

Tax Policy

The Roundtable's 2022 tax policy agenda is focused on ensuring that the tax code allows real estate to continue contributing to job growth, strong and healthy local communities, and a broad-based economic expansion. These objectives are best served by tax rules that adhere to certain well-grounded and enduring principles.

More specifically:

- » The tax code should encourage capital formation (from domestic and foreign sources) and appropriate risk-taking, while also providing stable, predictable, and permanent rules conducive to long-term investment;
- » The tax code should ensure that tax rules closely reflect the economics of the underlying transaction — avoiding both excessive marketplace incentives and disincentives that can distort the flow of capital investment;
- » The tax code should recognize that, in limited and narrow situations (e.g., low-income housing and investment in economically challenged areas), tax incentives are needed to address market failures and encourage capital to flow toward socially desirable projects; and
- » When tax changes are made, the new rules should provide a well-designed transition regime that minimizes dislocation in real estate markets.

In short, rational taxation of real estate assets and entities supports job creation and facilitates sound, environmentally responsible real estate investment and development, while also contributing to strong property values and well-served, livable communities.

In 2021, these tax principles were challenged on a number of fronts as lawmakers and the Administration looked for new revenue options to pay for ambitious legislative proposals, such as President Biden's budget proposal and subsequent House iterations, among others. These various proposals — changing the tax treatment of like-kind exchanges; raising the tax rate on pass-through businesses; taxing unrealized gains on an annual, mark-to-market basis; and others — remain under consideration. Most concerning are those proposals, such as restricting like-kind exchanges, that are discriminatory and narrowly aimed at real estate.

In addition to raising policymakers' awareness of the potential economic harm caused by several of the proposed tax increases, The Roundtable's tax policy agenda also seeks to advance tax proposals that will support economic growth, capital formation, and jobs. These include: (1) the Retail Revitalization Act (H.R. 840); (2) expanding the low-income housing tax credit; (3) FIRPTA reform – including Parity for Non-Traded REITs Act (H.R. 3123); and (4) extending the deadlines for Opportunity Zone tax incentives. These issues are described in greater detail below and in the remaining sections of the Policy Agenda.



As current Ranking Member and former Chairman of the House Ways and Means Committee, Rep. Kevin Brady (R-TX) has been a champion for tax policies that encourage economic expansion and job growth but avoid unintended consequences.

Like-Kind Exchanges

Fundamental to the health and financing of commercial real estate, like-kind exchanges (section 1031) helped stabilize property markets at the height of the COVID-19 lockdown and are facilitating a faster and smoother transition as many real estate assets are repurposed in the post-COVID-19 economy. The ability to defer capital gain when a taxpayer exchanges one property for another is an essential feature of the current tax system that spurs capital investment, especially during times of market corrections and liquidity shortages. Like-kind exchanges help cash-poor entrepreneurs and investors, including minority-owned and women-owned businesses, grow organically. Research 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.

President Biden's FY 2022 Budget proposed to restrict gain deferred through real estate like-kind exchanges to no more than \$500,000, or \$1 million in the case of a married couple, effective for exchanges in tax years beginning after 2021. The Roundtable opposes such restrictions, which would undermine the economic recovery and cause unintended and unnecessary risks to the strength and stability of U.S. real estate. A Roundtable-led coalition of more than 40 national organizations wrote to the congressional tax-writing committees in September, detailing how like-kind exchanges under section 1031 support jobs and investment; the health of U.S. commercial real estate and real estate markets; and the preservation of family-owned farms, ranches, and forestland. A Roundtable-supported nonbinding amendment to preserve section 1031 unanimously passed the Senate

Like-Kind Exchanges



New research finds that nearly **1 in 5 commercial real estate transactions** involve a party that is engaged in **a like-kind exchange**



That research also found that almost **40 percent** of all like-kind exchanges **involve rental housing**

Source: Professors David Ling and Milena Petrova, The Tax and Economic Impacts of Section 1031 Like-Kind Exchanges in Real Estate (Aug. 2020)

over the summer, and like-kind exchange restrictions were not included in the *Build Back Better Act*. The Roundtable remains committed to ensuring policymakers preserve like-kind exchanges in future legislation.

Capital Formation

Favorable tax rules for capital formation promote productive economic growth and job creation. For example, a low tax rate on capital gains reduces the cost of capital; drives patient, long-term investment; and encourages productive entrepreneurial activity. In recent years, however, the tax burden on capital has increased relative to the tax burden on corporate income and ordinary wages. Legislation that would discourage capital formation further by raising the tax rate on capital gain is misguided. Similarly, policymakers should reject well-intended but detrimental proposals to reverse longstanding tax principles, such as the axiom that capital gain is deferred until an asset is actually sold. On the contrary, policymakers should take additional steps to encourage and reward productive



House Ways and Means Committee Member Rep. Stephanie Murphy (D-FL) is a co-sponsor of Roundtable-backed legislation that would unlock capital for productive and job-saving investment and contribute to the economic recovery (The Retail Revitalization Act (H.R.840)).

investment through tax policies, such as Opportunity Zones, that mobilize long-term investment and support job growth and economic development. Three areas of capital formation are of particular focus for The Roundtable.

Capital Gains Rate - Today, long-term capital gain is taxed at a top rate of 20%, but the rate rises to 23.8% if the income is subject to the 3.8% tax on net investment income. President Biden's budget proposed raising the top capital gains rate to parity with the top tax rate on ordinary income (currently 37%, but proposed to increase to 39.6%). It also proposed extending the 3.8% tax on net investment income to the income of active business owners, including real estate professionals. The subsequent *Build Back Better (BBB) Act* approved by the House Ways and Means Committee would have raised the capital gains rate from 20 to 25% and expanded the scope of the 3.8% net investment income tax, as proposed by the President. Fortunately, the proposed increase in the general capital gains rate was not included in the revised *BBB Act* passed by the full House in November. The Roundtable is committed to preserving a meaningful reduced rate (relative to ordinary income) to encourage long-term capital investment.

Step-Up in Basis and Taxation of Gains at Death - The tax code levies a tax on appreciated gains when an individual dies through the estate tax, and policymakers should avoid the unfair and unintended economic consequences that would result from imposing a second tax on unrealized gains at death. President Biden's budget proposed to tax built-in gains at death unless the property is donated to charity, applicable to gains in excess of \$1 million. In addition, the President proposed taxing the built-in, 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). The Roundtable strongly opposes the double taxation of real estate gains at death and recommends Congress retain tax rules that allow family-owned and closely held

businesses to continue growing and creating jobs from one generation to the next. Proposals to tax unrealized real estate gains at death were not included in the House-passed *BBB Act*.

Mark-to-Market Tax Proposal - Senate Finance Committee Chairman Ron Wyden (D-OR) proposed 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. Initially, Chairman Wyden proposed applying the tax to taxpayers with more than \$1 million in annual income and/or more than \$10 million in assets for three consecutive years. Chairman Wyden later introduced a modified version of his mark-to-market proposal that would apply specifically to “billionaires.” The Roundtable is concerned that the so-called billionaires tax proposal is a foot in the door to achieve the much

Academic Study Finds Ending Capital Gains Treatment for Carried Interest in Real Estate Partnerships Would Result in Job Losses, Reduced Tax Revenue

Long Run Economic Impact of Carried Interest Legislation	
Real Estate-Related Job Losses	\$1.77 million
Reduction in Federal Tax Revenue	\$11.22 billion
Reduction in State/Local Tax Revenue	\$26.74 billion

Source: Professor Charles Swenson (USC Marsh School of Business), Center for Capital Markets Competitiveness, Impact on Jobs, Tax Revenue, and Economic Growth of Proposed Tax Increase on Carried Interest (Sept. 2021).

broader aim of a mark-to-market regime for every American family that has built up a modest amount of assets over their lifetime. The Roundtable strongly opposes such a tax on the grounds that such a regime is unconstitutional; undermines economic growth by promoting short-term trading and reducing the incentive for long-term savings and investment; would exacerbate our reliance on foreign capital and increase foreign ownership of U.S. assets; and would hurt charities, educational endowments, and churches. The House-passed *BBB Act* excludes a mark-to-market regime.

Pass-Through Taxation

Closely held partnerships and pass-through businesses drive job growth and entrepreneurial activity. Pass-through entities give owners flexibility in how they structure the risks and rewards of the business. Our pass-through regime is a strength of the U.S. tax system relative to our international competitors and contributes to our entrepreneurial culture and dynamic economy. In 2017, the *Tax Cuts and Jobs Act* created a new 20% deduction for pass-through business income to provide parallel tax relief for unincorporated businesses alongside the 40% reduction in the corporate tax rate.

In July 2021, Chairman Wyden proposed repealing the 20% deduction for pass-through business income for taxpayers earning over \$400,000/year (section 199A). Legislation passed by the House Ways and Means Committee over the summer of 2021 would have capped the maximum deduction under section 199A at no more than \$500,000. Moreover, through the combination of several, independent tax changes, the Ways and Means bill would have raised the top marginal income tax rate on many small and pass-through business owners from 29.6% today to 46.4%. The Roundtable strongly opposed such changes and recommended that legislation avoid tax changes that discriminate against specific industries or types of entities, such as partnerships and S corps.

Our pass-through regime is a strength of the U.S. tax system relative to our international competitors and contributes to our entrepreneurial culture and dynamic economy.

The House-passed *BBB Act* did not include restrictions on the 20% pass-through deduction and lowered the proposed maximum marginal tax rate on pass-through business income from 46.4 to 41.4%.

Carried Interest - Carried interest is the interest in partnership profits a general partner receives from the investing partners for managing the investment and taking on the entrepreneurial risk of the venture. Carried interest may be taxed as ordinary income or capital gain depending on the character of the income generated by the partnership. Lawmakers have introduced various proposals to change the tax treatment of carried interest since 2007. President Biden’s budget, as well as stand-alone bills, 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. Legislation passed by the Ways and Means Committee in the summer of 2021 would have extended the holding period required for carried interest to qualify as capital gain from 3 years to 5 years, but would have excluded real estate partnerships. The carried interest proposal was dropped in the House-passed *BBB Act*. 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.

Tax Proposals to Stimulate Retail Recovery, Housing Affordability, Economic Development in Struggling Neighborhoods, and Foreign Investment in US Real Estate and Infrastructure

The Roundtable continues to advocate a number of targeted tax legislative initiatives to address specific concerns around retail recovery, housing affordability, economic development in struggling neighborhoods, and foreign investment in U.S. real estate and infrastructure.

Pass-Through Taxation



Much of the real estate investment that takes place today uses **the partnership choice of entity**.

Real estate partnerships represent 50% of the nearly 4 million partnerships in the US. That's nearly 8 million individual partners.

Source: IRS, Statistics of Income (2021).

Specifically, The Roundtable urges action on the following issues:

- » *Retail Revitalization Act (H.R. 840)* – H.R. 840 would unlock capital for productive and job-saving investment and contribute to the economic recovery. The bill would modify an antiquated section of our tax code that limits the ability of real estate investment trusts (REITs) and real estate businesses to invest in their tenants, including retail tenants, at a time when there is a significant and urgent need for such investment to support our nation’s economic recovery and prevent further large-scale job losses and bankruptcies in the retail sector and its supply chain. The Roundtable urges Congress to pass this cost-effective and commonsense step to unlock capital and promote a market-based solution where economic stress is widespread.
- » *Affordable Housing* – The Real Estate Roundtable supports well-designed, targeted tax incentives like the low-income housing tax credit (LIHTC) that are aimed at boosting the construction and rehabilitation of badly needed affordable and workforce housing. The House-passed *BBB Act* would make important investments in the LIHTC by expanding the allocation of credits in the coming years. Other ambitious legislation, such as the *Affordable Housing Credit Improvement Act* (H.R. 2573, S. 1136) and Chairman Wyden’s proposal to create a middle-income housing tax credit modeled on LIHTC, merit serious consideration.
- » *Extension of Opportunity Zone Deadlines* – Opportunity Zones channel investment and spur economic growth in low-income communities by reducing the capital gains burden on investors that redeploy gains from prior investments to new opportunities in otherwise distressed

neighborhoods. Real estate projects financed through Opportunity Funds are an economic multiplier and a catalyst for permanent, lasting job creation. Under the Opportunity Zone statute, the tax benefits associated with Opportunity Zone investments are gradually diminishing. After December 31, 2021, new Opportunity Zone investments will not qualify for a reduction in the capital gains tax owned when gain is rolled over into an Opportunity Fund. In addition, the economic benefits of the deferral period for gain rolled into an Opportunity Fund are declining. Taxpayers must recognize the deferred gain at the end of 2026. In order to encourage investment in Opportunity Zones, a broad coalition led by The Roundtable is recommending that Congress extend the deferred gain recognition date by two years, through the end of 2028.

- » *FIRPTA Reform* – including the Parity for Non-Traded REITs Act (H.R. 3123) – The Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) imposes a discriminatory capital gains tax on foreign investors in U.S. real estate that does not apply to any other asset class. In so doing, the FIRPTA regime discourages capital formation and has been an effective deterrent to foreign persons investing in U.S. real estate. H.R. 3123 extends to non-traded REITs the safe harbor that allows a foreign shareholder to own up to 10% of a publicly traded REIT without triggering FIRPTA liability. The Roundtable recommends Congress pass H.R. 3123, as granting non-traded REITs parity with the FIRPTA treatment of exchange-traded REITs offers an opportunity to increase the flow of capital into U.S. commercial real estate and infrastructure with minimal negative impact, if any, on federal revenues.