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September 27, 2018

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

PA:LPD:PR (REG-107892-18)  
Courier's Desk  
Internal Revenue Service  
1111 Constitution Avenue, NW  
Washington, D.C. 20224

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

Re: Comments to REG-107892-18, Qualified Business Income Deduction, 83 Fed. Reg. 40884 (Aug. 16, 2018)

Dear Mr. Kautter and Mr. Paul:

On behalf of the more than 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 the proposed regulations under Section 199A of the Internal Revenue Code of 1986, as amended (the “Code”). Before delving into our specific comments, I want to commend you for the work done by your organizations in connection with the proposed regulations. It is clear that a great deal of time and effort went into developing the proposed regulations on a compressed timeline.

While the proposed regulations do provide much helpful guidance, there is one issue in particular that REALTORS® believe could be greatly clarified for the estimated 10 million<sup>1</sup> individuals who earn rental income from real property through direct ownership or a partnership, limited liability company, or S corporation.

Namely, the final regulations should explicitly provide that the rental of real property should be treated as a trade or business for purposes of Section 199A of the Code, even if the activity does not rise to the level of a trade or business for purposes of Section 162 of the Code. Such a provision could be included in the definition of a “Trade or business” in Prop. Treas. Reg. § 1.199A-1(b)(13). The definition in the proposed regulations already includes a similar provision with respect to the rental and licensing of certain property.

To support this position, NAR requests that a representative of the Association be allowed to testify in the public hearing scheduled for October 16.

**I. Due to Inconsistent Authority Regarding What Constitutes a Trade or Business, it will be Very Difficult for Individual Taxpayers to Know Whether their Rental Income is Eligible for the 199A Deduction**

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<sup>1</sup> Internal Revenue Service, Statistics of Income, “Individual Income Tax Returns Publication 1304 (Complete Report),” Tax Year 2016, Table 1.4.



Without the change discussed above, millions of individual taxpayers who earn rental income from real property would need to wade through voluminous and confusing references to tax authority to try to determine whether they believe<sup>2</sup> they are eligible for the deduction. As one commentator noted in an article entitled Defining 'Trade or Business' Under the Internal Revenue Code: A Survey of Relevant Cases, “[o]ne is left with much uncertainty as to whether any particular set of facts constitutes a trade or business.”<sup>3</sup>

For example, these individuals may look to Revenue Ruling 78-195.<sup>4</sup> This ruling concluded that a taxpayer was able to deduct expenses related to investment real estate under Section 162. In that ruling, the taxpayer “purchased a tract of unimproved, non-income-producing real property, which it held for two years without having made any substantial improvement...did not make any significant efforts to sell the property and did not engage in any other transactions in real or personal property or in other commercial activities.” An individual taxpayer may look at this ruling and reasonably conclude that any real estate activity should be treated as a trade or business.

However, of those individuals who are able to find this Revenue Ruling, some might note that the taxpayer was a corporation and wonder whether the ruling applied to them. Some may further wonder whether they need to form an S corporation to be eligible for the deduction.

There are a variety of other cases that similarly concluded that rental activity constitutes a trade or business even though there was minimal activity.<sup>5</sup> However, there are also a handful of cases that have found that rental activity did not constitute a trade or business.<sup>6</sup>

It appears even the IRS has held different views over time with respect to whether the leasing of real property should be treated as a trade or business. For example, Technical Advice Memorandum 8350008<sup>7</sup> concluded that property subject to a net lease did not constitute a trade or business.<sup>8</sup> In reaching that conclusion, the Memorandum dismissed a private letter ruling that stated, “it is the position of the Service that the rental of even a single piece of property involves the taxpayer in a trade or business. The degree of activity of the taxpayer, in the owning and renting out of real estate, is not a material factor in determining whether the taxpayer is engaged in a trade or business...”<sup>9</sup> The Memorandum did not distinguish the apparently conflicting views of the Service and merely noted that private letter rulings may not be relied upon by the general public. While that is certainly the case, this provides cold comfort to the millions of individual property owners who, without clear guidance, will need to make a determination regarding whether they are in a trade or business.<sup>10</sup>

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<sup>2</sup> Given the current state of the law, it is likely that many such taxpayers would not feel assured that they were eligible for the deduction without some additional guidance.

<sup>3</sup> E. John Lopez, Florida State University Law Review; Winter 1983. 11 Fla. St. U.L. Rev. 949.

<sup>4</sup> This assumes the individual would know where and what to look for and how to find this guidance. If not, the taxpayer may be forced to pay a professional tax accountant or attorney to perform the research, the cost of which could significantly reduce the benefit of any 199A deduction.

<sup>5</sup> *Hazard v. Commissioner*, 7 T.C. 732 (1946) (concluding that the taxpayer’s former home was property used in a trade or business when the property was leased and the only activity noted was the listing of the property for lease or sale); *Lagreide v. Commissioner*, 23 T.C. 508 (noting that “we have repeatedly held that [real estate devoted to rental purposes] is property held for use in a trade or business...”); *Campbell v. Commissioner*, 5 T.C. 272 (1945) (taxpayer inherited a parcel of real estate which he never occupied as a private residence, property was immediately listed for rent but was never occupied for seven years until its sale. The loss on sale of building was ruled to be an ordinary loss as it was used in carrying on a trade or business, albeit the property was never occupied nor did it produce actual profit).

<sup>6</sup> *Durbin v. Birmingham*, 92 F. Supp. 938 (S.D. Iowa 1950) (lease of land under a crop sharing contract was not a trade or business); *Anderson v. Commissioner*, 44 T.C.M. (CCH) 1305 (1982) (concluding that the taxpayer’s rental of 80 acres of farmland to a tenant farmer did not constitute a trade or business as taxpayer’s activities were not established to be sufficiently regular, systematic, and continuous to place him in the business of managing a rental farm property); *Balsamo v. Commissioner*, 54 T.C.M. (CCH) 608 (1987) (property held to not be in a trade or business when there were insufficient activities with respect to the property noting “our historical position that rental of one property constitutes a trade or business establishes a general not an absolute rule.”).

<sup>7</sup> TAM 8350008 (August 23, 1983).

<sup>8</sup> Although this was in the context of Code § 1231 and not Code § 162, we are not aware of any authority indicating that a trade or business is analyzed differently in those contexts.

<sup>9</sup> TAM 8350008 citing to PLR 6006244510A (June 24, 1960).

<sup>10</sup> It is interesting to note that Rev. Rul. 78-195 was not cited in this Memorandum.

The discussion in *Balsamo v. Commissioner* is also instructive regarding how difficult it would be for an individual taxpayer to be able to interpret the authorities with respect to what constitutes a trade or business. First, the case notes that neither the government nor the taxpayer was able to accurately articulate the correct U.S. Tax Court standard for what constitutes a trade or business in the context of rental real estate. The Tax Court noted that its historical position that the lease of a single property is a trade or business is a “general” rule but not an “absolute” rule and indicated that its view is that a single property could be a trade or business “under appropriate circumstances.” The Tax Court then noted that its standard is not the relevant standard in any event as the case was governed by the law of the Second Circuit, which required “‘regular and continuous activity of management’ under a facts and circumstances analysis.” Obviously, it may be very difficult for the millions of individual property owners to know which standard applies, let alone how to apply any standard that requires a particular level of activity.<sup>11</sup>

## **II. Congress Intended that the 199A Deduction be Simple for Taxpayers with Income Below Certain Thresholds**

It seems very clear that Congress intended that the 199A deduction be simple for the large majority of taxpayers. While taxpayers above certain income thresholds who want to take the 199A deduction are required to make sure that their business is not a specified service trade or business and that it has a sufficient amount of W-2 wages and/or investment in depreciable business assets, Congress specifically excluded taxpayers with income below these thresholds from these more complex requirements.

As a result, the deduction is supposed to be straightforward for those below the income thresholds. Ironically, while larger property owners often will have little difficulty in concluding that they are in a trade or business, without further guidance, the smaller property owner will be left with the complicated task to determine whether they are in a trade or business.

Of the millions of individuals who have received rental income noted above, over 80 percent of these real property owners have adjusted gross income under \$200,000, and of those owners with positive net rental income in these income groups have an average rental income of about \$10,000.<sup>12</sup> Given Congress’ intent to make the 199A deduction simple for taxpayers below certain income thresholds, it seems highly unlikely that the intent was for small property owners to have to navigate the complicated and conflicting law that currently exists to determine whether or not their rental real estate constitutes a trade or business.<sup>13</sup>

It is also clear that passive partners in real estate businesses and owners of public REIT shares are eligible for the deduction. Therefore, it seems highly incongruous that Congress intended to exclude other owners of smaller parcels of rental real estate due to insufficient activity with respect to the real property.

## **III. Conclusion**

As a “trade or business” is not defined in the statute, there is a great deal of latitude regarding how the term is ultimately defined in the final regulations. While the proposed regulations reasonably look primarily to Code § 162, the proposed regulations recognized that the Code § 199A definition of a “trade or business” should deviate from the definition in Code §

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<sup>11</sup> In addition to the difficulty that small taxpayers will face, IRS agents would also need to grapple with this confusing area of law in the context of Code § 199A which will create significant resource and financial costs for the government without any perceptible policy benefit unless there is a clear rule indicating that the rental of real estate would be treated as a trade or business for purposes of the 199A deduction.

<sup>12</sup> Internal Revenue Service, Statistics of Income, “Individual Income Tax Returns Publication 1304 (Complete Report),” Tax Year 2016, Table 1.4.

<sup>13</sup> While Congress intended that the legislation be simpler for those below certain income thresholds, we do not think it would be appropriate for the final regulations to create a special definition of a trade or business for certain income thresholds for two reasons. First, the legislation does not provide any indication that trade or business should be defined differently for different income levels. It seems more likely that Congress did not consider the confusing authority in this area and assumed that all rental income would have been treated as a trade or business. Second, creating such a rule would create additional complications and the need to develop methodologies to address the phase out provisions in the Code without any perceptible benefit. Of course, as Congress intended, all taxpayers above the income thresholds will still need sufficient W-2 wages and unadjusted basis in depreciable business property to be able to obtain the benefits of the deduction in Code § 199A.

162 when appropriate. This allows for a definition of a “trade or business” that is tailored to Code § 199A without impacting the manner in which a “trade or business” is defined in other areas of the Code.

Defining a “trade or business” so that all rents from real property are eligible for the 199A deduction is appropriate in the context of 199A. It seems clear that Congress intended for rental income to be treated as income eligible for the deduction, specifically granting the deduction to passive REIT shareholders. It also is clear that Congress wanted the deduction to be simple for owners of business with incomes below certain thresholds. Given the lengths to which Congress went for those with income below particular thresholds, it would be contrary to Congressional intent to promulgate a definition of a “trade or business” that would make it difficult for smaller real estate owners to determine if they were eligible for the deduction.

As illustrated in the discussion above, a generic definition of a “trade or business” under Code § 162 would subject these smaller real estate owner to a morass of legal authorities. While many of those authorities would support a position that minimal activities are needed for rental income to be a trade or business, it would seem appropriate to make this explicit in the definition of a “trade or business” in the final regulation.

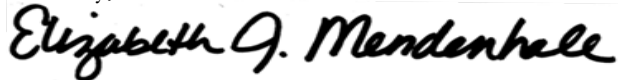
Accordingly, to make the 199A deduction workable for small real property owners, NAR believes specific guidance should be provided clarifying that all rental income is qualified business income.

Specifically, the Association requests that:

- The second sentence of Prop. Treas. Reg. § 1.199A-1(b)(13) be revised in the final regulations to insert the following language after “In addition,”  
  
“(i) rental of real property and (ii)”
- Clarify that Prop. Treas. Reg. § 1.199A-3(b)(2)(i) does not provide a different standard regarding what constitutes a trade or business and merely provides that a trade or business, as defined in Prop. Treas. Reg. § 1.199A-1(b)(13), must be conducted within the United States and the relevant income must be effectively connected with that business.

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

Sincerely,



Elizabeth Mendenhall  
2018 President, National Association of REALTORS®

cc: Thomas C. West, Jr.  
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