MBA Positions on Tax Policy

Tax laws and regulations should preserve opportunity and competition in commercial and multifamily real estate.

POLICY POSITIONS AND KEY POINTS

MBA encourages policymakers to support and enact tax laws that support long-term economic growth, which is the foundation of strong commercial, multifamily, and residential real estate markets. That includes supporting and enacting tax policies that enhance capital formation and liquidity for commercial real estate capital sources, which provides a stable foundation for long-term business decisions and otherwise foster a commercial real estate finance business climate that supports mortgage bankers.

Housing Tax Credits

There is a shortage of affordable housing in this country and a record low inventory of homes on the market. Several existing and proposed tax programs can help to increase affordable housing supply, which would benefit individual buyers, renters, and the housing market. These proposals would benefit low- and middle-income individuals and help enhance existing affordable housing programs and initiatives.

Overview of important housing tax credits:

- **Low-income housing tax credit (LIHTC):** The Tax Reform Act of 1986 established the LIHTC program to bolster and incentivize public-private partnerships in low-income housing. Since its inception, the program has helped finance millions of affordable rental homes in the United States. Credits are allocated to a state based on its population and developers compete for tax credits by submitting proposals to develop affordable rental housing that meets a state's priorities. The tax credit program remains one of the best tools for creating and preserving affordable housing.
- **Middle-income housing tax credit (MIHTC**) (proposal): Designed to complement LIHTC, MIHTC is a tax credit proposal aimed to encourage the construction of affordable housing for middle-class Americans. Under the proposal, states would receive tax credits based on their population, which they would then allocate to developers through a competitive process. These credits would then be sold to investors.
- **Commercial real estate refurbishment tax credit** (not yet proposed): A refurbishment tax credit would allow developers to reinvest in properties, such as offices, malls, retail, or hotel space, and repurpose these properties for the benefit of the surrounding communities. It would encourage the distribution of capital to underserved areas and outdated real estate properties.

Key Points

- MBA believes that public/private partnership programs are a critical source of funding for the preservation and development of affordable rental housing for low-income households.
- Improvements and enhancements to the existing LIHTC program, along with these other tax credit proposals, will serve as important vehicles to expand affordable housing resources to households across the country.

MBA Position

MBA supports the expansion and refinement of the LIHTC, and the development and implementation of MIHTC and commercial real estate refurbishment tax credit.

1031 Like-Kind Exchange

1031 like-kind exchanges encourage taxpayers to continue to invest in commercial real estate. In place since 1921, Section 1031 like-kind exchanges allow investors to defer (but not avoid) paying capital gains taxes on the sale of investment property if the proceeds are invested into a similar "like-kind" property. It does not eliminate the requirement to pay a tax, it simply changes the timing of when that tax is paid. By deferring the timing of the tax, like-kind exchanges encourage a liquid and highly flexible real estate market, which benefits businesses and consumers alike.

Key Points

- **1031 exchanges incentivize purchasing blighted properties.** 1031 makes commercial real estate, which is highly illiquid, more marketable. Increased liquidity is especially important to non-institutional investors in inexpensive properties, who account for most of the like-kind exchange market. At a time when housing shortages persist in many markets, 1031s offer a viable option for investors interested in transforming underused or vacant commercial properties into multifamily and other residential developments.
- **1031 exchanges are the fabric of commercial multifamily real estate.** Capital gains tax deferment through Section 1031 like-kind exchange treatment for real estate is a central part of the dynamic U.S. multifamily and commercial real estate market, motivating buyers and sellers and promoting investment in rental units, apartments, and other properties.
- **The majority of 1031 exchanges are small, not large, institutional investors.** Like-kind exchanges are part of a significant share of all commercial real estate transactions, particularly for smaller deals. Some policymakers and politicians view 1031 exchanges as a way for large investors to dodge taxes rather than defer them, but such claims fail to recognize that most participants are "mom and pop" investors, and the transactions rarely lead to a permanent tax deferral.
- **Without 1031 exchanges, investment in housing will decrease.** Eliminating like-kind exchanges likely would reduce transactions in most commercial real estate markets and

prices in some markets. Elimination would also decrease capital investment on acquired property.

- **1031 exchanges benefit the whole economy.** 1031 exchanges significantly benefit not only commercial real estate owners and operators but also the economy in general. By deferring tax liabilities, exchanges can help preserve scarce investment capital that investors can use to acquire larger properties, upgrade portfolios, and make capital improvements. Those activities create jobs and expand state and local governments' tax bases.
- **1031 exchanges help workforce and affordable housing, farmer, forest owners and land conservation organizations.** Roughly 40 percent of like-kind exchanges involve rental housing, so section 1031 is an important source of capital for affordable and workforce housing. Farmers, ranchers, and forest owners use like-kind exchanges to combine acreage, acquire higher-grade land, mitigate environmental impacts, and otherwise improve operations. Land conservation organizations rely on exchanges to preserve open spaces for public use or environmental protection.

MBA Position

MBA recommends real estate continue to receive capital gains tax deferment through like-kind exchange treatment of eligible sales.

Business Interest Deduction

The tax code permits business interest to be treated as a deductible expense, similar to deducting other costs of doing business. The 2017 Tax Cuts and Jobs Act (TCJA) imposed some limits on the deductibility of business interest but allowed real estate businesses options to elect out.

Key Points

- The commercial and multifamily real estate markets are supported by $4.5 trillion in mortgage debt, dramatically increasing the supply of apartments and other space and efficiency of the markets. Interest payments are a fundamental business expense and should be recognized as such for tax purposes.
- The business interest deduction is one that many businesses rely on to reduce their corporate tax burdens, especially industries that rely on debt, such as real estate investors.
- Elimination or reduction of this deduction could be detrimental to the real estate finance industry, as it would increase the cost of financing, which would limit real estate sales activity.
- Repealing or curtailing the deduction would make debt more expensive for all businesses and have a chilling effect on real estate investment in areas where it needs it the most – affordable rental housing.

MBA Position

MBA recommends that the deductibility of business interest, particularly for real estate, not be limited.

Section 199A Pass-Through Deduction

The 2017 Tax Cuts and Jobs Act created Section 199A of the Internal Revenue Code, which allows pass-through businesses to deduct up to 20 percent for its qualified business income (QBI). Section 199A helps ensure tax parity for the millions of employers organized as S corporations, partnerships, and sole proprietorships. The 2022 Inflation Reduction Act preserved the Section 199A deduction, although it is set to expire at the end of 2025.

Key Points

- Mortgage banking companies are frequently organized as pass-through entities. Preserving the 199A pass-through deduction will help continue to provide much needed liquidity in the mortgage market.
- Individually- and family-owned businesses, which represent the core of mortgage lending in this country, employ the majority of private-sector works and represent 95 percent of all businesses.
- Ensuring the continuation of Section 199A will support small lenders, facilitate the availability of mortgage credit, help create jobs, and strengthen our economy.
- Section 199A helps ensure tax parity for the millions of employers organized as S corporations, partnerships, and sole proprietorships.

MBA Position

MBA supports the current law QBI deduction for pass-through entities and recommends that it be extended beyond 2025.

PRIOR ADVOCACY:

TAX REFORM LEGISLATION:

On August 16, 2022, President Biden signed H.R. 5376, the *Inflation Reduction Act*, into public law. Debate on this legislation included a discussion of numerous provisions that affect the commercial/multifamily finance industry. Key outcomes strongly supported by MBA reflected in the negotiated version of the *Inflation Reduction Act* include the following:

- Preserves the current Section 199A small business “pass-through” provision that allows a 20% deduction against Qualified Business Income (QBI);
- Preserves current tax treatment for Section 1031 “Like-Kind Exchanges”;
- Does <u>not</u> include a provision to modify the capital gains tax treatment of “Carried Interest”;
- Does <u>not</u> include a provision to expand the application of the 3.8% Net Investment Income Tax (NIIT) to active “pass-through”-derived income;

- Does not include a proposal altering the treatment of "stepped-up" basis vis-à-vis estate taxes;
- Does not include a requirement that financial institutions report transactions that exceed $600 to the IRS; and
- Provides 10 years of tax credits to make properties more energy efficient:
  - Section 13301: Extension, Increase of Nonbusiness Energy Property Credit
  - Section 13302: Residential Clean Energy Credit Section
  - Section 13303: Energy Efficient Commercial Buildings Deduction
  - Section 13304: Extension, Increase, and Modifications of New Energy Efficient Home.

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