

# Real Estate Securities

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# NAR Exemption Request to SEC: The Public Comments Are In

By: Eric C. Perkins, Esq.

In recent years, the Real Estate Securities Group at Hirschler Fleischer has assisted its clients in raising in excess of \$8 billion of equity through TIC, REIT, Fund and other real estate-oriented securities offerings.

**ON NOVEMBER 9, 2007**, the Securities and Exchange Commission (“SEC”) issued a much-anticipated notice (Release No. 34-56779; File No. S7-26-07) (the “Notice”) concerning an application submitted on behalf of the National Association of Realtors (“NAR”) requesting an exemption from federal broker-dealer registration and reporting requirements under the Securities Exchange Act of 1934 (the “1934 Act”). The SEC called for comments from the public, and the comment period expired December 17, 2007. Set forth below is a synopsis of the feedback submitted to the SEC.

## I. General Observations and Common Themes

Approximately 3,000 concerned citizens responded to the Notice by submitting comments to the SEC. Based upon a review of the approximately 150 comments posted on the SEC website, the overwhelming majority of comments were submitted by individuals with ties to the securities industry (e.g., broker-dealer firms, registered representatives, and sponsors of securitized TIC programs). As a starting point, it seemed that most everyone supported the general concept of allowing real estate professionals to be compensated for their involvement in securitized tenant-in-common (“TIC”) offerings. However, the comments reflected significant differences of opinion in terms of how best to incorporate real estate professionals into the securitized TIC industry and the TIC offering process without fundamentally altering the nature of the TIC industry to the detriment of the investing public.

Not surprisingly, real estate industry professionals provided generally favorable comments in support of the NAR’s request. Securities industry professionals were more inclined to identify problems with various aspects of the NAR request and recommend substantive changes. There was an element of self-promotion and hyperbole in some of the comments, but several general themes were commonly cited and should set the stage for further review and analysis by the SEC before a final decision is rendered,<sup>1</sup> such as:

(1) Investor protection must be a primary goal.

(2) The SEC must provide sufficient guidelines describing how the real estate and securities industry professionals can work together in navigating the TIC offering process without jeopardizing the Regulation D, Rule 506 exemption upon which most, if not all, TIC offerings rely.

Another common response was to question the proposed requirement in the NAR request that the TIC security in question qualify as a replacement property for purposes of a like-kind exchange under Section 1031 of the Internal Revenue Code. Many suggested this requirement be deleted as it would be overly restrictive and fails to recognize that not all TIC investors come into TIC offerings as part of a Section 1031 exchange.

## II. Comments from the Securities Industry

While most comments from securities industry representatives were in favor of the general concept of permitting real estate professionals to receive compensation in connection with a securitized TIC offering, such approval was typically conditioned upon there being a reasonable resolution to several important concerns, including:

(1) The NAR request proposes an unworkable process for incorporating real estate professionals into the TIC offering process. Contrary to what was proposed in the NAR request, the securities professionals must be involved earlier in the process and have greater control over the distribution of information to investors to ensure compliance with applicable securities laws, address investor suitability issues, etc.

(2) The definition of “substantial real estate experience” necessary for a real estate professional to be eligible to rely on the requested exemption should be defined more narrowly and objectively. Education and industry certification standards are more relevant and useful in this context.

(3) There should be an established compensation or fee sharing structure to maintain a level playing field within the industry.

<sup>1</sup> One commenter suggested that a second public comment period would be appropriate to ensure all relevant issues are thoroughly considered. Another commenter suggested that the current proceedings should be converted into a formal rulemaking procedure.

# Safe Harbor for Harbor-View Property

By: John M. Ramey III<sup>1</sup>

A “dwelling unit” is defined as “real property improved with a house, apartment, condominium, or similar improvement that provides basic living accommodations including sleeping space, bathroom and cooking facilities.”

**ON FEBRUARY 15, 2008**, the Internal Revenue Service (“IRS”) released Revenue Procedure 2008-16 (the “Revenue Procedure”), stating in Section 2.06 thereof:

“The Service recognizes that many taxpayers hold dwelling units primarily for the production of current rental income, but also use the properties occasionally for personal purposes. In the interest of sound tax administration, this revenue procedure provides taxpayers with a safe harbor under which a dwelling unit will qualify as property held for productive use on a trade or business or for investment under § 1031 even though a taxpayer occasionally uses the dwelling units for personal purposes.”

The Revenue Procedure applies only to “dwelling units” that satisfy certain qualifying use standards. A “dwelling unit” is defined as “real property improved with a house, apartment, condominium, or similar improvement that provides basic living accommodations including sleeping space, bathroom and cooking facilities.”

The qualifying use standards are as follows: In the case of relinquished property (a) the taxpayer must have owned the property for the 24 month period immediately preceding the exchange and (b) within each twelve month period that makes up the 24 month period (i) the property must have been rented to another person at a fair rental for not less than 14 days and (ii) the taxpayer’s personal use of the property must not exceed the greater of 14 days or 10% of the number of days during the twelve month period that the property is rented.

While the calculations may be mechanical, determining fair rental and personal use is not. The Revenue Procedure directs taxpayers to Section 280A(d)(2) to determine the latter, but says the former will be determined based on all of the facts and circumstances.

What is clear is that documenting the use of the property is very important. So, while a dwelling unit that satisfies the qualifying use standards will be treated as having been held for investment or productive use in trade or business, even if some personal use has been made of it, only the taxpayer who meticulously documents the use of the property will ultimately be able to take advantage of the Revenue Procedure.

If you have questions about this or any other issues relating to Section 1031 or other real estate tax matters, please do not hesitate to contact the author.

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<sup>1</sup> Mr. Ramey is a shareholder with Hirschler Fleischer, a leading firm in the 1031 and tenant-in-common syndication fields, located in Richmond, Virginia

# Remember the 180-Calendar Day Exchange Period

Among the numerous requirements necessary to complete a deferred like-kind exchange under Section 1031, taxpayers must close on the acquisition of their like-kind replacement property or properties no later than the earlier of:

- (1) midnight of the 180th calendar day following the close of the relinquished property sale transaction; or
- (2) the due date of the taxpayer's federal income tax return for the tax year in which the relinquished property was sold, including any extensions of time to file.

Most of the time, the 180-day deadline is the only

relevant consideration. However, if the taxpayer sells his relinquished property toward the end of the year, the deadline for acquiring replacement property to complete his 1031 exchange becomes a trickier issue. In those situations, the taxpayer will have less than 180 calendar days to complete his 1031 transaction if the sale of his relinquished property closed between October 17 and December 31 of any given income tax year—unless the taxpayer files for an extension of time to file his federal and, if necessary, state income tax returns. Once the extensions of time have been filed, the taxpayer must complete his 1031 exchange transaction within the 180-calendar day period before actually filing federal and, if applicable, state income tax returns.

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- (4) Issues regarding liability risk sharing and responsibility for securities law compliance must be clarified.
- (5) The proposed "waiver of suitability" concept described in the NAR request should be rejected.

### III. Comments from the Real Estate Industry

There appeared to be significantly fewer comments from real estate professionals, most, if not all, of which

were solidly in favor of the NAR request. One of the few suggested changes was that the definition and application of the "substantial real estate experience" requirement be both simplified and broadened to allow more real estate professionals to earn compensation in connection with TIC transactions. Co-brokering was recommended as a mechanism to allow less experienced real estate professionals to partner up with more experienced colleagues to provide high-quality service to the investor and still fall within the protection of the exemption so as to receive compensation.

To read full article go to <http://www.hf-law.com/articles/SECNARExemptionArticle.pdf>  
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