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In Next Month's Issue

- The Economics of Syndicated Tenant in Common Investments

SYNDICATED TENANT IN COMMON INVESTMENTS, YOUR CLIENT, AND YOUR MALPRACTICE CARRIER MAKES 3!

The question we should be asking ourselves, "Will the syndicated Tenancy in Common Investment that your client bought, or will buy, be treated by the IRS as a tax partnership with the result that the Section 1031 exchange fails and your client is taxed on the exchange in the year of the original sale?"

The answer to this question involves a detailed review of a document which doesn't always exist, at least, before the end of the 45 day identification period. Many times a client will identify a prospective investment on the basis of the pre-prospectus sales material. This sales information does not contain sufficient details to determine whether the TIC investment contains a master lease agreement, which permits a sharing of revenue between the Sponsor and the TIC owners. While only a minority of TIC sponsors include a master lease type arrangement, with in excess of 200 spon-

sors at the end of 2004, it is hard to say if your TIC contains such an arrangement. Further, the trade association for TIC's, TICA, indicates that this type of arrangement is on the upswing.

The primary objection to a master lease arrangement in a TIC is that it involves the sharing of rental income between the owners and the sponsor. Where parties join together, having agreed that services and/or capital will be contributed by each to conduct a business, and the contributors shall participate in the distribution of profits, that is sufficient to create a partnership for tax purposes. Flexible profit sharing arrangements are a hallmark of partnerships.

TIC sponsors rely heavily on Revenue Procedure 2002-22, which does not address a master lease type arrangement. Revenue Procedure 2002-22 provides guidelines under which the IRS will rule whether a TIC investment qualifies under Section

1031. TIC sponsors should be more concerned with case law which defines the parameters of a partnership for tax purposes.

Further, TIC sponsors are quick to dismiss Revenue Procedure 2002-22 if it contravenes their transaction, such as control over leasing, management agreements that automatically renew, excessive fees and profits, including "repositioning fees" and profits on the sale to the TIC owners.

Further, recent TIC sponsors have included a call option where the TIC sponsors can buy back the investment at fair market value and take out dissenting TIC owners at appraised values. However, where as much as 35% of the equity goes to selling commissions and closing costs, fair market value purchase within 5-7 years after the original purchase can result in a significant loss to the TIC owners.