April 9, 2018

The Honorable David J. Kautter
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

The Honorable William M. Paul
Acting Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

RE: Provisions of the Tax Cuts and Jobs Act Impacting Real Estate

Dear Messrs. Kautter and Paul:

The International Council of Shopping Centers ("ICSC") appreciates the opportunity to provide comments on certain provisions of the Internal Revenue Code ("Code") enacted pursuant to "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018," P.L. 115-97 (commonly referred to as the "Tax Cuts and Jobs Act" or the "TCJA").

Founded in 1957, ICSC is the global trade association of the shopping center industry. Our nearly 70,000 members in over 100 countries include shopping center owners, developers, managers, investors, retailers, brokers, academics, and public officials. The shopping center industry is essential to economic development and opportunity. It is a significant job creator, driver of GDP, and critical revenue source for the communities it serves through the generation of sales taxes and the payment of property taxes. These taxes fund important municipal services like firefighters, police officers, school services, and infrastructure like roadways and parks. Shopping centers aren't only fiscal engines however. They are integral to the social fabric of our communities by providing a central place to congregate with friends and family, discuss community matters, and participate in and encourage philanthropic endeavors.

The shopping center industry is comprised of a large number of entrepreneurs that develop and own real estate, primarily using entities taxed as partnerships and real estate investment trusts. Each investment is typically held through tiers of legal entities, accommodating various investors, financing needs, and management structures. While some investments are held through investment funds, the majority are held through non-fund partnership arrangements that often provide the sponsoring developer a larger share of profit growth (i.e., a "carried interest"). Applying the new TCJA rules to these complex arrangements raises several topics in which further guidance is needed, as discussed below.

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I. Section 1061

Section 1061 raises the traditional long-term capital gain holding period from one to three years with respect to a partner's carried interest. We note that new Section 1061 contains a number of items that we request more clarity on below.

Sales of Partnership Assets vs. Partnership Interest

Section 1061 substitutes 3 years for 1 year under the Section 1222 long-term capital gain definition. Section 741 treats gain from the sale of a partnership interest as the sale of a capital asset to the extent Section 751 does not apply. We ask for clarification that the impact of the rule is as follows: (A) When a partnership capital asset is sold, the asset must have a 3-year holding period (taking into account any "tacked" holding periods) in order for the owner of the applicable partnership interest to treat its share of the gain from the sale of the asset as long-term capital gain; and (B) When the owner of the applicable partnership interest sells its partnership interest, any Section 741 capital gain recognized is only long-term capital gain to the extent the partner held such interest for the requisite 3-years.

Applicable Partnership Interest Excludes Single-property Joint-ventures

The definition of applicable partnership interest requires an applicable trade or business defined as an activity conducted on a regular, continuous, and substantial basis which consists, in whole or in part, of (A) raising or returning capital; and (B) developing or investing in specified assets. The definition clearly targets traditional "fund" type partnerships, consistent with the clear regulatory deference to the Secretary under Section 1061(b) to more clearly carve out gain attributable to assets "not held for portfolio investment on behalf of third party investors." We ask for clarification that single real estate development joint ventures are not an applicable trade or business for this purpose because taxpayers that receive interests in such ventures lack the regular capital raising criteria and moreover only involve a single project and thus do not satisfy the regular, continuous, and substantial requirements set forth above. We ask that this clarification recognize that if a single developer has a number of these individual project partnerships which may contain repeat capital investors, each partnership is separately considered an independent investment for purposes of determining whether the portfolio investment is on behalf of third party investors.

Gift Transfers of Partnership Interests

We note that Section 1061(d) contains a special anti-abuse rule for transfers of partnership interests to related persons. We request that future guidance clarify that this provision not apply to the common, non-abusive gift transfers of partnership interest as part of generational estate planning, which would simply succeed to the treatment of the transferor under Section 1061.

II. Qualified Improvement Property

The TJCA eliminated the separate definitions of qualified leasehold improvement, qualified restaurant, and qualified retail improvement and created a combined and expansive concept of "qualified improvement property," with the clear intent of providing a permanent 15-year (20-year ADS) accelerated depreciation life for such property as noted in the TJCA legislative history. Despite this clear intent for accelerated depreciation, the actual statutory language in Section 168 did not list qualified improvement property as 15-year property under Section 168(e)(3)(E). While we understand

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that the expectation is for a statutory technical correction to fix this drafting error, in the meantime, ICSC and its members request confirmation that they can rely on the clear legislative history showing qualified improvement property as 15-year (20-year ADS) property for tax reporting until the technical correction is adopted.

III. Basis Adjustments Eligible for Section 168 Expensing

Section 168(k), as amended by the TCJA, allows immediate expensing for qualified property, which in relevant part, means property the original use of which begins with the taxpayer or is acquired by the taxpayer. Acquired for this purpose is, in relevant part, premised on the property not having been used by the taxpayer prior to the acquisition. The aggregate-entity nature of partnerships and related basis adjustment creates the question of how basis adjustments under Sections 734(b) and 743(b) apply for purposes of such rule (for example, if a new or existing partner acquires partnership interest from an existing partner and receives a positive Section 743(b) basis adjustment in a qualified property). We request that future guidance clarify that under an aggregate treatment of partnerships such basis adjustment is treated as an eligible acquisition of qualified property even though the partnership itself already owned the underlying property. A similar interpretation question arises when a partnership redeems a historical partner for cash and may receive a positive basis increase in qualified property under Section 734(b). We note that Treasury Regulations Sections 1.734-1(e)(1) and 1.743-1(j)(4)(i)(B)(i) each provide that for purposes of Section 168, basis adjustments pursuant to Sections 734 and 743, respectively, are treated as “newly-purchased recovery property placed in service” when the basis adjustments occur. Accordingly, the regulatory framework supports expensing basis adjustments, and we respectfully request confirmation to that effect.

IV. Section 199A - Qualifying Business Income

Section 199A provides, in relevant part, to non-corporate taxpayers up to a 20-percent deduction with respect to a taxpayer’s qualified business income (“QBI”). That 20-percent deduction is limited in part by (1) 50% of the W-2 wages with respect to the qualified trade or business (the “W-2 Limitation”), or (2) the sum of 25 percent of the W-2 wages with respect to the qualified trade or business, plus 2.5 percent of the unadjusted basis immediately after acquisition of all qualified property (the “Property Limitation,” and collectively with the W-2 Limitation, the “199A Limitations”).

Partner-Level Definition of Trade or Business

Section 199A Limitations apply to “any qualified trade or business,” but the statute does not provide guidance on how to determine what constitutes such a trade or business. A single taxpayer will often conduct its real estate business through a series of regarded and disregarded entities, although it is all part of a single overall real estate business. The different entities are necessary for non-tax reasons such as financing, allowing for different investors per real estate development, or to allow a taxpayer to house all of its employees in a single management entity to more efficiently service all of its real estate partnerships. Consistent with the statutory application of Section 199A at the partner-level under Section 199A(f), we ask for clarification that the application of the 199A Limitations apply similarly, allowing the ultimate partner to aggregate the ultimate non-corporate taxpayer’s share of W-2 Wages and unadjusted basis for its real estate business for purposes of the 199A Limitations. Not only is this interpretation consistent with the partner-level application of Section 199A, but it avoids needless IRS and taxpayer administrative difficulty of an entity-by-entity approach. As part of this approach, we recommend that the Schedule K-1 be updated to show each partner’s share of W-2 wages and qualifying unadjusted basis.

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To further reduce administrative and interpretive complexity, we recommend defining trade or business using the long-standing and detailed rules under Section 469. These rules are already used by Section 1411 in a similar manner and, like the Section 1411 regulations, we suggest allowing taxpayers a one-time ability to regroup activities to take into account the new impact of Section 199A. We further recognize that the scope of Section 469 activity and an activity giving rise to QBI may not fully overlap and we are happy to work with you to further refine these concepts to address the statutory distinctions.

Meaning of Acquisition & Amortization Period

The Property Limitation of Section 199A applies to the unadjusted basis "immediately after acquisition." The term "acquisition" requires clarification with respect to self-constructed property and property transferred in a tax-free transaction, such as in a Section 721 contribution to a partnership.

For self-constructed property, the statute defined qualified property by reference to Section 167 (and therefore indirectly by reference to Section 168), which does address self-constructed property. For further clarification, we request that guidance allow taxpayers to rely on existing regulations addressing the meaning of acquisition in the self-constructed property context (e.g., Treas. Reg. 1.168(k)-1(b) and specifically the 10-percent safe harbor at Regulation Section 1.168(k)-1(b)(4)(iii)(B)(2). A related point is to clarify that post-acquisition improvements to acquired property that are placed in service after acquisition are included in the unadjusted basis of the property for purposes of the Property Limitation as of the date those improvements are placed in service.

Many real estate partnerships receive property as a result of a tax-free contribution under Section 721(a). We respectively request that, to the extent the tax basis carries over to the partnership, the unadjusted basis for purposes of the Property Limitation also carryover for the remaining tax life of such property. Further, to the extent that the contribution is in whole or in part treated as a taxable sale to the partnership, then such portion of the property should be treated as newly purchased with a new unadjusted basis for purposes of the Property Limitation.

The TCJA retained Section 1031 for real property. However, there is no direct guidance stating that replacement property received in a Section 1031 exchange has been acquired for purposes of Section 199A. Additionally, there is no guidance defining the unadjusted basis in that replacement property for purposes of Section 199A. Similar to our request for clarification of properties received pursuant to Section 721(a), we request clarification that the receipt of replacement property in a Section 1031 exchange should be treated as an acquisition of that property for purposes of Section 199A. We further request clarification that the unadjusted basis carries over from the exchanged property to the replacement property except for a step up to fair market value to the extent of any gain recognized on the exchange.

The TCJA eliminated technical terminations as previously defined in Section 708(b)(1)(B). However, partnerships subject to technical terminations prior to January 1, 2018, are required to depreciate Section 168 property subject to the technical termination as if the property were newly placed in service, thereby extending the depreciation life. We request confirmation that this reset depreciation life for pre-2018 technical terminations applies for purposes of the Property Limitation.

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Rental Income is Qualified Business Income

We request clarification that a partnership that operates real property and receives rent income is engaged in the conduct of a trade or business that gives rise to QBI for purposes of Section 199A and the rental income is QBI to all partners, regardless of whether a partner is an active or a passive partner. Specifically, the determination of a trade or business should follow traditional income tax concepts and be determined at the partnership level. Related to rental income, we request clarification that amounts earned in connection with managing rental properties not be treated as amounts earned from specified services within the meaning of Section 199A(d)(2). Specifically, to the extent an entity is in the business of real estate management, income earned by that entity should be treated as QBI, which is consistent with the intent of Section 199A specifically bringing within its application real property businesses.

Section 199A and Reasonable Compensation

Section 199A exempts from qualifying business income amounts: (1) reasonable compensation, (2) guaranteed payments, and (3) service payments made to partners in their non-partner capacity. The legislative history confirms that the term "reasonable compensation" relates to the traditional S corporation concepts of reasonable compensation. However, because the statute is not explicit we request that regulatory guidance clarify that no new concepts of reasonable compensation are imputed in the partnership context. This conclusion is well accepted by practitioners, and a deviation from that approach would add considerable complexity and unnecessary uncertainty. Furthermore, we note that there is no abuse from retaining the reasonable compensation standard only for S corporations because partnerships have their own set of guaranteed payment for services concepts for recognizing compensation income for their partners.

REIT Dividends Earned through RICs

Section 199A expressly applies the 20-percent deduction to REIT dividends. However, a similar provision does not apply to regulated investment companies ("RICs"). However, many REITs are held through RICs and the REIT dividend rule does not address whether the application to REIT dividends is retained as the dividend is passed through a RIC to the ultimate recipient. If there is not a look-through rule, there is an asymmetrical treatment for taxpayers that own REIT stock directly vs. indirectly through a RIC. This result appears to be unintended because there is no policy reason for treating the shareholders differently, nor does the asymmetrical treatment advance any of the express purposes of Section 199A. We request that Treasury exercise its regulatory authority under Section 199A to remedy this issue, and agree with the positions advanced by National Association of Real Estate Investment Trusts and the Investment Company Institute for ensuring all REIT investors are treated similarly.

IV. Section 163(j)

Section 163(j) generally limits a taxpayer's business interest deductions to 30 percent of a taxpayer's adjusted taxable income. For this purpose, "business interest" means any interest paid or accrued on indebtedness properly allocable to a trade or business. A real property trade or business, within the meaning of Section 469(c)(7), may elect to be exempt from the limitations under Section 163(j) at the cost of applying the longer ADS depreciation lives. Further, a taxpayer (including a REIT or partnership) with under $25 million of gross receipts for the trailing three tax years is exempt from this

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limitation (“Small Taxpayer Exception”), subject to the single employer aggregation rules of Section 448(c)(2).

Tiered Structures

The optional election for a real property trade or business does not address the key issue of determining the trade or business of an upper-tier holding entity that uses debt to fund an investment in a lower-tier real estate entity, such as a partnership or a REIT. For numerous commercial reasons, the foregoing structure is common, and it is understood among all participants that the activity to which the structure relates is a real property trade or business. We would like to add our support to the proposal in the Real Estate Roundtable letter dated February 21, 2018, advocating an approach utilizing the tracing approach in Treasury Regulation Section 1.163-8T to determine whether debt at an upper-tier level is “properly allocable” to a real estate trade or business.

Small Taxpayer Exception

The Small Taxpayer Exception aggregates entities under common control, which is defined by indirect reference (via Section 448(c)) to Sections 52 and 414. Treasury Regulation Section 1.52-1 separately defines common control with respect to “parent-subsidiary” relationships and “brother-sister” relationships. Effective control in the case of a partnership means ownership of more than 50 percent of the profits or capital of the partnership. While the regulations provide helpful conceptual guideposts, examples in either the Section 52 regulations or Section 163 regulations would be helpful in applying these principles, particularly in structures where a single general partner may be involved in numerous limited partnerships with similar limited partners and instances where profits and capital is difficult to determine because e.g., of the existence of profits interests and preferred interests. Because regulations under Section 414 reference the regulations under Section 52, a single set of examples should be sufficient for this purpose.

V. Section 118 Contributions to Capital Transition Relief

Revised Section 118 narrows the instances in which a contribution to a corporation’s capital is excluded from the corporation’s gross income. However, the change does not apply to any contribution made after the date of enactment by a governmental entity pursuant to a master development plan that has been approved prior to such date by a governmental entity. Given the significant negative change in the law and the reliance on Section 118 for many large and far reaching master development plans, we respectively request guidance that the definition of a “master development plan” be interpreted broadly to include any conditional or non-conditional grant approved in writing prior to the date of enactment. For this purpose, we request clarification that a master development plan is any plan for development or redevelopment of a property approved by a governmental entity prior to the date of enactment.

VI. Section 461(l)

Newly expanded Section 461(l) disallows net business losses to be used against non-business income for non-corporate taxpayers. As previously noted, real estate investments involve many complex ownership structures to take into account the various capital and service investments needed. We respectively request guidance to broadly interpret business income and losses so as to ensure a property netting of income and losses as part of the same overall real estate business. For example, the same real estate developer could receive fee or guaranteed payment income from a partnership which may economically net with a partnership loss allocable to the same person receiving the fee or

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guaranteed payment income. We respectively request that such income and loss be netted for purposes of Section 461(l) so as to not inadvertently cause the loss to be suspended when it economically nets with the guaranteed payment or fee income.

In conclusion, we hope this initial list of clarification items has been helpful. We welcome the opportunity to discuss these in more detail. For further questions, please contact Phillips Hinch, Vice President of Tax Policy, at phinch@icsc.org or (202) 626-1402.

Sincerely,

Tom McGee
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