The Real Estate Roundtable

October 2, 2024

The Honorable Lloyd K. Smucker
Chair, Main Street Tax Team
House Ways and Means Republicans
302 Cannon House Office Bldg.
Washington, DC 20515

The Honorable Mike Kelly
Chair, Community Development Tax Team
House Ways and Means Republicans
1707 Longworth House Office Bldg.
Washington, DC 20515

Dear Chairmen Smucker and Kelly:

The Real Estate Roundtable appreciates the opportunity to share its high-level comments on the pending expiration of the *Tax Cuts and Jobs Act of 2017* and ways in which tax policy can help families, workers, and small businesses.

The Roundtable brings together leaders of the nation's top publicly held and privately owned real estate ownership, development, lending, and management businesses with the leaders of major national real estate trade associations to jointly address key national policy issues relating to real estate and the overall economy. The U.S. real estate industry is navigating post-pandemic stresses associated with higher financing costs, increased operating expenses, regulatory pressures on banks, and uncertainty in the future use of the built environment. Notwithstanding these challenges, leaders in the industry are reimagining existing buildings and developing new ones that align with the demands of the new normal.

Commercial real estate encompasses many property types, from office buildings, warehouses, shopping centers, and apartment communities to data centers, life science facilities, senior housing, convenience stores and much more. The contribution of the industry to the nation's economy is enormous. The total value of America's commercial real estate is approximately $18-22 trillion, leveraged conservatively with about $4.7 trillion of debt. The development and operation of commercial buildings contributes $2.3 trillion to the nation's annual GDP.

Real estate is a leading employer in the United States, directly supporting 15.1 million well-paying jobs and careers in fields such as construction, skilled trades, brokerage, architecture and engineering, security, finance and accounting, and building maintenance. The collective efforts of this workforce provide the built spaces necessary for small businesses to grow, families to live, and the public to gather.

Market Square West • 801 Pennsylvania Ave., NW • Suite 720 • Washington, DC 20004 • Phone: 202-639-8400 • Fax: 202-639-8442 • www.rer.org

Taxes on real estate are the vital to the well-being of communities, paying for schools, police and fire departments, parks and libraries, and much more. Property taxes alone generate over 70 percent of local tax revenue. Nationwide, property tax rates on commercial real estate are significantly higher than the tax rates on homeowners. Strong real estate markets and well-occupied commercial buildings create healthy communities where streets are safe, small businesses and restaurants thrive, and economic opportunities are readily available.

Commercial real estate also provides a stable and secure investment for retirees, colleges and universities, and charities. Real estate is a staple in diversified investment portfolios, including 401(k) accounts. Pension funds, educational endowments, and charitable foundations have invested $900 billion in real estate.

Today, from construction to leasing, planning, and investment, post-pandemic structural shifts in how and where we live, work, shop and recreate are revolutionizing the world of commercial real estate. A legacy from the pandemic concerns remote work and the chain reaction it set off regarding office space needs, residential rents, city budgets, and urban transportation patterns. Likewise, even before the pandemic, retail shopping patterns and foot traffic were changing due to online shopping, and the United States was facing a serious lack of housing supply for lower- and middle-income Americans.

The pandemic magnified these challenges by disrupting building supply chains and imposing new restrictions on work practices, while at the same time boosting housing demand due to remote work. Whether the United States succeeds in addressing its severe shortage of rental housing, estimated at 4.3 million units, will depend on the continued health and strength of the real estate industry and its labor force of essential construction and other workers.

Federal tax policy and tax changes can have an extraordinary impact on the wellbeing of U.S. real estate, including property values and economic activity. Real estate is long-lived and capital-intensive, and minor changes in the tax treatment of capital assets can have major implications for current and future real estate investments. In addition, real estate is owned and operated largely through partnerships, REITs, and other pass-through entities. These arrangements provide greater business flexibility for differently situated owners and investors. Adverse changes in pass-through tax rules can have unintended and unanticipated consequences for real estate.

Over the last several decades, The Roundtable and the real estate industry have worked with policymakers to evolve the taxation of commercial real estate so that it more closely reflects the economics of investments and transactions, avoiding excessive incentives or disincentives that could overstimulate or penalize real estate activity. Consistent with this trend, the Tax Cuts and Jobs Act of 2017 retained core, longstanding tax rules for real estate, including the deductibility of interest, cost recovery rules that aim to align depreciation schedules with the economic life of a structure, and the deferral of gains reinvested in the business (like-kind exchanges).

As the Committee looks toward 2025 and the expiration of the non-corporate provisions of Tax Cuts and Jobs Act, The Roundtable urges you to preserve tax rules that: reflect the economics of real estate transactions; support capital formation and appropriate risk-taking; provide stable and predictable rules conducive to long-term investment; and recognize that, in limited and narrow situations (e.g., converting obsolete office buildings to housing and helping to address the climate crisis), tax incentives are needed to address market failures.

More specifically, we encourage the Committee to ensure that any major tax legislation in 2025 retain or include the following:

- **The current, reduced tax rate on long-term capital gains.** How a country taxes capital and capital formation has enormous consequences for its long-term economic growth, including its ability to create jobs and support durable wage gains. The United States' reduced tax rate on capital gain decreases the cost of capital, drives long-term investment, encourages productive entrepreneurial activity, attracts investment from around the world, and supports higher wages for U.S. workers. In addition, the lower rate on gains partially offsets the higher risk associated with illiquid real estate projects, as well as the economic effects of inflation. Lawmakers should reject proposals to increase the capital gains rate, tax unrealized gains, or double-tax gains at death (through the repeal of stepped-up basis). These proposals would depress entrepreneurship, reduce economic opportunity and mobility, and discourage productive, long-term investment. Taxing unrealized gains would add vast new complexity to the tax system, force the dismantling of many American businesses, upend over 100 years of federal taxation, require an unprecedented IRS intrusion into household finances, and create unknown and likely unintended consequences for the U.S. economy.

- **Partnership and pass-through tax provisions, such as section 199A, that allow privately owned and closely held businesses to compete on a level playing field with large corporations.** Half of the more than four million tax partnerships in the United States are real estate partnerships. These businesses rely on the clarity and certainty of well-grounded partnership tax rules when deploying capital. Our entity choice and pass-through rules are a differentiator and competitive strength that contributes to a culture of entrepreneurship and innovation found only in the United States. Flexible partnership tax rules drive job growth by permitting businesses to tailor their capital and ownership structures to meet the needs of diverse owners and investors. Lawmakers should permanently extend section 199A, the 20% deduction on pass-through business income (including REIT dividend income), which was enacted to avoid putting pass-through businesses at a severe competitive disadvantage to large C corporations. Similarly, lawmakers should reject proposals to expand the net investment income tax to all pass-through business income and reject reforms aimed at discouraging partnership formation, contributions of property to partnerships, and partnership borrowing (e.g., Chairman Wyden's partnership reform discussion draft). Congress should push back against administrative efforts to extend new tax burdens (Self-Employment Contributions Act) on limited partners or create new partnership tax rules that disregard the economic substance of transactions (partnership basis-shifting regulations). Rather than "killing the goose that lays the golden egg" by undermining entity choice and raising taxes on pass-through business income, Congress should look for ways to expand and improve our pass-through tax system.

- **The ability to grow and reinvest in productive real estate businesses through like-kind exchanges.** Section 1031 of the tax code allows taxpayers to defer capital gain when exchanging real estate for property of a like-kind. Like-kind exchanges allow businesses to grow organically with less unsustainable debt, creating a ladder of economic opportunity for minority, veteran, and women-owned businesses and cash-poor entrepreneurs who lack access to traditional financing. Like-kind exchanges also help get languishing properties into the hands of new owners who can put the properties to a better use. The transfer taxes and property reassessments that occur in conjunction with exchange transactions boost local tax revenue. By increasing investment and spurring property improvements, the provision supports property values, promotes economic growth and creates jobs for electricians, plumbers, and other skilled tradesmen. An estimated 10-20% of all commercial real estate transactions, including multifamily housing, involve a like-kind exchange; they are particularly important during periods of market stress or in low-income, hard-hit communities where outside sources of capital are less available. Section 1031 is more restrictive than gain deferral rules that apply to corporations (e.g., sections 351 and 368), and should be preserved.

- **Continued capital gains treatment for the value that a general partner contributes to a partnership beyond services (carried interest).** The tax code should reward risk-taking, and the capital gains rate should apply to more than just invested cash. Carried interest is not compensation for services, it is granted for the value the general partner adds beyond routine services (business acumen, experience, relationships), and it is a recognition of the risks the general partner takes (funding predevelopment costs, guaranteeing construction budgets, potential litigation). New limitations on carried interest would harm small businesses, stifle entrepreneurs and sweat equity, and threaten future improvements in neglected areas. They would increase the cost of building and modernizing infrastructure, workforce housing, and assisted living facilities, while deterring risky projects, such as the redevelopment of sites with potential environmental contamination.

- **Tax rules that promote foreign investment in job-creating U.S. real estate and infrastructure projects.** Foreign investment provides a critical source of passive funding for large, capital-intensive real estate and infrastructure projects. The *Foreign Investment in Real Property Tax Act* (*FIRPTA*) enacted in 1980 is outdated and imposes a discriminatory capital gains tax and tax compliance burden for these activities that does not apply to any other asset class. In 2015, Congress enacted bipartisan legislation (the *PATH Act*) to encourage foreign investment in real estate by scaling back the application of FIRPTA for foreign pension funds and increasing the ownership interest that a foreign investor can maintain in a publicly traded US REIT without triggering FIRPTA liability. Unfortunately, more recent administrative actions, such as the finalization in 2024 of FIRPTA regulations creating a new look-through regime for domestically controlled REITs, have disregarded legislative intent, disrupted common investment structures, and greatly expanded the reach of FIRPTA. Tax legislation should direct Treasury to withdraw the misguided FIRPTA regulations on domestically controlled REITs and extend the helpful 2015 reforms to non-publicly traded US REITs.

- **Reforms that spur the development of new and affordable housing, revitalize communities, and reduce climate-related risks by building on existing, market-based tax incentives.** Across the country, there is a severe shortage of affordable and workforce housing. At the same time, hybrid and remote work arrangements have reduced demand for office space and made some buildings obsolete. High vacancy rates and reduced foot traffic are hurting small businesses and restaurants that depend on vibrant downtowns and city centers. A diverse and accessible supply of housing is critical to the health and wellbeing of families and communities and the overall strength of the economy. While there are many facets to our housing challenges – restrictive state and local zoning and permitting policies, NIMBYism, rent control, etc. – smart tax policies have proven to be effective tools in stimulating new construction and bringing down housing costs. In addition, policymakers should continue building on the clean energy and energy-saving investments made in the *Inflation Reduction Act* (*IRA*). Any major tax and economic legislation in 2025 should include:

- A significant expansion of the highly successful and market-driven low-income housing tax credit (LIHTC). Tax legislation should increase the allocation of low-income housing credits to states and incorporate a much-needed modernization of the LIHTC rules, including a reduction in the private activity bond financing requirement for projects that do not receive credit allocations.

- A meaningful tax incentive for the conversion of older commercial buildings to housing. Congress should enact the bipartisan *Revitalizing Downtowns and Main Streets Act* (H.R. 9005), which would create a temporary tax credit to support the repurposing of older, underutilized commercial buildings to housing. Property conversions are a cost-effective means to develop new, affordable housing supply, revive struggling city centers and small businesses, restore local revenue sources, and reduce energy consumption. H.R. 9005 would complement state and local initiatives adopted across the country that aim to incentivize and remove barriers to property conversions, allowing conversions currently sidelined to move forward.

- Reform of tax accounting rules that deter housing construction by unfairly accelerating the federal income tax liability of condominium developers. When pre-selling condominium units prior to their completion, current tax accounting rules require developers to include a portion of the contract price in their gross income annually, even if they have no legal access to the funds. These discriminatory rules, which do not apply to single-family home construction, impose a tax penalty on condominium development and raise the cost of construction financing at a time when new home construction is badly needed. The bipartisan *Fair Accounting for Condominium Construction Act* (H.R. 4280) would replace the percentage-of-completion accounting rules with the more appropriate completed contract method.

- A long-term extension of expired and expiring Opportunity Zone (OZ) tax incentives. By channeling investment where it is most needed and prioritized by states and localities, the OZ capital gains tax incentives enacted in 2017 have stimulated job creation and economic growth in low-income communities. In the short period since their creation, Opportunity Funds that are focused on building housing—either entirely or as a component of their business strategy—have raised $30 billion in private capital from investors and have proved to be a critical source of financing for housing and jobs in distressed areas.

- Enhancements to the IRA clean energy and energy efficiency tax provisions to ensure they are effective in lowering energy costs and reducing climate-related economic risks. Consistent with other energy provisions, Congress should allow developers to transfer the tax credit for new, energy-efficient homes (section 45L) to third parties and modify the deduction for energy-efficient commercial building property (section 179D) to allow owners to transfer the deduction to the architects and engineers responsible for the project. Additionally, Congress should clarify that a deduction under section 179D does not reduce the taxpayer's basis in the property and should align the applicable energy-saving performance requirements with actual project timelines. Lastly, Congress should expand the definition of property qualifying for the section 48 investment tax credit to include heating cooling, refrigeration and other low emissions building equipment.

Notwithstanding the hurdles we face, durable and well-designed tax legislation in 2025 could help put the United States on course for years of dynamic and productive growth. As in the past, The Roundtable's approach to these and other tax policy issues will continue to be rooted in nonpartisan, data-driven, economics-based analysis. We look forward to working with the Committee in the next Congress on the priorities above to ensure that the United States maintains a competitive tax code that encourages capital formation, rewards entrepreneurial risk-taking, and supports critical policy objectives, including accessible and affordable housing and safe and healthy communities.

Sincerely,

Jeffrey D. DeBoer
President and Chief Executive Office

JDD/ch

cc: The Honorable Jason Smith
Chairman, House Committee on Ways and Means

The Honorable Richard E. Neal
Ranking Member, House Committee on Ways and Means

The Honorable Darin LaHood
Chairman, American Workforce Tax Team

The Honorable David Schweikert
Chairman, New Economy Tax Team

The Honorable Adrian Smith
Chairman, Rural America Tax Team

The Honorable Kevin Hern
Chairman, Global Competitiveness Tax Team