension, these communities with the greatest need for redevelopment and revitalization will suffer the greatest harm.

Energy Tax Incentives

Various energy tax incentives require extension before they expire at the end of 2008. ICSC is closely watching for the energy tax credit for solar energy, the commercial building tax deduction and the new investment tax credit for combined heat and power systems.

Solar Energy Tax Credit

In most cases, current technologies for onsite power generation are generally not economically suitable for retail installation without federal and state incentives. However, we believe that these incentives will lead to greater production of renewable power generating equipment (such as solar panels) and that the higher production will lower the unit price over time. Capitalizing on the expected capabilities of future technologies, the cost for renewable energy will become

competitive with coal-fired utility-provided electricity and hopefully these incentives will not be necessary one day. But today, they absolutely are required.

Commercial Building Tax Deduction

The Commercial Building Tax Deduction (“CBTD”) is set to expire on December 31 of this year, unless Congress and the President authorize an extension. Established through the Energy Policy Act of 2005, the CBTD encourages the use of energy-efficient equipment and design techniques in new and existing buildings.

However, the current provisions are complex and set unrealistically high hurdles for retail real estate to overcome before a building owner can qualify for CBTD. To receive the maximum deduction, the CBTD requires rather extreme increases in energy efficiencies to “push the envelope” on economics and technology. Although we strongly believe in an incentive-based approach to energy efficiency, if Congress is truly interested in creating incentives for a rapid and more broadly implemented energy efficiency initiative it should lower the targeted percentage of efficiency gains so that more small businesses can take advantage of them. After all, it really isn’t an incentive if no one can use it.

Carried Interest

Finally, I must make one comment about a tax proposal that is not a tax extender, but has been considered along with the extenders previously as a “pay for.” Commonly referred to as “carried interest,” this major change in the taxation of capital gains for partnerships would be significantly detrimental to many small real estate businesses. While the stated intent of this tax

increase is to address the perceived tax rate inequity applied to the extreme profits being realized by private equity and hedge fund managers, this legislation will directly impact the real estate industry, as most real estate ventures are organized and taxed as partnerships.

In 2005, the Internal Revenue Service reported that 2.8 million partnership tax returns were filed. Of those filings, 1.3 million were for real estate partnerships, representing 46% of the partnership tax returns.

Unlike some private equity or hedge fund firms, the “carried interest” for the general partner in a real estate endeavor is not guaranteed income. Most real estate partnerships are small businesses and they must exceed a significant contractual “hurdle,” allowing the limited partner or investor to realize return on investment before the general partner sees the first dollar of gain and usually only after a significant amount of time has passed.

By undercutting the economic incentive to build a project or redevelop an under utilized property, this change could significantly drive away investment from the commercial real estate sector and truly impact small businesses like the Kilduff Company that are focused on investments that come with inherent risk, such as investment in underserved markets or those associated with a significant environmental cleanup effort. Please consider the impacts of the tax extenders and the necessary offsets when you consider the tax needs of small businesses.

Conclusion

Madame Chairwoman, prompt enactment of the tax extenders legislation is necessary to promote economic growth, job creation, capital investment and energy security. ICSC looks forward to working with Congress to secure enactment of this vital legislation as soon as possible.

Chairwoman Velazquez and Ranking Member Chabot, thank you for holding this hearing and for giving me the opportunity to testify. I welcome any questions you may have.