Carried Interest in Retail Real Estate

Overview

A carried interest – or "the promote" as it is often referred to in the real estate context – is the risk-based partner's portion of the capital gain from the sale of a real estate development. For decades, the nature of the gain – whether capital or ordinary – has been determined at the entity level and applied equally to all partners.

Real estate developers are typically involved with a project for a year or more before outside investors provide financing. They are at risk for up-front expenses, such as obtaining title review, completing land surveys, conducting necessary environmental reports, preparing architectural documents and obtaining approvals from the local government.

The carried interest is the contractually agreed-upon share of the final proceeds associated with the project that the developer may receive after the investors have been paid their promised rate of return. It is not guaranteed and is justified based on the real risks associated with creating a successful shopping center, including recourse on debt, potential lawsuits, unforeseen environmental remediation, project delays and tenancy guarantees. A developer may also receive separate compensation or fees for work on the project, but these are treated as ordinary income. Those services may include, but are not limited to, construction, leasing and project management.

Changing the tax treatment of carried interest would disproportionately impact small, locally focused and family-run real estate partnerships.

Half of all partnerships in America are related to real estate.

Problem

Changes to carried interest would undo long-standing partnership law and dramatically change the dynamic of a retail real estate partnership.

Despite the narrative spread by some that this tax would impact large hedge fund managers, the burden of the changes to carried interest would disproportionately impact real estate partnerships, which make up half of all partnerships. Many of these are small, locally focused and family-run real estate businesses. Further, it would discourage investment in our communities, especially in underserved markets or brownfield sites that come with additional challenges and risks.

Proposals to eliminate carried interest would unfairly penalize entrepreneurs who use equity capital from outside investors and would increase reliance on debt. Existing partnerships, including family businesses and LLCs that may have been in existence for decades, would lose their capital gain treatment, potentially devaluing many existing properties.

Request

Oppose legislation to change the tax treatment of carried interest. Congress should promote economic growth, not penalize entrepreneurs trying to improve our communities.

For more information, contact Phillips Hinch at phinch@ICSC.com.

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