FEA
FEDERATION of EXCHANGE ACCOMMODATORS
The Voice of the 1031 Industry

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The Honorable Joseph R. Biden, Jr. Via Email: press@joebiden.com
Biden for President Campaign

RE: Tax Proposal Related to Like-Kind Exchanges

Dear Senator Biden,

The Federation of Exchange Accommodators ("FEA") is the national industry association for Qualified Intermediary companies that facilitate IRC Section 1031 like-kind exchanges for taxpayers. We are troubled by the Tax Policy Center's March 5, 2020 analysis of your campaign's tax proposal, which assumes your proposal "repeals the deferral of capital gains from like-kind exchanges" (at page 8). We write to provide you with some practical and empirical data to dispel common misunderstandings about Section 1031, as well as the economic stimulus powered by like-kind exchanges, who benefits, the ultimate payment of taxes, and the tax policy underpinning this important, 100 year-old tax tool.

Like-kind exchanges are used by and benefit a broad spectrum of taxpayers. Like-kind exchanges are important to the efficient operation and ongoing vitality of thousands of American businesses in a wide range of industries, business structures, and sizes, which in turn strengthen the U.S. economy and create jobs. These businesses provide essential products and services to U.S. consumers and are an integral part of our economy.

Section 1031 enables small and mid-sized businesses to make smart business decisions to transition into facilities and locations that will efficiently meet their needs for tomorrow, instead of being tax-locked into yesterday's inefficiencies. Exchanges of single-family rental units and small apartment buildings by middle-class individuals of modest means are common. Farmers and ranchers exchange acreage to relocate, consolidate or improve their operations without diminishing their cash flow. Additionally, Section 1031 encourages conservation conveyances of sensitive lands to achieve environmental goals and provide recreational space for the enjoyment of all Americans.

Economic impact studies have proven that like-kind exchanges stimulate the economy. A 2015 study by Professors David Ling and Milena Petrova, focusing on commercial real estate, found that businesses and entrepreneurs would have less incentive and ability to make real estate and other capital investments without like-kind exchanges. [1] The immediate recognition of a gain upon the disposition of property being replaced would impair cash flow and could make it uneconomical to replace that asset. This study further found that taxpayers engaged in a like-kind exchange invest significantly more capital in replacement property than non-exchanging buyers. Like-kind exchanges encourage the highest and best use of properties, thus improving communities while creating an improved local and state tax base.

Tax IS paid on the overwhelming majority of exchanged properties. The 2015 Ling-Petrova study also found that an overwhelming majority (88%) of replacement properties acquired in a Section 1031 exchange were ultimately disposed through a taxable sale, rather than through a subsequent exchange or other non-recognition transfer. Note that the remaining 12% would include dispositions through subsequent exchange, partnership dissolution, marriage dissolution, partition, foreclosure, death, gift, eminent domain and other court-ordered or non-sale transfer. Moreover, the data disclosed that 34% of exchanges incur some tax in the year of the exchange. [2] Bear in mind that there is immediate recognition of gain and tax liability to the extent that the taxpayer receives any cash or non-like kind property.

Section 1031 is based upon sound tax policy. The legislative history makes clear that two primary purposes of Section 1031 were: 1) to avoid unfair taxation of ongoing investments in property and 2) to encourage transactional activity. Section 1031 has survived repeated Congressional scrutiny because 1) it is based on sound tax policy that prevents

[1] David Ling and Milena Petrova, *The Economic Impact of Repealing or limiting Section 1031 Like-Kind Exchanges in Real Estate* (Mar. 2015, revised June 2015), at 5, http://www.1031taxreform.com/wp-content/uploads/Ling-Petrova-Economic-Impact-of-Repealing-or-Limiting-Section-1031-in-Real-Estate.pdf.

[2] Ling and Petrova, *Economic Impact*, at 5 and 10.

taxation of gain (or deductions for losses) when there is continuity of investment and no cashing out, and 2) it stimulates the economy through increased transactional activity that begets jobs and taxable revenue.

In summary, like-kind exchanges encourage capital formation. Since 1921, like-kind exchanges have stimulated capital investment in the United States by allowing funds to be fully reinvested in the enterprise. These investments benefit not only the taxpayers making the like-kind exchanges, but also generate jobs and taxable revenue for unrelated businesses upstream and downstream from the exchange transaction, such as real estate brokers, title and property insurers, escrow / settlement agents, lenders, appraisers, surveyors, attorneys, inspectors, contractors, building supply vendors and more. Eliminating or limiting like-kind exchanges in the best of times would have a negative economic impact, increasing the cost of capital, slowing the rate of investment, increasing asset holding periods, and reducing real estate transactional activity. In the face of the current COVID-19 pandemic, recession and economic upheaval, the contractionary impact on the U.S. economy and real estate industry would be severe.

Please feel free to contact any of us should you wish to discuss.

Very Respectfully,

Federation of Exchange Accommodators

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