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The One Big Beautiful Bill: Initial Analysis of Key Provisions for Investment Funds and Sponsors

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On May 22, 2025, the House of Representatives passed H.R. 1, the budget reconciliation bill known as the One Big Beautiful Bill Act (the Tax Bill). The Tax Bill proposes amendments to the Internal Revenue Code (the Code) that could have significant consequences for both individuals and businesses. This alert summarizes certain key tax provisions of the Tax Bill for the investment funds industry and sponsors.

The Tax Bill has now moved to the Senate for consideration, where further modifications to the tax provisions discussed below may be made. We will continue to provide updates as the bill advances through the legislative process in Congress.

- **No Carried Interest Provision**. Even though in the months prior to the passage of the Tax Bill, there was suggestion that the bill may address the taxation of carried interests, the bill does not contain any provision relating to the taxation of carried interests.
    - *Troutman Take: This is good news for U.S. fund sponsors that benefit from the favorable tax treatment of income received pursuant to a carried interest. It remains to be seen whether the Senate would introduce changes relating to carried interests.*

- **Section 199A Would Be Expanded**

  Current law: Section 199A of the Code was enacted by the Tax Cuts and Jobs Act of 2017 (TCJA) to provide a tax rate reduction to non-corporate owners of pass-through entities, thereby serving as somewhat of a parallel reduction to the corporate tax rate enacted by the TCJA. The Section 199A 20% deduction applies through 2025, and is generally based on the non-corporate taxpayer's allocable share of "qualified business income." The non-corporate owner may deduct 20% of his or her (i) qualified trade or business income from pass-through entities plus (ii) the aggregate amount of qualified REIT dividends (generally any REIT dividend that is not a capital gain dividend or qualified dividend income, and subject to certain holding periods). The 20% deduction results in a federal effective tax rate of as low as 29.6%. This has been a significant benefit to certain investment funds, particularly those that own interests in REITs.

  Tax Bill: The deduction would be increased to 23% and made permanent. Thus, the effective federal rate on income that is currently subject to a 37% rate could be reduced to an effective rate as low as 28.49%.

Section 199A's application would be expanded to the portion of dividends representing net interest income paid by a "business development company" (BDC) taxable as a regulated investment company (RIC).

Qualified REIT dividends would continue to have the benefit of Section 199A deductions.

- *Troutman Take: The Tax Bill would extend the Section 199A tax advantage that is currently provided to investors in REITs to investors in BDCs as well — and make such tax advantage permanent. Given that a BDC's assets often consist of mainly debt instruments, a substantial portion of its distributions may be eligible for the deduction. The changes for BDCs may increase the attractiveness of BDCs as vehicles for credit funds. This change would give fund managers greater structuring alternatives to consider by creating greater parity between BDC and REIT structures in cases where the underlying asset portfolio could qualify for either, such as a portfolio of mortgage-backed securities.*

- **163(j) Limitation on Interest Deductions Would Be Temporarily Relaxed**

  Current law: Section 163(j), enacted by the TCJA, generally limits the deduction for business interest expense to 30% of a taxpayer's "adjusted taxable income." For tax years before 2022, "adjusted taxable income" was calculated similar to earnings before interest, taxes, depreciation, and amortization (EBITDA), but for tax years starting in 2022, is calculated similar to earnings before interest and taxes (EBIT).

  Tax Bill: The definition of "adjusted taxable income" would once against be based on EBITDA (which is more favorable for taxpayers than EBIT under current law) for tax years 2025 to 2028.

  - *Troutman Take: Leveraged blockers would potentially have greater ability to deduct interest expense to reduce their taxable income.*

- **Increased Taxes, Including Withholding Obligations by Funds, on Certain U.S. Sourced Income Allocated to Foreign Taxpayers from Certain Countries**

  Current law: Foreign taxpayers with income that is effectively connected to a U.S. trade or business (ECI) generally are subject to regular U.S. tax rates on such income (currently 21% in the case of corporations and a maximum of 37% in the case of individuals). Foreign taxpayers with certain passive income that is not effectively connected to a U.S. trade or business (fixed, determinable, annual, or periodical income" or FDAP) are subject to tax at a flat rate of 30%, which rate is often reduced by a treaty between the U.S. and the relevant foreign country. FDAP income tax is collected by withholding. Interest income that qualifies as "portfolio interest" (generally, non-contingent interest received by certain unrelated investors not engaged in a lending business) is not subject to such withholding. Non-trade or business capital gains of foreign taxpayers are generally not subject to U.S. income tax. A foreign taxpayer's gain or loss from the disposition of a U.S. real property interest is treated as effectively connected to a U.S. trade or business, and the payor of such income is generally required to withhold tax from the payment.

  Foreign corporations that engage in a U.S. trade or business through a branch rather than a subsidiary are subject to an additional branch profits tax on their ECI.

Under Section 892, foreign governments are exempt from U.S. tax on certain of their investment income.

Tax Bill. New Section 899 would impose a retaliatory tax on persons that are residents of, or otherwise have sufficient nexus with, foreign countries that, in the view of the House of Representatives, unfairly target and impose discriminatory taxes on U.S. taxpayers doing business abroad. Increased tax rates would apply to certain types of income of persons that are residents of or otherwise have sufficient nexus with “discriminatory foreign countries” that impose “unfair foreign taxes.” Unfair foreign taxes would include (i) taxes that may be imposed under the undertaxed profits rules (UTPRs) of Pillar Two, (ii) digital services taxes (DSTs), (iii) diverted profits taxes (DPTs), and (iv) any tax, to the extent provided by the Secretary, that is an extraterritorial tax, discriminatory tax, or any other taxes enacted with public or stated purpose that it will be economically borne disproportionately by U.S. persons.[1]

An increased rate of 5% would apply for each year of the unfair tax, up to a 20% maximum increase. The increased taxes would be incremental additional taxes that would apply on top of tax rates that would otherwise apply. For example, if dividends would otherwise be subject to a 30% withholding tax, then Section 899, as proposed, could increase the rate to as high as 50%. If a tax treaty reduces the rate on dividends to 10%, then Section 899, as proposed, could increase the rate to as high as 30%.

The increased rates would apply to: (1) taxes on dividends, interest, royalties, rent, or other FDAP income (currently subject to 30% withholding, unless reduced by treaty), (2) income that is effectively connected with a U.S. trade or business (ECI) (but for individuals, ECI is limited to gains on the disposition of U.S. real property interests) and (3) FIRPTA withholding (currently 15%) on U.S. real property dispositions, (4) the branch profits tax, and (5) investment income of non-U.S. private foundations.

The Tax Bill would also modify the application of the base erosion and anti-abuse tax, or BEAT to corporations that are primarily owned by tax residents of discriminatory foreign countries.

In addition, the Tax Bill provides that the exemption from tax under Section 892 that applies to certain income of foreign governments (including their sovereign wealth funds) would no longer apply to foreign governments of discriminatory foreign countries.

Troutman Take:

- *Based on a footnote in the Committee Report, it is expected that portfolio interest would continue to be exempt from withholding, as would liquidating distributions by corporations, and non-liquidating distributions by corporations with no current or accumulated E&P. As a result, U.S. investment funds may place an even greater focus on the use of leveraged foreign blockers in tax planning, as well as planning to qualify for other exemptions from withholding.*

- *Increased focus may develop on creating offshore investment structures that seek to avoid foreign investors from being considered to have nexus with discriminatory foreign country.*

- *Given that Section 899 increases the tax on ECI of foreign corporations (but only the ECI from the sale of U.S. real property interests by individuals) and the fact that the Section 899 tax increase would apply to the branch profits tax, there may be decreased use of foreign blockers that are engaged in a U.S. trade or business.*

- *U.S. investment funds that allocate ECI to foreign investors should start to consider the potential for increased taxes on their foreign investors, and tax planning strategies to minimize such increased taxes.*

- *Foreign governments that currently do not have to file income tax returns with respect to dividends received from, or gain on the sale of a U.S. real property holding company because it is not a "controlled commercial entity" should start to consider they may have return filing obligations.*

- *Dividend distributions and capital gain dividends on the sale of U.S. real property by REITs to foreign residents of discriminatory foreign countries would become subject to increased withholding, thus increasing the compliance and withholding burden on REITs.*

- *It is possible that one or more countries that have an existing "unfair foreign tax" may terminate such unfair foreign tax and stop being a "discriminatory foreign country," thereby preventing the increased tax rate from apply to the U.S. income of their residents. U.S. investment funds with investors from discriminatory foreign countries should closely monitor how such countries deal with their unfair foreign taxes.*

- *There are many unanswered questions that funds may have to face relating to the practical application of Section 899, including the means to identify the persons with respect to which a fund must withhold.*

- *For the implications of Section 899 to lending in the U.S. by foreign lenders, please see our advisory: The Big Beautiful Bill and the Effects on Bank Lending Into the US.*

- **Increased Excise Taxes on Private University Endowments and Private Foundations**

  Current Law: A 1.40% excise tax is imposed on the net investment income of certain private colleges and universities.

  Tax Bill: The existing 1.40% tax would be amended with a new tiered tax rate structure under which the tax rate applicable to a private college or university would be based on the institution's "student-adjusted endowment." The highest rate of 21% would apply to institutions with adjusted student endowments of greater than $2 million.

  - *Troutman Take: Application of a rate of 21% (mirroring the corporate tax rate) would have the same result as the institution's income being considered UBTI.*

- **Increased Tax on Net Investment Income of Certain Private Foundations**

  Current Law: Private foundations that are exempt from tax are subject to a 1.39% excise tax on their net investment income.

Tax Bill: The tax bill would amend the existing tax with a new tiered system that maintains the current excise tax rate for private foundations with less than $50 million in total assets, but applies higher excise tax rates on private foundations reporting $50 million or more in total assets, with the highest rate of 10% applying to private foundations with $5 billion or more in assets. “Assets” that are taken into account are gross assets.

- **Miscellaneous Itemized Deduction Limits**

  Current law: By way of background, taxpayers may take either a standard deduction or itemize their deductions to compute their federal taxable income. All itemized deductions other than those specifically listed in Section 67(b) of the Code are “miscellaneous itemized deductions” Miscellaneous itemized deductions include, among many other expenses, investment expenses, legal fees and management fees. Before 2018, miscellaneous itemized deductions were allowed, but only to the extent they exceeded two percent of a taxpayer’s adjusted gross income. The TCJA temporarily eliminated miscellaneous itemized deductions for tax years through 2025.

  Tax Bill: The Tax Bill makes permanent the repeal of miscellaneous itemized deductions.

  - *Troutman Take: Investors in investor funds would permanently be disallowed from deducting management fees and other expenses. Tax planning to achieve an economic result similar to a deduction may be considered.*

For an initial analysis of key provision for the real industry, please see The One Big Beautiful Bill: Initial Analysis of Key Provisions for the Real Estate Industry.

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[1] Currently, countries that have one or more of a UTPR, DST, or DPR include: Argentina, Australia, Austria, Belgium, Bulgaria, Canada, Colombia, Croatia, Cyprus, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, India, Indonesia, Ireland, Israel, Italy, Kenya, Luxembourg, Nepal, Netherlands, New Zealand, Norway, Poland, Portugal, Romania, Rwanda, Slovenia, South Korea, Spain, Sweden, Thailand, Turkey, and UK.

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