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Department of the Treasury
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Person To Contact:
, ID No.
Telephone Number:

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CC:ITA:B02
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Date:
December 05, 2005

Legend:

Corporation =
Landlord =

Investor =
A =
B =
C =
D =
E =
F =

Dear :

This is in response to a letter dated October 6, 2004 that was submitted by the authorized representative of the Corporation. In that letter, a ruling was requested that the tenant-stockholders of the Corporation are entitled to deduct under section 216(a) of the Internal Revenue Code their proportionate shares of certain real estate taxes paid or accrued by the Corporation.

The Corporation was formed for the primary purpose of acquiring a leasehold interest in a portion of certain property owned by the Landlord, and making dwelling units, space and facilities located on that property available to shareholders of the Corporation for residential purposes. The property is currently leased from the Landlord by the Investor under a A-year lease that commenced in 2004. The Landlord and the Investor have agreed to split this lease into two separate leases. The first lease (the "Residential Ground Lease") will pertain to a portion of a pre-existing building (the "Annex Building") and the underlying land (the "Annex Land"). The second lease will pertain to the remainder of the building and land, which will continue in its present use

as a B leased and operated by the Investor. After completion of $C of improvements to the Annex Building by an entity wholly owned by the Investor, the Corporation will become the lessee under the Residential Ground Lease. The rent under the Residential Ground Lease will be D percent of the rent under the original lease. After improvements are completed, the Annex Building will have a useful life of 50 years.

An appraisal of the Annex Building and Annex Land concludes that the present value of the lease payments under the Residential Ground Lease is $E. The appraisal further concludes that the value of the Annex Land, without any improvements or encumbrances, is $F. Thus, the appraisal concludes that the rent payable under the lease is in no way attributable to the Annex Building.

Section 164(a)(1) of the Internal Revenue 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, section 1.162-11(a) of the regulations provides that taxes paid by a tenant on behalf of 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 section 164.

Section 216(a) allows a tenant-stockholder (as defined in section 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 section 164 and which are paid or incurred by the corporation on (a) the houses or apartment building owned or leased by the corporation and (b) the land on which such houses or building is situated. Sec. 216(a)(1), (b)(1)(B).

In Rev. Rul. 62-178, 1962-2 C.B. 91, a lessee was allowed a deduction under section 164 of the Code 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 revenue 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 section 164, and the tenant-stockholders of the lessee were allowed a section 216(a) deduction for amounts paid to the lessee representing their proportionate shares of the real estate taxes paid with respect to the building.

By contrast, in Rev. Rul. 62-177, 1962-2 C.B. 89, a lessee was not allowed a deduction under section 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 section 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 section 164, and the tenant-stockholders of the lessee were not allowed a section 216(a) deduction for amounts paid to the lessee representing their proportionate shares of the real estate taxes paid with respect to the building.

The facts in the present case, as provided by the taxpayer, are substantially similar to the facts in Rev. Rul. 62-178. The appraisal obtained by the taxpayer establishes that the Landlord will not receive any rent attributable to the building. Thus, under Rev. Rul. 62-178, the Corporation is treated as the owner of the building for purposes of section 164, and the tenant-stockholders are allowed a section 216(a) deduction for their proportionate share of the real estate taxes paid by the Corporation, but only to the extent that the taxes are attributable to the building rather than the land.

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

Sincerely,

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

cc: