THE CASE FOR PROTECTING SECTION 1031 LIKE-KIND EXCHANGES

By Erin Stackley

WHAT IS A "1031 LIKE-KIND EXCHANGE"?

Section 1031 of the Tax Code allows for tax-deferred "Like-Kind Exchanges," which occur when businesses or investors exchange one piece of property – real or personal – for another, and are able to defer capital gains taxes on their property until it is ultimately sold. They are frequently used in real estate for a wide range of properties – office buildings, warehouses, industrial space, farmland, and so forth. They encourage people who would otherwise not sell due to the tax implications to do so, thus letting development go forward and encouraging the efficient use of property. This, in turn, has the potential to boost the economy and create jobs.

There are many requirements for a "like-kind exchange," but in the context of real property, the basics are: an exchange of properties, which can be simultaneous or deferred (if it is deferred, there are other requirements, and an exchange facilitator is often used to ensure compliance with the law); both properties must be held for use in a trade or business or for investment (property held for personal use, such as a primary residence or a vacation home, does not qualify). Both properties must be within the United States. Participants in an exchange have 45 days from the date of selling property to identify potential replacement properties, and replacement property must be received and the exchange completed within 180 days of the sale of the original property.

Like-kind exchanges are fundamental to real estate, especially in the commercial sphere. Current law provides investors with maximum flexibility to manage their real estate portfolio, and encourages the efficient use of property. Doing away with the provision, or limiting its availability, will have a significant negative effect on real estate and the economy as a whole – reducing redevelopment projects, which results in fewer new jobs. Like-kind exchanges for real property provide liquidity to an illiquid asset, and repealing it would harm economic growth.

Yet, it is misunderstood by some in Congress to be a "loophole" in the tax code, and thus is an easy target in tax reform proposals. In the 113th Congress we saw two tax reform proposals, one each from the House Ways and Means Committee and the Senate Finance Committee. In both plans, put together by then-Chairman of the House Ways and Means Committee, Rep. David Camp (R-MI) and then-Chairman of the Senate Finance Committee Sen. Max Baucus (D-MT), Section 1031 of the IRC was repealed. The plans were released as "discussion drafts" in 2014, and were never formally introduced as legislation. That same year, the President's proposed FY 2015 budget included a provision on like-kind exchanges, capping them at $1 million.

WHAT IS NAR DOING?

NAR has been deeply concerned about the future of like-kind exchanges since the initial threats against it in the Camp and Baucus discussion drafts of 2014. While tax reform did not occur in the 113th Congress, this still signals a threat to this important provision which affects the livelihood of many Commercial REALTORS®, and if Congress decides to pursue tax reform in the 114th or later Congresses, 1031 could be a target. As a result, NAR has been strongly advocating for its protection on Capitol Hill, beginning with education efforts for Congressional offices on what a 1031 Like-kind exchange actually is and raising awareness of it.

In January 2014 NAR joined with a group of eighteen other real estate associations in sending a comment letter to the Senate Finance Committee arguing that repealing like-kind exchange rules would have the undesired effect of "locking up" real estate assets in the hands of current owners, not raising revenue as hoped. In addition, NAR participates in multiple coalitions focusing on protecting like-kind exchange rules, including associations concerned with both personal and real property exchanges. In January 2015 NAR conducted a survey of its commercial members and its affiliates, including SIOR, to collect data on how Realtors® are using like-kind exchanges in their businesses and what effect repeal would have on them. Though there is no legislation currently introduced which would repeal or limit like-kind exchanges, NAR is preparing for that possibility by working with other interested stakeholders to collect data on its usage and educate Members of Congress and their staffs on the importance of this provision to the economy. ■