OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

FROM: DEBORAH A. BUTLER
ASSISTANT CHIEF COUNSEL (Field Service)
CC:DOM:FS

SUBJECT:

This Field Service Advice responds to your memorandum dated July 26, 1999. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:

Taxpayer =
X=
Year 1 =
Year 3 =
Year 4 =
Year 5 =
Year 6 =
Year 7 =
Year 8 =

ISSUE(S):

1. Whether the taxpayer was required to seek approval of the Commissioner pursuant to I.R.C. § 442 before changing its accounting period in Year 8.

2. Whether the taxpayer could carry forward its net operating losses from prior tax years to its short period for Year 1.

3. Whether the taxpayer's failure to qualify for I.R.C. § 216 cooperative housing corporation status in the short year prevented it from qualifying in subsequent taxable years.

CONCLUSION:

1. The taxpayer was not required to seek the approval of the Commissioner in order to change its accounting period.

2. The taxpayer can carry forward its net operating losses,

3. The taxpayer's failure to qualify for cooperative housing corporation status in the short year does not affect its qualification in other years.

FACTS:

The taxpayer incorporated in Year 1 and began filing tax returns on a calendar year basis. In Year 3 it acquired land and a building and qualified as a cooperative housing corporation under I.R.C. § 216(b)(1). In Year 8 it sold shares of stock to X, an unrelated entity, in connection with a lease of commercial property in the building. X made pre-paid rental payments in January of Year 8 that caused it to lose its qualification as a cooperative because of the "20% rule" in I.R.C § 216(b)(1)(D).

The taxpayer filed a short year return for the period ending January 31, Year 8, attaching the following statement to the return:

> The corporation is hereby changing its fiscal tax year under the provisions of Reg. 1.442-1(c)(2). It does hereby affirm that the 5 conditions contained in that regulation are met and there is no infirmity in making the automatic election to change its year from a calendar year to one which ends on January 31.

The taxpayer filed a 12-month return for the year ended January 31, Year 9. The taxpayer has subsequently filed on the basis of years ended January 31.

While it was a cooperative housing corporation, the taxpayer incurred net operating losses for year 3, year 4, year 5, year 6, and year 7. The taxpayer used those losses in the short year return for the year ended January 31, year 8.

LAW AND ANALYSIS

Treas. Reg. § 1.442-1(c) provides that a C corporation can change its annual accounting period without prior approval of the Commissioner if the corporation complies with the relevant procedural rule and meets five requirements. Based on your submission, the procedural requirements were met and all five substantive requirements listed in the regulations were also met. The regulations under I.R.C. § 442 do not provide any special rules for cooperative housing corporations that would change this result.

For the years in question, net operating losses could be carried back 3 taxable years and forward 15 taxable years. For purposes of net operating losses, a fractional part of a year that is a taxable year under I.R.C. §§ 441(b) and 7701(a)(23) is treated as a taxable year. Treas. Reg. § 1.172-4(a)(2); Valley Paperback Manufacturers, Inc. v. Commissioner, T.C. Memo. 1975-311 (discussion of legislative history). Accordingly, absent any authority to the contrary, the taxpayer should be able to use its net operating losses from Years 1 through 7 in the short year ended January 31, Year 8. The regulations under I.R.C. § 172 do not provide any special rules for cooperative housing corporations. Furthermore, there is nothing in section 216 or the regulations thereunder that prevents use of the carryforward. Indeed, we would not expect to find such a limitation in the cooperative housing corporation provisions. Those provisions are designed to place the owner/occupants of housing cooperatives in the same place as homeowners with respect to the deduction of mortgage interest, real estate taxes as well as depreciation for those shareholders owning interests for business or investment purposes. In other respects, the corporation generally is subject to the same rules as other corporations.

Accordingly, we see no reason why the taxpayer could not change its annual accounting period and use the net operating loss carryforward against its income for that period.

A corporation having the characteristics set forth in section 216(b)(1) in a taxable year is a cooperative housing corporation in that year. A corporation not having those characteristics is not a cooperative housing corporation in that year. As Rev. Rul. 59-257, 1959-2 C.B. 101, states, “Whether or not a corporation is a cooperative housing corporation as defined in the Code must be determined with respect to each year.” In other words, the determination is made for each year independent of other years and the corporation’s status as a cooperative housing corporation can change from year to year. Accordingly, the taxpayer’s failure to qualify as a section 216 cooperative housing corporation in a short taxable year does not prevent it from qualifying in subsequent years.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

Our answers presuppose that the facts presented are correct; if any of them are not, the taxpayer may not have qualified for the automatic change in its accounting period. If development of the facts indicate that this is the case, the taxpayer should have filed a return for calendar year [redacted] with the consequences that flow from that, which include potential disallowance of cooperative housing corporation status for the entire tax year and a requirement that the net operating loss carryforward be used up in the calendar year return.

We considered that the taxpayer's plan was abusive and should be challenged on such a basis. However, after reflecting on this, we do not think that such an argument should be made and the transaction allowed. While the plan adopted by the taxpayer allowed it to, in effect, cushion the effects of a one-time receipt of income for one month without losing its cooperative housing corporation status for the rest of the year, we observe that the shareholders would not be entitled to the benefits of section 216 and the passthrough of deductions allowable under section 216 for that month. Given this analysis, and the statutory scheme that seems to allow this, we would not recommend challenging the transaction.

If you have any further questions, please call the branch telephone number.

By: _____

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