

Testimony of Iona Harrison
Representing the National Association of REALTORS®
Internal Revenue Service Public Hearing on Comments Related to
Proposed Regulations for Qualified Business Income Deduction
(83 Fed. Reg. 40884 (Aug. 16, 2018))
October 16, 2018

Introduction

Good morning.

My name is Iona Harrison and I am a real estate professional working in Upper Marlboro, Maryland. I have been in the real estate business my entire adult life, and I've served the real estate industry at the local, state, and national levels for many years in a variety of capacities.

Today, I am here representing the more than 1.3 million members of the National Association of REALTORS®. Our members are engaged in many activities including real estate sales and brokerage, property management, residential and commercial leasing, and appraisals.

NAR is grateful for all the hard work that Treasury and IRS have already invested in producing helpful guidance for taxpayers in dealing with the new 20 percent deduction for business income, and I am happy to have this opportunity to speak at this hearing today.

Owners of Small Rental Properties

I want to start out by emphasizing that unlike many who speak at these hearings, I am not a tax expert. Far from it. Rather, I am just a regular Realtor and an owner of rental real estate, much like the 10 million or so other Americans who report income from rental homes or apartments on their tax returns each year.

In fact, my main point today is that people like me really need guidance on the new tax deduction that is simple and easy to understand and apply.

You might be interested to know that about 40 percent of all NAR members own rental real property. And collectively we have millions of clients who are also rental property owners. These range from single family houses that were once

the home of the owner, to four-plexes to apartment buildings with dozens or even hundreds of units.

According to IRS data, more than 80 percent of these owners have incomes below \$200,000 per year, and the average amount of rent income of those who do not report a loss is about \$10,000.

Thus, these owners of rental real estate are by and large going to fall under the income thresholds that Congress set for the simpler calculations for the 20 percent business income deduction.

Final Regulations for 20% Deduction Should Be Simple as to Rental Income

When it comes to rental income and the 20 percent deduction, the biggest problem we see with the proposed regulations is that they require the owner to have specialized tax knowledge in order for them to determine whether their particular rental property should be considered a “trade or business.”

Specifically, the proposed regulations say it must be a “trade or business” under Section 162 in order to qualify for the deduction. Now, I am a reasonably well-informed and educated woman, but when I read this requirement, I am already confused. And I can tell you that the vast majority of my fellow property owners are also going to think this is far from clear.

It is a bit comforting to know that I am not alone in this confusion. Based on my discussions with some people who are tax experts, even many seasoned professionals do not understand the tax law distinction between a “trade or business” and real estate that is held for productive investment.

As I understand the proposed regulations, they are asking rental owners to refer to the large body of existing case law and administrative guidance to interpret the meaning of “trade or business.” From the practical point of view of a non-tax expert, this is very problematic.

First off, being able to access this body of case law and IRS guidance is daunting. Will we find these cases and rulings in the instructions for the form on which the 20 percent deduction is claimed? Will there be a page on the IRS website that offers a list of these cases, along with the facts and their decisions?

Will a call to the Internal Revenue Service likely shed any light on this question?

All of the uncertainty surrounding this question will probably cause the IRS to be inundated with questions from taxpayers. This could add a great deal to the Service's burden, especially during the filing season.

And even if such information is provided, is it really feasible that average taxpayers can pore through the cases and rulings and find a situation similar to their own, enabling them to come to a reasonable conclusion that they either qualify for the deduction or not?

The way I see it, guidance that requires rental property owners to wade through the mire of confusing and sometimes conflicting cases and rulings to discover if they qualify for the new deduction will most likely end up one of two ways.

Either they will be hopelessly confused from the start and just turn the question over to a tax professional, or they will just forget the case law and rulings and take the deduction anyway.

If it is the former, the value of the new deduction will be diminished significantly by the fee paid to accountants or lawyers.

And in the latter case, some will be right and some will be wrong in claiming the deduction, which will cause similarly situated taxpayers to be treated differently. And in some few instances, there will be an IRS examination, which will lead to more expense and confusion for the taxpayer and more burden on the IRS.

Congress Intended the 20% Deduction to Be Simple for Lower-Income Owners

As outlined in our comment letter, we believe there is ample evidence that Congress intended the 20 percent deduction to be relatively simple, at least for the vast majority of filers whose income is below the thresholds.

After all, the statute provides that those below \$157,500 or \$315,000 do not have to worry about the more complex computations that exist for those with higher incomes. Nor do they need to be concerned about whether they fall into one of the very perplexing "specified service businesses."

Therefore, it seems that Congress went out of its way to try to ensure that non-high-income lay persons without specialized tax knowledge would be able to fairly easily understand the requirements for the deduction and be eligible to claim it.

Final Regulations Should Clarify that for Purposes of 20% Deduction, All Rental Real Estate is Deemed to be in a “Trade or Business”

In conclusion, we urge the Treasury Department and the Internal Revenue Service to consider making the final regulations for the 20 percent deduction much simpler for owners of rental real estate.

This can and should be done by simply deeming that all such rental real property is a “trade or business” for purposes of section 199A of the Internal Revenue Code.

Doing so would vastly simplify the deduction for millions of owners of rental property with incomes below the threshold, as Congress intended. This move would also greatly simplify the administration of this part of the law for the IRS.

Further, we believe such a change to the final regulations would be entirely consistent with both the statute and with the proposed rules released in August.

The statute grants the 20 percent deduction to shareholders of Real Estate Investment Trusts, or REITs. It is hard to see how ownership in such an investment could constitute a trade or business under even the most liberal reading of the case law or rulings.

And we note that the proposed regulations have already made the move to exempt the rental of tangible property from the section 162 trade or business requirements in cases where the parties are commonly-controlled.

Great progress has already been made in providing sensible and straightforward guidance in relation to the 20 percent deduction. We urge you to now take this extra step and make this provision even more accessible, understandable, and useful for millions of those it was designed to benefit.

Thank you.