The Real Estate Roundtable
Pass-Through Business Income
Tax Policy

Summary

Real estate generally is owned and operated through “pass-through” entities that allow income to pass through to individual owners rather than taxing the income at the entity level. Pass-through entities such as partnerships, limited liability companies (LLCs), S corporations, and REITs are ideal for real estate because they give investors flexibility in how they structure the risks and rewards of these capital-intensive and relatively illiquid businesses.

The 20 percent deduction for pass-through business income enacted in 2017, Section 199A of the tax code, **expires at the end of 2025**. At that time, the effective marginal rate on pass-through business income would rise by over one-third. Tax legislation passed by the House Ways and Means Committee in May would permanently extend Section 199A and increase the deduction to 23 percent, lowering the top effective tax rate on qualifying income to 28.49 percent.

Key Takeaways

- Our pass-through regime is a competitive strength of the U.S. tax system. Most countries rely on inflexible corporate regimes that provide little ability for an entrepreneur to tailor the capital and ownership structure to meet the needs of the business and its investors.
- Half of the 4 million partnerships in the U.S. are real estate partnerships, and real estate activity constitutes a large share of pass-through business activity.
- Listed REITs allow small investors to invest in diversified, commercial real estate using the same single tax system available to partners and partnerships.
- Small and closely-held businesses drive job growth and entrepreneurial activity in the United States. Entity choice is a differentiator that contributes to our entrepreneurial culture.

Background

2017 Tax Cuts and Jobs Act (TCJA)

- In 2017, Congress reduced the corporate tax rate by **40 percent** and created a new **20 percent** deduction (Section 199A) for pass-through business income to avoid putting partnerships, S corporations, and REITs at a competitive disadvantage relative to large C corporations.
- Section 199A expires at the end of 2025. At that time, the effective marginal rate on pass-through business income is projected to increase significantly, from **29.6 percent to 39.6 percent**.
- Tax legislation considered in 2021 would have raised the top marginal income tax rate on many small and pass-through business owners from 29.6 percent to 46.4 percent.
- The Trump administration supports extending all of the expiring 2017 tax cuts, including Section 199A.

Recommendations

Extend Section 199A: Congress should continue to support **closely-held, entrepreneurial businesses** that create jobs and spur growth, and reject tax changes that discriminate against pass-through entities.

- Any new tax legislation should avoid the unintended consequences and potential harm caused by the stacking of tax increases on pass-through entities.
- Section 199A is appropriately targeted at businesses that hire workers and invest in capital equipment and property.
- Section 199A also helps preserve tax fairness vis-à-vis large corporations, promoting competition and entity choice.