

Biden administration's plan to tighten GILTI (including curbing foreign cross-crediting) would cause similar further beneficial repatriations from recalcitrant companies. Companies may balk at the GILTI and other Biden plan elements including the repeal of the FDII deduction (something that Alphabet wouldn't like, especially after the transfer from Bermuda, though the administration intends to retarget revenues from FDII deduction repeal toward research and development, something Alphabet cares about), but everyone's and not just the companies' or the companies' shareholders' success is at stake.

Patrick Driessen
Columbia, Md.
Aug. 23, 2021

Section 1031 Finds Defenders Coast to Coast

To the Editor:

Portland, Oregon is a continent away from the backroom deals of Congress, but it's the hometown of Senate Finance Committee Chair Ron Wyden, D-Ore. Obscure lobbying campaigns can connect two distant cities; to understand how and why Congress sustains special interests, one might connect the dots in between. Consider this example.

Section 1031 (or actually, its predecessor in intent) was added to the IRC in 1921 to allow deferral of tax on capital gains from "like-kind" exchanges of investments until final disposition of the asset. Congress, regulators, and the courts have narrowed and widened it into a tax dodge around which has grown a multi-billion-dollar industry of real estate executives and investors. It costs taxpayers about \$8.5 billion annually, according to the Joint Committee on Taxation.¹

The August 5 print issue of *Portland Business Journal* includes a column by two real estate executives.² The piece criticizes Treasury's green book proposal³ to limit the aggregate deferral of capital gains tax on 1031 transactions to \$1 million annually for joint filers (\$500,000 for singles). It would save the government about \$1.9 billion in fiscal 2023 (according to Treasury, whose section 1031-related estimates tend to be lower than JCT's).

The authors, Bill Brown and Dan Wagner, imply that section 1031 helps Black Americans build wealth and invest in Black communities — a bonus point for pamphleteers in our time. The weekly newspaper illustrated the column with a large photo of a Black man in a hardhat, dress shirt, and tie. "The Black American community has increased its share of the commercial real estate investment market through the prudent use of 1031 like-kind exchanges, making a critical reinvestment in their communities while building personal wealth," they assert without evidence.

¹JCT, "Estimates of Federal Tax Expenditures for Fiscal Years 2020-2024," JCX-23-20 (Nov. 5, 2020).

²Bill Brown and Dan Wagner, "Danger Lurks in Biden Plan to Cap CRE Investment Vehicle," *Portland Business Journal*, July 29, 2021.

³Treasury, "General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals" (May 2021) (green book).

This is a favored trope of lobbyists, who argue that enterprise zones, Opportunity Zones, the new markets credit, and even the carried interest loophole revive minority neighborhoods. Only by granting capital gains treatment to (mostly white) investors will African Americans get a taste of the good life.

The article continues, “A cap on 1031 exchanges right now — not just at \$500,000 but at any amount — would severely restrict the ability and willingness to reinvest in commercial real estate and redevelop properties at a time in our nation’s economy when eager, courageous, and committed investors are needed more than ever.”

Trickle-down tax policy. More than three-quarters of capital gains benefits go to taxpayers with seven-figure incomes. The equities markets are awash in investors.

“Section 1031 has been used to provide affordable multifamily housing in working class communities, reimagine commercial shopping centers, and allow growing businesses to expand their space across Portland.” The authors note an industry-funded study by a Big Four accounting firm that highlighted the virtues of section 1031. EY estimated that repeal of section 1031 would cost the economy \$8.1 billion in output.⁴

That’s about the same as the government’s deficit-financed tax expenditure and less than 0.04 percent of GDP. Perhaps the Treasury secretary would get a bigger bang for the buck by handing out Benjamins at the Boys and Girls Club? Consumer spending drives the economy, not investor tax savings.

“It is clear section 1031 is important to our region’s economy and generates significant tax revenue — much of which would be lost with a cap or change to section 1031.”⁵

Pray tell: How does tax deferral generate tax revenue? It’s arguable that section 1031 drains investment from nontax-favored alternatives. Put another way, section 1031 encourages tax-favored distortions that misallocate capital. If deals pencil out only because of tax breaks, we should be

skeptical of them. We needn’t see the dots, but let’s look anyway.

Dots 1A are the authors.

Wagner is identified in the *Business Journal* as senior vice president of government relations for the Inland Real Estate Group of Companies Inc. Based in suburban Chicago, Inland is engaged in finance, real estate, and other businesses. In March it issued a press release announcing that it had joined the Real Estate Roundtable’s (RER) section 1031 coalition.⁶

William E. (Bill) Brown is identified as cofounder of Springhill Real Estate Partners and former president of the National Association of Realtors. He’s in suburban Oakland; Springhill’s website indicates Brown has personal investments in Portland properties.⁷

So a couple wheeler-dealers get ink to defend a tax loophole. It’s not shocking that a local business paper — dot 2 — would publish their “opinion” extolling the value of a federal (and state) tax break to the local economy. After all, the authors are potential or actual advertisers and the readers their potential or actual clients.

Wagner and Brown note their association with the Federation of Exchange Accommodators (FEA), a special breed of real estate executive — dot 3A. FEA’s web address is the code section on which its prosperity rests: 1031.org. Naturally, FEA has a PAC — dot 4A. Wagner has contributed \$8,500 to it in 2020 and 2021, according to Federal Election Commission filings.⁸ (Brown’s name is not listed; his campaign contributions have gone to other entities.)

Dot 3B is the aforementioned RER, whose task is to generate congressional support for the industry. RER’s August 6 press release contended the importance of section 1031 to small farms and businesses (another trope) and trumpeted a letter opposing the Biden proposal signed by 88 House Republicans.⁹ A few weeks before Inland announced it had joined RER, Wagner

⁶Nicole Spreck, “Inland Is the First DST Company to Join the Real Estate Roundtable 1031 Like-Kind Exchange Coalition,” Inland Real Estate Group of Companies Inc. (Mar. 11, 2021).

⁷“Team, William Brown,” Springhill Real Estate Partners.

⁸Federal Election Commission, “Federation of Exchange Accommodators 1031 PAC, 2021-2022.”

⁹“House Republicans Urge Biden Administration to Preserve Like-Kind Exchanges,” The Real Estate Roundtable (Aug. 6, 2021).

⁴EY, “Economic Impact of Repealing Like-Kind Exchange Rules” (Mar. 2015).

⁵Brown and Wagner, *supra* note 2.

contributed to its PAC¹⁰ — dot 4B — which is much bigger than FEA's. Twelve other trade groups funded the EY study (dot 5A); tag them as dots 3 and 4, C through N. One of them, Brown's National Association of Realtors, dispensed \$11 million to candidates in the 2019-2020 cycle.

FEA retains Williams & Jensen PLLC (W&J), a Washington lobbying firm, to represent its interests — dot 5B. FEA currently pays W&J \$90,000 per quarter to monitor section 1031.¹¹ In the fourth quarter of 2017, when Congress was writing what's popularly known as the Trump tax law, FEA paid W&J \$240,000 to defend section 1031 (a provision from which Donald Trump personally benefits). In that law, Congress limited section 1031 exchanges to real property, shaving the cost by \$2.9 billion in 2023, according to JCT.¹²

Among FEA's PAC contributors are two Portland residents — dots 1B. The Beutler Exchange Group LLC was passed by William Beutler, now retired, to his daughter Toija. They have contributed \$17,500 to the PAC since 2017, giving \$10,000 this year.

A new recipient of the PAC is Wyden — dot 6A; he's received \$4,000 in 2021, since Democrats took Senate control. Wyden's House counterpart, Richard Neal, D-Mass. — dot 6B — has received \$30,000 since he became chair of the Ways and Means Committee in 2019.

On the top of Beutler's web page¹³ is a banner: "In a unanimous non-binding voice vote the Senate votes to preserve 1031! To view the vote, click *here*." The link is to the C-SPAN feed of the two minutes of consideration on August 10 of Sen. John Kennedy's amendment to the 2022 budget resolution — dot 7. In it, Kennedy, R-La., claims his amendment would "prohibit any changes to the treatment of like-kind exchanges."

That's a stretch. Students of the Senate budget reconciliation process and the exercise known as "vote-a-rama" (Kennedy's amendment was the last taken up in 15 hours of "debate") understand that these nonbinding resolutions prohibit

nothing and have the approximate effect of a press release. The decision whether to modify section 1031 will be made in Finance and in Ways and Means. (Kennedy is not on the Finance Committee.) Thus, we understand why Wagner and Brown, perhaps consulting with Beutler, targeted a journal read by the Portland business community: to generate pressure on Wyden to ignore the proposal.

If we return to their column, we might imagine Brown and Wagner's hypothetical African American (and SEC-accredited) investor, a married couple. Flush with home equity, retirement savings, and other assets, they seek a tax shelter. Finding an FEA practitioner, they put \$300,000 into a real estate investment pool. Some years later the value has grown to \$1.3 million; the couple enters a like-kind investment. Under the Biden proposal, they would still defer all tax. And using other provisions of the code, they could shield the gain from tax until death, leaving it to their children, who would receive stepped-up basis. No one would ever pay tax on the gain.

Moving from the hypothetical to the real: *Portland Business Journal* reported August 19 that two downtown buildings are on the market, both associated with the families that sold the Portland-based McCormick & Schmick's restaurant chain in 2012.¹⁴ The sellers' agent, Justin Poor, told the paper, "The generational asset has not been on (the) market in nearly 50 years. Timing makes sense for both families to sell." The report concluded, "Poor confirmed plans for what's called a 1031 exchange, essentially a way for real estate investors to sell one building and then put the money into another, similar one while deferring capital gains taxes."

How the proposed cap on tax-deferred sales would, as Brown and Wagner contend, "severely restrict the ability and willingness to reinvest in commercial real estate and redevelop properties" is unclear. Nor is it clear what makes real estate profits so special that they deserve a section like 1031.

¹⁰FEC, "Receipts."

¹¹"Client Profile: Federation of Exchange Accommodators," OpenSecrets.org (2019).

¹²JCT, "General Explanation of Public Law 115-97," JCS-1-18 (Dec. 2018).

¹³"Beutler Exchange Group LLC."

¹⁴Jonathan Bach, "Portland Buildings With Jake's Famous Crawfish, Apartments Up for Sale," *Portland Business Journal*, Aug. 19, 2021.

But there you have it. A century ago, Congress bought an economic sprinkler. It became a canal for federal largess thanks to a constellation of players: tax lawyers, their front groups on K Street, cheerleading local papers, our pay-to-play system of campaign finance, and cowed (or all-in) members of Congress.

Bennett Minton
Aug. 23, 2021

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