SECTION 1031 — A CENTURY OF SOLID TAX POLICY

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A WINTRUST COMPANY

Internal Revenue Code Section 1031 has been a powerful tax-deferral tool for more than a century. The statute allows owners of investment or business-use real property to exchange their property for "like-kind" investment or business-use property, within a short window of time, and in so doing, defer current recognition of gain.

Section 1031 is often labeled a "tax loophole" for wealthy individuals that allows investors to take their gain to the grave and never pay tax. A 2022 economic study puts this notion to rest. "The Tax and Economic Impacts of Section 1031 Like-Kind Exchanges in Real Estate", authored by professors David C. Ling and Milena Petrova, finds that fewer than 20 percent of the 1.6 million commercial real estate transactions reviewed involved a subsequent exchange. The "swap 'til you drop" phenomenon is, largely, a fallacy.

The study also highlights the myriad benefits Section 1031 produces. Investors who acquire replacement property as part of a 1031 exchange typically invest 15 percent more capital into their properties than non-1031 buyers. These investments create jobs and increase property values, which in turn increases the property tax base, providing revenue to local and state tax authorities. These increased taxes fund education, public services, and community improvements.

Section 1031 buyers have lower loan-to-value (LTV) ratios than non-1031 buyers. Lower LTVs on replacement property reduce systemic risk in the banking industry. Section 1031 exchanges remove friction in the commercial real estate market and encourage transaction activity. Investors who engage in Section 1031 exchanges have shorter holding periods than non-1031 investors.

The Biden Administration's 2025 Budget proposal to cap the amount of tax that can be deferred using IRC Section 1031 to $500,000 for an individual or $1 million for a married couple filing jointly, if implemented, would result in a decrease in transaction activity, higher rents, higher leverage levels, longer holding periods, and higher costs of capital.

The benefits afforded by IRC Section 1031, and the ancillary gains resulting from increased transaction activity, provide strong arguments in favor of retaining Section 1031 as is. A cap would be tantamount to repeal and would severely harm the commercial real estate industry.

Please visit our issues website for more information on the economic impact of 1031, and to reach out to your elected Representative expressing your support for the retention of Section 1031.

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