STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
WEATHERFIELD PARK III HOMEOWNERS' ASSOCIATION, INC.	:	DECISION DTA NO. 817614
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Years 1994, 1995 and 1996.	:	

Petitioner Weatherfield Park III Homeowners' Association Inc., c/o Joseph Guy, Treasurer, 42 Springfield Drive, Voorheesville, New York 12186-9322, filed an exception to the determination of the Administrative Law Judge issued on February 1, 2001. Petitioner appeared by Joseph Guy, Treasurer. The Division of Taxation appeared by Barbara G. Billet, Esq. (Kathleen Chase, Esq., of counsel).

Petitioner did not file a brief on exception. The Division of Taxation filed a brief in opposition. Petitioner filed a reply brief. Oral argument, at petitioner's request, was heard on October 10, 2001.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUE

Whether petitioner is exempt from the corporate franchise tax imposed pursuant to Tax Law § 209 and thereby entitled to a refund of taxes paid for the years 1994, 1995 and 1996.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

Petitioner, Weatherfield Park III Homeowners' Association, Inc. (the "Association"), was incorporated on September 29, 1989 as a not-for-profit corporation under section 102(a)(5) of the Not-For-Profit Corporation Law. The Association's Certificate of Incorporation states that petitioner was formed "to provide for maintenance, preservation and architectural control" of the third phase of the Weatherfield subdivision located on Springfield Drive and Upper Wedgewood Road, Town of Guilderland, County of Albany and State of New York as well as "to promote the health, safety and welfare of the residents" of such subdivision. The Weatherfield subdivision consists of approximately 300 townhouse and single-family residences, including the 48 single-family residences located in the third phase.

The real property at issue was originally owned by Weatherfield Property, Inc., the sponsor of the subdivision. Weatherfield Property, Inc. conveyed to the Association certain common areas including two berms, a large grassy area in the middle of the third phase of the subdivision containing two ponds, and wooded areas on both sides of the subdivision. The sponsor attached to the lots of the subdivision certain covenants, easements and restrictions contained in a Declaration of Covenants, Easements and Restrictions dated July 9, 1991, which included the following:

> (a) No dwelling, building, fence, garage or other structure shall be erected, altered or moved on the lots until the design and location is approved in writing by the Association.

(b) The Association may direct an owner of a lot to remove dead, diseased or insect infested bushes, trees or other vegetation from his lot. If the owner fails to comply with this request within 30 days, the Association may remove the vegetation at the sole cost to the owner.

(c) Trucks, vans, camper trailers, boats, motorcycles and commercial and recreational vehicles shall be kept garaged overnight.

(d) Only "umbrella" type clotheslines may be erected in the rear of any lot in the subdivision.

(e) The lots may be used for private residence purposes and only one residence may be erected on each lot and occupied by not more than one family.

(f) There shall not be erected or carried on or upon any lot any saloon, manufacturing establishment, stable, kennel, cattle yard, hog pen, chicken coop or privy vault nor shall any horse, cattle, hog, chicken or livestock be kept or maintained thereon.

(g) All front light, outside mail and paper box stands shall be in conformity with the style designated by the Association.

(h) No lawn ornaments, stone or concrete objects, statues or religious fixtures may be erected on any lot without the prior written approval of the Association.

(i) All exterior surfaces of structures on the lots requiring periodic painting, cleaning, washing or other maintenance is to be given such attention regularly and thoroughly so as to maintain a neat and clean appearance at all times. The color, design or components of a principal exterior building material, a principal exterior building element,

a fence or any structure on a lot may not be changed unless the owner has received prior written approval of the Association.

Attached to the Declaration of Covenants, Easements and Restrictions as an exhibit are the by-laws of the Association. The by-laws contain the following definitions:

> a. Common areas - areas of undeveloped land owned by the Association and reserved for the common use and enjoyment of the members (owners of lots in phase III of the subdivision) of the Association.
>
> b. Association charges - charges allocated and assessed by the Board of Directors to the owners and upon the lots in accordance with their Association interests, necessary to operate and maintain the common areas and meet Association expenses.
>
> c. Association expenses - all costs and expenses to be incurred by the Association pursuant to the Declaration in connection with the operation and maintenance of Association property and enforcing owner's obligations under the Declaration.

The by-laws further provide that the Board of Directors of the phase III subdivision shall have the power to maintain the common areas, contract for maintenance of the common areas, collect and enforce payment of all charges and assessments pursuant to the terms of the Declaration and enforce the Declaration and any easements and deed restrictions placed on the lots in the subdivision.

The two ponds that are incorporated in the common areas are also a part of the storm water system of the Town of Guilderland. The ponds accept the storm water off-flow from the streets and regulate out-flow into designated wetlands further downstream. These ponds are maintained by both the Association and the Town of Guilderland. The creation of the ponds was a prerequisite to the building development as a means of dealing with storm water run-off. Near the ponds is a plot of land owned by the Town of Guilderland upon which is located a pump station which services the public water supply for the development.

In response to petitioner's Application for Recognition of Exemption Under Section 501(c)(4) of the Internal Revenue Code ("IRC"), Form 1024, the Internal Revenue Service advised petitioner that in order for a homeowners' association to qualify, the organization is prohibited from conducting any activities related to the enforcement of private property maintenance. All documentation, such as by-laws and covenants, would have to be amended to eliminate any such references. The Internal Revenue Service suggested that, as an alternative to exemption under section 501(c)(4), petitioner could file Form 1120-H within the provisions of IRC § 528. Section 528, entitled "Certain homeowners associations," exempts from taxable income amounts received as membership dues, fees or assessments from the owners of real property located in the subdivision covered by the association. Wanting to avoid the expense and trouble of amending its by-laws and covenants, petitioner opted to file as a homeowners' association with the Internal Revenue Service pursuant to section 528 of the Code.

For each of the years at issue, petitioner filed with the Division of Taxation ("Division") a General Business Corporation Franchise Tax Return, Form CT-4, indicating and remitting tax due of $366.00, $349.00 and $448.00 for the years 1994, 1995 and 1996, respectively. On December 31, 1997, petitioner filed three claims for credit or refund of corporation tax paid, Form CT-8, for the years 1994, 1995 and 1996 requesting refunds of $366.00, $481.84[1] and $448.00, respectively. The basis of the claims for refund is that petitioner is a not-for-profit corporation, effectively exempt from Federal taxation, and therefore is not subject to New York State corporation franchise taxes.

[1]Petitioner's return for the year 1995 was filed late, subjecting petitioner to late penalty and interest, which brought its total payment to $481.84.

The Division denied petitioner's refund claims in a letter dated March 4, 1998. The Division explained that:

> it has consistently interpreted the dues collected by homeowners' associations for management of common property, as an "inurement of net earnings" benefitting their membership and therefore subjecting the associations to New York State (NYS) franchise tax.

The Division further explained that a homeowners' association, as that phrase is described in section 528 of the IRC, is included within the Federal definition of a corporation (IRC § 7701[a][3]), and thus is a corporation for New York State tax purposes. The letter concluded that petitioner must establish Federal tax-exempt status in order to be considered exempt from taxation for New York State purposes.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

In his determination, the Administrative Law Judge noted that Tax Law § 209(1) imposes a franchise tax on business "corporations," which are defined in section 208(1) to include an association. Thus, the Administrative Law Judge concluded that a homeowners' association formed under the Not-For-Profit Corporation Law is a "corporation" that is subject to the corporate franchise tax.

The Administrative Law Judge also noted that pursuant to the Division's regulations (20 NYCRR 1-3.4[b]), certain corporations may be exempt from the franchise tax if they are organized other than for profit, do not have stock or shares, are operated on a not-for-profit basis and no part of their net earnings inures to the benefit of any member. The Administrative Law Judge found that the term "net earnings" has been held to include more than the net profits of an organization as shown on its books or more than the difference between the gross receipts and disbursements. Further, applicable case law has held that where a corporation has multiple

responsibilities, the courts will consider which of its activities represents the main purpose of its activities and which are incidental thereto. If its main purpose is to benefit its members, it is not exempt. However, if benefit to the members is secondary and incidental, it is exempt.

The Administrative Law Judge rejected petitioner's contention that it is involved in several areas which benefit the general public. Despite petitioner's claims that its common areas are used by the public for fishing, its trails are used to access the forests beyond its borders and its maintenance of the ponds assists the storm water run-off system of the Town of Guilderland, the Administrative Law Judge concluded that these were not the main purposes for which the Association was formed and operated. Rather, the Administrative Law Judge found that petitioner was formed to provide for the maintenance, preservation and architectural control of the third phase of the Weatherfield subdivision and to promote the welfare of its residents. The Administrative Law Judge concluded that the main purposes for which petitioner was formed were enforcing the restrictions contained in the Declaration of Covenants, Easements and Restrictions and maintaining the common areas. The Administrative Law Judge determined that both of these activities directly benefitted the Association's property owners.

The Administrative Law Judge observed that while petitioner's common areas may be used by the general public, petitioner's by-laws define "common area" as being "reserved for the common use and enjoyment of the members." The Administrative Law Judge concluded that any use by the public of the common areas was incidental to the primary purpose of the Association to maintain and control the subdivision, including the common areas, through the covenants, restrictions and powers granted to it for the benefit of its members. Further, the Administrative Law Judge found that the creation and maintenance of the ponds as part of the

storm water run-off system of the Town of Guilderland was a requirement imposed by the Town as a condition of building the subdivision and simply replaced the existing natural run-off system.

The Administrative Law Judge rejected petitioner's argument that it was entitled to an exemption because of its similarity to the homeowner's associations in ***Rancho Santa Fe Assn. v. United States*** (589 F Supp 54, 84-2 USTC ¶ 9536) and ***Flat Top Lake Assn. v. United States*** (868 F2d 108, 89-1 USTC ¶ 9180). The Administrative Law Judge noted that these cases involved whether a homeowners' association constituted a "community"and was thus entitled to tax-exempt status as a social welfare organization pursuant to IRC § 501(c)(4). These cases did not consider whether the income of the association inured to the benefit of any of its members. In ***Rancho Santa Fe Assn. v. United States*** (***supra***), the Court concluded that the association was an independent community within the meaning of section 501(c)(4) due to the size of the housing development, its geographical separation from the central area of San Diego, the fact that it had its own post office and zip code, and the performance by the association of numerous governmental functions. In contrast, the Administrative Law Judge concluded that petitioner herein met none of the criteria which would make it an independent community within the meaning and intent of section 501(c)(4) of the IRC, and thus petitioner did not qualify for the social welfare exemption provided by such section. Based on all of the foregoing, the Administrative Law Judge concluded that petitioner did not qualify as a tax-exempt organization pursuant to 20 NYCRR 1-3.4(b) of the Business Corporation Franchise Tax Regulations, and was subject to the corporate franchise tax imposed by Tax Law § 209(1).

ARGUMENTS ON EXCEPTION

On exception, petitioner argues that the Administrative Law Judge erred in finding that the two ponds on petitioner's property are not maintained solely by petitioner. Petitioner asserts that these ponds are essential components of the storm sewer system used to control water runoff and their operation is a governmental function imposed on petitioner by the Town of Guilderland. Further, petitioner maintains that its total financial function is directed towards the maintenance of the common areas. No part of petitioner's dues money has ever been spent on enforcement of the covenants pertaining to the lots of individual homeowners. Petitioner states that its most substantial expense is the maintenance of the storm water containment ponds and their embankments. In addition, petitioner argues that its common areas are open to the general public. Petitioner claims that historical practice has rendered the Administrative Law Judge's definition of "common areas" irrelevant, in that restrictions have never been imposed and are likely unenforceable at this time. Thus, the general public has the same benefit from petitioner's earnings as petitioner's members. Petitioner disagrees with the Administrative Law Judge's conclusion that petitioner and the plaintiff in ***Rancho Santa Fe Assn. v. United States*** (***supra***) are not similarly situated. Finally, petitioner asserts that pursuant to Chapter 63 of the Laws of 2000, Article 9-A of the Tax Law was amended to provide an exemption from franchise tax to neighborhood associations filing Federal returns pursuant to IRC § 528. Although such exemption is prospective only, petitioner argues that this section provides general guidance for the treatment of neighborhood association revenues.

The Division argues, in opposition, that petitioner's activities do not constitute a governmental function such that petitioner's activities could be characterized as being primarily for the promotion of social welfare in order to entitle it to an exemption pursuant to 26 USC § 501(c)(4). Further, the Division maintains that petitioner is not an independent community within the meaning of that section, which was the focus of the Court in ***Rancho Santa Fe Assn. v. United States*** (***supra***). Although on exception petitioner asserts that the Town of Guilderland mandated and oversaw the installation of a system of street drains and piping which directs the runoff to ponds maintained by petitioner, the Division maintains that there is no evidence of this in the record and it is impermissible to introduce evidence after the record has been closed. Nor, the Division states, would the Town's insistence on such installations change the Administrative Law Judge's conclusion if it were supported by the record. Rather, the Division believes that the Town was exercising its own governmental function by requiring the builder to take steps to create a drainage system to offset the disturbance to the environment caused by building the housing development.

The Division alleges that petitioner's factual assertions about the amount of its budget spent on pond maintenance is not in the record and cannot be introduced at this juncture. The Division argues that the Administrative Law Judge properly found that petitioner was formed and operates for the primary purposes of enforcing the Covenants and Restrictions contained in its Declaration of Covenants and for maintaining the common areas. Both of these purposes benefit the Association's property owners. Petitioner's primary purpose is to benefit its members and any benefit to the general public is purely incidental. Although petitioner asserts on exception that historical practice has rendered the definition of common areas employed by

the Administrative Law Judge "irrelevant," the Division argues that there is no evidence in the record regarding historical practice. The Division believes that petitioner maintains common areas which serve a purely aesthetic purpose, enhancing the appearance of the community and inuring to the benefit of its member homeowners. Finally, despite the recent amendment to Article 9-A of the Tax Law for years subsequent to 1999, concerning the exempt status of neighborhood associations, the Division argues that there is no evidence that the provisions of that amendment were intended to be retroactive to prior tax years.

OPINION

We have held that a fair and efficient hearing process must be defined and final, and the acceptance of evidence after the record is closed is not helpful towards that end and does not provide an opportunity for the adversary to question the evidence on the record (***Matter of Purvin***, Tax Appeals Tribunal, October 9, 1997; ***see also***, ***Matter of Schoonover***, Tax Appeals Tribunal, August 15, 1991). As a result, we reject petitioner's attempts on exception to assert as facts matters which were not made part of the record at the hearing.

Petitioner has offered no evidence below, and no argument on exception, that demonstrates that the Administrative Law Judge's determination is incorrect. We find that the Administrative Law Judge completely and adequately addressed the issues presented to him and we see no reason to modify them in any respect. As a result, we affirm the determination of the Administrative Law Judge.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Weatherfield Park III Homeowners' Association, Inc. is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of Weatherfield Park III Homeowners' Association, Inc. is denied; and

4. The Division of Taxation's refund denial of March 4, 1998 is sustained.

DATED: Troy, New York
February 21, 2002

/s/Donald C. DeWitt
Donald C. DeWitt
President

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

/s/Joseph W. Pinto, Jr.
Joseph W. Pinto, Jr.
Commissioner