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Regarding COVID-19 and 1031 exchange in the current financial atmosphere - by Michael Packman

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What a time we are currently experiencing. Whenever we have these Black Swan events, I think of an old saying, “History doesn’t repeat itself, but it rhymes.” I have been reflecting on the last 25 or so years that I have spent in the business world. We have experienced many ups and downs in that time. What I have come to realize is that the feelings associated with each period are just as important as the cycles themselves. I am a big fan of Tony Robbins and had the privilege of traveling around the world with him for a while. Those travels were not only a source of fond memories for me, but more importantly are remembered for several immensely powerful insights. One that has really stuck with me is that business is 80% psychology. This is especially important to remember when faced with situations like we are currently experiencing. As I recall each period of expansion followed by recession, the emotions surrounding each are remarkably similar. The underlying factors for each boom and bust may be different, but the feeling that each period brings, whether good or bad, always feels like it will continue forever. This is human nature and always leads to excessive optimism right up until the start of a recession and extreme pessimism during the height that usually continues as we are coming out of it. If during each phase, we can have a higher level of awareness to the corresponding emotions associated with them, our emotional intelligence increases. This helps us to remain more balanced regardless of whether we are in the midst of a downturn or if the economy is in a major upswing. Not only does it help us to make better decisions, but also keeps us sane during the dark times.

So where does that leave us now? We are experiencing one of the largest amounts of uncertainty in modern history. When will the quarantine end? How much damage will have been done? Will there be a new resurgence of cases? If so, will we be forced to endure an even longer period of lockdowns? If so, what impact will that have on the economy? As if the health concerns were not enough in their own right, those of us in the business world need to make decisions without any clarity on what the future holds. This can be especially difficult for those planning to exchange a property via section 1031. I was recently fortunate enough to have a conversation with one of the most renowned experts in the space, Brad Borden. Brad, a tenured professor at Brooklyn Law School, advises on some of the most complex taxation components of real estate transactions and is also a prolific writer and speaker. Amongst his many writings is “Tax Free Like-Kind Exchanges,” the go-to resource on 1031s.

One topic of our conversation was what the government is doing to ease some of the pain for exchangers. On April 9th, 2020, the IRS published Notice 2020-23. As is unfortunately so often the case with IRS notices, there is a substantial lack of clarity. What at a minimum should be the case is to grant any exchanger whose 45-day identification period or 180-day period is set to end between April 1st, 2020 and July 15th, 2020 will have a 120 extension or until July 15th, whichever is later. There are some interpretations that the extension is only until July 15th regardless. This would be extremely unfair in cases where your 45-day period was extended until July 15th but then you only had 30 or 60 days to close on the property. Even with the generous interpretation, it may still be difficult to complete exchanges in the current environment. Not only has it affected due diligence and property inspections, but many sellers are afraid to put properties on the market due to the uncertainty. If the IRS is not lenient with concessions around 1031 exchanges, an already weakened real estate market could be hit far worse. If many of the property owners who were unable to complete exchanges are now not able to reinvest on a tax deferred basis, it will reduce the amount of new transactions as they will have less motivation to keep the money in real estate.

One way the IRS could reinvigorate the market would be to apply the extensions to all exchanges entered into from January 20th, 2020 (the date FEMA identified as the start of the COVID-19 emergency) until July 15th, 2020. This would create new demand as those who had previously thought their exchange had failed would now be given another chance at deferring taxes and a compelling reason to reinvest back into the market. The IRS has indicated that it will issue additional guidance in the form of FAQs which should be out shortly. As the shutdown has been government-mandated, hopefully they will give a generous interpretation.

Regardless of the short-term ramifications of the pandemic, and how uncertain we may feel now, I cannot help but think back to how it felt after 9/11 and 2008. When there is a lot of fear, even the air just does not feel right, similar to now. While I have some memory of those feelings, what I really remember is the immense opportunities in the years that followed. One great truth to hold on to is that this world of ours is ever-changing. While we might not want to remember that during the booms, it is a great source of comfort when the uncertainty is strong. Over the last couple of years, I have been hard pressed to find properties to be excited about as we were so late in the cycle. That has certainly changed, there will be many opportunities, you just will need to have the right mindset to take advantage of them. Every situation comes down to how we frame it. If we choose to take the positive view, any situation can be turned to our advantage.

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