

**Office of Chief Counsel  
Internal Revenue Service  
memorandum**

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subject: Tenant-in-Common Structures with Bankrupt Master Tenants

This advice may not be used or cited as precedent.

**ISSUE**

Whether the temporary pooling of funds on a non-pro rata basis and the appointment of a tenant-in-common owner ("TIC Owner") as a payment and/or communications agent because of the bankruptcy of the master tenant will cause the tenants-in-common to become partners in a partnership for federal income tax purposes?

**CONCLUSION**

If the tenant-in-common arrangements were not partnerships for federal income tax purposes prior to the temporary pooling of funds on a non-pro rata basis and the appointment of a TIC Owner as a payment and/or communications agent, these actions do not cause the TIC Owners to become partners for federal income tax purposes.

**FACTS**

X was a company engaged in the trade or business of sponsoring the syndication of undivided TIC interests in rental real property. X organized the sale of a substantial number of properties to a significant number of investors, mostly individuals.

**PMTA 2010-05**

In a typical offering of TIC interests, X, or an affiliate of X (“X Affiliate”), purchased real property (“Property”) for rental and then sold TIC interests in the Property to investors seeking to complete “like kind” exchanges pursuant to Internal Revenue Code (“Code”) § 1031. The purchase price for the TIC interest was comprised of cash received by the investor from the investor’s relinquished property and the assumption of debt encumbering the Property. In many cases, X or the X Affiliate retained a TIC ownership interest in the Property. The total number of TIC investors, including any interest retained by X or the X Affiliate, did not exceed 35 in any one property.

Contemporaneously with purchasing the TIC Interests, the TIC Owners leased the Property to Master Tenant, an affiliate of X, pursuant to a Master Lease. The TIC Owners entered into a Tenants-in-Common Agreement (the “TIC Agreement”) setting forth their rights and obligations with respect to the co-owned Property. The TIC Agreement contained certain conditions that are required for advance rulings with the Internal Revenue Service under Rev. Proc. 2002-22 (2002-1 C.B. 733). The TIC Agreement specifically requires the TIC Owners to share all revenues and fund all expenses related to the Property pro rata in proportion to their relative percentage TIC Interests.

X and several of the [REDACTED] affiliates filed petitions for [REDACTED] bankruptcy (“the Bankruptcy”). The Bankruptcy proceeding is pending. In many, if not all of the TIC properties marketed by X, the X Affiliate was [REDACTED]. As a direct result of the Bankruptcy, the TIC Owners undertook the following actions (collectively, “Certain Actions”) to protect their interests in the Property:

- (1) The TIC Owners pooled funds (initially on a non-pro rata basis) to timely pay legal fees and costs related to the Bankruptcy and to make debt service payments [REDACTED] with respect to debt encumbering the Property, with the intent of later effecting reimbursements among themselves in order to retroactively fund such fees, costs and debt service payments pro rata in proportion to the TIC Owners relative percentage TIC interests;
- (2) The TIC Owners designated one of the TIC Owners as a payment agent (the “Payment Agent”). The Payment Agents duties are limited to collecting funds from the TIC Owners and forwarding the funds to the TIC Owners’ legal counsel for disbursement. The Payment Agent does not separately maintain a bank account relating to the Property or the TIC Owners;
- (3) The TIC Owners designated one of the TIC Owners as a communications agent (the “Communications Agent”). The Communications Agent acts as a communication liaison between the TIC Owners and the attorneys, lenders, and other third parties involved with the Bankruptcy. The Communications Agent

only serves as a point of contact for distributing information between the TIC Owners and third parties.

The TIC Owners undertook the Certain Actions on an interim basis because of the Bankruptcy in order to protect the TIC Owners' investments in the Property. The Payment Agent and the Communications Agent do not receive (i) any compensation or other economic benefit for performing the tasks described in (2) and (3) above, or (ii) a power of attorney or other authority from the TIC Owners permitting such person to make decisions or execute documents on behalf of the TIC Owners.

[REDACTED]

[REDACTED] the initial non-pro rata pooling of funds has been equalized between the TIC owners in a reasonable amount of time. In most cases, however, TIC Owners equalized the non-pro rata pooling of funds greater than 31 days after the non-pro rata contribution by one or more TIC Owners. The TIC Agreement provides that, in the event that a cash contribution is required by the TIC Owners to pay expenses associated with the property, and one or more TIC Owner fails to make their pro rata contribution ("Non-Compliant TIC Owner"), the "Compliant TIC Owners" have the ability to recover these amounts from the Non-Compliant TIC Owner by either (i) diverting income from the Non-Compliant TIC Owner to the Compliant TIC Owners to make up for the shortfall, (ii) executing a forced sale of the Non-Compliant TIC Owner's TIC interest to the Compliant TIC Owners, or (iii) placing a legally enforceable lien against the Non-Compliant TIC Owner's interest in favor of the Compliant TIC Owners (collectively, the "Equalization Enforcement Actions"). [REDACTED]

[REDACTED]

## LAW & ANALYSIS

The central characteristic of a tenancy-in-common, one of the traditional concurrent estates in land, is that each owner is deemed to own individually a physically undivided part of the entire parcel of property. Each tenant-in-common is entitled to share with the other tenants the possession of the whole parcel and has the associated rights to a proportionate share of rents or profits from the property, to transfer the interest, and to demand a partition of the property. These rights generally provide a tenant-in-common the benefits of ownership of the property within the constraint that no rights may be exercised to the detriment of the other tenants-in-common.

Rev. Rul. 75-374 (1975-2 C.B. 261) concludes that a two-person co-ownership of an apartment building that was rented to tenants did not constitute a partnership for federal tax purposes. In the revenue ruling, the co-owners employed an agent to manage the apartments on their behalf; the agent collected rents, paid property taxes,

insurance premiums, repair and maintenance expenses, and provided the tenants with customary services, such as heat, air conditioning, trash removal, unattended parking, and maintenance of public areas. The ruling concludes that the agent's activities in providing customary services to the tenants, although imputed to the co-owners, were not sufficiently extensive to cause the co-ownership to be characterized as a partnership.

In Bergford v. Commissioner, 12 F.3d 166 (9th Cir. 1993), seventy-eight investors purchased "co-ownership" interests in computer equipment that was subject to a 7-year net lease. As part of the purchase, the co-owners authorized the manager to arrange financing and refinancing, purchase and lease the equipment, collect rents and apply those rents to the notes used to finance the equipment, prepare statements, and advance funds to participants on an interest-free basis to meet cash flow. The agreement allowed the co-owners to decide by majority vote whether to sell or lease the equipment at the end of the lease. Absent a majority vote, the manager could make that decision. In addition, the manager was entitled to a remarketing fee of 10 percent of the equipment's selling price or lease rental whether or not a co-owner terminated the agreement or the manager performed any remarketing. A co-owner could assign an interest in the co-ownership only after fulfilling numerous conditions and obtaining the manager's consent. The court held that the co-ownership arrangement constituted a partnership for federal tax purposes. In its decision, the court relied upon the limitations on the co-owners' ability to sell, lease, or encumber either the co-ownership interest or the underlying property and the manager's effective participation in both profits (through the remarketing fee) and losses (through the advances). Bergford, 12 F.3d at 169-170. See also Bussing v. Commissioner, 88 T.C. 449 (1987), *aff'd on reh'g*, 89 T.C. 1050 (1987); Alhouse v. Commissioner, T.C. Memo. 1991-652.

Rev. Proc. 2002-22 (2002-1 C.B. 733) specifies the conditions under which the Internal Revenue Service will consider a request for a ruling that an undivided fractional interest in rental real property (other than mineral interests) is not an interest in a business entity within the meaning of § 301.7701-3 of the Procedure and Administration Regulations. The guidelines set forth in the revenue procedure explicitly stated that they "are not intended to be substantive rules and are not to be used for audit purposes." Rev. Proc. 2002-22, § 3.

Section 6.08 of Rev. Proc. 2002-22 provides that "[e]ach co-owner must share in all revenues generated by the Property and all costs associated with the Property in proportion to the co-owner's undivided interest in the Property. Neither the other co-owners, nor the sponsor, nor the manager may advance funds to a co-owner to meet expenses associated with the co-ownership interest, unless the advance is recourse to the co-owner (and, where the co-owner is a disregarded entity, the owner of the co-owner) and is not for a period exceeding 31 days."

Section 6.11 of Rev. Proc. 2002-22 provides, in relevant part, that "[t]he co-owners' activities must be limited to those customarily performed in connection with the

maintenance and repair of rental real property (customary activities). Activities will be treated as customary activities for this purpose if the activities would not prevent an amount received by an organization described in § 511(a)(2) from qualifying as rent under § 512(b)(3)(A) and the regulations thereunder. In determining the co-owners' activities, all activities of the co-owners, their agents, and any persons related to the co-owners with respect to the Property will be taken into account, whether or not those activities are performed by the co-owners in their capacities as co-owners.”

#### Pooling of Funds on a Non-Pro Rata Basis

The TIC Owners pooled funds, initially on a non-pro rata basis, to expeditiously pay legal fees and costs related to the Bankruptcy, and to make debt service payments [REDACTED]. The Contributing TIC Owners intended to recover their non-pro rata advances from the other TIC Owners, as required by the TIC Agreement. The non-pro rata payments made by certain TIC Owners could not be equalized within the 31 days prescribed by Section 6.08 of Rev. Proc. 2002-22 due to the urgency of the Bankruptcy and difficulties in obtaining the identity and contact information of the other TIC Owners. The Compliant TIC Owners have, or affirmatively represent that they will, exercise the Equalization Enforcement Actions. Based on the stated facts, we conclude that the TIC Owners have not become partners in a partnership for federal income tax purposes even though one or more Non-Compliant TIC Owners has not made the equalization payments.

#### Appointment of the Communications Agent and Payment Agent

Given the circumstances resulting from the Bankruptcy of the [REDACTED], the TIC Owners' actions in appointing Communications and Payment Agents were not sufficiently extensive to cause the Tenancy in Common to be characterized as a partnership for federal income tax purposes. See Rev. Rul. 75-374.

Accordingly, the appointment of the Agents and the non-pro rata contributions by the TIC Owners, do not cause the TIC Owners to be considered partners in a partnership for federal income tax purposes.

Please contact David H. Kirk at (202) 622-3060 if you have any further questions.

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