

**The Real Estate Roundtable  
The Mortgage Bankers Association  
The Associated General Contractors of America  
National Multi Housing Council  
National Association of Realtors  
National Association of Real Estate Investment Trusts  
National Association of Industrial and Office Properties  
National Association of Home Builders  
National Apartment Association  
Manufactured Housing Institute  
International Council of Shopping Centers  
Building Owners and Managers Association International  
Appraisal Institute  
American Resort Development Association  
American Land Title Association  
American Seniors Housing Association  
American Hotel & Lodging Association**

July 25, 2007

United States Senate  
Washington, DC 20510

Dear Senator:

The above-listed organizations, representing all sectors of real estate, are opposed to H.R. 2834, legislation introduced by Representative Sander Levin (D-MI). This bill proposes to tax “carried interest” returns on investment partnerships as ordinary income – even if the income of the partnership is capital gain. If enacted, H.R. 2834 would significantly hamper the entrepreneurial enterprise in our country that builds communities, provides housing, creates jobs, rehabilitates neighborhoods, grows our economy, and produces tax revenue at all levels of government.

We acknowledge and appreciate that this legislation is intended to address important issues of tax fairness and the income disparity that exist in our country. We also realize that this is an area of tax policy that is neither black nor white. The courts, tax practitioners and the IRS have wrestled with how to tax carried interests for decades and current law is the best approach they can devise for this challenging issue. We want to work with you and your colleagues as you examine carried interest taxation and look forward to contributing to that process at the Ways and Means Committee hearing later in July. We do not believe H.R. 2834, however, presents the right solution.

H.R. 2834 would impose the most sweeping and potentially most disruptive new tax on real estate since the Tax Reform Act of 1986 which contained the passive loss limitation rules. Those rules contributed unmistakably to the real estate depression of the late 1980s and early 1990s.

The bill is being described as closing a “tax loophole” exploited by super highly compensated hedge fund and private equity fund managers. In fact, however, carried interests have been a fundamental part of investment partnerships for decades and this legislation reaches far beyond the super rich to entrepreneurs of all sizes.

Real estate partnerships, from the smallest venture to the largest investment fund, have a carried interest component. This is an interest in the capital gain of the partnership when it sells its property. Investing partners grant this interest to the general partners in recognition of the risk the general partner takes and the value he/she brings to the venture.

Approximately \$1 trillion in commercial and rental residential real estate is held privately in America today. This includes office buildings, apartments, shopping centers, hotels, industrial centers, manufactured housing communities and warehouses. The bulk of this capital is invested through partnerships that utilize carried interests. Current taxation of carried interests has worked well for many years and promoted entrepreneurial activity and economic growth on all levels.

By taxing as ordinary income the general partner’s share of the future and highly speculative profits in a real estate partnership, H.R. 2834 would deal a blow to entrepreneurial activity. The carried interest is what makes it worthwhile for the general partner to take the risk on a venture, real estate or other.

Below are some key points we ask you to keep in mind as deliberation of this bill moves forward:

- *Reduced Property Values.* H.R. 2834 would lower the after tax return of a real estate investment which will result in property values being diminished. This would reduce the property tax base that local governments rely on to run schools and provide government services.
- *Lower Capital Gain and Transfer Tax Receipts.* There is a perception that this bill will raise considerable tax revenue. In fact, potential revenues to the government may be somewhat diminished because the higher tax on gains would cause real estate owners to hold onto their properties longer to defer the tax and to achieve the return needed to compensate for the higher tax rate. This “lock in” effect created by higher tax rates slows the rate of capital gain tax revenues to the federal government. On the local level, fewer sales of real estate mean transfer tax revenues will fall as well and opportunities for redevelopment will become scarce.

- *Development Opportunities Will Be Forgone.* The most risky form of real estate is development. The willingness to take on development risk, especially in underserved communities, would be dampened by the higher taxes proposed by H.R. 2834 resulting in some development not occurring at all. Development provides construction jobs and jobs in the construction supply chain. In economically depressed communities, it's essential to achieving revitalization.
- *Risky Borrowing Encouraged.* H.R. 2834 would encourage real estate owners to borrow more money to avoid taking on equity partners. This favoring of debt over equity is risky to our economy and would create increased mortgage interest expense deductions which would lower federal tax revenues.
- *Ordinary Income Tax Rates Paid On Fees.* H.R. 2834 defines all carried interest as compensation for "services" – an over-simplified position in our view. The management and other fees charged by the general partners to the partnership are for services rendered. These fees are taxed at ordinary income rates and fund the partnership's operations. In those instances where the partnership investment under-performs, the fees are the only income the general partners receive. The fees are charged on the entire amount of partnership capital under management and paid on a recurring annual basis by the partnership. The management fee is typically 2% but other fees like acquisition, development, construction management, leasing and financing fees are also charged and taxed as ordinary income.
- *General Partners Contribute More Than Services.* The carried interest is granted by the limited partners to the general partner *not* for ministerial services, like leasing and property management, but for the value he or she will add to the venture *beyond* routine services and the risk he or she takes. This takes both tangible and intangible form. For example, the general partner develops the investment opportunity and brings it to the investors. The general partner contributes to the venture business acumen, a track record, "branding" and the experience and relationships necessary to make the venture successful.
- *General Partners Take On Partnership Risk.* The general partner is at risk for far more than the money it contributed. It's responsible for all partnership liabilities such as environmental contamination and lawsuits, and often explicitly guarantees matters such as construction completion, operating deficits and debt. The carried interest also is granted in recognition of the fact that the general partner is contributing "lost opportunity cost" – that is the other venture opportunities it is foregoing to devote attention to the one at hand. This is the "capital" in addition to the money the general partner invests in the partnership.

Again, we look forward to working closely with you on this important issue of carried interest taxation and all that it represents. It is complicated and far reaching policy with potentially broad economic ramifications. Therefore, we ask that you and your colleagues move with appropriate deliberation and caution.

Feel free to contact Steve Renna of the Real Estate Roundtable with any questions or comments. Call 202-639-8400 or email [srenna@rer.org](mailto:srenna@rer.org). Thank you.