The Real Estate Roundtable

Carried Interest

Tax Policy

Summary

A "carried" interest is the interest in partnership profits that a general partner receives from the investing partners for managing the investment and taking on the entrepreneurial risks of the venture, such as funding pre-development costs, guaranteeing construction budgets, and potential litigation. Carried interest is also granted for the value the general partner adds beyond routine services, such as business acumen, experience, and relationships. Carried interest may be taxed as ordinary income or capital gain depending on the character of the income generated by the partnership.

In the Tax Cuts and Jobs Act of 2017, Congress created a three-year holding period requirement for carried interest to receive long-term capital gains treatment.

In recent years, both Republican and Democratic leaders have proposed making policy changes that would increase the tax burden on carried interest. These include proposals to: (1) convert virtually all real estate-related carried interest income to ordinary income subject to the top tax rates and self-employment taxes; (2) treat carried interest as an interest-free loan from the limited partners to the general partner that is taxable upon grant, regardless of whether the partnership ever generates any profits; and (3) extend the current three-year holding period for carried interest capital gains treatment to five years.

Since carried interest and its tax treatment first emerged as a controversial political issue in 2007, **RER has consistently opposed legislative proposals to tax all carried interest at ordinary income rates.**

Key Takeaways

- **Carried interest is essential to real estate investment,** supporting housing development, economic growth, and the modernization of U.S. infrastructure. Carried interest changes would harm small businesses, stifle entrepreneurs and sweat equity, and threaten future improvements and infrastructure in neglected areas.
- Carried interest is **not compensation for services**. General partners receive fees for routine services (leasing, property management). Those fees are taxed at ordinary tax rates.
- Proposals to tax all carried interest as ordinary income would result in an enormous tax hike on the **2.2 million** real estate partnerships and **9.7 million** real estate partners across the country who develop, own, and operate income-producing real estate.
- Taxing carried interest at ordinary income rates would increase the cost of building or strengthening infrastructure, workforce housing, and assisted living, and would deter risky projects, such as sites with potential environmental contamination.
- The tax code should reward risk-taking**; the capital gains rate should apply to more than just invested cash.** The tax code has never, and should never, limit the reward for risk-taking to taxpayers who have cash to invest. An entrepreneur who forgoes the security of a salary to invest time and effort into starting a business should qualify for capital gains treatment in the same way that a passive investor qualifies when they put their cash into a public stock or private venture.
- Carried interest proposals apply retroactively to prior transactions and partnership agreements executed years earlier. The agreements were based on tax law **as it existed at the time**.
- Changing the results years later would undermine the predictability of the tax system and discourage long-term, patient investment.