Tax Issues

The Perspective of the Retail Real Estate Industry

Last year Congress passed the Tax Cuts and Jobs Act (TCJA), which reformed the federal tax code. Congress still has an important role to play to implement these changes and address unintended consequences.

Fixtures Fix (Qualified Improvement Property)

OVERVIEW

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 partitions, lighting, plumbing, flooring and communication outlets, in order to meet the specific needs of their new and existing tenants and to comply with government regulations.

Every year businesses spend billions of dollars on these property improvements, providing work for local contractors and skilled tradespersons, like electricians, plumbers, painters, and carpenters. In addition, these improvements often have a positive environmental impact, as building operators incorporate more energy-efficient equipment and green building techniques.

In 2015, Congress provided a permanent 15-year straight-line depreciation period for these property improvements, in the bipartisan Protecting Americans from Tax Hikes (PATH) Act.

PROBLEM

In tax reform, several separate categories of property improvements – leasehold, restaurant, and retail – were combined under a new definition called “qualified improvement property” (QIP). QIPs were intended to be depreciated over 15 years, making them eligible to qualify for bonus depreciation. Due to a drafting mistake, however, these improvements must be depreciated over 39 years, much longer than their economic life.

As a result of this tax uncertainty, businesses are delaying undertaking these vital capital expenditures, which makes it harder to attract new tenants and negatively impacts jobs and employers in our local communities.

REQUEST

ICSC supports prompt passage of legislation to address this drafting error. The Joint Committee on Taxation (JCT) has determined that doing so qualifies as a technical correction, meaning there is no additional cost to make this fix.

$3.9 Billion

Shopping Centers invested $3.9 billion in tenant improvements in 2017.

(Continued on reverse.)

Reinstate Contributions in Aid of Construction (Sec. 118)

A Critical Tool for Local Economic and Infrastructure Development

OVERVIEW

State and local governments frequently provide incentives to encourage private economic development in underserved communities. For example, a city might contribute an abandoned property, or provide environmental remediation, demolition, or a grant to a development project with the expectation that these enhancements will benefit the general public by providing additional jobs or greater local tax revenues for the community.

Another widely-used incentive is for a city to provide Tax Increment Financing (TIF). With a TIF, the local government issues bonds that will be paid by any increase in tax receipts generated by the new development. The money raised by the bonds is used by private developers who agree to improve the area for the local community.

PROBLEM

Prior to passage of the Tax Cuts and Jobs Act (TCJA), these types of economic incentives were generally not considered taxable income to the developer (IRC sec. 118). Rather, the developer would forego depreciation and other tax benefits, ultimately paying a larger tax bill when the project was sold. Thus, the federal and state taxes on these incentives were deferred but not eliminated.

The TCJA, however, made these common incentives subject to the federal income tax. The rationale for this change provided in the House Conference Report was to remove a federal tax subsidy for certain state and local incentives used to encourage businesses to relocate operations. However, this change hijacks local investments intended for underserved areas and sends a portion to the federal government instead.

> *For example, if a state or local government provides a TIF (Tax Increment Financing) of $100 and the partners are subject to a 37% tax rate, $37 of the TIF is paid to the federal government as income tax, leaving only $63 to be invested in the community.*

This change in the TCJA represents an inappropriate transfer of state and local government funds to the federal government. It is particularly troubling considering that the federal government has reduced its financial support of state and local economic development initiatives. Further, it runs counter to Congressional efforts to encourage public-private partnerships.

REQUEST

ICSC supports changes to Section 118 to ensure that legitimate economic development and infrastructure projects are not unfairly penalized by the federal tax code.

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