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## 'Tenant in Common' Properties Can Yield Tax Benefits

Recent IRS OK for 1031 Property Exchanges Spurs Popularity

**Property** owners/investors trying to increase their return on equity and cash flow should be aware of the **recent IRS** approval of "Tenant in Common" ownership.

In the year ahead, a significant number of commercial real estate transactions in San Diego will be Tenant in Common **1031 exchanges**.

A **1031** exchange allows an investor to defer paying capital gains tax on the sale of real estate, providing that certain rules are met. In March of 2002, the **IRS** sanctioned TICs as eligible candidates **for 1031 exchanges**. What does this sanction mean **for 1031** investors?

To answer this question, let's first reiterate the definition of a TIC and its purpose in the marketplace. A TIC is a form of ownership that allows multiple investors to own an undivided, deeded interest in a single **property**. TIC properties can include apartment complexes, industrial and office parks, and retail centers.

There are numerous benefits of investing in a TIC **property**. First, **property** management teams are already in place with TIC ownership. This eliminates many of the worries associated with building ownership, including the “Four T’s”: tenants, trash, turnover, and toilets. Second, companies offering TICs usually buy buildings with credit tenants who have long-term leases and qualify **for** non-recourse loans. Third, TIC properties provide a higher depreciation basis. Fourth, the current wave of TICs are those providing a cash flow in the neighborhood of 7-8 percent.

Moreover, the availability of TIC properties is growing in San Diego, where investors often can choose from an inventory of diverse **property** types. Growing availability allows investors to diversify their real estate holdings into several geographic locations and **property** types.

#### • **Determining 1031 Exchange Eligibility**

IRC Section **1031** is a powerful tool that allows investors to exchange investment **property for** other investment **property**. Owners of real **property** can sell their **property** and buy other like kind **property** without paying the capital gains tax.

Examples of **1031 exchanges** include (but are not limited to): land **for** an office building; an industrial **property for** a retail center; and rental houses **for** an industrial building.

Since the **IRS** sanction in March 2002, the **1031** umbrella has expanded to encompass TIC properties. General rules **for a 1031** exchange include the following:

- The exchanger cannot accept money during the transaction; he or she must use an intermediary to hold the proceeds while the exchange is in progress.
- The exchanger has 45 days to identify the replacement **property** or properties (this rule hopefully will soon change to 180 days).
- The replacement **property** or properties, as well as the debt, must be of equal or greater value to the **property** sold.
- The entire process **for** the acquisition of the identified replacement **property** or properties must be completed within 180 days of the sale.

### • Better To Sell Or Exchange?

Without a doubt, the biggest advantage to entering a **1031** exchange is to defer the tax burden. Another advantage is multi-generational. After a lifetime of tax deferral through exchanging, an investor may leave an investment **property** to his or her successors. The heirs will receive a stepped-up basis **for** the bequeathed **property** and will have to pay no tax if sold at the stepped-up basis.

If a **property** is sold without a tax-deferred exchange, the seller will receive the cash from the sale. However, the seller will be forced to pay a 15 percent “capital gains” tax, a 25 percent tax on recapture of depreciation, and a nine percent California state income tax. These taxes, on average, equal 30 percent of the profit from sale.

Overall, the eligibility of TICs **for 1031 exchanges** is a good thing **for** investors. If you haven't found your ideal exchange **property** within your identification period, a TIC **property** could be your solution. During the identification period, a TIC **property** can be listed along with other properties as your exchange **property**.

Bear in mind that all real estate transactions involve risk, so it is important to have accurate and current information on any **property** before making the decision to sell or exchange. Working with a qualified and experienced real estate broker well versed in all facets of the market – particularly with TIC properties and **1031 exchanges** – can be helpful in identifying an investment **property** that fits an investor's specific needs; and in executing a transaction that will yield the highest return on investment possible.

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