

# New York Cooperatives

Do They Qualify For Tax Deferral Under §1031?

1031

Knowledge

When buying into a cooperative (“co-op”), the exchanger acquires stock in the cooperative corporation that owns or leases an entire building. As a stockholder of the cooperative corporation, the taxpayer receives a long-term “proprietary” lease and the right to exclusive possession of an apartment. The co-op board acts very much like a landlord and the taxpayer is entitled to demand from the board many of the same services they expect in a rental building. The co-op board bills the taxpayer every month for a pro-rated share of the total cost of running the building, which usually includes the monthly mortgage payment for the entire building. The taxpayer pays this monthly bill, referred to as *maintenance*, in addition to any bank loan they may have obtained to purchase their specific apartment. With this in mind, can a co-op be exchanged under IRC Section 1031?

Yes. The IRS has consistently ruled that a New York co-op is like kind to real estate, even though ownership is held in the form of stock in a corporation. In PLR 200631012, the IRS approved a proposed exchange of co-op stock for real property and improvements to be acquired by family members and family-owned entities as tenants in common. In so ruling, the drafter noted that: “Whether stock in a cooperative apartment located in New York State constitutes real or personal property under §1031 is determined under New York law.” See, e.g., Rev. Rul. 55-749, 1955-2 C.B. 295. Although New York case law might suggest that there are conflicts concerning whether a cooperative interest in real property is real property (State Tax Comm'n v. Shor, 43 N.Y.2d 151, 371 N.E.2d 523, 400 N.Y.S.2d 805 (1977), questioned in *In re Pandeff*, 201 B.R. 865 (Bankr. S.D.N.Y. 1996)), various New York statutes treat an interest in a cooperative as equivalent to an interest in real property. N.Y. Civ. Prac. L. & R. §5206(a) (McKinney 1997) (homestead exemption); N.Y. Real Prop. Law § 279(5) (McKinney 1989) and N.Y. Pub. Auth. Law § 2402(5) (McKinney Supp. 2006) (mortgage for cooperative interest); N.Y. Real Prop. Tax Law § 467(3-a) (McKinney Supp. 2006) (real property tax for senior citizens); N.Y. Tax Law § 1402-a(a) (McKinney 2004) (“mansion tax”); and N.Y. Real Prop. Law § 254-b(1) (McKinney 1989) (limit on mortgage late charges) the drafter concluded with the following: “Accordingly, we rule that the interests in cooperative apartments in New York owned by Partnership and Company will be considered like kind, for purposes of §1031, to the improved and unimproved real property that Partnership and Company intend to acquire as replacement properties.”

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The foregoing PLR is consistent with prior PLRs issued by the IRS relating to proposed exchanges of co-op stock. See e.g., PLR 200137032, in which the IRS approved an exchange of stock associated with one residential unit for another unit in the same building. The IRS viewed both the interest in the co-op, which included a proprietary lease of more than 30 years duration, and the deeded interest to the condominium as real property interests. For other rulings involving the characterization of New York co-ops as real property interests under §1031, see IRS Letter Rulings 8810034, 8445010 and 8443054. The following statutes and cases support the premise that an interest in a co-op apartment may be considered real property in New York:

- N.Y. Civ. Prac. L & R §5206: Provides a homestead exemption from creditors.
- N.Y. Pub. Auth. Law §2402(5): Provides that a “mortgage” includes a loan by a bank to purchase stock in a co-op corporation.
- N.Y. Real Prop. Law §254-b: Limits late charges on loans secured by co-ops.
- N.Y. Real Prop. Law §279(5): Allows the issuance of mortgage loans for financing the co-op ownership of real estate.

In *State Tax Comm vs. Shor*, 43 N.Y. 2d. 151, 371 N.E. 2d 523), the New York Court of Appeals, for the most part, treated an interest in a co-op as an interest in real property.

Additionally, note that the IRS also allows taxpayers who own co-ops to take a tax deduction for their proportionate share of the real estate taxes allowed as a deduction to the corporation. In summary, there are many tax and legal advisors who believe there is a strong legal authority to support the idea that a co-op can accurately be classified as “real property” for 1031 exchange purposes.

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