REPORT #642

TAX SECTION

New York State Bar Association

Committee on Income from Real Property
Report on Section 216(e) of the Internal Revenue Code

January 12, 1989

Table of Contents

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January 12, 1990

The Honorable Fred T. Goldberg, Jr.
Commissioner of Internal Revenue
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Dear Commissioner Goldberg:

Enclosed is a Report by our Committee on Income from Real Property on Section 216(e) of the Internal Revenue Code. The principal draftsmen of this Report were Michael Hirschfeld, Stuart Rosow and Donald Zief.

The Report addresses a number of questions that still need to be clarified in order to achieve Section 216(e)'s intended purpose of providing relief from repeal of the General Utilities doctrine on the conversion from cooperative to condominium ownership of residential apartments used as principal residences. The questions are summarized on page 4 of the Report. The Report recommends that consideration should be given to dealing with these issues by regulation, although the present breadth of regulatory authority to accomplish all that is necessary may not be beyond question. The Report also concludes that certain other legislative changes, similarly listed on page 4 of the Report, may be appropriate to more fully implement the intention of Section 216(e).

Sincerely,

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Tax Report #642

NEW YORK STATE BAR ASSOCIATION

TAX SECTION

Committee on Income from Real Property[1]

Report on Section 216(e) of the Internal Revenue Code

January 12, 1989

The Technical and Miscellaneous Revenue Act of 1988 ("TAMRA") added Section 216(e) to the Internal Revenue Code of 1986 (the "Code") to alleviate the imposition of a corporate level tax on a cooperative housing corporation[2] when its shareholders convert their form of ownership from shares in a

[1] The principal draftsmen of this report were Michael Hirschfeld, Stuart Rosow and Donald Zief. Helpful comments were also received from William L. Burke, John A. Corry, James A. Levitan, Joel E. Miller and David Sachs.

[2] A cooperative housing corporation is defined in Section 216(b)(1) as 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 subsection (a) are paid or incurred is derived from tenant-stockholders."

A "tenant-stockholder" is defined in Section 216(b)(2) as "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."

cooperative to ownership of condominium units and an allocable portion of the common areas. The Tax Reform Act of 1986 (the "1986 Act") enacted certain provisions which resulted in the imposition of a corporate level tax on all nonliquidating and liquidating distributions of appreciated property by corporations.[3] The effect of these provisions on a cooperative housing corporation results in the imposition of tax on such a corporation if the shareholders convert their form of cooperative ownership into condominium form.[4]

Section 216(e) provides:

> Except as provided in regulations, no gain or loss shall be recognized on the distribution by a cooperative housing association[5] of a dwelling unit to a stockholder in such cooperation [sic] if such distribution is in exchange for the stockholder's stock in such corporation, and such exchange qualifies for nonrecognition of gain under section 1034(f).[6]

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[3] 3P.L. 99-514, 99th Cong., 2d Sess.(October 22,1986). The 1986 Act enacted new Code Section 336(a), which provides that gain or loss shall be recognized to a liquidating corporation on the distribution of property in complete liquidation as if such property were sold to the distributee at its fair market value. Code Section 311(b) contains a similar rule for nonliquidating distributions; the 1986 Act removed the remaining exceptions to this rule.

[4] In Private Letter Ruling 8812049(December 23,1987), the IRS held that under Section 336(a), a cooperative housing corporation would recognize corporate level gain where it recorded a condominium declaration, adopted a plan of liquidation and distributed its appreciated assets (i.e., apartments plus undivided tenancy in common interests in the common elements) pro rata to its shareholders.

[5] The use of the word "association" is assumed to be a drafting error; it should probably read "corporation."

[6] See text accompanying notes 15 and 16, infra. Section 1034(a) provides that if a taxpayer sells or otherwise exchanges a principal residence at a gain, and the taxpayer purchases a new principal residence within a period beginning two years before and ending two years after the sale of the "old residence," gain on the sale of the "old residence" is recognized only to the extent the sales price of the old residence exceeds the taxpayer's cost of purchasing the new residence (i.e., no gain is recognized if the cost of the new residence exceeds the selling price of the old residence).

This report expresses our views concerning some of the more important issues which arise under Section 216(e) and to suggest possible approaches Treasury Regulations may take.

General Comments

Section 216(e) ostensibly protects a cooperative housing corporation from a corporate level tax to the extent the shareholders meet the requirements for gain deferral under Section 1034. However, we believe that several issues must be resolved before the protection afforded by Section 216(e) complies with the Congressional intent.

We suggest that regulations be issued to address the following issues, although we are concerned that the breadth of the regulatory authority needed to accomplish all that is necessary may not be beyond question. The regulations should:

(1) provide a method for allocating the cooperative apartment corporation's basis in the apartment building to units owned by shareholders who do not meet the requirements for gain deferral under Section 1034, so that the amount of gain to be recognized by the cooperative corporation may be determined;

(2) provide a method for apportioning corporate level tax liability to those exchanging shareholders who did not meet the Section 1034 requirements for deferral of gain and caused the cooperative corporation to recognize income upon conversion;

(3) clarify the coordination between the provisions of Sections 1034 and 216(e);

(4) clarify what is included in the definition of “dwelling unit” and the tax treatment of “other property” distributed in exchange for cooperative housing corporation stock;

(5) address the recapture of tax benefit items;

(6) specify due diligence and record-keeping requirements for cooperative housing corporations converting to condominium ownership; and

(7) clarify that the cross-reference in section 216(e) to section 1034(f) is actually a reference to 1034(a) after application of section 1034(f).

We also suggest that legislation be considered that would offer:

(1) a legislative grace period from application of these rules; and

(2) extension of relief to any apartment that is used as a residence by the shareholder or a member of his family.

Discussion

1. Extent of Corporate Level Gain Recognition

Section 216(e) provides for a stockholder-by stockholder test for gain recognition. If the stockholder qualifies under Section 1034 for gain deferral, no corporate level tax is imposed, while if the stockholder does not so qualify, tax is imposed on corporate level gain.

An unresolved question under Section 1034 is the amount of the corporate level gain which must be recognized where the stockholder does not qualify for gain deferral. For example, assume that there are ten equal shareholders in a cooperative housing corporation. Nine of the shareholders occupy their cooperative apartment units as a principal residence, while one shareholder uses his apartment unit solely for business purposes and claims annual depreciation deductions with respect thereto. Assume each shareholder paid $100,000 for his unit, and that the basis of the nine “principal residence” shareholders in their units remains at $100,000 while the basis of the “business use” shareholder in his unit, which has been reduced by $25,000 of depreciation deductions, is $75,000. Each unit is worth $150,000 when the shareholders decide to convert their cooperative shares into condominium units. Assume that the corporation's basis in the apartment building at the time of conversion is $800,000. Each “principal residence” shareholder will have a realized gain of $50,000 but will not recognize any gain because of the gain deferral provisions of Section 1034, while the “business use” shareholder will realize and recognize gain of $75,000. The corporation would have a realized gain of $700,000 upon conversion ($1,500,000 aggregate fair market value less $800,000 basis). However, under Section 216(e), the corporation would

recognize only a portion of this realized gain, that portion which is attributable to its deemed sale of the “business use” shareholder's unit for the fair market value of $150,000.

The issue raised in the above scenario is determining the amount of the cooperative corporation's basis allocable to this unit. One method is to allocate based on relative values, i.e., each shareholder's unit in this example is worth the same amount -- $150,000 — so that 10% of the corporation's basis ($80,000) would be attributable to the unit owned by the “business use” shareholder, and the cooperative corporation would recognize a gain of $70,000 ($150,000 - $80,000). However, this method could result in skewed results where, for example, a 10% shareholder owns a unit which accounts for 15% of the total value of the units, because of differing rates of appreciation for different units over time. Because of this possibility, the simplest method of allocating basis may be to allocate in accordance with share ownership; i.e., a 10% shareholder will have 10% of the building's basis allocated to him, even if his unit accounts for more or less than 10% of the total value. We suggest that forthcoming regulations allocate basis in accordance with share ownership and that forthcoming regulations also provide a method for determining corporate level gain where a shareholder qualifies for partial gain deferral under Section 1034.

2. Apportionment of Corporate Level Tax

If the cooperative corporation incurs a tax liability because not all tenant-shareholders qualified for gain deferral under Section 1034, the tax presumably will ultimately fall on all condominium unit owners, as transferees of the cooperative corporation. This result causes those shareholders who did qualify for gain deferral under section 1034 (and who did not cause the corporate level tax to be imposed under section 216(e)) to fund a portion of the tax liability caused by the shareholders who did not qualify for Section 1034 treatment.

The fact that Section 216(e) is operative only if Section 1034 deferral treatment is available to a shareholder poses a difficult tax policy issue. Congress may have intended that corporate level gain be recognized if a shareholder does not qualify for gain deferral under the provisions of Section 1034, on the assumption that there exists a satisfactory mechanism for the tax burden to be borne by those shareholders causing gain recognition to the cooperative corporation. On the other hand, it may seem unfair to impose a tax on one shareholder by the will of the majority of other shareholders. (Upon contemplating a purchase of a cooperative apartment, must the prospective shareholder be informed that the present shareholders have been discussing a conversion to condominium ownership, so that if the prospective shareholder sold a principal residence within two years before the conversion date, he will cause the imposition of a corporate level tax and must be prepared to reimburse the other shareholders?)

Tenant-shareholders may adopt a variety of methods for dealing with this problem. However, we believe that a regulatory solution is appropriate, such that tax is imposed on only those shareholders who cause the 216(e) tax on the cooperative corporation. This could be accomplished by permitting an additional assessment on the shareholders who caused corporate level tax to be imposed, if permissible under state law, and by providing that such additional assessment will not result in the disqualification of the corporation as a cooperative housing corporation under Section 216.

3. Coordination of Section 216(e) with Section 1034

Section 216(e) affords protection against income recognition at the corporate level if the distribution of the dwelling unit to the stockholder in exchange for his stock "qualifies for nonrecognition of gain under Section 1034(f)."[7] Section 1034(c)(1) provides that for 1034 purposes, "An exchange by the taxpayer of his residence for other property shall be treated as a sale of such residence, and the acquisition of a residence on the exchange of property shall be treated as a purchase of such residence." Consequently, the relief afforded by Section 216(e) is available only if the deemed purchase of the condominium unit and the deemed sale of the cooperative unit are matched against each other under Section 1034. As explained in more detail below, the deemed purchase and sale upon conversion will be matched against each other (and thus permit nonrecognition of corporate level gain) only if all of the following are true: (i) each shareholder occupies his apartment

[7] See text accompanying note 6, supra. See also text accompanying notes 15 and 16, infra for our suggestion that the reference to Section 1034(f) be clarified so that it is clear that it means that nonrecognition of gain occurs under Section 1034(a) after application of Section 1034(f).

unit as his principal residence, (ii) the shareholder held his cooperative apartment unit for at least two years prior to the conversion, and (iii) the shareholder does not purchase a new principal residence for at least two years after the conversion.

A. Multiple Purchases Within Two Year Period.

Section 1034(c)(4) provides that where a taxpayer purchases more than one principal residence within two years after the sale of his "old" principal residence, only the last purchase is matched against the sale to determine the gain deferral under section 1034. Thus, assume Taxpayer A sells his old residence for $300,000, with a basis of $100,000, and within 6 months purchases a coop apartment for $300,000. A has a realized gain of $200,000. If this is the only purchase during the two-year period, then under the provisions of Section 1034(a),[8] the $200,000 gain is deferred and the basis of the coop will be $100,000 ($300,000 purchase price - $200,000 gain deferred). Assume, however, that nine months later, the co-op is converted into a condominium when the fair market value of the co-op has fallen to $250,000. Because the acquisition of a residence on the exchange of property is treated as a purchase under section 1034(c)(1), the conversion causes this purchase to be matched against the original sale instead of the deemed conversion sale of the cooperative apartment. Because this purchase is deemed to be for $250,000 and the original sale was for $300,000, $50,000 of the $200,000 realized gain on the original sale must be recognized by the shareholder. Also, there is a nondeductible loss on the deemed sale under Section 262 ($250,000 selling price less $300,000 purchase price).

[8] See footnote 6, supra.

Accordingly, because a conversion of a cooperative housing corporation to condominium ownership and the deemed distribution of the unit to the former co-op shareholder in exchange for his co-op shares is viewed as a purchase and sale transaction, the gain on such a deemed sale by the corporation is not protected by section 1034 if the conversion occurs within two years of the shareholder's original sale. Because Section 216(e) does not apply if Section 1034 does not protect a shareholder from gain recognition, the cooperative corporation is subject to tax as well as the shareholder in this instance.

It is not clear whether Congress intended this result. It may be that Congress intended Section 216(e) to operate whenever a shareholder met the principal residence requirement of Section 1034, regardless of whether the shareholder met the remaining requirements of Section 1034 for nonrecognition of gain. One way to eliminate the double tax in the above example would be by providing that, solely for applying Section 1034 for 216(e) purposes, the value (or purchase price) of the condominium unit on conversion will be deemed to be equal to the price paid for the shares in the cooperative housing corporation. This rule would allow Section 1034(c)(4) to operate and tax the shareholder, but would treat the exchange as qualifying for nonrecognition under Section 1034 for 216(e) purposes and protect the cooperative corporation from recognizing gain due to a deemed sale and purchase when the market value of the cooperative shares has not risen above their cost while the actual living space has not been sold or exchanged.

A simpler approach would be to assume nonrecognition for the shareholder under Section 1034 for 216(e) purposes as long as the shareholder met the principal residence requirement under Section 1034 for both the original sale and the cooperative unit.

This approach would permit Section 1034 to operate normally but would not trigger corporate level tax under Section 216(e) if the shareholder was dealing only in principal residences.[9]

There should be room to implement either of these approaches through regulations, but the authority may not be beyond question.

B. Multiple Sales.

A more pervasive problem for a taxpayer engaged in a conversion transaction arises if the taxpayer has two or more sales during a two-year period. Section 1034(d)(1)does not permit deferral treatment for gain on the sale of a principal residence if the taxpayer sold other property used as a principal residence within two years before such sale and any gain was deferred under section 1034. To illustrate the working of this rule in the conversion scenario, assume in the above example that instead of the market value of the coop apartment declining to $250,000, it increased to $340,000. Under the rule of Section 1034(c)(4) described above, this conversion/purchase will be matched against the original sale at $300,000, and because the deemed purchase price under the conversion is greater than the original selling price, the gain on the original sale should be deferred, thus avoiding the problem of Section 1034(c)(4) noted above.

[9] The Conference Agreement indicates that anticipated regulations to be promulgated under the regulatory authority granted in Section 216(e) are to be restrictive? i.e., such regulations are to assure that (i) the intended relief is provided only in cases where the house or apartment is in fact used by the taxpayer as his principal residence both before and after the distribution, and (ii) there is a full recapture of tax benefits (if any) that may have been claimed at the corporate level to the extent the same benefits could not have been claimed by the shareholder if he had owned the house or apartment directly and used it as his principal residence. Conf. Rep., No. 100-1104, 100th Cong., 2d Sess. 241 (1988). It is arguably relevant, however, that Section 216(e) addresses only Section 1034(f), leaving the usual breadth of authority for interpretation of the scope of Section 1034(a).

However, because the taxpayer sold his original home less than two years before the deemed sale of his co-op shares upon conversion, and gain on such sale was deferred under Section 1034(a), the rule of Section 1034(d)(1) would operate to deny deferral treatment on the conversion sale even if a principal residence is subsequently purchased. Thus, the realized gain of $40,000 on the conversion ($340,000 deemed selling price of co-op less $300,000 basis in co-op) must be recognized. Further, because 1034(a) does not apply to the conversion, Section 216(e) would also not protect the cooperative housing corporation from the recognition of an entity level tax.

Thus, because a conversion of a cooperative housing corporation to condominium ownership and the distribution of a condominium unit to a coop shareholder in exchange for his co-op shares is viewed as a second sale within two years of the first sale, the gain on such a deemed sale is not protected by Section 1034. Once again, the literal language of Sections 1034(d)(1) and 216(e) require taxation of the corporation if the shareholder is taxed on the conversion.

The impact of Section 1034(d)(1) on Section 216(e) is even more dramatic when there has been no change in value in the cooperative unit. Assume in the above example that the taxpayer sold his old residence for $300,000 and purchased a co-op apartment for $300,000. The apartment was worth $300,000 upon conversion which occurred fifteen months after the sale of the taxpayer's old residence. Under Section 1034(c)(4), the conversion purchase of the condominium is matched against the original sale and the taxpayer will recognize no gain. Section 1034 does not apply to the conversion sale of the coop apartment; however the apartment was sold for its adjusted basis of $300,000

and there is no gain realized. For Section 216(e) purposes, however, the exchange of the condominium unit for the shareholder's stock did not qualify “for nonrecognition of gain under Section 1034(f)” (even though there was no gain to be afforded nonrecognition) because the conversion purchase of the condominium was matched against the original sale of the old residence under Section 1034(c)(4) and not against the conversion sale of the shareholder's stock. Therefore, even though the shareholder has no gain, the coop's association would be subject to tax on part of any gain it realized on the liquidation.

We suggest that regulatory authority be exercised so as to afford protection to the cooperative corporation under Section 216(e), but not to disturb the present operation of Section 1034 with respect to taxation of the shareholder. However, as noted above, it may not be beyond question whether the grant of regulatory authority is broad enough to permit the Treasury Department to cure this through regulations.

4. Definition of “Dwelling Unit”

Section 216(e) protects against recognition of corporate level gain upon distribution of a “dwelling unit” to a stockholder. We suggest that regulations clarify what is included in this definition. A typical cooperative-to-condominium conversion may take the following form: (i) the cooperative corporation records a declaration of condominium subjecting the apartment building and land on which it is situate to the state's condominium act, each apartment is designated a separate

condominium unit with an appurtenant proportionate undivided tenancy-in-common interest in the common elements and an association of unit-holders is created; (ii)each cooperative shareholder exchanges his shares in the corporation for a deed to his condominium unit (which includes such unit's appurtenant common interest); (iii) the corporation transfers all other property, such as grounds-keeping equipment and lobby furniture and cash reserves to the unit-holders' association; and (iv) the corporation is dissolved.[10] Sometimes the dissolving cooperative corporation may transfer investment-type assets, such as stocks or bonds, directly to the unit-holders instead of distributing such assets to the unit-holders' association.

A condominium owner's undivided tenancy-in-common interest in common elements and areas may include an interest in commercial space and recreational facilities. Regulations should clarify whether, and to what extent, such items, as well as a unit-holder's interest in cash reserves and investment assets formerly held by the cooperative corporation, are included in the term “dwelling unit,” and therefore excluded in computing corporate level gain.[11]

It may be appropriate to include recreational facilities, but not commercial space, under the “dwelling unit” umbrella; i.e., a dwelling unit can conceivably include a right to use a swimming pool but not to income from commercial sources. By excluding commercial space and other property from the definition of “dwelling unit,” both the shareholder who otherwise

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[10] See Miller, “Congress Grants Coops Limited and Uncertain Relief from General Utilities Repeal,” 5 Tax Mgmt. Real Est. J. (January 4, 1989).

[11] Under Section 1034, property used by the taxpayer as his principal residence does not include personal property such as furniture, which is not a fixture under local law. Thus, gain attributable to the sale of such assets must be recognized. Treas. Reg. § 1.10341(c)(3)(i).

meets the requirements of section 1034 and the cooperative corporation incur a taxable event. For example, assume a tenant-stockholder's basis in his unit is $100,000. The tenant/stockholder receives a condominium unit (including a proportionate interest in appurtenant common areas) plus an undivided interest in cash reserves, and other tangible personal property, the sum total of which equals $150,000. The sum of the cash and personal property equals $25,000. Upon conversion, the tenant-stockholder would be viewed as having sold his unit for $150,000 but reinvesting $125,000 so that he would recognize a gain of $25,000 under Section 1034. This would also produce a corporate level gain, which is not protected by Section 216(e).

An alternative to excluding items from the definition of “dwelling unit” is to treat all property distributed as coming under the “dwelling unit” umbrella, but with a required basis allocation to all assets distributed, in order to ensure gain recognition on subsequent disposition of these assets. Finally, a possible “safe harbor” could be prescribed by regulations to the effect that “other property” would be included in the term “dwelling unit” as long as the value of such property did not exceed the lesser of 10% or some nominal amount of the total value of property distributed.

A further issue concerns the treatment of the property owned by the condominium unit-holders' association. A strong argument for inclusion in the term “dwelling unit” is that a unit-holder's interest in such property can generally not be separately transferred by individual action, yet a valid argument against such inclusion is that there is no direct limit on the type or amount of property such an association may own.[12] In this

[12] Id.

latter case, the transfer of property by the cooperative housing corporation to the unit-owners' association could generate a corporate level tax on the cooperative, as there is no section 216(e) protection. Regulations should address these concerns.

5. Recapture of Tax Benefits

As noted earlier, regulations are to insure that there is a full recapture of any tax benefits claimed at the corporate level to the extent the same benefits could not have been claimed by the shareholder if he had owned the house or apartment directly and used it as his principal residence.[13] For example, depreciation claimed by the cooperative corporation which shelters commercial or investment income earned by the cooperative should probably be recaptured, while depreciation which shelters rental income paid by the shareholders should probably not be recaptured However, regulations should not go so far as to deny the Section 216(e) relief in nonabusive situations. An anti-abuse provision may also be necessary so as to deny the benefits of Section 216(e) in certain cases.[14]

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[13] See footnote 9, supra.

[14] One such situation may be where a purchaser is desirous of acquiring the cooperative housing apartment building and tenant stockholders first convert to condominium ownership to avoid double-level taxation on the sale and subsequent liquidation of the corporation. A further issue concerns whether the cooperative corporation must recognize a gain upon liquidating or non-liquidating distributions if the mortgage on the building is in excess of the building's basis, even though all shareholders may qualify for deferral treatment under Section 1034. If the fair market value of the cooperative apartment building is equal to or less than the basis of the building and the mortgage liability is in excess of the basis, Sections 336(b) and 311(b) operate to cause the cooperative corporation to recognize gain upon condominium conversion if the distributee shareholders assume or take subject to the mortgage on the cooperative building. As a practical matter, the mortgage in excess of basis issue may not be a serious concern because many states do not permit blanket mortgages on condominium units. See, e.g.. N.Y. Real Property Law § 339-r.

6. Cooperative Corporation Due Diligence

Because under Section 216(e) the corporate level tax is dependent upon whether exchanging shareholders qualify for the gain deferral provisions of Section 1034, it is necessary for the cooperative corporation to ascertain the status of the exchanging shareholders. We suggest that the regulations specify exactly how this is to be accomplished and also provide an exemption from the imposition of any penalty on the cooperative corporation for an inadvertent failure to carefully determine the status of exchanging shareholders.

One alternative may be to require an affidavit from a converting shareholder, to the effect that the apartment unit is his principal residence, there have been no other purchases of principal residences in the immediately preceding two-year period or if there have, the selling price of the first such sale during this two-year period is less than the deemed purchase price of the condominium unit for which he is exchanging cooperative shares, and during the immediately preceding two year period, there have been no other sales of principal residences pursuant to which gain was deferred under the provisions of Section 1034.

Another alternative (or perhaps an additional requirement) is for the cooperative corporation to require federal and/or state income tax returns from the converting shareholders for the immediately preceding two-year period in order to ascertain purchases and sales of principal residences. (Of course, there is no guarantee that the results of a federal or state audit during this period will not change what a shareholder thought was a non-Section 1034 transaction into a transaction covered by Section 1034 and triggering the corporate level tax because of the issues discussed above.) Many

cooperative corporations already obtain this information for other purposes; all cooperatives now may be required to obtain it.

In effect, the passage of section 216(e), intended as a relief provision, may now require cooperative corporations to retain the same records as a shareholder must to substantiate that he qualifies for the gain deferral provision under Section 1034. We believe regulations should address how onerous this record-keeping requirement will be. Out of respect for the privacy of tax returns generally, we believe that the regulations should permit the less onerous alternative of permitting the cooperative corporation to rely on an affidavit so long as it does not know the affidavit is inaccurate.

7. Cross-reference to Section 1034(f)

Section 216(e) permits nonrecognition of gain to the cooperative corporation if the exchange of the dwelling unit distributed by the cooperative corporation to the stockholder in exchange for his stock would qualify for nonrecognition of gain under Section 1034(f) (emphasis added). However, Section 1034(f) merely provides that references to the taxpayer's “residence” are to be deemed to be references to cooperative corporation shares he owns.[15] Section 1034(c)(1) is the only provision which deals with exchanges and Section 1034(a) provides for nonrecognition of gain.[16] We suggest that the reference to Section 1034(f) in Section 216(e) be modified so that it is clear that

[15] In PLR 88049, supra note 4, taxpayer cited section 1034(f) in support of its argument that section 336(a) should not be extended to situations involving mere changes in the form of ownership of property where the scheme of management and shared ownership remains the same as before the conversion.

[16] See notes 6 and 8, supra.

nonrecognition of gain occurs under Section 1034(a) after application of section 1034(f).

8. Transition Relief

While the repeal of the General Utilities doctrine by the 1986 Act reflected a conscious policy decision on the part of Congress to tax corporations upon their liquidation, we question whether the specific impact of that repeal on coop to condominium conversions was considered at that time. In view of the lack of change of beneficial ownership accompanying a coop to condominium conversion and the perceived trap for the unwary that the legislation presented in this specialized area immediately after enactment of the 1986 Act, we would recommend legislative consideration of a grace period under which a coop could be converted to condominium status without incurring any corporate level tax (other than for recapture items). Such legislative grace period could be made retroactive only if there is a perception that prospective application would allow for transactions that may be viewed as abusive.

9. Extension of Coverage Based on Personal Use

Section 216(e) only offers relief from corporate level tax where the shareholder occupies his or her apartment as a "principal residence." Similarly, Section 1034 only offers relief to a shareholder who occupies the apartment as a principal residence although Section 1031 may offer relief to those shareholders who use their apartments in a trade or business (e.g., rental purposes) or hold for investment. There is no relief afforded at both the corporate level and the shareholder level for those individuals who use the apartment as a residence

but not a principal residence.

We would recommend consideration of a legislative amendment to both Section 216(e) and Section 1034 so as to allow solely for the purposes of a coop to condominium conversion, relief from corporate and shareholder level tax to an individual shareholder who owns an apartment that is used by the shareholder or a member of his family as a residence. We believe this appropriate in that most coop owners own coop shares merely as a method of owning an apartment and that this suggested legislative change would eliminate an unwarranted taxable event where there is solely personal use of the apartment with the underlying beneficial ownership not changing in any manner as a consequence of the conversion.