December 21, 2018

The Honorable Steven T. Mnuchin
Secretary of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

Dear Secretary Mnuchin:

The undersigned real estate associations would like to take this opportunity to thank the Administration for working diligently to issue guidance with respect to the Tax Cuts and Jobs Act (the "Act"), landmark tax reform legislation that we believe holds great promise for generating economic growth and fostering job creation.

As multifamily housing firms now begin to implement the new law, we want to draw your attention to a certain provision that we request the Treasury Department clarify so that the industry can build the 4.6 million new apartment units our nation needs by 2030. Without tax certainty, we are concerned that capital could sit on the sidelines and not be fully deployed.

Our request is that the Treasury Department act swiftly to avoid a potential unintended consequence regarding the depreciation of multifamily properties. In particular, we ask that the Treasury Department either issue a notice or use forthcoming regulations to clarify that existing multifamily buildings be depreciated over 30 years for firms that elect out of limits on interest deductibility.

By way of background, a provision of the Act limits the deductibility of interest expense, but allows a real property trade or business to elect out of the limitation if the trade or business applies the alternative depreciation system (ADS) to its real property. The Act also reduced the recovery period for residential rental property from 40 years to 30 years for purposes of the ADS.

It is unclear under the Act whether electing real property trades or businesses should apply a 30- or 40-year life to property placed in service before 2018. The confusion arises because the interest deduction limitation rules are based on taxable year concepts and have an effective date of taxable years beginning after 2017, while the effective date for the ADS recovery period change is based on a placed-in-service concept (as depreciation changes generally are). It is the combination of two different types of effective dates in the Act that gives rise to the confusion.

Treasury has issued proposed regulations under Section 163(j) regarding the ability of real property firms to elect out of the interest disallowance limitations. However, those rules do not fully explain the consequences of making the irrevocable election, particularly how existing property is treated under the election. We are concerned that without further guidance, taxpayers may be uncertain as to whether they should make the election.

While we believe that Congress' intent was to apply the 30-year period to all multifamily buildings, we are extremely concerned that without clarification, the statute potentially could be read to require that properties in existence prior to 2018 be depreciated over 40 years with regard to their remaining life.

We believe that reading the statute to require a 40-year depreciation period for multifamily properties in existence prior to 2018 does not reflect Congressional intent. (See the attachment that traces through the legislative evolution of the relevant provisions of the Act.) Moreover, there are few policy arguments for requiring real estate firms electing out of interest deductibility limits to depreciate existing buildings over 40 years (instead of the previously applicable 27.5 years), while allowing only new buildings to be depreciated over 30 years. Congress seems unlikely to have consciously wished to make such a drastic change.

Our view is that the Treasury Department has the authority to enable existing multifamily properties to be depreciated over 30 years. Treasury can do so either using the broad authority provided in Section 163(j) that addresses how real property trades or businesses elect out of limits on interest deductibility or under the "change of use" authority of Section 168(i)(5).

Specifically, Section 163(j)(7) provides that "Any such election shall be made at such time and in such manner as the Secretary shall prescribe, and, once made, shall be irrevocable." One consequence of making the election is that real property trades or businesses must depreciate real property using ADS. We believe that the "in such manner" language provides the Treasury Department with sufficient authority to allow electing real property trades or businesses to use post-enactment ADS (i.e., the 30-year life) for purposes of depreciating multifamily property. In other words, Treasury can allow real estate firms to make the option of interest deductibility limitation *in such manner* that requires a 30-year ADS life.

In addition, the legislative history makes it clear that Congress intended that the election out of the interest limitation and the required use of ADS be treated as a change in use of the property. (See, footnote 455 of the Senate Finance Committee report). Treasury has broad authority under Section 168(i)(5) to provide rules to implement changes in use of depreciable property, including rules to provide when such property is deemed placed in service.

In sum, we ask that the Treasury Department issue guidance that would enable real estate firms that elect out of the interest limitation to depreciate property over a 30-year ADS schedule. We are concerned that if not done quickly, many owners of existing multifamily assets will be unclear as to how the tax law should apply. The difference between 30 years or 40 years may be significant enough for some owners so as to influence whether they make the election. Without guidance, many owners might interpret the statute conservatively and depreciate the remaining lives of existing buildings using the 40-year ADS schedule. This would unnecessarily increase their tax liability and disrupt cash flows, reducing their ability to invest in their assets or develop new properties. That result would be contrary to the goal of the tax reform bill, and we ask that it be avoided.

We thank you for considering our views and again appreciate all you have achieved to date. Please do not hesitate to contact Cindy Chetti, the National Multifamily Housing Council's Senior Vice President of Government Relations, at 202-974-2300 should any questions arise.

Sincerely,

National Multifamily Housing Council
National Apartment Association
American Seniors Housing Association
Nareit
National Association of Home Builders
NATIONAL ASSOCIATION OF REALTORS®
CCIM Institute
Institute of Real Estate Management
The Real Estate Roundtable

cc:

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The Honorable William M. Paul
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ATTACHMENT

Treatment of Existing Residential Rental Property Held by an Electing Real Property Trade or Business

Prior Law

Residential rental property had a 27.5-year recovery period for regular tax purposes and a 40-year recovery period for purposes of the alternative depreciation system (ADS).

House Bill

The House bill to the Tax Cuts and Jobs Act (TCJA) provided a limitation on the amount of business interest that could be deducted in a taxable year. An exemption from the limitation was provided for real property trades or businesses. Property of exempt real property trades or businesses was excluded from the definition of qualified property for purposes of the expensing provision provided by the bill.

The House bill did not change the recovery period for residential rental property for either regular tax or ADS purposes.

Effective dates.--The interest limitation provision applied to taxable years beginning after December 31, 2017. Expensing generally applied to property acquired and placed in service after September 27, 2017.

Senate Bill

Chairman's mark (conceptual language)

The initial Chairman's mark provided a limitation on the amount of business interest that could be deducted in a taxable year. An election from the limitation was provided for real property trades or businesses.

The mark also shortened the regular tax recovery period for nonresidential real and residential rental property to 25 years (from 39 and 27.5 years, respectively). An electing real property trade or business was required to use ADS (40 years) to depreciate real property.[1]

Effective dates.--The interest limitation provision applied to taxable years beginning after December 31, 2017. The depreciation provisions (including the required use of ADS) applied to property placed in service after December 31, 2017. Thus, it appeared under the Chairman's

[1] The shift to ADS was not significant for nonresidential real property (moving from a 39-year to a 40-year recovery period). It was more significant for residential rental property (moving from a 27.5-year to a 40-year recovery period).

mark that an electing real property trade or business did not have to change its depreciation allowances for existing residential rental property.

Chairman's amendment to the Chairman's mark

Chairman Hatch's amendment #10 to the Chairman's mark changed the ADS recovery period for residential rental property to 30 years (from 40 years).[2]

Effective dates.--No effective date was provided in the language of the conceptual amendment. Thus, the effective date for the amendment was presumed to be the same as the effective date for the reduction in the regular tax life of such property (i.e., property placed in service after December 31, 2017, so that neither the amendment nor the underlying mark had any effect on existing residential rental property of an electing real property trade or business).

Legislative text and Senate Budget Committee report regarding the bill reported favorably out of the Senate Finance Committee

The statutory language and legislative history of the bill reported favorably out of the Senate Finance Committee were consistent with the conceptual language of the substantive provisions of the Chairman's mark and Hatch amendment #10 with respect to the treatment of residential rental property. That is, (1) the recovery periods for such property was reduced to 25 and 30 years for regular tax and ADS purposes, respectively, and (2) a real property trade or business electing out of the interest limitation was required to use the ADS for its property.

Effective dates.--However, the effective date for these substantive provisions appeared to have changed from the mark's prospective conceptual language. The reduction in recovery periods for such property for regular tax and ADS purposes continued to apply to property placed in service after December 31, 2017 (see, bill sec. 13204(c)(1)). However, legislative language also seemed to apply a retroactive effect for existing property. Section 13204(c)(2) of the bill provided that:

> In the case of property placed in service before January 1, 2018, *if the amendments made by this section result in*—
>
> > (A) an applicable recovery period which is less than the applicable recovery period for such property before enactment of such amendments, or
> >
> > (B) an applicable depreciation method which is more accelerated than the applicable depreciation method for such property before enactment of such amendments,

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[2] The 30-year period for residential rental property presumably was provided to address the issue discussed in footnote 1.

> the depreciation deduction for such property shall, for any taxable year beginning after December 31, 2017, be determined as if such property were placed in service on January 1, 2018. (*emphasis added*)

Footnote 455 to the Senate Budget Committee report seemed to indicate that the SFC bill was intended to apply retroactively to an electing real property trade or business by providing that, "The Committee intends that an election out of the interest limitation and resulting required use of ADS be treated as a change in use. See Treas. Reg. Sec. 1.168(i)-4." The statutory language cited above largely conformed to Treas. reg. sec. 1.168(i)-4(d)(3) (the change in use rules).

However, there is some question whether section 13204(c)(2) executed the intent to apply to existing property. The general rule of bill section 13204(c)(1) is to apply the provisions of section 13204 to property placed in service after December 31, 2017. Bill section 13204(c)(2) described how to apply these changes to property placed in service before January 1, 2018, but only "if the amendments made by this section result in" a shorter recovery period or more accelerated method. But there is nothing in the language of section 13204(c) that actually made the section 13204 substantive changes applicable to property placed in service before January 1, 2018.

Senate floor action

On the floor, the Senate approved Chairman Hatch amendment SA 1728 which appeared to address the drafting issue discussed in the prior paragraph. That amendment made it clear that the amendments made by bill section 13204 apply to an electing real property trade or business on a taxable year basis (i.e., to apply to depreciation on property already placed in service). It also provided statutory "change in use" language similar to that of the SFC bill. Because the effect of section 13204 was to reduce the applicable ADS recovery period for residential rental property from 40 to 30 years,[3] such property could be deemed placed in service on January 1, 2018 under the amendment, and thus the new 30-year ADS recovery period applied to existing property covered by amendment SA 1728.

A "perfecting amendment" by Leader McConnell, presumed to have no revenue effect, modified the Hatch SA 1728 amendment and provided effective date language for section 13204 similar to that of present law.

<u>Conference Agreement</u>

[3] Some could read the prerequisite of getting more favorable treatment to not apply to existing residential rental property being depreciated under the regular tax system because the bill extended the depreciable life of such property from 27.5 to 30 years. If this is the correct reading, then the only property that could have received the more favorable 30-year ADS life would have been existing property already being depreciated under the 40-year ADS life. Congress generally imposes the less favorable ADS on property for some other policy reason (e.g., the property isn't located in the U.S., it has tax-exempt financing, it is subject to tax-exempt use, etc.). It would seem odd that the Senate would have provided the shorter 30-year life for existing (disfavored) ADS property, but required the 40-year life for property not previously subject to the ADS restrictions. Thus, the better reading of the amendment would be to compare the prior 40-year ADS period to the new 30-year ADS period.

The conference agreement included the Senate version of section 13204, except that the shorter regular tax recovery period of 25 years for nonresidential real and residential rental property was not adopted. Thus, the conference agreement provided that (1) the ADS recovery period for residential rental property was shortened to 30 years, (2) an electing real property trade or business must use the ADS depreciation system, and (3) the use of the ADS system applied to property place in service before January 1, 2018.

Issue and Analysis

What is unclear from the conference agreement is whether, in applying the ADS system to the existing property of an electing real property trade or business, the appropriate depreciable recovery period should be 30 years or 40 years. It seems that the intent of the various Chairman Hatch amendments (as discussed above) was to make the 30-year life available for some existing property. The drafting of this intent was (unfortunately) cumbersome compared to the ultimate statutory language of the conference agreement. As a result, the ultimate conference agreement language does not appear to execute the intent to provide a 30-year life for existing property.

In addition to the various attempts to perfect the Hatch amendments, Congressional intent can be inferred from policy considerations. Legislative depreciation changes traditionally are done on a prospective basis; i.e., generally for property placed in service after a certain date. The interest disallowance rule of TCJA has a retroactive aspect – it applies to interest on debt incurred both before and after the effective date. Thus, it would seem appropriate to apply the required use of the ADS by electing real property trades or businesses to property in existence before the effective date as well. Because the interest disallowance provision applies with equal force to interest on both old debt and new debt, the ADS should be applied the same to old property and new property. Both should be determined based to the same recovery period. As a policy matter, Congress has decided that the appropriate ADS life for residential rental property should be 30 years. That life should also be used in applying the interest limitation election for all property subject to the limitation.

Similarly, in TCJA, Congress reduced the ADS life, but not the regular tax life, of residential rental property. Thus, property acquired on, before and after January 1, 2018 has a 27.5-year regular tax life. One would think the intent would be that all such property should have the same 30-year ADS life, particularly in a bill designed to promote economic growth.