Like-Kind Exchanges

Like-kind exchanges (LKEs) support the efficient deployment of capital and spur capital expenditure that create local jobs, support property values, generate state and local tax revenue, lower rents and reduce risk in the economy through less leverage. In addition to supporting healthy commercial real estate markets, LKEs are important to farmers and ranchers, as well as land conservation efforts.

The like-kind exchange of real estate under Section 1031 of the tax code have been allowed since 1921 and 10 to 20% of all commercial real estate transactions involve LKE. Under Section 1031, a taxpayer may exchange a property for another of "like kind" without recognizing taxable gain on the disposition of the old assets. This allows for capital to be immediately reinvested into the new property.

The deferral of gain is offset by a reduction in future depreciation deductions for the acquired asset, resulting in increased annual income, taxed at ordinary tax rates. Taxpayers ultimately recognize their gain when they "cash out" of the asset, and therefore have resources available to pay the taxes.

LKEs support jobs. Research by Ernst & Young estimates that LKEs support 568,000 jobs and generate $27.5 billion of labor income each year. By encouraging property improvements, LKEs create jobs in our communities, including skilled trades, architects, designers, material suppliers, movers, maintenance, qualified intermediaries, real estate brokers, title insurers, settlement agents, attorneys, accountants, lenders, property inspectors, appraisers and surveyors.

Generate revenue for states and localities. LKEs help get real estate into the hands of new owners with the time, resources and desire to restore and improve them. That turnover generates property transfer and recording fees and triggers property reassessments that increase the tax base. Improved retail properties generate more sales taxes to support local services.

Help small and minority-owned businesses expand and grow. Small firms and minority entrepreneurs frequently lack access to the capital markets and third-party lending facilities. Because owners are able to reinvest their proceeds on a tax deferred basis, properties acquired in an LKE carry less overall debt—30% less than when acquired through a taxable sale. In this way, LKEs create a ladder of economic opportunity for minority-, veteran- and women-owned businesses and other cash-poor entrepreneurs.

Stabilize property values during economic downturns. The deferral of gain on the relinquished property will often motivate the acquisition of replacement property by a buyer who would otherwise wait until economic conditions had fully recovered. By eliminating the "lock-in" effect, LKEs facilitate a faster and smoother transition as many real estate assets are repurposed in the post-COVID-19 economy.

Increase the supply of affordable rental housing. Multifamily housing transactions represent 40% of real estate LKEs. Tax incentives like the low-income housing tax credit do not apply to land acquisition costs, but investors can use an LKE to acquire land for the development of new housing.

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A 2015 study further revealed that 88% of exchanged properties were later disposed of through a taxable sale. And taxes paid are 19% higher when a property is exchanged then sold versus never having been exchanged.

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