Balber Pickard
Maldonado & Van Der Tuin, PC

1370 Avenue of the Americas, New York, New York 10019-4602
212 246-2400, Fax 212 765-4212, www.balberpickard.com

Memorandum

To: Cooperative and Condominium Directors and Managers

From: BPMV Cooperative/Condominium Practice Group

Subject: Amendment to the 80/20 Rule

Date: December 26, 2007

On December 20, 2007, President Bush signed into law legislation dramatically liberalizing the so-called "80/20 Rule" restricting the amount of non-shareholder income cooperatives may receive.[1] As a practical matter, the legislation will eliminate commercial income restrictions for most cooperatives.

Under the former rule, in order for a cooperative shareholder to receive the tax benefits normally afforded a homeowner, the cooperative could receive no more than 20% of its income from non-shareholder sources. As a result of this rule, cooperatives controlling substantial commercial space have often capped the rents payable by their commercial tenants below market rents in order to keep the cooperative's total non-shareholder income in line, or they have undertaken elaborate restructurings designed to have the excess commercial income flow to an entity other than the cooperative corporation.

Under the new legislation, a cooperative's shareholders will receive homeowners' tax benefits if ***any one of three*** tests are met: (i) if 80% or more of the cooperative's gross income is derived from shareholders (*i.e.*, the pre-existing test), or (ii) if 80% or more of the total square footage of the cooperative's property is used or available for use by shareholders for residential purposes, or (iii) if 90% or more of the expenditures of the cooperative are "for the acquisition, construction, management, maintenance, or care of the corporation's property for the benefit of" its shareholders.

Most high-rise and mid-rise buildings will clearly meet the second test, *i.e.*, 80% or more of their building is used for residential purposes, regardless of the extent of commercial income. Indeed, even smaller buildings may well meet the third test, *i.e.,* 90% of their expenditures are for the purposes listed. The precise meaning of this final test is somewhat unclear, but this expenditure test is virtually identical to the one for

---

[1] Section 216(b)(1) of the Internal Revenue Code formerly read as follows:

> The term "cooperative housing corporation" means 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*. (emphasis supplied).

This amendment amends subdivision (D) to add two additional, alternative tests for qualification as a "cooperative housing corporation."

homeowners' associations under section 528 of the Internal Revenue Code, and thus we anticipate that the regulations and rulings under section 528 will provide guidance in interpreting the new "90% rule" under Section 216.

Please contact us if you have had or anticipate issues with commercial income and would like guidance as to how the new legislation may apply to your particular circumstances.

BPMV Cooperative/Condominium Practice Group:

Eric D. Balber
Michael T. Manzi
Todd S. Pickard
Robin T. Silberzweig
John T. Van Der Tuin

[*Under attorney practice rules, we are required to state that this memorandum is "Attorney Advertising"*]