Capping 1031 Exchanges is a Recipe for Stagnation, Not Recovery

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An essential tool in rebuilding our American economy is at serious risk as part of the $1.8 trillion American Families Plan being considered in Washington—and the damage will be felt in every state, city and town still reeling from the ravages of COVID-19.

For the last 100 years, like-kind exchanges, which allow investors to defer taxes on property sale gains while reinvesting that money into new properties, have been a cornerstone of the U.S. commercial real estate market, generating economic benefits on every level which far exceed the amount of taxes deferred. The $1.8 trillion plan presented last month by President Joe Biden proposes to cap the amount of gains that can be deferred at $500,000.

This shortsighted and counterproductive cap is a recipe for economic stagnation, not recovery.

All across our state and right here in Tucson we have witnessed the closing of countless shopping malls, strip centers, and restaurants due to the pandemic. The fallout continues in hotels and office buildings. Virtual meetings will permanently replace significant business travel, and many people will work from home exclusively. A substantial reinvestment to repurpose these properties and redevelop commercial spaces will be required for the economy to regain its strength.

The Federation Exchange of Accommodators, the national organization of 1031 Exchange companies, analyzed the data for the state of Arizona from seven companies between 2015 to 2019. They found that there were 14,000 properties involved in exchanges, representing a total value of $23.4 billion. That is data from just seven companies and there are many more which support exchanges; it is estimated that 15%-20% of all commercial transactions nationally utilize a 1031.

Proponents of the cap argue that the provision is a "loophole" used to avoid payment of taxes. In reality, a 1031 exchange is a deferral, not an elimination of tax, with taxes paid over a 15-year window and, according to a study, 80% of the taxpayers do only one 1031 exchange and then dispose of the property in a taxable sale.

A restrictive cap—whether $500,000 or any other amount—on the ability to reinvest into commercial real estate and the redevelopment of properties at this critical juncture in our nation's economy would send an already struggling commercial real estate market into a tailspin.

Ernst & Young estimated that the reinvestment through 1031 exchanges in 2021 will support more than 560,000 new jobs paying more than $27.5 billion in labor income, generate $5 billion in federal taxes and add $55 billion to the GDP. That $5 billion in federal taxes generated in one year far exceeds the estimate in the 2021 Biden budget that says capping 1031 at $500,000 raises an average of $1.95 billion per year over 10 years. Why would anyone change Section 1031? It doesn't raise any money.

Like-kind exchanges play a critical role in many facets of the nation's economy, including:

- fueling the redevelopment of distressed commercial properties;
- financing the construction or renovation of multi-family and affordable housing;
- allowing business to move to bigger facilities while keeping their capital in the business;
- allowing the middle class to build a real estate portfolio which will one day fund retirement;
- supporting farmers, ranchers, and forest owners;
- promoting land conservation and environmental protection.

The resurgence of our economy will need to be generated from many sources, and the private sector must again play a significant role in the recovery. The best way to encourage improvements and strengthen this infrastructure stock is to keep section 1031 unchanged to encourage investment and most importantly, reinvestment in the real estate economy. ITB

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