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Department of the Treasury
Washington, DC 20224

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B07 – PLR-129174-03

Date:

October 24, 2003

LEGEND:

Corporation:

Taxpayer:

State:

Address:

Commercial Unit:

Date 1:

a:

b:

c:

d:

e:

f:

Dear Sir:

We received a letter from your authorized representative requesting a ruling for Taxpayer under § 216 of the Internal Revenue Code. This letter responds to that request.

The represented facts are as follows. Corporation is a cooperative housing corporation organized under the laws of State. Corporation owns the apartment building located at Address ("Building"). Building contains a residential units and b

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commercial units. Currently, c shares of common stock are issued and outstanding. All of the outstanding common stock has been allocated to the residential units. No stock has been allocated to the commercial units. The commercial unit ("Commercial Unit") at issue currently is leased by Corporation to Taxpayer. Taxpayer has subleased the unit to an unrelated third party. The lease will expire on or before Date 1.

Taxpayer proposes to exercise its right under the current lease with respect to the Commercial Unit, to surrender the lease to Corporation in exchange for d shares of Corporation's stock that will be specifically allocated to Commercial Unit and a separate proprietary lease for Commercial Unit. The right to occupy Commercial Unit for residential purposes will be subject to an existing sublease for commercial use of the space.

Pursuant to the proprietary lease agreement and section 216(b)(1)(B) of the Code, the owner of shares attributable to Commercial Unit will be granted a proprietary lease entitling such owner, as against Corporation, to occupy Commercial Unit for dwelling purposes or to use Commercial Unit for commercial purposes. The proprietary lease will grant the owner of the shares attributable to Commercial Unit the absolute right to take the necessary steps to lawfully convert Commercial Unit to residential use without the consent of Corporation.

Taxpayer has submitted the opinion of a consultant on building and zoning issues on the feasibility of converting Commercial Unit into a residential apartment. The governing zoning rules allow, as of right, the conversion of Commercial Unit to residential use. Commercial Unit presently contains a partial bathroom, but lacks shower or kitchen facilities. The estimated cost of converting Commercial Unit to residential apartment is approximately \$e. The approximate market value of Commercial Unit if converted to residential use is approximately \$f. The conversion of Commercial Unit to residential use is reasonable under all the facts and circumstances.

You requested a ruling that the allocation of a shares to Commercial Unit, Corporation's issuance and sale of such shares along with the issuance of a proprietary lease with respect thereto, and the proposed non-residential use of Commercial Unit will not prevent Corporation from meeting the requirements of section 216(b)(1)(B).

Section 216(a) provides that in the case of a tenant-stockholder (as defined in subsection (b)(2)), there shall be allowed as a deduction amount (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-

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(1) the real estate taxed allowable as a deduction to the corporation under § 164 which are paid or incurred but 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 and 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) provides, in relevant part, that in order to qualify as a “cooperative housing corporation” under § 216, each stockholder of the corporation, whether or not the stockholder qualifies as a tenant-stockholder under §§ 216(b)(2) and 1.216-1(f), must be entitled to occupy for dwelling purposes an apartment in a building or a unit in a housing development owned or leased by such corporation. The

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stockholder is not required to occupy the premises. The right as against the corporation to occupy the premises is sufficient. Such right must be conferred on each stockholder solely by reasons of his or her ownership of stock in the corporation. That is, 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 section 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 section 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 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.

Situation 2 of Rev. Rul. 90-35 provides as follows:

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

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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.

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.

The purchaser of shares attributable to the one unit [of the 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).

The existence of a long term commercial lease on the nonresidential unit will not disqualify the corporation from treatment as a cooperative housing corporation under § 216 of the Code provided that the unit is capable of conversion as provided and the purchaser of the shares has the right to occupy the unit as provided in § 1.216-1(d)(2) of the regulations.

Applying the above standards to the facts and representations submitted and subject to the below limitations, we conclude that the allocation of a shares of Corporation stock to Commercial Unit, and Corporation's issuance and sale of such shares along with the issuance of a proprietary lease with respect thereto, and the proposed nonresidential use of Commercial Unit will not prevent the Corporation from

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meeting the requirements of section 216(b)(1)(B) 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 expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion whether Corporation otherwise meets the requirements of § 216.

This ruling is directed only to the taxpayer(s) 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 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, we are sending a copy of this letter to your authorized representative. A copy of this ruling must be attached to any income tax return to which it is relevant.

Sincerely,

/s/

Joseph H. Makurath
Senior Technician Reviewer, Branch 7
Office of Associate Chief Counsel
(Passthroughs and Special Industries)