



*The Voice of the 1031 Industry*

June 18, 2024

**FEA Letter To:  
Republican Ways and Means Community Development Tax Team  
Republican Ways and Means Main Street Tax Team  
Republican Ways and Means New Economy Tax Team  
Republican Ways and Means Rural America Tax Team**

The Federation of Exchange Accommodators (FEA) expresses strong support for preserving the like-kind exchange rules under Internal Revenue Code Section 1031. The FEA is the trade association for Qualified Intermediaries (QIs) that facilitate tax deferred exchanges performed in accordance with Section 1031 of the Internal Revenue Code.<sup>1</sup> Section 1031 is a time-tested provision critical to the continued growth in U.S. commercial real estate market and the well-being of communities across the country.

In a like-kind exchange, an investor can elect to defer the taxation of capital gain on the disposition of investment or business-use real property if the taxpayer reinvests the proceeds in another property of a like-kind, in a short window of time.<sup>2</sup> The capital investment spurred by section 1031 supports a positive cycle of job-creating reinvestment in American communities. In so doing, like-kind exchanges increase economic mobility for cash-poor small business owners, farmers, and entrepreneurs including minorities, women, and veterans, while contributing to environmental conservation efforts, housing affordability, and redevelopment in economically impacted cities and towns.

**President Biden’s FY 2025 Budget.** We respectfully urge you to reject the proposal to restrict section 1031 included in President Biden’s FY 2025 Budget, which caps a like-kind exchange transaction to \$500,000. Given the state of the current real estate market, this will effectively repeal section 1031. **The FEA strongly supports retention of section 1031 in the tax code without amendment.**

The following highlights the benefits of section 1031 and tangible examples of uses of like-kind exchanges across the country.

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<sup>1</sup> See [Federation of Exchange Accommodators](#). Members include Qualified Intermediaries (QIs), their primary tax and legal counsel, and affiliated industries (TIC sponsors, banks, real estate brokers, title companies, settlement/escrow agents, etc.). Formed in 1989, the FEA was organized to promote the discussion of ideas and innovations in the industry, to establish and promote ethical standards of conduct for QIs, to offer education to both the exchange industry and the general public, and to work toward the development of uniformity of practice and terminology within the exchange profession.

<sup>2</sup> See 26 U.S. Code § 1031.

## **Benefits of Section 1031 Real Estate Like-Kind Exchanges**

**Like-kind exchanges are important to the health, recovery, and realignment of U.S. commercial real estate, due to the impacts of COVID-19 and higher interest rates.** By allowing tax deferral when one commercial property is exchanged for another, like-kind exchanges facilitate the movement of real estate into the hands of new owners with the time, resources, and desire to restore and improve them. This is particularly important given the need to repurpose or renovate many properties, specifically in the office, retail and hotel sectors, to meet post-pandemic needs. Without section 1031, many of these properties would deteriorate. They would remain underutilized because of the tax burden that would apply to an outright sale. In this way, like-kind exchanges are a powerful economic development tool that accelerates domestic investment. The provision is facilitating a faster and smoother transition to the post-pandemic economy.

**Like-kind exchanges contribute to financial stability in the commercial real estate market and the economy.** Exchanges have helped offset the general, post-pandemic decline in commercial real estate activity associated with rising interest rates and maturing loans, work-from-home trends, and economic uncertainty. In the first half of 2023, overall commercial real estate transaction activity fell more than 22% below its pre-pandemic level in 2019.<sup>3</sup> At the same time, industry data suggests the number of like-kind exchanges initiated increased nearly 15%.<sup>4</sup> This sustained exchange activity in a weakened market has supported price stability and reduced the likelihood of a market shock. As noted by Marcus & Millichap, one of the largest commercial real estate brokerages, “the liquidity created by 1031 exchanges can reduce the risk of commercial property default, which in turn reduces risk in the banking and financial systems that would otherwise imperil the broader financial market.” A 2020 study<sup>5</sup> estimates that at least 10-20% of commercial real estate transactions involve a like-kind exchange, which may be even more today.

**Like-kind exchanges, both large and small, are an engine of job creation.** Research by Ernst and Young reported that in 2021 economic activity generated by like-kind exchanges supported 976,000 jobs generating \$48.6 billion of labor income and contributing \$97.4 billion to the US GDP.<sup>6</sup> Employment directly and indirectly supported by exchanges includes jobs for skilled tradesmen, laborers, architects, designers, building material suppliers, movers, building maintenance and cleaning staff, security, landscapers, QIs, real estate brokers, title insurers, settlement agents, attorneys, accountants, lenders, property inspectors, appraisers, surveyors, insurers, and contractors.

According to Ernst and Young, this economic activity generated \$13.1 billion in federal, state, and local tax revenue. They also found that like-kind exchanges produce an additional \$6 billion in federal tax revenue due to foregone depreciation (reduced deductions) on the replacement property. Since 1031 exchanges generate significantly more revenue than would result from

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<sup>3</sup> Real Capital Analytics.

<sup>4</sup> Federation of Exchange Accommodators.

<sup>5</sup> Professors David Ling and Milena Petrova, “Tax And Economic Impacts Of Like-Kind Exchanges In Real Estate” (October, 2020), <https://1031buildsamerica.org/study-ling-petrova-2020/>.

<sup>6</sup> EY, ““Economic Contribution Of The Like-Kind Exchange Rules To The US Economy In 2021” (May, 2022), <https://1031buildsamerica.org/study-ey-lke-macroeconomic/>.

capping the provision, any cap or change to section 1031 would be detrimental to both the public and private sectors of the U.S. economy. By encouraging the reinvestment of capital and stimulating property improvements, exchanges create a more dynamic, job-creating real estate market which benefits the entire US economy.

**Like-kind exchanges can help increase the supply of affordable rental housing.** Like-kind exchanges can fill gaps in the housing supply not covered by other tax incentives for the development of affordable housing. Multifamily housing transactions represent 40% of real estate like-kind exchanges.<sup>7</sup> Tax incentives like the low-income housing tax credit do not apply to land acquisition costs. Investors in rental housing projects can use section 1031 to acquire land for the development of new housing. Expanding workforce housing will require significant investment of private capital. Any new limits on like-kind exchanges would increase the cost of rental housing.<sup>8</sup> The Ling-Petrova study concluded that an owner would have to raise rents significantly on tenants to offset the tax consequences of repealing section 1031.

**States and localities depend on like-kind exchanges for tax revenue.** Like-kind exchanges generate much-needed tax revenue for states and localities. The more frequent turnover of real estate attributable to section 1031 generates property transfer taxes and recording fees, as well as property reassessments that increase the tax base. Most importantly, because of lower debt and greater capital investment rates, the taxes paid on the subsequent sale of these properties are significantly greater.

**Taxes are frequently collected in the year of the like-kind exchange. This also benefits state and local governments.** The Ling-Petrova study found that in more than a third of exchanges, property owners pay some capital gains tax in the year of the exchange because of differences in the values of the replacement and relinquished property. The Ling-Petrova study found that fewer than 20% of replacement properties are disposed of through a subsequent like-kind exchange. In addition, the overwhelming majority of replacement properties acquired in a like-kind exchange are ultimately disposed of through fully taxable sales (not subsequent like-kind exchanges).

**Farmers, ranchers, and forest owners rely heavily on like-kind exchanges.** Farmers, ranchers, and forest owners use like-kind exchanges to reconfigure their businesses so that beginning farmers can join the business. A cap on like-kind exchanges would make it difficult to restructure farm operations and discourage the next generation of potential farmers from entering the business. Retiring farmers can exchange what may be their most valuable asset, their farm or ranch, for other real estate without diminishing the value of their life savings.

**Like-kind exchanges promote land conservation and environmental protection.** Land conservation organizations and farmers rely on like-kind exchanges to preserve open spaces for public use or environmental protection. Land conservation transactions often involve the exchange of environmentally sensitive areas for other less sensitive privately held property, which can be put into production. These transactions protect environmentally significant land and open space for the future while enabling private landowners to preserve capital for expansion or diversification of existing operations, retirement, or other needs.

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<sup>7</sup> Supra note 5 at 57, “Table 2: Distribution of 1031 exchanges based on CoStar data by property type.”

<sup>8</sup> Supra note 5 at 34-36.

**Section 1031 is well designed, promotes capital formation and makes the economy more efficient.** Section 1031 expands opportunities for businesses to relocate to better, more productive locations. The provision increases taxpayers’ ability to exchange older real estate assets for newer real estate assets better suited to the needs of surrounding communities and tenants. By eliminating the “lock-in” effect caused by taxing prior gain at the time of a transaction, exchanges increase the velocity of reinvestment—the rate at which businesses convert real estate assets to better match their business needs, to operate more efficiently, or to generate more income. Taxpayers using a like-kind exchange acquire replacement property that is valued more than 15% higher on average than the relinquished property.<sup>9</sup>

**Rules for like-kind exchanges are narrowly tailored and well-designed.** Congress first codified like-kind exchanges in 1921, not long after enactment of the income tax itself. Over time, Congress has modified and improved the provision. Since 1984, laws have eliminated potential abuses, created strict and uniform rules and procedures, and tightened section 1031 to avoid unintended results. In 2017, Congress narrowed the provision to apply only to real property.

**The deferral of tax on gains reinvested in a business represents a sound tax policy that is consistent with other provisions of the tax code.** The tax law has long treated most business entity formations, restructurings, and combinations as transactions that do not, and generally should not, give rise to the recognition of gain. See, e.g., I.R.C. §§ 351, 721. This is true even though, unlike section 1031, they all involve a transfer of property, from one taxpayer to another, in exchange for property that is materially different in kind. These nonrecognition rules ensure that the built-in gain or loss (and other tax attributes) of the party benefiting from nonrecognition are preserved, for future taxation in the ordinary course, largely as if the transaction had not occurred.

**A powerful tool for retirement savings.** The self-employed often own commercial real estate as part of, or incidental to, a small business venture, such as a farm, restaurant, or active service business. These investors often lack a company-sponsored 401(k) plan, and reinvesting proceeds from the sale of actively managed real estate into institutionally managed, passive interests in real estate through a like-kind exchange may be their only form of retirement saving. Much like traditional pension and deferred contribution plans, these arrangements allow small business owners and the self-employed to generate long-term income and a secure retirement.

**Like-kind exchanges help small and minority-owned businesses expand and grow.** Veteran-owned, women-owned, and minority-owned businesses were hit especially hard by the pandemic, higher interest rates, and inflation. These firms, and other small companies can use like-kind exchanges to expand and build equity in their companies without having to rely on bank loans and other third-party lending that can be difficult to obtain. Small firms and entrepreneurs lack access to the deep capital markets. Like-kind exchanges can help small and minority-owned businesses grow organically, without overreliance on unsustainable levels of debt and leverage. Properties

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<sup>9</sup> Supra note 5 at 70, “Table 13: Summary statistics for differences between replacement and relinquished property prices for like-kind exchanges vs. ordinary sales by state.”

acquired in a like-kind exchange carry less overall debt—30% less than similar real estate acquired outside of a like-kind exchange.<sup>10</sup>

### **Examples of the Use of Real Estate Like-Kind Exchanges**

#### **1. Like-kind exchanges are important to the health, recovery, and realignment of U.S. commercial real estate, due to the COVID impacts and higher interest rates.**

(A) During the previous recession, a large office tower in a city center owned by a failed financial institution unexpectedly came to market. As part of a like-kind exchange, a life insurer acquired the building, moved an operating subsidiary into the space and turned a dark office tower that would have been an ongoing blight in the city center into an economically vibrant and profitable space. Today, like-kind exchanges can be used as a similar tool when repurposing large retail and other commercial structures that may become available as a result of altered post-pandemic business models.

#### **2. Like-kind exchanges contribute to financial stability in the local commercial real estate market and the economy.**

(A) In Naperville, Illinois, a rundown shopping center where a K-mart had been, was revitalized using a 1031 exchange. The new 1031 buyers upgraded the property and signed Costco as an anchor tenant. Additional tenants filled in the remaining spaces and a worn-out property became vibrant again.

#### **3. Like-kind exchanges, both large and small, are an engine of job creation.**

(A) As part of a like-kind exchange, a farmer sold a parcel of land located on the outskirts of a metropolitan area to a local YMCA to construct a new building. The transaction created new jobs at the YMCA, improved surrounding roads and increased recreational and fitness opportunities for the community. In return, the farmer acquired a single-family rental property, which can be used as a tool for retirement savings.

(B) A family-owned garden center located in a small, suburban downtown area had limited space and minimal parking. A drugstore chain approached them with an offer for their location and built a much-needed drug store in the neighborhood. Using a like-kind exchange, the garden-center owners acquired a property that allowed the business to relocate to an area with significantly more space and plenty of parking. The exchange allowed the garden center to better serve customers with an expanded product line and more convenient parking, while still remaining within the community. The new drug store created jobs and filled a retail need in the neighborhood. It also contributes significantly more in local and state taxes.

#### **4. Like-kind exchanges can help increase the supply of affordable rental housing.**

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<sup>10</sup> Supra note 5 at 72, “Table 15: Summary statistics by year for initial leverage used by investors to acquire replacement properties for exchanges and ordinary acquisitions.”

(A) A flooring store located for decades in an industrial area in a large city found its location was no longer positioned to best serve its growing suburban customer base. Additionally, the store's urban industrial area was undergoing revitalization, which increased demand for affordable and low-income housing in the neighborhood. Using a like-kind exchange, the store sold its building in the city and purchased two replacement properties in suburban areas. The exchange allowed the store to move closer to its customers while also freeing up property in the urban neighborhood for much-needed affordable housing.

**5. Farmers, ranchers, and forest owners heavily rely on like-kind exchanges.**

(A) Farmers benefit from 1031 exchange by combining acres and/or exchanging into higher grade farms. For example, a farmer owned two 80-acre tracts of farmland located 20 miles away from his home operation. Farmer's neighbor listed for sale a 160 acre, higher quality tract adjoining the farmer's "home farm." Through a like-kind exchange, the farmer was able to divest the two distantly located 80 acre parcels, acquire the neighboring 160 acre tract, and combine his land holdings into a larger farm of 360 contiguous acres.

The like-kind exchange allowed the farmer to exchange into the new farm without reducing his purchasing power, provided him with the ability to combine his acres, increase operational efficiencies, and add to the original family farm. Section 1031 promotes reallocation of capital to higher quality assets and results in greater operational efficiencies.

(B) Farmers Benefit from 1031 Exchanges by Relocating Farm/Ranch Operations and Keeping Investment Dollars in the United States. An Amish couple owned 80 acres, a livestock operation and their homestead in a community in their home state and were relocating to an Amish community in another state. The couple exchanged out of the land and buildings on their current farm into a comparably priced farm/ranch operation in the new community. Section 1031 allowed the Amish couple to pursue their life plans and continue their farm/ranch activities in their new community without diminishing their purchasing power or ability to earn a comparable living. Property owners can relocate their investment assets, without fear of tax ramifications, to different locations suiting their needs. Section 1031 allows for exchanges of investment or business-use real estate in the United States for other investment or business-use property in the U.S. Domestic property cannot be exchanged for foreign property. Section 1031 incentivizes and promotes investment within the U.S.

**6. Like-kind exchanges promote land conservation and environmental protection.**

(A) A farmer owned 80 acres of environmentally sensitive converted wetlands that had been row cropped. A watershed improvement district offered to buy a permanent conservation easement from farmer whereby the land would be restored to wetlands toward the end goal of improving downstream water quality. Farmer exchanged out of the permanent conservation easement into non-environmentally sensitive crop land. Section 1031 facilitated and promoted the farmer's participation in the conservation program and allowed an exchange into less environmentally sensitive

acres, all while preserving his asset and earning base. Section 1031 incentivizes participation in conservation programs designed to improve water quality, reduce soil erosion and bolster wildlife habitat.

- (B) 1031 Exchange Used in Mississippi River Watershed. Water quality issues have been going on for some time along the Mississippi River. Nutrient discharge from agricultural watersheds in Iowa and other states along the Mississippi watershed has resulted in a large dead zone in the Gulf of Mexico. This is a major concern for the EPA, USDA, state agencies and farm groups. The State of Iowa is implementing a Nutrient Reduction Strategy to make improvements. Locally, concerns for drinking water, flooding impacts, and loss of recreational value are all downstream challenges that benefit from upstream solutions within watersheds.

In response to issues like this, the Iowa Department of Natural Resources (IDNR), the NRCS and other private and public organizations have implemented programs to acquire permanent conservation easements to take environmentally sensitive farm fields out of production, restore wetlands, install buffer strips, stabilize highly erodible acres and otherwise restore water quality to waterways in Iowa and other states that feed the Mississippi River.

Farmers are using §1031 to exchange permanent conservation easements for other productive farmland outside of environmentally sensitive areas without any loss of investment occasioned by immediate tax liability on the gain. 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.

- (C) Grassland Reserve Program. A large grazing association in Southeastern Idaho was approached by the NRCS about placing a Grassland Reserve Program (GRP) easement to the USDA on some grazing land to limit further development and preserve the native grasslands and wildlife habitat. The amount of money generated by the sale of the easement if distributed to the individual members of the Association would not have provided any appreciable benefit after payment of taxes. However, by using §1031 to defer recognition of tax gain, the Association was able to acquire other neighboring properties to block up its ownership, expand its grazing capacity and generally enhance the operations of the Association, without any erosion of investment value. Because of the ranchers' ability to use like-kind exchanges, the NRCS succeeded in its goal of obtaining a limitation on development, enhanced public recreational opportunities and preservation of wildlife habitat and fisheries.

Conservation easement transactions like the examples above, used in conjunction with §1031 exchanges, result in a win-win situation for the landowner/taxpayers, the land itself, and the general public, along with state, local and Federal

governments. The impetus to complete these transactions will be significantly reduced if §1031 is repealed or substantially limited.

**7. Section 1031 is well designed, promotes capital formation, and makes the economy more efficient.**

(A) The Chicago Neighborhood Initiatives (CNI) developed a national grocery store in a food desert in the Bronzeville neighborhood on Chicago's south side. The site was formerly the Ida B. Wells public housing complex. The property had been vacant for more than 15 years. CNI developed a Mariano's grocery store, and a New York investment group purchased a new development through a 1031 exchange. This outside capital infused a rebirth of jobs, housing, and commerce into the Chicago neighborhood.

**8. A potential tool for retirement savings.**

(A) A farming couple owned 1,000 acres of farmland and operated a 150 head dairy operation. The couple had three adult children all living and working in or near the capitol city in their state. None of the children desired to return to operate the dairy operation. The farming couple expected to retire from the farm in five years. Upon retiring, the couple desired to sell their dairy operation and reside near their children and grandchildren. Toward this end, the couple sold off 100 acres of their farm and exchanged into a rental condominium unit in the capitol city. Upon retiring five years later, the couple would be permitted under tax law to convert the previously income producing property into either their second home or their primary personal residence. The couple will retain the remaining 900 acres of farmland and receive an ongoing retirement income stream by renting the acres to a tenant farmer. The like-kind exchange allowed the farming couple to plan for retirement and relocation near their family by exchanging into a different non-farm asset without reducing the value of their nest egg earned through their lifetimes of hard work. Section 1031 serves as a flexible retirement planning tool for farmers and ranchers.

**9. Like-kind exchanges do help small and minority-owned businesses expand and grow.**

(A) A family-owned garden center located in a small, suburban downtown area had limited space and minimal parking. A drugstore chain approached them with an offer for their location and built a much-needed drug store in the neighborhood. Using a like-kind exchange, the garden-center owners acquired a property that allowed the business to relocate to an area with significantly more space and plenty of parking. The exchange allowed the garden center to better serve customers with an expanded product line and more convenient parking, while still remaining within the community. The new drug store created jobs and filled a retail need in the neighborhood. It also contributes significantly more in local and state taxes.



(B) A member of the Asian American Hotels Owners Association (AAHOA) in Texas explained that 1031 exchanges have been essential to the family business. Their strategy has been to acquire run-down buildings via 1031 exchange and turn them into vibrant hotels that people enjoy visiting.

*If you have any questions, please contact David Franasiak, Principal, Williams & Jensen, PLLC at [defranasiak@wms-jen.com](mailto:defranasiak@wms-jen.com).*