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IRS Tenant-in-Common Ruling Appears Limited

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 By Therese Fitzgerald, Editor/Ancillary Products

Real estate executives are busy interpreting the impact of a Treasury Department and Internal Revenue ruling yesterday on 1031 tenant-in-common structures.

According to Revenue Ruling 2004-86, investors in multi-owner Delaware statutory trusts formed to own real estate can defer capital gains taxes on an exchange if the exchange is in a property interest or an interest in a trust, as defined by the IRS. If the trust does not meet the IRS specifications, it is considered a partnership or corporation--not real estate--and not eligible for tax deferral. Treasury officials had previously indicated that Delaware statutory trusts may be partnerships and may not able to offer their investors tax deferral on exchanges.

"In order for the taxpayer to complete the like-kind exchange, they need to have the exchange be in a property or a trust; it does not work in a partnership," said a Treasury Department spokesperson.

Typically, each tenant-in-common investor sets up a single-member limited liability company. Using the Delaware statutory trust structure, however, would save both time and money.

The Investment Exchange Program Association filed a white paper with the IRS in December of 2002 explaining why Delaware statutory trusts should be eligible for tax deferral.

"It was our belief that, even if it was a common entity holding the property, you had to look through the entity; it was a disregarded entity," said Patricia Del Rosso, president of Inland Real Estate Exchange Corp. and a director of the Tenant-in-Common Association.

But while the ruling offers some guidance, Del Rosso said, it seems to be limited guidance. In her opinion, because a key element of the ruling was that Delaware statutory trusts not "vary the investment due to market fluctuations," it will be limited to master lease deals whereby you have a property master-leased by a sponsor to tenant-in-common owners or a simple single-tenant triple net lease where the lease terms would be co-terminus with the mortgage and Delaware statutory trust terms.

"This ruling isn't going to upset the apple cart or change much," said Del Rosso.

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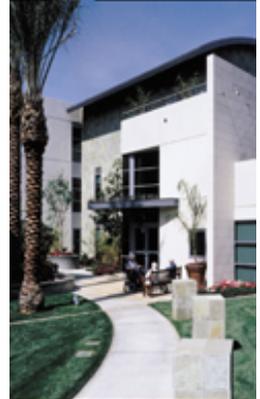
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