The Real Estate Roundtable

Pass-Through Taxation

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.

Congress permanently extended the 20-percent pass-through deduction in the One Big Beautiful Bill Act (OB3 Act), signed into law on July 4, 2025. More recently, Democratic members of Congress have introduced legislation to repeal the pass-through deduction for taxpayers with incomes over $1 million and restructure partnership taxation.

Over the last two years, RER has submitted three amicus briefs (e.g., RER submission in *Soroban*, December 2025) in support of taxpayers challenging the government's recent assertion that limited partners are subject to self-employment taxes (SECA) unless the LP is also passive investor. The government position, which could have significant negative consequences for real estate partnerships, is inconsistent with the intent, language, and spirit of the 1977 statute that exempts limited partners from SECA.

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.
- 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.

Background

Pass-Through Business Income Deduction

- Congress enacted a 20 percent deduction for pass-through business income in the Tax Cuts and Jobs Act of 2017 (Section 199A).
- The pass-through deduction applies to pass-through income to the extent the business pays wages to employees and/or owns tangible, depreciable property (such as real estate). Specified services businesses (e.g., law firms, accounting firms, etc.) are not eligible for the deduction.
- Section 199A lowers the top marginal income tax rate on qualifying pass-through business income from 39.6 percent to 29.6 percent.
- Section 199A was scheduled to expire at the end of 2025. The OB3 Act permanently extended the pass-through deduction.
- Legislation introduced after enactment of the OB3 Act by a handful of House Democratic members (*Equal Tax Act*, H.R. 5336) would repeal Section 199A for business owners with annual incomes over $1 million.
- Also in 2025, Senate Finance Ranking Democrat Ron Wyden (D-OR) proposed comprehensive reforms to restructure partnership taxation. The *PARTNERSHIPS Act* (S. 2095) would increase the tax burden on partnerships by an estimated $727 billion over the next 10 years.

Recommendations

Preserve Pass-Through Tax Rules and 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, and it should be retained.
- Section 199A helps preserve tax fairness vis-à-vis large corporations, promoting competition and entity choice.
- In addition, Congress should avoid partnership tax reforms that will discourage capital formation, make it harder to contribute property to a partnership, or undermine the ability to finance partnership operations and activities. Congress should also avoid tax reforms that retroactively and unfairly change the economics of prior transactions.
- Lastly, fundamental changes such as rewriting or reinterpretation of the limited partner exception from self-employment taxes should be considered through the legislative process, not by administrative fiat.

The Real Estate Roundtable

Preserving HSR Real Estate Transaction Exemptions

Tax Policy

Summary

The Hart-Scott-Rodino Act (HSR) requires parties to certain mergers and acquisitions to file premerger notification reports with the Federal Trade Commission (FTC) and Department of Justice (DOJ) and observe a waiting period before closing. Since 1996, the FTC has exempted certain real estate transactions from HSR reporting requirements because these acquisitions are unlikely to violate antitrust laws.

In May 2026, RER submitted comments urging the FTC and DOJ to preserve the real estate exemptions, warning that removing them would impose substantial costs and delays on lawful real estate transactions without delivering any clear antitrust benefit. RER emphasized that real estate markets remain local, highly fragmented, and shaped by property type, geography, zoning rules, neighborhood characteristics, and other market-specific factors.

Key Takeaways

- The real estate exemptions were adopted in 1996 because certain categories of real property acquisitions were considered unlikely to violate antitrust laws.
- The exemptions cover several categories of real property acquisitions, including office, residential, retail, hotel, warehouse, agricultural, recreational, and other rental real estate assets.
- The agencies have not provided evidence that circumstances have changed materially since the exemptions were adopted, or that exempted real estate transactions have had a negative effect on competition.
- Eliminating the exemptions would impose new regulatory burdens, increase costs, slow closings, disrupt market liquidity, and create additional uncertainty at a time when capital formation remains critical to investment and development.
- Removing the exemptions would not be a targeted way to address concerns about single-family housing acquisitions by large institutional investors, and could instead increase costs for homebuilders and residential developers working to address the nation's housing shortage.

Background

HSR Real Estate Exemptions

- Congress authorized the FTC to exempt from HSR reporting requirements transactions that are not likely to violate antitrust laws.
- In 1996, the FTC adopted specific real estate exemptions under 16 C.F.R. § 802.2 and 16 C.F.R. § 802.5 after concluding that certain categories of real property acquisitions were unlikely to raise antitrust concerns.
- At the time, the FTC said the exemptions would "remove an unnecessary burden from business" and allow the FTC and DOJ to better focus resources on transactions more likely to cause competitive harm.
- HSR filing fees can reach up to $2.46 million depending on deal size, before accounting for legal, financial, and operational costs associated with preparing filings.
- The vast majority of transactions covered by the exemptions do not involve single-family housing, and many single-family housing transactions would not meet the HSR filing threshold even if the exemptions were removed.

Recommendations

Preserve the Real Estate Exemptions: The FTC and DOJ should retain the longstanding HSR real estate exemptions and avoid imposing new filing requirements on transactions that remain unlikely to raise antitrust concerns.

- The agencies should not eliminate or curtail the exemptions absent evidence that exempted real estate transactions have harmed competition.
- Any review of the exemptions should recognize that real estate markets are local, fragmented, and shaped by property-specific and geography-specific factors.
- Concerns about single-family housing acquisitions should be addressed through more targeted tools, rather than broad changes affecting a wide range of commercial, residential, agricultural, retail, warehouse, hotel, and other real estate transactions.
- Preserving the real estate exemptions would help maintain market liquidity, support capital formation, and protect investment needed for housing, economic growth, and the broader real estate economy

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 past year, both Republican and Democratic leaders have proposed making policy changes that would increase the tax burden on carried interest.

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 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.
- Unfair retroactive application of carried interest legislation to existing partnerships would distort the economics of private-sector agreements with unknown and potentially damaging consequences for real estate markets and the overall economy.

Background

Proposed Changes to Carried Interest

- In February 2025, President Trump informed Republican congressional leaders that one of his main tax priorities is "closing the carried interest tax deduction loophole." Shortly thereafter, a group of 13 Senate Democrats reintroduced the *Carried Interest Fairness Act* (S. 445).
- The *Carried Interest Fairness Act* would convert virtually all real estate-related carried interest income to ordinary income subject to the top tax rates and self-employment taxes.
- Former Senate Finance Chairman Ron Wyden (D-OR) has proposed treating 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.

Recommendations

Retain Current Law on Carried Interest: Carried interest changes would harm small businesses, stifle entrepreneurs and sweat equity, and threaten future improvements and infrastructure in neglected areas.

- Such changes 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.

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.
- In 2020, the White House Council of Economic Advisers estimated that the Opportunity Funds had raised **$75 billion** in private capital in the first two years following the incentives' enactment, including **$52 billion** that otherwise would not have been raised. The council projected this capital could lift one million people out of poverty, decreasing poverty in OZs by 11 percent.
- Despite major hurdles such as COVID-19 and high interest rates, more recent estimates suggest OZs have attracted over **$120 billion** in capital.
- Today, **72 percent** of U.S. counties contain at least one OZ, and **32 million** people live in the 8,764 OZ-designated census tracts.

Background

One Big Beautiful Bill Act

- The OB3 Act permanently extended the OZ tax incentives, including the full exclusion of capital gain on OZ investments held for 10 years.
- Beginning in 2027, the new law provides a rolling, five-year deferral period for prior gain that is invested in an Opportunity Fund (this ends the prior problem of a shrinking OZ tax incentive as the statutory recognition date for deferred gain approaches).
- The law also provides for a re-designation of OZ census tracts by state governors every 10 years and tightens the definition of a low-income census tract that is eligible for an OZ designation.
- The OB3 Act establishes additional benefits for rural OZs, including a lower substantial improvement test for real estate projects, as well as transparency/reporting measures for all Opportunity Funds.

Recommendations

Support Implementation of New Rules: The OB3 Act represented an important and positive step forward in OZ tax policy and will ensure that the incentives continue to help mobilize capital for productive real estate investment, spur hiring in low-income areas, and boost housing supply.

- The U.S. Department of the Treasury should act quickly to lock in the legislative gains with well-designed guidance that supports implementation of the new rules. The guidance should clarify the eligibility of

projects that started but were not completed prior to the expiration of the TCJA deadlines. Continuing expenditures on these long-term projects should qualify for OZ benefits.

- Treasury and/or Congress should consider actions that can be taken to encourage continued OZ investment in 2026. Otherwise, there is a risk that OZ investment will largely cease ("OZ dead zone") as investors wait until the new OZ regime takes effect on Jan. 1, 2027. In December 2025, RER submitted a formal request to Treasury for an expedited Revenue Procedure that provides safe harbors for long-term investments in expiring TCJA OZs. In March 2026, RER followed up this request with draft guidance for Treasury and the IRS to consider (Letter, Revenue Procedure).
- Congress should also 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

- Unlike other tax policies, such as immediate expensing, the capital gains preference only **rewards smart, productive investments** that generate profits.
- 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**.
- **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.

Background

State of Capital Gains

- Traditionally, the U.S. has taxed long-term capital gain at a lower rate than ordinary income. Since 1921, the only exception was a brief three-year period after the Tax Reform Act of 1986, when Congress lowered the top ordinary tax rate from 50 percent to 28 percent and created temporary tax parity between ordinary and capital income.
- Long-term capital gain is currently taxed at a top rate of 20 percent.
- However, the rate increases to 23.8 percent if the income is subject to the 3.8 percent tax on net investment income. The net investment income tax applies to real estate gains earned by passive investors and not income earned from the active conduct of professionals in real estate.
- A tax on unrealized gains would require the IRS to police households as they identify, tabulate, and value all their worldly possessions. The tax would thrust the IRS into a new and unwelcome role. The agency would become a permanent, live-in accountant and watchdog over every aspect of household finances, consumer activity, and economic life.

Recommendations

Maintain a Reduced Tax Rate on Capital Gains: 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.**

- The differential tax treatment of liquid and illiquid investments would distort markets and give rise to wasteful new tax shelters and taxpayer games.

Reward Risk-Taking: 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 foregoes a traditional job in favor of starting a business forfeits many protections and benefits offered to employees, such as a pre-negotiated salary.

- The capital gains preference **compensates entrepreneurs** for this risk, including the potential complete loss of their time and capital.

Preserve the Integrity of Our Tax System: 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

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

Background

Like-Kind Exchanges

- Since 1921, the tax code has allowed taxpayers to defer capital gain when exchanging real property used in a trade or business for a property of a like-kind, which today is covered in Section 1031.
- In 2017, Congress narrowed Section 1031 by disallowing its use for personal property (art, collectibles, etc.). Congressional Republicans initially considered repealing 1031 for real estate as well.
- The previous Biden administration would have restricted gains deferred through like-kind exchanges to no more than $500K per year ($1M/couple). A similar proposal has appeared in the last six budgets submitted by Democratic administrations.
- The *Equal Tax Act* (H.R. 5336), introduced in the summer of 2025 by a handful of House Democrats, would severely restrict 1031 transactions.

Recommendations

Preserve Current Policy on Like-Kind Exchanges: The existing tax treatment of like-kind exchanges under Section 1031 supports healthy real estate markets and property values.

- 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.
- **Section 1031 is facilitating a smoother transition** as real estate assets are re-purposed in the post-COVID economy.
- 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 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. The One Big Beautiful Bill Act (OB3 Act) included a provision that will allow more real estate businesses to fully deduct their business interest and qualify for 100 percent bonus depreciation on their nonresidential, interior improvements.

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 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.

Background

Business Interest and Depreciation

- The final 2017 tax 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 leasehold and nonresidential interior improvements for five years, phasing down thereafter.
- The 30 percent interest limit did 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.
- The OB3 Act reinstated (effective Jan. 1, 2025) and permanently extended a broader EBITDA definition of income for purposes of the section 163(j) limit on business interest. This change will allow many taxpayers to own and operate commercial real estate under the general §163(j) business interest limitation, a requirement for 100 percent expensing of leasehold and interior improvements.
- Following passage of the OB3 Act, RER asked Treasury to issue guidance allowing taxpayers to retroactively modify or revoke prior elections out of the interest deductibity limits in order to benefit from the fully restored bonus depreciation incentive in the legislation (RER letter, Oct. 17, 2025). This relief was issued in March 2026 in the form of subregulatory tax guidance (IRS Rev. Proc 2026-17). The guidance will spur new property improvements while ensuring that existing property owners are able to avail themselves of an important benefit included in the OB3 legislation.

Recommendations

Avoid 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.

- The change to the EBITDA/163(j) definition in the OB3 Act 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.
- Congress should avoid changes to cost recovery rules, such as shorter depreciation schedules, if they are paid for or offset with reforms that deny real estate owners' ability to deduct borrowing costs, an ordinary and necessary business expense.

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 income, dividends, and capital gains earned by investors from foreign countries deemed as maintaining "unfair" tax regimes. Section 899 was ultimately dropped from the One Big Beautiful Bill Act (OB3 Act) and a recent OECD agreement to carve out U.S. companies from the global minimum tax agreement has significantly reduced the likelihood that Section 899 will be revived.

Key Takeaways

- With approximately $1.5 trillion of U.S. commercial real estate debt coming due in the next three years, foreign equity investments in U.S. assets are often an important source of capital as commercial real estate owners seek to restructure, refinance, or sell their properties.
- Discouraging foreign investment weakens U.S. competitiveness, raises the cost of capital for U.S. developers, and undermines efforts to revitalize urban cores, modernize infrastructure, and expand the housing supply.

Background

FIRPTA "Look-Through" Rule

- In April 2024, the Treasury Department issued final regulations under FIRPTA that introduced a "look-through" rule to determine whether a real estate investment trust (REIT) or regulated investment company (RIC) qualifies as a "domestically controlled qualified investment entity" (DCQIE) under Section 897(h)(4)(B) of the Internal Revenue Code.
- For decades, Treasury regulations interpreted the phrase "directly or indirectly" to refer to actual ownership and not constructive ownership through unrelated entities. Domestic C corporations—including those with significant foreign ownership—were treated as U.S. persons for purposes of determining whether a REIT was domestically controlled.
- The 2024 final regulation would have reversed this position. It have would required "look-through" treatment of any non-public domestic C corporation if 50 percent or more of its stock is held (directly or indirectly) by foreign persons.
- The rule would have applied retroactively, including to long-established structures created under the prior legal regime.

Taxation of Sovereign Investors

- Section 892 of the tax code generally exempts investment income earned by foreign governments from U.S. income tax. The Section 892 exemption does not apply, however, if the foreign government effectively

controls the U.S. business or is deemed to be engaged in a commercial activity. The Section 892 exemption is critical for sovereign wealth funds, foreign pension funds, and other foreign governmental entities investing in U.S. real estate.

- In December 2025, Treasury released final Section 892 regulations and issued new proposed regulations addressing two key questions: 1) when a foreign government has effective control of an entity engaged in commercial activities, and 2) when an acquisition of debt is considered commercial activity. Although well-intended, aspects of these regulations could severely disrupt inbound real estate investment and raise the cost of capital for U.S. real estate projects.

State-level Restrictions on Foreign Real Estate Investment

- States that have enacted or considered restrictions on foreign investors in real estate and agricultural land include Florida, which enacted Senate Bill 264 in 2023. The law aims to limit and regulate the sale and purchase of certain Florida real property by "Foreign Principals" from "Foreign Countries of Concern."

Proposed "Section 899" Tax

- Section 899, as proposed in initial versions of the 2025 budget reconciliation bill, would have operated through the tax code's foreign residency rules, and in many cases made the Treasury Department responsible for determining whether a foreign country imposes unfair taxes and could therefore face escalating penalities. This would have resulted in uncertainties for foreign investors, where individual tax rates could change from year to year or between administrations.
- The provision would have extended to a wide range of passive investors—including sovereign wealth funds, pension funds, high-net-worth individuals, and insurance companies—with the economic burden often falling on U.S. borrowers under typical loan covenants that shift tax-law risk to domestic parties.
- Lawmakers also contemplated retroactive application to income from investments made months or years prior—a move that would have undermined global confidence in U.S. property markets.
- Policymakers dropped Section 899 from the OB3 Act after G7 countries pledged to exempt the U.S. from the OECD Pillar Two global minimum tax. The OECD released a side-by-side agreement in January 2026 to carve out U.S. companies from the global minimum tax. Congressional leaders have said they are prepared to reconsider the proposal if needed, if the agreement is not fully implemented.

Recommendations

Reform FIRPTA and Finalize Regulations Withdrawing the "Look-Through" Rule: The federal government should reform FIRPTA and act quickly to finalize proposed regulations repealing the look-through rule.

- In March 2025, RER resubmitted detailed comments challenging the legality of the FIRPTA look-through rule and describing its harm to U.S. real estate and the broader economy. The letter asked the new administration to repeal the provision on several grounds:
    - **The rule exceeds Treasury's authority.** Congress explicitly authorized "look-through" rules for REITs and RICs in Section 897(h)(4)(E) but deliberately excluded domestic C corporations. Treasury's new interpretation reads into the statute a rule Congress rejected.
    - **It reverses decades of well-settled law.** Treasury's 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.
    - **It impedes investment in the U.S. economy.** Foreign capital as a share of total U.S. CRE investment has already fallen from over 16 percent in 2018 to less than 6 percent in 2024. The rule risks further reducing capital formation for job-creating U.S. real estate and infrastructure projects.

- On Oct. 21, 2025, in a very welcome development, Treasury issued proposed regulations that would repeal the FIRPTA look-through rule for domestically controlled REITs. The preamble to the proposed regulations conveyed the adminstration's strong agreement with the policy and economic arguments in RER's March 2025 letter. RER wrote to Treasury in December 2025 commending the administration and urging finalization of the regulations.

Revise Proposed Tax Reglations on Sovereign Investors: In February 2026, RER submitted a detailed comment letter urging Treasury to revise the proposed Section 892 regulations to prevent disruptions to sovereign investment in U.S. real estate.

- The letter recommended targeted fixes, including clear grandfathering rules; clarifying that customary minority protections do not create effective control; confirming that withholding agents may rely on foreign government self-certifications; and adding safe harbors (for certain distressed-debt modifications).
- RER's position was reinforced by Tax Policy Advisory Committee (TPAC) Chair Joshua Parker's March 2026 Bloomberg op-ed, which encouraged Treasury to modernize the rules without discouraging long-term foreign capital flows.
- Treasury officials have publicly indicated that the department is revising the proposed Section 892 regulations, citing feedback from the investment and real estate industry, including RER.
- In late May 2026, consistent with RER's request, Treasury issued proposed regulations modifying the effective dates in December's proposed rules and clarifying that the final regulations will include generous grandfathering and transition rules to avoid adversely affecting current investments. These changes were made even while the agency continues its consideration of the underlying substantive questions.

Use Caution Around State-Level Rule Changes: 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.

Avoid Enacting Section 899 or Make Substantial Revisions to the Proposal: 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.