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INSTITUTE OF REAL ESTATE MANAGEMENT

Retain the Section 1031 Like-Kind Exchange

CCIM Institute believes that it is in our nation's best interest for Congress to encourage real estate investment in the United States by creating a tax system that recognizes inflation and a tax differential in the calculation of capital gains from real estate, while stimulating economic investment and, consequently, leveling the playing field for those who choose to invest in commercial real estate. Essentially, this tool kills two birds with one stone by encouraging both the sale of one property and the purchase of the replacement property. These transactions are vital to economic stability.

Background

With a total value of approximately $5.26 trillion, commercial real estate's contribution to the nation's economy is enormous. Real estate activity accounts for nearly one-quarter of the taxes collected at all levels of government (this includes income, property, and sales taxes). Our industry is also one of the leading employers in the United States. Real estate assets and investment drive gains in economic productivity.

Like-kind exchanges under Section 1031 of the Internal Revenue Code allow property owners to defer taxes on gains realized from the sale of like-kind real property until a future date. The like-kind exchange technique is fundamental to the real estate investment sector. The current law provides investors with the maximum flexibility in managing their real estate portfolio. Real estate is essentially an illiquid asset that requires substantial commitments of cash. Flexibility is needed in order to assure the free movement of property and capital.

- A like-kind exchange does not avoid taxation.
  Taxes are still paid in the great majority of cases, whether upon the sale of the replacement property, incrementally through increased taxes from forgone depreciation, or by inclusion in a decedent's taxable estate.
- A like-kind exchange encourages development and spurs economic activity.
  Exchanges stimulate real estate transactions and encourage U.S. businesses to reinvest in their domestic operations, as domestic and foreign properties are not like-kind. By avoiding a tax-induced lock up of properties, like-kind exchange rules increase the frequency of property transactions and ensure a more dynamic real estate sector that drives real estate reinvestment and construction activity.

  Due to the pandemic, large amounts of retail and office space are expected to become vacant or underused. Like-kind exchanges provide the flexibility and encourage capital investment for the highest and best use of real estate, which improves communities, grows the economy, creates jobs, and increases local and state tax bases.
- Repealing the 1031 like-kind exchanges will reduce economic growth.
  A 2015 study by Ernst & Young found that if revenue from repealing 1031 exchanges is used to pay for higher government spending, GDP is estimated to fall by $13.1 billion each year in the long run.

Congressional Action to Date

Although legislation has not yet been introduced, President Joe Biden recently unveiled The American Families Plan, which would invest $1.8 trillion into programs such as education, child care and paid family leave. However, to pay for the plan, the President also proposed a number of tax increases including ending 1031 like-kind exchanges for gains greater than $500,000.

It is important to lay the groundwork toward educating legislators about the importance of the like-kind exchange to the real estate industry now.

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