



MORTGAGE BANKERS ASSOCIATION

VIA ELECTRONIC SUBMISSION

October 1, 2018

Internal Revenue Service
1111 Constitution Avenue NW
Washington, DC 20224

**Re: Proposed Regulations Concerning the Qualified Business Income Deduction
under Section 199A of the Internal Revenue Code (REG-107892-18; RIN 1545-BO71)**

Ladies and Gentlemen:

The Mortgage Bankers Association, the national association of the real estate finance industry,¹ is pleased to submit this comment letter in response to the notice of proposed rulemaking issued by the U.S. Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) providing guidance on the implementation of the new Section 199A of the Internal Revenue Code.

I. OVERVIEW

MBA appreciates the efforts of Treasury and the IRS to clarify the applicability of the passthrough deduction, while specifically noting the unique nature of the business of financing.

In particular, we appreciate the clarification in the preamble that a passthrough entity in the trade or business of “making loans” is specifically not in the field of “financial services,” a field that is ineligible for the deduction. The reasoning for the clarification also supports the conclusion that financing businesses, including mortgage banking companies, should also be eligible for the passthrough deduction.

¹ The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation’s residential and commercial real estate markets; to expand homeownership; and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies and others in the mortgage-lending field. For additional information, visit MBA’s website: www.mba.org.

However, to ensure that those passthrough entities engaged in financing activities can receive the benefit of the deduction as intended by Congress, we believe additional clarification is needed. Specifically, we urge Treasury and the IRS to clarify that the terms “dealing in securities” and “brokerage services” do not include the business of financing real estate, which is the fundamental business of mortgage banking companies. Without the necessary clarification or guidance, many taxpayers that Congress intended to help with the passthrough deduction could be confused, and the resulting competitive imbalance could be inconsistent with the very purpose of section 199A.

II. BACKGROUND

Mortgage banking companies are in the business of financing real estate, with a focus on financing real estate for borrowers in markets across the country. Mortgage banking companies engage in the business of financing with regard to single-family homes, multifamily rental housing, retail centers, office buildings, industrial facilities or other real estate in our economy.

As a type of mortgage banking company, independent mortgage banking companies generally have a regional business focus and are not affiliated with depository banking institutions. Notably, many independent mortgage banking companies are organized as passthrough entities and *compete directly with* mortgage banking companies with a national footprint, as well as banks and other lending institutions.

Section 199A allows a 20 percent deduction of qualified business income from entities organized as passthrough entities (e.g., a partnership, S corporation or sole proprietorship). The purpose of Section 199A is to maintain a competitive balance between C corporations (which benefit from a greatly reduced tax rate under the Tax Cuts and Jobs Act) and businesses organized as passthrough entities that compete with those C corporations. The inclusion of section 199A was critical to the passage of the Tax Cuts and Jobs Act.²

In crafting section 199A, Congress intended the passthrough deduction to apply to actual business income of passthrough entities (i.e., income generated as a result of business activity) – not to

² See, e.g., U.S. Senator Ron Johnson (R-Wis.), *Statement on Current Tax Reform Proposals* (Nov. 15, 2017) (“We have an opportunity to enact paradigm-shifting tax reform that makes American businesses globally competitive, helps our economy reach its full potential, and creates greater opportunity and bigger paychecks for every American. In doing so, it is important to maintain the domestic competitive position and balance between large publicly traded C corporations and “passthrough entities” (subchapter S corporations, partnerships and sole proprietorships). These businesses truly are the engines of innovation and job creation throughout our economy, and they should not be left behind. Unfortunately, neither the House nor Senate bill provide fair treatment, so I do not support either in their current versions. I do, however, look forward to working with my colleagues to address the disparity so I can support the final version.”), accessed at <https://www.ronjohnson.senate.gov/public/index.cfm/2017/11/johnson-statement-on-current-tax-reform-proposals>.

wage income or its equivalent.³ To prevent the deduction from applying to wage income recharacterized as business income, and to ensure that the deduction is applicable to taxpayers based on the character of their business, Congress provided statutory exclusions from the application of the deduction for certain types of trades or businesses. Specifically, the deduction is not available to a “specified service trade or business” (SSTB) with business income above a certain threshold amount.

Section 199A defines SSTB largely by incorporating (with some modifications) sections 1202 and 448. The preamble of the proposed regulations provides that, while section 199A incorporates and references sections 1202 and 448, guidance under sections 1202 and 448 “is not an appropriate substitute for clear and distinct guidance governing what constitutes an SSTB under section 199A.” This is because the scope, purposes and objectives of sections 1202 and 448 are very different from those of section 199A, which is intended “to benefit a wide range of businesses.”⁴

As a result, Treasury and the IRS determined that interpretations in the proposed guidance would apply only to section 199A, and not to those other sections.⁵ In addition, where language in section 199A was not explicitly defined in the statute, the proposed regulations have looked to the “ordinary meaning” to interpret terms used in section 199A.⁶ Using the ordinary meaning is important to craft guidance that taxpayers will understand.

In a notable interpretation of the section 199A definition of SSTB, the definition of “financial services” clarifies that that term does not include “taking deposits or making loans.”⁷ MBA agrees with the interpretation here, which clearly reflects Congress’ intent and, in effect, clarifies that trades or businesses that “take deposits” or “make loans” are not examples of “financial services” trades or businesses that would qualify as SSTBs. This is relevant to our comments because it explicitly clarifies that “making loans” is not the SSTB of “financial services.”

³ See, e.g., the *Tax Cuts and Jobs Act, H.R. 1, Section-by-Section Summary*, released by the House Ways and Means Committee (indicating congressional intent to “prevent the recharacterization of actual wages paid as business income”); see also Joint Committee on Taxation, *Description of the Chairman’s Mark of the “Tax Cuts and Jobs Act,”* 18 (prepared for markup scheduled for Nov. 13, 2017) (“Qualified business income does not include any amount paid by an S corporation that is treated as reasonable compensation of the taxpayer. Similarly, qualified business income does not include any guaranteed payment for services rendered with respect to the trade or business, and to the extent provided in regulations, does not include any amount paid or incurred by a partnership to a partner who is acting other than in his or her capacity as a partner for services.”).

⁴ 83 Fed. Reg. at 40896.

⁵ Id.

⁶ See, e.g., explanations of definitions of law, accounting, actuarial science, brokerage services, and investment and investment management, id. at 40897-40900.

⁷ Id. at 40898.

What is also fundamentally relevant is the reasoning underlying that clarification. That is, in the context of considering whether banking is a “financial service,” Treasury and the IRS considered that the SSTB definition in section 199A incorporates most of the “qualified trades or businesses” listed in section 1202(e)(3)(A), but does not incorporate the “qualified trades or businesses” listed in section 1202(e)(3)(B) (which includes banking, insurance and financing businesses). Treasury and the IRS agreed that these drafting choices by Congress suggest that the definition of “financial services” should be narrowly construed, and accordingly clarified that “financial services” does not include “taking deposits or making loans.”⁸ We believe this strongly supports our view that the business of “financing,” including mortgage banking, is not intended to fall within the definition of SSTB.

Consistent with the interpretation and reasoning in the proposed regulations, MBA specifically requests additional clarification that “dealing in securities” and “brokerage services” do not include the business of financing. Lack of clear guidance in these areas in the proposed regulations will result in inconsistency, and therefore confusion for taxpayers who “need certainty in determining whether their trade or business generates income that is eligible for the section 199A deduction.”⁹ Moreover, given that mortgage banking companies organized as passthrough entities compete directly in the real estate finance market with C corporations, the lack of clarifying guidance will result in a competitive imbalance that is squarely inconsistent with the very reason that section 199A was enacted.

III. AREAS FOR CLARIFICATION

A. “Dealing in Securities”

One major concern lies in the definition of “dealing in securities” under the proposed regulations, which provides as follows:

⁸ See id. (“Commenters requested guidance as to whether financial services includes banking. These commenters noted that section 1202(e)(3)(A) includes the term financial services, but that banking in [sic] separately listed in section 1202(e)(3)(B) which suggests that banking is not included as part of financial services in section 1202(e)(3)(A). The Treasury Department and the IRS agree with such commenters that this suggests that financial services should be more narrowly interpreted here. Therefore, proposed § 1.199A-5(b)(2)(ix) limits the definition of financial services to services typically performed by financial advisors and investment bankers and provides that the field of financial services includes the provision of financial services to clients including managing wealth, advising clients with respect to finances, developing retirement plans, developing wealth transition plans, the provision of advisory and other similar services regarding valuations, mergers, acquisitions, dispositions, restructurings (including in title 11 or similar cases), and raising financial capital by underwriting, or acting as the client’s agent in the issuance of securities, and similar services. This includes services provided by financial advisors, investment bankers, wealth planners, and retirement advisors and other similar professionals, but does not include taking deposits or making loans.”).

⁹ See id.

For purposes of section 199A(d)(2) and paragraph (b)(1)(xii) of this section only, the performance of services that consist of dealing in securities (as defined in section 475(c)(2)) means regularly purchasing securities from and selling securities to customers in the ordinary course of a trade or business or regularly offering to enter into, assume, offset, assign, or otherwise terminate positions in securities with customers in the ordinary course of a trade or business. For purposes of the preceding sentence, however, a taxpayer that regularly originates loans in the ordinary course of a trade or business of making loans but engages in no more than negligible sales of the loans is not dealing in securities for purposes of section 199A(d)(2) and this section. See §1.475(c)-1(c)(2) and (4) for the definition of negligible sales. (Emphasis added.)

This definition could be read to be inconsistent with the intent of Congress (as evidenced by the businesses listed in section 1202(e)(3)(**B**) not incorporated into the section 199A definition of SSTB and Treasury and the IRS' clarification of “financial services”) to exclude banks and financing businesses, including mortgage lending companies, from the definition of SSTB. Just as “financial services” should not include the businesses of banking or making loans, “dealing in securities” should not include the businesses of banking or financing/making loans. The definition should reflect that conclusion. In other words, the definition of “dealing in securities” should clarify that financing businesses, including mortgage banking companies, do not fall within the definition.

The need for clarification arises because many banks and other financing businesses – including mortgage lending companies – regularly originate loans and sell more than a negligible amount of the loans they originate in the ordinary course of their business. Therefore, absent explicit clarification that “dealing in securities” does not include financing companies, the proposed definition can create confusion as to whether mortgage lending companies’ loan sales constitute selling securities to customers in the ordinary course of a trade or business.

As an initial matter, therefore, we ask that Treasury and the IRS clarify that the term “purchasing securities” does not include making loans for purposes of section 199A and this definition. While purchasing securities may include originating loans for purposes of section 475, there is no statutory or public policy reason not to use the ordinary meaning of the term here. The ordinary meaning of purchasing securities does not include making loans. Accordingly, we urge Treasury and the IRS to clarify that, for purposes of this definition, “purchasing securities” does not include making loans.

The proposed regulations also define “dealing in securities” by reference to “customers.” Equally important, therefore, is whether mortgage banking companies are selling “*to customers*” – within the ordinary meaning of the proposed regulation – when they sell to government sponsored enterprises (GSEs), loan aggregators, or other financial institutions for purposes of financing their mortgage lending business, managing liquidity or other related business reasons, rather than to borrowers.

In our view, sales “to customers” within the ordinary meaning of that term, in the context of a definition of “dealing in securities,” means selling to customers for the purpose of dealing in securities. This is not what mortgage banking companies do. Rather, a mortgage banking company that sells its loans does so in order to provide the liquidity needed to engage in its financing business. Such origination and sale activities are the business of “making loans” to consumers and should be clearly distinguished from the trade or business of “dealing in securities” as contemplated by this definition under section 199A.

Importantly, this distinction between the ordinary meaning of selling to “customers” – for the purpose of dealing in securities – and mortgage bankers’ loan sales is reflected in the treatment of broker-dealers versus mortgage bankers under federal securities laws. For example, mortgage banking activities fall outside of the broker-dealer registration requirements under the Securities and Exchange Act of 1934.

Congress likely intended to exclude the true “broker-dealer” from taking this deduction. Therefore, the final regulations in defining “dealing in securities” should focus on true broker-dealer activities, while including exemptions and clarifications that will achieve Congress’ goal of making the section 199A deduction available for a large number of taxpayers based on the character of their trade or business.

In order to narrow the scope of the definition of “dealing in securities” to better reflect Congress’ intent to exclude the trade or business of mortgage banking from the definition of SSTB, MBA recommends that Treasury and the IRS adopt one or more of the following:

1. Amend the definition of “dealing in securities” as follows [additions in *italics*, deletions in ~~strikeout~~]:

For purposes of section 199A(d)(2) and paragraph (b)(1)(xii) of this section only, the performance of services that consist of dealing in securities (as defined in section 475(c)(2)) means regularly purchasing securities from and selling securities to customers in the ordinary course of a trade or business or regularly offering to enter into, assume,

offset, assign, or otherwise terminate positions in securities with customers in the ordinary course of a trade or business.

~~For purposes of the preceding sentence, however, a taxpayer that regularly originates loans in the ordinary course of a trade or business of making loans but engages in no more than negligible sales of the loans is not dealing in securities for purposes of section 199A(d)(2) and this section. See §1.475(c)-1(c)(2) and (4) for the definition of negligible sales.~~

For purposes of this section, a taxpayer that regularly originates or purchases loans in the ordinary course of a trade or business of making loans and regularly sells or otherwise transfers the loans to government-sponsored enterprises (GSEs), aggregators, or other financial institutions for purposes of financing the business or managing liquidity is not dealing in securities.

2. Provide additional clarifying language, for example, either of the following:

(a) An explanation or description in the preamble or in the definition of “dealing in securities,” noting that the definition is intended to be narrow, and specifically applies only to taxpayers that are engaged in broker-dealer activities for which registration under federal law (i.e., pursuant to regulations promulgated by the U.S. Securities and Exchange Commission) would be required. This would provide much-needed clarification that mortgage banking companies are not engaged in a trade or business that constitutes “dealing in securities” for purposes of section 199A; or

(b) An explanation similar to the explanation of “financial services,” clarifying that the definition of “dealing in securities” is intended to capture trades or businesses that are engaged in the performance of services relating to securities investments, rather than trades or businesses that are engaged in the financing of real estate or mortgage loans. For instance, a stockbroker or securities dealer is actively involved in buying and selling securities for its own account or for third parties, whereas a mortgage banking company is actively involved in originating mortgage loans (i.e., making loans), and in the course of such activity, may sell the loans for purposes of financing the business or managing liquidity as part of its financing business.

In addition to the above, MBA believes that adding the following example to the regulations would help to provide much-needed clarification for the industry.

Ex. 1. XYZ Mortgage Company is a business that is structured as a passthrough entity that provides real estate loans for borrowers. XYZ is licensed in the state of Maryland to operate as a mortgage banking company. XYZ regularly originates loans secured by real estate for borrowers – which includes taking loan applications, processing the application, underwriting, and, as applicable, funding the loan needed for the borrowers to purchase real estate. The loans are secured by the purchased real estate. XYZ may or may not retain the servicing of the loans. In the ordinary course of its business, XYZ sells or otherwise transfers the originated loans to the GSEs or other financial institutions. The proceeds of the sale are used to finance additional loans or support its financing business. XYZ is not dealing in securities as the term is defined in section 199A. XYZ is in the business of financing, and is therefore, not an SSTB.

In sum, we believe it is imperative that the final regulation provide an explanation that clarifies that the definition of SSTB is not intended to include mortgage banking companies that are in the business of making loans -- regardless of how many such loans are sold in order to finance the business or manage liquidity. This would be consistent with Congress' intent and objective, which was clearly reflected by the intentional exclusion of the trade or business of financing from the definition of SSTB under section 199A.

B. “Brokerage Services”

The proposed definition of “brokerage services” provides as follows:

[T]he performance of services in the field of brokerage services includes services in which a person arranges transactions between a buyer and a seller with respect to securities (as defined in section 475(c)(2)) for a commission or fee. This includes services provided by stock brokers and other similar professionals, but does not include services provided by real estate agents and brokers, or insurance agents and brokers.

We recommend that the proposed definition more clearly communicate that the term “brokerage services” does not include services provided by financing businesses, including mortgage banking companies.

As a starting point, we believe that Congress intended to exclude services provided by financing businesses from the definition of “brokerage services.” This conclusion is supported by the language of section 199A and by the interpretation of that provision in the context of the proposed regulations' definition of “financial services.” As described above, Treasury and the IRS analyzed

the section 199A definition of SSTB, concluded that “financial services” should not include the business of banking, and clarified that “financial services” does not include “making loans.”¹⁰

It is clear under this analysis that “brokerage services” should similarly not include banking, insurance or *financing* businesses. That is, “financial services” and “brokerage services” are both among the trades or businesses in section 1202(e)(3)(A) that were incorporated into the section 199A definition of SSTB. By contrast, banking, insurance and *financing* businesses all are trades or businesses listed in section 1202(e)(3)(B) that were *not* incorporated into the section 199A definition of SSTB. Accordingly, just as “financial services” as an SSTB should exclude banking (and insurance and financing businesses), the definition of “brokerage services” should exclude banking, insurance and financing businesses. This is significant to our members because *the mortgage banking business is unequivocally the business of financing.*

The clarifying examples in the proposed definition of “brokerage services” are consistent with this analysis. First, the proposed definition of “brokerage services” does not include the *insurance business* (“does not include services provided by ... insurance agents and brokers”). Under the analysis above, the business of insurance, along with banking and financing businesses (enumerated in section 1202(e)(3)(B)), all fall outside the scope of the definition of SSTB.

Second, the definition clarifies that it does not include “services provided by real estate agents and brokers,” which in our view would exclude services provided by real estate *financing businesses*. Under the analysis above, the business of financing, along with banking and insurance businesses, all fall outside the scope of the definition of SSTB.

The exclusion of real estate agents and brokers effectively excludes services provided by real estate financing businesses because the activities that fall within the ordinary meaning of the term real estate agent or broker includes real estate financing activity. For example, real estate agents often help with financing, and the laws of seven states explicitly define “real estate broker” to include a person that engages in real estate financing activities.¹¹ Moreover, it would be appropriate to align the use of use the ordinary meaning of these terms with Congress’ intent to exclude banking,

¹⁰ Id.

¹¹ See Arizona (AZ Rev. Stat. Ann § 32-2101(48)(k)), California (Cal. Code Regs. Tit. 10 § 2728), Michigan (MCL §§ 339.2501(k), (u)), Minnesota (Minn. Stat. Ann. § 82.55, subd. 19(b)), New Jersey (N.J. Stat. Ann. § 45:15-3), New York (N.Y. Real Prop. Law § 440(1)) and South Dakota (S.D. Codified Laws § 36-21A-6(2)). While Treasury and the IRS have indicated a preference for not basing classification as an SSTB on the application of state licensing laws to avoid different treatment across different states, see discussion at 83 Fed. Reg. at 40897, state law definitions of “real estate broker” are relevant evidence of the ordinary meaning of the term, which may appropriately apply across all jurisdictions.

insurance and financing businesses from the definitions of SSTBs. As a result, we believe that excluding services provided by real estate agents and brokers from the brokerage services definition would exclude services provided by real estate financing businesses.¹²

We nevertheless urge explicit clarification that the scope of the definition of “brokerage services” does not include services provided by real estate financing businesses. The necessary clarification could be accomplished, for example, by adding the following language to the examples described in the proposed definition [recommended additions in *italics*, deletions in ~~strikeout~~]:

This includes services provided by stock brokers and other similar professionals, but does not include services provided by real estate agents and brokers, ~~or~~ insurance agents and brokers, *or services provided by real estate financing businesses, including with respect to making loans.*

In sum, in order to more clearly communicate to financing businesses, including mortgage banking companies, that they are eligible for the tax relief that Congress intended them to receive, we urge Treasury and the IRS to specify in the final regulation that the business of financing or making loans does not fall within the definition of “brokerage services.”

* * *

¹² We also note that mortgage banking companies, clearly are not “stock brokers or other similar professionals.” Dictionary definitions of stock brokers generally describe licensed brokers that buy and sell securities on a stock exchange on behalf of clients. See, e.g., Merriam-Webster (“Stockbroker. a broker who executes orders to buy and sell securities and often also acts as a security dealer”); <https://www.merriam-webster.com/dictionary/stockbroker>; BusinessDictionary.com (“Stockbroker. Licensed agent who has to pass certain qualifying tests to be certified to offer securities investment advice to investors. He or she may (1) counsel what and when to buy, (2) counsel whether to hold or sell securities, (3) execute buy-sell orders on behalf of the investors, and (4) charge a percentage of the transaction amount as brokerage fee for the services rendered. Also called registered representative”); <http://www.businessdictionary.com/definition/stockbroker.html>. Mortgage banking companies are not similar to these professionals.

IV. CONCLUSION

We strongly urge Treasury and the IRS to apply the analysis it applied in connection with the proposed definition of “financial services” across other proposed definitions of SSTBs. In particular, we urge clarification that financing businesses, including mortgage banking companies, do not fall within the definition of “dealing in securities,” and that “brokerage activities” do not include activities performed by financing businesses, including mortgage banking companies. By doing so, Treasury and the IRS would ensure that financing businesses, including mortgage banking companies, that Congress intended to help with the section 199A passthrough deduction, will realize the tax relief they were intended to receive. This, in turn, would be consistent with the competitive environment intended by Congress.

We appreciate this opportunity to provide our comments on this important rulemaking. Please contact Fran Mordi at fmordi@mba.org and Bruce Oliver at boliver@mba.org with questions about this comment letter or for more information.

Sincerely,

A handwritten signature in black ink, appearing to read "R. D. Broeksmit". The signature is fluid and cursive, with a long horizontal stroke at the end.

Robert D. Broeksmit, CMB
President and CEO
Mortgage Bankers Association