

REDACTED DECISION – DK# 16-231 NFN-M

FILED

BY: CRYSTAL S. FLANIGAN, ADMINISTRATIVE LAW JUDGE

SUBMITTED FOR DECISION ON MARCH 17, 2019

ISSUED ON SEPTEMBER 4, 2019

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OFFICE WEST VIRGINIA
SECRETARY OF STATE

NOTE: THIS ADMINISTRATIVE DECISION WAS APPEALED BEYOND THE OFFICE OF TAX APPEALS

BEFORE THE WEST VIRGINIA OFFICE OF TAX APPEALS

FINAL DECISION

On February 12, 2016, the Auditing Division of the West Virginia State Tax Commissioner’s Office (the “Tax Department” or the “Respondent”) issued a denial of net operating loss, against the Petitioner. This denial was issued pursuant to the authority of the State Tax Commissioner, granted to him by the provisions of Chapter 11, Article 10 *et seq.*, of the West Virginia Code. The denial was for tax years 2003-2013 and was decreased from \$ _____ to \$ _____.

The Petitioner timely filed its Petition for Reassessment with this Tribunal on April 18, 2016. Subsequently, notice of a hearing was sent to the Petitioner and in accordance with the provisions of West Virginia Code Section 11-10A-10 a hearing was held on September 13, 2018, at the conclusion of which the parties filed legal briefs. The matter became ripe for a decision at the conclusion of the briefing schedule.

FINDINGS OF FACT

1. The Petitioner is a condominium homeowners association located in a West Virginia County. Tr. 11.

2. The Petitioner has two sources of income, member income and non-member income. *Id.*

3. Member income is sourced from the monthly homeowners association (hereinafter “HOA”) fees of the association/condo owners. *Id.*

4. Member income is not taxable to the Petitioner for Federal and State income tax purposes. *Id.*

5. Non-member income are fees charged to individuals for use of materials that are provided by the Petitioner. Tr. 12.

6. Non-member income is taxable to the Petitioner for Federal and State income tax purposes. Tr. 11.

7. The Petitioner’s federal taxable income is determined under 26 United States Code Section 528. Petitioner’s Brief, p. 5.

8. West Virginia Corporate Net Income Tax is based upon a taxpayer’s federal taxable income and thus, United States Code Section 528 controls. *Id.*

DISCUSSION

The issue is whether the Petitioner is entitled to claim net operating losses (hereinafter “NOL”) pursuant to West Virginia Code § 11-24-6(d) and 26 United States Code § 528. The parties agree that the federal taxable income for the Petitioner is determined under Internal Revenue Code Section 528 because West Virginia Corporate Net Income Tax is based upon a taxpayer’s federal taxable income and thus, would be the controlling law of this case. 26 United States Code § 528 provides as follows:

(a) General rule.--A homeowners association (as defined in subsection (c)) shall be subject to taxation under this subtitle only to

the extent provided in this section. A homeowners association shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes.

26 U.S.C.A. § 528 (West).

Furthermore, the homeowners association taxable income is defined as follows:

(d) Homeowners association taxable income defined.—

(1) Taxable income defined.--For purposes of this section, the homeowners association taxable income of any organization for any taxable year is an amount equal to the excess (if any) of--

(A) the gross income for the taxable year (excluding any exempt function income), over

(B) the deductions allowed by this chapter which are directly connected with the production of the gross income (excluding exempt function income), computed with the modifications provided in paragraph (2).

(2) Modifications.--For purposes of this subsection—

(A) there shall be allowed a specific deduction of \$100,

(B) no net operating loss deduction shall be allowed under section 172, and

(C) no deduction shall be allowed under part VIII of subchapter B (relating to special deductions for corporations).

26 U.S.C.A. § 528 (West).

West Virginia Code § 11-24-6(d) provides, as follows:

(d) *Net operating loss deduction.* -- Except as otherwise provided in this subsection, there is allowed as a deduction for the taxable year an amount equal to the aggregate of: (1) The West Virginia net operating loss carryovers to that year; plus (2) the net operating loss carrybacks to that year: *Provided*, That no more than three hundred thousand dollars of net operating loss from any taxable year beginning after the thirty-first day of December, one thousand nine hundred ninety-two, may be carried back to any previous taxable year. For purposes of this subsection, the term "West Virginia net operating loss deduction" means the deduction allowed by this

subsection, determined in accordance with Section 172 of the Internal Revenue Code of 1986, as amended.

W. Va. Code Ann. § 11-24-6 (West).

West Virginia Code § 11-24-6(d) cites to 26 United States Code Annotated Section 172 which allows net operating losses, “[T]here shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year.”¹ 26 U.S.C.A. § 172 (West). Even though section 172 provides for net operating losses, it doesn’t matter because section 528 prohibits it in this instance.

Furthermore, the parties agree that 26 United States Code Section 528 controls the issue in this case. The Petitioner strongly argues that they elected to be a 528 homeowners association so that they would receive favorable tax treatment for exempted income. While the Petitioner argues the intricacies of net operating losses over the course of several years, it does not provide an explanation as to how it overcomes the net operating loss provision of 26 United States Code 528(d)(2)(B).²

The Respondent cites to 26 United States Code Section 528 as controlling the issue in this case, which does not provide for a NOL to homeowners associations. The Respondent acknowledges that the Petitioner was incorrectly granted a NOL of \$ _____ and has agreed to waive this amount due to his own error. However, the Respondent maintains that the Petitioner is not entitled to any additional NOL. The Petitioner is clearly bound by §528(d)(2)(B), which states that “no net operating loss deduction shall be allowed under section 172.” The Petitioner did not file a Reply to the Respondent’s Brief or offer any counter to NOL being disallowed. The

¹ Neither party argues that another section of the United States Code controls.

² The Petitioner’s argument is based upon the difference between member (nontaxable) income and non-member (taxable) income, the accounting of net operating losses for tax years 2003 through 2013, and the amounts that should be carried forward from tax year to tax year.

Petitioner, as a homeowners association under section 528, is undoubtedly barred from deducting any net operating losses. Therefore, the Petitioner has not met its burden of showing that it is entitled to the NOL that it seeks.

CONCLUSIONS OF LAW

1. It is the duty of the Tax Commissioner to see that the laws concerning the assessment and collection of all taxes and levies are faithfully enforced. W. Va. Code § 11-1-2 (West 2010).

2. “The Tax Commissioner shall collect the taxes, additions to tax, penalties and interest imposed by this article or any of the other articles of this chapter to which this article is applicable.” W. Va. Code Ann. § 11-10-11(a) (West 2010).

3. Any NOL claimed as an adjustment to West Virginia taxable income for West Virginia Corporate Net Income Tax, must be claimed in accordance with the provisions of 26 U.S.C. § 172.

4. A homeowners association is expressly prohibited from claiming any Net Operating Loss pursuant to 26 U.S.C. § 172. 26 U.S.C. § 528(d)(2)(B).

5. The Petitioner in this matter has not carried its burden of proving that the credit denial was erroneous, unlawful, void, or otherwise invalid.

DIPOSITION

WHEREFORE, it is the **FINAL DECISION** of the West Virginia Office of Tax Appeals that: the credit denial regarding net operating losses issued on February 2, 2016, except for \$ _____, is hereby **AFFIRMED**.

WEST VIRGINIA OFFICE OF TAX APPEALS

By: _____
Crystal S. Flanigan
Administrative Law Judge

Date Entered