

# Tax Laws and Regulations

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

## BACKGROUND

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, provide a stable foundation for long-term business decisions, and otherwise foster a commercial real estate finance business climate that supports mortgage bankers.

Households and businesses take the tax treatment of transactions into account when making long-term economic decisions. For example, businesses consider tax treatment of investments, costs, earnings, etc. when deciding where to direct efforts and investment. Therefore, MBA called for caution with respect to any tax changes that could harm the real estate market recovery or deter capital from investment in the real estate market.

## TAX REFORM LEGISLATION

On December 22, 2017, President Trump signed H.R. 1, *the Tax Cuts and Jobs Act*. This comprehensive tax legislation has numerous provisions that affect the commercial/multifamily finance industry. Key outcomes strongly supported by MBA that are reflected in the Tax Act include the following:

- Preservation of business interest deductibility for real estate;
- Preservation of like-kind exchanges (under section 1031) for real property;
- Preservation of the Low-Income Housing Tax Credit;
- Preservation of the tax-exempt status of private activity bonds that finance affordable housing; and
- Preservation of the tax treatment of mortgage servicing rights.

## REGULATORY IMPLEMENTATION OF TAX REFORM

Although the Tax Cuts and Jobs Act has been enacted, the regulatory implementation of the statute remains critically important. A number of provisions in the Tax Act require greater clarity and guidance. Among them, the scope of the *pass-through deduction* provisions in the new section 199A of the Internal Revenue Code requires clarification. In particular, the definition of a "specified service business" (SSTB) – which are not eligible for the deduction – is not clear

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enough to sufficiently eliminate all ambiguity regarding which types of pass-through entities are eligible for the pass-through deduction.

MBA strongly advocated in meetings with the Internal Revenue Service (IRS), Treasury and Office of Management and Budget (OMB) officials and in formal comment letters responding to proposed IRS guidance regulations, that mortgage banking companies engaged in the *financing of real estate* (whether commercial or residential real estate), including independent mortgage bankers (IMBs), should *not* be considered to be "specified service trades or businesses" and, as a result, they should be eligible for the pass-through deduction under the new tax law.

On February 8, 2019, the IRS issued final guidance rules addressing the pass-through provision. Addressing our concerns only in part, the final regulations provide that a key consideration will be whether the company is engaged in "making loans" (not an SSTB) vs. "arranging lending transactions between a lender and a borrower" (an SSTB). Each company should apply the regulations to the particular facts and circumstances of its business with the assistance of expert tax and other advisors. MBA continues to analyze the guidance with the help of outside tax experts, to assist our members.

## OPPORTUNITY ZONES

The Tax Cuts and Jobs Act establishes tax incentives to encourage economic growth and investment in distressed communities designated as Opportunity Zones by providing federal income tax benefits to taxpayers who invest in businesses located within those areas. MBA supports this objective.

While the tax incentives relate to equity investments of capital gains, the Opportunity Zone provision also creates opportunity for debt financing. Notably, MBA member companies can provide mortgage debt financing for the acquisition and substantial improvement of business properties that is necessary to trigger the tax benefits. In this regard, we are pleased that the new provision and the proposed guidance provide substantial flexibility in how the financing of Qualified Opportunity Zone Business projects may be structured.

Treasury and the IRS published proposed regulations on November 29, 2018. MBA submitted comments December 21, 2018, highlighting the role for debt financing and urging the IRS to address practical considerations, including the application of the 180-day period for reinvestment of capital gains into a Qualified Opportunity Fund to address circumstances under which reinvestment within that time period may be impractical. Final regulations have not yet been issued.

MBA is working with our members across multiple capital sources to ensure that they are prepared to play a critical role in financing Opportunity Zone projects. For example, we offered an *Opportunity Zone Implications for Real Estate* webinar in November 2018 and an *Opportunity Zones and CRE Lending* panel at our 2019 CREF Conference and Expo. We will continue to monitor developments in this area for CRE lending impacts and opportunities.

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