March 15, 2018

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

Dear Secretary Mnuchin:

We are writing on behalf of the members of the National Multifamily Housing Council (NMHC) and the National Apartment Association (NAA) who represent the $1.3 trillion apartment industry and its nearly 39 million residents. We would like to take this opportunity to congratulate the Administration for working with Congress to enact 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 several provisions that we request the Treasury Department clarify so that our 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.

**Depreciation Period of Existing Multifamily Buildings**

Our first 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, Section 13204 of the tax reform law ("Applicable Recovery Period for Real Property") reduces the recovery period for residential rental property from 40 to 30 years for purposes of the alternative depreciation system (ADS) and requires real estate firms electing out of the limits on interest deductibility of Section 163(j) to use ADS to depreciate multifamily buildings. While we believe that Congress' intent was to apply this 30-year period to multifamily buildings in existence before enactment of the tax law and those yet to be placed in service, we are extremely concerned that without clarification, the statute potentially could be read to require that multifamily properties in existence prior to 2018 be depreciated over 40 years with regard to their remaining life.

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 section 13204(b) of the statute that gives rise to the confusion.

We believe that Congress did not intend for existing multifamily buildings to be depreciated over 40 years for real estate firms electing out of interest deductibility limits. Reading the statute to require existing buildings to be depreciated over 40 years is unlikely to reflect Congress' intent from a policy perspective. 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 IRC Section 163(j)(7) that addresses how real property trades or businesses elect out of limits on interest deductibility or under the "change of use authority" of IRC Section 168(i)(5).

Section 163(j) as amended by the tax reform law generally limits a taxpayer's allowable deduction for business interest. The legislation, however, enables real property trades or businesses to elect out of the limitation and requires 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. (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 or 40 years may be significant enough for some owners so as to influence whether they make the election. Many owners who opt out of interest deductibility limits might interpret the statute conservatively and depreciate the remaining lives of existing buildings using the 40-year ADS schedule. This would unnecessarily disrupt cash flows and increase their tax liability, 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.

## Pass-Through Tax Deduction for Qualified Business Income

The multifamily industry is also eagerly awaiting guidance regarding the 20 percent deduction for pass-through income under new IRC Section 199A. We believe that if properly implemented, this provision has the potential to unleash significant investment and job creation in the multifamily industry.

As the Treasury Department drafts implementing guidance, we do have three initial requests:

First, the new law requires that the pass-through deduction be determined for each qualified trade or business, but it does not provide a definition of trade or business. We request that the Treasury Department issue guidance enabling individuals to aggregate or group all qualified business activities at the partner level in a manner consistent with IRC Section 469. This would help ensure entities can focus on their business activities rather than engaging in costly restructuring efforts. Additionally, we would ask that Treasury specifically allow income earned from the development, operation and management of real estate assets to qualify for the deduction.

Second, the Treasury Department should provide rules regarding the unadjusted basis of property acquired pursuant to a like-kind exchange. Such basis should be no less than the unadjusted basis of the property relinquished in the exchange plus any cash or other consideration provided in the exchange. Taxpayers engaging in like-kind exchanges remain fully invested in real estate and should not be negatively impacted when they reallocate a portfolio. Indeed, providing onerous rules regarding the unadjusted basis for exchange property would reduce the velocity of real estate transactions and amount of aggregate investment in the sector.

Third, the new law allows REIT dividends to fully qualify for the 20 percent deduction. Treasury, however, should clarify that shareholders who invest in a REIT through a mutual fund are eligible as well. Approximately half of REIT shares are held in mutual fund portfolios.

We believe the new and novel pass-through deduction will lead to further questions and concerns being raised. We look forward to working with the Treasury Department on additional matters related to the provision as the regulatory process moves forward to ensure this deduction is as effective as possible.

**Deductibility of Business Interest**

NMHC/NAA were most grateful that lawmakers enabled real estate firms to elect to fully deduct business interest. Given that a typical multifamily deal can be 65 percent debt financed and that the Federal Reserve reports that as of the end of 2017, there was $1.31 trillion in outstanding multifamily mortgage debt, implementation of this provision will be critical. We ask the Treasury Department quickly clarify that a taxpayer may use any reasonable allocation method to deduct business interest attributable to a real property trade or business and that debt to capitalize such enterprises is fully deductible. Our goal is to avoid any disruption to the multifamily industry that relies so heavily on debt-financed capital.

NMHC/NAA thank you for considering our views. We again congratulate you on this landmark achievement and hope to work with you to make it as successful as possible. Please do not hesitate to contact Cindy Chetti, NMHC's Senior Vice President of Government Relations, at 202-974-2300 should any questions arise.

Sincerely,

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