NATIONAL ASSOCIATION of REALTORS®

Elizabeth Mendenhall
2018 President

Bob Goldberg
Chief Executive Officer

ADVOCACY GROUP
William E. Malkasian
Chief Advocacy Officer/Senior Vice President

Jerry Giovaniello
Chief Lobbyist

500 New Jersey Ave., NW
Washington, DC 20001-2020
Ph. 202-383-1194
WWW.NAR.REALTOR

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The Honorable David J. Kautter
Acting Commissioner
Internal Revenue Service and
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable William M. Paul
Principal Deputy Chief Counsel and
Deputy Chief Counsel (Technical)
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Dear Mr. Kautter and Mr. Paul:

On behalf of the 1.3 million members of the National Association of REALTORS® ("NAR" or the "Association"), I am grateful for the opportunity to provide comments with regard to Section 199A of the Internal Revenue Code of 1986, as amended, which was added by Public Law 115-97, commonly referred to as the Tax Cuts and Jobs Act of 2017 (the "TCJA"). These comments are designed to assist you with your current efforts to draft proposed regulations that reflect congressional intent for a meaningful and robust tax reduction for individual entrepreneurs and other businesses organized as pass-through entities.

NAR is America's largest trade association, and its members are real estate professionals engaged in a wide range of activities including real estate sales, property management, residential and commercial leasing, and appraisal. The business approach of REALTORS® is focused on helping fulfill a family's fundamental need for shelter. NAR has long prided itself as a voice for not only its members, but for America's 81 million homeowners, as well as the millions more Americans who aspire to own their homes one day. An important number of NAR members are also involved in providing professional services in connection with commercial real estate.

The new Section 199A deduction will have a significant beneficial impact on NAR's membership. However, NAR is concerned that without meaningful guidance, many taxpayers that Congress intended to receive this new benefit may be uncertain that they qualify for it. This possibility is particularly likely given the lack of clarity around the definitions and determination of "specified service trade or business."[1]

For taxpayers above certain income thresholds, the deduction does not apply to income from a "specified service trade or business" as defined in Section 199A(d)(2). Section 199A(d)(2)(A) specifically incorporates the provisions of Section 1202(e)(3)(A) in order to define the term "specified service trade or business" for purposes of Section 199A.

[1] Meaningful guidance not only helps taxpayers determine their eligibility for the Section 199A benefit, but also helps the IRS Examination function efficiently and fairly enforce the tax laws. If taxpayers' rights to this benefit are not clarified in the forthcoming guidance, the rights will have to be clarified through the burdensome and expensive audit, appeals, and litigation process.

Section 1202(e)(3)(A) refers to:

> any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees

Section 199A(d)(2) then modifies this provision by: (1) disregarding the words "engineering" and "architecture"; (2) substituting the term "employees or owners" for "employees"; and (3) adding the performance of services that consists of investing and investment management, trading, or dealing in securities, partnership interests or commodities.

NAR recognizes that Section 199A presents a number of technical issues and interpretative challenges. However, the members of NAR (and millions of similarly situated taxpayers) will benefit most from clarification of three specific issues related to the definition of "specified service trade or business." These issues are discussed more fully below.[2]

I. Definition of "Brokerage Services"

Because Section 1202(e)(3)(A) refers to "brokerage services," a cursory reading of the statute could unfortunately suggest real estate brokers could be viewed as operating "specified service trades or businesses" even though they should not be covered. NAR believes such a reading would be incorrect and respectfully requests that forthcoming guidance provide two clarifying points.

A. *Definition of "brokerage services."*

First, NAR recommends that the proposed guidance provide a clear definition of the activities that constitute "brokerage services." Ideally, the forthcoming guidance would confirm that the term "brokerage services" was intended to be confined to brokerage services provided with respect to the buying and selling of stocks, securities, and other intangible assets, and was not intended to encompass real estate and other transactions with close ties to building and construction. This is consistent with the manner in which Congress has defined the term "broker" in another context[3] and appears consistent with the intended scope of "specified service businesses."

As noted above, the performance of services in the fields of engineering and architecture were specifically excluded from the term "specified service trade or business." As with services performed in the fields of engineering and architecture, services provided by real estate brokers and others in related businesses are essential and add value to real estate. Moreover, the additions to the Section 1202(e)(3)(A) definition in Section 199A(d)(2) further indicates the turn of the definition away from real estate and toward intangible assets, as these additional activities are primarily related to the latter. Furthermore, there is no indication in the legislative history that the phrase "brokerage services" was intended to reach the normal activities of a real estate professional working as a real estate broker. Therefore, it seems appropriate that the term brokerage should be defined in the same manner as Congress has done before and we recommend that a brokerage be defined as "the business of executing transactions in securities for the account of others."

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[2] NAR notes that the there is a broad grant of regulatory authority in Section 199A(f)(4). Even in the absence of a specific grant of regulatory authority, we believe that the guidance requested by this letter would be normal interpretative guidance in accordance with Section 7805.

[3] *See*, *e.g.*, Section 3(a)(4)(A) of the Securities Act of 1934 ("The term 'broker' means any person engaged in the business of effecting transactions in securities for the account of others.")

However, even if the guidance does not confirm the exclusion of real estate brokerage businesses, NAR urges the inclusion of a workable clear definition of brokerage services.[4] The activity of brokerage services in the context of real estate is the specific activity of executing transactions on behalf of clients in exchange for a commission.

Defining "brokerage services" in the real estate context as the specific activity of executing transactions on behalf of clients in exchange for a commission is consistent with Treasury Regulation Section 1.448-1T(e)(4)(iv)(B), Example (5), which provides the following:

> A taxpayer is in the business of executing transactions for customers involving various types of securities or commodities generally traded through organized exchanges or other similar networks. The taxpayer provides its clients with economic analyses and forecasts of conditions in various industries and businesses. Based on these analyses, the taxpayer makes recommendations regarding transactions in securities and commodities. Clients place orders with the taxpayer to trade securities or commodities based on the taxpayer's recommendations. The taxpayer's compensation for its services is typically based on the trade orders. The taxpayer is not considered to be engaged in the performance of services in the field of consulting. The taxpayer is engaged in brokerage services. Relevant to this determination is the fact that the compensation of the taxpayer for its services is contingent upon the consummation of the transaction the services were intended to effect (i.e., the execution of trade orders for its clients).[5]

It should also be noted that the legislative history to Section 199A indicates that the Section 448 authorities would be appropriate guidance in interpreting "specified services trade or business."[6]

Defining "brokerage services" in the real estate context as the specific activity of executing transactions on behalf of clients in exchange for a commission is also consistent with the congressional intent behind Section 199A to provide broad tax relief to non-corporate businesses as evidenced by the legislative history to Section 199A.[7] Specifically, note the following passage from the report released by the Senate Budget Committee:

> The Committee believes that a reduction in the corporate income tax rate to 20 percent provided by the bill does not completely address the income tax rate on business income. Many businesses are conducted in the form of pass-through entities, namely partnerships and S corporations. Further, businesses are frequently conducted as sole proprietorships, rather than through a legal entity that is treated for tax purposes as separate from the individual who owns the business. The income of businesses conducted in pass-through form or in sole proprietorship form is subject to

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[4] Certain cases under Section 469(c)(7)(C) appear to address whether a real estate agent can be considered a real estate professional under the tests of Section 469(c)(7) (presumably by including time spent with regard to a brokerage trade or business). *See*, *e.g.*, *Donald R. Fitch, et ux. V. Commissioner*, T.C. Memo 2012-358. The Association notes that ultimately these cases focus on services provided in rental activities and so have little guidance with regard to the nature and extent of "brokerage services" for purposes of Section 199A.

[5] This definition is consistent with Section 3(a)(4)(A) of the Securities Act of 1934 ("The term 'broker' means any person engaged in the business of effecting transactions in securities for the account of others.")

[6] The Conference Report contains several footnotes that looked to Section 448 and its accompanying regulations for purposes of explaining the "specified service trade or business" elements of Section 199A.

[7] An underlying purpose of the TCJA was to lower tax rates for "C" corporations while also treating pass-through business income equitably. This was a core principle of the Unified Framework for Fixing our Broken Tax Code (the "Framework") which was developed and released by the White House, the House Committee on Ways and Means, and the Senate Committee on Finance. The Framework was the foundation upon which the TCJA was built and provided in part:

> TAX RATE STRUCTURE FOR SMALL BUSINESSES The framework limits the maximum tax rate applied to the business income of small and family owned businesses conducted as sole proprietorships, partnerships and S corporations to 25%. The framework contemplates that the committees will adopt measures to prevent the re-characterization of personal income into business income to prevent wealthy individuals from avoiding the top personal tax rate.

In his December 18, 2017 letter to Senator Bob Corker, Senator Orrin Hatch confirmed that Section 199A as enacted by the Senate and modified in Conference was intended to achieve this goal of equitable treatment for pass-through businesses.

tax in the hands of their individual owners at the income tax rates of individuals. To treat corporate and non-corporate business income more similarly under the income tax, the bill provides a 17.4-percent deduction for qualified business income of individuals.

B. *No presumption that a real estate broker provides "brokerage services."*

As a fundamental matter, the fact that a taxpayer is licensed as a "real estate broker" or holds a related license for state law purposes should not create a presumption that any particular service provided by the licensee is a specified service trade or business.

Without clear guidance, a reader of the statute might simply assume that a state-issued "real estate broker" or related license conclusively establishes that a taxpayer is providing brokerage services. This assumption would be faulty because it does not take into consideration the actual services being provided.

In order to: (1) avoid potential disparate treatment created by different state law licensing requirements; and (2) focus on the nature of the services; it would be helpful if the proposed guidance contained an explicit statement holding a "real estate broker" license or a related license under state law does not give rise to a presumption that particular services provided by the holder of the license would be considered a "specified services trade or business."

II. Identifying when the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners

The modified inclusion of the "reputation and skill" element from Section 1202(e)(3)(A) will lead to some uncertainty for purposes of Section 199A and you have received comments that propose certain "metrics" for interpreting what determines whether an asset is attributable to the "reputation and skill" of employees and owners.[8] NAR's concern is that certain of these proposed metrics could reach inappropriate results. For example, a focus on whether a "product" is delivered would seem to cause an implication that many businesses that are not specified service business, but that do not deliver a physical product, should be treated as specified service businesses. A similar issue already exists under Section 1202, but it seems possible to apply a facts and circumstances analysis there in order to identify the "principal" asset. See, e.g., Owen v. Commissioner, T.C. 2012-21 (the court identified the principal asset of the trade or business as the intellectual property of the business, and not the skill of the employees).[9] NAR's members request that the guidance confirm the facts and circumstances result suggested by Owen.

In addition, NAR believes that it would be helpful to confirm that the phrase "the principal asset" implies a quantitative test for identifying a specified service trade or business under Section 199A(d)(2)(A). The reputation and skill of employees or owners is a part of the success of any business, but taxpayers should have confidence that a positive reputation in the community will not force them to forego the intended benefits of Section 199A. It seems that the reputation and skill of the employees or owners would only rise to the level of "the principal asset" of a trade or business when the reputation and skill accounts for over half of the value of the business.[10]

Choosing another test, such as one that would define a principal asset as the asset with the most value, would yield odd and inconsistent results. For example, if the skill and reputation of employees and owners represented 6% of the assets of the company, but the company had many other assets (none of which

[8] The New York State Bar Association in its Report No 1392 (March 23, 2018) identified a number of potential metrics, including: (1) a focus on whether the activity delivers a product - a business of providing "products" always qualifies for the deduction; (2) a focus on a balance sheet test (focus on workforce in place as a balance sheet asset); (3) a mechanical test that considers the ratio of compensation to revenue; and (4) a focus on whether the services were "highly skilled."

[9] Real estate companies will often hold intellectual property that is similar to the assets discussed in *Owen*. For example, the principal asset of a particular real estate company could potentially be the franchise under which it operates.

[10] This quantitative approach is consistent with existing guidance under Treasury Regulation Section 1.441-4T(f) that will treat "the principal" activity of a corporation as the performance of personal services when more than half of the corporation's compensation costs are attributable to the performance of personal services.

exceeded 5% of the value of the company) the company might be treated as a specified service business under this definition. It seems unlikely that such a result was intended.

III. Identifying Separate Trades or Businesses

It is important to emphasize that firms that may provide brokerage services may also engage in a variety of activities that are not "brokerage services." For example, these businesses may provide title services, property management services, project and/or construction management, building maintenance, real estate referrals, and/or relocation services. Furthermore, an entity that employs an individual who holds a broker license may earn revenues by providing services to third-party independent contractors.[11] These are activities that would not appear to be "brokerage services."[12]

It would be helpful for guidance to confirm that business income from "specified service trades or businesses" does not negatively impact the treatment of business income from other non-specified service businesses. This is consistent with existing tax law that clearly acknowledges that a taxpayer can engage in multiple trades or businesses simultaneously.[13] The forthcoming guidance should confirm this point for purposes of Section 199A.

In the wake of the enactment of the TCJA, many taxpayers are considering restructuring to clarify their different activities as separate trades or business for purposes of maximizing the Section 199A deduction. For example, a real estate company that employs an individual with a broker license and provides various services to independent real estate salespersons, as indicated above, might also offer title services. Such firm may consider operating the title services through a separate entity in order to insulate that trade or business from any uncertainty surrounding the definition of brokerage services. Some are even wondering if they need to sell all or a portion of their businesses so that one portion of the business that might be a specified service business does not taint the other businesses that, on their own, would not be a specified service trade or business. This sort of restructuring is economically inefficient, particularly in light of the fact that Section 199A is scheduled to effectively expire before 2026.

In order to minimize administrative costs and provide clarity for both taxpayers and the government, the guidance should provide the identification of separate trades or businesses for purposes of Section 199A should not be dependent on the presence or absence of legal entities. For example, a taxpayer can conduct three separate section 199A trades or businesses through a single S corporation. Alternatively, a taxpayer could conduct a single section 199A trade or business through a partnership and a personal Schedule C activity.

This approach is consistent with the largely permissive grouping regime under the passive activity loss rules of Section 469. Specifically, Treasury Regulation Section 1.469-4 allows taxpayers to define their "activities" in a way that may be inconsistent with traditional section 162 trade or business standards.[14] NAR acknowledges

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[11] While NAR members may follow different business models, we note that it is not uncommon for a real estate business to provide independent real estate salespersons with: office space, education, training, coaching, peer support, customer relationship management systems, forms, email, document storage, mail and delivery, discounts on third party services (advertising, printing, Fed Ex, etc.), transaction management systems and reporting systems, escrow services (hold and track earnest money deposits), website, advertising, lead generation, legal assistance, conference rooms, office equipment, phone and internet, marketing & design, secretarial, and relocation assistance. In many situations, the entity that employs the individual holding the broker's license is being compensated primarily for these services and not for any transactional assistance that may have been provided to the actual buyer or seller of real estate.

[12] In the context of Section 1202, the IRS issued a private letter ruling (PLR 201717010) that held that a corporation that provided testing services for health care providers was not itself in the trade or business of providing health services. A similar result was apparently reached in PLR 201436001 where the IRS held that a corporation that specialized in the commercialization of experimental drugs was not in a disqualified activity for purposes of Section 1202 (i.e., was not performing services in the health field or any other non-qualifying area). While we recognize that private letter rulings are not precedent, these rulings provide a helpful context for thinking about services that a real estate firm may be providing to other real estate professionals.

[13] *See, e.g.*, *Laney v. Commissioner*, T.C. Memo 1997-403, where the court determined that the taxpayer's original consulting business comprised of providing services to various companies was distinctly different from the leasing of real property and that the leasing business was not an expansion of his original trade or business. *See also Hardy v. Commissioner*, 93 T.C. 684 (1989). *See*, *e.g.*, *Curphey v. Commissioner*, 73 T.C. 766, 775 (1980), when determining whether a taxpayer, employed by a hospital, could take deductions in connection to rental real estate, provided that there was no argument from the Service that a taxpayer could not engage in two or more trades or businesses or be in a profession and a business. *See also Achong v. Commissioner*, 246 F.2d 445, 447 (9th Cir. 1957) and *Sherman v. Commissioner*, 16 T.C. 332, 337 (1951).

[14] Because this identification would just be for Section 199A purposes, this identification presumably would not trigger change in accounting method concerns.

that a permissive regime would create uncertainty if unregulated, and so notes that it would be reasonable to incorporate a procedure similar to the Revenue Procedure 2010-13 rules for identifying Section 469 activities. A taxpayer would identify his or her relevant section 199A trades or businesses in an attachment filed with tax return for 2018.

For example, assume a shareholder-employee of a real estate company taxed as an "S" corporation holds a broker license. That company is compensated to execute transactions on behalf of clients, but the company is also compensated for other activities. In particular, part of the fee the company receives at closing is compensation for the "back office" services that it provides to real estate salespersons who act as independent contractors. The company also receives separate compensation for an active property management operation. Assuming "brokerage services" is considered to extend to real estate transactions, then the company would have some brokerage service operations (i.e., the transactions it executes on behalf of clients in exchange for a commission), but it also provides real estate services to independent real estate professionals and to property owners. In this case, it should be appropriate for the company to attach a statement to its return that indicates that it is engaged in three separate operations for purposes of Section 199A: (1) brokerage services activity, (2) real estate professional support operations, and (3) property management. The company should then be able to allocate income and expenses among the various operations in a reasonable manner. Essentially, the relatively discrete brokerage service activities of facilitating closings and executing transactions should not require the shareholders to lose the benefit of Section 199A for the rest of the company's activities.

IV. Real Estate's Contribution to America's Economy

Real estate accounts for nearly 20 percent of GDP with nearly $64,000 in economic activity generated from every existing home sale. The industry encompasses a multitude of property types, from homes, office buildings, warehouses, retail centers and regional shopping malls, to industrial properties, hotels, convenience stores, multifamily housing, medical centers, recreational areas, raw land, senior living facilities, data centers, telecommunications towers, agricultural land, gas stations and much more. The current total value of America's real estate is more than $53.2 trillion, leveraged conservatively at about 27.7 percent (over $38.5 trillion of equity; $14.8 trillion of debt).

The real estate industry is also one of the leading employers in the United States. Residential and commercial real estate companies are engaged in a broad array of activities, generating millions of real estate-related jobs. These include jobs in construction, planning, architecture, building maintenance, management, environmental consulting, leasing, sales, mortgage lending, accounting and legal services, investment advising, interior design and others. One job is created for every two existing homes sold, while three jobs are created for every new home built. A great many other jobs in various industries support the real estate sector. Economic activity is also created by the recirculation of the income generated by residential and commercial real estate into the economy.

Real estate activity accounts for nearly one-quarter of taxes collected at all levels of government (this includes income, property and sales taxes). Property taxes alone constitute 31.3 percent of the state and local tax base and taxes derived from real estate ownership and transfer represent the largest source – in some cases approximately 70 percent – of local tax revenues, helping to pay for schools, roads, law enforcement and other essential public services. Real estate provides a safe and stable investment for individuals across the country, notably retirees. Over $300 billion is invested in real estate and real estate-backed investments by tax-exempt organizations (pension funds, foundations, educational endowments and charities). By its very nature, as the place where goods and services are conceived, manufactured, and sold, commercial real estate makes other types of productivity possible. New real estate investment – modernizing office buildings, building manufacturing facilities, and upgrading infrastructure, etc. – contributes to the productivity and efficiency of American firms and their workers. And residential real estate is where American families call home and where our children learn and grow.

In short, residential and commercial real estate is deeply embedded in all aspects of the way Americans live, work, shop, play, invest, and live. Its significance in our economy and our lives simply cannot be overstated.

V. Conclusion

The National Association of REALTORS® believes that the guidance is necessary under Section 199A to help our membership and taxpayers in general achieve the intended benefits of Section 199A.

Specifically, we request that:

- The term "brokerage services" be defined as "the business of executing transactions in securities for the account of others";
- If real estate activity cannot be excluded entirely, the term "brokerage services" in the context of real estate activity be defined as the activity of executing transactions on behalf of clients in exchange for a commission;
- The presence of a real estate broker license create no presumption as to the nature of the underlying trade or business operations;
- The determination of when the principal asset of a trade or business is the reputation or skill of one or more of its employees or owners be determined under a general facts and circumstances analysis; and
- Procedures be adopted that allow taxpayers to easily identify and report their separate operations for purposes of Section 199A (even if conducted within a single legal entity).

While some members of NAR are organized as and operate through "C" corporations, it is disconcerting that the absence of meaningful guidance may prevent many other NAR members from achieving their intended benefits under the TCJA. NAR respectfully requests that the above points be considered for purposes of any forthcoming guidance.

Please let us know if you have any questions. NAR would be pleased to provide further comment if you so request.

Sincerely,

Elizabeth J. Mendenhall

Elizabeth Mendenhall
2018 President, National Association of REALTORS®

cc: Thomas C. West, Jr.
Tax Legislative Counsel

Krishna P. Vallabhaneni
Deputy Tax Legislative Counsel

Holly Porter
Associate Chief Counsel