New law eases the limitation on business interest expense deductions for 2025 and beyond

Interest paid or accrued by a business is generally deductible for federal tax purposes. But limitations apply. Now some changes under the One Big Beautiful Bill Act (OBBBA) will result in larger deductions for affected taxpayers.

Limitation basics

The deduction for business interest expense for a particular tax year is generally limited to 30% of the taxpayer's adjusted taxable income (ATI). That taxpayer could be you or your business entity, such as a partnership, limited liability company (LLC), or C or S corporation. Any business interest expense that's disallowed by this limitation is carried forward to future tax years.

Business interest expense means interest on debt that's allocable to a business. For partnerships, LLCs that are treated as partnerships for tax purposes, and S corporations, the limitation on the business interest expense deduction is applied first at the entity level and then at the owner level under complex rules.

The limitation on the business interest expense deduction is applied *before* applying the passive activity loss (PAL) limitation rules, the at-risk limitation rules and the excess business loss disallowance rules. For pass-through entities, those rules are applied at the owner level. But the limitation on the business interest expense deduction is generally applied *after* other federal income tax provisions that disallow, defer or capitalize interest expense.

The changes

The OBBBA liberalizes the definition of ATI and expands what constitutes floor plan financing. For taxable years beginning in 2025 and beyond, the OBBBA calls for ATI to be computed before any deductions for depreciation, amortization or depletion. This change more closely aligns the definition of ATI to the financial accounting concept of earnings before interest, taxes, depreciation and amortization (EBITDA) and increases ATI, thus increasing allowable deductions for business interest expense.

For taxable years beginning in 2025 and beyond, the OBBBA also expands the definition of floor plan financing to cover financing for trailers and campers that are designed to provide temporary living quarters for recreational, camping or seasonal use and that are designed to be towed by or affixed to a motor vehicle. For affected businesses, this change also increases allowable deductions for business interest expense.

Exceptions to the rules

There are several exceptions to the rules limiting the business interest expense deduction. First, there’s an exemption for businesses with average annual gross receipts for the three-tax-year period ending with the prior tax year that don’t exceed the inflation-adjusted threshold. For tax years beginning in 2025, the threshold is $31 million. For tax years beginning in 2026, the threshold is $32 million.

The following businesses are also exempt:

- An electing real property business that agrees to depreciate certain real property assets over longer periods.
- An electing farming business that agrees to depreciate certain farming property assets over longer periods.
- Any business that furnishes the sale of electrical energy, water, sewage disposal services, gas or steam through a local distribution system, or transportation of gas or steam by pipeline, if the rates are established by a specified governing body.

If you operate a real property or farming business and are considering electing out of the business interest expense deduction limitation, you must evaluate the trade-off between currently deducting more business interest expense and slower depreciation deductions.

It’s complicated

The rules limiting the business interest expense deduction are complicated. If your business may be affected, contact us. We can help assess the impact.