April 15, 2013

E-MAIL: Tax.reform@mail.house.gov

Comments: Real Estate Tax Reform Working Group – Section 1031 Exchanges

Ladies & Gentleman:

I am writing to express my concern regarding potential modifications to or repeal of IRC Section 1031 and ask you to consider the following:

IRC §1031 is neither a loophole, nor a tax savings vehicle, but rather a powerful economic engine based on sound tax policy. The non-recognition exchange policy is premised on the understanding that the taxpayer continues with the same qualifying investment, with no intervening receipt of cash, and is left in the same tax position as if the relinquished asset was never sold. This valuable section should not be eliminated or limited.

§1031 is not an unfair tax break for the wealthy or large corporations. On the contrary, it is one of the few incentives available to and used by taxpayers of all sizes. A recent industry survey showed that 60% of exchanges involve properties worth less than $1 million, and more than a third are worth less than $500,000.

§1031 permits efficient use of productive capital and cash flow while allowing taxpayers to shift to more productive like-kind property, change geographic locations, diversify or consolidate holdings, or otherwise transition to meet changes in business needs or lifestyle. Tax-deferred exchanges provide an important stimulus to a multitude of economic sectors, having local, national and global effect.

§1031 exchanges contribute significantly to the velocity of the economy and promote investment in the U.S. Owners of domestic real estate are encouraged by the tax benefits to reinvest in U.S. real estate, rather than place their money in other or foreign investments. An automobile manufacturer, for example, cannot receive tax deferral benefits by shuttering a US plant, and moving the facility to Asia. §1031 provides a strong incentive to multinational companies to maintain and increase investments in the US.

§1031 stimulates the economy, encouraging real estate transactions, and encouraging companies to replace and upgrade machinery and equipment, stimulating purchases and sales of machinery, equipment, railcars, aircraft, trucks and other vehicles sooner, because tax on the gain can be deferred.

§1031 stimulates the agricultural economy. Farmers and ranchers use §1031 to combine acreage or acquire higher grade land or otherwise improve the quality of the operation. Retiring farmers are able to exchange their most valuable asset, their farm or ranch, for other real estate without diminishing the value of their life savings.

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§1031 provides only a temporary deferral; taxes are not eliminated. Gain will be recognized and taxed when the taxpayer sells and effectively "cashes out" of the asset.

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 relinquished (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.

Elimination of §1031 would result in a substantial increase in depreciation deductions and reduced income tax revenue.

Elimination of §1031 would have a chilling effect on real estate and other business transactions. Without the tax incentive, many transactions, including sales and purchases of real estate, machinery, equipment and leased assets will be delayed or abandoned, and real estate values will be further eroded.

Fewer transactions also translate into fewer jobs not only in the §1031 exchange industry, but also in the real estate, construction, title insurance, mortgage and other related industries, equipment lease financing, vehicle and heavy equipment rental and manufacturing, after-market alteration, customization and installation industries. Fewer transactions ultimately result in fewer jobs at factories, restaurants, dry cleaners and other local small businesses that generate revenue from the after tax dollars of employed workers.

Elimination of §1031 would tax cash flow, not wealth. §1031 permits a continuity of investment by the taxpayer without reducing cash flow available for growth of the business. The value of assets exchanged, whether farmland, commercial or rental residential real estate, machinery, equipment, vehicles or other business-use or investment assets, remains invested in the taxpayer's business. **The taxpayer doing a §1031 exchange is not taking any profit from this transaction; it is being plowed back into the business.** This is in stark contrast to taxing the gain on the sale of one stock for another stock. Stocks are relatively liquid, third party investments in someone else's business. §1031 exchanges are available only to direct owners of business-use or investment assets, which by their nature, are illiquid. Taxing third party investors on their profits from the sale of stock does not impact the cash flow or operation of the business; but a tax to the direct owner of a productive asset directly reduces the cash flow available for reinvestment into other productive assets.

§1031 permits high volume owners of personal property assets, such as cars, trucks, tractors, trailers, heavy equipment, rail cars, mining and agricultural equipment, to preserve cash flow and increase transactional volume. Unlike real estate assets, which *appreciate* in value, gain on personal property business use assets is derived by calculating the difference between the fair market value of the used equipment and its *depreciated* tax basis. Many of these productive assets are depreciated over a 5 year MACRS schedule. The impact of bonus depreciation, intended to stimulate manufacturing and sales by allowing a first year depreciation deduction of 50% - 100% of the value of the asset, has left taxpayers with artificially low tax basis, and large built-in gains. For example, an equipment leasing company that wishes to *replace* equipment purchased in 2010 already has a zero tax basis in that equipment, and would lose 40% of the value of the sold asset to taxes if §1031 were not available. This would result in a direct reduction of cash flow available for purchase of new equipment. Owners and lessors of equipment and fleets utilize §1031 safe harbor guidelines to appropriately manage nonrecognition of gain when assets are replaced, preserving cash flow, and preventing a forced downsizing of the business.

Without the current treatment under §1031, cash-strapped owners of business-use and investment assets could be forced to downsize their businesses, farms, ranches, real estate holdings, etc. if they don't have sufficient ***additional*** cash flow to acquire replacement assets ***and*** pay tax on the gain or depreciation recapture of the old asset.

Section 1031 provides significant benefits to taxpayers of all sizes with a "spillover" economic stimulus effect on a myriad of industries and small businesses across the country. Economic policy efforts today focus on encouraging investment in productive assets, encouraging additional borrowing by qualified investors, increasing the velocity of transactions, absorbing and redeploying difficult assets, and discouraging fearful contraction and cash hoarding.

Section 1031 encourages just this type of growth by mandating reinvestment in like-kind assets, increasing ordinary income from additional investment in higher value assets and job growth, discouraging the hoarding of capital and penalizing profit taking by taxing value taken out of the economy.

Section 1031 not only encourages reinvestment over profit taking, it provides a strong incentive to keep that investment at home, in the United States.

Thank you for your consideration on this matter.

Very truly yours,
1031 Asset Exchange

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