



Real Estate Report

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Capitalization of Interest

by Brenda Jemmott, Tax Manager

Are you aware that interest incurred during the construction period is capitalized whether or not the interest was actually paid on a construction loan?

Certain direct and indirect costs are required to be capitalized as property. IRC Section 263A(f)(1) requires interest to be capitalized where it is paid during the production period and allocable to property which has a long useful life, an estimated

capitalized and included as land and building costs.

It is generally understood that construction period interest is capitalized, but many do not realize that the capitalization of interest cannot be avoided by deferring payment of operational costs or taking out operating lines of credit or other debt, so that current cash flow is available to fund development costs. Treasury Regulations section 1.263A-9 requires the use of the avoided cost method to determine the amount of capitalized production period interest. This method requires the capitalization of the interest which would have been avoided if accumulated production expenditures had been used to repay or reduce the taxpayer's outstanding debt. The underlying assumption under this method is that debt of the taxpayer would have been repaid or reduced but for the payment of development costs.

Because these interest capitalization rules are complex, you should seek the advice of a RINA real estate professional before financing construction costs.

Capitalization of interest cannot be avoided by deferring payment of operational costs or taking out operating lines of credit or other debt

production period exceeding 2 years or an estimated production period exceeding 1 year and cost exceeding \$1,000,000. This means that for most real estate development projects all of the interest incurred during the development period must be

Upcoming Real Estate Seminar

RINA, along with Oakland law firm *Burnham Brown and Bay Area Development Company*, is hosting a real estate seminar

Thursday, May 22, 2008
Round Hill Country Club
Alamo

Our featured speaker
Gary Allen with KNBR

Our panelists will be discussing the challenges of owning and leasing real property to closely-held businesses.

Contact Pamela Raumer for more information at 925-274-5740 or praumer@rina.com.

COMING SOON

The Second Edition of
RINA's
Brokerage Firm
Real Estate Survey.



What is a Family Limited Partnership?

by Brad Gai, Audit Stockholder

A Family Limited Partnership (FLP) is a tax planning, asset protection and financial planning technique that allows families to hold, manage and control wealth with several generations of family members as partners.

An FLP usually starts with the senior generation transferring assets to a Partnership. The assets transferred are usually, real estate, marketable securities, bonds, and other appreciating assets. In return for transferring these assets to the partnership the transferor will receive either a general partnership and/or a limited partnership interest in the FLP and then either gift or sell these units to other family members. By doing this, family wealth can be consolidated making transfers on death easier and in many cases less costly, tax wise. Experienced professionals (i.e. an attorney and CPA) should be consulted to determine if this entity is right for you. Contact a RINA estate planning professional for more details.



Dealer vs. Investor

by Tom Neff, Tax Manager

I sold several real estate investments this year. Will the IRS treat me as a “dealer”?

Unfortunately, the answer is not entirely clear. Therefore we must rely on court established factors such as, why the property was acquired, the extent of improvements and advertising to increase sales, and duration of ownership. The most important factors are the number, frequency, and substantiality of sales. Frequent buying and selling of real estate indicates a trade or business of real estate sales, which results in ordinary income treatment. However, individuals who demonstrate real estate activities are insubstantial to their normal occupation may preserve capital gain. One relief provision applies to subdividing a single tract of land; promotion and sales of lots from a single tract will not be treated as a trade or business. A qualified RINA tax adviser may be able to help you structure your transaction to ensure the most favorable tax status.



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Ask the CPA

by Tom Neff, Tax Manager

Q: Are there any new developments in the area of like-kind exchanges of Tenancy-In-Common (TIC) interests?

A: Under Revenue Procedure 2002-22, a TIC interest, unlike a partnership interest, is considered like-kind property for purposes of an IRC §1031 exchange. However, the FTB is auditing §1031 exchanges of TIC interests in some instances where the TIC more closely resembles a partnership.

FTB is following the Revenue Procedure 2002-22 conditions as a *minimum requirement* for determining the existence of a TIC interest. However, the FTB will request substantiation of those conditions in order to make a determination. The FTB is considering facts and circumstances, to determine whether an interest in a rental property is a TIC interest both in form and in substance.

The primary issue, which is whether the parties actually intended to and did in fact join together for an “undertaking of an enterprise,” will hinge on the following factors:

- the agreement between the parties, and whether its terms are being followed
- control over income and capital, and the right to take distributions
- whether the parties share in net profits and losses
- whether the business was conducted in the joint names of the parties, and whether they held themselves out as a joint venture
- whether separate books were maintained for the venture

Careful consideration needs to be given to each of these factors in structuring an exchange of real property held as a TIC.

To discuss your situation in more detail, please contact Tom Neff at (510) 893-6908.