



The Voice of the 1031 Industry

1255 SW Prairie Trail Parkway
Ankeny, IA 50023
Phone: (515) 244-6515
Fax: (515) 334-1174
www.1031.org
www.1031taxreform.com

Like-Kind Exchanges Complement the Blueprint for Tax Reform

The Blueprint for Tax Reform proposes immediate expensing with unlimited loss carryforward for all tangible & depreciable personal property assets and real estate improvements, except land. The Blueprint also proposes elimination of the business interest expense deduction. Like-kind exchanges under IRC section 1031 are needed to fill in the gaps.

1. **Section 1031 should be retained in our tax code in its present form because it removes friction from business transactions** and stimulates economic activity that would not otherwise benefit from the Blueprint. At the state tax level, it is noteworthy that multiple states declined to adopt “bonus” depreciation and likely will not adopt 100% expensing, yet they continue to recognize the importance of retaining like-kind exchanges.
2. **Expensing does not cover land**, which typically represents 30% or more of the value of commercial real estate, and up to 100% of agricultural land investments. If real estate owners are faced with reducing the value of their investments and life savings through capital gains tax, even with lower rates, they will likely hold onto these properties longer, resulting in a “lock-in” effect.
3. **Like-kind exchanges remove the lock-in effect, allowing taxpayers to make good business decisions** without being impeded by negative tax consequences. Like-kind exchanges stimulate economic activity – property improvements that benefit communities, increase property values, and generate jobs ancillary to the exchange transactions.
4. **Like-kind exchanges make the economics work for conservation conveyances** of environmentally sensitive lands that benefit our environment, preserve wildlife habitats, and create recreational green spaces for all Americans. Farmers and ranchers depend upon Section 1031 to trade into more productive, less sensitive land.
5. **Unlike the Blueprint, like-kind exchanges provide a mechanism for asset sales and replacement purchases that bridge 2 tax years.** Absent §1031, taxpayers would be forced to acquire new assets prior to year-end, or be faced with recapture tax on the Year 1 sale with less equity available for the replacement purchase in Year 2. This would create a disincentive to engage in real estate and personal property transactions during the 4th quarter, resulting in tax-driven market distortions. Seasonal businesses especially benefit from exchanges in which assets are divested in late autumn and replaced in early spring at the start of the new season, thereby eliminating off-season expenses without any negative tax consequences.
6. **Like-kind exchanges provide incentive for capital formation** for landowners, who would be particularly disadvantaged if they had neither the option of a tax deferred exchange nor expense deductions for land acquisition and interest on related debt. Section 1031 permits tax deferral with equal value reinvestment into replacement property. Under the Blueprint, commercial real estate owners with a low basis would need to acquire replacement property worth at least 30% more than what they sold, just to have a sufficient expense deduction to offset total gain.
7. **Like-kind exchanges eliminate potential expensing abuse** and “gaming of the system.” When purchasing, the opportunity to immediately expense real estate improvements provides a taxpayer with a tremendous incentive to inflate the allocated value of improvements to maximize the write-off. When selling, there would be an equally powerful, but opposite, incentive to minimize the value of the buildings and over-allocate value to the land, thereby reducing recapture tax on the improvements at ordinary income tax rates, and benefiting from lower capital gains tax rates on the land, essentially cutting the tax bill in half.