Concord Village, Inc. v. Commissioner, 65 T. C. 142 (1975)

Reserve funds in cooperative housing corporations are taxable unless they constitute contributions to capital, and forfeitures from membership sales above transfer value are includable in gross income.

Summary

Concord Village, Inc. , a nonstock, not-for-profit housing cooperative, challenged the IRS's determination that certain reserve funds and membership forfeitures were taxable income. The Tax Court ruled that funds in the painting and general operating reserves were taxable because they were not contributions to capital, while funds in the replacement reserve were excludable as capital contributions. Additionally, amounts forfeited to the cooperative from membership sales exceeding the FHA-specified transfer value were held to be taxable income to the cooperative.

Facts

Concord Village, Inc. , a nonstock, not-for-profit housing cooperative, was organized under FHA regulations. It collected monthly carrying charges from members, which were allocated to various reserve accounts, including replacement, general operating, and painting reserves. When members sold their memberships, they had to forfeit any amount above the FHA-specified "transfer value" to Concord. During the tax years 1966, 1967, and 1968, Concord collected forfeitures totaling $5,546, $2,500, and $2,500, respectively.

Procedural History

The IRS determined deficiencies in Concord's income tax for the years 1965 through 1968, asserting that the amounts accumulated in the reserve accounts and the forfeitures from membership sales were taxable income. Concord filed a petition with the U. S. Tax Court, challenging these determinations. The Tax Court heard the case and issued its opinion on October 28, 1975.

Issue(s)

1. Whether unexpended funds collected by petitioner housing cooperative from its members and earmarked for and accumulated in the replacement, general operating, and painting reserves are includable in petitioner's gross income?
2. Whether amounts that petitioner's members receive from the sale of their memberships which are in excess of the FHA-established transfer value of the memberships and which are forfeited to Concord are includable in petitioner's gross income?

Holding

1. No, because the funds accumulated in the replacement reserve are contributions

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to capital under section 118 and thus excludable from gross income. Yes, because the funds in the general operating reserve and the painting reserve are not contributions to capital and are taxable under section 61(a).
2. Yes, because the forfeitures are gain to Concord and includable in its gross income under section 61(a).

Court's Reasoning

The court distinguished between the three reserve accounts. Funds in the replacement reserve were deemed contributions to capital because they were earmarked solely for capital expenditures necessary to maintain the value of membership, and were collected under contract in proportion to each member's equity interest. The general operating reserve funds were not contributions to capital because they were used for ordinary expenses and were not restricted to capital expenditures. The painting reserve funds were also not contributions to capital, as painting is a repair and maintenance expense, not a capital expenditure. The court relied on *Park Place, Inc.* for the taxability of overassessments in the general operating and painting reserves. Regarding membership forfeitures, the court applied the ruling in *General American Investors Co.* , holding that such forfeitures constituted taxable income to Concord because they were realized free of any restrictions as to use.

Practical Implications

This decision clarifies the tax treatment of reserve funds in cooperative housing corporations. Cooperative housing corporations must carefully structure their reserve accounts to ensure that funds earmarked for capital expenditures are treated as contributions to capital and thus excludable from gross income. Funds used for operational expenses or repairs are likely to be taxable. Additionally, the decision establishes that forfeitures from membership sales above the transfer value are taxable to the cooperative, impacting how such cooperatives account for and report these amounts. This ruling may influence how similar cases are analyzed, particularly in determining the tax implications of various types of reserve funds and forfeitures in cooperative housing arrangements.

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