TIAA-CREF | Center for Farmland Research

Synopsis of Research Reports:

"The Impacts of the Tax-Deferred Exchange Provision on Farm Real Estate Values"

The Federal Income Tax Code's Section 1031 provision allows participants to defer capital gains tax from the exchange of a like-kind asset. The provision was first introduced in 1921, but in 1984, Congress substantially amended the provision and established new parameters for compliance. Under the current provision, the owner must identify a property to acquire within 45 days of relinquishing the original property, and once the property has been identified, the owner must close on the exchange property within 180 days. An exchange can also be conducted by relinquishing a property to a qualified intermediary (a third party) who then transfers the replacement property to the taxpayer. The third party exchange has become the predominant form of Section 1031 exchanges involving agricultural land.

Many farmland market participants have suggested that Section 1031 exchanges have artificially raised the price of farmland. The narrow time window to identify and acquire replacement properties increases the search costs and reduces the bargaining power of participants. In addition, if the value of the relinquished property exceeds that of the acquired property, the realized capital gains are subject to taxation, and as a result, there is an incentive to acquire properties valued at least equal to the original property.

A small number of previous empirical studies estimate the price impacts of the Section 1031 exchange provision in other real estate market, such as apartment and commercial properties, and the estimated price premiums range from 1% to 29%. This is the first study to examine the impacts of 1031 exchanges on farmland prices. The study examines a set of 3,580 farm real estate transactions recorded between January 2003 and December 2006 in 55 agricultural counties across Indiana. Roughly 6% of the transactions were acquired under 1031 exchange.

An empirical model was constructed to control for differences across parcels, including acreage, yield, population density, school quality, surrounding land cover, year, and distance to nearby highways, interstates, towns, and cities. In addition, the model controls for the price of neighboring farmland parcels and the fact that 1031 exchange participation is not a randomly occurring phenomenon. The estimation results suggest that parcels acquired under 1031 exchange provision are associated with a 1.3% price premium.

Available at: Dillard, J.G., T.H. Kuethe, C. Dobbins, M. Boehlje, and R.J.G.M. Florax (2013) "The Impacts of the Tax-Deferred Exchange Provision on Farm Real Estate Values" *Land Economics* 89 (3): 479–489.