STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
BEECHWOOD GARDENS OWNERS, INC.	:	DETERMINATION DTA NO. 808531
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Years 1985 and 1986.	:	

Petitioner, Beechwood Gardens Owners, Inc., 42-40 Bell Boulevard, Bayside, New York 11361, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the years 1985 and 1986.

On March 17, 1991 and March 27, 1991, respectively, petitioner by its representative, Julius Simon, C.P.A., and the Division of Taxation by William F. Collins, Esq. (Vera R. Johnson, Esq., of counsel) consented to have the controversy determined on submission without hearing, with all briefs due by August 5, 1991.[1] On April 22, 1991, the Division of Taxation submitted documentary evidence. Petitioner submitted its brief and exhibits on August 6, 1991. The Division submitted its brief on October 15, 1991. After due consideration of the record, Marilyn Mann Faulkner, Administrative Law Judge, hereby renders the following determination.

ISSUES

I. Whether Internal Revenue Code § 277(a) applies to petitioner.

II. Whether the Division of Taxation correctly computed taxable income pursuant to Tax Law § 208.9.

[1]At the request of the parties, the last day on which to submit briefs was adjourned until October 25, 1991.

III. Whether the stipulated facts can be modified to conform to two new issues raised by petitioner:

(a) Whether interest income constituted membership income pursuant to Internal Revenue Code § 277(a).

(b) Whether certain expenses constituted non-membership or non-operating expenses.

FINDINGS OF FACT

On April 19, 1991, the parties stipulated to the facts which have been incorporated into Findings of Fact "2" through "21" and "26".

Petitioner, Beechwood Gardens Owners, Inc., is a domestic corporation incorporated in New York State on April 30, 1982, with its principal place of business at 42-40 Bell Boulevard, Bayside, New York during the years at issue.

Petitioner is a corporation having only one class of stock outstanding. During the years at issue, its principal business activity was to operate and maintain an apartment building, which it owned, for its stockholders.

One of the privileges petitioner's stockholders received was the right to occupy for dwelling purposes at least one unit in the apartment building. No tenant-stockholder was entitled to receive any distribution outside of earnings, profits or liquidating dividends.

Petitioner filed Federal corporation income tax returns (Form 1120) on a calendar year basis and used a cash receipts and disbursements method of accounting.

More than 80%[2] of petitioner's gross income for 1985 and 1986 was derived from receipts from petitioner's tenant-stockholders.

Petitioner's total gross income for 1985 amounted to $388,942.00, all of which, with the exception of interest income in the amount of $3,493.00, was derived from tenant-stockholders

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[2]In the stipulation signed by both parties it was stated that "80% of the petitioner's gross income for 1985 and 1986 is derived from receipts from petitioner's tenant-stockholders"; however, as noted in the Division's brief, this statement was a typographical error inasmuch as it is obvious from the amounts stipulated that more than 80% of petitioner's gross income for 1985 and 1986 was derived from the tenant stockholders.

or transactions with or on behalf of its tenant-stockholders ("membership income").

In computing Federal taxable income, petitioner's total deductions on its 1985 tax return was $468,040.00. The deduction represented expenses incurred in connection with providing services to petitioner's tenant- stockholders. These expenses exceeded adjusted gross income. For the period ending December 31, 1985, excess expenses amounted to $82,591.00 ($385,449.00 [membership income] - $468,040.00).

For the period ending December 31, 1985, petitioner's Federal taxable income, before an allowance for net operating loss deductions was applied, was ($79,098.00) (-$82,591.00 [excess expenses] + $3,493.00 [non-membership income]).

When petitioner computed its Federal deductions, it included a Federal accelerated cost recovery system ("ACRS") deduction for the period ending December 1, 1985 in the amount of $79,504.00. This Federal ACRS deduction included ACRS depreciation for property placed in service in New

York State for the taxable periods beginning after December 31, 1984 in the amount of $5,933.00.

After subtracting ACRS depreciation for property placed in service in New York State for the taxable periods beginning after December 31, 1984 from the Federal ACRS deduction for the period ending December 31, 1985 (e.g., $79,504.00 - $5,933.00 = $73,571.00), petitioner was required to add Federal ACRS depreciation in the amount of $73,571.00 to its Federal taxable income before an allowance for a net operating loss deduction was applied.

Petitioner's allowable New York State depreciation for the period ending December 31, 1985 amounted to $55,330.00, all of which was attributable to expenses incurred in connection with providing services to petitioner's stockholders.

In computing its Federal deductions for the period ending December 31, 1985, petitioner included New York State franchise taxes in the amount of $791.00 which were attributable to petitioner's principal business activity in connection with providing services to petitioner's

stockholders.

Petitioner's total gross income for 1986 was $398,152.00, all of which, with the exception of interest income in the amount of $22,783.00, was income derived from tenant-stockholders or transactions with or on behalf of its tenant-stockholders.

In computing its Federal taxable income for the period ending December 31, 1986, petitioner was entitled to total deductions in the amount of $536,882.00 as reported on its 1986 tax form 1120. The entire amount of these deductions was attributable to expenses incurred in connection with providing services to petitioner's tenant-stockholders and exceeded petitioner's adjusted income for the period ending December 31, 1986[3] in the amount of $161,513.00 ($375,369.00 [membership income] - $536,882.00).

For the period ending December 31, 1986, petitioner reported Federal taxable income, before an allowance for a net operating loss deduction was applied, of ($138,730.00) (-$161,513.00 [excess expenses] + $22,783.00 [non-membership income]).

In computing its Federal deductions, petitioner included a Federal ACRS deduction for the period ending December 31, 1986 in the amount of $82,096.00 which included ACRS depreciation for property placed in service in New York State for taxable periods beginning after December 31, 1984 in the amount of $8,525.00.

After subtracting ACRS depreciation for property placed in service in New York State for the taxable periods beginning after December 31, 1984 from the Federal ACRS deduction for the period ending December 31, 1986 (e.g., $82,096.00 - $8,525.00 = $73,571.00), petitioner was required to add ACRS in the amount of $73,571.00 to its Federal taxable income.

For the period ending December 31, 1986, petitioner's allowable New York State depreciation amounted to $55,330.00, which was attributable to expenses incurred in connection with providing services to petitioner's tenant stockholders.

In computing its Federal deductions for the period ending December 31, 1986, petitioner

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[3]In the stipulation, this date was stated as December 31, 1985; however, it is clear from the previous paragraphs that the parties meant December 31, 1986.

included New York franchise taxes in the amount of $900.00, all of which were attributable to petitioner's principal

business activity in connection with providing services to petitioner's tenant-stockholders.

The Division commenced a franchise tax audit of petitioner's books and records in 1989 for the years 1985 and 1986. On May 12, 1989, the Division issued to petitioner four notices of deficiency asserting deficiencies in the total amount of $5,822.00, exclusive of interest. Two of the notices asserted franchise tax in the amount of $1,797.00, plus interest, and $3,179.00, plus interest, for the respective years 1985 and 1986. The two remaining notices assessed Metropolitan Commuter Transportation Surcharges in the respective amounts of $305.00, plus interest, and $541.00, plus interest for the years 1985 and 1986.

In two statements of audit adjustment, dated May 12, 1989, the Division explained the recomputations of petitioner's franchise tax liability for 1985 and 1986. The Division stated that section 208.9(a) of Article 9-A provides that entire net income is presumed to be the same as the total taxable income which the taxpayer is required to report to the U.S. Treasury Department subject to certain modifications and that section 277 of the Internal Revenue Code limits the membership expenses (deductions) to the extent of membership income and provides that excess membership deductions be treated as a deduction attributable to membership income in the succeeding year. The Division's recomputations were as follows:

	1985	
Federal taxable income before net operating loss deduction (1120, line 30/CT-3 line 17)		($ 79,098.00)
Total deductions in computing Federal taxable income (1120, line 27)	$468,040.00	
Total deductions allowed to membership income (See 1120, line 6 for membership income)	385,449.00	

Excess membership deductions	82,591.00
Federal taxable income required to be shown on report	3,493.00
Add: New York State franchise tax (CT-3, line 22)	791.00
Add: ACRS deduction (CT-3, line 17; CT-399, line 3 and (4)(e)	73,571.00
Total	77,855.00
Less: allowable New York depreciation (CT-3, line 29; CT-399 line 4-i)	55,330.00
Adjusted entire net income	22,525.00[4]
Tax @ 10%	2,253.00
Tax per report (CT-3, line 8)	456.00
Tax deficiency	1,797.00

1986

Federal taxable income before net operating loss (1120, line 301 CT-3 line 17)		($138,730.00)
Total deductions in computing Federal taxable income (1120, line 27)	$536,882.00	
Total deductions allowed to membership income (See 1120, line 6 for membership income)	375,369.00	
Excess membership deductions		161,513.00
Federal taxable income required to be shown on report		22,783.00
Add: New York State franchise tax (CT-3, line 22)		900.00
Add: ACRS deduction (CT-3, line 17; CT-399, line 3 and 4-e		73,571.00
Total		97,254.00
Less: allowable New York depreciation (CT-3, line 29; CT-399 line 4-i)		55,330.00
Adjusted entire net income		41,924.00[5]
Tax @ 10%		4,192.00
Tax per report (CT-3, line 8)		1,013.00
Tax deficiency		3,179.00

After a conciliation conference was held, the conciliation conferee sustained the statutory notices by two conciliation orders dated May 18, 1990.

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[4]In contrast, on its 1985 corporation franchise tax report, petitioner deducted the full excess membership deduction in its calculation to arrive at allocated taxable net income of ($60,066.00).

[5]In contrast, in its 1986 corporation franchise tax report, petitioner deducted the full excess membership deduction in its calculation to arrive at allocated taxable net income of ($119,589.00).

Petitioner filed two petitions dated August 8, 1990 challenging the assessments, stating (1) that the co-op corporation was not a membership organization and, therefore, was not required to limit membership expenses to membership income and (2) that the adjustment of depreciation as done by New York State was incorrect.

In the Division's answer, dated September 24, 1990, it stated that petitioner failed to limit the costs incurred in the operation of its cooperative to the extent of income received from its members as required by Internal Revenue Code § 277 and that it had to modify its entire Federal taxable income by adding the Federal ACRS deductions and subtracting from that amount the New York State allowable depreciation deductions as required by Tax Law § 208(9)(b).

In their stipulation, the parties agreed that the sole issues in the controversy being submitted were (1) whether the Division correctly determined that petitioner was subject to the provisions of Internal Revenue Code § 277 and (2) whether the Division "correctly computed petitioner's entire net income by first adjusting petitioner's membership income, limiting said income to the extent of petitioner's membership expenses and then adjusting for depreciation instead of as the petitioner contends adjusting the petitioner's depreciation deduction first and then adjusting the petitioner's membership income." The parties further stipulated that the facts as stated in the stipulation were "true and pertinent to a resolution of the...matter and the [issues as stated above were] the sole issues raised in this matter."

SUMMARY OF THE PARTIES' POSITIONS

In brief, petitioner argued that Internal Revenue Code § 277 does not apply and instead that Internal Revenue Code § 216 and subchapter T apply. Petitioner also appeared to argue that the interest income of $3,493.00 in 1985 and $22,783.00 in 1986 were intertwined and inseparable from its principal business activity and, therefore, should be considered as income against which the membership expenses should be deducted (thereby reducing the adjusted entire net income by a comparable amount). Petitioner further argued that the Division did not consider expenses in the amount of $1,277.00 for 1985 and $3,786.00 for 1986 in determining

its tax liability. In support of this argument, petitioner attached to its brief three documents: a schedule of expenses entitled "Expenses Applicable to Non Operating Income year ended December 31, 1985"; a Depreciation and Amortization 1989 BTS form consisting of two pages; and a 1990 U.S. income tax return for Homeowners Association (Form 1120-H) which, but for line 18, had not been filled out. Petitioner finally argued that a "[d]epreciation adjustment should not have been made against non-operating income and expenses for New York State purposes."

In brief, the Division contended that Internal Revenue Code § 277 applies to cooperative housing corporations; that the Division correctly calculated the depreciation adjustment; and that the Division correctly allocated petitioner's membership income and membership expenses. The Division further noted that petitioner raised for the first time in brief that the Division failed to consider certain expenses allegedly incurred in connection with non-membership activities and that the interest income should be categorized as membership income. The Division argued that petitioner's new arguments contradicted the facts contained in the stipulation; that, consequently, these arguments should not be considered; and that, in any event, petitioner has not provided any evidentiary proof to support these new allegations.

CONCLUSIONS OF LAW

A. Tax Law § 208.9 provides that in computing corporation franchise tax the entire net income shall be the same as the entire taxable income which the taxpayer is required to report to the U.S. Treasury Department subject to certain additions, including (1) New York State franchise taxes which were deducted in computing Federal taxable income and (2) amounts allowable for recovery property as the ACRS deduction pursuant to Internal Revenue Code § 168 (20 NYCRR 3-2.3[a][5], [17]). In determining the Federal taxable income, Internal Revenue Code § 277(a) provides, in pertinent part, that:

> "In the case of a social club or other membership organization which is operated primarily to furnish services or goods to members, and which is not exempt from taxation, deductions for the taxable year attributable to furnishing services, insurance, goods, or other items of value to members shall be allowed only to the extent of income derived during such year from members or transactions with members.... If for any taxable year such deductions exceed such income, the excess

> shall be treated as a deduction attributable to furnishing services, insurance, goods, or other items of value to members paid or incurred in the succeeding taxable year." (Emphasis added.)

Based on Internal Revenue Code § 277(a), the Division determined petitioner's Federal taxable income for purposes of applying Tax Law § 208.9 by limiting the deductions to the membership income. Thus, in determining the addition to Federal taxable income pursuant to Tax Law § 208.9, the Division started with a Federal taxable income of $3,493.00 for 1985 and $22,783.00 for 1986, in contrast to petitioner's calculations of ($79,098.00) for 1985 and ($138,730.00) for 1986. The Division determined that $3,493.00 in 1985 and $22,783.00 in 1986 constituted non-membership income against which no membership deductions could be taken, and that Federal taxable income with respect to membership income was limited to $0 for both 1985 and 1986 because, pursuant to Internal Revenue Code § 277(a), deductions which exceeded membership income should be deferred to the succeeding taxable year.

B. Here, the issue is whether Internal Revenue Code § 277 applies to petitioner. Revenue Ruling 90-36 of the Internal Revenue Service clearly provides that Internal Revenue Code § 277 applies to limit the deductions of a "cooperative housing corporation", as defined by Internal Revenue Code § 216(b)(1) (Mertens, Laws of Federal Income Taxation, 1989-1990, Rulings, citing Concord Consumers Housing Cooperative v. Commr., 89 TC 105 [1987]). Section 216(b)(1) defines a "cooperative housing corporation" as 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."

Based on the stipulated facts, petitioner is a cooperative housing corporation, as defined by Internal Revenue Code § 216(b)(1) (see, Findings of Fact "3", "4" and "6"), to which Internal

Revenue Code § 277 applies.

C. In support of its argument that Internal Revenue Code § 277 does not apply, petitioner refers to a statement made in the decision in Park Place, Inc. v. Commr. (57 TC 767) which reads as follows:

> "Part I of [subchapter T] applies to the taxable year of any corporation operating on a cooperative basis after December 31, 1962, and that necessarily includes a section 216 cooperative housing corporation. Sec. 1381(a)(2)." (Id. at 779.)

Petitioner also distinguishes Concord Consumers Housing Cooperative v. Commr. (supra) arguing that, in Concord, the corporation was a not-for-profit corporation whereas Beechwood Gardens Owners, Inc. is a for-profit corporation. Petitioner further notes that neither party in Concord contended that the petitioner was a cooperative to which section 216 or subchapter T applied and that, therefore, these sections were not considered in reaching the decision in Concord. Petitioner also refers to the concurring opinion in Concord wherein the concurring judge stated that:

> "we are not holding that the provisions of section 277 supersede the provisions of subchapter T in a case where the latter provisions apply. In such a case, I think a different analysis would be required, with at least the possibility that a different result might be reached." (Id. at 127.)

Because of the rather abbreviated nature of petitioner's arguments, it is difficult to understand precisely what petitioner's argument is with respect to subchapter T. Presumably, petitioner's argument is that subchapter T applies to Beechwood and, therefore, a different analysis and different result is required; however, petitioner has not articulated what that analysis should be. Part I of subchapter T involves the tax treatment of cooperatives (IRC §§ 1381-1383). Even if subchapter T applied to petitioner, there is nothing on the face of these statutes that would indicate that the deduction deferral provisions of Internal Revenue Code § 277 would not apply. Similarly, the case law cited by petitioner does not imply that the application of subchapter T would contradict the application of these deduction deferral provisions of Internal Revenue Code § 277 to petitioner. The "different analysis" referred to in Concord dealt with a separate issue concerning patronage dividends under subchapter T (see

discussion, infra, Conclusion of Law "D"). Moreover, as noted by the Division, the court in Concord specifically stated that it would not address the interrelationship of Internal Revenue Code §§ 216, 277 and subchapter T.

In conclusion, the Division correctly followed the statutory scheme of Internal Revenue Code § 277 and Tax Law § 208.9 in its computation of petitioner's tax deficiency (including the point at which the depreciation adjustment should be made) and petitioner has not presented any persuasive argument to the contrary. Thus, I find in favor of the Division with respect to the issues stipulated by the parties.

D. Subsequent to the stipulation and petition, petitioner raised two new arguments: (1) that the interest income should have been considered membership income, and (2) that certain expenses in the amount of $277.00 for 1985 and $3,786.00 for 1986 were non-membership expenses which were not considered by the Division in reducing petitioner's tax liability. As noted by the Division, these arguments contradict the stipulated facts. Petitioner, however, has not requested that the stipulated facts be modified to conform to its arguments. In any event, I will deem petitioner's arguments to be such a request.

The Tax Appeals Tribunal Rules of Practice provide, in pertinent part, that:

> "[a] stipulation shall be treated, to the extent of its terms, as a conclusive admission by the parties to the stipulation, unless otherwise permitted by the tribunal, administrative law judge or presiding officer, or agreed upon by the parties. The tribunal, administrative law judge or presiding officer will not permit a party to a stipulation to qualify, change or contradict a stipulation in whole or in part, except where justice requires..." (20 NYCRR 3000.7[e]).

Justice may require findings of fact contrary to the facts stipulated by the parties if there is evidence in the record which clearly contradicts the stipulated facts (see, Matter of Nelson, Tax Appeals Tribunal, September 12, 1991, citing Jasionowski v. Commr., 66 TC 312). Here, petitioner has not presented evidence in support of its new allegations warranting modifications to the stipulated facts. With respect to its argument that interest income was membership income, petitioner states, in brief, that it "obtained a new first mortgage which yielded money needed to fund large major capital outlays needed in the buildings...[and that it] incurred mortgage refinancing cost of $30,360...spent $259,533 in capital improvements plus an

additional $97,460 in 1990." Based on these claims, petitioner argues that the interest earned was so closely intertwined and inseparable from the main cooperative's business activity that it should be included as part of the cooperative's earnings and not separately taxed. In support of its theory, petitioner submitted as additional evidence a Depreciation and Amortization 1989 BTS form and cited to Illinois Grain Corp. v. Commr. (87 TC 435), Cotter & Company v. United States (765 F2d 1102 [Fed Cir 1985]), and St. Louis Bank for Cooperatives v. United States (224 Ct Cl 289, 624 F2d 1041 [1980]). Petitioner, however, has not presented any evidence, in the form of a sworn statement or documents, to support its claim that the income, which it stipulated as non-membership income, constituted interest income from loans used for capital improvements. Petitioner submitted only a Depreciation and Amortization 1989 BTS form indicating that certain capital improvements were placed in service in 1981 through 1989 and that depreciation deductions were taken on such items. This document alone does not constitute proof of petitioner's allegations.

In any event, even assuming petitioner could prove its factual allegations, its legal argument has no merit. As noted by the Division, petitioner's reliance on Illinois Grain, Cotter and St. Louis is misplaced. These cases did not address the issue of whether interest income was derived "from members or transactions with members" within the meaning of Internal Revenue Code § 277(a). Instead, the cases concerned whether interest income constituted patronage source income within the meaning of subchapter T. Under subchapter T, patronage dividends, as defined by Internal Revenue Code § 1388(a),[6] may be excluded from the gross income of organizations pursuant to Internal Revenue Code § 1382(b). Internal Revenue Code §§ 277(a) and 1382(b) address two different situations. Here, there is no issue with respect to patronage dividends. Petitioner apparently argues, however, that the standards set forth in the case law cited with respect to determining patronage source income should be used in

[6]Section 1388(a) provides that patronage dividend means an amount paid to a patron by a subchapter T organization "on the basis of quantity or value of business done with or for such patron" but does not include any amount paid to a patron to the extent that "such amount is out of earnings other than from business done with or for patrons" (emphasis added).

determining whether income is derived "from members or transactions with members" under Internal Revenue Code § 277(a). The Tax Court in Concord Consumers Housing Cooperative v. Commr. (supra) specifically declined to adopt the analysis used under subchapter T cases with respect to patronage dividends in defining "membership income" for purposes of Internal Revenue Code § 277. The court stated that it was "not prepared to say that

'income derived...from members or transactions with members' under sec. 277 has the same meaning as income 'from business done with or for its patrons' under sec. 1388(a)" (id. at 123, n. 17). While the cases cited by petitioner liberally interpret what constitutes income from business done with or for its patrons (e.g., interest income from short-term commercial paper found to be patronage source income because organization must borrow money to retain large amounts of capital in order to function as a seasonal business), the language in section 277(a) is more restrictive. The language adopted in section 1388(a) -- income "from business done...for its patrons" -- lends itself to a more expansive interpretation than does the language contained in section 277(a) -- "income derived...from its members or transactions with members". In any event, the issue of membership income under section 277(a) was squarely addressed in Concord wherein the Tax Court determined that interest income on two reserve accounts and on a mortgage escrow account held by the member organization, a Federally-subsidized and non-profit corporation, was not income derived from members, even though such accounts were required to be maintained under the organization's agreement with the Federal Housing Administration and the Michigan State Housing Development Authority. Thus, the decision in Concord provides more persuasive authority for the treatment of interest income under section 277(a) than does the case law cited by petitioner.

E. Finally, petitioner's argument concerning certain expenses which it claims the Division should have deducted against non-membership income does not warrant modification of the stipulated facts. In support of its contention, petitioner submitted with its brief a typed document, entitled "Expenses Applicable to Non Operating Income year ended December 31,

1985 and year ended December 31, 1986", containing various expenses concerning refinancing, management fees and professional fees which were broken down into operating expenses and non-operating expenses for the respective years of 1985 and 1986. No further documents or explanations were submitted with respect to petitioner's allegation concerning these expenses. By itself, this document is self-serving, not probative and cannot reasonably be relied upon as proof of petitioner's claim.

F. The petition of Beechwood Gardens Owners, Inc. is denied and the four notices of deficiency, dated May 12, 1989, are sustained.

DATED: Troy, New York

ADMINISTRATIVE LAW JUDGE