OUR POSITION: ICSC has strongly opposed the proposed tax increase on carried interest since it was originally introduced in 2007. This potential tax hike does not recognize the entrepreneurial risk and personal guarantees associated with a real estate partnership. Furthermore, without a carve-out for real estate, it could result in significant unintended consequences, such as increased taxes on family partnerships with real estate holdings.

Background:
Carried interest is often mischaracterized as a tax loophole for wealthy hedge fund and private equity fund managers. However, in the real estate industry, carried interest has been used for more than 50 years as a way to align partnership interests and value the inherent risk associated with commercial real estate projects.

The risks acknowledged by carried interest include: pre-capitalization preparations costs, loan guaranties and carve-outs, liabilities for environmental concerns, and lawsuits.

As well, in a real estate partnership, carried interest is not compensation for services or a fee waiver; it is recognition of the risk absorbed by the general partner in a real estate partnership. The general partner pays ordinary income taxes on any fees received from the partnership for standard services such as leasing or construction management. Additionally, unlike private equity firms, the carried interest for the general partner in a real estate partnership is not guaranteed income. Most real estate ventures must overcome return on investment hurdles, which result in the limited partner realizing a full return on investment before the general partner sees the first dollar of gain.

Proposed legislation would create a 150% tax increase on carried interest and change the nature of the income from capital gains to ordinary income. While the original stated intent of this proposal was to address the perceived tax rate inequity applied to private equity and hedge fund managers, it will disproportionately impact the real estate industry as half of all partnerships are real estate.

Current Situation:
Changing the tax treatment for carried interest continues to be mentioned in the press. Several Republican presidential candidates have included provisions on this issue as part of their campaign tax plans and President Obama continues to push Congress to increase taxes on carried interest. In 2013, Ways and Means Chairman David Camp (R-MI) put forth legislation related to carried interest, but included a carve-out for real estate partnerships, acknowledging the associated economic risk. ICSC and other real estate groups continue to work with the Ways and Means Committee to improve the carve-out to meet their intent. However, we do not believe that any meaningful tax related legislation will be enacted before 2017.

Conclusion:
ICSC members absorb the financial risk associated with economic development to bring products and services to our communities. By undercutting the economic incentive to build a project or redevelop an under-utilized property, taxing carried interest in real estate partnerships will drive away investment from the commercial real estate sector and hurt our ability to create jobs and economic development.

According to the IRS, in 2013, the real estate sector accounted for half (49.8%) of all partnerships and just over a quarter (27.7%) of all partners.

According to a report from Douglas Holtz Eakin, the estimated economic loss due to the crowding out of economically viable projects is between $15 billion and $20 billion annually.

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