The DI Wire

Study Finds 1031 Exchanges Generate $7.8 Billion in Tax Revenue

https://thediwire.com/study-finds-1031-exchanges-generate-7-8-billion-in-tax-revenue/

June 03, 2021

As the Biden Administration proposes placing limits on a century-old tax deferral provision, a new research study conducted by Ernst and Young found that 1031 exchanges are expected to generate $7.8 billion in federal, state and local taxes this year.

Since 1921, Section 1031 of the Internal Revenue Code has allowed investors to postpone paying capital gains taxes on investment property sales if they reinvest the proceeds into a similar investment property within a

specified time frame. Typically, once a property is sold, investors have 45 days to identify a replacement property and 180 days to complete a 1031 exchange transaction.

Ernst and Young partnered with a coalition of industry groups, such as the Alternative & Direct Investment Securities Association and the Institute for Portfolio Alternatives, to estimate the current economic activity supported by the like-kind exchange rules within the U.S. economy in 2021.

The macroeconomic study estimates that 1031 exchanges and their associated activity support approximately 568,000 jobs, generating $27.5 billion in labor income to the national economy and $55.3 billion to the U.S. gross domestic product in 2021.

In addition to the approximately $7.8 billion in federal, state and local taxes, foregone depreciation, or reduced deductions, on the replacement properties, is estimated to bring in another $6 billion per year in income tax revenue.

The Biden Administration has proposed capping gains deferred under like-kind exchanges at $500,000 to pay for the $1.8 trillion American Families Plan.

Julie Baird, president of the Federation of Exchange Accommodators, said that a cap on like-kind exchanges would "effectively eliminate Section 1031 and cripple the commercial real estate market."

The DI Wire
Not for public use, for reference only

"Many large commercial properties such as hotels, office buildings and retail spaces need to be reimagined or renovated as a result of the pandemic," said Baird. "These exchanges generate jobs for people such as contractors, construction workers, building material suppliers and many more. Without Section 1031, people will simply hold onto their properties instead of repurposing them."

Another study released last year, The Tax and Economic Impacts of Section 1031 Like-Kind Exchanges in Real Estate, found that eliminating 1031 exchanges would disrupt many local property markets, harm both tenants and owners, and small investors.

The study was conducted by David Ling Ph.D., a professor at the University of Florida, and Milena Petrova Ph.D., an associate professor at Syracuse University. It was sponsored by a coalition of advocacy groups led by the Real Estate Research Consortium, which includes ADISA and the IPA.

As part of the study, the authors analyzed CoStar data from approximately 816,000 property transactions that took place in 880 core-based statistical areas from January 1, 2010 until June 30, 2020, with a median price of $1.1 million and a total transaction volume of $3.4 trillion.

The authors concluded that the share of 1031 exchanges likely range from 10 to 20 percent of all commercial real estate transactions over the sample period. In addition, the median sale price of a property involved in a 1031 exchange in 2018 and 2019 equaled approximately $500,000.

The Ling and Petrova study also found that 1031 buyers invest more capital into replacement properties than

non-1031 buyers.

In his recent article, Don’t Call it a Loophole!, ADISA’s executive director John Harrison discusses why 1031 exchanges are not a “shady, tax-avoidance scheme conducted by large, faceless corporations.”

“The word ‘loophole’ paints all real estate owners as dubious rulebreakers looking to take advantage of our real estate system,” said Harrison. “This could not be further from the truth. We work in one of the most highly regulated industries in the world, and Section 1031 is a valid and vital tool utilized by small and large real estate investors alike.”

According to the Ling and Petrova study, 80 percent of properties acquired through an exchange are later sold in a taxable transaction, at which time the tax is paid. The remaining 20 percent includes all non-taxable transfers such as foreclosure, eminent domain, partition or other court ordered transfer, divorce, partnership dissolution, gift and death.

Securitized 1031 exchange programs are also structured as securities and sold through the broker-dealer community, with the vast majority structured as Delaware statutory trust offerings.

Click here to visit The DI Wire directory page.

Not for public use, for reference only