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Property owners ready to fight for 1031 swaps, a lucrative tax break targeted by Biden

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[Commercial real estate](#) owners are mobilizing to defend a cherished tax break that the [Biden administration](#) has put squarely in its sights.

The benefit, known as a [1031 Exchange](#), is one of the most lucrative loopholes in the entire tax code. It enables [real estate](#) investors to swap one property for another without [paying taxes](#) on the transaction. There's no limit to how many trades can be made and if an investor dies while holding appreciated real estate, the investor's heirs inherit the property on a step-up basis—meaning they pay no taxes on the gain when they sell.

1031 Exchanges were created in the 1920s to help farmers, but they became popular in commercial real estate after Congress “clarified the process” in 1990, the Federation of Exchange Accommodators said. One of the most famous beneficiaries was Donald Trump, who 16 years ago used a 1031 swap to acquire 30% of a Midtown office tower that is his company's [most valuable](#) real estate holding.

Researchers [estimate](#) 1031 swaps account for up to 20% of commercial real estate transactions today.

“It's how my clients expand their real estate holdings,” said Peter Buell, a partner at accounting firm Marcum. “A lot of these transactions wouldn't occur if they were taxed.”

On Tuesday the Biden administration moved to change the rules of the game. It proposed to eliminate the benefits of 1031 Exchanges when gains exceed \$500,000. The proposal, which must be approved by Congress, is part of a series of measures the White House said would “ensure that high-income Americans pay the tax they owe under the law—ending the unfair system of enforcement that collects almost all taxes due on wages, while regularly collecting a smaller share of business and capital income.”

Real estate and financial executives weren't pleased to see 1031s under attack.

James Whelan, president of the Real Estate Board of New York, said: “This deeply flawed proposal would damage investments in critical infrastructure, such as housing, at a time when they are most needed—and it could ultimately leave property owners with no choice but to increase rents if their properties are no longer economically viable.”

Morgan Stanley said in a report on Wednesday: “The elimination of this advantage is a double whammy as the Biden proposal would also tax capital gains at 39.6% vs. 20% currently.”

This isn't the first time a Democratic administration has tried to rein in 1031s. In 2016 President Barack Obama proposed to eliminate capital-gains deferrals exceeding \$1 million in the transactions, saying that doing so would bring in \$19.5 billion in deferred or avoided taxes over time. But Congress wouldn't go along.

Reform came in 2017 as part of President Trump's tax overhaul, with one giant exception: 1031 Exchanges were done away with for art, cars and even airplanes—but not for real estate. It just so happens that a big slug of Trump's wealth stems from a 1031 swap.

In 2005 Trump traded the 30% stake he held in the West Side residential development formerly known as Trump Place for a 30% stake in 1290 Sixth Ave., an office tower whose tenants are banks and top law firms. Based on data provided by the building's majority owner, Vornado Realty Trust, Trump collects \$53 million in annual rent—more than he gets from Trump Tower, 40 Wall St. or his hotel in Washington, D.C.

Vornado has been trying to sell 1290 Sixth Ave. for months, but the real estate industry is lobbying to ensure another 1031 swap can be struck. In March the Mortgage Bankers Association, Nareit and about 30 other real estate groups sent a

letter to Treasury Secretary Janet Yellen extolling the virtues of 1031 trades, describing them as vital to rebuilding the economy.

“Like-kind exchanges of real estate under section 1031 of the tax code support job growth and investment; the health of U.S. commercial real estate and real estate markets; and the preservation of family-owned farms, ranches, and forestland,” the letter reads.

Buell said clients typically use 1031s to trade one underperforming property for another they find more desirable. The money they would have spent on taxes goes instead to improvements.

“They put people to work,” he said.