New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-82(2)C
Corporation Tax
March 10, 1982

STATE OF NEW YORK
STATE TAX COMMISSION

ADVISORY OPINION PETITION NO. C811207A

On December 7, 1981, a Petition for Advisory Opinion was received from Cornhill Commons Homeowners Association, Inc., 28 Willow Pond Way, Penfield, New York 14526.

The issues here raised are (1) whether a homeowners association incorporated under the Not-For-Profit Corporation Law is exempt from the Franchise Tax on Business Corporations imposed under Article 9-A of the Tax Law, and (2) whether such a homeowners association, if so subject to tax, is required to file annual tax returns.

The Cornhill Commons Homeowners Association, Inc. (Petitioner) will be incorporated under the Not-For-Profit Corporation Law as a non-stock corporation by the principals of the Mark IV Construction Co., Inc., the sponsor of the Cornhill Park Subdivision. The sponsor is currently engaged in the construction and sale of townhouses and detached homes within the subdivision. Each purchaser will hold a fee interest in his property and will automatically become a member of Petitioner. Petitioner will hold title to the common areas of the development.

Members will pay monthly maintenance and various assessment charges to Petitioner for:

1. Operation and maintenance of the common areas.
2. Exterior maintenance of townhouses.
3. Insurance on the town houses and common areas.
4. Creation of a reserve for contingencies as the Board of Directors deems proper.

The only source of Petitioner's income will be charges paid by members and interest on funds held by Petitioner.

Petitioner will qualify as a homeowners association for federal income tax purposes under section 528 of the Internal Revenue Code.

Subdivision one of section 209 of the Tax Law, contained in Article 9-A, imposes the Franchise Tax on Business Corporations, as follows:

> "For the privilege of exercising its corporate franchise, or of doing business, or of employing capital, or of owning or leasing property in this state in a corporate or organized capacity, or of maintaining an office in this state, for all or any part of each of its fiscal or calendar years, every domestic or foreign corporation, except corporations specified in subdivision four of this section, shall annually pay a franchise tax upon the basis of its entire net income, or upon such other basis as may be applicable as hereinafter provided . . . . "

A homeowners association formed under the Not-For-Profit Corporation Law is clearly a corporation described in the foregoing provision, and is not a corporation specified in subdivision four of section 209 of the Tax Law.

Subdivision (b) of section 1-3.4 of the Business Corporation Franchise Tax Regulations describes an exemption applicable to:

> "(6) corporations organized other than for profit which do not have stock or shares or certificates for stock or for shares and which are operated on a non-profit basis no part of the net earnings of which inures to the benefit of any officer, director, or member, including Not-For-Profit Corporations and Religious Corporations . . . . " 20 NYCRR §1-3.4(b)(6).

As thus stated, the exemption is not applicable to a corporation if any part of the net earnings thereof inure to the benefit of its members. This denial of exemption based on the inurement of the net earnings of a corporation to its members is based upon similar language found in subsection (c) of section 501 of the Internal Revenue Code of 1954. This language is also found in the Internal Revenue Code of 1939 and, indeed, predates such code.

Throughout its history, the term "net earnings" has consistently been held to mean more than the net profits of an organization as shown on its books and more than the difference between gross receipts and disbursements in dollars. (Northwestern Municipal Association, Inc. v. United States, 1938, 99 F. 2d 460). Indeed, it is well established that inurement of any of the earnings to a member would constitute an "inurement of net earnings" for the benefit of such individual. (People of God Community v. Commissioner of Internal Revenue, 1980, 75 TC 127). It is apparent from Petitioner's description of the use of its funds that the net earnings of Petitioner will inure to the benefit of its members. This conclusion is supported by an analysis of section 528(c)(1)(D) of the Internal Revenue Code, which defines the term "homeowners association" and which provides that an association qualifies as a homeowners association only if:

> "no part of the net earnings of such organization inures (other than by acquiring, constructing, or providing management, maintenance, and care of association property, and other than by a rebate of excess membership dues, fees or assessments) to the benefit of any private shareholder or individual . . . . "

The implication is clear that, for federal income tax purposes, the provision of management and the maintenance and care of association property constitute an "inurement of net earnings" of the homeowners association to the benefit of its members. Such interpretation is applicable herein. 20 NYCRR §1-2.1.

Accordingly, Petitioner will be subject to the Franchise Tax on Business Corporations imposed under Article 9-A of the Tax Law, and will be required to pay an annual franchise tax upon the basis of its entire net income or upon such other basis as may be applicable. It is to be noted that, pursuant to the provisions of subdivision nine of section 208 of the Tax Law, Petitioner's entire net

income for purposes of Article 9-A of the Tax Law will be presumed to be the same as its federal taxable income as computed under section 528(d) of the Internal Revenue Code. Petitioner will be required to file an annual corporation franchise tax return on Form CT-3 (long form) or CT-4 (short form), whichever is appropriate.

DATED: March 9, 1982

s/LOUIS ETLINGER
Deputy Director
Technical Services Bureau