

## Revenue Procedure for Tenant in Common Ownership in Tax-Deferred Exchanges (Rev. Proc 2002-22)

Rev. Proc. 2002-22 does not provide the "safe harbors" for TIC programs. Instead, Rev. Proc. 2002-22 offers a series of

- **Guidelines** for requesting advance rulings to assist taxpayers in preparing a ruling request on specific "co-ownership" structures and proposed transactions, and
- **Conditions** present in the proposed TIC structure under which the IRS normally will consider a request for a ruling.

These Guidelines and Conditions constitute requirements for advance rulings and are the clearest set of principles the Service has set out as to its thinking on TIC programs.

**I.** The *Guidelines* outline specific information to be submitted for a ruling request. Rulings will be given only for actual, not hypothetical, transactions. The request must contain a complete statement of all facts relating to the co-ownership, promotion, financing and management of the specific property and to each of the actual co-owners.

**II.** The following *Conditions* must "ordinarily" be satisfied for the Service to consider a request. "Nevertheless, ... the Service may consider a request for a ruling... where the facts and circumstances clearly establish that such a ruling is appropriate." (The following is a summary of the 15 listed Conditions.)

**1. Tenants In Common Ownership** by each of the co-owners under local law.

**2. Number of Co-Owners** is limited to no more than 35 persons (husband and wife are treated as a single person).

**3. No Treatment of Co-Owners as an Entity** so that co-owners not file a partnership tax return or otherwise conduct business under a common name or hold themselves out as a partnership, corporation or other business entity.

**4. Co-Ownership Agreement** where the co-owners may enter into a limited co-ownership agreement that may run with the land.

**5. Voting** the co-owners must retain their voting rights for unanimous approval required for any sale, lease or release of a portion or all of the property, any negotiations or re-negotiations of indebtedness secured by the property, the hiring of any manager, or the negotiation of any management contract. For all other actions, the co-owners may agree to be bound by a vote of more than 50% of the undivided interests.

**6. Restrictions on Alienation** in general, each co-owner must have the right to transfer, partition, and encumber their interest in the property without the agreement or approval of any person. However, restrictions required by a lender and that are consistent with customary commercial lending practice are not prohibited. Moreover, the co-owners or the sponsor may have a right of first offer and a co-owner may agree to offer an interest for sale to the other co-owners or the sponsor at fair market value before exercising any right to partition.

**7. Sharing Proceeds and Liabilities Upon Sale of Property** if the property is sold, any debt secured by the property must be satisfied and the remaining proceeds distributed to the co-owners.

**8. Proportionate Sharing of Profits and Losses** where each co-owner must share in all revenue generated by the property and all costs associated with the property in proportion to their interests in the property.

**9. Proportionate Sharing of Debt** where the co-owners must share in any indebtedness secured by the property in proportion to their undivided interests in the property.

**10. Options** where a co-owner may issue an option to purchase the undivided interest (call option), provided the exercised price reflects fair market value of the property determined as of the time the option is exercised. A co-owner may not acquire an option to sell the undivided interest (put option) to the sponsor, the lessee, another co-owner or the lender.

**11. No Business Activities** where the activities of the co-owners must be limited to those customarily performed in connection with the maintenance and repair of rental real estate. See Rev. Rul. 75-374, 1975-2 CB 261.

**12. Management and Brokerage Agreements** where the co-owners may enter into management or brokerage agreements, which must be renewable no less frequently than annually with a sponsor or co-owner but not a lessee. The management agreement may authorize the manager to maintain common bank accounts for the collection and deposit of rents and to offset expenses associated with the property against any revenues before dispersing each co-owners'

share of net revenues. The management agreement may authorize the manager to take certain actions on behalf of the owners (subject to the voting regime described above in Paragraph 5). The fees may not be based in whole or in part on the income or profits derived from the property and the fees may not exceed the fair market value of the manager's services.

**13. Leasing Agreements** where all leasing agreements must be bona fide leases for federal tax purposes and rents reflect the fair market value for the use of the property.

**14. Loan Agreements** where the lender with any debt that encumbers the property or is used to buy an undivided interest may not be a related person to any co-owner, the sponsor, the manager, or any lessee of the property.

**15. Payments to Sponsor.** The amount of any payment to the sponsor for the acquisition of the co-ownership interest and services must reflect the fair market value of the interest acquired and the services rendered and may not depend, in whole or in part, on the income or profits derived from the property.

### **CONCLUSION**

While the Rev Proc does not provide a "safe harbor" for transactions that are structured under a TIC ownership, it does provide a useful guideline. Few, if any TIC programs comply with all 15 points. Some points are generally considered to be more important than others when determining whether the ownership structure would be considered a partnership by the IRS. Anyone considering buying a TIC property should carefully evaluate how the TIC agreement compares to Rev Proc 2002-22.