## *Concord Consumers Housing Cooperative v. Commissioner, 89 T. C. 141 (1987)*

Interest income earned on reserve and escrow accounts required by regulatory agreements is classified as nonmembership income under Section 277 of the Internal Revenue Code.

### Summary

Concord Consumers Housing Cooperative, a nonprofit organization providing low-income housing, challenged the IRS's classification of interest earned on its reserve and escrow accounts as nonmembership income under Section 277. The Tax Court ruled that such interest, despite being derived from funds required by regulatory agreements, was not income from members or transactions with members. The court's decision was based on the plain language of the statute and its legislative history, which aimed to prevent taxable membership organizations from using investment income to offset losses from member services. The court allocated 5% of the cooperative's expenses to this nonmembership income, highlighting the practical challenge of accurately apportioning costs.

### Facts

Concord Consumers Housing Cooperative, a nonprofit corporation, provided housing for low and moderate-income families and was subject to regulatory agreements with the Federal Housing Administration (FHA) and the Michigan State Housing Development Authority (MSHDA). These agreements required the establishment of a replacement reserve fund, a general operating reserve fund, and a mortgage escrow account. Interest earned on these accounts during the taxable years ending March 31, 1976, 1977, and 1978, totaled $21,997, $15,181, and $19,324, respectively. The cooperative reported this interest as income but incurred significant operating losses and did not specifically allocate any deductions to this interest income.

### Procedural History

The IRS issued a statutory notice of deficiency, classifying the interest income as nonmembership income under Section 277 and disallowing deductions related to this income. Concord Consumers Housing Cooperative filed a petition in the U. S. Tax Court to contest these determinations. The Tax Court, after reviewing the case, upheld the IRS's position on the classification of the interest income but allowed a 5% allocation of certain expenses to this nonmembership income.

### Issue(s)

1. Whether the interest earned on the replacement reserve, general operating reserve, and mortgage escrow accounts constitutes "income derived * * * from members or transactions with members" (membership income) within the meaning of Section 277(a).

© 2025 SCOTUSreports.com. All rights reserved. 

2. If not, and if such interest constitutes nonmembership income, what deductions are properly attributable to the production of such nonmembership income?

## Holding

1. No, because the interest income was not received from members or transactions with members, and the legislative history and purpose of Section 277 support treating all investment income as nonmembership income.
2. Yes, because while the taxpayer did not maintain precise records, a reasonable approximation of 5% of certain expenses was allocable to the nonmembership income, based on the available evidence and the principle from Cohan v. Commissioner.

## Court's Reasoning

The court focused on the plain language of Section 277, which limits deductions for expenses incurred in providing services to members to the extent of membership income. The legislative history of Section 277, enacted to prevent taxable membership organizations from avoiding tax on nonmembership income, was crucial. The court noted the nexus between Section 277 and Section 512(a)(3), which applies to tax-exempt organizations, and concluded that all investment income, including interest on required reserve accounts, is nonmembership income. The court rejected the cooperative's argument that the interest should be considered membership income because it was earned on funds required by regulatory agreements, emphasizing that such a distinction would be inconsistent with the statutory language and legislative intent. In allocating deductions, the court applied the Cohan rule, allowing a 5% allocation of expenses to the nonmembership income due to the cooperative's failure to maintain precise records.

## Practical Implications

This decision clarifies that interest earned on reserve and escrow accounts, even when required by regulatory agreements, is nonmembership income under Section 277. Taxable membership organizations must carefully track and allocate expenses related to such income, as the court will make reasonable approximations if precise records are not maintained. The ruling may impact similar organizations by increasing their tax liabilities, as they cannot offset nonmembership income with losses from member services. Practitioners should advise clients to maintain detailed records of expenses related to nonmembership income and consider the potential tax implications of reserve accounts. Subsequent cases, such as Rolling Rock Club v. United States, have continued to apply this interpretation of Section 277, reinforcing its practical significance for nonprofit and cooperative organizations.

© 2025 SCOTUSreports.com. All rights reserved. 