

NAR Issue Summary

Federal Tax / Section 1031 Like-Kind Exchange

NAR Committee:

Commercial Federal Policy Committee

Federal Taxation Committee

What is the fundamental issue?

Since 1921, U.S. tax law has recognized that the exchange of one investment or business-use property for another of like-kind results in no change in the economic position of the taxpayer, and therefore, should not result in the immediate imposition of income tax. The like-kind exchange rules permit the deferral of taxes, so long as the taxpayer satisfies numerous requirements and consummates both a sale and purchase of replacement property within 180 days. Real estate investors and commercial real estate practitioners place a very high priority on retaining the current like-kind exchange rules.

I am a real estate professional. What does this mean for my business?

The exchange rules often provide a real estate professional with an opportunity to facilitate two transactions: the sale of the relinquished property and the purchase of the replacement property. Any curtailment of the exchange rules will make both pieces of exchange transactions more difficult to conclude and would mean that many transactions would not take place. The like-kind exchange technique is among the most important of all tax provisions for real estate investors and commercial real estate professionals.

NAR Policy:

NAR opposes any change that would undermine the deferral mechanisms associated with exchanges or lead to fewer transactions.

The like-kind exchange technique is fundamental to the real estate investment sector. The current law provides investors with a great deal of flexibility in managing their real estate portfolio. Real estate is essentially an illiquid asset that requires substantial commitments of cash. Flexibility is needed in order to assure the free movement of property and capital. This, in turn, results in economic growth and job creation.

Opposition Arguments:

Opponents of NAR policy may argue that deferring taxation of any investment is



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improper, especially when it has been disposed of. Moreover, with capital gains tax rates for most individuals at their lowest level since World War II (15% for most), the burden on investments is modest.

Legislative/Regulatory Status/Outlook

No bipartisan legislation related to Section 1031 was introduced in the 114th Congress or so far in the new 115th Congress (which began in January 2017). However, identical bills were introduced in the 114th Congress in both the House and Senate that would limit the use of the like-kind exchange deferral as a way of partially offsetting the cost of provisions that would shore up multiemployer pension plans. Support for these bills was limited to a relatively small number of Democrats, which indicates that there is not much chance of this legislation moving forward in a Republican-controlled Congress.

Of more concern, however, is the fact that Members of Congress in both Houses and both parties continue to express the desire to overhaul the tax system, with some leaders indicating that "everything is on the table." A staff discussion draft released by former Finance Committee Chairman Max Baucus (D-MT) in November 2013 proposed repealing Section 1031. A similar tax reform draft plan was released by former Ways and Means Committee Chairman Dave Camp (R-MI) in February 2014, which would also repeal Section 1031.

The likelihood of comprehensive tax reform moving toward enactment has gone up considerably with the election of Donald Trump and another Republican-controlled Congress. So far, none of the leading tax reform plans explicitly state that Section 1031 Like-Kind Exchanges are targeted for repeal. However, these plans are not fully developed and tax policy experts believe that as tax reform moves through the legislative process, more provisions will be eliminated to help keep tax reform revenue neutral. And because 1031 is generally perceived by much of the population and even some policymakers as an unwarranted "loophole" that is only available to the wealthy, the provision is thought to be vulnerable to attack.

NAR is working with other interested stakeholders to oppose the repeal or limitation of the like-kind exchange provision and to educate Members of Congress and their staffs on the importance of this provision to the economy. For example, NAR is an active member of two separate coalitions devoted to preserving the 1031 like-kind exchange. These coalitions have funded two separated studies on the impact that repealing Section 1031 would have on the economy and on the real estate sector. Moreover, the coalitions continue to have meetings with Members of Congress to explain the importance of tax-deferred exchanges in their states and districts. Also, NAR lobbyists often mention the importance of keeping 1031 when meeting with Members and staff on other issues.



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Current Legislation/Regulation (bill number or regulation)

None at this time.

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