

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

Number: **200436010**

Release Date: 9/3/04

Index Number: 216.00-00

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B07 – PLR-163018-03

Date:

May 04, 2004

LEGEND:

Corporation:

State:

Address:

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Dear :

We received your letter requesting a ruling regarding the application of § 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 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. The floor d

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commercial unit ("Commercial Unit") at issue currently is leased by Corporation on a month-to-month lease to an unrelated third party.

Corporation proposes to convert Commercial Unit to cooperative ownership. Corporation will allocate newly issued shares of common stock to Commercial Unit for sale. Commercial Unit is e square feet in size. Corporation anticipates allocating f shares to Commercial Unit. Corporation arrived at this allocation based on the existing allocations of shares to residential apartments for the rest of the building.

A purchaser of shares attributable to Commercial Unit will enter into a proprietary lease with Corporation. The proprietary lease will grant the purchaser of the shares attributable to Commercial Unit the right to occupy the unit for dwelling purposes. The proprietary lease also will entitle the purchaser to occupy the unit for commercial purposes. The proprietary lease will grant the purchaser of the shares attributable to Commercial Unit the absolute right, at the purchaser's sole cost and expense, to convert the unit to residential use.

Corporation represents that the local zoning law and building regulations currently permit modification of Commercial Unit to residential use as a matter of right. Corporation submits facts and representations to show that it would be reasonable to convert Commercial Unit to residential use. The size and location of Commercial Unit is such that, with certain modifications, it could be converted into a residential apartment. The estimated cost of converting Commercial Unit to a residential unit is approximately \$g. The approximate fair market value of Commercial Unit after conversion to a residential unit is \$h.

You requested a ruling that the allocation of f 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 § 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 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.

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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 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 § 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. 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). 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

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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. Rev. Rul. 90-35.

Applying the above standards to the facts and representations submitted and subject to the limitations below, we conclude that the allocation of shares 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 non-residential use of Commercial Unit will not prevent Corporation from meeting the requirements of § 216(b)(1)(B), provided the 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 Corporation's equity in the apartment building and land which is attributable to the apartment 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, or whether purchasers of stock qualify as tenant-stockholders within the meaning of § 216(b)(2).

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.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by penalty of perjury statements 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.

A copy of this ruling must be attached to any income tax return to which it is relevant.

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Sincerely,

Leslie H. Finlow  
Chief, Branch 7  
Office of Associate Chief Counsel  
(Passthroughs and Special Industries)