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<u>Introduction</u>

Good morning, Chairman Baucus, Ranking Member Hatch, and members of the Committee. My name is Harrison LeFrak, and I am Vice Chairman of the LeFrak Organization. I appreciate the opportunity to discuss why maintaining the current taxation of pass-through entities is essential for the continued health and growth of real estate, oil and gas, entrepreneurship and investment in the United States.

<u>Our Business</u>

The LeFrak Organization is comprised of three business platforms: real estate development, energy exploration, and investments -- ground-floor investments in the companies of tomorrow as well as securities management and ownership.

<u>Real estate</u>: The LeFrak Organization was founded in 1901 and owns an extensive portfolio of real property concentrated in the New York, Los Angeles, South Florida, and London metropolitan areas.

The LeFrak Organization and its affiliated companies have developed and built a majority of their own portfolio. Since the late 1980's, affiliates of The LeFrak Organization have developed Newport, the largest new waterfront community in the United States. Newport has transformed an abandoned rail yard into what is now more than 1% of New Jersey's gross state product. We have recently begun new projects in Miami Beach and North Miami, Florida.

<u>Energy Exploration</u>: Affiliates of the company have originated and drilled a significant number of on-shore oil and gas wells in the continental United States. We have a very exciting shale oil project in Nebraska, which if successful, will be transformative to the

state. As a domestic explorer and producer, we are doing our small part for America's energy independence.

Investment Management: Affiliates of the LeFrak Organization have provided and continue to provide strategic capital to entrepreneurs and early state businesses in technology, financial services and health care. We have invested in numerous start-up companies that have created hundreds of new jobs. Locations of these companies include California, South Florida, Michigan, Texas and New York. In addition, the LeFrak Organization has been an investor in fixed and income securities, equity securities, currencies and commodities.

Why Partnerships Are Essential for the Success of Our Business[1]

Partnerships allow our business to establish discrete entities for each enterprise. Each project, building or oil field is in its own partnership. The ownership of each project or business reflects the objectives, risk tolerance and liquidity needs of various family members and investors. In addition, each partnership provides a discrete way to measure the success or failure of outcomes and to limit risk on a project-by-project basis.

Furthermore, our lenders demand separate partnerships for each activity they are financing. Lenders want a guarantee that the assets they are financing are protected and not subject to third party claims arising from unrelated business activities. Lenders demand that the assets are compartmentalized, especially in the event of bankruptcy.

Why We Do Not Use Corporations

We do not use corporations as investment vehicles to conduct our business because the cumulative rate of taxation on our enterprises would be confiscatory. The following example illustrates why the use of corporations would be inefficient:

[1] Pass-through entities are crucial to the success of the American economy. These businesses employ 54 percent of the private sector work force and pay 44 percent of federal business income taxes. Further, more than 20 million workers are employed by pass-through businesses with more than 100 employees. In 2008, 90 percent of all businesses were pass-throughs.

Comparison of Corporate versus Partnership Tax Rates (Top Brackets)

Tax Type	*Partnership*	*Individual Partner*	*Corporation*	*Dividend to Individual Shareholder*
Federal Income Tax Rate		35% (2012) 39.6% (2013)	35% (2012)	
Federal Personal Income Tax - Qualified Dividend Tax Rate				15% (2012) 43.4% (2013)
New York State Income Tax Rate		8.82%	7.1%	8.82%
New York City Income Tax Rate		3.876%	8.85%	3.876%
New York City Unincorporated Business Tax Rate	4%			

In 2012, our business is conducted in partnership form and our combined effective tax rate is **51.188%** (this calculation does not take into account AMT and PEP/Pease). That means that more than half of our income is devoted to taxes.

In 2012, if our business were conducted in corporate form and all profits were paid as a dividend to enable capital to be reinvested, our combined effective tax rate would be **64.53%** (this calculation does not take into account AMT and PEP/Pease).

In 2013, if our business is conducted in corporate form, all profits are paid as a dividend to enable capital to be reinvested, and Congress does not extend the 2001/2003 tax cuts, our combined effective tax rate would be **78.45%** (this calculation does not take into account AMT and PEP/Pease).

We as a family enterprise reinvest more than 95 percent of our business income back into our business activities and this tax proposal would be particularly onerous. We also rely entirely on our on capital to fund our business activities and do not receive one dollar of carried interest income.

Consequences of Imposing Corporate Tax on Partnerships

If this proposal becomes law, my family will stop building, stop drilling, and stop taking any risks.

As you can see based on the comparison of partnership and corporate tax rates, we would have paid 64.53% of our business income as tax if our business were taxed as a corporation. And that means we would have to work roughly seven and a half months a year to pay our taxes. In 2013, we would have to work nine and a half months to pay our taxes.

Add on top of that a 55% estate tax, and there is little incentive for entrepreneurs like us to continue to work.

The LeFrak Organization employs directly and indirectly more than 3000 people, and many of them would lose their jobs. We are a blue collar jobs machine everywhere we invest. The only jobs this proposal would create are for tax lawyers and accountants, as this proposal would add incredible complexity and enormous effort to our annual tax compliance process.

A lot of the complexity would need to be addressed in transition. Are current entities grandfathered? If not, how would partnerships address the change in economics that were not part of the business when the investors came together or when lenders lent the money to finance the business or when business decisions were made?

How would this proposal work? Would the determination of the partnerships subject to corporate treatment be based on income, revenue or size of assets? Would it apply on an annual basis, where an entity may be subject to corporate tax one year but not subject to corporate tax the next? Is there a taxable event when the partnership shifts into corporate tax and vice versa? How would this proposal apply when a partnership is owned by another entity, such as where a REIT has an interest in a partnership? What will states do, including the ones that conform to the Internal Revenue Code and the ones that don't?

There are numerous other transition and structural issues that Congress would need to address. I urge you to avoid adding such complexity to an already overly complex tax code.

Since Ronald Reagan, the policy of Congress has been to eliminate the double taxation of business income. This proposal goes in the opposite direction from that policy.

More important than my family and other entrepreneurs is what this proposal would do to the United States. Many investors, including pension funds, State pension funds, foundations, charitable funds and other tax-exempt entities, currently invest in American partnerships without paying an entity level of tax. An additional level of tax will substantially reduce their returns and force them to seek returns offshore in other financial centers, including London, where foreign law does not impose a level of tax at the partnership fund level. The entire investment management industry, important to my home city of New York, would find itself uncompetitive with most other countries in the world.

My own family would have incentives to invest offshore, because we could avoid double taxation on our investments and benefit from foreign tax credits. Why would someone want to pay an entity level of tax in the United States when jurisdictions like Australia, Canada and the United Kingdom do not have an entity level of tax on such income?

Conclusion

Any imposition of new taxes on pass-through entity will have disastrous results not only on my family's enterprises but also on many American jobs. I strongly urge Congress and the Administration to abandon the proposal in the President's Framework for Business Tax Reform.

This concludes my testimony and I would be happy to answer any questions you might have.