Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:

Telephone Number:

Refer Reply To:
CC:ITA:B02
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Date:
April 20, 2012

TY:

Legend

Corporation =
Landlord =
Tenant-Sponsor =
Holdings =
Address =

A =
B =
X =
Y =

State =

Date 1 =
Date 2 =

Dear

This letter is in response to a letter dated October 20, 2011 that was submitted by the authorized representative of Corporation. In that letter, a ruling was requested that Corporation and the tenant-stockholders of Corporation are entitled to deduct under § 164 and § 216(a) of the Internal Revenue Code certain real estate taxes paid or accrued by Corporation.

Landlord, a limited liability corporation, is, and has been, the owner of real property (land and building) located at Address (the Property).

Tenant-Sponsor, a limited liability company, is, and has been, in the business of investing in and owning and selling real estate.

On Date 1, Landlord leased the Property to Tenant-Sponsor. The term of the lease (the Ground Lease), including unfettered and continuous options to renew, is for X.

The provisions of the lease provide that it is a net lease, with Tenant-Sponsor responsible for all expenses and maintenance thereafter relating to the property, and it also provides that, with the consent of Landlord, Tenant-Sponsor was required, in accordance with the first amendment to the Ground Lease to, in effect, expend, exclusive of soft costs, a minimum of $A to reconstruct the property. Tenant-Sponsor, irrespective of soft costs, expended $B in the reconstruction of the building. The reconstruction/renovation of the property resulted in the erection, in all material respects, of a new building on the Property.

The Ground Lease and the first amendment to the Ground Lease specifically contemplated that Tenant-Sponsor would submit an offering plan with respect to the cooperative development plan to the Attorney General of State, in accordance with State law governing the development and sale of residential cooperatives.

Effective Date 2, which followed the completion of the construction by Tenant-Sponsor, Tenant-Sponsor assigned the lease for the property containing the reconstructed building to Holdings, a newly formed limited liability company, as the tenant under the lease. Thereafter, Holdings merged into Corporation, a newly formed State corporation, so that the result was that Corporation succeeded to all of the rights and obligations of Holdings, becoming the tenant under the Ground Lease, owning the leasehold estate created thereunder (the Leasehold Estate), for the reconstructed and improved real property, which is now subject to a filed plan of cooperative residential ownership under State law.

The result is that Corporation owned a “ground lease” for the real property for a term of X. The real property contained a completed new building with cooperative apartments held for sale by the original Tenant-Sponsor, the entity that constructed the new building to house the cooperative, which had been transferred (by means of what was in effect, an assignment of the lease) to Corporation.

While the term of the lease is for X, Corporation represents that the useful life expectancy of the new building is only Y for a building like the new building on the Property.

The lease provides that Tenant-Sponsor and any successor of Tenant-Sponsor, which is Corporation, is required to pay all real estate taxes imposed upon the building and the land by any governmental authority.

Corporation represents that Corporation qualifies as a cooperative housing corporation under § 216(b)(1) of the Internal Revenue Code and the stockholders, who purchased

stock representing their apartments in the building, qualify as tenant-stockholders of Corporation under § 216(b)(2).

An appraisal of the land and building obtained by Corporation concludes that the rent payable under the ground lease is, in substance and practice, allocated and attributable solely to the land, and that no part of that rent is really allocated or attributable to the new improvements.

Section 164(a)(1) of the Code allows a deduction for state, local, and foreign real property taxes in the taxable year in which such taxes are paid or accrued. Section 1.164-1(a) of the Income Tax Regulations provides that taxes generally are deductible only by the person on whom they are imposed. Furthermore, § 1.162-11(a) provides that taxes paid by a tenant to or for a landlord for business property are considered additional rent; thus, the landlord rather than the tenant is allowed a deduction for the payment of the taxes under § 164.

Section 216(a) allows a tenant-stockholder (as defined in § 216(b)(2)) a deduction for certain amounts paid or accrued to a cooperative housing corporation within the taxable year. These amounts include the tenant-stockholder's proportionate share of real estate taxes which are allowable as a deduction to the corporation under § 164 and which are paid or incurred by the corporation on (a) the houses or apartment building and (b) the land on which such houses (or building) are situated. Section 216(a)(1).

In Rev. Rul. 62-178, 1962-2 C.B. 91, a lessee was allowed a deduction under § 164 for real estate taxes paid on a building (but not the underlying land), even though legal title to the building was vested in the lessor of the land. The ruling reasoned that the enjoyment of the entire worth of the building was in the lessee because the lessor received no rental income attributable to the building and the useful life of the building, which was erected by the lessee with its own funds, was substantially shorter than the term of the lease. Thus, the lessee was treated as the owner of the building for purposes of § 164, and the tenant-stockholders of the lessee were allowed a § 216(a) deduction for amounts paid to the lessee representing their proportionate shares of the real estate taxes paid with respect to the building.

In contrast, in Rev. Rul. 62-177, 1962-2 C.B. 89, a lessee was not allowed a deduction under § 164 for real estate taxes that the lessee had paid on a building. In that case, the building was pre-existing and it was not constructed by the lessee. Although the useful life of the building was less than the term of the lease, the lessor was treated as the owner of the building for purposes of § 164 because the lessor received rental income attributable to the building. Thus, the lessee was not treated as the owner of the building for purposes of § 164 and the tenant-stockholders of the lessee were not allowed a § 216(a) deduction for amounts paid to the lessee representing their proportionate shares of real estate taxes paid with respect to the building.

The facts of the present case as provided by Corporation are substantially similar to the facts in Rev. Rul. 62-178. The appraisal obtained by Corporation concludes that the

rent payable under the ground lease is allocable solely to the land, and no part of the rent payable under the ground lease is attributable to the improvements. In addition, the useful life of the building is substantially shorter than the remaining term of the ground lease. Thus in accordance with Rev. Rul. 62-178, (a) Corporation will be treated as the owner of the building for purposes of § 164, and (b) Corporation (under § 164) will be entitled to deduct the real estate taxes, other than that attributable only to the land (under § 164) and each tenant-stockholder's rental or maintenance payments paid to Corporation will be deemed to include his or her proportionate share of the aforementioned taxes, other than that attributable only to the land, which will be deductible under § 216(a)(1) and § 164.

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.

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.

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, a copy of 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. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Thomas D. Moffitt
Branch Chief, Branch 2
(Income Tax & Accounting)

cc: