CRE Finance Council
The Voice of Commercial Real Estate Finance

Tax Reform: Interest Deductibility Fact Sheet

Real Property Borrowers Avoid New Interest Deduction Limitations

Last updated: June 1, 2018

Executive Summary

- Section 13301 of the Tax Cuts and Jobs Act (H.R. 1), signed into law in December 2017 generally denies a deduction for net business interest expense in excess of 30% of a business's adjusted taxable income (ATI).

- The 30% restriction does not, however, apply to *electing* "real property trades or businesses." Such businesses are defined as "any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business."

- Real property trades/businesses that elect out of the interest deductibility restriction must use alternative depreciation system (ADS) recovery periods for cost recovery purposes. The ADS periods for residential rental property and nonresidential real property are 30 years and 40 years, respectively.

- The new interest deduction limitation is effective as of January 1, 2018. It is important to note that the new 163(j) limitation only applies if the taxpayer has gross receipts of $25 million or more.

INTEREST DEDUCTIBILITY QUICK FACTS

- New 30% ATI limit on business interest deductibility does not apply to electing real property trades and businesses.

- Businesses electing out of interest deductibility restriction must use 40-year ADS recovery period for nonresidential real property.

- "Real property trade or business" includes real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business.

- Additional technical rules are expected to be issued in regulations, including rules regarding attribution of interest to i to multiple businesses (i.e., when one business is exempt from the rules for computing the limitation with respect to partners in a partnership (the existing rules will likely be expanded and refined).

Next Steps

- **Implementing the new tax law:** H.R. 1 instructs and/or authorizes the Treasury Department to write *numerous* new rules to effectuate these new provisions in the tax code and additional rules are expected to be issued with respect to section 163(j)
  - The IRS has issued Notice 2018-28 addressing certain high-level issues with respect to section 163(j) (e.g., the limitation applies to consolidated groups of corporations on a consolidated basis, carryforwards of disallowed interest from past years is subject to the limitation, all "C" corporation interest is treated as "business" interest, and certain rules for computing the application of the limitation to partners in a partnership. These rules, as well as additional guidance, is expected in future regulations.

- **Technical Corrections Legislation:** There have been numerous technical correction issues identified in the first weeks since the law's enactment. To address these issues legislatively, 60 votes in the Senate likely will be required. Therefore, passage of any such bill in this mid-term election year will be a very difficult process.

CREFC Policy & Strategy

To the extent CREFC members identify the need for technical corrections, regulatory guidance and/or additional clarity with respect to the interest deductibility provisions under the new tax law, CREFC will remain engaged throughout any regulatory and/or technical corrections processes to ensure these provisions are implemented in a clear, workable, beneficial manner.

Additional Background & History

- Under the pre-H.R. 1 tax code, businesses could deduct interest payments on amounts borrowed without limitation (except in certain narrow cases involving payments to foreign related parties), which reduced the cost of investment and facilitated increased economic activity by allowing businesses greater access to capital to maintain and expand their operations.

- Limiting the interest deduction was presented generally in the House Republican Tax Reform Blueprint in 2016 as a trade-off for immediate expensing, which CREFC also opposed.

- Because debt financing is particularly important in the real estate industry, CREFC argued during the tax reform debate that restricting this deduction—particularly for real property businesses—risked destabilizing the recovering economy. Beyond the real estate industry, many others, including agriculture, finance, construction, telecommunications, and mining, would be harmed by any new limitations under this provision.

- Ultimately—despite tremendous pressure on lawmakers to find revenue to offset various tax reductions in the comprehensive tax reform package—we, along with our industry group partners, were successful in preserving full interest deductibility for electing real property trades and businesses—a big victory for CREFC members and the broader real estate sector.

CREFC Resources

Steptoe & Johnson Memo on CRE-related Tax Issues, December 4, 2017

CREFC Side-by-Side Comparing Various Tax Vehicles, December 4, 2017

For further Information, see CREFC's Research Center at: https://www.crefc.org/library