

An update to the “Economic contribution of the like-kind exchange rules to the US economy in 2021”

Prepared on behalf of the 1031 Like-kind Exchange Coalition

May 2022

Key findings: Economic activity supported by the like-kind exchange rules in 2021

Annual impact relative to size of US economy in 2021

976k Total jobs supported by like-kind exchange rules



46%

447k jobs

Businesses that make use of like-kind exchange rules



21%

209k jobs

Suppliers to businesses that make use of like-kind exchange rules



33%

320k jobs

Related consumer spending

\$48.6b Total labor income supported by like-kind exchange rules



40%

\$19.4b labor income

Businesses that make use of like-kind exchange rules



27%

\$13.0b labor income

Suppliers to businesses that make use of like-kind exchange rules



33%

\$16.1b labor income

Related consumer spending

\$97.4b Total value added supported by like-kind exchange rules



40%

\$39.3b value added

Businesses that make use of like-kind exchange rules



27%

\$26.1b value added

Suppliers to businesses that make use of like-kind exchange rules



33%

\$32.0b value added

Related consumer spending

Outline

- ▶ Update to May 2021 EY report on like-kind exchange rules
- ▶ Overview of the like-kind exchange rules
- ▶ Tax and economic policy rationale for like-kind exchange rules
- ▶ Modeling approach
- ▶ Estimating the direct economic activity supported by the like-kind exchange rules
- ▶ Estimating spillover economic activity supported by like-kind exchange rules
- ▶ Key results: Economic activity supported by the like-kind rules
- ▶ Annual direct investment supported by the like-kind exchange rules, by industry, 2021
- ▶ Employment supported by the like-kind exchange rules, by industry, 2021
- ▶ Taxes paid by, and related to, the use and users of the like-kind exchange rules
- ▶ Sensitivity of economic contribution estimates
- ▶ Caveats and limitations

Update to May 2021 EY Report

- ▶ Original May 2021 report assumed that the level of like-kind exchange activity in 2021 would follow projections for overall economic growth to recover to 2019 levels.
- ▶ However, the economic recovery was accompanied by a surge in like-kind exchange activity, in part, due to the transition of many qualified real property assets to new or modified uses to meet post-pandemic business models and needs.
- ▶ EY surveyed nine qualified intermediaries facilitating like-kind exchanges in different market segments and geographies representing large national companies as well as small-to-medium sized regional companies.
- ▶ The survey found that the dollar volume and number of transactions of relinquished and replacement properties between 2019 and 2021 increased by about 70%.
- ▶ The 70% increase in like-kind exchange activity from 2019 to 2021 was used to update the estimates in the original May 2021 report.

Overview of like-kind exchange rules

- ▶ Like-kind exchange rules: “the exchange of real property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment.”

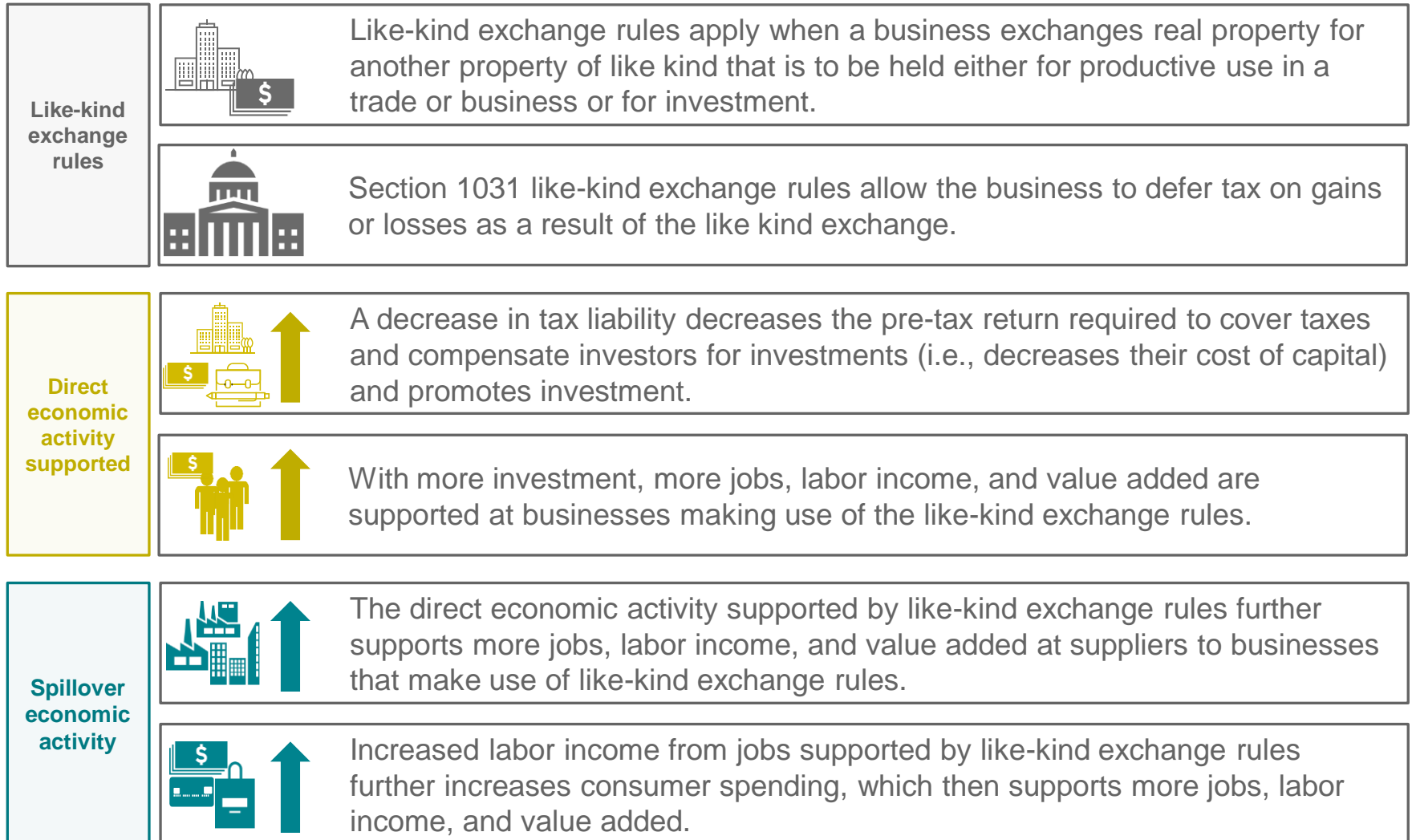
Internal Revenue Code Section 1031

- ▶ A taxpayer exchanging like-kind property is not required to recognize a taxable gain or loss at the time of the exchange; tax is deferred.
- ▶ Businesses: Expand opportunities to relocate to better locations, increase the ability to exchange older and sometimes inefficient assets for more efficient properties, and otherwise better align business assets with current and future business needs.
- ▶ Overall economy: Reduce the tax impediments to the transfer of property, which improves the overall allocation of capital by making it easier to assign assets to their most productive uses.

Tax and economic policy rationale for like-kind exchange rules

- ▶ Rationales for deferring tax on gains and losses realized in like-kind exchanges
 - ▶ Encourages investment and transactional activity. Imposing tax on continuing investment discourages and slows the velocity of investment, resulting in market illiquidity and increased cost of capital.
 - ▶ Better matching of investments with business needs. Tax deferral permits a business to expand opportunities to relocate, consolidate or acquire better, more efficient assets that meet current and prospective needs.
 - ▶ Improved allocation of capital. Reducing impediments to the transfer of property improves the overall allocation of capital and encourages the highest and best use of real property.
 - ▶ Preservation of cash-flow. A like-kind exchange preserves cash flow and avoids liquidation of other assets or increased reliance on debt financing due to tax considerations.
 - ▶ Expensing unavailable. Unlike personal property, real property cannot be expensed.

Modeling approach



Estimating the direct economic activity supported by the like-kind exchange rules

- ▶ Like-kind exchange rules encourage investment by reducing the tax cost of investment.
- ▶ Taxes raise a business' cost of capital because the business has to earn enough to cover taxes and still pay a competitive return to investors.
- ▶ This analysis estimates the cost of capital* with and without the like-kind exchange rules.
- ▶ An estimate of the responsiveness of investment to the cost of capital (the “investment elasticity”) from economic research is then applied to estimate the investment supported by the like-kind exchange rules.
- ▶ The change in investment is then translated into jobs, labor income, and value added based on the composition of like-kind exchange activity.
- ▶ The baseline amount of investment, jobs, labor income, and value added for businesses that make use of like-kind exchange rules is estimated primarily from capital stock data from the US Bureau of Economic Analysis (BEA) and analysis from Ling and Petrova (2020) that uses real estate data from CoStar.

* This framework is commonly used by the Congressional Budget Office, Congressional Research Service, Joint Committee on Taxation, and US Treasury Department and accounts for the major features of the federal income tax system (e.g., tax depreciation, tax rates, investor-level taxes).

Estimating spillover economic activity supported by like-kind exchange rules

- ▶ An input-output model of the US economy (IMPLAN Model) is then used to estimate the supplier purchases and consumer spending related to the economic activity directly supported by the like-kind exchange rules:
 - ▶ Supplier purchases supported by like-kind exchange rules. Like-kind exchange rules support purchases of goods and services from other businesses, which support jobs, labor income, and value added at these supplier businesses. Moreover, demand for these goods and services leads to additional rounds of economic activity as suppliers to the businesses purchase operating inputs from their own suppliers, and so on.
 - ▶ Consumer spending supported by like-kind exchange rules. This refers to the consumer spending supported by workers at the businesses that make use of like-kind exchanges and their suppliers. When these workers spend their earnings at US businesses (e.g., grocery stores, retailers, movie theaters), they support economic activity in those sectors. The earnings that these workers spend on food at a restaurant, for example, supports jobs at the restaurant and at farms, transportation companies, and other businesses that are involved in the restaurant's supply chain.

Key results: Economic activity supported by the like-kind rules

Economic activity supported by the like-kind investment at businesses that make use of the like-kind exchange rules

	Businesses that make use of the like-kind exchange rules	Suppliers and related consumer spending	Total
Employment	447,000	529,000	976,000
Labor Income	\$19.4 billion	\$29.1 billion	\$48.6 billion
Value Added	\$39.3 billion	\$58.1 billion	\$97.4 billion

Note: All estimates are for economic activity in the United States and are relative to the US economy in 2021. Labor income is a component of value added. Figures may not sum due to rounding.
Source: EY analysis.

Employment supported by the like-kind exchange rules, by industry, 2021

NAICS description	Businesses that make use of the like-kind exchange rules	Suppliers and related consumer spending	Total
Leisure and hospitality	145,600	61,600	207,200
Trade, transportation, and utilities	124,800	90,400	215,200
Financial activities	49,000	75,800	124,800
Education and health services	43,100	65,200	108,300
Professional and business services	42,100	111,500	153,600
Manufacturing	17,400	30,000	47,400
Other Services	14,600	59,900	74,500
Construction	6,700	8,200	14,900
Information	2,100	9,700	11,800
Natural resources and mining	1,600	16,700	18,300
Total	447,000	529,000	976,000

Note: All estimates are for economic activity in the United States and are relative to the US economy in 2021. Figures may not sum due to rounding.

Source: EY analysis.

Taxes paid by, and related to, businesses that make use of the like-kind exchange rules, 2021

Dollars in millions

	Businesses that make use of the like-kind exchange rules			Related suppliers	Related consumer spending	Total
	Business taxes	Employee taxes	Total direct			
Federal taxes	\$1,085	\$2,190	\$3,275	\$2,205	\$2,725	\$8,205
Individual income taxes	\$190	\$1,420	\$1,610	\$1,080	\$1,330	\$4,020
Payroll taxes	\$650	\$650	\$1,300	\$880	\$1,090	\$3,270
Corporate income taxes	\$210	\$0	\$210	\$140	\$180	\$530
Excise taxes	\$25	\$60	\$85	\$60	\$70	\$215
Customs duties and fees	\$10	\$60	\$70	\$45	\$55	\$170
State and local taxes	\$755	\$1,200	\$1,955	\$1,310	\$1,610	\$4,875
Property taxes	\$310	\$250	\$560	\$380	\$470	\$1,410
Sales taxes	\$180	\$270	\$450	\$300	\$370	\$1,120
Individual income taxes	\$0	\$520	\$520	\$350	\$430	\$1,300
Excise, license, and other taxes	\$190	\$160	\$350	\$230	\$280	\$860
Corporate income taxes	\$75	\$0	\$75	\$50	\$60	\$185
Total taxes	\$1,840	\$3,390	\$5,230	\$3,515	\$4,335	\$13,080

Note: All estimates are relative to the US economy in 2021. Figures may not sum due to rounding.

Source: EY analysis.

Sensitivity of economic contribution estimates

- ▶ The holding period of the real property exchanged for a like-kind real property, considering depreciation schedules, can have a significant impact on the economic activity supported by the like-kind exchange.
- ▶ While a “central” holding period of approximately 8.5 years was used, a result from an EY survey of businesses that make use of the like-kind exchange rules, actual holding periods can vary.
- ▶ The figure below presents estimates using a shorter holding period (“short”) of approximately 7 years and a longer holding period (“long”) of approximately 12 years.

Total economic contribution; dollars in billions, employment in thousands



Note: All estimates are for economic activity in the United States and are relative to the US economy in 2021. Labor income is a component of value added. Figures are rounded.
Source: EY analysis.

Caveats and limitations

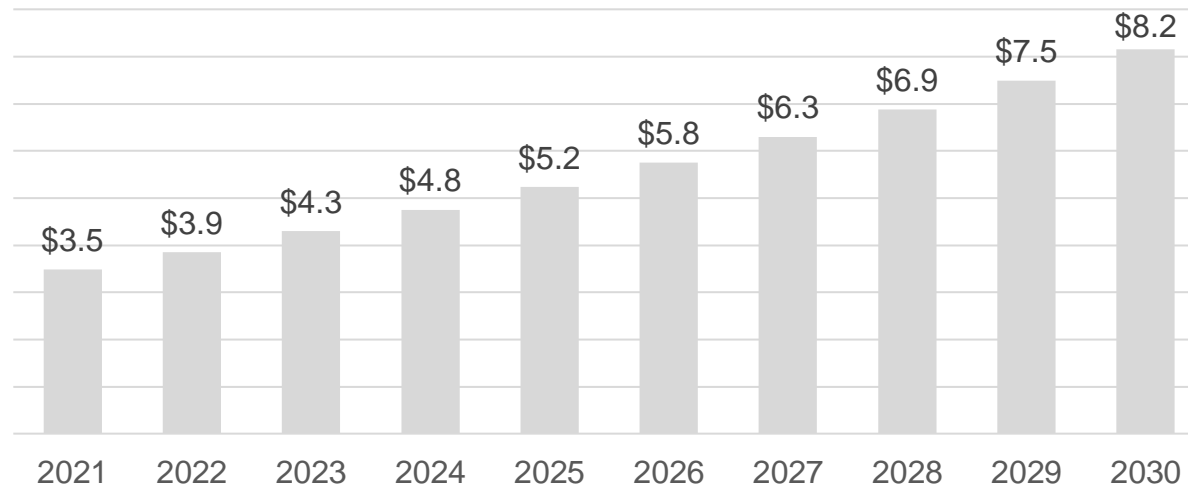
Any modeling effort is only an approximate depiction of the economic forces it seeks to represent, and the economic model developed for this analysis is no exception. Several limitations and caveats are noteworthy:

- ▶ **Results show a static snapshot of economic activity.** The input-output modeling approach used in this analysis shows the 2021 economic activity of businesses that make use of the like-kind exchange rules based on their relationships with other industries and households in the US economy. The results do not reflect the impacts of an expansion or contraction of economic activity.
- ▶ **Amount of like-kind exchange activity in 2021 uncertain.** This analysis of the economic activity supported by the like-kind exchanges rules relies on the most recent data available plus a survey of like-kind exchange activity in 2019 and 2021 of nine qualified intermediaries to estimate the level of like-kind exchange activity in 2021. Accordingly, the estimates contained in this report reflect the surge in like-kind activity as business began to transition real property assets in the aftermath of the pandemic. These high-level estimates may under- or overestimate the level of like-kind exchange activity in 2021.
- ▶ **Estimates are limited by available public information.** The analysis primarily relies on information reported by the US BEA and Ling and Petrova (2020), which relies on data obtained from CoStar. The analysis did not attempt to verify or validate this information using sources other than those described in the report.
- ▶ **Analysis only examines the amount of investment that is supported by the like-kind exchange rules.** In addition to the potential economic activity that is supported by the investment activities themselves, there would be expected benefits related to the more efficient allocation of capital, which are not quantified in this analysis but would be in addition to the impacts presented. Moreover, the like-kind exchange rules affect the amount of revenue raised by the federal government. This change in revenue results in a change in the federal deficit, government spending or transfers, other taxes, or a combination thereof. These changes in turn, impact the US economy. These impacts on the US economy are not within the scope of this analysis.

Appendix: Foregone depreciation from the use of like-kind exchange rules

- ▶ While businesses that make use of the like-kind exchange rules are able to defer capital gains taxes, they forgo depreciation deductions that would otherwise be claimed on replacement property under a fully taxable transaction
- ▶ The foregone depreciation offsets some of the revenue cost of tax deferral
- ▶ The federal revenue associated with the foregone depreciation is estimated to average \$6 billion annually (over the 10-year budget window)

Estimate of federal revenue associated with forgone depreciation offsetting the benefit of tax deferral under the like-kind exchange rules (dollars in billions)



Note: Derived from the Joint Committee on Taxation's most recent published tax expenditure estimates (Nov 2020) and Internal Revenue Service Line count data from Form 8824 on Like-Kind Exchanges.
Source: EY analysis.