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

TSB-A-91 (9) C
Corporation Tax
March 27, 1991

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C910125A

On January 25, 1991, a Petition for Advisory Opinion was received from Lake Shore Hills Homeowners Association, P.O. Box 138, Kinderhook, New York 12106.

The issue raised by Petitioner, Lake Shore Hills Homeowners Association, is whether it is subject to franchise tax under Article 9-A of the Tax Law.

Petitioner is a New York State not-for-profit corporation formed in 1983 by the developer of the Lake Shore Hills subdivision for the purpose of preserving, protecting and enhancing the value of the community facilities of the subdivision. The community facilities consist solely of property on which is situated the association's common water supply, septic system and pool area which is solely for use by association members.

The developer's declaration for the homeowners association filed with the Attorney-General of the State of New York provides that the developer will remain in absolute control of the homeowners association until more than half of the units are sold. While Petitioner was incorporated in 1983, it was not activated until 1988 when the required number of units were sold. Prior to 1988, any funds expended on what is now association property were paid separately by the developer. The first dues were collected in 1988 and such dues are the only source of funds for Petitioner. The dues collected roughly equal the expenses incurred. The expenses are solely for items such as lawn care, road and pool maintenance, etc. No member has individually benefitted in any way from any funds expended by Petitioner. All funds are spent as directed in Petitioner's declaration for the community facilities.

Petitioner has filed Form l120H with the Internal Revenue Service under section 528 of the Internal Revenue Code for 1988 and 1989 and has filed franchise tax returns under Article 9-A for such years.

Section 209.1 of the Tax Law, in effect for taxable year 1983, 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, or upon such other basis as may be applicable as hereinafter provided, . . .

The meaning of the term "corporation" set forth in section 208.1 of the Tax Law for taxable year 1983 provides that:

> "[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 is clearly a corporation described in the foregoing provision, and is not a corporation specified in section 209.4 of the Tax Law.

Section 1-3.4(b) of the Business Corporation Franchise Tax Regulations (hereinafter "Article 9-A 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 ....

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 section 501(c) 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 homeowner 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., Adv 0p St Tax Comm, March 9, 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. See also, Pickwick at Rocky Point Beach Club, Inc., Adv Op Comm T & F, October 15, 1987, TSB-A-87(26)C.

Herein, Petitioner was inactive from the date of organization in 1983 until 1988. Accordingly, for taxable years 1983 through 1987, there was no inurement of net earnings to Petitioner's members and Petitioner is not subject to tax for such years pursuant to section 1-3.4(b)(6) of the Article 9-A Regulations.

However, in taxable year 1988, Petitioner became active and Petitioner collected dues and began to maintain the association's property. Beginning with taxable year 1988, Petitioner's net earnings inured to the benefit of its members and under section 1-3.4(b)(6) of the Article 9-A Regulations, Petitioner is no longer exempt from the tax imposed under Article 9-A of the Tax Law.

Further, the meaning of the term "corporation", as amended by the Laws of 1989 (ch 61), is set forth in section 208.1 of the Tax Law, as follows:

> The term "corporation" includes an association, within the meaning of paragraph three of subsection (a) of section seventy-seven hundred one of the internal revenue code, a joint-stock company or association, a publicly traded partnership treated as a corporation for purposes of the internal revenue code pursuant to seventy-seven hundred four thereof and any business conducted by a trustee or trustees wherein interest or ownership is evidenced by certificate or other written instrument...

For purposes of section 7701(a)(3) of the Internal Revenue Code, an association is an organization whose characteristics require it to be classified for purposes of taxation as a corporation rather than another type of organization such as a partnership or a trust. Section 301.7701-2(a) of the Treasury Regulations provides that the major characteristics ordinarily found in a pure corporation which, taken together, distinguish it from other organizations are (1) associates, (2) an objective to carry on business and divide the gains therefrom, (3) continuity of life, (4) centralization of management, (5) liability for corporate debts limited to corporate property, and (6) free transferability of interests. An organization will be treated as an association if the corporate characteristics are such that the organization more nearly resembles a corporation than a partnership or a trust.

Section 208.9 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 section 208.9 of the Tax Law.

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

section 208.9 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 for taxable years 1988 and 1989 and after, 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. 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 section 208.9 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.

DATED: March 27, 1991

s/PAUL B. COBURN
Deputy Director
Taxpayer Services Division

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