LIKE-KIND EXCHANGES

NMHC/NAA Viewpoint

Congress rightly retained like-kind exchanges for real property as part of the Tax Cuts and Jobs Act enacted in late 2017. Proposals to revise or restrict like-kind exchanges may have a significantly harmful effect on the value and trading of property.

Ensuring the nation has sufficient housing is an important public policy goal, and one that is pursued through housing and tax policy. One way tax laws support investment in real estate is through Section 1031 like-kind exchanges.

Retained for real property as part of the *Tax Cuts and Jobs Act* enacted in late 2017, like-kind exchange rules encourage investors to remain invested in real estate by allowing property owners to defer capital gains tax if, instead of selling their property, they exchange it for another comparable property. As long as the taxpayer remains invested in real estate, tax on any gain is deferred. When the taxpayer ultimately does sell the asset, the property tax is paid. (An example of a like-kind exchange is offered below.)

Like-kind exchange rules play a crucial role in supporting the multifamily sector by encouraging investors to remain invested in real estate while still allowing them to balance their investments to shift resources to more productive properties, change geographic location, or diversify or consolidate holdings.

Like-kind exchanges help efficiently allocate capital in the apartment industry and ensure that the industry can meet the demand for housing.

In addition, without like-kind exchanges, property owners are deterred for tax reasons from selling assets that are in need of capital investment. Exchange rules allow those owners to transfer the property to new owners who can invest the necessary capital to revitalize the asset. Thus, like-kind exchange rules facilitate job-creating property upgrades and improvements. This incentive to invest is particularly critical given research commissioned by NMHC/NAA that shows the nation will need 4.6 million new apartments by 2030.

Like-Kind Exchange Example

Taxpayer A owns a 10-unit multifamily property worth $1.5 million. His tax basis, or current investment interest, in the property is $1 million, leaving a $500,000 taxable gain if he were to sell it. The owner wants to sell this property to purchase a $1.2 million, 10-unit apartment building. If he were to sell the first building and buy the second, he would have to pay tax on the $500,000 gain, which might discourage him from pursuing the transaction.

With a like-kind exchange, he can exchange the assets and defer some of those gains. In this transaction, he exchanges his property for the new one and receives $300,000 from the seller. His tax basis in the new property remains at $1 million. He pays capital gains tax on the $300,000 gain and defers tax on the remaining $200,000 gain ($500,000 taxable gain minus $300,000) until he sells the new asset. A Section 1031 exchange allows him to continue investing in job-creating real estate instead of being forced to hold properties solely for tax considerations.