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# MEMORANDUM

TO: ELEVENTH ANNUAL REAL ESTATE SYMPOSIUM ATTENDEES

FROM: GEOFFREY N. TAYLOR, ESQ.

RE: TENANCY IN COMMON AND 1031 EXCHANGES

DATE: May 4, 2004

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Sales of property generally result in gain recognition. Gain is, roughly speaking, the difference between the acquisition cost and the sale price. However, gain can be deferred in connection with a "1031 exchange" (named for the associated Internal Revenue Code section). In a typical 1031 exchange, an owner sells real estate and purchases like-kind, replacement property. The replacement property must be identified within 45 days after the sale and purchased within 180 days after the sale. There are also limitations on the number of properties that can be identified within the 45-day period. An independent intermediary often prepares the exchange agreement and handles the money because the seller's actual or constructive receipt of the sales proceeds before receipt of the replacement property might disqualify the exchange from non-recognition treatment. A significant issue for the seller is always that if identifying and closing on a replacement property. Recently tenant in common investment programs have come into vogue to address that need.

In a tenancy in common investment program ("TIC"), each tenant owns an undivided fractional interest in property, such as an office or apartment complex. A perceived advantage of TICs versus individually-owned property is cash flow maintenance and potential appreciation while shifting the responsibility of and the problems associated with property management to a third party.

Historically, one problem with purchasing a TIC interest was the uncertainty of whether the investment could qualify for non-recognition treatment upon exchange or whether the investment would be treated as a partnership interest and thus be excepted from non-recognition treatment. Stated another way is a TIC eligible Section 1031 Exchange Property. In Revenue Procedure 2002-22 the IRS established a process by which an investor or TIC sponsor could obtain a ruling that the interests in a particular TIC will qualify for non-recognition treatment in a like-kind exchange if certain conditions are met (e.g., no more than 35 co-owners and unanimous owner approval for hiring or retaining a property manager or selling the property).

TICs that have received a favorable ruling from the IRS may offer advantages over individual ownership. The relatively ready availability of TIC investment program properties can assist sellers facing the 45-day and 180-day deadlines to identify and purchase replacement property. The growing popularity of TICs (in large part due to the IRS guidance described above) has expanded the market for replacement interests and the sponsors will be quick to close on the replacement purchase.

An investor considering purchasing an interest in a TIC should be cautious and diligent. Because TICs receive far less regulatory oversight than the securities industry, fewer safeguards exist to protect the investor against potential fraud or mismanagement by the sponsor. The investor should scrutinize the track record of the sponsor and the particular aspects of the underlying property, including the financial strength of tenants, length of leases, pricing of comparable properties and physical condition of the structures. Financial statements that are reviewed by a third party should be provided regularly to the investor.

Our firm has significant experience with 1031 exchange arrangements. If you would like to discuss a deferred exchange transaction with us or nee advice about a possible TIC transaction, please contact me at (248) 827-1871 or gnt@maddinhauser.com.