Carried Interest in Retail Real Estate

Position

ICSC strongly opposes tax increases on carried interest. Carried interest should be treated as a long-term capital gain if the underlying asset is held for at least one year – the same requirement as for all capital assets.

Issue

Changes to carried interest go far beyond taxing hedge fund managers. Many retail real estate businesses are small (48% of ICSC member firms have fewer than 10 employees), locally focused and family-run (65% of ICSC owner/ developers). This tax increase would discourage investment in our communities, especially underserved markets or brownfield sites that come with additional challenges and risks.

Background

Because commercial real estate is typically too expensive for a single person to invest in, individuals form joint ventures where money is pooled to purchase a property. The developer knows the local market but does not have sufficient capital to go it alone. The investors do not have the expertise to do a development or understand the needs of the local community.

A carried interest – or "the promote" as it is referred to in real estate – is the contractually agreed-upon share of proceeds associated with the project that the developer may receive after the investors have been paid their promised rate of return. It is granted in recognition of the risks the general partner takes with respect to the partnership's liabilities. These risks can include funding predevelopment costs, guaranteeing construction budgets and financing, and exposure to potential litigation over countless possibilities.

Under established partnership tax law, the nature of these distributions has been determined at the entity level and applied equally to all partners. When the source of the distribution to the developer is from rental income, it is taxed as ordinary income. When the distribution is from the sale of the property, it is a capital gain.

Request

Oppose the Ending Wall Street Tax Giveaway Act (H.R. 2686/S. 4123) and the Ending the Carried Interest Loophole Act (S. 3317).

Any changes to partnership tax rules will have a tremendously negative impact on the real estate industry. Congress should adopt policies that promote economic growth. A tax increase on carried interest would unfairly penalize entrepreneurs who use equity capital from outside investors.

In a recent survey of ICSC members, 49% report that more than half the deals they are working on would not have been made without carried interest.

Changing the tax treatment of carried interest would disproportionately impact small, locally focused and family-run real estate partnerships.

Half of all partnerships in America are related to real estate.

For more information, contact Phillips Hinch at phinch@ICSC.com.

ICSC