

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B07-PLR-119720-02

Date:

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Legend:

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Dear :

We received your letter requesting rulings under §216 of the Internal Revenue Code. This letter responds to your request.

The represented facts are as follows. Corporation is a cooperative housing corporation organized under the laws of State. Corporation owns an apartment building ("Building") consisting of a basement and a floors. Building, as currently configured, consists of b residential apartments and c units being used for commercial purposes. The c commercial units account for d and e square feet.

Corporation proposes to convert the commercial units to cooperative ownership. Corporation is authorized to issue f shares of common stock, of which g have been issued and are outstanding. Corporation intends to issue stock attributable to the commercial units, in an amount which bears a reasonable relationship to the portion of

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the value of the Corporation's equity in Building and land attributable to the commercial units. The shares attributable to the commercial units will be fully paid up. Each commercial unit will have no more than one purchaser.

The proprietary lease of the Corporation will entitle the purchasers of the shares allocated to the commercial units to use the units for retail or residential purposes. The lease will also entitle the purchasers to make renovations and alterations necessary to convert the retail space to residential use. The purchasers of the shares attributable to the commercial units will, at all times, have the right, as against the Corporation, to occupy the commercial units for dwelling purposes.

Corporation has submitted the opinions of a real estate appraiser and an architectural firm on the reasonableness of converting the commercial units to residential use. The governing zoning rules and regulations allow, as of right, the conversion of the commercial units for residential use. The anticipated costs of converting the units to residential apartments similar to other apartments in the building are \$h and \$i, respectively. The average cost of conversion is \$j per square foot. The appraised fair market values of the units, after conversion to residential use, are \$k and \$l, respectively. The cost of conversion is approximately m% of the fair market value of the units after conversion to residential use. The conversion of the commercial units to residential use is reasonable under all the facts and circumstances.

You requested the following rulings:

1. Provided that Corporation satisfies the requirements of §216(b)(1)(A), (C), and (D) of the Code, neither the issuance of stock by Corporation to be allocated to the commercial units, nor the possible nonresidential use of the commercial units will prevent Corporation from qualifying as a cooperative housing corporation within the meaning of §216(b)(1) of the Code.

2. A person who purchases the stock of Corporation attributable to one of the commercial units for use of such unit as a store will qualify as a "tenant-stockholder" for purpose of §216(b)(2), provided such stock is fully paid up and in an amount which bears a reasonable relationship to the portion of the value of Corporation's equity in the building and land attributable to the unit which the purchaser is entitled to occupy.

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 house or apartment building, or (B) in the acquisition of the land on which the houses (or apartment building) are situated.

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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 and 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 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 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, 1990-1 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 zoning, building, and fire codes permit both the conversion and residential use of the unit as a matter of right.

Whether conversion of a unit to residential use is reasonable will depend on all the facts and circumstances. Generally, conversion will be reasonable where the unit is structurally similar to existing residential units in the building, has ready access to

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plumbing and utility sources, and the cost of converting the unit to residential use is not disproportionate to the fair market value the unit would have if the unit were sold as a residence.

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

X Corporation is a cooperative housing corporation, as defined in section 216(b)(1) of the Code, 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 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 office 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 local 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, rather than 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.

Applying the above standards to the facts and representations submitted and subject to the below limitations, we conclude that: (1) provided that Corporation satisfies the requirements of §216(b)(1)(A), (C), and (D) of the Code, neither the issuance of stock by Corporation to be allocated to the commercial units, nor the possible nonresidential

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use of the commercial units will prevent Corporation from qualifying as a cooperative housing corporation within the meaning of §216(b)(1) of the Code; and (2) a person who purchases the stock of Corporation attributable to one of the commercial units for use of such unit as a store will qualify as a “tenant-stockholder” for purpose of §216(b)(2), provided such stock is fully paid up and in an amount which bears a reasonable relationship to the portion of the value of Corporation’s equity in the building and land attributable to the unit which the purchaser is entitled to occupy.

Except as specifically ruled herein, we neither express nor imply any opinion concerning the federal tax consequences under the cited provisions or any other provision of the Code. This ruling is directed only to the taxpayer requesting it. §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 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
Special Technician Reviewer, Branch 7
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)