

# Congress Signals 1031 Exchange Provision at Risk

The 1031 Exchange Provision may be on the chopping block as Congress searches for changes to raise tax revenue in support of the proposed income tax cuts. A 1031 exchange allows a seller of real estate to defer capital gains taxes by reinvesting in a “like-kind” property, thus allowing an investor to reinvest in the similarly valued property without coming out of pocket; the capital stays in the market. If a sweeping tax reform bill doesn’t get traction in Congress, there is still a good chance a narrower tax rate cut will get passed, according to lobbyists on Capitol Hill working on tax legislation. Congress will be looking for areas of the Tax Code to raise revenue to finance such tax cuts, and the 1031 exchange is one provision that could be at risk.

The 1031 exchange tax benefit is criticized by many Democrats and some Republicans as a loophole that has limited benefits for the economy, thus putting it at risk to pay for lower tax rates. Real estate investors push back, saying getting rid of the provision would be “devastating” to the economy because like kind exchanges are used in up to 20% of commercial real estate transactions (according to a report by Green Street Advisors). A 2015 Ernst & Young study, “**Economic Impact of Repealing Like-Kind Exchange Rules**,” on the economic impact of repealing like-kind exchanges concluded that a repeal would slow economic growth, reduce GDP, and hurt owners of real property and many U.S. small businesses.

Enacted in 1921, 1031 exchanges were originally used by neighboring farmers to manage property lines. Mitigating the possible loss of 103 exchanges is a proposal to allow real estate investors to treat the entire cost of improvements (excluding land) as a business expense versus depreciating the costs over time.

According to the June 13, 2017 *Wall Street Journal* article “**1031 Exchange, a Cherished Real Estate Tax Break, Faces Extinction**,” the House Ways and Means Committee hasn’t yet released a bill and there is disagreement among Republicans about where they are heading. Lawmakers have had “good discussions” on like-kind exchanges but haven’t “come to closure” yet with a decision. Today, the threat to 1031 exchanges is real because the Republican-controlled congress looks to be getting behind it.