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Telephone Number:

Refer Reply To:

CC:CORP:1 – PLR-116111-04

Date:

August 11, 2004

In Re

Corporation =

a =

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Date 1 =

State X =

Dear

In a letter dated March 15, 2004 you requested rulings under §§ 305, 307, 311 and 216 of the Internal Revenue Code (the “Code”). The information submitted for consideration is summarized below.

Corporation is a cooperative housing corporation organized under the laws of State X. Corporation owns land and a building (the “Building”). The Building contains a residential units, which are leased to tenant-stockholders, and b commercial units (“Commercial Units”), which are currently leased to unrelated lessees.

Corporation has outstanding one class of common stock, which is allocated to the residential units. Each holder of common stock is entitled, solely by reason of the ownership of such common stock, to occupy a residential unit pursuant to the terms of a

proprietary lease with Corporation. As of Date 1, there were c shares of common stock issued and outstanding and owned by d tenant-stockholders.

Corporation proposes the following transaction to allocate shares of stock to the Commercial Units:

- (i) Corporation will form a limited liability company ("LLC") with Corporation as the sole member. LLC will not elect to be classified as other than a disregarded entity.
- (ii) Corporation will transfer newly issued shares of Corporation's common stock (the "New Shares") to LLC, which will be allocated to Commercial Units.
- (iii) Corporation will then distribute all of the membership interests in LLC pro rata to Corporation's tenant-stockholders. LLC will not elect to be classified as other than a partnership.

Owners of the New Shares will be entitled, solely by reason of the ownership of such shares, to occupy Commercial Units for dwelling purposes pursuant to the terms of a proprietary lease with Corporation. As such, they will be entitled to install facilities in Commercial Units for cooking, sleeping, and sanitation normally found in a residence.

The following representations have been made in connection with the proposed transaction:

- (a) The number of New Shares allocated to Commercial Units will bear a reasonable relationship to the ratio of the value of Corporation's equity in Commercial Units to the value of Corporation's equity in the Building and the land.
- (b) The local zoning law and building regulations currently permit modification of Commercial Units to residential use as a matter of right.
- (c) It would be reasonable to convert Commercial Units to residential use.

Section 301.7701-3(a) of the Procedure and Administration Regulations provides that a business entity that is not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) (an eligible entity) can elect its classification for federal tax purposes. An eligible entity with at least two members can elect to be classified as either an association (and thus a corporation under § 301.7701-2(b)(2)) or a partnership, and an eligible entity with a single owner can elect to be classified as an association or to be disregarded as an entity separate from its owner. Elections are necessary only when an eligible entity does not want to be classified under the default classification or when an eligible entity chooses to change its classification.

Section 301.7701-3(b)(1) provides that, unless it elects otherwise, a domestic eligible entity is (i) a partnership if it has two or more members; or (ii) disregarded as an entity separate from its owner if it has a single owner.

In Rev. Rul. 99-5, 1999-1 C.B. 434, Situation 1, LLC, which for federal tax purposes is disregarded as an entity separate from its owner, is converted to a partnership when the new member, B, purchases an interest in the disregarded entity from the owner, A. B's purchase of 50% of A's ownership interest in the LLC is treated as the purchase of a 50% interest in each of LLC's assets which are treated as held directly by A for federal tax purposes. Immediately thereafter, A and B are treated as contributing their respective interests in those assets to a partnership in exchange for ownership interests in the partnership.

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.

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 reason 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 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.

Based upon the information submitted, representations made, applying the above standards, and provided Corporation satisfies the requirements of § 216(b)(1)(A), (C), and (D), we conclude as follows:

(1) Initially, LLC will be treated as an entity disregarded from its owner. Accordingly, Corporation will be treated as the owner for federal tax purposes of the New Shares held by LLC. The distribution by Corporation of the LLC interests will be treated as a distribution by Corporation of the LLC assets (the New Shares). Immediately after the distribution, the stockholders of Corporation will be treated as

contributing the New Shares to a new LLC ("New LLC"). Unless it elects otherwise, New LLC will be treated as a partnership for federal tax purposes.

(2) The distribution of New Shares of Corporation's stock by Corporation attributable to Commercial Units in the Building and the grant of proprietary leases appurtenant to those shares will not cause Corporation to fail to satisfy the requirements of § 216(b)(1)(B) of the Code.

(3) The proposed distribution by Corporation of the New Shares will be a non-taxable stock distribution excluded from the gross income of the tenant-stockholders (§ 305(a)).

(4) The proposed distribution by Corporation of the New Shares will not result in the recognition of gain or loss by Corporation (§ 311(a)).

(5) The basis of the stock in Corporation held by a tenant-stockholder immediately prior to the proposed distribution by Corporation of the New Shares will be allocated between the stock held immediately prior to the distribution and the New Shares received in the distribution in proportion to the fair market value of the stocks of each immediately after the distribution (§ 307(a) and Treas. Reg. §1.307-1(a)).

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

No opinion is expressed about the tax treatment of the proposed transaction under other provisions of the Code or Income Tax Regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the proposed transaction that are not specifically covered by the above rulings. 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). In addition, we express or imply no opinion concerning the tax consequences of § 721.

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

In accordance with the power of attorney on file in this office, a copy of this ruling letter will be forwarded to your representatives.

Sincerely yours,
Associate Chief Counsel (Corporate)

By: _____
Mark S. Jennings
Chief, Branch 1

cc: