TAX REFORM

Lawmakers are calling for reform of the nation’s tax code to foster economic competitiveness and economic growth. Tax reform has the capacity to fundamentally reshape the multifamily industry as it did after the passage of the last comprehensive tax reform law – the Tax Reform Act of 1986. Apartment firms pay tax when they build, operate and sell properties or transfer communities to their heirs. The industry has long supported the following principles for tax reform:

- **Flow-Through Entities.** The multifamily industry is dominated by “flow-through” entities (e.g., LLCs, partnerships, S Corporations, etc.) instead of publicly-held corporations. This means the company’s earnings are passed through to the partners who pay taxes on their share of the earnings on their individual tax returns. **Congress must not reduce corporate tax rates at the expense of flow-through entities.**

- **Like-Kind Exchanges.** Like-kind exchange rules enable property owners to defer capital gains tax if, instead of selling their property, they exchange it for another comparable property. These rules encourage property owners to remain invested in the real estate market. **Tax reform should recognize the current value of like-kind exchanges and retain incentives to invest in real estate.**

- **Deduction for Business Interest.** Multifamily developers generally borrow, in many cases as much as two-thirds of total cost, to finance apartment development. Eliminating the current deduction for business interest expenses is being considered as part of a comprehensive tax overhaul. Such an elimination would greatly increase the cost of debt financing for projects and inhibit development activity when the nation is suffering from a shortage of apartment homes. **Tax reform should recognize the key role that debt financing plays in real estate development.**

- **Depreciation Rules.** Some have sought to raise revenue by significantly extending the 27.5-year depreciation period of apartments and increasing the 25 percent depreciation recapture tax rate applicable to sales. Cost recovery rules should reflect the life of properties. Extending the depreciation period would reduce development and investment, leading to lower real estate values and stifling the industry’s role in job creation. **Tax reform should reflect the critical role cost recovery plays in our ability to create new jobs.**

- **Carried Interest.** Real estate development carries considerable financial risks. In fact, one in 10 multifamily projects never breaks ground. Because of the risks involved, many real estate partnerships use “carried interest” to encourage innovation and entrepreneurship. Carried interest represents a return on an underlying, long-term capital asset, as well as risk. Developers assume responsibility for risks, including recourse debt, litigation risks and cost overruns. **Current tax law properly treats carried interest as a capital gain.**

- **Low-Income Housing Tax Credit (LIHTC).** Reductions in the corporate rate have serious implications for LIHTC program, the major financing incentive for development of low-income housing. Undermining this public-private partnership would exacerbate the shortage of affordable rental units. **Tax Reform should ensure the viability of and strengthen the LIHTC program.**

Much is at stake for the apartment industry’s ability to meet the nation’s housing needs. NMHC/NAA support tax reform that promotes economic growth and investment in rental housing without unfairly burdening apartment owners and renters relative to other asset classes.
ON POINT:
TAX REFORM

BACKGROUND

*Tax reform has the capacity to fundamentally reshape the multifamily industry, as it did after the passage of the last comprehensive tax reform law – the Tax Reform Act of 1986. Much is at stake for the apartment industry’s ability to meet the nation’s housing needs. House Republicans released a blueprint for tax reform in June 2016 that would significantly alter the taxation of multifamily real estate. This includes reductions in the top tax rate on pass-through businesses; enabling all investment except for land to be immediately deducted from income; and eliminating the deductibility of business interest. The Blueprint is a starting point for reform efforts. As the process moves forward, NAA/NMHC will analyse all proposals in their totality to determine how the multifamily industry will be impacted.*

KEY TALKING POINTS

Primary Message: Tax reform should promote economic growth and investment in rental housing without unfairly burdening apartment owners and renters.

FLOW-THROUGH ENTITIES

- The multifamily industry is dominated by “flow-through” entities (e.g., LLCs, partnerships, S Corporations, etc.) instead of C corporations.

Key Message: Congress must not reduce corporate tax rates at the expense of flow through entities.

LIKE-KIND EXCHANGES

- Like-kind exchanges encourage property owners to remain invested in real estate while providing them with the flexibility to shift resources to more productive properties, different geographic locations or to diversify or consolidate assets.

- Eighty-eight percent of properties acquired through a like-kind exchange are disposed of in a taxable sale, so like-kind exchanges are not used to defer tax indefinitely.

Key Message: Tax reform should recognize the value of like-kind exchanges and retain investment incentives.

CARRIED INTEREST

- Multifamily developers assume responsibility for risks, including recourse debt, litigation risks and cost overruns.

- Current tax law properly treats carried interest as a capital gain because it represents a return on an underlying, long-term capital asset, as well as risk.

Key Message: Tax reform should retain current treatment of a carried interest as a capital gain.
**DEPRECIATION**

- Some lawmakers have suggested extending the 27.5-year depreciation period of multifamily buildings.
- Doing this would reduce development and investment at a time of severe shortage of workforce housing.
- A 2015 MIT study suggests that depreciation should not be longer than current law, and possibly shorter.

*Key Message: Tax reform should reflect the critical role that cost recovery rules play in real estate investment.*

**DEDUCTIBILITY OF BUSINESS INTEREST**

- Over three-quarters of multifamily properties are owned by pass-through entities that are largely reliant on the debt markets to finance their operations.
- A typical multifamily deal is composed of 65 percent debt and 35 percent equity.
- Curtailing the deduction will increase the cost of borrowing, curb apartment construction and/or push up rents.

*Key Message: Tax reform should recognize the key role that debt financing plays in real estate investment.*

**LOW-INCOME HOUSING TAX CREDIT (LIHTC)**

- The LIHTC program is responsible for the financing of nearly 3 million apartments since its inception in 1986.
- Any reduction in the corporate rate will reduce the value of the LIHTC.
- LIHTC deals are already being impacted because of uncertainty around tax reform.

*Key Message: Tax Reform should ensure the viability of and strengthen the LIHTC.*