

Tenant in Common Structures for Real Estate Families Pursuing Separate 1031 Exchanges

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For real estate families considering **1031 exchanges**, tenant in common (TIC) ownership structures can provide both flexibility and tax efficiency. This approach can allow different family members to pursue individual capital gains deferral strategies while maintaining shared ownership of investment property.

Overview

Families that own investment real estate together frequently face the challenge of balancing collective ownership with individual tax planning objectives. A recurring issue arises when different family members wish to sell property and pursue separate Section 1031 like-kind exchanges to defer capital gains taxes. One commonly used tool to achieve this flexibility is the tenant in common (TIC) structure.

Properly structured, TIC ownership allows each family member to be treated as a separate taxpayer for 1031 purposes—permitting some to exchange while others cash out or pursue different investment strategies. However, the structure carries technical requirements and practical pitfalls that must be carefully managed.

Advantages of TIC Structures for Families

Exchange Flexibility

- Each co-owner can decide independently whether to engage in a 1031 exchange.
- Provides liquidity options: one family member may sell and pay taxes, while another exchanges into new property.

Estate and Succession Planning

- TIC interests can be transferred by gift or inheritance more easily than partnership or LLC units.
- Facilitates <u>estate planning with investment property</u>, allowing heirs to hold fractional ownership without forcing a collective decision.

Simplicity

- Unlike LLCs or partnerships, TIC ownership requires no entity-level filings or state franchise taxes.
- Each owner holds a direct deeded interest in the property.



Structuring Considerations

Separate Taxpayer Requirement

Each family member must hold title directly as a tenant in common—not through a disregarded entity (unless carefully structured).

Revenue Ruling 2002-22 Guidelines

The IRS has published criteria under which a TIC interest is respected for tax purposes. Key points include:

- Each TIC owner must have the right to transfer, encumber, or partition their interest.
- No more than 35 co-owners.
- Restrictions on centralized management resembling a partnership must be avoided.

(See IRS Revenue Procedure 200-22 for detailed guidance.)

Operating Agreement / TIC Agreement

While not required, families often enter into a TIC agreement to govern cost-sharing, management decisions, and sale procedures. Careful drafting is essential to avoid "partnership-like" attributes that could jeopardize 1031 treatment. Families should also consider whether a TIC or an alternative structure, such as **joint ventures or structured investments**, is more appropriate for their long-term strategy.

Financing Issues

- Mortgage lenders may resist multiple co-borrowers, particularly where fractional interests exist.
- In connection with non-recourse real estate financings, mortgage lenders will likely require so-called "carve out" or "bad boy" guarantees from a principal of each TIC owner.
- Coordination with lenders is critical, especially when refinancing or selling.

Potential Pitfalls

Risk of Partnership Recharacterization

If co-owners behave like a partnership—sharing profits, restricting transfers, or delegating broad management powers—the IRS may treat the TIC as a partnership, disqualifying a 1031 exchange.

Liquidity and Transferability

TIC interests may be harder to sell than partnership units; limited market demand exists for fractional deeded interests.



Family Disputes

- Co-owners have equal rights of possession; disputes may arise regarding property use, management, or sale timing.
- Partition actions—forcing sale or division of property—are a legal risk.
- When disputes escalate or properties face financial pressure, families may need legal support with **workouts and restructurings** to preserve investment value.

Administrative Complexity

- Each owner must separately account for income, expenses, depreciation, and tax filings.
- Shared costs (insurance, maintenance, property taxes) require coordination.
- Administrative burdens may increase when TIC interests are layered into larger <u>real estate</u> <u>development projects</u>, where coordination across multiple owners is critical.

Practical Takeaways for Families

- Plan early: Advance structuring avoids IRS scrutiny and financing headaches.
- **Use strong agreements**: A well-drafted TIC agreement helps prevent disputes and keeps the structure within IRS guidelines.
- **Coordinate financing**: Engage lenders early to avoid issues with refinancing or carve-out guarantees.
- **Think about succession**: TIC structures can simplify transfers to heirs and support broader estate planning goals.
- Assess family dynamics: TIC ownership works best when co-owners share aligned expectations and trust.

Next Steps

TIC structures can be a powerful tool for families seeking to preserve 1031 flexibility and accommodate divergent investment horizons. To ensure compliance and protect your tax-deferral strategy, it's essential to align legal, tax, and financing considerations from the outset.

If your family is considering a sale or 1031 exchange, our <u>real estate attorneys</u> can help evaluate TIC structures, draft tailored agreements, and coordinate with lenders to minimize IRS risk. <u>Contact</u> <u>us</u> to discuss how we can support your planning.

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