Summary

The Tax Cuts and Jobs Act of 2017 included strict new limits on the deductibility of business interest, generally restricting deductions to 30 percent of the taxpayer's EBITDA (earnings before interest, tax, depreciation, and amortization). However, the bill also included a key provision that allows commercial real estate (a real property trade or business) to opt out of the interest limitation. The One Big Beautiful Bill Act (OB3 Act) included a provision that would allow more real estate businesses to fully deduct their business interest and qualify for 100 percent bonus depreciation on their nonresidential interior improvements.

Recent proposals from Members of Congress would further tighten restrictions on the deductibility of interest and disallow private real estate funds from using the real property trade or business election. Other legislation would deny business interest expense deductions for owners of data centers and large owners of single-family rental homes.

Key Takeaways

- Debt is a fundamental part of a real estate entity's capital structure and, in addition to property acquisition costs, is used to finance day-to-day operations like meeting payroll, buying raw materials, making capital expenditures, and building new facilities.
- New restrictions on interest deductibility would cause enormous damage to U.S. commercial real estate by dragging down property values and discouraging new investment. Fewer loans could be refinanced, fewer projects could be developed, and fewer jobs would be created.
- The ability to finance investment and entrepreneurial activity with borrowed capital has driven jobs and growth in the U.S. for generations. America's capital markets are the deepest in the world and provide our economy with a valuable competitive advantage.
- **Commercial banks are the dominant source of financing for commercial real estate investment.** Like other entrepreneurs, small and medium-sized real estate developers and investors lack access to equity markets and rely on traditional lending to grow and expand.
- The OB3 Act's change to the EBITDA/163(j) definition is a positive development that will allow more real estate businesses to fully deduct their interest while also expensing their property improvements and upgrades. The change will accelerate the modernization and repositioning of real estate assets that is critical to meet post-pandemic business needs.
- Concerns regarding excessive borrowing or use of leverage are better addressed through flexible financial regulatory tools that can be revisited and revised, not tax penalties that permanently distort the allocation of capital in the economy.