September 24, 2021

The Honorable Ron Wyden
Chairman, Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Wyden:

The undersigned organizations, which employ millions of Americans in all aspects of developing, operating, financing and improving the Nation's real estate, write to express significant concerns with your pass-through reform discussion draft.

As drafted, the legislation would upend the tax rules that currently apply to four million partnerships in the United States and their 27.4 million partners. These partnerships are the backbone of small business, start-up, and entrepreneurial activity in the United States. Collectively, they drive growth in employment and create new job opportunities at rates that greatly exceed other types of business entities, including corporations. In 2018, partnerships paid over $700 billion in salaries and wages to millions of workers across the country. Between 2000 and 2019, small businesses – which are organized primarily as partnerships and LLCs – accounted for 65 percent of net new job creation.

Collectively, the pass-through proposals in your discussion draft constitute a fundamental overhaul and restructuring of partnership tax law. Rather than seeking to reduce tax complexity and ease the administrative burden on taxpayers, however, the changes appear aimed primarily at raising revenue—$172 billion according to the press release. As a result, the legislation would increase the tax burden on U.S. partnerships by an average of $43,000.

Real estate partnerships represent nearly half of the four million partnerships in the United States. They include a wide variety of arrangements that range from two friends who purchase, improve, and lease a modest rental property to a large private real estate fund that raises capital from sophisticated institutional investors to develop large, mixed-use structures requiring years, if not decades, to plan, permit, and construct. Partnerships allow widely owned, public companies such as REITs to raise capital in joint ventures with partners to finance their business operations with equity capital. What all of these real estate partnerships have in common is that they are actively investing capital, hiring employees or contractors, and contributing to the development and improvement of productive assets that provide a place for others to live, work, shop, or recreate. The press release accompanying the discussion draft inferred that partnerships are little more than tax shelters for wealthy investors and mega-corporations—we believe this idea could not be more mistaken. Commercial real estate businesses, organized as partnerships, bear substantial economic risks and, in so doing, generate property tax revenue that allows local governments to continue delivering critical public services to communities.

Provisions in the legislation would alter the tax rules that apply when a partnership is formed and property is contributed, creating new barriers to business formation. Other provisions would changes the rules when a partnership borrows to finance its growth and expansion, as well as when a partnership distributes profits and gains to the owners. The legislation would also change the rules that apply when a partner transfers his ownership interest to another person and reduce the flexibility

of partners to determine how best to allocate partnership income and deductions among the owners of the business. Beyond the changes in tax liability, the legislation would generate enormous new and unnecessary tax complexity and compliance costs.

Moreover, the draft bill could undermine critical priorities in the *Build Back Better Act*, including the provision of affordable housing. Low-income housing tax credit projects rely on complex partnerships to bring diverse parties together to serve a common purpose—the construction and rehabilitation of rental housing for low-income tenants. The legislation would adversely affect tax provisions that sponsors of these projects rely on, including the ability to flexibly allocate tax attributes based on substantial economic effect. Similarly, Congress has designed green tax incentives to work primarily through complex partnership structures. If enacted, the *Neighborhood Homes Investment Act* will rely on partnerships to subsidize the construction of new homes for low-income homebuyers.

The proposal requiring that partners share all debt in accordance with partnership profits, depending on how it is interpreted, could overturn decades of tax law with respect to nonrecourse borrowing by a partnership, effectively raising the after-tax cost of capital. Longstanding tax rules allow taxpayers the ability to allocate "excess nonrecourse liabilities" flexibly as long as the arrangement is consistent with the way they share deductions or other significant items. The proposal requiring partnerships to use the "remedial" method for recognizing gain in appreciated property would force partners to pay tax on unrealized gains at ordinary income rates, distorting both the character and timing of income relative to the actual economics of the business. Provisions such as mandating asset revaluations would add significant compliance costs.

The proposed overhaul of partnership tax law is not limited in application to future transactions, many of the provisions would apply retroactively to economic arrangements entered into years, and sometimes decades, earlier. For example, a real estate partnership that relied on the well-established substantial economic effect safe harbor in the section 704(b) regulations to determine how income, gain, loss, deductions, and credits would be distributed among the partners would no longer be able to do so after 2023, even though the arrangement is defined in the partners' existing partnership agreement. Partners who transferred property to a partnership in any year prior to 2021 in transactions in which they entered into full-recourse debt guarantees in order to cover their negative capital accounts would be fully taxable on such transfers beginning in 2022, even though their contractual guarantees would remain in place. We urge you to avoid tax reforms that retroactively and unfairly change the economics of prior transactions, particularly when those transactions involved carefully negotiated agreements between independent parties and relied on existing tax law.

Given time, bipartisan reforms to partnership audit rules enacted in 2015 will gradually allow the IRS to more effectively enforce partnership laws and reduce potential abuses, a principal concern underlying the draft. Treasury and the IRS have taken additional steps on their own to improve partnership reporting, including the reporting of tax capital accounts as of 2020. These actions need time to show results.

Changes of this magnitude to tax rules affecting four million partnerships merit a full vetting and thoughtful consideration, including hearings, sufficient time for public comments, and a committee mark-up with opportunities for amendments and modifications. The sheer complexity and novelty of the proposals warrant a deliberative process to ensure there are no unintended consequences. Introducing uncertainty, or randomness, into the tax treatment of millions of businesses is not something to be done lightly.

Partnerships, supported by the flexibility of Subchapter K of the tax code and our well-developed system of pass-through business taxation, contribute immensely to the culture of dynamic entrepreneurship that is missing in many parts of the world where business activity is dominated by large, public corporations. The partnership tax regime is a critical part of our "intangible infrastructure": the legal, regulatory, and tax system that makes the United States the envy of the world when it comes to innovation, risk-taking, and productive investment. Erosion of pass-through taxation and the partnership form, as outlined above, could undermine productivity growth, job creation, and American enterprise.

With millions of Americans still unemployed and others who have yet to return to the labor force, we encourage you to focus instead on reforms that will strengthen and expand partnerships' ability to create jobs and economic opportunities. Please do not hesitate to contact Ryan McCormick, Senior Vice President and Counsel of The Real Estate Roundtable (rmccormick@rer.org), if you or your staff have questions or would like additional information on these comments.

Sincerely,

American Hotel and Lodging Association
American Resort Development Association
American Seniors Housing Association
Asian American Hotel Owners Association
Associated Builders and Contractors
Building Owners and Managers Association (BOMA) International
CCIM Institute
Council for Rural and Affordable Housing
CRE Finance Council
ICSC
Institute of Real Estate Management
Leading Builders of America
Manufactured Housing Institute
Mortgage Bankers Association
NAIOP, The Commercial Real Estate Development Association
Nareit
National Apartment Association
National Association of Home Builders
National Association of REALTORS®
National Multifamily Housing Council
REALTORS® Land Institute
Society of Industrial and Office REALTORS®
The Real Estate Roundtable

CC: Senate Majority Leader Charles Schumer and Minority Leader Mitch McConnell

Members of the Senate Finance Committee

House Speaker Nancy Pelosi and Minority Leader Kevin McCarthy

Members of the House Ways and Means Committee