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Study Shows Like-Kind Exchanges
Increase Real Estate Investment, Capital Improvements and Jobs

Repeal of Section 1031 Would Disrupt Local Property Markets,
Slow Economic Growth, and Harm Tenants and Owners

Ankeny, IA — The Federation of Exchange Accommodators (FEA) is pleased to announce that a study released by the Real Estate Like-Kind Exchange Coalition, of which the FEA is a member, finds the cost of Internal Revenue Code §1031, known as like-kind exchanges, is largely overestimated while benefits of the provision are undervalued. The study concludes that the real estate industry benefits greatly from like-kind exchanges through increased investment, reduced leverage, shorter holding periods and improved liquidity.

I.R.C. §1031 allows for the deferral of capital gains tax and ordinary income tax on business or investment use property if the property is exchanged for like-kind business or investment use property. The study concludes that the provision encourages business owners to reinvest their cash flow into their businesses, which in turn encourages U.S. job creation and stimulates economic growth. Like kind exchanges are used in a variety of industries in addition to real estate.

The study was commissioned in response to legislative proposals to repeal Section 1031 and conducted by Professors David C. Ling (University of Florida) and Milena Petrova (Syracuse University). The study reports widespread use of §1031 in the real estate market, and after reviewing more than 1.6 million real estate transactions over a 17-year period, concludes that like-kind exchanges not only contribute to an increase in investment, but also to overall taxes paid.

The study finds that repeal or curtailment of §1031 would result in a decrease in real estate prices, an increase in rent for tenants in the long term, and an overall decrease in real estate investment. Other negative impacts include longer holding periods which leads to less transactional activity and greater reliance on the use of debt rather than equity. The effects of a repeal would harm tenants and real estate owners, local property markets and the overall economy.

The study debunks the popular misconception that like-kind exchanges are used to indefinitely avoid capital gain and depreciation recapture taxes. The researchers found that in 88% of the real estate like-kind exchanges studied, investors disposed of the exchanged replacement property through a taxable sale, rather than through a second exchange. On average, these subsequent sales of exchanged replacement properties resulted in a 19% percent higher tax liability compared to the sale of a property acquired after an ordinary sale, ultimately generating greater tax revenue.

“This study demonstrates that in the case of real estate exchanges, taxes are ultimately paid to the Treasury, and at the same time, exchange transactions boost investment and create a healthy economic environment for the real estate market” said Mary Cunningham, President of the Federation of Exchange Accommodators, a member of The Real Estate Like-Kind Exchange Coalition. She noted that the study found that like-kind exchanges are associated with an average replacement property investment that is 33% higher than in a non-exchanged property.

The commercial real estate impact study dovetails with a macro-economic study of §1031 repeal released by Ernst & Young LLP in March 2015. The Ernst & Young study also found the cost of like-kind exchanges to the Treasury is likely overstated since government estimates of the tax cost do not account for the effect of a repeal on ancillary businesses and the broader economy. The authors of both studies concluded that the true cost of like kind exchanges is a mere fraction of government estimates in the long run.

The full study can be found here.

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The Coalition is comprised of more than a dozen industry associations whose members represent a diverse group of U.S. business owners and individuals.