

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:7-PLR-140289-01

Date:

February 27, 2003

LEGEND:

Corporation:

State:

a:

b:

c:

d:

e:

Dear \_\_\_\_\_ :

We received your letter requesting rulings for Corporation under §§ 216, 305, and 311 of the Internal Revenue Code. This letter responds to your request.

Corporation is a cooperative housing corporation organized under the laws of State. Corporation owns a building, which consists of a residential units and a ground floor that contains b nonresidential units. Currently, c shares of common stock of Corporation are issued and outstanding. All of the outstanding common stock has been allocated to the residential units. No stock has been allocated to the nonresidential space on the ground floor.

The local zoning law and building code regulations currently permit modification of the commercial unit to residential use. The size and location of the nonresidential space is such that, with certain modifications, it could be reasonably converted into residential units comparable to the existing residential units in the building. The nonresidential unit is currently leased to a commercial tenant.

Corporation proposes to issue d shares of its authorized but unissued stock allocable to the nonresidential space. A proprietary lease will entitle the owners of the stock, as against Corporation, to occupy the nonresidential space for dwelling purposes solely by reason of the ownership of such shares.

Corporation further proposes to distribute to its current tenant stockholders the d

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shares of stock that will be allocated to the nonresidential space. The tenant-stockholders then plan, but are not required, to contribute the shares of stock allocated to the nonresidential space to a limited liability company (LLC) in exchange for e% of the membership interests in the LLC. The LLC will perform certain activities in connection with its ownership of the shares of stock allocated to the nonresidential space.

You requested the following rulings:

1. The issuance of d shares of Corporation stock by Corporation to the nonresidential space and the possible nonresidential use of the unit will not prevent Corporation from qualifying as a cooperative housing corporation under § 216(b).
2. For purposes of § 216(b)(1)(D), the income Corporation receives from the LLC, or from any stockholders who choose not to transfer their shares to the LLC, will be income derived from tenant-stockholders.
3. The proposed stock distribution by Corporation will not be treated as a distribution to the tenant-stockholders to which § 301 applies by reason of section 305(b) or (c) but will constitute a distribution to which § 305(a) applies. Thus, the distribution will not result in taxable income to any of the Corporation's shareholders.
4. No gain or loss will be recognized to the Corporation upon the distribution of the stock in accordance with section 311(a).
5. The transfer to a newly formed LLC by some or all of Corporation's shareholders of their newly received shares will have no adverse affect upon any of the above conclusions.

#### Ruling Requests 1 and 2

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 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-

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(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 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. 90-35, 1990-1 C.B. 48, provides conditions under which allocating

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shares of stock to non-residential apartments will not prevent a cooperative housing corporation from meeting the requirements of section 216(b)(1)(B).

Based on the information submitted and representations made, and applying the standard of Rev. Rul. 90-35, we conclude that: 1. The allocation of d shares of Corporation stock to the nonresidential space and the possible nonresidential use of the unit will not affect the status of Corporation as a cooperative housing corporation within the meaning of § 216(b)(1); and

2. For purposes of § 216(b)(1)(D), the income Corporation receives from the LLC, or from any stockholders who choose not to transfer their shares to the LLC, will be income derived from tenant-stockholders provided that the fully paid-up requirement of § 216(b)(2) is met.

#### Ruling Requests 3 and 4

Section 305(a) provides the general rule that except as otherwise provided gross income does not include the amount of any distribution of the stock of a corporation made by the corporation to its shareholder with respect to its stock.

Section 305(b) provides that distributions in lieu of money, disproportionate distributions, distributions of preferred stock on common stock, distributions of preferred stock and distributions of convertible preferred stock are treated as section 301 distributions of property.

Under §§ 305(c) and 1.305-7 a change in conversion ratio, a change in redemption price, a difference between redemption price and issue price, a redemption which is treated as a distribution to which section 301 applies, or any transaction having a similar effect on the interest of any shareholder may be treated as a distribution with respect to any shareholder whose proportionate interest in the earnings and profits or assets of the corporation is increased by such change, difference, redemption, or similar transaction.

Section 311(a) provides that, except as provided in section 311(b), no gain or loss is recognized to a corporation on the distribution (not in complete liquidation) with respect to its stock of (1) its stock (or rights to acquire its stock), or (2) property.

Section 311(b) provides that gain is recognized by a corporation if it distributes property to a shareholder and the fair market value of such property exceeds its adjusted basis.

Sections 307(a) and 1.307-1(a) provide that if a shareholder receives stock as a distribution on stock previously held and under section 305 such distribution is not includible in gross income, then the basis of the stock with respect to which the distribution was made shall be allocated between the old and the new stocks in proportion to the fair market values of each on the date of the distribution.

Based on the foregoing, we conclude with respect to ruling requests 3 and 4 that:

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3. The proposed distribution by Corporation of the shares will be a nontaxable stock distribution excluded from the gross income of the tenant-stockholders under ' 305(a); and 4. The proposed distribution of the shares will not result in the recognition of gain or loss by Corporation in accord with ' 311(a)(1). Further, the cost or other basis of the stock in Corporation held by a shareholder immediately prior to the distribution of the shares will be allocated between the stock immediately prior to the distribution of the shares and the shares received in the distribution in proportion to the fair market value of the stocks of each immediately after the distribution in accordance with ' 307(a). Additionally, the proposed distribution of the shares will not diminish the earnings and profits of Corporation available for later dividend distributions within the meaning of sections 316, 1.312-11(b) and (c).

#### Ruling Request 5

Based on the information submitted and representations made we conclude that: the transfer to a newly formed LLC by some or all of Corporation's shareholders of their newly received shares will have no adverse affect upon Ruling Requests 1, 2, 3, or 4.

Except as expressly provided herein, we express or imply no opinion concerning the 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) of the Code provides that it may not be used or cited as precedent.

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

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.

Sincerely,

*/s/*

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

Industries)