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 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 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, permitting 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.

The Carried Interest Fairness Act would disproportionately impact small, locally-focused and family-run real estate partnerships.

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

Problem

Legislation has been introduced that would recharacterize carried interest as wage income, subject to ordinary income and employment taxes. The Carried Interest Fairness Act of 2021 (H.R. 1068/S. 1598) 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 nearly half of all partnerships. Many of these are small, locally-focused and family-run real estate business. Further, it would discourage investment in our communities, especially in underserved markets or brownfield sites that come with additional challenges and risks.

This bill 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.

Request

Oppose legislation to tax carried interest as ordinary income. The retail real estate sector is struggling from the impact of COVID-19. Congress should promote economic growth, not penalize entrepreneurs trying to make our communities better.

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

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