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FEA Update

American Families Plan – Impact upon
Section 1031 Like-Kind Exchanges

&

Key Findings of the
Ling & Petrova Micro-Economic Impact Study
EY Macro-Economic Impact Study

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President Biden's American Families Plan

- Proposed Cap to Section 1031:
 - *“The President would also end the special real estate tax break, which allows real estate investors to defer taxation when they exchange property – for gains greater than \$500,000.”*
 - This cap would effectively kill Section 1031, and is one-half of the amount proposed by the Obama Administration.
 - No other details beyond these words, with an unclear effective date – **which could be retroactive to January 1, 2021.**

President Biden's American Families Plan

- Proposed Cap to Section 1031:
 - Definition of “gain”, over what period of time, and by whom (individual vs. partnership entity v. parties to the exchange) are missing.
 - Immediate impact on commercial real estate when combined with the proposed capital gains increase and step up in basis will be devastating.
 - Biden's Budget proposal and Treasury's blue book are both due in mid May.

What is the Threat?

- **We now have a direct threat to Section 1031.** According to the document released by the White House:

“The President would also end the special real estate tax break -- that allows real estate investors to defer taxation when they exchange property -- for gains greater than \$500,000...”

- FEA has been preparing for this threat for the past two years.
- We have built a strong defense: 1031 real estate coalition, updated economic studies, congressional fundraisers, QI data project, virtual Hill visits with congressional staff.

Legislative Outlook – Timing

- Speaker Nancy Pelosi has said that the plan, perhaps merged with the American Jobs Plan, (which addresses infrastructure and raises corporate tax rates), will pass the House **by the July 4th recess.**
- The bill will likely be on a straight party line vote.
- It is likely that the **Senate will pass the bill by September, perhaps sooner, and may work through the August recess.**
- The Ways and Means Committee and Senate Finance Committee will play a critical role, as will the House and Senate Democratic leadership.

Legislative Outlook – Timing

- The Budget Reconciliation process will be employed again, requiring only **51 votes in the Senate**. This procedure used to pass the American Rescue Plan in March 2021 and the Tax Cuts and Jobs Act in 2017.
- We are asking our Democratic allies on the Hill to help us preserve Section 1031 and have found support on the tax writing committees.
- FEA is generating grassroots, grasstops, direct and continued contact with key members and staff.
- FEA has sponsored over 31 fundraisers in 2020 to date with more planned.

Preservation of Section 1031: What are We Doing?

- The FEA has built a vibrant defense to preserve Section 1031 against possible legislation to repeal or cap the dollar amount of real estate like kind exchanges.
- Our focus in 2020 and 2021 has been on Democrats in the House and Senate who are close to President Biden, and members of the tax writing committees and leadership.

What Can You Do To Help?

- Get involved by writing letters and calling your Congressperson and other elected leaders.
- Participate in fundraisers and Zoom meetings with congressional staffers.
- Reach out to your friends about joining our efforts to combat the proposed limit to Section 1031,
- **Consider a contribution to the FEA 1031 PAC.**

Updated Sec. 1031 Economic Impact Studies

- **Ling & Petrova**

- Updated October 2020
- Micro-economic study focused on Commercial Real Estate
- Principal authors: Professors David C. Ling, PhD & Milena Petrova, PhD

- **EY**

- Updated May 2021
- Macro-economic study focused on direct and indirect economic activity generated by Sec. 1031 exchanges
- Principal authors: Robert Carroll, PhD & Brandon Pizzola, PhD

2020 Ling & Petrova Micro-Economic Study – Key Findings

- 10-20% of all CRE transactions are 1031 exchanges
- **Exchanges preserve capital & encourage capital improvements** which:
 - ✓ Create jobs;
 - ✓ Add to state & local tax bases.
- **Greater investment**– 1031 Buyers invest more capital (15.4%) into Replacement Properties than non-1031 Buyers.
- Exchange acquisitions are associated with
 - ✓ **Greater equity & lower leverage** – 30% LTV for 1031 v 43% LTV for non-1031
 - ✓ Reduced credit risk for investors and lenders.
- Exchanges
 - ✓ Encourage **shorter holding periods**
 - ✓ **Improve marketability** of illiquid CRE

2020 Ling & Petrova Study – Key Findings continued

- 38% of all CRE exchanges involve multi-family housing
- Nationally, half of all exchanges valued above \$575,000
- Vast majority of 1031s are one-time events, followed by taxable sale.
 - ✓ Less than 20% of replacement properties are disposed of in a subsequent exchange
- Elimination of 1031 would cause
 - ✓ **Decrease** in transaction activity, capital investment & real estate prices (prices ↓ 6%)
 - ✓ **Increase** in holding periods, cost of capital, leverage and rents (rents ↑ 6%).
- 63% of tax-deferral is recovered by Treasury through reduced depreciation deductions
- Tax expenditure is overstated

2021 EY Macro-Economic Impact Study – Key Findings

- Study measures **direct impact and ancillary economic activity** (indirect impact):
 1. Exchanging taxpayer businesses
 2. Supplier businesses
 3. Related consumer spending
- Exchanges
 - ✓ **Reduce** the cost of capital
 - ✓ **Increase** investment in the US economy,
 - ✓ **Generate** jobs, labor income and value-added in the economy.
 - ✓ **Remove** the “lock-in” effect
 - ✓ **Promote** highest & best use of property
 - ✓ **Encourage** more efficient deployment of capital & efficient business growth

2021 EY Study – Key Findings continued

- In 2021, 1031 exchanges will support:
 - Creation of 568,000 jobs
 - \$27.5 billion of labor income
 - \$55.3 billion of value added to US economy (GDP)
- Since exchange activity is likely underestimated, exchanges may support:
 - Creation of 710,000 jobs;
 - \$34.4 billion of labor income;
 - \$69.1 billion of value added to US economy;

2021 EY Study – Key Findings continued

- Exchanges contribute to Federal, State & Local tax revenue
 - ✓ **\$7.8 billion per year in Federal, State & Local taxes**
 - \$5 billion Federal
 - \$2.8 billion State & Local
 - ✓ **PLUS \$6 billion per year of additional income taxes due to foregone depreciation** (reduced deductions) on the replacement property