

# Client Alert

Real Estate Department

April 23, 2008

## Tenant in Common Checklist

**Question:** We have owned the property as Tenants in Common (“TICs”) for an extended period. We do not have a written agreement between us. We are signing a new, very significant lease. What ownership issues should we address?

- Answer:**
- All TICs must agree to the lease. Any material modification will also require unanimity unless there is a written agreement to the contrary. (IRS Rev. Proc. 2002-22 permits a manager or agent to implement lease modifications by majority vote. Rev. Proc. 6.05.) Consider appointing a manager or an agent who may sign modifications by majority vote.
  - You will not lose tax treatment as a TIC if all TICs hire a manager for a one year term. (Rev. Proc. 6.05)
  - You will not lose TIC tax treatment if, after the lease is approved, a specific power of attorney is granted by a TIC to sign the lease (Rev. Proc. 6.05). A global POA is not permitted, however.
  - Any TIC may start a partition action at any time. Consider an agreement requiring a buy/sell mechanism prior to a partition. The Rev. Proc. permits a fair market value option in favor of the TICs who do not wish to partition but does not permit a prohibition on partition unless required by a third party mortgagee.
  - TICs may transfer their TIC interest to third parties. Consider an agreement requiring a right of first offer or refusal. The Rev. Proc. permits a right of first refusal or similar buy/sell right to prevent such sales.
  - Consider an agreement to create a buy/sell right in the event of a bankruptcy of a TIC.
  - Capital raises must be accomplished by percentage interest. Preferred returns are not permitted under the Rev. Proc. Consider obtaining any required cash up front. Profits must be split strictly by TIC percentages.
  - The manager may maintain a common bank account but net revenues must be disbursed every 3 months according to the Rev. Proc. The manager may obtain insurance (Rev. Proc. 6.12). The manager may not take a share of profits.
  - A pass through lease, i.e., a lease which permits the tenant to sublease and keep profits, would not fit within the safe harbor of the Rev. Proc. See Rev. Proc. 6.13 (Rents paid by a lessee must reflect fair market value.).

As an alternative, consider a transfer of the TICs to an LLC.

- Pros:**
- Easier voting provisions (majority or super majority).
  - Easier enforcement of the lease.
  - Eliminates partition risk.
  - Provides greater continuity.
  - No transfer taxes in New York if same beneficial interests are maintained.
- Cons:**
- Deed recording charges.
  - Minority rights inevitably diluted.
  - Need unanimous consent to the transfer.
  - The individual TICs could no longer benefit from separate IRS Section 1031 exchanges if the property is sold. Unless the ownership is split up later, only the LLC could exchange the property.

This is a summary only and is not legal advice. The specific facts and circumstances must be reviewed carefully. The Rev. Proc. And other applicable laws must be reviewed prior to taking any action.

---

Thomas D. Kearns  
tkearns@olshanlaw.com

This publication is issued by Olshan Grundman Frome Rosenzweig & Wolosky LLP for informational purposes only and does not constitute legal advice or establish an attorney-client relationship. To ensure compliance with requirements imposed by the IRS, we inform you that unless specifically indicated otherwise, any tax advice contained in this publication was not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code or (ii) promoting, marketing, or recommending to another party any tax-related matter addressed herein. In some jurisdictions, this publication may be considered attorney advertising.

Copyright © 2008 Olshan Grundman Frome Rosenzweig & Wolosky LLP. All Rights Reserved.