Summary of Key Elements of Tax Reconciliation Bill

Provided by RLI member Dan Wagner

Below is an initial summary of key elements of the legislation relevant to real estate. Please note that this summary is not exhaustive, and it is subject to change and correction as we continue to work through the details. First and foremost, key omissions from the bill:

- No changes to the deductibility of state and local business-related property taxes
- No changes to the tax treatment of carried interest
- No changes in capital gains, like kind exchanges, or the general cost recovery period for commercial real estate
- No increase in the top tax rate for individuals

In addition to permanently extending broad-based individual tax reforms (lower rates, higher standard deduction, larger child tax credit, limitations on mortgage interest deduction and other itemized deductions), the bill includes a number of other important provisions. These include the following:

1. **Permanent Increase in the deduction for qualified pass-through business income (section 199A) from 20% to 23%.** The bill preserves the eligibility of REIT dividends, as well as wage and capital rules that allows the real estate operating income of partnerships to qualify. The rate change lowers the maximum effective tax rate on qualifying income to 28.49%.
    a. In addition, the bill modifies the phase-out rules to allow specified services trade or businesses (e.g., law firms, accounting firms, asset managers, hedge funds, consulting businesses, etc.) to qualify for a partial 199A deduction on all income. The maximum deduction for an SSTB would be 5.75% (25% of the 23% deduction).
2. **Five-year reinstatement of 100% bonus depreciation for property placed in service after 1/19/25 and before 1/1/30.** Under current law, the bonus depreciation rate is 40% in 2025, 20% in 2026, and eliminated thereafter. Under changes made in 2015 and 2017, leasehold and other nonresidential real estate improvements can qualify for bonus depreciation if the taxpayer operates under the general business interest deductibility rules.
    a. Restoration of bonus depreciation should provide a meaningful incentive for taxpayers to upgrade and improve existing nonresidential properties.

3. **Opportunity Zones.** The bill would mandate a new round of OZ designations based on nominations from state governors. The new OZs would be in effect from 1/1/27 through 12/31/33. The bill would modify the definition of qualifying low-income census tracts, and at least 33% of the OZ designations must be rural areas. The bill would allow taxpayers to invest up to $10K of ordinary income in an opportunity fund. Recognition of prior gain that is rolled into an opportunity fund would be deferred until 12/31/33 (with a potential 10% basis bump if invested for 5 years before the gain is recognized; 5% bump after 7 years no longer available).
    a. The bill also includes extensive information reporting requirements that may not survive Senate parliamentary requirement (Byrd Rule).
4. **Low-income housing tax credit expansion.** The bill includes a 4-year, 12.5% increase in the allocation of low-income housing tax credits to States (2026-2029). The bill also lowers the private activity bond financing requirement that allows projects to qualify for low-income housing credits without an allocation from the State housing finance agency. The PAB threshold is reduced from 50% to 25% on a permanent basis.
5. **Factory expensing.** The bill permits nonresidential real property used in the manufacturing, production, or refining of tangible personal property to elect 100% expensing. The provision is intended to apply to manufacturing, agricultural production, chemical production, and refining property. Construction must begin after 1/19/25 and before 1/1/29, and original use must commence with the taxpayer.
6. **Rollback of clean energy tax credits.** The bill terminates or phases out most of the clean energy tax credits that were expanded or created in the Inflation Reduction Act of 2021. The legislation repeals the credits for EV recharging stations, home energy improvements, and residential solar property placed in service after 12/31/25, and new energy efficient homes placed in acquired after 12/31/25 (transition rule if construction began before 5/12/25.
    a. Transferability of credits authorized in the IRA is generally repealed for facilities that begin construction after the date that is two years after the date of enactment.
    b. The enhanced deduction for energy efficient commercial buildings (sec. 179D) is preserved.

7. **Modifications to business interest deductibility.** The bill reinstates the taxpayer-favorable EBITDA definition of income used to measure the limit on deductible business interest. The change is effective from 1/1/25 through 12/31/29.

8. **Disallowance of certain SALT deductions for pass-through business owners.** The bill clarifies that state and local property taxes paid or accrued in a trade or business, or relating to the production of income, remain deductible. The bill disallows the deductibility of state and local income, excess profits, and general sales taxes paid or accrued by a specified services trade or business (SSTB) under section 199A (e.g., law, finance, health, consulting, athletics, performing arts, and other service-related businesses).

    a. The provision includes rules aimed at capturing substitute payments authorized under various state laws after 2017.

    b. Income taxes paid to a state or locality by a partnership or S corporation in conjunction with other non-SSTB activities (e.g., real estate trade or business) remain deductible).

There are other important changes in the legislation that could have indirect implications for real estate investment. These include:

- Increase in the tax on university endowments (up to a maximum of 21%)
- Increase in the tax on private foundations (up to 10%)
- Authorization of retaliatory tax measures against foreign companies and investors based in countries that adopt discriminatory or extraterritorial taxes
- Changes to the section 179 small business expensing allowance
- Exclusion of interest income for certain types of lending