Statement
Of
Dave Ratner
Dave's Soda and Pet City
Agawam, Massachusetts

On behalf of
The National Retail Federation

Tax Incentives for Business in Response to a Minimum Wage Increase

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Contact:

Rachelle Bernstein
Vice President, Tax Counsel

Liberty Place
325 7th Street NW, Suite 1100
Washington, DC 20004
800.NRF.HOW2 (800.673.4692)
202.783.7971 fax 202.737.2849
www.nrf.com

Mr. Chairman and Members of the Committee, my name is Dave Ratner. I am the owner of Dave's Soda and Pet City, a mini chain of 4 pet stores in Springfield, Amherst and Northampton, Massachusetts. I am appearing today on behalf of the National Retail Federation (NRF). I am also a member of the Board of Directors of the Retail Association of Massachusetts. I am pleased to have the opportunity to testify today on Tax Incentives for Business in Response to a Minimum Wage Increase.

By way of background, The NRF is the world's largest retail trade association, with membership that comprises all retail formats and channels of distribution including department, specialty, discount, catalog, Internet, independent stores, chain restaurants, drug stores and grocery stores as well as the industry's key trading partners of retail goods and services. NRF represents an industry with more than 1.4 million U.S. retail establishments, more than 23 million employees - about one in five American workers and 2005 sales of $4.4 trillion. As the industry umbrella group, NRF also represents more than 100 state, national and international retail associations, including the Retail Association of Massachusetts.

I founded Dave's Pet City in 1975. I started with one store and one employee in Hadley, Massachusetts, and today I have four stores and 86 employees. I am proud to say that the reason my business has grown, and even thrives, is that we have the best and nicest folks in the world working at Dave's. Dave's has always been an integral part of the community. We sponsor many teams, plays, community events, library functions, charity events, etc. We set the standard for small businesses in our area with such programs as Dave's Student of the Month, summer reading programs and educational programs. Dave's has been chosen as Small Business of the Year by the Greater Springfield Chamber of Commerce and is a perennial winner of the people's choice awards for best pet shop in Western Massachusetts. I am frequently invited to speak on how to start and grow a business.

I commend Chairman Baucus for holding a hearing on tax measures that might help small businesses, especially in light of a minimum wage increase. In Massachusetts, the minimum wage was increased from $6.75 to $7.50 an hour, effective January 1 of this year. Because my policy is to pay my workers more than minimum wage, when there is a minimum wage increase, it causes me to increase wages throughout my labor force. I just increased the wages of my entry level workers to $7.75 an hour, as a result of the Massachusetts minimum wage hike. I plan to increase the wages of my more experienced employees in a corresponding manner. For a small business, these government mandated increases in overall payroll take a particularly heavy toll as we strive to compete with the national chains.

I am not here today to voice opposition to a federal minimum wage increase. Obviously, the Massachusetts legislature has already acted on this issue, so the minimum wage increase that Congress is considering today will not affect small businesses in my state. Of course, the cost of living in Massachusetts is higher than in many states, so it is appropriate that wage structures vary in different parts of the country. As a representative of the National Retail Federation, I am here representing small retailers from all over the United States. Retailers, who employ one in five American workers, are among the industries hardest hit by a minimum wage increase. For many, the current proposals would represent a 41% increase in entry-level wages. For most retailers, an increase in entry-level wages necessitates an increase in all wages in order to treat our more experienced workers fairly and maintain the vitality of our work force.

It is increasingly difficult for small, independent retailers to compete with the large chains. Because wholesalers price their goods based on volume purchased, we pay more for our inventories than do the large chains. Other costs of doing business also tend to be higher because the level of our purchases of goods or services is so much smaller than the big chains. A national chain may even have the ability to negotiate multiple leases with national operators of shopping malls. Most significantly, we do not have the benefit of the "branding" that a national chain has.

Small retailers must compete in other ways. I believe the best way to compete is with more service – more people on the selling floor to assist customers. A forced increase in payroll structure limits my ability to maintain or increase payroll. As a result of the January 1 Massachusetts minimum wage increase, we have implemented a hiring freeze and will adjust our workers' schedules to avoid overtime. Over the longer term, we will need to find other cost reductions to make up for the wage hike, because we cannot raise prices and still compete. We certainly will not be able to do some of the innovations we were hoping would help us better compete against the major chains.

Within the context of this hearing, I am here today to suggest the elimination of a tax code provision that discriminates against retailers. Under current law, retailers that own their stores must write off improvements to those stores over 39 years while retailers that lease their stores can write those improvements off over 15 years. For me and thousands of small retailers across the country, eliminating this discriminatory treatment would greatly reduce the cost of improving our stores and free up capital as wages go up and we strive to compete with large national chains that benefit from economies of scale. Legislation to eliminate this discriminatory treatment, S. 3806, was introduced in the last Congress by Finance Committee Members, Senator Olympia Snowe, by my Senator, John Kerry, as well as Senator Blanche Lincoln. I urge you to consider including this legislation as part of a minimum wage tax package.

Depreciation of Improvements to Retail Stores

The existing 39-year recovery period for real estate grossly overstates the useful life of structures and, even more so, the improvements made to structures, increasing the cost of capital and distorting business decisions. Studies conducted by the Treasury Department[1], Congressional Research Service[2] and private economists[3] have all found that the depreciation life for buildings is too long and that the depreciation life for building improvements is even worse. In fact, tax depreciation rules for investment in nonresidential structures may be the only type of investment where tax rules provide for decelerated cost recovery. As a result, current depreciation allowances generate high tax costs for these investments and reduce investment in these projects.

In the retail trade sector of the economy, structures and especially their improvements rarely last 39 years. Retailers generally remodel their stores every five to seven years to reflect changes in customer taste and needs. Remodeling is needed to maintain the retailer's customer base and compete with newer stores. Moreover, many improvements, such as interior partitions, ceiling tiles, restroom accessories, paint, etc., may only last a few years before requiring replacement.

A provision to temporarily reduce the depreciable life of *leasehold* improvements from 39 to 15 years was enacted as part of the American Jobs Creation Act of 2004 (AJCA). AJCA also temporarily reduced the depreciable life of improvements to restaurants, regardless of whether the restaurant was leased or owned. These provisions were recently extended by the Tax Relief and Health Care Act of 2006. Under these provisions, improvements made to buildings that are leased would be depreciated over 15 years, but improvements made to buildings that are owned would still have to be depreciated over 39 years, except for improvements to restaurants, which were given a 15 year life regardless of whether the restaurant is leased or owned. The leasehold/restaurant improvement provision will expire for property placed in service after December 31, 2007.

Approximately, half of retail stores are leased and about half are owned by the retailer. For retailers that lease their property, the leasehold improvement provision greatly reduces the cost of improvements to their stores. However, the leasehold improvement provision puts

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[1] *Report to the Congress on Depreciation Recovery Periods and Methods,* Washington, D. C.: U.S. Department of the Treasury, July 2000.
[2] Jane G. Gravelle, *Depreciation and the Taxation of Real Estate,* Congressional Research Service, The Library of Congress, Washington, D.C.: May 5, 1999.

[3] See, for example, Deloitte and Touche, LLP., *Analysis of the Economic and Tax Depreciation of Structures.* Washington, D. C., June 2000.

retailers that own their stores at a competitive disadvantage because they must continue to write-off store improvements over a 39-year period.

In my business, I am currently squeezed by the high cost of making improvements to my stores. I currently operate four stores, two of which I lease and two of which I own. I will be moving my fourth store in the near future, to a larger building I recently purchased that was an Ames Department store and stood empty for several years. I need to renovate the store before I can open it. The renovation costs are huge to get this older building up to Code, and the renovations must be written off over 39 years. Once I am able to open this store, I anticipate that I will be hiring an additional 15 employees to work there, because will be a much larger store than the one I am replacing.

Both of the major national chains with which I compete lease most of their stores in shopping centers. When they renovate their stores, they can write off the costs over 15 years. Of course, with respect to the two stores that I lease, I can write off my improvements over 15 years, as well. With respect to my other two stores, I must write off improvements over 39 years. This discrepancy makes no sense.

Retailers generally make more of an investment in the community when we own our stores. When a neighborhood deteriorates, the retailer who leases his store can break the lease or wait for it to expire and move to a new location. Retailers that own their stores have a bigger investment and a stronger incentive to work towards revitalizing the community. For some of my independent retailer colleagues, the store may have been passed down from previous generations and is the principal asset of a family-owned business. We should not have to pay a higher price for our renovations because we own a store, rather than lease.

The Joint Tax Committee in its 2005 report to this Committee on expiring tax provisions questioned whether the leasehold improvement provision's bias toward leasehold retail property improvements over non-leasehold retail property improvements is appropriate[4]. We agree that the tax code should not provide an incentive to lease rather than own similar property. A 39 year life for building improvements is too long, regardless of whether the property is leased or owned. The current Tax Code bias can easily be remedied by extending the terms of the provision to apply to improvements to retail space, regardless of whether leased or owned.

Conclusion

The economic data is clear that the depreciable life for improvements to buildings is far too long. The shortened depreciation life for leasehold improvements needs to be expanded to

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[4]Joint Committee on Taxation, *Description and Analysis of Certain Federal Tax Provisions Expiring in 2005 and 2006* (JCX-12-05), March 11, 2005, at p. 50.

include improvements made to non-leasehold retail property. Shortening the depreciable life for improvements to stores owned by retailers will eliminate discriminatory treatment suffered by those of us who own our stores, whether we are large or small businesses. For small businesses, like mine, this provision will allow us to more easily afford the store updates we need to make to compete with large chains in shopping malls, especially in light of rising payroll costs.

Retailers grow their businesses by expanding their locations and opening new sites. When we expand, we hire more people to work in these locations. Lowering the tax cost of these expansions allows us to grow our businesses and increase employment.