

Preliminary Summary of the Final Regulations under Section 199A

January 2019

On January 18, 2019, IRS and Treasury (collectively, “Treasury”) released long-awaited final regulations implementing Section 199A – the pass through deduction provisions – of the tax reform legislation. As you may recall, the regulations, as proposed in August 2018, provided some guidance, but did not provide sufficient clarification on whether a mortgage banking company that is organized as a pass through entity is eligible for the deduction. MBA engaged in extensive advocacy during all stages of this rulemaking on behalf of our residential independent mortgage bankers, commercial/multifamily independent mortgage bankers and community banks.

Under Section 199A, a “specified service trade or business” (SSTB) is generally not eligible for the 20% pass through deduction, so a key question is whether the business of mortgage banking is an SSTB. Among the types of SSTBs listed in the statute are financial services, brokerages services, and businesses “dealing in securities.”

The final regulations provide additional clarity on some matters, while others will require further analysis of the rules. The following is a short summary of Treasury’s guidance relevant to the application of the deduction to mortgage banking companies. ***This summary is not intended to be legal advice. Because many determinations under section 199A are inherently fact-specific, please consult your tax advisor on the specific implications to you and your business.***

- **Financial Services:** The final regulations, consistent with the proposed regulations, confirm that the performance of services in the field of financial services does not include taking deposits *or* making loans. In effect, the regulations specifically clarify that the trade or business of making loans is not an SSTB and is therefore eligible for the pass through deduction. The final regulations also provide that “arranging” lending transactions between a lender and borrower constitutes the performance of services in the field of financial services, and is therefore an SSTB.

Thus, a key question may be whether the activities of a particular mortgage banking company constitute the trade or business of “making loans” versus “arranging” lending transactions between a lender and borrower. How an individual company is viewed under section 199A will depend on an analysis of the facts and circumstances of its business model and the nature of what the company does.

- **Brokerage Services:** The regulations clarify that the performance of services in field of brokerage services includes services in which a person arranges transactions between a buyer and a seller with respect to securities. Such a trade or business is an SSTB that is ineligible for the pass through deduction. While MBA will further analyze the question of whether this provision is applicable to mortgage lenders, we urge members to work with their advisors for a more specific or business-tailored implication of this provision.

- **Dealing in Securities:** The proposed regulations provided that regularly purchasing securities from and selling securities to customers in the ordinary course of a trade or business is “dealing in securities.” The final regulations provide a very important clarification for mortgage lenders — that “originating loans” will not be treated as “purchasing securities for the purpose of determining whether a taxpayer is ‘dealing in securities.’”

Thus, a mortgage banking entity that originates and sells loans in the ordinary course of its trade or business (regardless of how many sales and to whom the sales are made) is not dealing in securities. Hence, such a taxpayer is not an SSTB as a result of that activity, and is eligible for the pass through deduction. This reflects MBA’s recommendation that, for purposes of this definition, originating loans should not be considered to be the purchase of a security.

A mortgage company that “regularly” offers to purchase loans and sells those loans *may* be treated as an SSTB that is ineligible for the pass through deduction. Treasury declined to adopt MBA’s recommendation that a mortgage lender that both originates and purchases loans should be excluded from the SSTB definition. This provision requires further review of the entire rule to determine the implications for correspondent lending activities.

- **Community Banks:** MBA member Subchapter S community banks requested clarification that all activities within the bank are banking trades or business, and thus, excluded from the SSTB definition. Treasury declined to adopt that recommendation.
- **Conclusion:** Among the issues addressed by the final regulations, the regulations provide the greatest clarity to MBA members that are engaged in the origination and sale of mortgages in the secondary market – either to aggregators or to the GSEs. Additional analysis and interpretation will be needed to determine the impact of other provisions as they apply to the facts and circumstances of each member’s business model and activities. MBA will continue to analyze the regulations and will work with member companies and outside consultants in order gain further clarity regarding the impact of the regulations on the mortgage lending industry.