

Fractional Ownership Through Real Estate Exchanges

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On March 19, 2002, the Internal Revenue Service issued Revenue Procedure 2002-22. This Revenue Procedure, explains the conditions under which the Internal Revenue Service, would consider a request for a ruling that an undivided interest referred to as (fractional ownership or T.I.C.'s, tenants-in-common) would be considered an interest in other real estate deemed of a "like-kind" for exchange purposes.

This Revenue Procedure provides for a new approach to real estate investing. For those sellers (taxpayers) of business-held or investment real estate, who are disposing of their property known as the "relinquished property" and having to acquire other property known as their "replacement property" to complete a real estate exchange.

A real estate exchange is an opportunity to PAY NO CAPITAL GAINS TAX when disposing of business-held or investment real estate. One of the biggest problems that people have in successfully completing a deferred exchange transaction is not knowing what they are going to purchase as a replacement property. Another concern is acquiring a replacement property without the headaches of management.

Real Estate is no different than any other form of a business. It doesn't manage it self. Although real estate has been one of the most secure, safest and successful investment vehicles, one of the biggest problems associated with it has been the management headaches involved in ownership.

Today, this problem has been eliminated, through the use of what's being called fractional ownership or T.I.C.'s (tenants-in-common). Some of the advantages of this form of co-ownership includes the ability to acquire a portion of a high-quality institutional grade property that has been previously reserved for only large institutional investors in the past. In addition, it eliminates active property management and alleviates the burdens of being a landlord, so it doesn't matter where the property is located. This allows the investors to purchase in markets that are experiencing great growth and allows for property management to be provided through real professionals.

Most real estate investors own their properties as a sideline to their full-time jobs, and have little time to devote to their real estate investments. As baby-boomers approach retirement, they seek to eliminate the hassle of active property management and take a more passive approach to ownership investing.

This form of co-ownership can provide the same economic benefits such as appreciation potential, tax savings, equity build-up and cash flow without the landlord responsibilities normally associated with real estate ownership. Many “burned-out” landlords who believe in real estate as an I.D.E.A.L. Investment, or those who are not believers of the Stock-Market will turn to this form of Real Estate Investing ownership.

There are companies who provide this form of fractional ownership. Qualified Intermediaries for real estate exchanges are in a perfect position to do so because of the nature of their business.

For nearly two years the tax community has awaited guidance that the Internal Revenue Service indicated would be forthcoming, anticipating a set of rules which might formally bless certain co-ownership arrangements, and thus give taxpayers some certainty in this area. While Revenue Procedure 2002-22 does not create such a safe harbor, it does signify where the Service would be willing to issue a favorable ruling on a specific co-ownership structure.

So, if you are looking for an alternative to sole ownership of real estate as an investment without the headaches of property management, then “fractional ownership” might be what you are looking for. As with an real estate exchange transaction, always consult a professional qualified intermediary first.

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