

Are Properties Owned As Tenants In Common "Like-Kind" in a 1031 Exchange?

One of the most critical aspects of a Section 1031 is the idea that the properties involved must be “like-kind” to one another. This gives rise to a common misconception that “since I sold a single-family rental, I must buy a single-family rental.” The IRS clarified this issue in 2002 when it issued Revenue Procedure 2002-22.

At its core, Revenue Procedure 2002-22 authorized the acquisition of a Tenants in Common (“TIC”) interest in real estate as Replacement Property for other interests in real estate. In short, a TIC is a form of real estate ownership where two or more people each own undivided interests in the entire property. For a tenants in common ownership structure to be valid, and not construed as a partnership, several factors will be considered, including:

- (i) the existence of a written tenants in common agreement among the co-owners;
- (ii) the co-owners do not hold themselves out as a partnership by filing a partnership return, trading under a business name, or otherwise; and
- (iii) their voting rights, rights to profits and losses, and other rights and responsibilities must be proportional to their respective investments in the property.

Where an investor wishes to acquire a TIC interest as Replacement Property in a 1031 Exchange, the identification of that TIC interest should be precise and explicit. It is not enough to identify “a TIC interest in 214 E. Second Street, Ottumwa, Iowa.” Rather, the identification should specify the fraction or percentage interest to be acquired, such as “an undivided one-half interest in 214 E. Second Street, Ottumwa, Iowa” or perhaps “an undivided 14.5 percent interest in 105 E Third Street, Ottumwa, Iowa.”

The use of the TIC ownership structure allows multiple investors to pool their resources to acquire a larger or more expensive property than they could otherwise acquire individually. And not everyone investing in the TIC property must be participating in a 1031 Exchange. For example, Rosa just sold a \$125,000 investment property as part of a properly structured 1031 Exchange. She has found a great property in which to reinvest, but at \$1.1M, it is too expensive for her. Rosa invites several of her friends to reinvest with her, each contributing various amounts to the purchase. Rosa will identify and acquire an undivided 11.36 percent interest in the property, with her friends acquiring the remaining portion of the property. asked of the Exchanger on the exchange reporting form 8824 about compliance with these rules.