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

TSB-A-87 (26) C
Corporation Tax
October 15, 1987

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C870618A

On June 18, 1987, a Petition for Advisory Opinion was received from Pickwick at Rocky Point Beach Club, Inc., P.O. Box 300, Rocky Point, New York 11778.

The question raised is whether Petitioner, a homeowners association, is subject to tax under Article 9-A of the Tax Law. Also, would Petitioner be subject to tax under Article 9-A if for federal income tax purposes an election is made to be treated as a homeowners association under section 528 of the Internal Revenue Code.

Petitioner is a homeowners association organized on April 28, 1967 under the provisions of the New York Membership Corporations Law (repealed and replaced by the Not-For-Profit Corporation Law, effective September 1, 1970 (L. 1969 c. 1066)) and its sole purpose is to maintain a private beach in Rocky Point, New York. Membership is required for any record owner of a fee or undivided fee interest in any lot, which is subject by covenants of record to assessment by the association.

Petitioner does not maintain common areas of the development, does not maintain the exteriors of the individually owned homes and does not carry insurance on the common areas, except for the private beach. In fact, the maintenance of the private beach is Petitioner's only activity.

Management states that each year's dues income approximately equals each year's expenses leaving an immaterial amount of income or loss.

Petitioner has never filed federal or New York State corporation tax returns. For 1987, Petitioner will elect to file its federal income tax return pursuant to the provisions of section 528 of the Internal Revenue Code.

Subdivision one of section 209 of the Tax Law, as amended by Chapter 817 of the Laws of 1987, imposes a 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 base, or upon such other basis as may be applicable as hereinafter provided, . . .

The meaning of the term "corporation" is set forth in subdivision one of section 208 of the Tax Law, as follows:

> "[t]he term 'corporation' includes a joint-stock company or association and any business conducted by a trustee or trustees wherein interest or ownership is evidenced by certificate or other written instrument;..."

A homeowners association formed under the Not-For-Profit Corporation Law (New York Membership Corporations 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 from tax 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 1986. This language is also found in the Internal Revenue Code of 1954 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). 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.

In Cornhill Commons Homeowners Association, Inc., Advisory Opinion of the State Tax Commission, March 10, 1982, TSB-A-82(2)C, it was determined that such interpretation is also applicable for purposes of Article 9-A of the Tax Law. In the instant case, it is apparent from Petitioner's description of the association's activities, namely, the maintenance of the private beach for the homeowners, that the net earnings of Petitioner will inure to the benefit of its members. Therefore, Petitioner is not exempt from the tax imposed under Article 9-A of the Tax Law.

Subdivision nine of section 208 of the Tax Law defines entire net income as "total net income from all sources, which shall be presumably the same as the entire taxable income ... which the taxpayer is required to report to the United States treasury department,.., except as hereinafter provided .... " Therefore, the taxable income reported for federal income tax purposes is the starting point for computing entire net income. After determining federal taxable income, it must be adjusted as required by such subdivision nine of section 208 of the Tax t aw.

If a homeowners association elects to file as a homeowners association pursuant to section 528 of the Internal Revenue Code, the association's federal taxable income for purposes of subdivision nine of section 208 of the Tax Law will be presumed to be the same as its taxable income as computed under section 528(d) of the Internal Revenue Code.

Accordingly, Petitioner is 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. Whether Petitioner elects to file its federal income tax return pursuant to section 528 of the Internal Revenue Code or files a regular corporate federal income tax return has no impact on determining if Petitioner is subject to tax under Article 9-A of the Tax Law. If Petitioner elects to file as a homeowners association pursuant to section 528 of the Internal Revenue Code, Petitioner's federal taxable income for purposes of subdivision nine of section 208 of the Tax Law, will be presumed to be the same as its taxable income as computed under section 528(d) of the Internal Revenue Code. Petitioner is required to file an annual corporation franchise tax return on Form CT-3 (long form) or CT-4 (short form), whichever is appropriate.

Paragraph one of subsection (a) of section 1085 of the Tax Law imposes an addition to tax for failure to file a timely return under Article 9-A, at the rate of five percent of the tax due for each month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate. If it is shown that the failure to file a return was due to reasonable cause and not due to willful neglect, such addition to tax will not be imposed.

The determination of whether the failure to file a return is due to reasonable cause is a question of fact not susceptible of determination in an Advisory Opinion. An Advisory Opinion merely sets forth the applicability of pertinent statutory and regulatory provisions to "a specified set of facts." Tax Law, section 171, subd. twenty-fourth; 20 NYCRR 901.1(a). For guidance in determining whether reasonable cause exists, see Part 46 of the Corporate Tax Procedure and Administration regulations. 20 NYCRR 46.

DATED: October 15, 1987

s/FRANK J. PUCCIA
Director
Technical Services Bureau

NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.