Box 3 - 10/16/96

Social Security Administration
Prayer in School
Space Launch Trade Agreements
Saversky
Wellstone
1996 State of the Union
Subchapter "S" Corporations
Sunrise Fine - Long Island
Timber
Terrorism
Thank Yous

OA 8164
NARA 5825
ENCLOSURES FILED OVERSIZE ATTACHMENTS

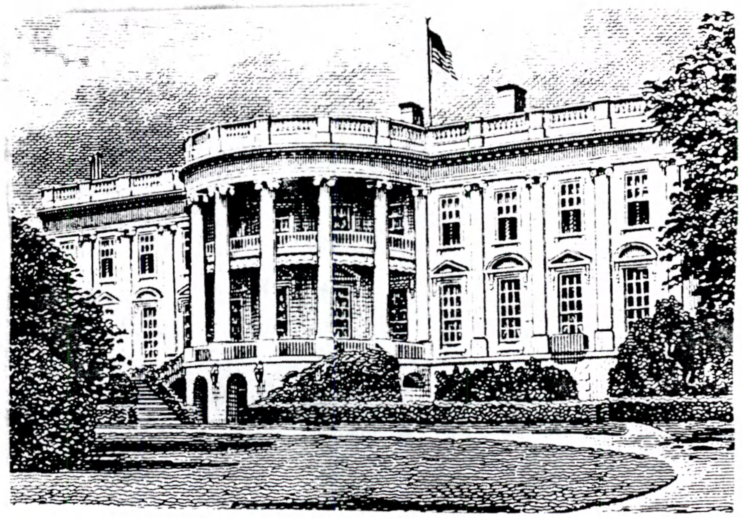
<u>DOT</u>
Amtrak
Beijing Aviation Negotiations
FAA Diversity Training
ICC
Metro North
NY Post Office
FAA Personnel reform
Saudi planes
Tracking Initiatives
Truckers Fatigue
WH Conf on Travel and Tourism
UPSP merger

<u>DOTReas</u>
Depreciation recapture rules

<u>VA</u>
Gulf War Syndrome
Lockheed Martin
Mis
VOA
Vets preference
Vets Appts
Vet IUPG Activity
Spdicy Group
Scheduling
Travel
PT Phone call

United Nations General Assembly public Members Appt.
US Enrichment Corp
Beijing Womens conference
Urban Econ. Develp.
US attorneys

<u>USDA</u>
Long Island fires



Spoke w/ Sandi 5/1

File Treasury

THE WHITE HOUSE
WASHINGTON

OFFICE OF THE DEPUTY CHIEF OF STAFF
HAROLD ICKES

JENNIFER O'CONNOR   SHANA TESLER

________OTHER

TO: Sandi Mancini
fax#: 622 0073   phone#:
date: #of pages:

SUBJECT: Can whoever handles "depreciation recapture rules" as part of capital gains tax do a brief memo to Harold on what admin's position on it is & who is on what side among constituency groups? Send it back to me as soon as it can happen. - Call w/ questions. Thanks! Shana

THE WHITE HOUSE, WASHINGTON, DC 20502 (202)456-6350, FAX (202)456-7929

International Council
of Shopping Centers

3/7 copy
to Jen O'C
for response

Done
12 March

Sent to
Sandi
Mancini
4/17 for
response.
LM - 4/22

FACSIMILE TRANSMITTAL FORM

DATE: March 6, 1996

TO: The Honorable Harold Ickes

Deputy Chief of Staff for Policy and Political Affairs

FROM: Russell R. Pratt

Sr. Staff Vice President for Government Relations

FAX NUMBER: 202/456-1121

**NUMBER OF PAGES: 8
(including cover)**

197 8199

REMARKS/INSTRUCTIONS:

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If you wish to transmit a telecopy, we are able to receive documents 24 hours a days, 7 days a week. Our facsimile number is (703) 549-8712.

ICSC Government Relations Office
1033 N. Fairfax Street
Suite 404
Alexandria, VA 22314

International Council of Shopping Centers
1033 N. Fairfax Street, Suite 404
Alexandria, VA 22314-1540
703/549-7404 Fax: 703/549-8712

Russell R. Pratt
Senior Staff Vice President
Government Relations

March 6, 1996

VIA FACSIMILE

The Honorable Harold Ickes
Deputy Chief of Staff for
Policy and Political Affairs
The White House
1600 Pennsylvania Avenue, NW
Washington, DC 20500

Dear Mr. Ickes:

Sylvan Cohen, former President of the International Council of Shopping Centers, requested that I contact you to followup on a recent telephone conversation regarding an issue of great importance to the shopping center industry -- depreciation recapture.

Both Congress and the Administration have suggested changes to the current law depreciation recapture rules as part of the proposed capital gains tax cut. Such a measure would put real estate at a great disadvantage against other forms of investment and would have a negative impact on the economy. To illustrate the seriousness of this issue, I am attaching a recent letter to the President as well as supporting materials that describe the depreciation recapture issue.

ICSC and the entire real estate industry strongly support efforts to balance the federal budget and provide incentives that promote a strong economy. Cutting the capital gains tax is an essential element in this effort.

I hope you will convey our concerns to the President. If you need to discuss this issue in greater detail, please do not hesitate to contact me.

Sincerely,

Russ

Russell R. Pratt
Senior Staff Vice President
Government Relations

attachments

recycled paper

The National Real Estate Organizations

American Resort Development Association
Building Owners and Managers Association International
International Council of Shopping Centers
Manufactured Housing Institute
Mortgage Bankers Association of America
National Association of Industrial and Office Properties
National Apartment Association
National Association of Home Builders
National Association of Real Estate Investment Trusts
National Association of Realtors
National Multi Housing Council
National Realty Committee

February, 1996

February 14, 1996

The Honorable William J. Clinton
The President of the United States
Executive Office of The President
1600 Pennsylvania Avenue, NW
Washington, DC 20500

Dear Mr. President:

The undersigned national real estate organizations, representing over two million individuals and companies that own, build, manage, and finance commercial and residential real estate, are alarmed by reports that the budget negotiators may consider revising real estate's long-standing depreciation recapture rules as part of a proposed capital gains tax cut.

We firmly believe that taxing straight-line depreciation recapture at a higher rate than capital gains would, for a vast majority of real estate transactions, significantly undermine any benefit of a capital gains tax cut. Such a measure would put real estate at a great disadvantage relative to other forms of investment, lead to decreased real estate values, and expose the nation's real estate markets to recessionary conditions.

We strongly agree that a balanced budget will lead to lower interest rates and long-term economic growth. Since discussions about capital gains tax relief are likely to remain associated with the budget negotiations, we feel it is imperative for you to hear our views on capital gains taxation and to carefully consider the negative economic consequences that a change in the depreciation recapture rules would have on real estate transactions and values across the country.

Sincerely,

American Resort Development Association
Building Owners and Managers Association International
International Council of Shopping Centers
Manufactured Housing Institute
Mortgage Bankers Association of America
National Association of Industrial and Office Properties
National Apartment Association
National Association of Home Builders
National Association of Real Estate Investment Trusts
National Association of Realtors
National Multi Housing Council
National Realty Committee

DEPRECIATION RECAPTURE DEVELOPMENTS

When a depreciable asset such as real estate is sold at a gain, some element of that gain is attributable to depreciation deductions taken in prior years. These deductions have the effect of reducing the basis of the asset. Since the gain is the difference between the selling price and the basis, the depreciation element of the gain must be taken into account.

<u>Example</u> Taxpayer A purchased a building for $1 million. During the years A has owned the property, depreciation deductions of $250,000 have been taken, so the remaining basis is $750,000. In the current year, A sells the property for $1.1 million. A has a gain in excess of cost of $100,000. Under current law and under the vetoed bill, this portion of the gain is clearly treated as a long term capital gain. Assuming maximum tax rates, this element of the gain would be taxed at 28% under current law, and at 19.8% under the vetoed bill.

<u>Issue</u> What is the proper treatment of the $250,000 in prior depreciation deductions?

<u>Current Law</u> The maximum rate on the full gain is 28%. Because the capital gain is measured under current law as the difference between selling price and adjusted basis and treated as ordinary income, the depreciation recapture rules have no practical effect.

<u>Prior Law</u> Before the capital gains exclusion was repealed in 1986, special rules prescribed the treatment of prior depreciation. Generally, for most commercial property, a taxpayer who had used the straight-line method of depreciation was required to "recapture" (or recognize as income) all prior depreciation deductions. These amounts were treated as long-term capital gains, and therefore taxed at rates no higher than the prevailing capital gains rates (20% from 1981 through 1986). Thus, as a practical matter, gain in excess of basis was treated as a capital gains. Depreciation deductions on personal property and certain accelerated depreciation deductions for real property were recaptured and taxed as ordinary income at ordinary rates.

<u>Administration Recommendation</u> There has been discussion during budget negotiations on capital gains to add a recapture provision to the vetoed bill. This provision would be a hybrid of prior and current law. Under the recommendation, the depreciation recapture amount would be taxed at 28%, and any remaining capital gain in excess of purchase price would be taxed at the appropriate capital gains rate. Thus the recaptured amount would not be treated as ordinary income, nor would it be treated as capital gain.

<u>NAR Position</u> NAR opposes this recommendation. It treats real estate unfairly compared to other capital gains assets, and imposes a disadvantage that would be experienced only by the real estate industry. In today's market, it is particularly punitive, because many owners who have acquired properties since 1987 are often unable to sell property for even the original purchase price. For these owners, there would, in effect, be no capital gains reduction.

<u>NAR Recommendation</u> Any capital gains reduction enacted in 1996 should treat all assets in the same manner. Capital gains cuts should be proportional among all classes of assets, and should not single out any industry or class of assets.

Sample U.S. Real Estate Investment - Shopping Center

Projected Taxes From A Hypothetical $ 5.75 Million Investment

Summary of Total Taxes

	Taxes On Real Estate Investment			Taxes On Stock Investment		
	Current Law	Hatch / Lieberman Proposal	Admin. Proposal	Current Law	Hatch / Lieberman Proposal	Admin. Proposal
10 Year Investment						
Ordinary	2,264,119	2,264,119	2,264,119	2,264,119	2,264,119	2,264,119
Capital	1,267,254	896,130	124,000	1,267,254	896,130	905,181
Recapture	0	0	1,093,654	0	0	0
Total Tax	$3,531,373	$3,160,249	$3,481,773	$3,531,373	$3,160,249	$3,169,300
20 Year Investment						
Ordinary	11,054,430	11,054,430	11,054,430	11,054,430	11,054,430	11,054,430
Capital	3,617,234	2,557,901	1,104,000	3,617,234	2,557,901	2,583,738
Recapture	0	0	2,071,634	0	0	0
Total Tax	$14,671,664	$13,612,331	$14,230,064	$14,671,664	$13,612,331	$13,638,168
40 Year Investment						
Ordinary	8,204,003	8,204,003	8,204,003	8,204,002	8,204,002	8,204,002
Capital	7,972,134	5,637,438	3,064,000	7,972,134	5,637,438	5,694,382
Recapture	0	0	3,682,534	0	0	0
Total Tax	$16,176,137	$13,841,441	$14,950,537	$16,176,136	$13,841,440	$13,898,384

CAPITAL GAIN TAX ON AVERAGE U.S. OFFICE BUILDING PURCHASED IN 1986 AND SOLD IN 1996

The average U.S. office building purchased in 1986 would sell today for less than its original purchase price. Therefore, a capital gains tax cut would provide an "unlocking" benefit only if the current real estate depreciation recapture rules are maintained. Some may suggest revising these rules so that any capital gain tax cut would apply only to gain above original cost. Such action would be of no benefit for the typical real estate transaction and real estate investments would be disadvantaged vis-à-vis other investments.

According to data from the National Real Estate Index, in 1986 the average purchase price for an office building in the United States was $169.60 per square foot. In 1996 the projected average selling price per square foot of the same U.S. office space is $151.66 -- an amount substantially less then the original purchase price. Even so, there would be taxable gain on the sale of this asset, measured against adjusted basis, due to straight-line depreciation deductions claimed during the ownership period. Since 1964, the real estate depreciation recapture rules have stated that if real estate is sold at a gain then depreciation deductions taken equal to straight-line depreciation are recaptured and taxed as capital gain. However, depreciation deductions in *excess* of straight-line depreciation are recaptured and taxed as ordinary income.

Therefore, as illustrated in the first column of the table below, under current law even though the asset would sell for less than its original purchase price, because straight-line depreciation has been claimed, all of the gain in the transaction would be capital gain, taxed at 28 percent. The second column in the table demonstrates that legislation approved by approved by Congress (the Archer/Hatch/Lieberman proposal) would reduce the tax rate on this gain to 19.8%.

<u>Tax Calculations</u>	<u>Current Law</u>	<u>Archer/Hatch/Lieberman</u>
Acquisition Price (1986)	$1,000,000	$1,000,000
Depreciation	($463,158)	($463,158)
Suspended Passive Losses	$101,847	$101,847
Adjusted Tax Basis	$638,689	$638,689
Sale Price (1996)	$894,204	$894,204
Selling Expenses	($53,652)	($53,652)
Adjusted Sales Price	$840,552	$840,552
Adjusted Sales Price	$840,552	$840,552
Adjusted Tax Basis	($638,689)	($638,689)
Total Taxable Gain	$201,863	$201,863
Taxable Gain Attributable to Depreciation	$201,863	$201,863
Capital Gain Tax on Depreciation Gain	$56,522	$39,969
Taxable Gain in Excess of Depreciation	$0	$0
Capital Gain Tax on Depreciation Excess	$0	$0
Total Capital Gains Tax	$56,522	$39,969
Adjusted Sales Price	$840,522	$840,522
Capital Gains Tax	($56,522)	($39,969)
Loan Payoff	($480,070)	($480,070)
Net Cash Flow to Equity From Sale	$303,960	$320,513
Equity Contribution	($281,000)	($281,000)
Profit (Loss) From Sale	$22,960	$39,513
Profit After Tax From Sale	$22,960	$39,513
Total Capital Gains Tax	$56,522	$39,969

Any suggestion to provide a capital gains tax cut only to the gain above the original purchase price (for example by retaining the 28% tax on recaptured depreciation) would be of <u>no</u> benefit to most real estate property owners and most real estate transactions. For the typical transaction there would be <u>no</u> change from current law. Therefore, no "unlocking" of assets would take place.

Assumptions

The assumptions used in the above example, summarized in the following table, are real. Based on data from the National Real Estate Index, the 1986 purchase price per square foot was the national average purchase price at the time, and the 1996 sale price is the current projected national average selling price. The financing terms and amortization period were the typical terms provided by life companies (the most conservative real estate lenders in the mid-1980s) as compiled by the American Council of Life Insurance.

ASSUMPTIONS

Finance Assumptions:	
Building Square Feet	5,896
Purchase Price Square Foot	$169.60
Acquisition Price	$1,000,000
Equity Requirement	$281,000
Amount Financed	$719,000
Mortgage Amortization Period	20
Interest Rate	9.55%
Sale Assumptions:	
1996 Sale Price Square Foot	$151.66
Sale Price	$894,204
Other Assumptions:	
Purchase Capitalization Rate	9.30%
Selling Costs	6.00%
Depreciation Schedule	19 years, straight line
Percent Land Allocation	20%

Conclusion

Upon sale, after paying $56,522 of federal taxes under current law and repaying the initial $281,000 equity investment, the owner of this average office building in America would realize an after tax profit from the sale of $22,960 — in many cases, an amount insufficient to pay state transfer taxes, or to motivate the owner to enter into the transaction. The Archer/Hatch/Lieberman proposal (approved by the House of Representatives) would "unlock" this asset by reducing the federal tax owed to $39,969, and thereby increase the profit from sale to $39,513 — thus stimulating the transaction.

However, because the property would sell for less than the original purchase price, the capital gains tax cut would provide this stimulative benefit only if the current depreciation recapture rules are maintained. A capital gains tax cut made applicable only to gain in excess of original cost would be of no benefit for this typical transaction and would create a disincentive for real estate vis-à-vis other assets.

January 25, 1996

file
treasury
airline
fuel
tax

Frank can here 1x/mo mtg
Celia Perry = on steering committee

Marvin

fuel
tax
issue

waiver → to a point → then need legislatively
to enforce - can't waive w/o legisl.

Treas → wants to lay low
can't waive w/o stat.

Qs = Late fees to be changed

if not Pres - Eric Toder
if Pres worn - refer to LS

cc the two on it

Feinstein 11^{00} Weds
Forbes 10 Thurs / Jacobsen 11 Thurs