Ernst & Young Section 1031 Economic Study

Economic Impact of Repealing Like-Kind Exchange Rules Synopsis

Highlights

The study finds that repeal of IRC Section 1031:

- results in less federal revenue
- shrinks the economy by $8.1 billion
- discourages investment
- negatively impacts the overall economy, with an unfair concentration in certain industries
- unfairly burdens certain businesses and taxpayers
- is at cross-purposes with the goals of tax reform

Findings

The analysis finds that **repeal of the like-kind exchange rules increases the cost of capital in the economy**, even when combined with lower tax rates. The higher cost of capital is found to **discourage business investment** which **adversely affects the overall economy**.

Repealing like-kind exchange rules would subject businesses that rely on these rules to a **higher tax burden** on their transactions, resulting in **longer holding** periods, greater reliance on debt financing, and **less-productive deployment of capital in the economy**. Moreover, many affected businesses are in pass-through form, which would not receive a benefit if the revenue from repeal of like-kind exchange rules is used to finance a lower corporate income tax rate.

Implications

The net impact suggests that this policy change is at cross-purposes with some of the objectives of tax reform. While repealing like-kind exchange rules could help fund a reduced corporate income tax rate, its repeal increases the tax cost of investing by more than a corresponding revenue neutral reduction in the corporate tax rate.

Repeal of Like-Kind Exchange Rules Would Cause

Higher Cost of Capital	Increased Holding Periods	Increased Reliance on Debt Financing	Reduction of the Velocity of Investment
Even when combined with combined with lower taxes, the higher cost of capital negatively affects the economy across different uses of the associated revenue.	Survey respondents of both personal property and real estate like-kind exchange activity expect that asset holding periods would increase by more than 20% under repeal.	Repeal would increase the cost of equity financing, as businesses would pay tax upon sale. This makes debt financing relatively less expensive. Consequently, businesses may increase their leverage by borrowing funds.	Longer holding periods reduce the velocity of investment, meaning capital is redeployed in the economy more slowly.

Impact on GDP, Investment and Labor

When the revenues are used to finance a revenue neutral reduction in the corporate income tax rate, this analysis finds that the combined impact would result in a **smaller economy**, with **less investment** and l**ower labor incomes for workers**.

- GDP is estimated to fall by $8.1 billion each year (0.04% decline in 2013 dollars) in the long-run.
- Investment is estimated to fall by $7.0 billion (0.18% decline in 2013 dollars) in the long-run.
- Labor income is estimated to fall by $1.4 billion (0.11% decline in 2013 dollars) in the long-run.

Important Comparisons

Estimated tax revenue to Treasury over 10 years (repeal score for years 2014-2023 by Joint Committee on Taxation)	$40.9 billion
Estimated reduction of overall U.S. GDP over 10 years (EY Study)	($61 – $131 billion)

This analysis finds that pairing the repeal of this provision with a revenue neutral reduction in the corporate income tax rate would adversely affect the economy in the long-run.

Long-run effect of repeal on GDP each year under revenue-neutral reduction in the corporate income tax rate and alternative policy scenarios:

Scenario	Annual GDP change ($billions)	Annual GDP change (%)
Use increased revenue to reduce corporate income tax rate	-$8.1	-0.04%
Alternative policy 1: Use increased revenue to increase government spending	-$13.1	-0.07%
Alternative policy 2: Use increased revenue to reduce business sector taxes	-$6.1	-0.03%

Note: Long-run dollar figures are scaled to the 2013 US economy.
Source: EY analysis.

Study Sponsors

This Ernst & Young study was sponsored by The Section 1031 Like-Kind Exchange Coalition.

The Coalition is comprised of more than a dozen industry associations whose members represent of a diverse group of U.S. business owners and individuals. Coalition members represent more than a million businesses and taxpayers. Sponsors of the study represent real estate associations, an agricultural association and equipment / vehicle associations.

- Federation of Exchange Accommodators (FEA)
- National Association of Realtors (NAR)
- National Association of Real Estate Investment Trusts (NAREIT)
- Real Estate Roundtable (RER)
- National Multifamily Housing Council (NMHC)
- International Council of Shopping Centers, Inc. (ICSC)
- Alternative & Direct Investment Securities Association (ADISA)
- Associated Equipment Distributors (AED)
- Equipment Leasing and Finance Association (ELFA)
- Iowa Soybean Association (ISA)
- American Rental Association (ARA)
- American Car Rental Association (ACRA)

About the Study

This Ernst & Young analysis examines the macroeconomic impact of recent proposals to repeal the IRC Section 1031 like-kind exchange rules. These rules are used extensively in the real estate, transportation, equipment/vehicle rental and leasing, and construction industries.

Download the Study

Download the study here.