



The Voice of the 1031 Industry

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Dear Senator:

Regarding the request of Senators Baucus and Hatch for your input toward the goal of comprehensive tax reform, we urge you to communicate your support for retention of IRC §1031 (tax-deferred like-kind exchanges) in the law's present form because it meets all 3 tests for inclusion in the "blank slate".

The Federation of Exchange Accommodators ("FEA") is the industry association for exchange facilitators, also known as Qualified Intermediaries ("QI"). FEA member companies facilitate tax-deferred exchanges of investment and business use properties under IRC §1031 for taxpayers of all sizes, from individuals of modest means to high net worth taxpayers and from small businesses to large entities. An industry survey disclosed that approximately 60% of all exchanges facilitated by FEA members are for transactions under \$1 million.

1. Help grow the economy

Section 1031 tax-deferred exchanges provide a vital stimulant to our economy, fueling transactions that create jobs. Section 1031 provides significant benefits to taxpayers of all sizes with a "trickle down, spillover" economic stimulus effect on a myriad of industries and small businesses across the country. It allows recognition of gain on the sale of qualifying assets to be deferred by using the proceeds from the sold asset to buy replacement assets of the same kind or class. This deferral benefit permits efficient use of capital to preserve and manage cash flow, encouraging U.S. businesses to reinvest in their domestic businesses, rather than offshoring business activity.

The attached "Impact of §1031 on the Economy" details the many ways in which §1031 is a powerful economic stimulator to the real estate, manufacturing, farming, equipment leasing, transportation and other industries. Section 1031 contributes to the velocity of the economy because it encourages transactional activity. It requires that all of the value of the exchanged asset be reinvested in like-kind property, thus any profits are plowed back into the business and continue to fuel that economic sector. Elimination of §1031 would result in a direct tax upon operating cash flow, not wealth, because no profit is being taken from the exchange transaction. Elimination would have a significant chilling effect upon transactional activity with substantial negative impact upon a multitude of U.S. economic sectors.

Economic policy efforts focus on encouraging investment in productive assets, encouraging additional borrowing by qualified investors, increasing the velocity of transactions, redeploying underutilized or idle assets, and discouraging fearful contraction and cash hoarding. Section 1031 encourages growth by mandating reinvestment in like-kind assets, increasing job growth and ordinary income generated by additional capital investment, discouraging the hoarding of capital and penalizing profit taking by taxing value taken out of the economy.

2. Make the tax code fairer

Section §1031 is fair and it is working well for a broad spectrum of taxpayers at all levels, in all lines of business, including individuals, partnerships, limited liability companies and corporations. Restrictions or changes to §1031 are unnecessary and would not result in greater simplification nor additional revenue to the US Treasury. Section 1031 has been in the Internal Revenue Code since 1921 and is based on sound tax policy predicated on continuity of investment by the taxpayer. It has been subjected to Congressional scrutiny multiple times, each time being retained, affirming the importance of §1031.

Section 1031 exchanges structured under the IRS regulatory safe harbors using professional Qualified Intermediaries are neither tax savings vehicles nor “abusive tax avoidance schemes.” Rather, they are legitimate transactions utilizing an important tax planning tool. Payment of tax occurs: 1) upon sale of the replacement asset; 2) incrementally, through increased income tax due to foregone depreciation; or 3) by inclusion in a decedent’s taxable estate, at which time the value of the replacement asset could be subject to estate tax at a rate more than double the capital gains tax rate.

3. Promote other important policy objectives

FEA members are professional exchange facilitators for whom acting as a Qualified Intermediary is a core business. Importantly, Qualified Intermediaries function as unofficial gate keepers for the IRS, promoting compliance with the technical requirements for proper exchange treatment. Modification of §1031 into a “rollover” structure, without QIs, would cause a decrease in tax revenue through improperly claimed §1031 treatment and increased auditing costs. Moreover, professional QIs are subject matter experts that simplify §1031 by guiding their clients and their tax advisors through the process, providing proper documentation, holding funds, and other services.

Section 1031 directly impacts jobs. The approximately 150 FEA members are entities ranging from small businesses to large publicly traded companies and banks that together employ at least 1,500 people in jobs directly related to the QI business. Additionally, the transactional activity stimulated by §1031 results in jobs in the real estate, construction, title insurance, mortgage, banking, equipment lease financing, vehicle and heavy equipment rental and manufacturing, after-market alteration, customization and installation industries. Some title insurance companies estimate that 20 to 25% of all commercial real estate sale transactions involve properties that are part of an exchange. Fewer transactions ultimately result not only in fewer jobs in these industries, but also indirectly at factories, restaurants, dry cleaners and other local small businesses that generate revenue from the after tax dollars of employed workers.

In conclusion, §1031 not only meets the three tests for retention, it provides a strong incentive to keep economic growth and investment at home, in the United States. If you have any questions, or wish to discuss any of these matters, please contact any of us.

Sincerely,



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