FEDERATION of EXCHANGE ACCOMMODATORS
The Voice of the 1031 Industry

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Concerns with The Tax Reform Act of 2014
Proposal to Eliminate I.R.C. Section 1031 Like-Kind Exchanges

The Federation of Exchange Accommodators (FEA) is the industry association for exchange facilitators, also known as Qualified Intermediaries ("QI"). FEA member companies facilitate tax-deferred exchanges of investment and business use properties under IRC §1031 for taxpayers of all sizes, from individuals of modest means to high net worth taxpayers and from small businesses to large corporations.

The FEA supports the goals of tax reform: to achieve a simpler, fairer, and flatter tax code that is more efficient and results in greater financial growth, job creation, and a strengthened economy. Equally important, we encourage preserving incentives for investment in hard assets, equipment and machinery used by growing businesses to spur economic growth and productivity. We hope that in the lengthy, methodical process of tax reform, careful deliberation and modification will be employed to achieve these desirable goals without creating unintended consequences of unfairness and economic stagnation.

The House Ways and Means Committee stated, **"Every dollar small businesses spend on taxes and tax compliance is a dollar they do not have to invest in equipment, start a new production line, hire a new employee or provide more in wages and benefits."**[1] The Committee further posited, **"Our outdated international tax system actually encourages American businesses to keep profits and jobs outside of America."**[2] The Committee concluded, **"Simply put, if taxes were not so high…businesses would have the resources to reinvest in their businesses and help grow the economy of their communities."**[3]

The tax deferral benefit provided by §1031 is a valuable tool for meeting each of these goals and provides a powerful engine to the U.S. economy. Like-kind exchanges promote transactional activity that results in job creation and taxable income that, in turn, fuels other businesses, including small and mid-sized businesses. Further, since domestic real estate and assets used predominantly within the United States cannot be exchanged for foreign real estate and assets (such as machinery and equipment) used predominantly in foreign countries, the §1031 deferral benefit directly stimulates reinvestment in U.S. communities and businesses, promoting job growth within our own borders.

We oppose the proposal to eliminate like-kind exchanges and encourage retention of IRC §1031 in the law's present form because:

1. **When the myths are busted and the impacts of depreciation, the estate tax, and the economic stimulus from like-kind exchanges are considered, neither elimination nor restrictions to §1031 would result in additional revenue to the U.S. Treasury, an improvement to the tax code, or any benefit to the U.S. economy.**
2. Sec. 1031 is consistent with goals of efficiency, neutrality, fairness, and simplicity within the tax system.
3. Sec. 1031 promotes business decisions that stimulate U.S. job creation and growth of the U.S. economy.
4. Definitions of "like-kind" are well understood and §1031 exchanges facilitated by Qualified Intermediaries are neither abusive nor administratively difficult for either the IRS or taxpayers.
5. Sec. 1031 works well for, and is widely used by, a broad spectrum of taxpayers at all levels, in all lines of business, including individuals, partnerships, limited liability companies, and corporations.
6. Sec. 1031 has remained in the tax code since 1921, notwithstanding repeated Congressional scrutiny, because it is based on sound tax policy that is predicated on continuity of investment by the taxpayer.

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[1] *"The Tax Reform Act of 2014, Fixing Our Broken Tax Code So That It Works For American Families and Job Creators," House Ways and Means Committee, p.11.*
[2] *Ibid., p.9*
[3] *Ibid., p.10*

Consider the following:

- **Repeal of Section 1031 will cause a Decline in Real Estate Values**
  Anecdotal evidence suggests that at least 25% of commercial real estate sale transactions involve §1031 exchanges. A substantial volume of sales transactions involving agricultural property also utilize §1031 exchanges. These types of real estate are highly illiquid assets, making it difficult to generate a profit and requiring long-term investment. Repeal of §1031 will have a chilling effect upon real estate investment. Without the tax-deferral incentive, many transactions will be abandoned or delayed, causing stagnation in the real estate marketplace and blight in neighborhoods. Investors will be motivated to invest in more liquid, non-real estate investments in which profits can be realized more quickly. Additionally, a decline in real estate values would imperil the U.S. banking system through reduction of value of commercial real estate loan collateral, causing the banking system to return to the unstable condition of the 2009 recession and with it, a lack of available credit, further stifling real estate transactions.

- **Section 1031 is a Powerful Economic Stimulator, Encouraging Investment in Small and Medium Sized Growing Businesses thereby Promoting U.S. Job Growth**
  Section 1031 exchanges contribute to the velocity of the economy by stimulating a broad spectrum of real estate transactions which generate taxable income and tax revenue through real estate commissions, insurance premiums, financial services, and increased property taxes. Non-real estate economic sectors are also stimulated because §1031 encourages companies, small businesses, farmers and ranchers to replace and upgrade machinery and equipment, thus stimulating purchases, sales, and manufacturing of construction and agricultural machinery, equipment, railcars, aircraft, trucks, cars, marine vessels, and other assets. Section 1031 provides significant benefits to taxpayers of all sizes with a "trickle down, spillover" economic stimulus to a myriad of industries and small businesses across the country. ***This deferral benefit permits efficient use of capital to preserve and manage cash flow, encouraging U.S. businesses to reinvest in their domestic operations, rather than offshoring business activity.***

- **Elimination of §1031 Would Tax Cash Flow, not Wealth.**
  Section1031 permits a continuity of investment by the taxpayer without reducing cash flow available for growth of the business. The value of assets exchanged, whether farmland, commercial or rental residential real estate, machinery, equipment, vehicles or other business-use or investment assets, remains invested in the taxpayer's business. ***The taxpayer doing a §1031 exchange is not taking any profit from this transaction; instead, profits are being plowed back into the business.*** This is in stark contrast to taxing the gain on the sale of stock for other securities. Stocks and other securities are relatively liquid, third party investments in someone else's business. Section 1031 exchanges are available only to direct owners of business-use or investment assets, which by their nature, are illiquid. ***Taxing third party investors on their profits from the sale of stock does not impact the cash flow or operation of the business; but a tax to the owner of a productive asset directly reduces the cash flow available for reinvestment into other productive assets.***

- **Repeal of §1031 Will Not Increase Fairness**
  Section §1031 is fair and working well for entrepreneurs and a broad spectrum of taxpayers at all levels, in all lines of business, including individuals, partnerships, limited liability companies, and corporations. An industry survey showed that 60% of exchanges involve properties worth less than $1 million, and more than a third are worth less than $500,000.

- **The Gain Does Not Go Away; At Some Point the Tax is Paid**
  Section 1031 exchanges structured under the IRS regulatory safe harbors using professional Qualified Intermediaries are neither tax savings vehicles nor "abusive tax avoidance schemes." Rather, they are legitimate transactions utilizing an important tax planning tool. ***Payment of tax occurs**:* 1) ***upon sale*** of the replacement asset; 2) incrementally, ***through increased income tax due to foregone depreciation***; or 3) by ***inclusion in a decedent's taxable estate***, at which time the value of the replacement asset could be ***subject to estate tax at a rate more than double the capital gains tax rate***.

- **Section 1031 Is Not Administratively Difficult for Either the IRS or Taxpayers**
  Like-kind exchanges conducted within the regulatory safe harbors under §1031 using professional Qualified Intermediaries are straight-forward transactions that follow a well-understood set of rules, procedures and documents. Taxpayers claiming tax-deferral treatment must report certain information on IRS Form 8824

with their tax returns. Determination of whether the rules have been complied with is not complicated. Professional Qualified Intermediaries are subject matter experts who simplify §1031 by guiding clients and their tax advisors through the process, providing proper documentation, holding funds, and offering other services. Qualified Intermediaries function as unofficial gate keepers for the IRS, promoting compliance with the technical requirements for proper exchange treatment. Repeal of like-kind exchanges would result in greater complexity and expense because history and human nature have taught us that taxpayers will spend more in legal fees to develop more complicated ownership structures to avoid or defer recognition of taxable gain.

- **The Definition of Like-Kind is Well Understood**
  Section 1031, enacted in 1921, and Treasury Regulations in effect since 1991 provide specific frameworks for determining whether assets are "like-kind" and specifically provide that real estate within the U.S. is not like-kind to real estate located abroad. Similarly, personal property assets used predominantly within the U.S. are not like-kind to the same type of asset to be used predominantly in a foreign country. Simply put, §1031 encourages reinvestment in the U.S. and in U.S. operations.

- **Elimination of §1031 Will Not Raise Significant Revenue**
  Like-kind exchanges are essentially revenue neutral because gain deferred is directly offset by a reduction in future depreciation deductions available for assets acquired through an exchange. The tax basis of newly acquired replacement property is reduced by the amount of the gain not recognized due to the exchange of the relinquished (sold) property. Thus, the taxpayer forgoes an equal dollar amount of future depreciation deductions on the replacement property, resulting in increased annual taxable income over time, taxed at ordinary income tax rates.

Good economic policy initiatives are designed to encourage investment in productive assets, thereby stimulating additional borrowing and investment by qualified investors, increasing the velocity of transactions, redeploying underutilized assets, and discouraging fearful contraction and cash hoarding. Section 1031 encourages economic growth by mandating reinvestment in like-kind assets, while increasing jobs and ordinary income generated by additional capital investment. The transactional activity stimulated by §1031 results in jobs in the real estate, construction, title insurance, mortgage, banking, equipment lease financing, vehicle and heavy equipment rental and manufacturing, after-market alteration, customization and installation industries. Fewer transactions ultimately result not only in fewer jobs in these industries, but also indirectly at factories, restaurants, dry cleaners, and other local small businesses that generate revenue from the after tax dollars of employed workers.

In conclusion, §1031 should be retained because it not only serves the goals of tax reform, it promotes economic growth and investment at home, in the United States.