# Carried Interest in Retail Real Estate

## Overview

A carried interest 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 has been determined at the entity level and applied equally to all partners – the risk-based partners and the financial partners.

The carried interest is the contractually agreed-upon share of the final proceeds associated with the project. 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, permitting delays and tenancy guarantees. It is also important to note that the general partner receives separate compensation for services treated as ordinary income for work on the project. Those services may include, but are not limited to, construction, leasing and project management.

Despite our opposition, the 2017 Tax Cuts and Jobs Act lengthened the holding period for those with a carried interest to receive long-term capital gain treatment. The new 3-year holding period (increased from the 1-year long-term capital gain) is expected to begin when the property is "placed in service." Because a development or redevelopment project takes 3 or more years on average to be built, the actual holding period for a carried interest in real estate is closer to 6 or more years from when the initial investment is made.

## Problem

Several bills have been introduced – S. 781/H.R. 1735 and S 1639 – that would change the whole dynamic of a retail real estate partnership and tax the risk-based partner's carried interest as ordinary income. Regardless of the false narrative spread by some that this tax would impact large hedge fund managers, the proposed carried interest legislation would disproportionately impact small, locally focused and family-run real estate partnerships, with nearly half of all partnerships in America related to real estate. The proposed changes would have far-reaching implications for the real estate industry and would discourage investment in our communities, especially in underserved markets or brownfield sites that have additional challenges.

These bills would unfairly penalize entrepreneurs who use equity capital from outside investors and 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. We could see the same results as the retroactive tax increases in the Tax Reform Act of 1986, which caused commercial real estate values to plummet and exacerbated the Savings and Loan Crisis in the late 1980s and 1990s.

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Nearly half of all partnerships in America are related to real estate.

## Our position

Oppose legislation to tax carried interest as ordinary income. Congress should promote economic growth, not penalize entrepreneurs trying to make our communities better.

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