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Today's aging baby boomer generation fuels Tenant in Common 1031 exchanges

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After spending decades managing a ten (10) unit apartment building, John decided it was time to sell the building and the attendant management headaches, but was concerned about securing his retirement with sufficient income to meet his needs. Selling the fully depreciated building, paying the capital gains and recapture tax, and investing the net proceeds into a fixed income investment would leave his cash flow short. Deferring the tax through a 1031 exchange would preserve his equity, but could still leave him with active management burdens. Enter a popular new real estate investment – the Tenant in Common (TIC).

TICs

A TIC is a form of real estate asset ownership in which two or more persons have an undivided, fractional interest in the asset, where ownership shares are not required to be equal, and where ownership interests can be inherited. Under the most common TIC structure, each co-owner receives an individual deed at closing for his or her undivided percentage

interest in the entire property.

Revenue Procedure 2002-22 issued by the IRS allows up to 35 TIC owners in any one property. Minimum purchase requirements are structured to meet this limitation and can range as low as \$150,000 equity. The typical entrance in a whole commercial building begins at \$1 million, but through TIC ownership, the average person is able to enjoy ownership in an institutional-type property with a minimum purchase. Besides reliable income (usually between 6% - 8% cash on cash) and growth potential, these properties are able to attract tenants with greater financial strength and stability than possible for the individual landlord. Most of the day-to-day property operations are handled by a master lessee or a property manager, who have extensive experience in real estate. Thus, situations that arise in day-to-day operations will be addressed quickly and efficiently, and the TIC owner will enjoy the freedom from property management.

TIC Trends

In 2002, when Revenue Procedure 2002-22 was issued, \$356 million in TIC investments were sold by 10 to 15 sponsors. In 2005, a survey of the members of the Tenant-In-Common Organization ("TICA"), a trade organization of composed of TIC sponsors, estimates that over \$4 billion in TIC investments will be sold in 2005 by 65 sponsors. Much of this substantial growth is fueled by aging baby boomers seeking wealth preservation and cash flow. Wealth preservation can be accomplished through a tax free exchange, and the cash flow can be provided by the TIC investment.

Tax Free Exchanges

Internal Revenue Code ("IRC") § 1031 provides that no gain or loss will be recognized on the exchange of property held for productive use in a trade or business or for investment if the property is exchanged solely for property of a like kind which is to be held either for productive use in a trade or business or for investment. As used in IRC § 1031(a), the words "like-kind" refer to the nature or character of the property and not to its grade or quality. The fact that any real estate is improved or unimproved is immaterial for the fact relates only to the grade or quality of the property and not to its kind or class. In other words, all US real estate (no matter what the form) is like kind real property and im-

proved real estate may be exchanged for unimproved real estate; city real estate may be exchanged for a farm, etc. A TIC structure that follows Revenue Procedure 2002-22 should qualify as replacement property for 1031 purposes.

The tricky part of exchanging into a TIC interest is the timing. Under the deferred exchange rules, the taxpayer must identify replacement property within 45 days and close within 180 days. With the TIC industry so hot, many TIC deals sell out immediately. Working with a qualified intermediary that has numerous contacts with TIC brokers can help to ensure that the taxpayer gets into the investment.

Conclusion

In our hypothetical, John can exchange his apartment building for a single TIC interest or for number of TIC interests that are diversified geographically and by use. Although he will save on taxes, he will incur fees and pay a premium for a slice of an otherwise unattainable piece of real estate. John is happy though because he has freed himself of property management hassles, preserved his equity through tax deferral, and provided himself with a stream of income for retirement.

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