



The Voice of the 1031 Industry

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May 6, 2020

Mr. Leon Cooperman
Chairman and Chief Executive Officer
Omega Family Office, Inc.
810 Seventh Avenue – 33rd Floor
New York, New York 10019

RE: Comments Calling for End of Like-Kind Exchanges

Dear Mr. Cooperman,

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 your call for the elimination of like-kind exchanges in your Oct. 30, 2019, letter to Senator Elizabeth Warren as well as your comments on multiple CNBC programs, including your most recent interview on April 23, 2020. We write to provide you with some practical and empirical data to dispel common misunderstandings of Section 1031, as well as the economic stimulus powered by like-kind exchanges, who benefits, the ultimate payment of the taxes, and the tax policy underpinning this 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 microeconomic study by Professors David Ling and Milena Petrova, focusing on commercial real estate, found that 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.

A macroeconomic analysis by Ernst and Young quantified the benefit of like-kind exchanges to the U.S. economy by recognizing that the exchange transaction is a catalyst for a broad stream of economic activity involving businesses and service providers that are ancillary to the exchange transaction, including brokers, appraisers, insurers, lenders, contractors, suppliers and others that support, augment or facilitate the exchange and the investment, along with other small businesses whose livelihood depends on the after-tax dollars of gainfully employed workers. The 2015 Ernst &

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 and 10, <http://www.1031taxreform.com/wp-content/uploads/Ling-Petrova-Economic-Impact-of-Repealing-or-Limiting-Section-1031-in-Real-Estate.pdf>.

Young study found that either repeal or limitation of like-kind exchanges could lead to a decline in U.S. GDP of up to \$13.1 billion annually.²

Tax IS paid on the overwhelming majority of exchanged properties. The 2015 Ling and Milena Petrova found that an overwhelming majority (88%) of replacement properties acquired in a §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.³ 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 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 unrelated businesses upstream and downstream from the exchange transaction. Eliminating or limiting like-kind exchanges would have a contraction effect on our economy by increasing the cost of capital, slowing the rate of investment, increasing asset holding periods, and reducing transactional activity. Given the current and future economic climate, our nation's tax policies should encourage, rather than hinder, the survival and successful growth of small and mid-sized businesses.

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

Sincerely,

Federation of Exchange Accommodators

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² Ernst & Young, *Economic Impact of Repealing Like-Kind Exchange Rules*, (Mar. 2015, Revised Nov. 2015), at (iii), <http://www.1031taxreform.com/wp-content/uploads/Ling-Petrova-Economic-Impact-of-Repealing-or-Limiting-Section-1031-in-Real-Estate.pdf>.

³ Ling and Petrova, *Economic Impact*, at 5.
FEA ltr to Cooperman 5-6-20