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LEGEND:

Corporation	=
Location	=
Year 1	=
n	=
o	=
p	=
q	=
r	=
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v	=
w	=
x	=
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State	=
Event	=
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Dear :

This letter is in response to the letter from your authorized representative dated December 30, 2004, and subsequent correspondence, requesting rulings under § 216 of the Internal Revenue Code.

The facts are represented to be as follows. Corporation is a cooperative housing corporation located in Location. Corporation was formed in Year 1 by the developer of

the property. Corporation owns n disconnected towers of o floors, which sit on approximately p acres of land. There are a total of q units in the buildings, which range in size from r to s square feet, with an average size of t to u square feet. Approximately v of the units have been held as the principal residence of a tenant-stockholder for at least 2 years. Approximately w of the units have been held as the principal residence of a tenant-stockholder for less than 2 years. Between x and y of the units are rented to third parties by tenant-stockholders. A few units are held as a second residence by a tenant-stockholder. The initial proprietary leases for the units had a 99 year term, which is the longest allowable under State law. Corporation further represents that it complies with all of the requirements of § 216(b)(1).

As a result of Event, Corporation's buildings sustained substantial damage. The extensive repair and renovation of the buildings took many years and was in excess of the Corporation's insurance. Corporation incurred nearly $z of debt to pay for the repair and renovation, including the refinancing of some of Corporation's pre-existing debt.

Corporation has proposed to subdivide the buildings into condominium units, and distribute some of the condominium units to tenant-stockholders in exchange for the redemption of their stock and the cancellation of the related proprietary leases. Tenant-stockholders who do not participate in the redemption will continue to own stock in Corporation, which will continue to operate as a cooperative housing corporation. However, tenant-stockholders who do not initially participate in the redemption will have the opportunity to participate in the future. After the plan is approved by the tenant-stockholders, Corporation will obtain the required approvals of the relevant state and local authorities. Each tenant-stockholder will be responsible for paying their portion of the debt on the property, their portion of the cost of the conversion, and their portion of any corporate level tax arising from the conversion. Corporation's board will review requests from any tenant-stockholder that wish to have their stock redeemed in exchange for their unit. In deciding whether to approve the conversion, the board will consider all relevant factors including whether the unit was used as the tenant-stockholder's principal residence, the number of requests received, the ability of the tenant-stockholder to pay the costs of conversion, and the cost to Corporation of the conversion. Each tenant-stockholder who uses their unit as their principal residence will be entitled to the conversion subject to providing such documentation, indemnification, or security as the board requires. Corporation shall complete the conversion within 60 days of the approval of the tenant-stockholder's request.

Corporation requests the following rulings:

(1) Corporation will recognize no gain or loss upon the subdivision of the buildings into condominiums.

(2) Corporation will recognize no gain or loss on the distribution of the condominiums to tenant-stockholders who utilize their units as their principal residences.

(3) For purposes of § 216(e), a tenant-stockholder's unit shall be considered the tenant-stockholder's principal residence so long as the residence satisfies the definition provided in § 1.121-1(b) without the necessity of also satisfying the two-year home and use requirement provided in § 121(a).

(4) Corporation will recognize gain in an amount equal to the amount the fair market value of the distributed units exceed the adjusted basis of the units in the hands of Corporation on the distribution of units to tenant-stockholders who do not utilize their units as their principal residence.

(5) Corporation will not be disqualified as a "cooperative housing corporation" within the meaning of § 216(b)(1) with respect to any distribution of a unit to a tenant-stockholder in exchange for all of the tenant-stockholder's stock in Corporation and the cancellation of the related proprietary lease.

(6) Corporation will continue to qualify as a "cooperative housing corporation" within the meaning of § 216(b)(1) even though, in accordance with the plan of conversion, Corporation will own a number of condominiums rather than the undivided buildings.

(7) No gain or loss shall be recognized by each tenant-stockholder who exchanges their stock in Corporation and cancels the related proprietary lease in exchange for a unit that is used as the tenant-stockholder's principal residence.

(8) Each tenant-stockholder who exchanges their stock in Corporation and cancels the related proprietary lease for a unit that is used as the tenant-stockholder's principal residence shall have the same basis in the unit as the tenant-stockholder had in their stock in Corporation.

(9) Each tenant-stockholder who exchanges their stock in Corporation and cancels the related proprietary lease for a unit that is used as the tenant-stockholder's principal residence shall have the same holding period in the unit as the tenant-stockholder had in their stock in Corporation.

(10) For purposes of valuing each unit to be distributed to a tenant-stockholder by Corporation, the proprietary lease encumbering the unit and held by the tenant-stockholder shall be taken into account by Corporation and the tenant-stockholder.

(11) Amounts considered to be contributions of capital excluded from income pursuant to § 118 shall not be considered gross income for purposes of the "80 percent gross income" test set forth in § 216(b)(1)(D).

RULING REQUEST #1

Section 61 of the Internal Revenue Code provides that gross income means all income from whatever source derived.

Section 1001(a) provides that the gain from the sale or other disposition of property is the excess of the amount realized over the adjusted basis provided in § 1011 for

determining gain and the loss is the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized. Under § 1001(c), the entire amount of gain or loss must be recognized, except as otherwise provided.

A partition of jointly owned property, or a change in the form of ownership from joint tenancy to tenancy in common, is not a sale or other disposition of property. Rev. Rul. 56-437, 1956-2 C.B. 507. Likewise, subdividing a tract of land into sub-lots is not a taxable disposition of property under § 1001. See Rev. Rul. 70-7, 1970-1 C.B. 175.

Therefore, we hold that the conversion of Corporation's cooperative housing apartments into condominium units will not be considered a sale, exchange or other disposition of property. Thus, the Taxpayer will recognize no gain or loss on the conversion.

RULING REQUEST #2 and #3

Section 216(e) provides that, except as provided in regulations, no gain or loss shall be recognized on the distribution by a cooperative housing corporation of a dwelling unit to a stockholder in such corporation if such distribution is in exchange for the stockholder's stock in such corporation and such dwelling unit is used as his principal residence (within the meaning of section 121).

Section 121(a) provides that gross income will not include gain from the sale or exchange of property if, during the 5-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating 2 years or more.

The phrase "used by the taxpayer as the taxpayer's principal residence for periods aggregating two years or more" in § 121(a) constitutes a two-prong test. See Guinan v. United States, 2003-1 USTC (CCH) P50,475 (D. Ariz. 2003). First, § 121(a) requires the taxpayer to use the property as the taxpayer's principal residence. Determining whether a property is the taxpayer's principal residence requires an analysis of the relevant facts and circumstances ("facts and circumstances test"). Section 1.121-1(b)(2) of the Income Tax Regulations. After the taxpayer's principal residence has been determined, the days that the taxpayer's occupied the principal residence are added up to determine whether the taxpayer has used the principal residence for the requisite two years.

The Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788, 836 (1997)(TRA 1997), amended §§ 216 and 121 and repealed § 1034. Prior to its amendment under TRA 1997, § 216(e) provided that "no gain or loss shall be recognized . . . if such exchange qualifies for nonrecognition of gain under § 1034(f)." Former § 1034 provided that gain from the sale or exchange of a principal residence (old residence) was recognized only to the extent that the taxpayer's adjusted sales price of the old residence exceeded the taxpayer's cost of purchasing a new residence within the

replacement period (generally 2 years before or after the date of sale). Under former § 1034, whether property qualified as a taxpayer's principal residence was determined on the date of the sale or exchange applying a facts and circumstances test. See former § 1.1034-1(c)(3) of the Income Tax Regulations. Although reference to § 1034 in § 216(e) has been replaced with a reference to § 121, TRA 1997 does not demonstrate Congressional intent to modify the limitation of nonrecognition at the corporate level to the extent that the shareholder's unit qualifies as the shareholder's principal residence under the facts and circumstances test. Thus, for purposes of § 216(e), a shareholder's unit will be considered the shareholder's principal residence if the residence is the shareholder's principal residence under the facts and circumstances test as provided in § 1.121-1(b) of the regulations without the necessity of also satisfying the two-year ownership and use requirement provided in § 121(a).

Therefore, we hold that Corporation will recognize no gain or loss on the distribution of the condominiums to tenant-stockholders who utilize their units as their principal residences and that, for purposes of § 216(e), a tenant-stockholder's unit shall be considered the tenant-stockholder's principal residence so long as the residence satisfies the definition provided in § 1.121-1(b) without the necessity of also satisfying the two-year ownership and use requirement provided in § 121(a).

RULING REQUEST #4

Section 1001(a) provides that the gain from the sale or other disposition of property is the excess of the amount realized over the adjusted basis provided in § 1011 for determining gain and the loss is the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized. Under § 1001(c), the entire amount of gain or loss must be recognized, except as otherwise provided.

Section 216(e) provides that, except as provided in regulations, no gain or loss shall be recognized on the distribution by a cooperative housing corporation of a dwelling unit to a stockholder in such corporation if such distribution is in exchange for the stockholder's stock in such corporation and such dwelling unit is used as his principal residence (within the meaning of section 121).

The non-recognition provided by § 216(e) is limited to those circumstances where the dwelling unit being distributed by the cooperative housing corporation is used as the tenant-stockholder's principal residence. Where the dwelling unit distributed is not used as the tenant-stockholder's principal residence, the general rules of § 1001 will apply. Therefore, we hold that Corporation will recognize gain in an amount equal to the amount by which the fair market value of a distributed unit exceeds the adjusted basis of the unit in the hands of Corporation on the distribution of a unit to a tenant-stockholder who does not utilize his unit as a principal residence.

RULING REQUEST #5

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 subsection (a) are paid or incurred is derived from tenant-stockholders.

Section 1.216-1(e)(3) provides that none of the stockholders of the corporation may be entitled, either conditionally or unconditionally, except upon a complete or partial liquidation of the corporation, to receive any distribution other than out of earnings and profits of the corporation.

Although § 216(b)(1)(C) does not specifically qualify the term “any distribution” as any distribution with respect to stock, a mere distribution from creditor to debtor apart from and incidental to the corporation-stockholder relationship is not within the contemplation of the statute, because the language “not out of earnings and profits of the corporation except on a complete or partial liquidation of the corporation” clearly contemplates a distribution made with respect to stock. Rev. Rul. 75-547, 1975-2 C.B. 89.

While the term “any distribution” contemplates a distribution made with respect to stock, it does not contemplate a distribution of an apartment in complete redemption of a tenant-stockholder’s stock in the cooperative housing corporation. To the extent it is applicable, the complete redemption of a tenant-stockholder’s stock in exchange for an apartment is governed by § 216(e).

Therefore, we hold that Corporation will not be disqualified as a “cooperative housing corporation” within the meaning of § 216(b)(1) with respect to any distribution of a unit to a tenant-stockholder in exchange for all of the tenant-stockholder’s stock in Corporation and the cancellation of the related proprietary lease.

RULING REQUEST #6

Section 1.216-1(e)(2) provides, in relevant part, that each stockholder of the corporation, whether or not the stockholder qualifies as a tenant-stockholder under section 216(b)(2) and paragraph (f) of this section, 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.

Revenue Ruling 78-31, 1978-1 C.B. 76, considered a scenario where a cooperative housing corporation owned a portion of an apartment building. Revenue Ruling 78-31 concluded that there is no requirement that a cooperative housing corporation must own an entire apartment building in order to satisfy the provisions of § 216 (b) (1) (B). It is sufficient that the corporation owns the apartments that its tenant-stockholders are entitled to occupy. In addition, the fact that the apartments are condominium units does not preclude the cooperative housing corporation from being considered as owning apartments in a building.

Therefore, we hold that Corporation will continue to qualify as a "cooperative housing corporation" within the meaning of § 216(b)(1) even though, in accordance with the plan of conversion, Corporation will own a number of condominiums rather than the undivided buildings.

RULING REQUEST #7

Revenue Ruling 85-132 considered the issue of whether the exchange of stock in a cooperative housing corporation for legal title to a condominium unit and an undivided interest in the common elements results in nonrecognition of gain under § 1034. Revenue Ruling 85-132 concludes that the exchange of the tenant-stockholder's stock in the corporation for legal title to the condominium unit occupied by the tenant-stockholder and an undivided interest in the common elements will qualify as a sale within the meaning of § 1034(a), and no gain or loss will be recognized to the tenant-stockholder on such sale, subject to the limitations of § 1034(a) and § 1.1034-1.

In 1988, Congress enacted § 216(e) as § 6282 of the Technical and Miscellaneous Revenue Act of 1988, P.L. 100-647, with an effective date retroactive to the Tax Reform Act of 1986. Section 216(e) was enacted to provide corporate level relief from the application of § 336 to the extent § 1034 had already provided for nonrecognition on the tenant-stockholder level. Section 216(e), as enacted, provided that except as provided in regulations, no gain or loss shall be recognized on the distribution by a cooperative housing corporation of a dwelling unit to a stockholder in such corporation if such distribution is in exchange for the stockholder's stock in such corporation and such exchange qualifies for nonrecognition of gain under § 1034(f). The Conference Report states that "no gain or loss is recognized to a residential housing cooperative when property that qualifies as a principal residence is distributed to a tenant-stockholder in exchange for the tenant-stockholder's stock, to the extent the exchange qualifies for nonrecognition at the shareholder level under section 1034 of the Code." *See* H.R. Conf. Rep. No. 100-1104, at 242 (1988).

Section 216(e), as enacted, provided for no gain or loss where the exchange of the tenant-stockholder's stock for the unit qualifies for nonrecognition of gain under § 1034(f). Under Revenue Ruling 85-132, the conversion is treated as a sale, in which the taxpayer has sold his principal residence in the cooperative housing corporation and

immediately bought a condominium for the same price, triggering the rollover of all gain under § 1034(a) for the tenant-stockholder.

In the Taxpayer Relief Act of 1997, Congress amended § 121 and repealed § 1034. In conjunction with the repeal of § 1034, the Taxpayer Relief Act of 1997 provided a conforming amendment to § 216(e) to reflect the § 1034 repeal. The 1997 amendment to § 216(e) resulted in the current language, which provides that no gain or loss shall be recognized on the distribution by a cooperative housing corporation of a dwelling unit to a stockholder in such corporation if such distribution is in exchange for the stockholder's stock in such corporation and such dwelling unit is used as his principal residence (within the meaning of § 121). The legislative history to the Taxpayer Relief Act of 1997 provides no explanation of the amendment to § 216(e).

Revenue Ruling 85-132 established that the conversion of a cooperative housing corporation into condominium ownership is a sale or exchange, subject to the rules of former § 1034. Section 216(e) was enacted to provide a corporate level complement to the treatment already afforded by § 1034 on the tenant-stockholder level. When § 1034 was repealed in 1997, § 216(e) was amended to reflect the substitution of amended § 121 as the key provision governing the sale of an individual's principal residence. There is no indication in the statute or legislative history to suggest that Congress intended to make any change to § 216(e) other than the replacement of the reference to § 1034 with a reference to § 121. Absent a showing of Congressional intent to broaden the application of § 216(e) to include tenant-stockholders, § 216(e) should continue to be interpreted as only addressing the consequences to the cooperative housing corporation on the conversion to condominium ownership. Because the conversion is treated as a sale or exchange, the tax treatment of the tenant-stockholders who use their units as their principal residence is governed by § 121, to the extent it applies.

Therefore, we hold that, consistent with the treatment of the conversion as a sale or exchange, and subject to the provisions of § 121, gain or loss shall be recognized by each tenant-stockholder who exchanges their stock in Corporation in exchange for a unit that is used as the tenant-stockholder's principal residence to the extent that the unit's fair market value exceeds the tenant-stockholder's basis in his stock.

Accordingly, each tenant-stockholder may exclude from gross income the gain from the exchange of the stock in Corporation only if the requirements of § 121 have otherwise been satisfied. In determining whether a tenant-stockholder meets the requirements of § 121, if Corporation meets all the requirements of § 216 to be a cooperative housing corporation, the exchange of the tenant-stockholder's stock in Corporation for a condominium unit will qualify as an exchange of the unit the tenant-stockholder is entitled to occupy as a result of holding such stock. Further, the ownership and use tests of § 121 discussed above will be applied as though the tenant-stockholder owned and used such unit. See § 121(d)(4).

RULING REQUEST #8

Section 1012 provides that the basis of property is its cost. The cost is the amount paid for such property in cash or other property. Section 1.1021-1(a) of the regulations. The basis of property acquired in an exchange is its fair market value, unless otherwise provided in the Code or regulations. See Philadelphia Park Amusement Co. v. United States, 126 F. Supp. 184 (Ct. Cl. 1954). Therefore, we hold that the basis in the condominium unit for each tenant-stockholder who exchanges their stock for a condominium unit will equal the fair market value of the shareholder's condominium unit.

RULING REQUEST #9

Section 1223(1) provides that, in determining the period for which a taxpayer has held property received in an exchange, there shall be included the period for which the taxpayer held the property exchanged if the property has, for the purposes of determining gain or loss from a sale or exchange, the same basis in whole or in part in the taxpayer's hands as the property exchanged, and the property exchanged at the time of such exchange was a capital asset as defined in § 1221 or property described in § 1231.

Because the basis in the acquired condominium unit will not be determined by reference to the basis of the co-op stock, § 1223(1) is inapplicable. A tenant-stockholder's holding period for the stock will not be tacked on to the shareholder's holding period for the condominium unit. Instead, we hold that the holding period will run from the date that the tenant-stockholder acquires the condominium unit.

RULING REQUEST #10

Section 216(b)(1)(B) provides that, among other requirements for being considered a cooperative housing corporation, 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

Section 1.216-1(e)(2) provides, in relevant part, that each stockholder of the corporation, whether or not the stockholder qualifies as a tenant-stockholder under § 216(b)(2) and paragraph (f) of this section, 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. 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.

A lease between a cooperative housing corporation and a tenant-stockholder is often the mechanism under which a tenant-stockholder takes possession of a unit in the

cooperative. However, under § 216(b)(1)(B), a tenant-stockholder has the right to possess a unit in the building solely due to the ownership of stock in the corporation. The lease between the corporation and a tenant-stockholder functions much like the covenants typical with the direct ownership of residential real property. Therefore, the lease should be viewed as a condition on the tenant-stockholder's ownership of stock in the corporation and not as a separate asset. Any valuation of a unit to be distributed to a tenant-stockholder would necessarily include any conditions on the ownership of that unit.

Therefore, we hold that, for purposes of valuing each unit to be distributed to a tenant-stockholder by Corporation, the proprietary lease encumbering the unit and held by the tenant-stockholder shall be taken into account by Corporation and the tenant-stockholder.

RULING REQUEST #11

Section 216(b)(1)(D) provides that, a cooperative housing corporation is a corporation 80 percent or more of the gross income of which for the taxable year in which the taxes and interest described in subsection (a) are paid or incurred is derived from tenant-stockholders.

Section 118 provides that in the case of a corporation, gross income does not include any contribution to the capital of the corporation.

The requirement in § 216(b)(1)(D) that eighty percent or more of the gross income of the cooperative housing corporation for the taxable year must be derived from tenant-stockholders contemplates that only items that would be includible in the gross income of the corporation are included in determining whether eighty percent of the gross income is derived from tenant-stockholders. Thus if an item is not considered gross income to the cooperative housing corporation it is not taken into account for purposes of § 216(b)(1)(D). See *Eckstein v. United States*, 452 F.2d 1036 (Ct. Cl. 1971). Therefore, we hold that amounts considered to be contributions of capital excluded from income pursuant to § 118 shall not be considered gross income for purposes of the "80 percent gross income" test set forth in § 216(b)(1)(D).

Except as specifically provided, no opinion is expressed or implied as to the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter. This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

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