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Like-Kind Exchanges

Tax Reform That Kills Like-Kind Swaps a Red Flag for Farmers

Farmers could get a big tax hit when they sell land if House Republicans replace like-kind exchanges with immediate expensing as part of a broader tax reform effort.

The House GOP plan, released last year, doesn't mention the fate of like-kind exchanges in its proposed tax system overhaul, leaving some lobbyists to speculate that the omission was intentional. Tax code Section 1031 like-kind exchanges allow people to defer paying capital gains taxes on the sale of property if the proceeds are reinvested in a similar property.

It appears there are congressional tax-writers who ''are of the opinion that with lower tax rates and the ability to immediately expense assets, you wouldn't need 1031 anymore,'' said Suzanne Goldstein Baker, executive vice president and general counsel at Investment Property Exchange Services Inc., a company that offers like-kind exchange services. That type of reasoning is based on ''faulty logic,'' she said at a recent American Bar Association tax section meeting.

Baker, who serves on the board of directors, the executive committee, and the government affairs committee for the Federation of Exchange Accommodators, told Bloomberg BNA May 31 that the group is drafting a letter to Congress detailing its Section 1031 concerns. The letter is to be submitted to the House Ways and Means Committee on June 1 in response to a May 18 tax reform hearing.

The immediate-expensing provision in the GOP tax plan would allow businesses to fully and immediately write off investments in tangible property such as equipment and buildings, and intangible assets such as intellectual property. It doesn't apply to land.

Baker said that she isn't opposed to immediate expensing, but that the provision's carve-out of land paired with the omission of like-kind exchanges would create gaps that could put taxpayers in land-heavy industries at a disadvantage.

In commercial real estate, ''the rule of thumb is the land is 30 percent of the value, the structure is 70 percent. But depending on location and the condition of the building, that land component could be as much as 50 or 60 percent,'' she said. In farming, that number is even higher. Land can represent 80 percent to 100 percent of a farmer's property investments, Baker said.

'All Kinds of Reasons' ''There are all kinds of reasons why farmers do like-kind exchanges for land,'' many of which improve business operations, said Pat Wolff, senior director of congressional relations at the American Farm Bureau Federation. These include:

- swapping land to stay out of the path of urban development and remain close to suppliers;
- exchanging distant land for land that is closer to the rest of the farm so that the property is contiguous and easier to manage; and
- acquiring land that is more productive or less environmentally sensitive.

If land can't be expensed and farmers aren't able to defer capital gains taxes on swaps so that they have money to reinvest in the new property, they're more likely to hold on to land and stop engaging in such transactions, Baker said.

''We're not too concerned about increasing tax burdens on land,'' said Alan Cole, an economist with the conservative Tax Foundation. ''The reason to be concerned about tax burdens on some kind of good or investment is that you might expect less of it to be produced,'' he told Bloomberg BNA in an email. But this critique doesn't apply to land, he said.

''Land is fixed. Increasing the tax burden on land mostly makes incumbent landholders poorer and the Treasury richer, without too many effects on the broader economy.''

Conservation Easements Eliminating like-kind exchanges could dampen use of conservation easements, which benefit everyone through improved environment, habitat preservation, and creation of hunting, fishing, and green spaces, Baker said.

Section 1031 ''is a huge driver of permanent conservation easements and conservation conveyances,'' she said.

Farmers are using 1031 ''to exchange permanent conservation easements in environmentally sensitive farmland for other productive farmland outside of these sensitive areas without any loss of investment occasioned by immediate tax liability on the gain,'' the FEA said in a recent policy paper.

''Given the need to maintain the value of their investments and to derive comparable income from replacement farmland, farmers would be far less likely to sell environmentally sensitive lands or conservation easements restricting productive use if they were required to use after-tax dollars, essentially being forced to downsize,'' the paper said.

David A. Brown, president of IPE 1031, a company that provides qualified intermediary services for like-kind exchanges, said he has seen the benefits for conservation easements in his own practice. ''In the corn belt states there is substantial attention being placed on reducing agricultural nutrient runoff,'' he said in an email to Bloomberg BNA. ''Farmers are participating in sales of permanent conservation easements to take highly erodible land out of production and establish buffers to help with the effort of filtering runoff into streams and rivers,'' he said.

Brown estimated that participation in these programs would be cut by at least half if farmers lose the ability to exchange.

'Chopping Block' ''I think the 1031 industry is correct to be concerned that 1031 could be on the chopping block,'' said Steven M. Rosenthal, a senior fellow at the Urban-Brookings Tax Policy Center. Former Ways and Means Committee Chairman Dave Camp (R-Mich.) proposed eliminating like-kind exchanges in his 2014 tax reform plan, ''so it's clearly in play,'' he told Bloomberg BNA.

Emily Schillinger, communications director for Ways and Means, said the committee's members appreciate the role that like-kind exchanges play in the current system. ''They are carefully considering what the role of these exchanges would be in our new pro-growth tax code with full and immediate expensing,'' she told Bloomberg BNA in an email.

Rosenthal agreed that the House GOP's immediate-expensing proposal wouldn't fully replace the benefits of like-kind exchanges in certain circumstances. However, he said, he doesn't sympathize with efforts to preserve Section 1031 exchanges, calling them a ''long-standing loophole.'' The statute has been expanded far beyond Congress's original intent, he said.

''There's very little justification in the income tax world to start excluding different assets from taxable realization events,'' he said. ''We should try to collect on realizations across the board,'' not have benefits for certain industries while excluding others, Rosenthal said.

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The FEA paper on like-kind exchanges is at http://src.bna.com/oSE.

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