Is Eliminating Section 1031 Real Estate Exchanges a Priority for the Biden Administration?

Although there is some political pressure to do away with 1031s, this popular tool used by real estate investors to defer capital gains and build wealth enjoys broad congressional support.

Ricky B. Novak

Presidential administrations come and go, but legislative changes made during those administrations can dramatically impact real estate investors and their behavior for years, if not decades, after the president leaves office.

Over the years, Section 1031 exchanges have been at the epicenter of both threatened and actual legislative change. Occasional support from Congress to narrow the scope of the section has proven that proposals to scale it back can be a winning issue and, therefore, a political football worth kicking.

However, similar attempts at change have failed, including the most recent annual proposals by the Biden administration to roll back Section 1031 effectively to the point of extinction. Will the Biden administration's targeting of Section 1031 continue for four more years, or will it end after the election in November?

Real estate investor and former President Donald Trump is officially the presumptive 2024 Republican presidential nominee. What impact might a Trump election victory have on Section 1031 exchanges? Or will it not matter who wins the White House? Has Congress simply lost interest in supporting further changes to what remains of Section 1031? Now is the appropriate time to take a look at what changes could be on the horizon for using Section 1031 exchanges to defer tax from real estate gains.

Section 1031 Exchanges Then and Now

Generally, Section 1031 of the U.S. tax code allows owners of real property held for productive use in a trade or business, or as an investment, to defer paying capital gain tax otherwise payable upon the sale of the property, if the seller purchases other qualified real property of equal or greater value to replace it.

This type of tax-deferred exchange has been permitted under the code for more than 100 years, and at one time applied to assets other than real property, including personal property such as works of art and aircraft.

However, nuances of this section of the code have changed over the past century. The most recent major revision came with passage of the 2017 Tax Cuts and Jobs Act during the Trump administration, which repealed tax-deferred exchanges for personal property, leaving it applicable only to real property.

Prominent Democrats continue to apply political pressure to narrow the scope of Section 1031 considerably, with much of this pressure coming directly from the White House. As of this writing, the Biden administration's 2025 proposed budget calls for the complete closure of the Section 1031 like-kind exchange tax deferral.

The *General Explanations of the Administration's Fiscal Year 2025 Revenue Proposals*, published by the Department of the Treasury on March 11, 2024, describes the administration's position simply by reiterating its position in all of its previous proposed budgets — namely to impose an annual cap on the deferral of capital gains to $500,000 for each taxpayer, or $1 million for married individuals filing jointly.

Previously, both the Obama administration and the 2016 Clinton campaign proposed similar drastic changes to Section 1031, and the current president's desire to follow suit predates the 2020 election.

A fact sheet issued by the White House on March 9, 2023, discussing the proposed 2024 budget summarizes the Biden administration's position on Section 1031 exchanges as follows:

"The budget saves $19 billion by closing the 'like-kind exchange' loophole, a special tax subsidy for real estate. This loophole lets real estate investors put off paying tax on profits from real estate deals indefinitely as long as they keep investing in real estate. This amounts to an indefinite interest-free loan from the government. Real estate is the only asset that gets this sweetheart deal."

At present, there is no annual cap on the amount of gain resulting from the sale of qualified properties in an exchange. This feature makes Section 1031 exchanges very attractive to real estate investors facing large taxable gains resulting from the sale of appreciated real property.

RICKY B. NOVAK
The Strategic Group of Cos. and Strategic 1031 Exchange Advisors

The proposed annual cap on tax-deferred capital gains is so low that, should it be adopted by Congress, the change would effectively eliminate exchanges for all but the smallest real estate investors and stifle transactional real estate sales, resulting in a significantly negative economic impact.

Also curious is the Biden Administration's use of the term "loophole" to describe Section 1031 exchanges. A tax "loophole" generally refers to an unplanned and unintended gap within the Internal Revenue Code, which savvy taxpayers and their advisors strategically navigate to their advantage. It is generally a term with a negative connotation.

Section 1031 is not a loophole, having been written directly into the tax code decades ago and specifically supported by Congress as a way to incentivize and encourage taxpayers to reinvest in real estate as a way to build and preserve wealth. Of note, it is a tool used by both "mom-and-pop" investors and larger institutional investors alike.

Legislative Initiatives, Executive Actions

In previous years, by failing to pass proposed budgets, Congress did not adopt the administration's position on cutting back Section 1031. And no one in the current Congress seems willing to introduce separate legislation to implement the changes. In late March of this year, Congress approved, and the president signed, a federal spending bill funding the government through the end of fiscal year 2024.

However, changes to the tax code are

in other proposed legislation, the Tax Relief for American Families & Workers Act of 2024, which the House of Representatives approved by a wide margin in January, but Republicans in the Senate are refusing to support. The version passed by the House does not propose changes to Section 1031 at all, and it seems unlikely the Senate will propose changes in theirs.

The Biden administration has been a strong proponent of increasing the inventory of affordable housing and improving access to it. However, legislation introduced to support these initiatives has found little backing in Congress. Some executive actions undertaken by the administration also are focused on providing financing and incentives to grow the inventory of affordable housing.

For example, under the Housing Supply Action Plan, the Biden administration will use financing programs and other strategies involving various government entities to lower housing costs. It plans to achieve this goal by reducing barriers to new housing construction like restrictive and costly land use and zoning rules; expanding financing for affordable, energy-efficient and resilient housing; and promoting commercial-to-residential conversion opportunities, particularly for affordable and zero-emissions housing.

The Department of Transportation is also making billions of dollars in low-cost loans available for new housing construction near transportation.

Final Thoughts

The Biden administration's proposals to incentivize real estate investment are focused primarily on home affordability, which is clearly a high priority for the president.

The White House will need legislative approval for some of these proposals, and Republicans in the current Congress do not seem inclined to give it. As for Section 1031 exchanges, the president's failed past attempts to eliminate them suggests that Congress simply is not interested in letting it happen, at least not in the way the president has proposed.

An attempt by the opposition to restore or expand Section 1031 would reveal any legislators who believe previous cuts went too deep, and at the very least would suggest a belief by some that the issue of tax-deferred exchanges might be a political football worth keeping in play for another day. However, no legislator has made the effort, and there is no indication any will.

And what about former President Trump? Should we have concerns about a Trump administration again amending Section 1031? Recall that it was the 2017 Tax Cuts and Jobs Act during the Trump administration that repealed tax-deferred exchanges for personal property, leaving it applicable only to real property.

At this point in his campaign, he has been silent on the issue, and any such changes seem unlikely. No real threats to the applicability of Section 1031 to real property were championed by President Trump while he held office. Considering his long career as a real estate investor, developer and owner, it seems unlikely he would have any such designs.

For more than a year, real estate investors have been frustrated by the lack of buyers caused primarily by the rapid rise in mortgage rates, which began in earnest during the spring of 2022. In 2024, as the rate of inflation slows and the risk of a recession in the near term wanes, many investors are eager for buyers and anxious to deploy their gains by exchanging into new properties.

Section 1031 was written into the U.S. tax code decades ago and supported by Congress to incentivize taxpayers to reinvest in real estate, thereby preserving wealth. (Photo credit: Andy Feliciotti)

Even in the best of times, investment real estate is a highly illiquid asset. Eliminating Section 1031 exchanges now will be more than merely closing a supposed tax loophole. It will slow the market even further, and for that reason it is hard to imagine a scenario where Senate Republicans would vote to allow it, unless the proposal is attached to other legislation they overwhelmingly support.

Further, while eliminating the Section 1031 tax deferral has been one of President Biden's initiatives, it does not seem to be a top priority. If it were, his proposal would be more thoughtful and would consider the added negative pressure on investment real estate that ending the tax deferral will cause.

Unless the current or next Biden administration approaches the issue of scaling back Section 1031 exchanges in a more thoughtful and economic way, perhaps first by ceasing to insist that this clearly written, intentional and longstanding section of the U.S. tax code is a tax loophole, we expect its efforts to eliminate or significantly limit them will fail as they have in the past. ●

Ricky B. Novak is a co-founder of The Strategic Group of Cos. based in Atlanta and is CEO of Strategic 1031 Exchange Advisors LLC. He specializes in niche areas of tax planning and works directly with high-net-worth investors, family offices and their trusted advisors. Novak would like to give special thanks to the 1031 team at Strategic 1031 Exchange Advisors for their assistance in researching this article.