

Carried Interest: Taxation of the Promote in a Real Estate Partnership

The 111th Congress is considering including a proposal in H.R. 4213, the Tax Extenders Act, which would increase the tax on “carried interest” for the general partners of entrepreneurial enterprises. The proposal would require carried interest to be taxed as regular income instead of capital gains, a substantial tax increase. The “carried interest” proposal is directed at hedge fund and other financial managers. Under this definition, however, managing general partners of multifamily housing development deals would also be subject to higher tax rates on profits from a property sale. NAHMA opposes this proposal because it creates a disincentive for developers and investors to become the managing general partner in multifamily housing development deals.

- Existing law taxes capital gains classified as carried interest at a rate of 15 percent.
- The version of H.R. 4213 passed by the House contains the carried interest proposal, which would tax profits received from a property sale as regular income at a rate of 35 percent.
 - Many Members of Congress see the tax revenue generated by the carried interest proposal as a way to offset the cost of other tax changes.
 - The Obama Administration supports the proposal. They requested a version of the carried interest proposal in the FY 2010 and FY 2011 budget requests.
 - This proposal has also been introduced as stand-alone legislation, H.R. 1935.
- Senate Finance Committee leadership does not support the “carried interest” proposal and have removed it from their version of H.R. 4213.
 - The House is considering including it as a tax offset for H.R. 4213 once more.
- However, Members of Congress have not considered that increasing the tax rate would undermine the underwriting of established real-estate partnership deals.
 - Increasing the tax on the managing general partners of a multifamily property reduces the compensation they expected to receive for the assuming the additional risk, responsibility, and liability of the deal the other investors and partners are not subject to.
- The tax increase is expected to have a number of negative effects on the American economy and society.¹ This tax increase could discourage new construction, which would lead to reductions in:
 - Property tax revenues to state and local governments due to less construction;
 - The number of multifamily rental housing units; and
 - The number of construction jobs available.

NAHMA opposes the carried interest proposal. From our point of view, the change in the tax treatment of carried interest creates a disincentive for managing general partners to assume the risks and liabilities in a multifamily housing development deal. We fear fewer owners will step up to become managing general partners for these deals. We are also concerned this tax increase will discourage apartment construction, resulting in fewer units of affordable housing available. We encourage Congress to remove the proposal from consideration or modify it so that affordable multifamily housing developers are not impacted.

¹ Robert Dietz of AVP Tax and Policy Issues. “Tax Policy and Carried Interest: Facts and Figures.” *Multifamily Market Outlook*, National Association of Home Builders (December 30, 2009).