Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Number: **199942022**
Release Date: 10/22/1999

Date:
July 27, 1999

Re:

Legend: Corporation:
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Dear

This is in response to a letter, dated, requesting rulings concerning the application of § 216(b) of the Internal Revenue Code to Corporation.

The represented facts are as follows. In Year, Corporation became a cooperative housing corporation under the laws of State. There are s residential apartments in the building to which t shares of stock are allocated. The building also includes professional offices, retail space and a below grade parking garage. Corporation now proposes to create two units X and Y (Commercial Units) in the commercial space and to convert the Commercial Units to cooperative ownership by issuing a total of u additional shares of stock attributable to the Commercial Units. Currently, the proposed Commercial Units are being leased to v retail stores. The retail store leases expire within w months.

The proposed proprietary lease entitles the purchaser(s) of the additional shares

attributable to the Commercial Unit(s) to occupy for dwelling purposes the Commercial Unit(s) solely by reason of the ownership of shares of Corporation stock. In addition, under the proprietary lease, the purchaser(s) of the shares of Corporation stock allocated to the Commercial Unit(s) may, at the purchaser(s) option, use the unit(s) for commercial or residential purposes.

The Corporation also represents that the local zoning law and building regulations currently permit modification of the Commercial Units to residential use. The material submitted indicates that it would be reasonable to convert the Commercial Units to residential use. The size and location of the Commercial Units is such that, with certain modifications, each could be converted into a dwelling unit. The Corporation further represents that the proposed allocation of u shares of Corporation stock to the Commercial Units bears a reasonable relationship to the portion of the fair market value of the Corporation's equity in the building and the land on which it is situated.

You have specifically requested two rulings:

1) The sale of shares and the grant of a proprietary lease to a purchaser of shares allocable to a commercial unit will not cause the Corporation to fail to satisfy the requirement of § 216(b)(1)(B).

2) The sale of shares and the grant of a proprietary lease to a purchaser of shares allocable to a commercial unit will not cause the Corporation to fail to satisfy the requirement of § 216(b)(1)(A).

Section 216(a) provides that in the case of a tenant-stockholder (as defined in § 216(b)(2)), there shall 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 shareholders 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 the 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.

Rev. Rul. 74-241, 1974-1 C.B. 68, holds 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 which contains facilities for cooking, sleeping, and sanitation normally found in a principal residence.

Rev. Rul. 90-35, 1990-2 C.B. 48 states 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 referred to in (1) and residential use of the unit as a matter of right.

Rev. Rul 87-130, 1987-2 C.B. 68, states that the general purpose of § 216 is to place the tenant-stockholders of a cooperative apartment in the same position as the owners of dwelling houses so far as deductions for interest and taxes are concerned. Although Congress was willing to permit tenant-stockholders to deduct a share of their corporation’s mortgage interest and real estate taxes in proportion to their shareholdings, Congress feared tenant-stockholders might try to distort the allocation of such expenses by manipulation of the corporation’s capital structure. Rev. Rul. 87-130 held that the cooperative shares in issue there offered no opportunity for such abuse because they had identical valuation, voting, and distribution rights.

Rev. Rul. 87-130 also indicates that the focus of the "one and only one class of stock outstanding" requirement of § 216(b)(1)(A) of the Code is on the identity of rights in a cooperative housing corporation accorded tenant-stockholders as owners of the

corporation's stock. The cooperative shares are separate and distinct from the proprietary leasehold agreements. Ownership of a block of cooperative shares entitles the stockholder to enter into a leasehold agreement with the cooperative. The leasehold agreements, not the shares, provide stockholders with differing leasehold rights to occupy specific apartment units and to use specific garage spaces.

Applying the above standards to the facts submitted and representations made and subject to the limitation below, we have concluded that Corporation meets the requirements of § 216(b)(1) provided that Corporation also satisfies the requirements of § 216(b)(1)(C) and (D). Specifically, neither the issuance of stock by the Corporation to be allocated to the Commercial Units nor the possible nonresidential use of the Commercial Units will prevent the Corporation from qualifying as a cooperative housing corporation within the meaning of § 216(b)(1).

Except as ruled above, no opinion is expressed or implied as to the federal tax consequences of this transaction under any other provision of the Code.

The ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this ruling should be attached to the taxpayer's tax return filed for the year in which the transaction referred to in this ruling is completed.

Sincerely,

James C. Gibbons

James C. Gibbons
Assistant to the Chief, Branch 7
Office of the Assistant Chief Counsel
(Passthroughs & Special Industries)