



BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the **Matter** of the Appeal of )  
 )  
EASTRIDGE TOWNHOUSE **OWNERS'** ASSOCIATION )

Appearances:

For Appellant: Robert **L.** Castle  
Certified Public Accountant

For Respondent: James **C.** Stewart  
Counsel

O P I N I O N

This appeal is made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Eastridge Townhouse Owners' Association against a proposed assessment of additional franchise tax in the amount of \$362 for the income year 1979. **Subsequent** to the filing of **this appeal, appellant** paid the assessment. Accordingly, pursuant to section 26078 of the Revenue and Taxation Code, the appeal will be treated as an appeal from the denial of a claim for refund.

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Appeal of Eastridge Townhouse Owners' Association

The issue presented is whether appellant is a membership organization within the meaning of section 24437 of the Revenue and Taxation Code.

Appellant, a homeowners' association, is a California corporation which owns and maintains a **clubhouse, streets**, swimming pool, and tennis court. Membership in the association is restricted, presumably to those who own property in the Eastridge Development. Although appellant may have qualified as a tax-exempt homeowners' association, it chose not to file the required application, and therefore is a taxable corporation. (Rev. & Tax. Code, **§§ 23701, 23701t.**)

On its 1979 franchise tax return, appellant reported income of \$64,599 from membership dues and of \$6,346 **from** interest. It claimed expense deductions of \$124,486, resulting in a net loss of \$53,541. Upon audit, respondent determined that section 24437 of the Revenue and Taxation Code was applicable and that appellant was entitled to deduct expenses connected with the furnishing of services to its members only to the extent of its income from its members. It also determined that all but \$100 of appellant's claimed expenses were incurred in connection with the furnishing of services to its members. Therefore, it disallowed all the claimed deductions in excess of the amount of membership dues plus \$100. Respondent issued a **proposed** assessment reflecting this determination. After considering appellant's protest, respondent affirmed the proposed assessment, and this appeal followed.

Section 24437 of the Revenue and Taxation Code provides that in the case of a taxable social club or other membership organization which is operated primarily to provide its members with goods **or** services, expenses incurred in connection with the furnishing **of** goods or services to members for a taxable year are deductible only to the extent of **income** derived, during that year, from members or transactions with members. Appellant contends that this section does not apply to it because it is not a membership organization.

Section 24437 of the Revenue and Taxation Code is substantially similar to section 277 of **the Internal Revenue Code**. Therefore, interpretations of the federal statute are relevant to the correct interpretation of the state statute. (Andrews v. Franchise Tax Board, 275 **Cal.App.2d** 653 [**80 Cal.Rptr. 403**] (1969).) The Internal Revenue Service's proposed regulations issued under

Appeal of Eastridge Townhouse Owners' Association

section 277 characterize a membership organization as "any taxable organization operated on a mutual, cooperative or similar basis whose primary activity is providing members with services, facilities, or goods." (Treas. Reg. **§ 1.277-1(b)(1)** (proposed).) On the other hand, an organization operated primarily to realize gains to be distributed among its shareholders in proportion to their equity **interest** is not a membership organization. (Treas. Reg. **§ 1.277-1(b)(1)** (proposed).)

While we recognize that the Service's proposed regulations are not authoritative in this case, we do find the logic contained therein compelling. We believe this definition to be in accord with the purpose of Revenue and Taxation Code section 24437 and its federal counterpart. Those sections were enacted to prevent situations where:

membership organizations, which also have business or investment income, serve their members at less than cost and **offset** this book loss against their business or investment income and as a result pay no income tax.

(S. Rep. No. 552, 91st Cong., 1st Sess. (1969) [1969 U.S. Code Cong. & Ad. News **21031**].)

**Appellant's** primary argument is that it is not a membership organization because the California Department of Real Estate has placed severe restrictions on who can join a homeowners' association. Although appellant states that traditionally membership organizations have few or no restrictions on membership, it has not cited any authority in support of its position. Furthermore, the regulations which define the term "membership organization" do not indicate that the presence or absence of membership restrictions is relevant to the issue of whether an organization is a membership organization. (Treas. Reg. **§ 1.277-1(b)(1)** (proposed).) We, therefore, conclude that appellant's membership restrictions do not prevent it from being a membership organization.

Appellant also argues that because it is a taxable corporation, it should be subject only to the same rules as other corporations. We must reject this argument since section 24437 of the Revenue and Taxation Code establishes a separate rule for those taxable corporations which are membership organizations. If appellant intended to argue that its incorporation precluded it from operating on a mutual or cooperative basis, we must disagree. The federal regulations specifically state that when

Appeal of Eastridge Townhouse Owners' Association

determining if an organization is operating on a **mutual** or cooperative basis, it is immaterial whether or not the organization is incorporated. (Treas. Reg. § 1.2'77-1 **(b)(1)** (proposed).)

Finally, appellant states that it is required by law to replace property as it wears out and that it has properly accounted for certain receipts as contributions to capital. Appellant has not explained, and we cannot discern, how these facts are relevant to the issue at hand. Respondent has not asserted that appellant improperly characterized any receipts as contributions to capital **and**, in fact, has made no adjustments to the amount of income actually reported by appellant on its franchise tax return.

For the above reasons, we must sustain respondent's action.

Appeal of **Eastridge** Townhouse Owners' Association

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and **good** cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the claim of Eastridge Townhouse Owners' Association for refund of franchise tax in the amount of \$362 for the income year 1979, be and the same is hereby sustained.

Done at **Sacramento**, California, this 28th day Of July , 1983, by the State Board of Equalization, with Board **Members** Mr. Bennett, Mr. Collis, Mr. Dronenburg, Mr. Nevins and Mr. Harvey present.

William M. Bennett , Chairman

Conway H. Collis - - , Member

Ernest J. Dronenburg, Jr. , Member

Richard Nevins , Member

Walter Harvey\* , Member

\*For Kenneth Cory, per Government Code section 7.9