



*The Voice of the 1031 Industry*

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Center for American Progress  
1333 H St., NW, 10<sup>th</sup> FL  
Washington, DC 20005  
Attn: Mr. Harry Stein, Ms. Alexandra Thornton and Mr. John Craig

Dear Mr. Stein, Ms. Thornton and Mr. Craig:

The Federation of Exchange Accommodators (FEA) is the only national trade organization formed to represent exchange facilitators (also known as “qualified intermediaries” or “QIs”) and other businesses that are directly involved in §1031 like-kind exchange activity.

We are writing in response to comments included in your report, “The Growing Consensus to Improve Our Tax Code” related to the proposals to repeal or limit like-kind exchanges under I.R.C. §1031. We support the goal of making the “tax code work better for everyone – not just the wealthy and well connected,” but disagree that repeal or limitation of §1031 will further tax reform goals. The reasons cited in your paper justifying repeal of §1031 are based on myths or are misstatements of the legislative history of §1031.

**Myth 1: The Congressional purpose for §1031 is no longer relevant.**

**Truth: Section 1031 was enacted in 1921 for two primary purposes that are even more relevant today in our global economy.**

The report cites the U.S. Treasury’s General Explanations of the Administration’s FY2015 Revenue Proposals that states (at p.102) that the “rule’s historical justification with respect to real property—the difficulty of valuing exchanged property—is no longer true.”

There were three purposes for §1031 set forth in the Congressional Record from the time of the section’s initial passage. The first two purposes were: **1) avoiding unfair taxation of ongoing investments**, which allows taxpayers to maintain investments in property without being taxed on theoretical (i.e. “paper”) gains and losses during the course of a continuous investment, and **2) encouraging active reinvestment**, which encourages the exchange of property and promotes transactional activity.

A third purpose, administrative convenience, i.e. “the difficulty of valuing exchanged property,” ceased to be relevant to the policy underlying the statute in 1924 when Congress abandoned administrative convenience as a purpose motivating the use of like-kind property exchanges in the Act of March 4, 1924, ch. 294, 1, 42 Stat. 1560. This long-defunct third purpose, which the U.S. Treasury acknowledges is no longer true, is curiously the only rationale for repeal cited by Treasury.

Section 1031 has survived repeated Congressional scrutiny because 1) it is based on sound tax policy that prevents taxation of gain (or deductions for losses) when there is continuity of interest and no cashing out, and 2) it stimulates the economy through transactional activity.

**Myth 2: The absence of a precise definition of “like-kind” is administratively difficult for the IRS and creates the opportunity for abuse.**

**Truth: The definition of “like-kind” is well understood. Section 1031 is neither administratively difficult for either the IRS or taxpayers nor is it abusive.**

The report, citing the Tax Reform Act of 2014, states that “the current rules have no precise definition of ‘like-kind,’ which often leads to controversy with the IRS and provides significant opportunities for abuse.”

Treasury Regulations in effect since 1991 provide specific frameworks for determining whether assets are “like-kind.” Like-kind exchanges conducted within the regulatory safe harbors under §1031 using professional Qualified Intermediaries are straight-forward transactions that follow a well-understood set of rules, procedures and documents. Taxpayers claiming tax-deferral treatment must report certain information on IRS Form 8824 with their tax returns. Determination of whether the rules have been complied with is not complicated. Further, professional Qualified Intermediaries promote compliance, and are subject matter experts who simplify §1031 by guiding clients and their tax advisors through the process, providing proper documentation, holding funds, and offering other services.

**Myth 3: Section 1031 allows taxpayers to avoid capital gains taxes, and to defer gain indefinitely until the gain and related tax are eliminated at death.**

**Truth: Under §1031, taxes are deferred—not eliminated. At some point the tax gets paid.**

The report states that Rep. Camp’s staff “caution that the rules enable investors to defer capital gains taxes for decades or avoid them entirely if the owner of the property dies before realizing their gain for tax purposes.” Citing a journal article, the report also asserts that §1031 rules are frequently used to “avoid capital gains taxes on real estate investments.”

Section 1031 exchanges structured under the IRS regulatory safe harbors using professional Qualified Intermediaries are neither tax savings vehicles nor “abusive tax avoidance schemes.” Rather, they are legitimate transactions utilizing an important tax planning tool. **Payment of tax occurs:** 1) **upon sale** of the replacement asset; 2) incrementally, **through increased income tax due to foregone depreciation**; or 3) by **inclusion in a decedent’s taxable estate**, at which time the value of the replacement asset could be **subject to estate tax at a rate more than double the capital gains tax rate**. It should also be noted that taxpayers utilizing §1031 exchanges include corporations and other business entities that cannot “take the gain to the grave.”

**Myth 4: Like-kind exchanges are used only by the wealthy or well connected.**

**Truth: Like-kind exchanges are used by a broad spectrum of taxpayers at all levels.**

Section 1031 is fair, benefitting taxpayers of all sizes, from individuals of modest means to high net worth taxpayers and from small businesses to large entities. Transactions represent taxpayers at all levels, in all lines of business, including individuals, partnerships, limited liability companies, and corporations. A 2011 FEA industry survey concluded that 60% of exchanges involved properties worth less than \$1 million, and more than a third were worth less than \$500,000. Exchanged properties include real estate, construction and agricultural equipment, railcars, vehicles, ships and other investment and business-use assets. Tax deferral benefits are only available if the taxpayer continues their investment by acquiring like-kind replacement property. This restriction retains value and stimulates economic activity within an economic sector that has a ripple effect. Thus, even the relatively rare exchanges of art and classic cars, cited in your report, stimulate business for auction houses, galleries, artists, framers, insurers, auto dealers, mechanics and body shops.

**Myth 5: Elimination of §1031 like-kind exchanges will raise significant revenue.**

**Truth: When the impacts of 1) the economic stimulus effect of §1031 and 2) the effect of depreciation, are taken into account, any Treasury revenue raised from elimination of §1031 would be negligible.**

The report cites the Joint Committee on Taxation’s estimate that elimination of §1031 will raise approximately \$41 billion over 10 years. This ignores that §1031 is a powerful economic stimulator, encouraging investment in small and medium sized growing businesses, thereby promoting U.S. job growth. Section 1031 exchanges contribute to the velocity of the economy by stimulating a broad spectrum of transactions which, in turn, generate jobs and taxable income through business profits, wages, commissions, insurance premiums, financial services, and discretionary spending by gainfully employed workers. This transactional activity raises state,

local and federal tax revenue through transfer, sales and use taxes and increased property taxes. The loss of this economic stimulus would be costly to the U.S. economy, creating a chilling effect on real estate transactions, reduced demand for manufactured goods, and job loss as many transactions will be abandoned or delayed by taxpayers unwilling or unable to withstand an effective tax on their working cash flow.

With respect to depreciable assets, like-kind exchanges are essentially revenue neutral because gain deferred is directly offset by a reduction in future depreciation deductions available for assets acquired through an exchange. The tax basis of newly acquired replacement property is reduced by the amount of the gain not recognized due to the exchange of the sold property. Thus, the taxpayer forgoes an equal dollar amount of future depreciation deductions on the replacement property, resulting in increased annual taxable income over time, taxed at ordinary income tax rates.

**Conclusion: Section 1031 is neither a loophole nor tax savings vehicle, but rather a powerful economic engine based on sound tax policy that promotes growth and employment.**

The FEA supports the goals of tax reform: to achieve a simpler, fairer, and flatter tax code that is more efficient and results in a broader tax base, minimized economic distortion, greater financial growth, job creation, and a strengthened economy. We realize that reform requires well-reasoned change. We also believe that achieving meaningful reform starts with preserving existing incentives for investment that are proven tools used to spur economic growth and productivity within the United States.

Section 1031 provides significant benefits to taxpayers of all sizes with a “trickle down, spillover” economic stimulus to a myriad of industries and small businesses across the country. This deferral benefit permits efficient use of capital to preserve and manage cash flow. Most importantly, since domestic assets are not like-kind to foreign assets, §1031 encourages U.S. businesses to reinvest in their U.S. operations, rather than offshoring business activity.

Attached are two whitepapers published by the FEA, “*Impact of IRC §1031 on the Economy*” and “*Legislative History of Tax Policies Supporting IRC Section 1031*,” addressing the issues raised in this letter in greater detail. Please feel free to contact any of us should you have any questions or wish to discuss.

Sincerely,

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