1031 Exchange Improvement Act

The United States government's tax system includes a number of tax deferrals, such as investing in retirement through a traditional 401(k) or individual retirement account (IRA). Another such deferral is the like-kind exchange for commercial real estate.

In a like-kind exchange (also known as a 1031 exchange due to its location in the Internal Revenue Code), when a commercial property is exchanged for another commercial property, the tax from the sale of the original property can be deferred until real property is sold for cash, at which point all of the gains from 1031 exchange properties have to be paid in full. For example, if a real estate investor purchases a house for $250,000 and then sells it for $300,000, they would ordinarily have to immediately pay a tax on the $50,000 of capital gains. However, under a like-kind exchange, they could defer their capital gains tax payment to a later date by purchasing a replacement property.

Without the 1031 exchange, would-be sellers would likely hold on to their properties longer, even if they could get a fair return for their sale, simply to avoid a steep capital gains tax bill. This would create gridlock in the market. Preventing such gridlock ultimately stimulates more taxable transactions, as not every party to a 1031 exchange defers taxes.[1]

After decades without timing restrictions for use of 1031 tax deferral, Congress passed the Deficit Reduction Act of 1984 requiring the identification of a substitute property within 45 days of the sale of the previous property and purchase of the substitute property within 180 days of the sale.[2] While the 180-day deadline protects against tax evasion, the 45-day period is overly restrictive, forcing some property buyers to make purchases that do not truly meet their needs.

Recognizing this, the IRS extended the 45-day deadline for an additional 120 days during the COVID-19 pandemic. Like many other rules and statutes loosened during the pandemic, the 45-day identification period was likely never needed and simply further complicated an already complex set of tax rules.

Bill Specifics

- Eliminate the 45-day period to identify 1031 exchange properties.

[1] In fact, some dynamic modeling of the 1031 exchange provision estimates that it actually *increases* tax revenue.
[2] The IRS and Congress pursued these timelines after the 9th Circuit ruled on *Starker v. United States*, deciding that 1031 exanchages could occur over a number of years rather than a simultaneous exchange.