

SUPPORT ECONOMIC MOBILITY, ENTREPRENEURIAL RISK-TAKING, AND AMERICA'S REAL ESTATE

June 14, 2021

Dear Member of Congress:

The undersigned organizations, which represent a broad spectrum of America's real estate, urge you to preserve longstanding tax law as it relates to partnerships and profits interests (carried interest).

Well-intentioned but misguided legislation like the *Carried Interest Fairness Act* (H.R. 1068), and the President's budget proposal to tax carried interests as ordinary income, would result in an enormous tax increase on countless Americans who use partnerships to develop, own, and operate real estate. These sweeping changes, if enacted, would discourage individuals from pursuing their entrepreneurial vision, tax the sweat equity that makes real estate more productive and useful, and slow economic growth. The results would be particularly harmful to industries that seek to build a business or asset with lasting value over an extended time horizon.

If enacted, the proposed changes would make it more expensive to construct or improve real estate and infrastructure, including workforce housing, senior living communities, and industrial properties, to name just a few. Some development will not happen because the economic reward of carried interest could no longer compensate general partners for their higher level of risk. For example, investments that support economic inclusion or carry environmental benefits—new affordable housing, commercial projects in long-neglected neighborhoods, or the remediation and redevelopment of land with potential contamination—could be passed up in favor of projects with greater certainty for the partners but less potential upside.

In addition, the proposals would have profound, unintended consequences for the main streets of cities all across our country. Property taxes on real estate contribute 75 percent of local tax revenue and provide a stable and reliable source of funding for critical public services like education and law enforcement. Prior studies have found that carried interest legislation could result in reduced construction activity, lower property values, and decreased wages in the real estate industry.

Over the next several years, buildings throughout the country will need to be reimagined, repurposed, and converted to a new use in the post-COVID era. Lawmakers should be enacting policies to mobilize and encourage capital formation for new real estate investment, not creating new tax barriers.

The false narrative surrounding the carried interest issue is that it targets only a handful of hedge fund billionaires and Wall Street executives. On the contrary, the carried interest proposals are far more expansive than advertised. They would apply to real estate partnerships of all sizes—from two friends owning and leasing a townhome to a large private real estate fund with institutional investors.

Much of the real estate investment that takes place today uses the partnership choice of entity. According to the IRS, real estate partnerships represent half of the four million partnerships in the United States. In 2018, those real estate partnerships owned \$7.6 trillion in assets, owed \$3.6 trillion in mortgage debt and nonrecourse loans, earned \$46 billion in net rental income, paid \$28 billion in wages, and recognized \$52 billion in net long-term capital gain. These two million real estate partnerships and their 8.6 million partners own and operate multifamily rental housing, office buildings, shopping centers, hotels, distribution centers, senior living communities, and other commercial real estate in every town, city, and region of the country.

Most partnerships in all businesses reward the general partner with a share of the ultimate capital gain that reflects the risk they have taken—equity capital, assumption of business risk, or through good old-fashioned sweat equity. Reward for these latter forms of risk is “carried interest.”

In real estate, success is measured largely by the capital appreciation of the property. Under current law, this capital appreciation is long-term capital gain for all partners. The carried interest is not compensation for services. General partners receive fees for routine services like leasing and property management. Those fees are taxed at ordinary tax rates. The carried interest is granted for the value the general partner adds to the venture *beyond* routine services, such as business acumen, experience, and relationships. It is also recognition of the risks the general partner takes with respect to the general partnership’s liabilities. These risks can include funding predevelopment costs, guaranteeing construction budgets and financing, and exposure to potential litigation over countless possibilities.

The tax code has never, and should never, limit the reward for risk taking to taxpayers who have cash to invest. An entrepreneur who foregoes the security of a salary in order to invest their time and effort into starting a business that may or may not succeed should qualify for capital gains treatment the same way that a deep-pocketed and passive investor qualifies when they put their cash into a public stock or private venture. Unfortunately, the *Carried Interest Fairness Act* and the President’s proposal would limit capital gain treatment only to taxpayers who have cash to invest. Those who invest entrepreneurial innovation, risk taking, and sweat equity would no longer receive capital gain treatment. This would reduce economic mobility by increasing the tax burden on less-advantaged entrepreneurs.

Moreover, the legislation would apply retroactively to partnership agreements executed years—often decades—earlier. These negotiated agreements between the partners were based on well-established tax law as it existed at the time. By changing the tax results years later,

the proposals would undermine the predictability of the tax system and discourage the long-term, patient investment that moves our economy forward.

Achieving tax fairness is complicated. Simple solutions often are not solutions at all. We urge you to preserve current tax law as it relates to carried interest.

Sincerely,

The Real Estate Roundtable
American Hotel and Lodging Association
American Resort Development Association
American Seniors Housing Association
Asian American Hotel Owners Association
Building Owners and Managers Association (BOMA) International
CCIM Institute
Institute of Real Estate Management
International Council of Shopping Centers
Mortgage Bankers Association
NAIOP, Commercial Real Estate Development Association
National Apartment Association
National Association of Home Builders
National Multifamily Housing Council