Federal Tax / Section 199A Qualified Business Income Deduction

NAR Committee:

Federal Taxation Committee

What is the fundamental issue?

The centerpiece of the 2017 Tax Cuts and Jobs Act (TCJA) was a provision that significantly lowered (from 35% to 21%) the income tax rate paid by regular corporations. However, most businesses in the U.S. are not regular C corporations but are organized as limited liability companies, S corporations, partnerships, or as sole- proprietorships. These entities all "pass through" their income or losses to the owners of the business who pay any tax due on their own tax returns.

The authors of TCJA knew that if they limited the tax cut only to regular corporations, many constituents with pass-through businesses would be upset to miss out on the tax cut and also could decide to change their entities to C corporations to cut themselves in on the tax cut action.

Therefore, to deliver a similarly significant tax cut to pass-through businesses, the TCJA provided a new kind of tax deduction for pass-through businesses. Unlike normal tax deductions, this new idea (called the "Qualified Business Income Deduction (QBI)" or the "199A Deduction)" is not based on an expenditure but equals up to 20 percent of the net business income of the entity after all other business expenses have been deducted.

Unfortunately, this new business deduction was somewhat complex, both in concept and in its application. Most of this complexity comes from concerns of Congress that the deduction be available only for businesses, including bona fide independent contractors, but not those who are employees who decide to try to talk their employers into making them independent contractors. Thus, the new law included a number of so-called "guardrails" around the deduction, which added complexity.

Further, Congress was concerned that enterprises in certain types of personal service businesses not be able to claim the deduction if their income is above certain thresholds. These restricted types of businesses are referred to by the new law as "non-specified service businesses" and include those in the following fields:

> *"any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, investing or investment managing, trading, dealing in certain assets, 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."*

When this language first appeared in the draft legislation, it appeared to be very bad news for real estate professionals, for two reasons. First, the term "brokerage services" seemed to rule out the use of the deduction by real estate agents and brokers. And second, it appeared that the threshold would be a fairly low dollar amount.

Two separate events occurred that mitigated these concerns and ended up making the new deduction available to a great many, if not most, real estate professionals who are in business for themselves as

independent contractors or through another kind of pass-through business. First, the final legislation included threshold limits that are quite high – for 2025, $197,300 of taxable income for single tax filers and $394,600 for those who file a joint tax return. Below these limits, the specified services restriction does not apply. And even for a range above these limits, a partial deduction is available on a phased-out basis.

Even better, the second event clarified that "brokerage services" does not include real estate brokerage, but only brokerage for intangible assets, such as stocks and bonds. This came from favorable regulations promulgated by the Treasury Department and the Internal Revenue Service at the behest of NAR and others.

However, there is further complexity in the issue in that those with incomes above the same thresholds listed above cannot take a straight 20% deduction off their net income but must use a separate formula that depends on the amount of wages and/or business investment the entity has for the tax year. Specifically, the deduction for those businesses whose owners have taxable income higher than the applicable threshold is limited to the greater of 1) 50% of the W-2 wages paid by the business, or 2) the total of 25% of the W-2 wages paid by the business plus 2.5% of the original cost basis of the tangible depreciable property of the business at year end.

In sum, this deduction, which applies to the great majority of NAR members, was the biggest benefit of the Tax Cuts and Jobs Act of 2017. It did have one significant problem however – it was set to expire at the end of 2025.

As the statutory demise date of the 199A deduction began to grow closer in 2024 and early 2025, many members of Congress expressed support for extending the deduction on a permanent basis in the tax reform bill that would be formulated to take care of this and other expiring provisions of the TCJA.

Even many of those who voted against the 20 percent qualified business income deduction in 2017 expressed support for extending it, at least for those business owners whose income was below $400,000, or who were not in large legal or accounting firms.

In early 2025, President Trump and Republican congressional leaders began crafting a tax reform bill that included the permanent extension of the qualified business income deduction and most other expiring provisions. NAR Advocacy was a prime supporter of including this permanent extension, and made sure members of Congress knew that this was a top priority of our members.

When the One Big Beautiful Bill Act (OBBBA) was signed into law on July 4, 2025, the permanent 199A deduction was included with a few improvements, as follows:

- OBBBA expanded the income phase-in ranges over which the deduction begins to be limited or to disappear. For single filers, the range was increased from $50,000 to $75,000. For joint filers, the range was increased from $100,000 to $150,000.
- OBBBA introduced new $400 minimum QBI deduction for taxpayers with at least $1,000 of QBI from an active business in which they materially participate. These amounts are set to be indexed for inflation after 2026.

I am a real estate professional. What does this mean for my

business?

The qualified business deduction was a huge boost for most real estate professionals who are in business for themselves or who own an S corporation, limited liability company, or partnership. The deduction essentially means that not only are the regular C corporations qualified to get a significant tax cut on their business income but so are independent contractors and others who do business in one of these "pass-through" forms. This deduction can be as high as 20% of the net income from the business. As indicated above, however, having taxable income above the thresholds can greatly complicate the computation or result (in some cases) with a much smaller deduction. For example, a real estate agent or broker with income above the threshold who does not have a lot of business assets will get little or no deduction.

The provision in the One Big Beautiful Bill Act making the deduction permanent and modestly improving it was one of the most significant provisions in the 2025 tax reform act.

NAR Policy:

NAR strongly supported the new deduction for qualified business income and urged Members of Congress to include the self-employed and owners of pass-through businesses in the tax cut bill as it would have been highly inequitable for only regular corporations to get this kind of tax relief. And NAR also pushed for high thresholds.

In addition, NAR worked with Treasury and the IRS to exclude real estate brokerage activities from the definition of "brokerage services" as a prohibited category for business owners earning over the threshold amounts.

In 2024 and 2025, NAR was a leading advocate of making this tax deduction permanent.

Opposition Arguments:

When the 199A deduction was first being debated in 2017, some Members of Congress believed all of the tax cut provisions of the TCJA were ill-advised and opposed them. In addition, because many of the provisions of the new law were at first temporary, including the qualified business income deduction, and were in effect only through December 31, 2025, some opponents of the tax relief were opposed to extending them beyond that time. Most opposition to the basic deduction melted away in the years after 2018, when the deduction first took effect, and as the expiration date approached, most former congressional opponents were mostly focused on restricting the deduction to higher-income individuals and/or to those in large legal or accounting firms.

Legislative/Regulatory Status/Outlook

Now that the qualified business income deduction has been made a permanent part of the tax law, there is at present little danger of it being removed from the Internal Revenue Code, though opponents of higher-income individuals receiving the deduction may attempt to limit the deduction to them in the future.

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Current Legislation/Regulation (bill number or regulation)

None at this time.

Legislative Contact(s):

Joe Harris, jharris@nar.realtor, 202-383-1226
Evan Liddiard, eliddiard@nar.realtor, 202-383-1083

Regulatory Contact(s):

Evan Liddiard, eliddiard@nar.realtor, 202-383-1083