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The Real Estate Roundtable

January 18, 2018

The Honorable Steven T. Mnuchin
Secretary of the Treasury
1500 Pennsylvania Ave., NW
Washington, DC 20220

Dear Secretary Mnuchin:

Congratulations and thank you for the critical role you played in passing the *Tax Cuts and Jobs Act*. The Real Estate Roundtable shares the Administration's goals of creating jobs and spurring economic growth. The positive impact of the tax changes is already evident in the economy. However, rulemaking and guidance will be critically important to the long-term success of the new tax law. Based on input we have received from real estate industry leaders across the country, below are some initial comments and recommendations respectfully offered with the hope of helping Treasury achieve our shared objectives.

As a general matter, our view is that a flexible approach that incorporates safe harbors and allows taxpayers to rely on existing standards, conventions, and rules would reduce the need and incentive for inefficient business restructuring or inactivity pending the issuance of final rules. In particular, early Treasury guidance would help avoid economic disruptions in 2018. We intend to provide more detailed comments to you and your staff in the days and weeks ahead. In the short term, however, temporary or immediate guidance in the following areas would provide a boost to economic activity:

- **Interest limit.** In tax reform, lawmakers recognized that continued full deductibility of interest on the approximate $3.8 trillion of outstanding commercial real estate debt is fundamental to the stability and growth of the economy. This recognition is consistent with the interest regimes in other countries, such as the United Kingdom. *See* Finance (No. 2) Act 2017, sched. 5, ch. 8 (U.K.). However, to avoid economic disruptions, early guidance is needed to clarify that taxpayers may deduct interest on debt incurred in a real property trade or business, determined using any reasonable allocation method, and including debt incurred to capitalize entities that are engaged in a real property trade or business. Such guidance could certainly be temporary, perhaps through 2018, pending more definitive guidance which should be prospective only.

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- **Pass-through deduction – aggregation of activities.** The new pass-through deduction is a powerful provision that will spur entrepreneurship and responsible risk-taking. The deduction is determined separately for each qualified trade or business, but the law does not define what is a distinct trade or business. Early guidance should provide that for 2018 and later, until final prospective guidance is issued, all qualified trade or business activities may be aggregated at the partner level for purposes of the wage and asset tests. This would be consistent with the statutory rule aggregating all such businesses when determining whether the taxpayer has a loss from such businesses. Until definitive guidance can be issued, such a rule would avoid disruptive and potentially unnecessary restructurings. Alternatively, at a minimum, aggregation should be permitted that is consistent with the principles and policies of I.R.C. section 469 (whether or not there is any formal grouping or other election under those rules).

- **Pass-through deduction – specified services.** Certain service businesses in listed fields are ineligible for the pass-through deduction. Businesses that provide otherwise permissible services to such businesses on an arm's length basis (such as a commercially operated hospital parking structure) should be not be considered impermissible businesses. If necessary, such a safe-harbor could be limited to entities that do not share common ownership or control with the principal user of the services.

- **Pass-through deduction – like-kind exchanges.** The transfer of real estate in a like-kind exchange should not adversely affect a taxpayer's pass-through deduction, particularly since the underlying capital investment in the business is continued. Early guidance should clarify that a like-kind exchange will not reduce the taxpayer's basis for purposes of the pass-through capital calculation.

- **Pass-through deduction – REIT dividends.** Ordinary dividends from real estate investment trusts (REITs) qualify for the pass-through deduction. Nearly half of all listed REIT shares are held by investors through mutual funds. Early guidance should confirm that the benefit of the deduction applies to shareholders invested in REITs through a mutual fund. The statute includes express regulatory authority with respect to such tiered structures.

- **Pass-through deduction – principal asset test.** Taxpayers are understandably unclear on what it means to disallow the pass-through deduction for businesses whose "principal asset" is the skill or reputation of its employees or owners. Treasury should consider issuing early guidance that clarifies that the skill or reputation of a firm's employees are not considered an "asset" of the firm other than when they are reflected in an amortizable tax asset (such as workforce in place). In addition, a clear mechanical rule should be provided for gauging whether such intangible assets, together with the owner's skills or reputation, constitutes the principal asset of the firm.

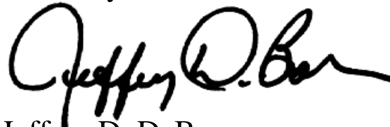
- **Pass-through deduction – reasonable compensation.** The pass-through deduction includes wage and capital rules to deter the conversion of compensation to business income. Consistent with current rulings and the legislative history for the new law, early guidance should clarify that the reasonable compensation exclusion from qualifying business income is limited to S corporations, and that partners and sole proprietors are not required to provide or designate any amount of their net business income as reasonable compensation.

- **Cost recovery.** The law creates a new category of "qualified improvement property," but the final language does not reflect the clear legislative intent, as expressed in the conference report, to provide a 15-year recovery period. A Treasury or IRS Notice, a Bluebook statement, or other guidance confirming that qualified improvement property is subject to a 15-year recovery period (and consequently is eligible for bonus depreciation) would be helpful in avoiding delays or disruptions in business investment.

Enactment of this landmark tax legislation is a major achievement. The comments above reflect an initial review and assessment of key issues where clarifications could be most useful, in the short term, in helping ensure that it spurs investment, growth, and job creation.

The Real Estate Roundtable is appreciative of your thoughtful and considerate approach to tax reform. We will continue to work closely with you, the Congress, and the Administration to accelerate economic growth and improve local communities.

Sincerely,



Jeffrey D. DeBoer
President and CEO