

Office/Medical Condos And Timeshares As §1031 Qualifying Property

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Notwithstanding the state of the credit markets, the demand for office and other space in NYC and surrounding areas remains strong. Increasingly after considering the tax consequences, business owners are electing to purchase, rather than rent, their office and business space. Consequently, the interest in office and medical condominiums has been rising.

Developers too are seeing the value of creating office and medical condominiums thereby giving themselves the opportunity to rent or sell units in such buildings.

The fact that there is demand for office and medical condominiums is good news for owners of existing buildings with conversion potential. Buyers of such condos not only benefit from the advantages of ownership vs. leasing but also from the benefits that IRS §1031 offers. Fee ownership can create tax benefits that cannot generally be derived from leasing. Internal Revenue Code §1031 applies to “property held for productive use in a trade or business for investment.” Whether property is held “for investment” can require a fairly in depth examination of the facts and circumstances, whether property is being used in a trade or business is generally self-evident. Any property owned by an investor, which is used, by such investor for the operation of a business fits squarely within the definition of §1031 qualifying real property and thus will likely qualify for use in a tax deferred exchange. Thus, acquiring a condominium for office, medical or another business use can lead to adding property to one’s portfolio that can readily in the future be used in a §1031 exchange. Further, it is not necessary for the investor to buy a similar office or medical condominium as replacement property in the event the property is sold in a §1031 exchange. Though purchasing another office or medical condominium would generally qualify for §1031 purposes, the investor would not be restricted to such properties but would have the option to purchase any other real property used in its trade or business or held for investment. In addition, as acquiring another office or medical condominium for similar use would likewise qualify as replacement property under §1031, investors can relocate their businesses without capital gain tax consequences by performing a §1031 exchange.

Likewise, if an investor is in the midst of an exchange and seeking replacement property, the rise in the number of office and medical condominiums being created provides investors with additional replacement property options. This also allows investors with different spending requirements to be able to locate one or more office condominiums that in aggregate will allow the investor

to meet his/her reinvestment requirements and achieve 100% deferral. As one can either hold property for investment or for use in a trade or business to qualify under §1031, investors are not required to use the acquired condominium for their own trade or business purposes but can, alternatively, rent the condominium to another user and qualify the property as §1031 property by thus holding it for investment purposes.

Thus, while the popularity of office and other condominiums has given developers an opportunity to reap additional value from already highly appreciated property; the existence of such product in greater quantity provides additional tax benefits and options to investors as well.

Other property types that involve a fractional ownership interest in a fee or a larger building include timeshares and tenant in common interests. Even if the hotel market slows somewhat, it is expected that the market for timeshares in cities such as Manhattan and vacation destinations is likely to continue to thrive as the demand for short term stay housing continues to be high. Properly structured, timeshares that are considered real estate can also often qualify for use as relinquished or replacement property in a §1031 exchange. Generally speaking, the timeshare must grant the owner of the timeshare legal title to the property, rather than merely a right to use the property for a specified period of time. Additionally, as with all §1031 property, the owner must establish that the timeshare is held primarily for investment purposes, as opposed to personal use. Thus, a timeshare used exclusively for the owner’s personal enjoyment would not qualify. When searching for replacement property or considering investments to acquire, the potential to acquire a timeshare in a hotel property should not be overlooked. Many hotels today offer timeshares for sale in various locations and management of the property as well. Such investments are one of the few types of investments along with tenant in common programs that enable an investor to own a property without management responsibilities but with all the tax benefits of ownership.

Investors should always consider the tax consequences of ownership and engage appropriate legal and tax advice prior to entering into any transaction.

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