CRE Finance Council®
The Voice of Commercial Real Estate Finance

Tax Reform: Like-Kind Exchanges

1031s Remain in Place for CRE Transactions

Last updated: June 1, 2018

Executive Summary

- Section 13303 of the Tax Cuts and Jobs Act (H.R. 1), signed into law in December 2017, generally allows taxpayers to defer gains on like-kind exchanges under Internal Revenue Code section 1031 only with respect to real property that is not held primarily for sale. Thus, as under prior law, no gain or loss is recognized on the exchange of real property held for productive use in a trade or business or for investment if that real property is exchanged solely for real property of 'like kind' that will be held either for productive use in a trade or business or for investment.

- The new law also clarifies that real property located in U.S. and real property located outside the U.S/ are not properties of a like kind for purposes of section 1031.

LIKE-KIND EXCHANGES QUICK FACTS

- Under the Tax Cuts and Jobs Act, deferral of gain on like-kind exchanges is limited to exchanges of real property that is not held primarily for sale.

- The new law clarifies that real property in the U.S. and real property outside of the U.S. are not properties of a like kind.

- The provision applies to exchanges completed after Dec. 31, 2017. Under a transition rule, a taxpayer may complete a like-kind exchange of personal property if the taxpayer has either disposed of the relinquished property or acquired the replacement property before Dec. 17, 2017.

- Details related to jurisdiction will need clarification going forward.

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Next Steps

- **Implementing the new tax law:** H.R. 1 instructs and/or authorizes the Treasury Department to issue numerous new rules to effectuate the new provisions added to the tax code. Section 13303 of the legislation contains no regulatory directives specifically applicable to like-kind exchanges. However, new code section 199A(h) instructs the Treasury to provide guidance for determining the unadjusted basis immediately after qualified property is acquired in involuntary conversions or like-kind exchanges. While there are no specific rulemaking directives in the law's like-kind exchange provision, the IRS may determine that additional regulatory guidance on issues involving like-kind exchanges is warranted.

- **Technical Corrections Legislation:** There were numerous technical-correction issues identified in the first weeks post the law's enactment. To address these issues legislatively, 60 votes in the

  Senate likely will be required. Therefore, passage of any such bill in this mid-term election year will be a very difficult process. Congressional staff have begun work on a corrections bill, however, in the event a bipartisan agreement can be reached during the lame-duck Congressional session post the election.

CREFC Policy & Strategy

To the extent CREFC members identify the need for technical corrections, regulatory guidance, and/or additional clarity with respect to the like-kind exchange provision under the new tax law, CREFC will remain engaged throughout any regulatory and/or technical corrections processes to ensure this provision is implemented in a clear, workable, and beneficial manner.

Additional Background & History

- Section 1031 of the tax code allows the tax-free exchange of similar assets (known as “like-kind” exchanges), such as real estate, as long as the property received is for business or investment purposes and the exchange is conducted within a certain time period. Specifically, it allows individuals to defer capital gains taxes on the proceeds of a sale by reinvesting the proceeds into a similar asset. No capital gains taxes are applied unless an individual ultimately sells the property in a taxable sale, as opposed to participating in another exchange.

- Allowing the tax-free reinvestment of proceeds from one asset into another “like-kind” asset encourages an efficient real estate market. Investors are able to reallocate their investment capital without having their investment proceeds diminished by taxes before they have an actual economic gain.

- During the tax reform debate, CREFC warned that repealing the like-kind exchange provision would cause longer holding periods and a heightened ‘lock-in’ effect, leading to significantly reduced investment activity. CREFC heard from a large number of members on this issue as it drives a significant volume of transactions.

- Retaining the like-kind exchange provision is a major victory for CREFC members. If the provision were repealed, the real estate sector stood to lose approximately $6 billion per year, and a reduction in real property transactions would have led to reduced financings associated with such transactions.

CREFC Resources

Steptoe & Johnson Memo on CRE-related Tax Issues, December 4, 2017

CREFC Side-by-Side Comparing Various Tax Vehicles, December 4, 2017

For further Information, see CREFC’s Resource Center at: https://www.crefc.org/library