International Council of Shopping Centers

AUGUST RECESS TALKING POINTS

CARRIED INTEREST

The President's budget plan proposes to increase the taxation of a general partners "promote" or "sponsor's share" (a.k.a. carried interest) from the current and more favorable capital gain rate of 15% to the higher ordinary income tax rate of 35%.

- Many real estate ventures are organized as limited partnerships, with the general partners' interest treated as compensation for services, making them subject to carried interest taxes.
  - While the stated intent of this proposal is to address the perceived tax rate inequity applied to private equity and hedge fund managers, it will disproportionately impact the real estate industry.
  - The general partner is currently required to pay ordinary income taxes on the fees received from the partnership for standard services such as leasing or construction management. The carried interest for the general partner reflects the risk they take on behalf of the partnership.
  - This proposal will hit small to medium size developers the hardest. Small and mid-sized developers are less likely to be able to negotiate favorable terms with the investing partner.
- By treating the general partner's interest in a partnership as compensation for services, the risk that the general partner undertakes on behalf of the partnership is not recognized.
  - The direct risks include all partnership liabilities for environmental concerns, lawsuits, loan guaranties and carve-outs. The general partner also guarantees construction completion, leasing, operating deficits and debt.
  - Often, a "hurdle" or minimum return rate is built into the partnership's return, which result in the limited partner realizing a return on investment before the general partner sees the first dollar of gain. Moreover, the general partner often experiences a significant "hold" time of the asset before recognizing any gain.
- This proposed tax increase will threaten economic development projects.
  - If this tax increase is enacted, economic development in the most underserved areas will likely become too big a risk to undertake. This disruption in real estate development will threaten jobs and economic growth that are critical to local communities nationwide.
  - The estimated economic loss due to the crowding out of economically-viable projects is between $15 billion and $20 billion annually.
  - By undercutting the economic incentive to build a project or redevelop an underutilized property, this change could significantly drive away investment from the commercial real estate sector when it is most needed.