National Association of REALTORS®

1031 Like-Kind Exchange Myth Busters

April 2021

The 1031 like-kind exchange tax benefit has been around since 1921--that's 100 years! It is used by a broad range of Americans, including farmers and ranchers, and there is a mountain of data showing its proven economic benefits. If 1031 were repealed or limited, it could cause serious harm to the economy or even a collapse of the already reeling commercial real estate industry.

In his first address to Congress, President Biden proposed limiting the deferral of gain from like-kind exchanges to $500,000.

NAR has been very proactive and vigilant on this issue and cautions that there is a long legislative process ahead. We believe most Members of Congress will understand the risks to the economy of limiting this key tool and reject this proposal.

Let's bust some 1031 Myths:

- **MYTH: 1031 is only used only by the super-wealthy.**
  - **FACT:** Recent data shows that only 5 percent of exchanged properties are held by regular corporations.
  - **FACT:** The vast majority of properties exchanged are actually held by mom-and-pop investors—sole proprietors and pass-through businesses (such as partnerships and S corporations).
- **MYTH: Limiting the use of 1031 to smaller exchanges only impacts high-rollers.**
  - **FACT:** The larger the size of the real property exchange, the more potential the deal has to create jobs because large properties attract big new investments that result in lots of construction as well as ongoing jobs in resulting business enterprises using the updated properties.
  - **FACT:** Once an arbitrary cap is placed on a provision, over time the value erodes due to inflation, limiting the usefulness of the provision to fewer and fewer opportunities.
- **MYTH: Cutting 1031 is an easy way for the government to raise new tax revenue.**
  - **FACT:** Taxes paid are 19-percent higher when a property is exchanged then sold versus never having been exchanged.
  - **FACT:** The great majority of properties now swapped under the like-kind exchange would not be sold if tax was due. Rather, their owners would continue to sit on the property, and the growth opportunity for putting the investment to better use would be wasted with the government collecting little in extra revenue.
- **MYTH: People use indefinite exchanges to avoid paying taxes.**
  - **FACT:** A 2015 study revealed that 88-percent of exchanged properties were later disposed of through a taxable sale and mostly with more tax collected than if the exchange had never happened.
  - **FACT:** Allowing investors a free flow of capital allows them to buy into higher-priced and more productive properties, which creates more tax revenue—and job opportunities and growth.

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The 1031 Like Kind Exchange Is a Key Tool for Investing in Diverse and Inclusive Communities

By Dan Wagner, Senior Vice President Government Relations The Inland Real Estate Group

As property owners strive to put diversity and inclusion concepts into action, the like-kind exchange established in Section 1031 of the U.S. tax code can serve as a powerful tool that fosters economic development and promotes job growth for people from all walks of life.

For 100 years, the like-kind exchange has allowed real estate owners to exchange their property for other income-producing properties and defer the tax on any unrealized gain. When the owner eventually liquidates the investment, the government collects the full amount of taxes. In many cases, the new property grows in value beyond the original investment, thus yielding an even greater value for property owners and increased tax revenue for the government.

Section 1031 can benefit a variety of people in various socio-economic and demographic groups. It is the ultimate equal opportunity tax code provision because it provides an efficient and effective means for individuals to grow their wealth. More importantly, it also assists and incentivizes large economic impact commercial real estate projects in underserved markets that can have a positive effect on low-income, minority, and inner-city neighborhoods.

Investment in Underserved Communities

Recently, the Biden Administration introduced a proposal to cap the amount of 1031 like-kind exchange real estate at just $500,000. Unfortunately, this cap would have a materially negative impact within the communities that his American Families Plan and infrastructure plans are intending to help. By allowing property owners to defer capital gains taxes without a threshold limit, the like-kind exchange encourages and channels those dollars into real estate in underserved areas. For instance, the additional capital saved by not having to pay the tax immediately can be invested to help reposition an abandoned shopping area or an underused warehouse. These outdated properties can be transformed into more productive uses, such as affordable work-force housing or a job-generating e-commerce hub. In fact, the independent Ling and Petrova study confirmed that property owners who leveraged the like-kind exchange garnered appreciably greater capital investment in properties compared to those who purchased without an exchange.

But don't just take my word for it. Here are just a few poignant testimonials that support this position:

"As the Black community explores avenues for growth of their financial opportunities...the 1031 like-kind exchange (as it is) is more important now than ever," said Norman Alexander, President of the Ridgecrest Area REALTOR® Association and a member of the California Association of Black Real Estate Professionals.

"Every time we sell an apartment complex, we use the 1031; and if it were not available, we would not be able to make that transaction," said Bill Brown, 2017 Past President of the National Association of REALTORS® who is an African American business owner of Springhill Real Estate Partners. Brown further stated, "My Company spends anywhere from $7,000 to $10,000 per unit on remodeling. This helps provide jobs for laborers as well as materials such as carpeting, cabinets and many other goods." This continuous remodeling not only provides jobs in the community, but it also improves the quality of life for those who rent and live in these apartments.

David Doig, President and CEO of Neighborhood Initiatives developed a national grocery story in the food desert of a Chicago's Southside Bronzeville neighborhood. The site was formerly the demolished Ida B. Wells Public Housing Complex where it remained a vacant lot for more than 15 years. David's company developed a Mariano's grocery store in its place and then a New York investment group purchased the new development through a 1031 like-kind exchange. This outside capital infused a rebirth of jobs, housing, and commerce into the community.

The 1031 Like Kind Exchange Is a Key Tool for Investing in Diverse and Inclusive Communities

By Dan Wagner, Senior Vice President Government Relations The Inland Real Estate Group

"We need to keep the 1031 like-kind exchange (as it is) in our tax code because it is another tool to encourage private capital to flow into commercial real estate projects that will help revitalize our underserved communities," said Leon Walker, President and CEO of DL3 Realty and developer of the Wholefoods, Starbucks and Chipotle in Chicago's Southside Englewood Community.

Investment in Job Creation

Jobs. Jobs. Jobs. Everyone on both sides of the political spectrum agrees that a robust job market is important for creating pathways to growth in underserved communities. It is a proven fact that like-kind exchanges have a multiplier effect in a community when it comes to creating and maintaining jobs. An Ernst and Young (E&Y) study concluded that if Section 1031 is limited or eliminated, real estate transactions would decrease, the cost of capital would increase, and GDP would contract. The study found that 1031 exchanges generate $4.4 billion in additional investment and 568,000 jobs each year. This equates to labor income of $27.5 billion during 2021. A majority of these jobs come from the capital improvements that are made to properties after a like-kind exchange which create jobs including: electricians, carpenters, plumbers, contractors, masons, and building material suppliers.

An important part of our economy are the trade unions that provide a strong and talented workforce. "Our local IBEW 701 is very involved with economic development and the 1031 like-kind exchange is a great tool to create jobs for our members," said Frank Furco, Business Manager of IBEW Local 701.

Investment in Pension Income for IBEW Local 701 Union Members and More

The International Brotherhood of Electrical Workers Local 701 supports the 1031 like-kind exchange because Section 1031 transactions are important to Real Estate Investment Trusts (REITs) (and therefore the pensions and 401 (k) plans that invest in REITs). Specifically, Section 1031 enables a REIT to effectively manage its real estate portfolio, exchanging properties to manage risk and maximize return. This benefits both working and retired Americans that own REIT stocks in their retirement savings funds, especially trade unions who fund their own pensions. For example, IBEW 701 invests in REITS for their members' pension funds which provides a strong case to ensure REITS remain strong. Many of these members work and live in the very same communities that benefit from the economic expansion provided by the 1031 like-kind exchange.

1031 Like-Kind Exchanges Generate Tax Revenue

From a policy perspective, it is also important to note that capping the 1031 like-kind exchanges could also reduce taxable income to the government. The E&Y Study highlights that tax revenue to federal, state and local governments related to 1031 transactions totals over $7 billion a year. Income and sales tax revenues from jobs and economic activity generated through exchanges would decline significantly if Section 1031 were limited.

Conclusion

It is imperative to help economically underserved and disadvantaged populations. While reasonable minds can debate specifics, it is also important not to do harm to the very same communities we seek to help. A practical and tangible way to help provide opportunities for people from a variety of backgrounds and economic status is through supporting the Section 1031 like-kind exchange and not capping its ability to help transform communities for the better. It is crucial that our elected officials know how essential this tax code provision is to providing opportunities to their constituents in the communities they represent. **Please go to www.ipa.com/1031s/ to learn how you can help preserve this vital tool of economic security.**

1031s Prove Their Worth

April 3, 2021

Originally published NAR's Commercial Connections: https://www.nar.realtor/commercial-connections/1031s-prove-their-worth.

What would really happen if legislators did away with the Section 1031 Like-Kind Exchange in an attempt to raise federal revenues? As commercial real estate professionals know, such a move would have the opposite of the intended effect, stifling economic activity and ultimately eroding GDP. And yet, the 1031 is perennially under threat, says Evan Liddiard, CPA, director of federal tax policy for the National Association of REALTORS®. That's primarily because many legislators and their staff see the provision as a giveaway to the wealthy; they don't have a clear understanding of why tax-deferred exchanges exist or how they work.

NAR is part of a coalition that helped preserve like-kind exchanges of real property during negotiations for the 2017 Tax Cuts and Jobs Act. That coalition has been on high alert since candidate Joe Biden proposed repeal of 1031s as a way to fund certain social programs. And although getting COVID-19 under control has been Job One for the Biden administration, the president's tax plan is likely to surface in the spring or summer. "We have to continuously work on educating Washington about the 1031," says Liddiard.

In late 2020, NAR and its coalition partners began that work anew, updating research that was used back in 2015–2016 to help dispel the myths and demonstrate the benefits of 1031s. However, nothing is more powerful in the eyes of elected officials than real-life examples in their home states, Liddiard says.

REALTORS® are in a great position to share those examples: A majority of REALTORS® working in commercial sales helped to facilitate at least one 1031 exchange in the past several years, according to NAR. Two 1031 success stories, recently published in REALTOR® Magazine and excerpted here, demonstrate the benefits that can accrue to businesses, individual investors, and communities.

Exchange transactions led to new development and jobs in two Chicago-area locations, one now a Mariano's grocery store and the other a Wendy's restaurant.

Success Story 1: Shiny New Anchor

When a grocery chain pulls up stakes, the results can ripple through a community for years. That situation began in 2013, when Safeway announced it was closing its Dominick's Finer Foods stores in the Chicago market, including three locations in suburban Naperville, Ill.

One of those Dominick's properties anchored a shopping mall called Fox Run Square. "Grocery stores are probably one of the safest types of anchored shopping center," says Christine Jeffries, president of the Naperville Development Partnership. But the older centers "tend to get dog-eared and need reinvestment and modernization." The owners may not have money to sink into improvements; at the same time they may be ready to sell it and realize a big capital gain. "So, they just sit on the property."

The 35 investors in Fox Run Square didn't want to do that. They strategized with Rahul Sehgal, chief investment officer at Inland Private Property Corp., and sold the mall to Bradford Real Estate Corp. for $25.6 million in 2014. By using a 1031 exchange, the investment group was able to defer capital gains taxes. Without the exchange, the investors would have held onto the property and tried to renegotiate with the bank, says Sehgal. "Our investors did not have the nearly $30 million of additional capital that the developer spent. Even if they had come up with that kind of money with our assistance, that property would have sat vacant for a long time."

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The deal led to the construction of a new Mariano's grocery store on the Dominick's site in 2016. Most of the mall's tenants, primarily small businesses, stayed on, continuing the employment and services they had long provided the community. "It's about keeping and supporting the small businesses," Sehgal says. "You can't support them unless you have an anchor, no matter how loyal a base they have." The two other former Dominick's properties in Naperville followed a different trajectory. After both were leased by Albertsons Companies, one was still unoccupied in 2020, and the other only recently became home to an Amazon Fresh store. Jeffries said the dark buildings took a toll on the community. "We started seeing a lot of vacancies [nearby]. Albertsons was paying rent, but there wasn't the same traffic, the same vibrancy you would have had if a grocery store had occupied there immediately."

Success Story 2: Farm to Table

In 2014, Craig Fernsler's 95-year-old client sold a farm in Williamsport, Pa., to a company that wanted to build a plant there. Of the $4 million purchase price, a little under $2 million had gone into a passive investment for her.

She wanted to put the remaining funds into a replacement property but didn't know how. "My immediate goal was to find out the client's and her family's risk tolerance and what they were really looking for," says Fernsler, CCIM, senior director at KW Commercial in Blue Bell, Pa.

What Fernsler found, and the family chose, was an investment in a new corporate-guaranteed Wendy's fast-food restaurant in Chicago. "There were minimal risks," Fernsler says. "This was a new 15-year lease with increases in rent that Wendy's would pay my client. And Wendy's would take care of snow removal, lawn care, and any repairs and maintenance. The [client's] kids knew this Wendy's would be staying in business."

The Wendy's was built on the site of a dilapidated warehouse. When it was determined that the groundwater and soil were contaminated, the developer hired a company to oversee removal of the storage tank and collect samples for testing. Eventually, more than 4,200 tons of soil were removed and disposed of in accordance with environmental safety requirements.

"Nobody was working in that run-down warehouse for years," Fernsler says. The restaurant brought employment and drew more people to the area, creating more activity and traffic to nearby businesses. In addition, Fernsler says. "I worked with an attorney and a title company. The developer hired people to construct the building. Engineers were hired, as well as a surveyor, an attorney who took the project through the approval process with the municipality, and the municipality attorneys. Everybody that touched this was paying regular income taxes. And transfer tax was paid when the transaction happened. This kind of transaction creates a chain reaction, but if you take away 1031s, the chain breaks."

About Commercial Connections

Commercial Connections is published four times annually and distributed to members of the National Association of REALTORS® and commercial real estate industry leaders. To subscribe to the newsletter, update your NRDS profile to include commercial interests in the "Field of Business" list.

National Association of REALTORS®

1031 Coalition Letter

March 16, 2021

NAR, along with the rest of the Real Estate 1031 Coalition, sent a letter to the leaders of the tax-writing committees in Congress outlining dozens of reasons why limiting or repealing like-kind exchanges is a bad idea.

March 16, 2021

The Honorable Ron Wyden
Chairman
Senate Committee on Finance
219 Dirksen Senate Building
Washington, DC 20510

The Honorable Richard Neal
Chairman
House Committee on Ways and Means
1105 Longworth House Building
Washington, DC 20515

The Honorable Mike Crapo
Ranking Member
Senate Committee on Finance
219 Dirksen Senate Building
Washington, DC 20510

The Honorable Kevin Brady
Ranking Member
House Committee on Ways and Means
1105 Longworth House Building
Washington, DC 20515

Dear Chairmen Wyden and Neal and Ranking Members Crapo and Brady:

The undersigned organizations support your efforts to broaden the economic recovery and invest in critical, long-term priorities. Recognizing that you will be reviewing the impact of existing tax provisions in the weeks ahead, we write today to underscore the importance of like-kind exchanges to our economy.

Like-kind exchanges of real estate under section 1031 of the tax code support job growth and investment; the health of U.S. commercial real estate and real estate markets; and the preservation of family-owned farms, ranches, and forestland. Communities and nonprofit organizations use like-kind exchanges to conserve land for the benefit of the public and future generations. Gains reinvested in new property through an exchange create a ladder of economic opportunity for small and minority-owned businesses and entrepreneurs, and generate much-needed tax revenue for States and localities. Also, like-kind exchanges increase the supply of affordable rental housing by filling gaps in housing supply not covered by other incentives. For these reasons, and those described below, like-kind exchanges will continue to contribute significantly to the Nation's economic well-being and help us recover more quickly from the pandemic.

Like-kind exchanges will accelerate our economic recovery from the pandemic by preventing real properties from languishing, underutilized and underinvested. By allowing property owners to defer capital gain when one property is exchanged for another, like-kind exchanges help get 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, particularly in the office, retail and hotel sectors, to meet post-pandemic needs. Without section 1031, many of these properties would languish—underutilized and underinvested—because of the tax burden that would apply to an outright sale. In this way, like-kind exchanges are a powerful tool that accelerates domestic investment.

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NATIONAL ASSOCIATION OF REALTORS®

1031 Coalition Letter

March 16, 2021

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 the last four decades, you and your Colleagues have thoughtfully modified and improved the provision. Since 1984, laws have eliminated potential abuses, created strict and uniform rules and procedures for an exchange, and tightened section 1031 to avoid unintended results. Most recently, in 2017, Congress narrowed the provision to eliminate like-kind exchanges for all assets other than real property. As a result of these efforts, like-kind exchanges are now a deeply ingrained and beneficial feature of commercial real estate markets. Today, exchanges represent a large share of overall real estate transaction activity. New research by Professors David Ling (Univ. Fla.) and Milena Petrova (Syracuse U.) estimates that 10-20 percent of commercial real estate transactions involve a like-kind exchange.

Like-kind exchanges help small and minority-owned businesses expand and grow. Veteran-owned, women-owned, and minority-owned businesses have been hit especially hard by the pandemic, and we support provisions in the American Rescue Plan to help these employers. These firms and other small businesses 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 that finance the activities of large corporations. Like-kind exchanges help small and minority-owned businesses grow organically, without overreliance on unsustainable levels of debt and leverage. Because owners are able to reinvest their proceeds on a tax-deferred basis, properties acquired in a like-kind exchange carry less overall debt—30 percent less than similar real estate acquired outside of a like-kind exchange.

Like-kind exchanges are an engine of job creation. New research by EY estimates that like-kind exchanges support 568,000 jobs generating over $55 billion of annual value added, including $27.5 billion of labor income. Employment directly and indirectly supported by exchanges includes jobs for skilled tradesmen, architects, designers, building material suppliers, movers, building maintenance and cleaning staff, security, landscapers, qualified intermediaries, real estate brokers, title insurers, settlement agents, attorneys, accountants, lenders, property inspectors, appraisers, surveyors, insurers, and contractors. By encouraging the reinvestment of capital and stimulating property improvements, exchanges create a more dynamic, job-creating real estate market.

Farmers, ranchers, and forest owners heavily rely on like-kind exchanges. Farmers, ranchers, and forest owners use like-kind exchanges to combine acreage, acquire higher-grade land, mitigate environmental impacts, or otherwise improve the quality of their operations. They may use like-kind exchanges to reconfigure their businesses so that young or beginning farmers can join the business. Retiring farmers are able to exchange 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 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

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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.

Increasing the supply of affordable rental housing requires like-kind exchanges. Like-kind exchanges can fill gaps in the housing supply not covered by other incentives for the development of affordable housing. Multifamily housing transactions represent 40 percent of real estate like-kind exchanges. Expanding workforce housing will require significant investment of private capital. However, tax incentives like the low-income housing tax credit do not apply to land acquisition costs. Investors can use section 1031 to acquire land for the development of new housing. New limits on like-kind exchanges would increase the cost of rental housing. 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 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.

For many Americans, like-kind exchanges are a principal tool for retirement savings. The self-employed often own real estate as part of, or incidental to, a small business venture, such as a farm, restaurant, or service business. These individuals 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. Similarly, prudent portfolio management by institutionally managed real estate funds using like-kind exchanges provides important diversification in retirement savings options for workers investing through 401(k) plans.

Like-kind exchanges reduce the cost of capital and make 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 assets for newer 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 lift the velocity of reinvestment—the rate at which businesses convert 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 percent higher on average than the relinquished property.

Additional federal taxes are collected in the years following a like-kind exchange. Capital gain deferred in an exchange reduces the owner's tax basis in the replacement property. This results in smaller depreciation deductions going forward. In more than a third of exchanges, property owners pay some capital gains tax in the year of the exchange because of

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differences in the values of the replacement and relinquished property. 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). The Ling-Petrova study found that less than 20% of replacement properties are disposed of through a subsequent like-kind exchange.

Like-kind exchanges help stabilize property values and real estate markets during an economic crisis. Finally, like-kind exchanges have helped stabilize commercial real estate markets during the COVID-19-induced economic crisis, and they will continue to do so in its aftermath. During periods of economic stress, exchanges stimulate commerce and facilitate needed price discovery when buyers, sellers, or lenders are otherwise reluctant to engage in transactions. The ability to defer the gain on the relinquished property will often motivate the acquisition of replacement property by a buyer who would otherwise wait until economic conditions had fully recovered. This activity can effectively "unfreeze" property markets and helps avoid deeper swings in property values during severe economic downturns. Moreover, in the post-pandemic economy, many real estate assets will be repurposed to meet shifts in demand. Section 1031 will facilitate a faster and smoother transition, accelerating the economic recovery.

* * *

We share your commitment to addressing structural weaknesses and inequalities in the economy. Today, following years of careful legislating and regulatory rulemaking, section 1031 supports job growth, creates a ladder of economic opportunity for small businesses, cash-poor entrepreneurs, and farm, ranch, and forest owners, and constitutes an important tool for the environmental conservation of land for future generations. For these reasons, like-kind exchanges will have an important role in the economic recovery and beyond. The study on the economic impact of like-kind exchanges by Professors David Ling and Milena Petrova is attached, and we will share the full macroeconomic modeling by EY when it is finalized. If you or your staff would like additional information or have questions regarding like-kind exchanges, please do not hesitate to contact Ryan McCormick of The Real Estate Roundtable at (202) 639-8400 or rmccormick@rer.org.

Sincerely,

ADISA—Alternative & Direct Investment Securities Association
American Farm Bureau Federation
American Hotel & Lodging Association
American Land Title Association
American Resort Development Association
Asian American Hotel Owners Association
Building Owners and Managers Association (BOMA) International
CCIM Institute
Commercial Real Estate Finance Council
Federation of Exchange Accommodators

1031 Coalition Letter

March 16, 2021

Forest Landowners Association
Institute for Portfolio Alternatives
Institute of Real Estate Management
International Council of Shopping Centers
Land Trust Alliance
Latino Hotel Association
Mortgage Bankers Association
NAIOP, the Commercial Real Estate Development Association
Nareit
National Alliance of Forest Owners
National Apartment Association
National Association of Black Hotel Owners, Operators and Developers
National Association of Home Builders
NATIONAL ASSOCIATION OF REALTORS®
National Cattlemen's Beef Association
National Council of Farmer Cooperatives
National Multifamily Housing Council
REALTORS® Land Institute
The Conservation Fund
The Nature Conservancy
The Real Estate Roundtable

Attachments

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Commercial Real Estate Needs Help Stabilizing

July 23, 2020

Originally published in REALTOR® Magazine: https://magazine.realtor/news-and-commentary/commentary/article/2020/07/commercial-real-estate-needs-help-stabilizing .

This article was updated on Oct. 13, 2020.

By Shannon McGahn

Eliminating 1031 like-kind exchanges would hit mom and pop investors hardest and cause a devastating domino effect on the economy.

Thanks to forbearance and other emergency benefit programs, the residential real estate market is holding strong during the pandemic. Millions of Americans are actually seeing their home values increase. This brings a great sense of security to families and a much-needed dose of confidence in the economy.

But not all real estate is equal.

Because of the pandemic, tens of thousands of American small businesses have permanently shuttered, nationwide unemployment rates remain near 8%, and a full economic recovery still appears months away. As a result, new tenants are in short supply, commercial real estate is hemorrhaging, and the effects are impacting commercial property values across the country.

We don't need a history lesson from the 2008 housing crash to know how devastating a domino effect can be to real estate and the overall economy.

Without further intervention, the situation could go from bad to worse. With punitive and misguided new policies, it could go from worse to catastrophic.

One of the pillars of commercial real estate is the 1031 like-kind exchange, which allows investors to defer paying taxes on the sale of real estate if the money is immediately reinvested in another productive property.

"The myth of the indefinite exchange to avoid taxes is just that—a myth."

Some believe like-kind exchanges are used only by the super-rich and think closing this so-called "loophole" would create an easy pot of gold at the end of the rainbow. So, let's bust a few myths about who uses Section 1031 and whom it benefits.

Recent data shows that only 5% of exchanged properties are held by regular corporations. The vast majority are actually held by mom and pop investors—sole proprietors and pass-through businesses such as partnerships and S corporations.

A 2015 study further revealed that 88 percent of exchanged properties were later disposed of through a taxable sale. And taxes paid are 19-percent higher when a property is exchanged then sold versus never having been exchanged.

The myth of the indefinite exchange to avoid taxes is just that—a myth.

Allowing investors a free flow of capital allows them to buy into higher-priced and more productive properties which creates more tax revenue—and job opportunities and growth.

Commercial Real Estate Needs Help Stabilizing

July 23, 2020

The idea that repealing 1031 would raise revenue is a pipe dream. The great majority of properties now swapped under the like-kind exchange would not be sold if tax was due. Rather, their owners would continue to sit on the property, and the growth opportunity for putting the investment to better use would be wasted with the government collecting little in extra revenue.

Beyond the preservation of 1031 like-kind exchanges, other types of assistance are needed to prevent the collapse of commercial real estate.

More initiatives like PPP will help small business owners outlast the pandemic and pay their bills and workers.

Other actions like remote online notarization help stabilize the industry and grease the wheels of commerce. This innovation is so far covered in a patchwork of state rules, but a uniform approach nationwide could be critical during the pandemic.

The real estate industry makes up nearly one-fifth of the entire American economy, and access to property ownership in the U.S. is the envy of the world. Any policy to weaken this foundation harms the economy at a time when we need to deploy every tool possible to support it.

Shannon McGahn

Senior Vice President, NAR Government Affairs
Shannon McGahn is chief advocacy officer for the National Association of REALTORS®. Read her full bio.