

September 4, 2019

The Honorable Richard Neal  
Chairman  
House Committee on Ways and Means  
1102 Longworth House Office Building  
Washington, DC 20515

The Honorable Charles Grassley  
Chairman  
Senate Committee on Finance  
219 Dirksen Senate Office Building  
Washington, DC 20510

The Honorable Kevin Brady  
Ranking Member  
House Committee on Ways and Means  
1139 Longworth House Office Building  
Washington, DC 20515

The Honorable Ron Wyden  
Ranking Member  
Senate Committee on Finance  
219 Dirksen Senate Office Building  
Washington, DC 20510

Dear Chairmen Neal and Grassley and Ranking Members Brady and Wyden,

The undersigned real estate associations would like to take this opportunity to request that Congress correct a drafting oversight in the *Tax Cuts and Jobs Act* (TCJA) that requires certain multifamily buildings to be depreciated over 40 years as opposed to the congressionally intended 30 years. We ask that this clarification be included in any tax legislation that may be enacted this year, so that the multifamily industry can build the 328,000 new apartment units our nation needs annually between today and 2030.

Under the TCJA, multifamily real estate firms may elect out of limitations on interest deductibility so long as they agree to depreciate new property under the Alternative Depreciation System (ADS). The TCJA also reduced the ADS recovery period for multifamily property from 40 years to 30 years.

Our view is that congressional intent (see the Attachment that traces through the legislative evolution of the relevant portions of the Act) was to apply this 30-year period to buildings in existence and subject to a 27.5-year depreciation period before enactment of the law, as well as to new property. However, due to a drafting oversight, the law subjects multifamily property in existence prior to 2018 to the old 40-year period rather than the intended new 30-year period. Firms able to abide by limits on interest deductibility will continue to depreciate multifamily property over 27.5 years.

This issue is of tremendous importance to the multifamily industry and directly impacts our ability to invest in the production and preservation of multifamily units. Owners of multifamily property placed in service prior to 2018 who elect to retain a full deduction of business interest must now take a 31.25 percent reduction in depreciation deductions. This foregone deduction translates into the loss of funds that would otherwise be available to build new properties and address the nation's lack of housing supply or upgrade existing properties and ensure they are not lost to obsolescence. We ask that Congress address this unintended result and clarify that all multifamily property may be depreciated over 30 years, regardless of the date such property was placed in service, for firms electing out of limits on interest deductibility.

Notwithstanding our view that Congress' intent was to require a 30-year depreciation period, the Internal Revenue Service (IRS) on December 21, 2018, issued Rev. Proc. 2019-08 and concluded that such property placed in service prior to 2018 must be depreciated over 40 years. Until the IRS issued Rev. Proc. 2019-08, it was unclear under the Act whether electing real property trades or businesses would be required to apply a 30- or 40-year life to property placed in service before 2018. The confusion

arose 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 gave rise to the confusion. We were disappointed that the IRS concluded a 40-year depreciation period should apply to multifamily property placed in service prior to 2018 for firms electing out of limits on interest deductibility.

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 intended such a drastic change. Furthermore, because the interest disallowance rule in the TCJA 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 on 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.

We request that Congress swiftly enact legislation clarifying that all multifamily property that was subject to a 27.5-year depreciation period prior to the enactment of the TCJA may be depreciated over 30 years for firms electing out of limits on interest deductibility. We are concerned that if not done quickly, many owners of existing multifamily assets will face disrupted cash flows and greater tax liabilities. This would result in reduced investment in both existing and new units and act to exacerbate the significant housing challenges the national already faces.

We thank you for considering our views. 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  
International Council of Shopping Centers  
NAIOP, the Commercial Real Estate Development Association  
Nareit  
National Association of Home Builders  
NATIONAL ASSOCIATION OF REALTORS®  
CCIM Institute  
Institute of Real Estate Management  
National Leased Housing Association  
The Real Estate Roundtable

Cc:

Members of the House Committee on Ways and Means  
Members of the Senate Committee on Finance

## 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.<sup>1</sup>

*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

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<sup>1</sup> 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).<sup>2</sup>

*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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<sup>2</sup> 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,<sup>3</sup> 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.

### **Conference Agreement**

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<sup>3</sup> 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 placed 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.