Potential fiscal cliff tax code changes will help real estate

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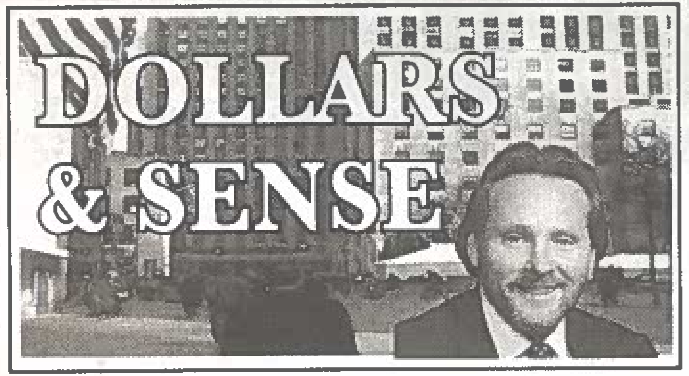

with Bob Knakal

Q: How will a deal or the lack of a deal on the fiscal cliff impact the commercial real estate sales market?

A: We should operate under the assumption that a deal will be made at some point. It may be before the end of the year or it may be shortly into 2013 but a deal will be done. The impact on our commercial real estate sales market will be dependent upon what the components of that deal are.

The most impactful aspect of a potential deal is how it will affect interest rates as the relationship between interest rates and property values is highly correlated. We need a deal that will increase revenue and reduce spending, particularly on the unsustainable entitlement programs which are like trains headed toward brick walls.

There are dozens of aspects of a potential deal that are worth discussing but there are two potential changes to tax policy that would be very beneficial to commercial real estate.

The first is allowing U.S. companies to repatriate the trillions of dollars they are holding in accounts overseas at advantageous tax rates to inject that capital into our economy. This would be very stimulative and would cost the taxpayer effectively nothing. A tangible percentage of this capital would find its way into the commercial real estate investment sales market.

Another tax law change that would help our local sales market would be reforming a law which disadvantages real estate investments, relative to any other type of investment, for foreign based buyers.

I am referring to the Foreign Investment in Real Property Tax Act of 1980, commonly referred to as FIRPTA. U.S. tax laws and regulations impose excessive tax barriers on foreign capital investment in U.S. real estate and should be withdrawn or modified significantly. The central obstacle to greater capital investment in U.S. real estate by non-U.S. investors is FIRPTA.

Based upon the fears of some politicians in the Midwest, who were originally concerned about limiting foreign control over U.S. farm land, FIRPTA was proposed and passed by congress to limit what foreigners could do with "our property". FIRPTA requires foreign persons who dispose of U.S. real property interests to pay taxes in the U.S. on any gain realized on the disposition. This process imposes considerable administrative burdens, not only on foreign investors disposing of their U.S. real estate assets but also, on the purchasers of such properties who are responsible for administering withholding taxes.

Additionally, the law requires foreign investors to file a U.S. income tax return at the end of the year in which they sell their real property interests.

Further political support for FIRPTA was seen noticeably in the mid 80's when Japanese investors were actively purchasing trophy assets in New York City, most notably Rockefeller Center. It is hard to imagine that there is any fundamental basis for this concern. Properties controlled by foreign owners are generally managed by U.S. companies, leased by U.S. companies, serviced by U.S. companies and produce tax revenue paid to New York City. The attorneys representing these investors are likely U.S. firms as are their title insurers. What is the basis of the fear people have about buildings being owned by overseas investors? In the nearly 30 years that I have been selling properties in New York, I have yet to witness a foreign investor acquiring a property in New York, picking it up, and transplanting it back to their homeland.

Real estate is unfairly treated relative to other types of investments in the U.S. by foreign persons as they are not required to pay gains taxes upon the disposition of any other assets. Thus, FIRTA unfairly discriminates against U.S. real estate as an asset class. We believe that U.S. policy makers should move swiftly to eliminate or modernize FIRPTA.

Both of these potential tax code changes would be stimulative to our economy and beneficial to our commercial real estate market. They would encourage U.S. corporations operating overseas to bring offshore generated profits back home and would encourage foreign real estate investors to increase capital allocations towards the U.S. marketplace.