The Real Estate Roundtable

AUGUST 2021 TOWN HALL

TAX AND FISCAL RECONCILIATION FACT SHEET

The Congressional debate over a massive $3.5 trillion "human infrastructure" initiative formally began this week as the Senate turned its attention to the FY 2022 budget resolution. The initiative is expected to include broad-based tax increases and could include provisions targeting real estate. Below, we review the outlook and timing for legislation and highlight key tax proposals affecting the real estate industry.

A budget resolution, if adopted by both chambers, would authorize Congressional Democrats to use special "reconciliation" rules to avoid a filibuster in the Senate and pass the actual legislation along party lines.

The Senate completed consideration of its budget resolution this week. House Speaker Nancy Pelosi has indicated the House will consider the budget resolution before the end of the month. Both Chambers will then be on recess until mid-September.

Starting in mid-September and continuing in October, we expect House and Senate Democrats to resume meeting internally to make the difficult decisions on what provisions to include in the $3.5 trillion reconciliation bill, including which tax increases.

On the spending side, the reconciliation bill will likely include some combination of funding for affordable housing, universal pre-K education, two years of free community college, a Medicare expansion (adding dental, vision, and hearing benefits), elder care, child care, paid family and medical leave, anti-poverty programs (including expanded earned income and child tax credits), investments aimed at mitigating climate change, and much more.

We expect the reconciliation bill to include a large and as-yet undefined amount of tax increases to offset a significant share of the $3.5 trillion in new spending. President Biden's budget included $2.75 trillion of tax increases for his combined physical and human infrastructure initiatives (not including tax compliance measures). The Administration's tax proposals are a starting point for the internal discussions and negotiations underway on the reconciliation bill.

The President's tax proposals, if enacted, could have large and potentially damaging impacts on the real estate industry. The Roundtable is working closely with other national real estate organizations, similarly situated industries, and outside experts to raise awareness of real estate's importance to the economic recovery and job creation, the many ways in which current tax law supports capital investment and entrepreneurial risk-taking, and the risks and potential unintended consequences of tax changes.

We anticipate the next several weeks will be a critical period in which policymakers' views on these tax issues are solidified and decisions on how to proceed are made. Roundtable Members concerned about potential tax increases should consider reaching out to Members of Congress and are invited to use Roundtable materials (draft letter, talking points) as a resource.

Below, we outline the key real estate-related tax proposals under consideration as part of the reconciliation debate.

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Like-Kind Exchanges

- President Biden proposes to restrict gain deferred through real estate like-kind exchanges to no more than $500,000 per-year, or $1 million in the case of a married couple.
- The President's proposal would be effective for exchanges completed in tax years beginning after 2021.
- New research finds that nearly 1 in 5 commercial real estate transactions involve a party that is engaged in like-kind exchange and almost 40% of all like-kind exchanges involve rental housing.
- The research also shows that like-kind exchanges increase net investment, boost state and local tax revenue, stimulate capital expenditures which leads to job growth, reduce leverage and financial risk, lower rents for households, and support healthy property values.

Capital Gains

- President Biden proposes to raise the top capital gains rate to parity with the top tax rate on ordinary income (currently 37%, but proposed to increase to 39.6%).
- The President's capital gains tax increase would apply to transactions occurring after April 28, 2021.
- In addition, the President is proposing to extend the 3.8% tax on net investment income to the income of active business owners, including real estate professionals; the 3.8% tax applies to both capital gains and rental income.
- Senate Finance Committee Chairman Ron Wyden (D-OR) proposes to enact a mark-to-market regime for capital assets in which built-in gain is taxed on an annual basis, regardless of whether the asset is sold.

Step-Up in Basis and Taxation of Gains at Death

- President Biden proposes to tax built-in gains at death unless the property is donated to charity. The proposal would apply to gains in excess of $1 million.
- The President's proposal would apply in addition to the estate tax, which already imposes a tax of up to 40% on the fair market value of an individual's estate ($5.85 million in 2021).
- In addition, the President proposes to tax the built, unrealized gains of property held in a trust or partnership if the property has not been taxed for 90 years (draft Senate legislation would reduce the term to 21 years for property held in trust).
- Under these proposals, the taxpayer has not sold an asset and realized an actual gain, so there is no cash with which to pay the tax. Unlike a portfolio of publicly traded stock, a building is one asset and the proposal would effectively force the liquidation of real estate when it transfers from one generation to the next.

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Pass-Through Business Income

- Chairman Wyden has proposed repealing the 20% deduction for pass-through business income for taxpayers earning over $400,000/year.
- The pass-through deduction reduces the top tax rate on qualifying pass-through businesses from 37% to 29.6%. It applies to the rental and operating income of commercial real estate businesses. It also applies to ordinary REIT dividend income.
- The deduction was enacted in the Tax Cuts and Jobs Act to provide tax relief for the 28 million businesses that organized as sole proprietorships, partnerships, and S corporations and to avoid putting pass-through businesses at a competitive disadvantage relative to public corporations, which received a 40% reduction in their tax rate.

Carried Interest

- President Biden's budget, as well as the stand-alone Carried Interest Fairness Act (Rep. Bill Pascrell, D-NJ), would convert virtually all carried interest income attributable to gain from the sale of real estate to ordinary income subject to both ordinary income tax rates and self-employment taxes.
- The tax code should continue to reward risk taking and Congress should reject tax changes that limit capital gains treatment to invested cash. Proposed carried interest changes would harm small businesses and partnerships; stifle entrepreneurial risk taking and sweat equity; and threaten improvements and infrastructure in long-neglected neighborhoods most in need of investment.

Energy Efficiency Tax Incentives

- Both the Senate Finance and House Ways and Means Committees are considering including green energy tax incentives in reconciliation legislation. The Senate Finance Committee recently passed the Clean Energy for America Act, which includes over $250 billion new incentives for renewable fuels, vehicles, electricity, and energy-efficient building improvements.
- The Roundtable has worked with Members of Congress from both parties to advance legislation (E-QUIP Act) to provide accelerated depreciation for high performance, energy-efficient improvements to existing buildings.

Affordable Housing

- President Biden's budget dedicates $32 billion to the expansion of the low-income housing tax credit, a provision that helps subsidize the construction and rehabilitation of affordable housing.
- The President's proposed investment in additional LIHTC allocations represents more than a 30 percent increase over the current federal subsidy.