Why tenant-in-common (TIC) ownership may be one of the best kept estate planning secrets

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A Tenant-In-Common (TIC) ownership interest in real estate can be purchased, sold, gifted, willed, or inherited in the same manner as any property held in fee simple deeded ownership with one major exception, according to the IRS, TIC ownership is a minority interest which receives a valuation discount for estate planning purposes. Upon the TIC owner's death, his or her interest in the TIC passes through inheritance as directed by will, trust or other estate planning document. The interest is not divided among the other existing TIC owners contrary to Joint Tenants With Right Of Survivorship (JTWROS) ownership. Unlike property held in JTWROS, TIC interests do not avoid probate. However, TIC ownership has different purposes and uses, and there are advantages to using it as an investment vehicle.

Potential Tax Advantages

From an estate planning perspective, TIC investors' heirs benefit from multiple tax advantages upon inheriting the real estate. Not only will TIC investors holding appreciated property avoid federal and state capital gains and federal depreciation taxes by holding the property until death but their heirs also may gain tax advantages through a "stepped up" basis in that property, allowing the heirs to sell their TIC interest, if they so wish, without paying the decedent's aforementioned deferred taxes.

Determining Fair Market Value

Similar to any asset owned at death, a TIC investment is appraised at fair market value the day the investor dies or at the alternate valuation date of six months after death as allowed by the Internal Revenue Code. In estate planning, one of the major tools utilized to reduce the value of an estate is to create a Family Limited Partnership (FLP) with the heirs as Limited Partners (LP) and the Donor(s) as the General Partners (GP) and place the parent's assets therein. Since the partnership operating agreement states that the shares of the LP can only be sold to other shareholders, there is no secondary market to sell an owner's interest at fair market value. This "Minority Interest Discount" is reluctantly permitted and frequently challenged by the IRS. Therefore, a discount to the decedent's estate of about 35% - 40% for real estate owned by a FLP is unwillingly accepted by the IRS. Over the past 10 years, the IRS has vigorously attacked FLPs with limited success. Hence, owning a FLP in an estate assures you that the IRS will take a very close look and possibly challenge a decedent's estate.

When you place assets (1031 or cash) into a TIC investment, since you are a co-owner, the estate also receives a minority discount of about 35% - 40% which is virtually completely overlooked by the IRS when settling a decedent's estate as compared to the decedent's FLP ownership. This is why it is preferential to utilize a TIC to obtain a minority discount for estate planning involving Real Estate rather than an FLP. Here is an interesting scenario: You purchase a TIC and place the LLC ownership into a FLP, do you receive a double minority discount? Many estate planning experts say

"Yes."

Planning in Advance

There are two goals to achieve when planning an estate: Minimize taxes and get the property into the heir's hands with the highest possible basis from which to calculate future capital gains. Unfortunately, the two goals often conflict with one another. For example, owning a TIC in a single-member LLC, a disregarded entity by the IRS, could allow the owner to give away interests in the LLC before death as an estate reduction tool. Given the TIC value is considered a minority discounted interest of 35% - 40%, the heirs would actually receive an additional 54% - 67% of real property value for gifted interest. In this scenario, the owner is obviously attempting to reduce the estate's taxable value by annually giving away, gift tax free, up to $12,000 per heir per year per heir or recipient (i.e. husband and wife can gift $24,000 per year). For example, if 25% of the interest in TIC property is gifted pre-death to minimize estate taxes, the remaining 75% is included in the decedent's estate receives a stepped-up basis.

The 2010 Question

What about the magic year 2010 when by law all federal estate taxes are supposed to vanish? Should investors plan around that year by moving to an estate tax free state and plan to die in 2010? The answer is probably not, if Tony Soprano is not an heir since Dr. Kevorkian is out of business. It is reasonable to expect that congress will change the estate tax law prior to 2010, which likely will affect the proposed repeal. It is wise to advise clients to prepare their estate plans based on current tax laws utilizing flexible estate planning tools and make appropriate adjustments as the laws change.

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