General Counsel Memorandum 34219-General Counsel's Response to Proposed [at That Time] Revenue Ruling 72-102 [IRC Section 501(c)(4)]a

Cross Reference Data

Topical
Exempt organizations
Form 990

Citation
IRC Section-501(c)(4)
Cases-Rancho Santa Fe
-Flat Top Lake Association v. U.S.A
-Commissioner v Lake Forest, Inc.
-Lake Petersburg Association v. Commissioner
-Portland Golf Club v. U.S.
Regulations Section-1.501(c)(4)
Revenue Ruling-72-102

Summary

GCM 34219 responds to the proposed (at that time) Rev. Rul. 72-102 on the definition of community used in IRC Sec. 501(c)(4).

- Defining a community based on numbers or size would be arbitrary and unrealistic.
- Determining whether the organization provides a community benefit for the "community as a whole" better reflects the intention of IRC Sec. 501 (c)(4).

Caution: The authors have omitted certain portions of this GCM that, in the authors' opinion, are not relevant to homeowners' associations. The deleted portions are denoted by * * * .

General Counsel's Response to Proposed [At That Time] Revenue Ruling 72-102 [IRC Section 501 (c)(4)] GCM 34219

Date Numbered: October 30, 1969
REV. RIJL. 72-102

Internal Control Number: CC:1:1-3368 sr.2:CEP 0501.04-00

HAROLD T SWARTZ

Assistant Commissioner (Technical)
Attention: Director, Miscellaneous and Special

Provisions Tax Division In re:

Reference is made to your memorandum (T MS:EO:R:1-FRR) dated February 6, 1969 transmitting for our concurrence or comment a proposed ruling letter relative to the exemption of the above-captioned

association as a 'social welfare" organization.

You have concluded that the association qualifies as an organization described In section 501 (c)(4). Despite some doubts about how properly to characterize the true nature and purpose of homeowners' associations such as... , this office would agree that section 501(c)(4) has been given a flexible enough interpretation over the years that support can be marshaled for your conclusion. Our analysis of the case may be of some help to you.

The association was organized on. .. as a non-stock, non-profit corporation under the laws of .... The association was formed to comply with the filed by ... as the owner of real property and declaring its desire to create thereon .... To preserve the values and amenities in the community, the ... deemed it desirable ....

The property in question consists of ... residential units and common areas. Each residential unit consists of a townhouse and site. There are ... groups of between. .. to ... connected units each. The grouped units are clustered in a "U" shape and contain streets, sidewalks and curb parking. The common green area consists of fingers of land between the groupings and land beyond the lot lines around the perimeter of the "U". The ... owns all of the streets, sidewalks, and parking area and the common green area.

Membership in the ... is compulsory with ownership of a lot. Annual dues are ... per lot subject to change based on increases in the Consumer Price Index. It is represented that such dues are the exclusive source of the . . . funds. There are no recreational facilities. Upon dissolution, assets of the. .. will be dedicated .... (Article ... of the ... charter.)

The activities of the. .. are mainly twofold:

1. Administering and enforcing covenants and restrictions in the . . . includes architectural control, such as, approval for fences and alterations of residential properties. The . . . will trim unkept plantings, keep vacant properties in good order and repair property exteriors not properly maintained, all at the expense of the owner. These services are not regularly provided, but will be undertaken by the .. . whenever a property owner permits his property to fall in a state of disrepair.

2. Owning, maintaining and administering the common area includes enforcing rules governing the use of the common areas, mowing and fertilizing the common green area, patching sidewalks and streets and snow removal.

Based on these facts your proposed ruling letter holds that the ... is exempt under section 501(c)(4). Your transmittal memorandum notes that while the activities of the ... conform with published Service position, i.e., preserving the appearance of a community (Rev. Rul. 67-6, C.B. 1967-1, 135) and providing quasi-governmental services (Rev. Rul. 66-221, C.B. 1966-2, 220 and Rev. Rul. 66-148, C.B. 1966-1, 143), nevertheless the question is posed whether a cluster of ... townhouses within a larger residential development is a "community" within the purview of section 1.501(c)(4)-1 (a) (2) (f) of the regulations.

Section 501 (c) (4) provides for exemption from taxation of organizations "not organized for profit but operated exclusively for the promotion of social welfare." Section 1.501 (c)(4)-1 (a)(2)(i) provides:

An organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community." Your Branch Position Report dated October 4, 1968, points out the problems encountered in your attempt to define "community" as used in section 1.501 (c) (4)-1 (a) (2)(i) when considering the activities carried on by homeowners' maintenance organizations. According to that report you have rejected a strictly

"numbers" approach as well as a case by case consideration. The question was raised whether regarding the smaller associations as "communities" nullifies Rev. Rul. 67-325, C.B. 1967-2, 113, and also whether the flow of benefits primarily to members undermines your questioning of the position taken in Rev Rul. 55-495, C.B. 1955-2, 259. In addition, consideration was given to the question whether there is any difference between "community" for purposes of section 501 (c) (4) and section 501 (c) (3). Other peripheral questions were considered which are not pertinent to resolution of the instant problems.

Speaking generally the term "community' has been variously defined and takes on significance in both the criminal and civil law areas. For example, often in criminal law the good character of the accused is put in issue. In this sense "community" can mean a neighborhood (Craven v. State, 111 So. 769, 22 Ala. App. 39) or even a hotel where the accused worked for many years (Hamilton v. State, 176 So. 94, 129 Fla. 219). The same meaning carries over to the civil law area. Used in its ordinary sense "community" means a neighborhood or vicinity. An interesting dissertation on the subject appears in **Lukens Steel Co. v. Perkins, 107 F 2d, 627, 631, 70 App. D.C. 354 (1938).** Where a manufacturer enters a Government contract, the Public Contracts Act of 1936 required the Secretary of Labor to establish minimum wages for the "locality" where the manufacture or furnishing materials, supplies, etc. is located. In Lukens the Secretary of Labor determined that the prevailing minimum wage for persons in the steel industry was 621/2 cents per hour in the locality described which embraced 14 states and the District of Columbia. The Court held that the term "locality" does not embrace such a vast area. In the course of its opinion the Court noted that in ordinary and common usage "locality" is synonymous in meaning with such words as "place", "vicinity", "neighborhood" and "community", and though all of those words are too indefinite to be used for purposes of exact measurement in terms of acres or square miles, neither they nor "locality" itself in any case connote large geographical areas with widely diverse interests. Continuing, the Court observed that the word "place" in its ordinary significance has a distinctly limited meaning and the word "community" connotes a congeries of common interests arising from associations, social, business, religious, governmental, scholastic, recreational, involving considerations of public health, fire protection, water, sewage, transportation, and other services which bind together the people of such a community or set them quarreling with each other.

We do not believe the term "community" as used in the regulations implementing section 501 (c)(4) has, or was intended to have, any different or specialized meaning. Thus, we cannot say the determination that a cluster of townhouses constitutes a "community" is incorrect as a matter of law. In any case we agree that an attempt to define "community" solely on the basis of a numbers approach would be arbitrary and unrealistic. More importantly, we do not think the precise size of an organization, whether or not its size and composition is such as to justify considering it as a "community," is the pivotal question in determining whether the organization is providing a "community" benefit in the sense contemplated by section 501 (c)(4) and its regulations. In short, other factors in a case of this kind must be evaluated and will, moreover, usually be of greater significance in determining the outcome.

Review of the instant case and of the associated files gives us the impression these homeowner associations are formed in an honest attempt to maintain a dignified and attractive community; that responsibility rests upon the homeowner association. The association has the sole responsibility of maintaining and administering the common properties and facilities and administering and enforcing declarant's covenants, conditions and restrictions. There is nothing in the picture suggesting these associations are schemes of developers, or others, to circumvent the lax laws. In sum, it may be conceded that these associations perform a useful and valuable function even if the members are but a small segment of "the community as a whole" (it would be more traditional, of course, to regard the township, or the county, in which the cluster of ... townhouses is situated as the "community as a whole,"). We would not question that good

maintenance of even one small segment benefits the "community as a whole," and thus is "promoting in some way the common good ...."

Of course, it does not necessarily follow that such an association is "operated exclusively for the promotion of social welfare" and so entitled to exemption under section 501 (c)(4). However, as pointed out in, among other places, the study entitled Preliminary Analysis of Unadministrability of Exempt Organizations Area prepared in 1966 by Technical and Chief Counsel people for the Commissioner's use in responding to a commitment to furnish the Assistant Secretary for Tax Policy with a description of the principal problems the Service feels are involved in the administration of the exemptions area:

• .. No stable concept of [the] scope of the provision [501(c) (4)] has been developed .... In practical application [the] section has largely been a dumping ground for organizations which failed to qualify as charitable organizations, but were accepted as social welfare organizations because of a consensus that for one reason or another they should not be taxed."

• .. an impossible interpretative situation has resulted from vagueness of the key words "social welfare". As the regulations put it, social welfare is being "primarily engaged in promoting in some way the common good and general welfare of the people of the community'. There is general agreement that social welfare signifies benefit to the community but beyond that knowledgeable technical people are unable to agree on the meaning of the term. The practical result is that almost any group activity not classifiable under any other provision, not patently illegal or detrimental to the community and not involving private gain is accorded "social welfare classification."

Measured by the above "standards," the ... is a group activity; it is not classifiable under any other provision of section 501; its purposes and activities are not patently illegal or detrimental to the community (however broadly or narrowly that term "community" is construed); the ... the terms of which it was conceived to enforce and carry out, and the corporate charter under which it operates, appear to rule out the possibility of private gain. In addition, it has represented to the Service that its sole source of income is assessments and receipts from members. We believe that any reasonable reserve it may accumulate therefrom may be regarded as held in an implied trust exclusively for the uses and purposes contemplated by the ... and charter.

Consequently, while in our judgment there is no compelling reason to expanded the already unwieldy concept of "social welfare" to include this new class of organizations, neither, in the light of all the existing precedents under section 501 (c)(4), is there a compelling legal argument for keeping such organizations out despite their marked differences from the "neighborhood improvement association" that has hitherto been considered qualified for 501(c)(4) status.

We believe, and are sure you agree, that any revenue ruling based on a favorable ruling in a case like this one, should spell out the several factors on which the conclusion is based carefully and clearly as a counter to any claim that these are, essentially, private undertakings.

BRIEFING NOTE

The letter ruling upon which the position taken in this Revenue Ruling is based was considered by Chief Counsel. Also, see G.C.M. 34219, dated 10-30-69. The Revenue Ruling itself was considered by

Chief Counsel.

The Revenue Ruling holds an organization that administers covenants for the preservation of the architecture and appearance of a housing development, and owns and maintains property for the use of all residents of the development is benefiting the development (community) as a whole, and thus is exempt under section 501(c) (4). However, the activities must be primarily for the benefit of the development as a whole rather than for the individual residents or developer.

Chief, Exempt Organizations Branch

Date

SECTION 501.---EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.

26 CFR 1.501(c)(4)-1: Civic organizations and local associations of employees.

Note:

a GCM 34219 expands on the discussion of the definition of "community" in Rev. Rul. 72-102.

Gary Porter, CPA is licensed by the California Board of Accountancy and the Nevada Board of Accountancy. His practice is limited to common interest realty associations consisting of condominium, homeowners, timeshare, cooperative and condo hotel associations. Mr. Porter id the creator and coauthor of PPC's (Practitioners Publishing Company) Guide to Homeowners Associations and Other Common Interest Realty Associations and Homeowners Association Tax Library, in addition to more than 200 articles. Mr. Porter has been quoted or published in The Wall Street Journal, Kiplinger's Personal Finance, Money Magazine, The Practical Accountant, Common Ground, Condo Management, and CAI's The Ledger Quarterly. He has been working with homeowners associations since 1976, and has been a frequent presenter at industry and CPA venues; speaking at events for more than 30 state CPA societies.