



OVERVIEW

PLR 200826005, 200829012 and 200829103:

Two Party TIC Arrangements Approved

In letter rulings obtained under Revenue Procedure 2002-22, the IRS ruled that 50% undivided fractional interests in several jointly owned properties are not partnership interests for purposes of qualification as eligible replacement property under § 1031.

In each of the rulings, two co-owners owned 50% undivided interests in several properties through various affiliated entities. Each of the properties was governed by a virtually identical tenants-in-common agreement. These agreements generally satisfied the requirements of Revenue Procedure 2002-22. However, there were a few variations that appear to be limited to two party co-ownerships.

First, section 6.06 of the Rev. Proc. provides that each co-owner must have the right to transfer its interest in the property without the approval of any person, but non-selling co-owners may also have a right of first offer if a co-owner exercises its right to sell. The agreements in these rulings went farther than a right of first offer and provided that, if the sale would result in a change in control of the property, a specified buy-sell procedure must be followed. Under this procedure, the initiating co-owner desiring to transfer or sell had to give the other co-owner a pre-offer notice. If the co-owners could not agree on a purchase price, the initiating co-owner could force a sale by setting a fixed price for the property as a whole at which the other co-owner must either sell its interest or buy the out the initiating co-owner. The rulings hold that the buy-sell procedure is consistent with granting an option to acquire 50 percent of the property at fair market value under Section 6.10 of the Rev. Proc. (which allows a co-owner to grant an option at FMV to sell, but not to acquire a put option) because the co-owners are unrelated and are dealing at arms' length. While section 6.06 also requires that the co-owners retain the right of partition, the co-owners in the rulings agreed to invoke these buy-sell procedures prior to exercising the right of partition. Moreover, the co-owners agreed that the property may be partitioned through arbitration.

Second, section 6.06 of the Rev. Proc. also provides that the co-owners must have the right to encumber their interest in the property without the approval of any person. In these rulings, however, each co-owner had the right to approve the pledge of the other co-owner's interest in the property. The rulings conclude that because there are only two 50 percent interests in each property, the co-owners' right to pledge their interest or otherwise encumber the property were activities that could significantly diminish the value of the other 50 percent interest in the property. Therefore, requiring the approval of the other co-owner for a pledge is consistent with the requirement under section 6.05 of the Rev. Proc. that each co-owner has the right to approve an arrangement that will create a lien on the property.

Third, each property in the rulings was subject to a non-recourse loan extended by an unrelated lender, but certain provisions were guaranteed by the co-owners, or an affiliate. If any co-owner or affiliate paid more than the co-owner's 50 percent share of the amount due under the loan agreement, pursuant to a guaranty or otherwise, that co-owner had a right to be indemnified by the other co-owner for the amount in excess of a 50 percent share of the expense.

Fourth, each property was leased to an affiliate of one of the co-owners, along with leases to other unrelated lessees. This affiliate conducted a business that was unrelated to the management and leasing of the property. The rent payable under the leases (including the affiliate lease) was not dependent on the profits derived by the lessee (other than an amount based on a fixed percentage or percentages of receipts or sales).

These rulings are similar to the earlier PLRs 2006250009 and 200625010, and they allow some flexibility for two person co-ownerships to meet the requirements of Rev. Proc. 2002-22.