Business Interest Deductibility

Tax Policy

Summary

The 2017 tax bill included strict new limits on the deductibility of business interest, generally restricting this 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.

Since 2022, the general 30 percent business interest limitation has applied a less favorable rule that uses the taxpayer's EBIT (earnings before interest and tax) rather than EBITDA as the base for measuring the amount of deductible interest. In 2025, extension of EBITDA rule, which was in effect from 2018-2021, is under review as Congress considers extension of the 2017 tax bill.

Tax legislation passed by the House Ways and Means Committee in May would reinstate the EBITDA tax rule for business interest deductibility for five years: 2025-2029.

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.
- The ability to finance investment and entrepreneurial activity with borrowed capital has driven jobs and growth in the United States 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.

Background

EBITDA Rule

- The original 2017 House Republican tax plan—the House blueprint for tax reform—would have eliminated the deductibility of all business interest (including commercial real estate debt) while replacing depreciation rules with the immediate expensing of all future capital investment, including real property.
- The final legislation included a revised Section 163(j) in which the deductibility of business interest is generally limited to 30 percent of the taxpayer's EBITDA. It also included 100 percent expensing of equipment and machinery (not real estate) for five years, phasing down thereafter.
- The 30 percent interest limit does not apply to an electing real estate business. However, an electing real estate business is required to use the alternative depreciation system, which includes slightly longer cost recovery periods for real property and cannot immediately expense leasehold and other interior improvements.

Recommendations

Extend the EBITDA Rule: Congress should extend the EBITDA rule that was in effect from 2018-2021 and avoid passing new restrictions on business interest deductibility.

- Business interest expense is appropriately deducted under the basic principle that interest is an ordinary and necessary business expense. Interest income is taxable to the recipient.

- 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.