

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:BO7-PLR-104483-01

Date:

May 31, 2001

Re:

Legend: Corporation:
Building:
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State:
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Dear

In a letter dated December 29, 2000, you requested a ruling on behalf of Corporation that the proposed transaction will not affect Corporation's status as a cooperative housing corporation under § 216(b) of the Internal Revenue Code (Code). This is in response to your request.

The represented facts are as follows. Corporation is incorporated under the laws of State. Corporation owns Building. Building contains r residential apartments and commercial space. The ground floor of Building contains one residential apartment and the commercial space. Corporation operates Building as a cooperative housing corporation as that term is defined in § 216(b). Each stockholder of Corporation common stock has a proprietary lease that entitles the stockholder to occupy for dwelling purposes a unit in Building. Corporation was authorized to issue s shares of common stock. Corporation allocated t shares of stock to the r residential units. These shares are issued and outstanding. The remaining shares are unissued.

At the present time, the commercial space is occupied by commercial lessees. The commercial leases expire in less than u years. When the commercial lessees vacate the premises, the commercial lessees must restore the premises to their previous

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condition. Corporation proposes to allocate y of the authorized but unissued shares of common stock to the ground floor commercial space. As part of this plan, Corporation will create two commercial units Y and Z (Commercial Units) and offer the stock for sale.

The proprietary lease associated with the common stock entitles the owners of the shares attributable to the Commercial Units to occupy for dwelling purposes the Commercial Units solely by reason of the ownership of shares of Corporation stock. The local zoning and building regulations currently permit modification of the Commercial Units to residential use as a matter of right. In addition, based on the facts and representations submitted, it would be reasonable to convert the Commercial Units to residential use. The size and location of the Commercial Units are such that, with certain modifications, each could be converted into a residential unit comparable to existing residential units in Building. Further, the proposed allocation of y shares of Corporation stock to the Commercial Units bears a reasonable relationship to the portion of the fair market value of Corporation's equity in the building and the land on which it is situated.

Section 216(a) provides that in the case of a tenant-stockholder (as defined in § 216(b)(2)), there will be allowed as a deduction amounts (not otherwise deductible) paid or accrued to a cooperative housing corporation within the taxable year, but only to the extent that such amounts represent the tenant-stockholder's proportionate share of -- (1) the real estate taxes allowable as a deduction to the corporation under § 164 which are paid or incurred by the corporation on the houses or apartment building and on the land on which such houses (or building) are situated, or (2) the interest allowable as a deduction to the corporation under § 163 which is paid or incurred by the corporation on its indebtedness contracted -- (A) in the acquisition, construction, alteration, rehabilitation, or maintenance of the houses or apartment building, or (B) in the acquisition of the land on which the houses (or apartment building) are situated.

Section 216(b)(1) provides that the term "cooperative housing corporation" means a corporation -- (A) having one and only one class of stock outstanding, (B) each of the stockholders of which is entitled, solely by reason of his ownership of stock in the corporation, to occupy for dwelling purposes a house, or an apartment in a building, owned or leased by such corporation, (C) no stockholder of which is entitled (either conditionally or unconditionally) to receive any distribution not out of earnings and profits of the corporation except on a complete or partial liquidation of the corporation, and (D) 80 percent or more of the gross income of which for the taxable year in which the taxes and interest described in § 216(a) are paid or incurred is derived from tenant-stockholders.

Section 216(b)(2) provides that the term "tenant-stockholder" means a person who is a stockholder in a cooperative housing corporation, and whose stock is fully paid-up in an amount not less than an amount shown to the satisfaction of the Secretary as bearing a

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reasonable relationship to the portion of the value of the corporation's equity in the houses or apartment building and the land on which situated which is attributable to the house or apartment which such person is entitled to occupy.

Section 1.216-1(e)(2) of the Income Tax Regulations provides that, in order for the corporation to qualify as a cooperative housing corporation, each stockholder of the corporation must be entitled to occupy for dwelling purposes an apartment in a building or a unit in a housing development owned or leased by the corporation. The stockholder is not required to occupy the premises. The right as against the corporation to occupy the premises is sufficient if conferred on each stockholder solely by reason of ownership of stock in the corporation. In other words, the stock must entitle the owner thereof either to occupy the premises or to a lease of the premises. The fact that the right to continue to occupy the premises is dependent upon the payment of charges to the corporation in the nature of rentals or assessments is immaterial.

Rev. Rul. 74-241, 1974-1 C.B. 68, provides that, for purposes of § 216(b)(1)(B), the term "apartment in a building" means an independent housekeeping unit consisting of one or more rooms containing facilities for cooking, sleeping, and sanitation normally found in a principal residence.

Rev. Rul. 90-35, 1990-2 C.B. 48, provides that Rev. Rul. 74-241 does not require that a unit presently contain all the facilities normally found in a principal residence in order to constitute an apartment in a building for purposes of § 216(b)(1)(B). Accordingly, a unit will be treated as meeting that definition if (1) the stockholder is entitled to convert the unit to an apartment, as defined in Rev. Rul. 74-241, solely by reason of ownership of stock in the cooperative housing corporation; (2) the conversion of the unit would be reasonable under all the facts and circumstances, including structural feasibility and cost; and (3) the applicable local zoning, building, and fire codes permit both the conversion and residential use of the unit as a matter of right.

Rev. Rul. 90-35 considers the following facts:

X Corporation is a cooperative housing corporation, as defined in § 216(b)(2), that owns land and a building thereon containing apartments. All units in the multistory building are residential apartments, except for three units on the ground floor that are leased for use as professional offices. All of X's issued and outstanding shares are allocated to the residential apartments in the building.

X proposes also to allocate authorized but unissued shares to the professional office units and sell them to the corporate or individual occupants of those offices. The professional units are structurally similar to residential units in the building. Although the offices do not contain sleeping or cooking facilities, they do contain one or more rooms that

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contain sanitation facilities normally found in a dwelling unit. Moreover, it would be reasonable to add sleeping and cooking facilities normally found in a dwelling unit to the office units under all the facts and circumstances. The cost of adding sleeping and cooking facilities is equal to approximately 20 percent of the fair market value the professional units would have if they were sold as residential units. Ownership of the shares attributable to the office units would entitle the tenant-stockholders to install sleeping and cooking facilities and occupy the units for dwelling purposes upon approval of the board of directors of the corporation. X has agreed that such approval would not be unreasonably withheld and that it would cooperate in effecting the conversion.

The entire building, including the professional units, is located in an area that is zoned for residential use, except that the ground floor may have certain enumerated nonresidential uses that include use as professional offices. The ground floor units could be converted from office use to residential apartment use as a matter of right under the applicable zoning, building, and fire codes.

Further, in situation 2 of Rev. Rul. 90-35, the shares allocated to one of the professional offices will be sold to a third party and not the current occupant. The existing commercial lease has one year to run until it terminates. If shares are allocated to the unit and sold to a third party, the third party will succeed to the lessor's rights and obligations under the existing commercial lease.

Finally, Rev. Rul. 90-35 provides that in situation 2, the purchaser of shares attributable to the one unit [of professional offices] is temporarily barred from occupancy by the existing commercial lease. Nevertheless, ownership of stock confers occupancy rights upon the stockholder as against the corporation and the fact that a current occupant has the right to remain in possession of the unit under a pre-existing lease is immaterial for purposes of § 216(b)(1)(B).

Applying the above standards to the facts and representations submitted and subject to the below limitations, we conclude that the proposed transaction will not affect the status of Corporation as a cooperative housing corporation under section 216(b)(1)(B).

Except as specifically ruled herein, we neither express nor imply any opinion concerning the federal tax consequences of this transaction under the cited provisions or any other provision of the Code. This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted

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in support of the request for rulings, it is subject to verification on examination.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer. A copy of this letter must be attached to any income tax return to which it is relevant.

Sincerely,
Joseph H. Makurath
Acting Chief, Branch 7
Office of Associate Chief Counsel
(Passthroughs & Special Industries)