REVEUNE RULING 75-371

Cross Reference Data

Topical

Capital contributions
Commingling of funds
Contingency "reserves"
Contributions to capital
Pool furniture
Separate bank accounts
Special assessments

Citation

IRC Sections --118, 263, 277
Cases -*Raytheon Production Corp. v. Commissioner*
-United Grocers v. U.S.A.
-The Board of Trade of the City of Chicago and subsidiaries v. Commissioner
-Maryland Country Club, Inc., Plaintiff v. United Sates of America, Defendant
Regulations Section -1.118.1
Revenue Rulings -74-563, 75-370
Private Letter Ruing -200027029
GCM -35929, 36188, 37466, 37857
Technical Advice Memorandum -9539001
Other Rulings -98ARD 176-4, FSA 1992-0208-1

Summary

Revenue Ruling 75-371 holds that a special assessment for the purchase of personal property (furniture for the swimming pool) by a condominium associations is a contribution to capital. The assessment was deposited in a separate bank account. However, regular assessments, including contingency reserves, are taxable as ordinary income.

Defines "Reserves" Qualifying for Contributions to Capital; Specifically Excludes Contingency Reserve; Specifies That Excess Operating Income May Be Returned to Members.

Rev. Rul. 75-371, 1975-2 CB 52, (Jan. 1, 1975)

Section 118.-CONTRIBUTIONS TO THE CAPITAL OF A CORPORATION. 26 CFR 1.118-1: Contributions to the capital of a corporation. (Also Section 61; 1.61-1.) Condominium management assessments; personal property. –Special assessments for the replacement of personal property, collected by a nonexempt condominium management corporation from its unit owner-stockholders and accumulated in a separate bank account, are contributions to capital.

[Text]

Advice has been requested whether, under the circumstances described below, a special assessment[1] collected by a nonexempt condominium management corporation from its unit owner stockholders and accumulated in a separate bank account[2] for a specific capital expenditure will qualify as a contribution to the capital of the corporation under section 118 of the Internal Revenue Code of 1954.

The taxpayer, a condominium management corporation, was incorporated under the law of state M by the unit owners of a condominium housing project to provide, among other things, the management, maintenance and care of the common elements of the project, including the swimming pool. Every unit owner of the project must be a stockholder of the taxpayer and the only stockholders are condominium unit owners. The corporation is not an exempt organization

for Federal income tax purposes. Under the provisions of its charter, the corporation may own personal property. The corporation owns all the equipment and tools necessary to provide services to the unit owners and any other personal property located or used in the common elements of the project. The corporation is supported by periodic assessments against the unit owners. An unpaid assessment is a lien on the property of the unit owner-stockholder.

The by-laws of the management corporation require that any assessment must be approved at a stockholder meeting by a majority vote of the unit owner-stockholders. In January 1974, the unit owner-stockholders decided at their annual meeting in accordance with the bylaw requirements to levy and collect a special assessment of 2x dollars a month for 14 months from each unit owner. The assessment will be deposited in a special account and will not be commingled with the general assessment funds. The assessment will be used only to replace the outdoor furniture surrounding the swimming pool.

Section 61 of the Code and section 1.61-1(a) of the Income Tax Regulations provide, in part, that gross income means all income from whatever source derived, unless excluded by law.

Section 1.118-1 of the regulations provides that, in the case of a corporation, section 1118 of the Code provides an exclusion from gross income with respect to any contribution of money or property to the capital of the taxpayer. If a corporation requires additional funds for conduction its business and obtains such funds through voluntary pro rata payments from its stockholders, the amounts, so received being credited to its surplus account or a special account, such amounts do not constitute income, although there is no increase in the outstanding shares of stock of the corporation. **But the exclusion does not apply to any money or property transferred in consideration of goods or services rendered**.

In United Grocers, Ltd. V. United States, 308 F.2d 634 (9th Cir. 1982), aff'g. 186 F. Supp. 724 (N. D. Calif. 1960), the Court of Appeals held that monthly payments by the members of a nonprofit retail grocers' cooperative were made in consideration of, and in payment for, services rendered by the cooperative and not as contributions to capital. **The court said the dominant factor in determining whether the amounts were contributions to capital or payment for goods or services was the motive or purpose and intent in making the contribution**. See also Rev. Rul. 74-563, 1974-2 C.B. 38, in which special assessments to pave the parking lot of a homeowners associations are capital contributions by the homeowners-members.

In the instant case the special assessment is specifically earmarked and segregated to replace the outdoor furniture surrounding the swimming pool. It is assessed pro rata upon each unit owner-stockholder. Moreover, the availability of various types of personal property, including outdoor furniture, adds tot eh attractiveness or usefulness of the condominium project and, therefore, enhances the value of a unit owner-stockholder's property. Since ownership of the taxpayer is inextricably and compulsorily tied to the acquisition and enjoyment of a unit owner's property, this enhanced value is sufficient to show the motive or purpose and intent for paying the special assessment something other than a payment for services rendered by the taxpayer to its unit owner-stockholders.

Accordingly, the special assessment for replacing outdoor furniture is a contribution to the taxpayer's capital under section 118 of the Code.

With respect to regular assessments, section 61 of the Code defines gross income as all income, from whatever source derived, except as otherwise provided by law. Funds collected by a nonexempt organization by mean of assessments for the purpose of normal operating expenses are taxable as ordinary income under section 61. **Any funds accumulated as contingency [3] reserves are also includable in the organization's gross income because the Internal Revenue Code does not provide for such accumulations without tax consequences.**

However, a condominium management corporation may operate in such a manner as to qualify for the benefits of subchapter T (sections 1381 through 1388) of the Code, thereby permitting the corporation to accumulate funds for reasonable business needs.

If a condominium management corporation qualifies under subchapter T it may retain without paying tax thereon up to 80 percent of its otherwise taxable income received from its unit owner-stockholders. This is accomplished by distributing to the unit owner-stockholders qualified patronage dividends as defined in section 1388 of the Code for which the corporation would receive a deduction. **These patronage dividends may be paid 20 percent in cash and 80 percent in qualified written notices of allocation. Thus, 80 percent of the otherwise taxable income from the unit owner-stockholders could be retained in cash by the corporation for its reasonable business needs.[4]**

Further, the unit owner-stockholders who do not use their condominium unit in their trade or business for the production of income may exclude the patronage dividends from their gross income. See section 1.1385-1(c)(2)(l) of the regulations.

In addition, when a condominium management corporation receives annual assessments from its unit owner-stockholders in excess of its needs to meet actual expenses paid or incurred for such taxable year, such excess may be returned directly or indirectly to them. See Rev. Rul. 70-604, 1970-2 C.B. 9, which describes a condominium management corporation whose sole activity in accordance with its bylaws is the management, operation, maintenance, and replacement of the common elements of the condominium property. **An annual meeting is held by the unit owner-stockholders of the corporation, at which time they decide what is to be done with any excess assessments not actually used for the purposes described above, i.e., they decide either to return the excess to themselves or to have the excess applied against the following year's assessments. The excess assessments for the taxable year over and above the actual expenses paid or incurred for the purposes described above are not taxable income to the corporation since such excess in effect has been returned to the unit owner-stockholders.**

Also, compare Rev. Rul. 75-370, which holds that special assessments collected by a condominium management corporation for the replacement of elevators and the roof are not includable in the corporation's gross income under section 61 of the Code because the corporation was acting merely as an agent with respect to the funds.

Practical Considerations

[1] This revenue ruling, like Revenue Rulings 74-563 and 75-370, rules on special assessments only. However, the IRS appears to define "special assessment" as any assessment for other than operating purposes. That would mean any assessment for reserves (whether a monthly, annual, or one-time assessment) is considered to be a "special assessment."

[2] It requires a separate bank account.

[3] It explicitly states that contingency funds do not meet the test of being capital in nature.

[4] It also indicates that an association may operate as a cooperative (although not a cooperative housing corporation as defined in Code Section 216).