1031 Exchanges and Tenants in Common (TICs)

By: Dennis Kamensky, tax accountant and real estate consultant

A few days ago I received a telephone call from an old friend and client. He was selling a rental property that he had owned for many years, and had greatly appreciated in value. He was very concerned about the tax consequences of selling this property and, “were there any way to avoid paying the taxes on the capital gains.” I set up a consultation appointment and together we went through the various options and scenerios involved in selling this property.

First, I explained to him how to determine the exact amount of capital gain and the approximate amount if income taxes (both federal and state) he would pay by just selling this property and taking the profit. He didn’t realize that all the depreciation that had been taken on his income tax returns for all the years he had owned this property had to be added back into his capital gain (the tax term is “recapture of depreciation”). And, that this amount would be taxed at 25% and not at the 15% rate like most other long term capital gains. Also, since he lives in the great state of California he would pay 9.3% of the entire capital gain in state income taxes (Ca. does not give any tax break for long, or short, capital gains). Therefore, given his tax bracket, he would pay over 30% of the gain in taxes. What could he do?

I suggested doing a 1031 tax-deferred exchange. He could sell the property, not touch the proceeds using a third party accommodator, then identify within 45 days up to 3 replacement investment properties, and then purchase one or more properties with 180 days. All his proceeds would have to go into the new property (ies), and the total cost of all the replacement properties would have to be equal, or greater than, the net selling price of the property that was sold. In this way he could defer all the capital gains on his sale and continue to own investment real estate.

The problem was he was tired of being a landlord, dealing with tenants and various management companies. There really is a “burnout” factor in owning rental property. But, there is a very good solution to this problem.

I suggested he look into Tenants in Common (TIC) investments. These real estate investments are specifically designed for people who want to do 1031 exchanges to avoid paying all the taxes, and want safe, secure, real estate investments that are managed and run by knowledgeable real estate professionals. Isn’t it better to defer paying your taxes on the capital gains, and continue having all your money work for you (usually paying you and 8% cash-on-cash return on your money invested)? The IRS, under regulation procedure 2002-22 has accepted TIC ownership as qualifying for 1031 tax-deferred exchanges. Many people, who own income-producing real estate, are tired of all the hassles of owning and running these properties. In California (the SF Bay

Area especially), they’re tired of all the government anti-landlord bureaucracies and the fact that the cash flow is very low and inconsistent. What we have is great real estate appreciation and flat rental income. Now may be the time to sell and look into doing a 1031 exchange into a more secure, better cash flow, TIC. After all, we worked hard to make money on our real estate investments. Let’s simplify our lives, and have a more secure and stable future.

Dennis Kamensky has over 30 years experience as a tax accountant and real estate consultant. He is the author of WINNING ON YOUR INC OME TAXES, WOMEN AND TAXES, and has appeared on over 250 radio and TV shows. He presently is a managing partner in the real estate investment firm, SVC Partners. SVC Partners. He is directly involved in purchasing investment property for 1031 TIC exchanges. Dennis can be reached at 510-339-9680 or email him at dkamensky@svcpartners.com