The Real Estate Roundtable
Pass-Through Taxation
Tax Policy

Summary

Entity choice rules allow U.S. businesses to choose how they will be taxed, and real estate generally is owned and operated through "pass-through" entities—partnerships, LLCs, S corporations, and REITs. These pass-through entities allow income and often deductions to pass through to individual investors. Pass-through entities give investors greater flexibility in how they allocate the risks and rewards of these capital-intensive and relatively illiquid businesses. Our partnership tax rules facilitate the ability of differently situated parties, such as entrepreneurs and capital providers, to come together for productive activities that create jobs and strengthen communities.

Despite the economic benefits of our pass-through tax regime, pass-through rules are often challenged by certain lawmakers who claim that the rules: (1) disproportionately benefit upper-income taxpayers and large corporations, (2) give taxpayers too much ability to pick and choose how and when to pay tax, and (3) are too complicated for the IRS to enforce.

Several proposals in recent years would significantly restrict pass-through taxation or raise tax rates on pass-through income, effectively raising the tax burden on real estate investment. These proposals include:

- Extending the 3.8 percent net investment income tax to all pass-through business income,
- Capping or phasing out the 20% deduction for pass-through business income (section 199A) for taxpayers with incomes exceeding certain levels (see, e.g., Equal Tax Act, H.R. 5336),
- Repealing REIT dividends' eligibility for the 20% pass-through business income deduction (sec. 199A),
- Limiting taxpayers' ability to deduct state and local taxes (SALT) paid by pass-through entities under state laws enacted in response to the Tax Cuts and Jobs Act,
- Requiring partnership liabilities (including recourse debt) to be allocated based on the partners' shares of partnership profits, rather than actual economic liability,
- Restricting how taxpayers account for built-in gains and losses on appreciated or depreciated property when it is contributed to a partnership, and
- Recharacterizing all partnership profits interests (carried interest) as ordinary income.

Support for proposals to raise revenue on the backs of pass-through businesses may grow in the months and years ahead as pressure increases for Congress to address rising debt and deficits. For example, Senate Finance Ranking Democrat Ron Wyden (D-OR) has claimed that his PARTNERSHIPS Act (S. 2095) to reform partnership tax rules would raise over $725 billion.

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.
- Pass-through businesses account for roughly 95% of all U.S. businesses, and these businesses are the drivers of job growth, innovation, and productive risk-taking.
- 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.
- Publicly traded 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 U.S. Entity choice is a differentiator that contributes to our entrepreneurial culture.

The Real Estate Roundtable
Carried Interest
Tax Policy

Summary

A “carried” interest is the interest in partnership profits that a general partner receives from the investing partners for managing the investment and taking on the entrepreneurial risks of the venture, such as funding pre-development costs, guaranteeing construction budgets, and potential litigation. Carried interest is also granted for the value the general partner adds beyond routine services, such as business acumen, experience, and relationships. Carried interest may be taxed as ordinary income or capital gain depending on the character of the income generated by the partnership.

In the Tax Cuts and Jobs Act of 2017, Congress created a three-year holding period requirement for carried interest to receive long-term capital gains treatment.

In recent years, both Republican and Democratic leaders have proposed making policy changes that would increase the tax burden on carried interest. These include proposals to: (1) convert virtually all real estate-related carried interest income to ordinary income subject to the top tax rates and self-employment taxes; (2) treat carried interest as an interest-free loan from the limited partners to the general partner that is taxable upon grant, regardless of whether the partnership ever generates any profits; and (3) extend the current three-year holding period for carried interest capital gains treatment to five years.

Since carried interest and its tax treatment first emerged as a controversial political issue in 2007, **RER has consistently opposed legislative proposals to tax all carried interest at ordinary income rates.**

Key Takeaways

- **Carried interest is essential to real estate investment,** supporting housing development, economic growth, and the modernization of U.S. infrastructure. Carried interest changes would harm small businesses, stifle entrepreneurs and sweat equity, and threaten future improvements and infrastructure in neglected areas.
- Carried interest is **not compensation for services**. General partners receive fees for routine services (leasing, property management). Those fees are taxed at ordinary tax rates.
- Proposals to tax all carried interest as ordinary income would result in an enormous tax hike on the **2.2 million** real estate partnerships and **9.7 million** real estate partners across the country who develop, own, and operate income-producing real estate.
- Taxing carried interest at ordinary income rates would increase the cost of building or strengthening infrastructure, workforce housing, and assisted living, and would deter risky projects, such as sites with potential environmental contamination.
- The tax code should reward risk-taking**; the capital gains rate should apply to more than just invested cash.** The tax code has never, and should never, limit the reward for risk-taking to taxpayers who have cash to invest. An entrepreneur who forgoes the security of a salary to invest time and effort into starting a business should qualify for capital gains treatment in the same way that a passive investor qualifies when they put their cash into a public stock or private venture.
- Carried interest proposals apply retroactively to prior transactions and partnership agreements executed years earlier. The agreements were based on tax law **as it existed at the time**.
- Changing the results years later would undermine the predictability of the tax system and discourage long-term, patient investment.

Summary

Created in 2017, Opportunity Zones (OZs) are designated, low-income census tracts where qualifying investments are eligible for reduced capital gains taxes. By channeling investment where it is needed, OZs help stimulate jobs, generate economic opportunity, and improve the built environment in low-income communities. The decentralized design of OZs allows more investors and stakeholders to participate in the market and invest in these projects.

The One Big Beautiful Bill Act (OB3 Act), signed into law on July 4, 2025, permanently extended the OZ tax incentives and made a number of helpful reforms that will further increase the provisions' positive impact in low-income communities.

Since the passage of the OB3 Act, the Real Estate Roundtable has focused on ensuring that investment and capital continue to flow into OZs during the transition from the OZ 1.0 to OZ 2.0 regime.

IRS Notice 2026-40 incorporates several Roundtable recommendations and provides helpful guidance for businesses and funds that are undertaking ambitious, long-duration, and sustained real estate investments.

Specifically, the guidance allows for investments in OZ 1.0 census tracts after 2026 if the expenditure is made in the ordinary course of the business, or if it is pursuant to a working capital plan and the business receives and spends certain percentages of its working capital by the end of 2026.

Key Takeaways

- In their short tenure, OZs have created jobs and spurred billions of dollars of new investment in economically struggling communities across the country.
- Opportunity Funds finance affordable, workforce, and senior housing; grocery-anchored retail centers; and commercial buildings that create spaces for new businesses and jobs.
- Recent estimates suggest OZs have attracted over $120 billion in capital.
- Congress should continue working on improvements to the OZ tax incentives to boost their scale and impact. These improvements should include:
    - Removing limitations on the type of capital eligible for investment in Opportunity Funds.
    - Adding a new OZ tax benefit for the conversion of older, obsolete commercial buildings to housing.
    - Codifying, lengthening, and improving the OZ working capital safe harbor.
    - Increasing flexibility of Opportunity Fund ownership, investment, restructuring, and leasing arrangements.
    - Modifying the substantial improvement threshold to cover a broad range of real estate rehabilitation and development projects.
    - Promoting greater foreign investment.

Summary

For over 100 years, with one brief exception (1987-1990), the U.S. has taxed long-term capital gain at a lower rate than ordinary income. Previous administrations have proposed raising capital gains tax rates and taxing unrealized gains.

RER encourages Congress to continue to support investment and job creation with a meaningful capital gains incentive.

Key Takeaways

- The reduced capital gains rate partially offsets the higher risk that comes with illiquid, capital-intensive real estate projects, as well as the economic effects of inflation. The current structure decreases the cost of capital, drives long-term investment, encourages productive entrepreneurial activity, draws investment from around the world, and increases U.S. workforce productivity and competitiveness.
- Unlike other tax policies, such as immediate expensing, the capital gains preference only rewards smart, productive investments that generate profits.
- High taxes on capital income make it harder to attract the investment needed to rebuild our urban centers. Opportunity Zone capital gains incentives facilitated $75 billion in new investment in low-income communities in the first two years after enactment.
- Current law on capital gains encourages taxpayers to put capital to work on projects that won't pay off for many years. By taxing business assets and investments annually, a tax on unrealized gains would remove one of the major incentives for patient, productive capital investment.
- Risk capital differs from wage compensation. The entrepreneur who forgoes a traditional job in favor of starting a business forfeits many protections and benefits offered to employees, such as a pre-negotiated salary.
- A proposed tax on unrealized gains is quite possibly unconstitutional. Supreme Court jurisprudence has applied a realization requirement to determine whether gains or profits constitute income taxable under the 16th Amendment.
- In addition, taxing unrealized gains would trigger wasteful disputes and litigation, detracting from productive economic activity. Annual valuation requirements will require costly appraisals. Valuation disagreements will be a constant source of audits and administrative appeals.

The Real Estate Roundtable
Real Estate Like-Kind Exchanges
Tax Policy

Summary

Under section 1031, the tax code allows taxpayers to defer capital gains when exchanging real property used in a trade or business for a property of a like-kind.

In 2017, Congress narrowed Section 1031 by disallowing its use for personal property (art, collectibles, etc.). The last six budgets put forward by Democratic Administrations have proposed severe restrictions on real estate like-kind exchanges. Congressional Republicans initially considered repealing 1031 for real estate as well. In 2025, a group of House Democrats introduced legislation that would impose restrictions on such transactions. **RER advocates for preserving the current tax treatment of like-kind exchanges.**

Key Takeaways

- **15-20 percent of commercial transactions** involve a like-kind exchange. Exchanges help get languishing properties into the hands of new owners who improve them and put them to their best use.
- Academic and outside research has found that exchanges spur capital expenditures, increase investment, create jobs for skilled tradesmen and others, reduce unnecessary economic risk, lower rents, and support property values.
- Like-kind exchanges allow businesses to grow organically with less unsustainable debt, creating a ladder of economic opportunity for minority-, veteran-, and women-owned businesses and cash-poor entrepreneurs that lack access to traditional financing.
- Land conservation organizations rely on exchanges to **preserve open spaces for public use** or environmental protection.
- Like-kind exchanges helped **stabilize property markets** at the height of the COVID-19 lockdown. Exchanges are even more important during periods of market stress when external financing is harder to obtain.
- Roughly **40 percent** of like-kind exchanges involve rental housing. Section 1031 helps fill gaps in the financing of affordable housing. Unlike the Low-income Housing Tax Credit, developers can use Section 1031 to **finance land acquisition costs for new affordable housing projects**.
- Exchanges help low-income, hard-hit, and distressed communities where outside sources of capital are less available. Section 1031 also supports public services (police, education) by boosting transfer/recording/property taxes (nearly 3/4 of all local tax revenue).
- Section 1031 is consistent with corporate and partnership tax rules that defer gains when the proceeds are retained and reinvested in businesses (sections 721, 731, 351, and 368).

The Real Estate Roundtable
Business Interest Deductibility
Tax Policy

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.

The Real Estate Roundtable

Protecting Access to Foreign Investment in U.S. Real Estate

Tax Policy

Summary

Foreign investment is a major source of capital for U.S. commercial real estate, but new federal regulations, a wave of state-level restrictions, and proposed legislation threaten to deter the deployment of global capital in U.S. assets.

First, in April 2024, the Treasury Department issued final regulations that greatly expanded the reach of the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA), creating a new and unprecedented "look-through" rule that in effect would raise the tax burden on inbound real estate capital. Tax regulations proposed by the Trump administration in October 2025 would repeal the 2024 look-through rule. Separately, in December 2025, Treasury issued final Section 892 regulations and proposed new regulations that could disrupt inbound real estate investment from foreign governmental entities.

Second, at the state level, 20 states have enacted restrictions on foreign investors in real estate and agricultural land, and eight states have considered similar measures.

Third, Congress recently considered a tax proposal—known as Section 899—that would impose higher U.S. tax rates on investors from foreign countries deemed as maintaining "unfair" tax regimes. Section 899 was ultimately dropped from the One Big Beautiful Bill Act (OB3 Act) after the US and OECD agreed to carve out U.S. companies from a global minimum tax agreement.

Key Takeaways

- Foreign capital is a critical source of capital for U.S. real estate and infrastructure investment. Policies that discourage foreign investment weaken U.S. competitiveness, raise the cost of capital for U.S. developers, and undermine efforts to revitalize urban cores, modernize infrastructure, and expand the housing supply.
- Treasury's proposed repeal of the FIRPTA look-through rule is a positive development.
    - The rule exceeds Treasury's authority. Congress explicitly authorized "look-through" rules for REITs and RICs, but excluded domestic C corporations. Treasury's 2024 interpretation reads into the statute a rule Congress rejected.
    - The "look-through" rule reverses decades of well-settled law. Treasury's 2024 interpretation of the statute is contradicted by the structure and legislative history of Section 897, the only IRS ruling on the topic, and judicial opinions concerning the application of constructive ownership rules generally.
    - The "look-through" rule is retroactive and disruptive. It imposes the regulations on investment structures in place for years and creates significant uncertainty for foreign investors in REITs and infrastructure.
- States enacting or considering restrictions on foreign investment in real estate should proceed carefully to prevent unintended consequences that could hold back economic growth and capital formation.
- State-level restrictions have national implications and seem to fly in the face of the Commerce Clause of the Constitution in that they interfere with the free flow of interstate and foreign commerce.
- Congress should continue to oppose proposals such as Section 899 that could disrupt global capital flows and chill passive investment in U.S. real estate and infrastructure.
- If a "retaliatory tax" like Section 899 moves forward, lawmakers should modify the measure to exempt passive, non-controlling minority investment in U.S. real estate in order to protect an important source of financing and capital.