

# 1031 Exchange FOCUS

SECTION 1031 OF THE INTERNAL REVENUE CODE IS ONE OF THE GREATEST WEALTH BUILDING TOOLS AVAILABLE TO THE INVESTOR



## → THE TENANT-IN-COMMON (TIC) ALTERNATIVE

*Internal Revenue Code Section 1031 allows investors to defer the payment of capital gains taxes when selling investment property and exchanging into other like-kind investment property.*

Tenant-in-common (TIC) ownership in real estate has been around for a very long time. Recently, an entire industry has blossomed around the concept of fractional ownership in real estate.

The reason for the emergence of the new industry is that in 2002, the IRS announced conditions under which it would rule favorably that an undivided fractional interest in real estate constitutes a tenancy-in-common interest (TIC) and not an interest in a business entity such as a partnership.

This ruling had particular significance for real estate investors as a tenant-in-common interest in real estate qualifies for 1031 Exchange treatment, whereas a partnership interest does not.

With guidelines established for what can qualify for 1031 Exchange treatment, many large "institutional grade" properties have since been sliced up and sold to groups of individual investors. The individual TIC owners are on deed and considered direct owners of the real estate. Each investor takes a "pro rata" share of income, tax benefits and appreciation. TIC investors also benefit from the ability to acquire institutional grade property that might otherwise have been unattainable.

The advantages of TIC ownership can be significant. With large properties come economies of scale. Professional management may now make economic sense, relieving the owners of the burdens of management. Predictable, stable cash flow can also be a benefit of

owning a much larger property with a diverse tenant base. TIC ownership, however is not without its disadvantages.

Co-ownership can be a problem. Someone used to "calling the shots" regarding his/her portfolio may not be comfortable with the group decision making process required by TIC ownership. Liquidity is also an issue. Currently there is not a well established secondary market for fraction real estate ownership, so those who need immediate liquidity may encounter difficulties.

### **How It Works:**

TIC's are typically sold through a broker/dealer network. Although technically real estate, the government requires that the brokers who publicly market and sell TIC's be registered with the Securities Exchange Commission (SEC). TIC's won't typically be listed on your local MLS and chances are the local realtor won't be selling them. So investors will want to deal directly with a brokerage firm or financial planner that specializes in TIC's.

The typical structure includes 12 to 20 TIC investors in a property (the IRS will allow no more than 35) and often there is a minimum equity requirement to participate. Once acquired, a TIC investment can be sold, gifted, bequeathed by will or inherited and is subject to property taxes, gift taxes, estate and inheritance taxes in the same manner as a sole ownership property.

For more information on TIC property and the brokers that sell them, feel free to contact Asset Exchange Company.

*The subject matter in this newsletter is intended as general information only and not intended as tax or legal advice. Please always consult your tax or legal advisor for any specific tax or legal matters.*

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