Biden Is Going After 1031 Exchanges Again. CRE Is Mobilizing To Stop Him

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News

When President Joe Biden presented his administration's proposed budget for fiscal year 2023, he again included a new tax rule that would essentially eliminate 1031 exchanges, or like-kind exchanges, which are widely used to lower taxes for those buying and selling commercial real estate.

If Biden is able to get the budget past with the new rule in place — capping the capital gains deferral at $500K for an individual and $1M for a couple — real estate experts say it could spell disaster for an already-challenged industry and for the U.S. economy.

Wikimedia Commons/The White House
President Joe Biden in July 2021

After two years of pain from the pandemic's effects on the real estate industry, with inflation at the highest it has been in a generation and interest rates already on the rise, Engineered Tax Services founder and CEO Julio Gonzalez said the proposal, if enacted, would cause a major slowdown for the entire industry.

"During a time where we're having hyperinflation, I think it would be really devastating to the real estate industry. Last week we started raising interest rates, so that already alone hurts the real estate industry," he said. "If you're going to take away 1031, that's like putting the nails in the coffin for most real estate players."

Current policy allows investors to sell a real estate asset and then use sale proceeds to purchase another property of a similar value, so long as they can make a purchase within 180 days. The gain on the sale of the property goes untaxed as long as it is reinvested.

Biden said he would get rid of 1031 exchanges on the 2020 campaign trail and instead expand funding for the care economy. But that elimination has yet to happen. Instead, the newest federal budget proposals suggest keeping lower-value 1031 exchanges intact — a move that real estate investors say is akin to scrapping 1031 altogether.

"The effect of the cap is likely to be very equivalent or close to equivalent to eliminating section 1031," Phillips Nizer LLP Managing Partner and Real Estate Practice co-Chair Marc Landis said. "Being able to defer half a million is small potatoes."

In last year's budget, the Biden administration also proposed modifying 1031 exchanges via a value cap rather than eradicating the policy. And while it never happened, the threat spurred a wave of 1031 exchange activity as real estate investors sought to offload high-cost, high-tax assets in the Northeast and the West Coast in exchange for lower-cost properties in business-friendly Sun Belt locales.

Many mom-and-pop businesses own the real estate that houses their restaurants or shops, and the proposed rule would make it difficult for them to upgrade or move facilities, Landis said. And while bigger players in real estate investment may not face the same existential struggles, Landis says a lack of access to 1031 exchanges will mean investors may be stuck with properties that they can't utilize or renovate.

"This time last year, everybody was racing to complete their 1031 deferral exchanges in 2021 because they were afraid [the elimination] might happen," said Landis, who predicts that a similar rush may happen again if the federal government is able to advance the cap on 1031 exchanges.

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The White House

But real estate investors speaking to *Bisnow* said with real estate lobbyists making their interests clear on Capitol Hill, change to the 1031 policy is unlikely. Evan Liddiard, senior policy representative for federal taxation at the National Association of Realtors, told *Bisnow* in an email that NAR had spent time last year with policymakers on both sides of the aisle explaining the impact of limiting 1031 exchanges.

"NAR opposes any changes to the like-kind exchange rules, and we are redoubling efforts to explain to policymakers the negative impact of a limit in the amount of gain that can be deferred," Liddiard wrote.

NAR and other experts argue that restricting 1031 exchanges will mean property owners are more likely to sit on their assets rather than selling them, causing slowdowns in other industries like construction, spelling bad news for the U.S. economy.

Gonzalez argued that limiting 1031 exchanges is shortsighted. While the move may generate more tax revenue for the federal government to fund other programs, it will mean a slowdown in real estate transactions — generating less gross revenue for the government long-term.

Research from Ernst & Young, prepared on behalf of the 1031 Like-Kind Exchange Coalition and published last May, estimated that current 1031 exchange rules generate $55.3B in economic impact and $4.4B in related consumer spending and investments.

"With every 1031 exchange, even the smallest one, there are probably at least 30 jobs that are generated," IPX1031 Vice President Suzanne Goldstein Baker told *Bisnow* this week. "And when you think about the job generators, it's the much larger properties that generate far more jobs."

The real estate industry effectively convinced Congress to kill the 1031 cap in last year's budget, and the industry's lobbyists are mobilizing in opposition again, exuding confidence that the rule won't see the light of day.

"We have all spent a lot of time and energy educating our policymakers as to the powerful economic stimulus that is provided by section 1031," Goldstein Baker said.

"There's no real appetite for raising this particular tax in Congress in a midterm election year," Landis added. "I don't think it's likely that Congress is going to push this one forward."

Contact Ciara Long at ciara.long@bisnow.com
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