IRS Letter Ruling 200706014

Cross Reference Data

Topical
- Exempt organizations
- Form 990
- Adverse determination
- Community
- Homeowners Association
- Access

Citation
- IRC Sections 501(c)(4), 528
- Regulations Section 1.501(c)(4)-1, 1.528-1, 3, 8
- Revenue Rulings 72-102, 74-99, 80-63
- Rancho Santa Fe Association v. USA
- Flat Top Lake Association v. USA

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Summary

Homeowners association previously exempt under IRC Section 501(c)(4) had its exempt status revoked as a result of an examination. The IRS explained that while the Association was granted exempt status at the time of application based upon documents and a description of activities as presented at that time, the law was later clarified that an exempt organization must be open to the general public. Based upon information obtained during the examination, the Association is not open to the public.

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IRS Letter Ruling 200706014 (Nov. 15, 2006)

Exception from tax on corporations, certain trusts, etc. (Exempt v. not exempt); Civic leagues and social welfare groups (See also 0501.03-25); Local associations of employees.

CERTIFIED MAIL —RETURN RECEIPT REQUESTED

We have enclosed a copy of our report of examination explaining why we believe an adjustment of your organization's exempt status is necessary.

If you do not agree with our position you may appeal your case. The enclosed Publication 3498, The Examination Process, explains how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

If you request a conference, we will forward your written statement of protest to the Appeals Office and they will contact you. For your convenience, an envelope is enclosed.

If you and Appeals do not agree on some or all of the issues after your Appeals conference, or if you do not request an Appeals conference, you may file suit in United States Tax Court, the United States Court of Federal Claims, or United States District Court, after satisfying procedural and jurisdictional requirements as described in Publication 3498.

You may also request that we refer this matter for technical advice as explained in Publication 892, Exempt Organization Appeal Procedures for Unagreed Issues. If a determination letter is issued to you based on technical advice, no further administrative appeal is available to you within the IRS on the issue that was the subject of the technical advice.

If you accept our findings, please sign and return the enclosed Form 6018, Consent to Proposed Adverse Action. We will then send you a final letter modifying or revoking exempt status. If we do not hear from you within 30 days from the date of this letter, we will process your case on the basis of the recommendations shown in the report of examination and this letter will become final. In that event, you will be required to file Federal income tax returns for the tax period(s) shown above. File these returns with the Ogden Service Center within 60 days from the date of this letter, unless a request for an extension of time is granted. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

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If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Date: November 15, 2006

Symbol: Not Given

Uniform List No.: 501.04-01

[Code Secs. 501]

Exception from tax on corporations, certain trusts, etc. (Exempt v. not exempt); Civic leagues and social welfare groups (See also 0501.03-25); Local associations of employees.

This is a Final Adverse Determination as to your exempt status under section 501(c)(4) of the Internal Revenue Code.

Our adverse determination was made for the following reasons:

O fails to meet the requirements for exemption under IRC 501(c)(4).

Based on the above, we are revoking your organization's exemption from Federal income tax under section 501(c)(4) of the Internal Revenue Code effective D. You have executed the Form 6018-A agreeing to this revocation.

You are required to file Federal income tax returns on Form 1120. You may elect to file form 1120-H and be treated as a homeowners association as described in Internal Revenue Code section 528. These returns should be filed with the appropriate Service Center for all years beginning after D2.

Form 1120 must be filed by the 15th day of the third month after the end of your annual accounting period. A penalty of $20 a day is charged when a return is filed late, unless there is reasonable cause for the delay. However; the maximum penalty charged cannot exceed $10,000 or 5 percent of your gross receipts for the year, whichever is less. This penalty may also be charged if a return is not complete, so please be sure your return is complete before you file it.

You have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers. You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling or writing to:

IRS - Taxpayer Advocate

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels, gets prompt and proper handling.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely yours, Marsha A. Ramirez, Director, EO Examinations.

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Redaction Legend
O = organization

ISSUE NAME: Tax Exempt Status

RETURN: Form 990

ISSUE:

Tax Exempt Status under IRC 501(c)(4) of the Internal Revenue Code.

FACTS:

O received exemption under Internal Revenue Code (IRC) Section 501(c)(4). Sources of income for the organization include Membership dues and assessments, dividends and interest from securities, and other miscellaneous income. Property owned by the Organization is not accessible to the general public due to a Security Gate being installed.1

LAW:

Revenue Ruling 74-99 1974-1 CB 131, (Jan. 01, 1974) A homeowners association, to qualify for exemption under Section 501(c)(4) of the Code, (1) must serve a “community” which bears a reasonable recognizable relationship to an area ordinarily identified as governmental, (2) it must not conduct activities directed to the exterior maintenance of private residences, and (3) the common areas or facilities it owns and maintains must be for the use and enjoyment of the general public; Rev. Rul. 72-102 modified.

The Internal Revenue Service has been requested to clarify the circumstances in which an organization similar to the homeowners' association described in Rev. Rul. 72-102, 1972-1 C.B. 149 may qualify for exemption under section 501(c)(4) of the Internal Revenue Code of 1954. The characteristics of the organization of homeowners described in Rev. Rul. 72-102 are generally typical of many such organizations formed in recent years that seek exemption under section 501(c)(4) of the Code and may be summarized as follows: The organization is formed by a commercial real estate developer as an integral part of a plan for the development of a subdivision. Membership in the association is required of all purchasers of lots in the development. Membership is open only to the developer (at least for such time as he owns property in the development) and those who purchase lots. The organization is supported by periodic assessments against the members and an unpaid assessment constitutes a lien on the property of the homeowner-member. The stated purposes of the organization are, generally speaking, to administer and enforce covenants for preserving the architecture and appearance of the given real estate development, and to own and maintain common green areas, streets, and sidewalks.

The foregoing format is spelled out in written documents which form a part of, and are inextricably tied to, enforceable contracts for the sale and purchase of private property. In the light of this combination of factors, the prima facie presumption is that these organizations are essentially and primarily formed and operated for the individual business or personal benefit of their members, and, as such, do not qualify for exemption under section 501(c)(4) of the Code. However, an organization of this kind may in certain circumstances overcome the presumption and qualify for recognition of exemption under section 501(c)(4).

Thus, notwithstanding the combination of characteristics which the organization in Rev. Rul. 72-102 has in common with many other homeowners' associations, it was considered to have established its qualification for recognition of exemption as an organization described in section 501(c)(4) of the Code. In reaching this conclusion Rev. Rul. 72-102 reads, in part, as follows: `For the purposes of section 501(c)(4) of the Code, a neighborhood, precinct, subdivision, or housing development may constitute a community. For example, exempt civic leagues in urban areas have traditionally represented neighborhoods or other subparts of much larger political units. By administering and enforcing covenants, and owning and maintaining certain non-residential, non-commercial properties of the type normally owned and maintained by municipal governments, this organization is serving the common good and the general welfare of the people of the entire development.'

Increasing experience with homeowners' associations of this general kind has demonstrated, however, that the Revenue Ruling does not delineate the bases for the favorable holding in the case clearly enough to prevent misconceptions as to its scope. Specific questions have been raised as to (1) the scope of the term `community' as used in the ruling; (2) whether an organization whose program includes activities devoted to exterior maintenance of private residences comes within the ambit of the ruling; and (3) the interpretation of the phrase `non-residential, non-commercial properties of the type normally owned and maintained by municipal governments.'

One misconception generated by Rev. Rul. 72-102 is that the ruling appears unqualifiedly to equate a housing development with the term `community' within the meaning of section 501(c)(4) of the Code, thereby giving rise to the implication that any housing development may qualify as a community for exemption purposes regardless of any other attendant facts and circumstances in the case. Rev. Rul. 72-102 is hereby modified to reject its apparent acceptance of such a narrow definition of `community' for purposes of section 501(c)(4).

A community within the meaning of section 501(c)(4) of the Code and the regulations is not simply an aggregation of homeowners bound together in a structured unit formed as an integral part of a plan for the development of a real estate subdivision and the sale and purchase of homes therein. Although an exact delineation of the boundaries of a `community' contemplated by section 501(c)(4) is not possible, the term as used in that section has traditionally been construed as having reference to a geographical unit bearing a reasonably recognizable relationship to an area ordinarily identified as a governmental subdivision or a unit or district thereof.

A second feature of Rev. Rul. 72-102 that has been subject to misinterpretation is whether, consistent with the position taken in the Revenue Ruling, an organization whose program includes, but is not limited to, activities directed to exterior maintenance of private residences may qualify for recognition of exemption under section 501(c)(4) of the Code. In the given facts in the Revenue Ruling there was no mention of any exterior maintenance activity. One of the stated purposes of the organization in Rev. Rul. 72-102, however, is to enforce covenants for preserving the architecture and appearance of a housing development. It has been contended that exterior maintenance activities may properly be justified and subsumed under that purpose. Given the combination of factors discussed above surrounding the formation and operation of this type of homeowners organization, the exterior maintenance activities reinforce the prima facie presumption that the organization is operated essentially for private benefit. See Rev. Rul. 69-280, 1969-1, C.B. 152, in which exemption of an organization formed to provide maintenance of exterior walls and roofs of members' home is denied under section 501(c)(4) of the Code. See also Rev. Rul. 74-17, page 130, relating denial of exemption under section 501(c)(4) of an organization formed by unit owners in a condominium housing project to provide for the management, maintenance and care of all the areas and elements in the project that are owned in common by the unit owners.

Another aspect of Rev. Rul. 72-102 that has given rise to some misconception of the ruling's scope involves interpretation of the phrase `non-residential, non-commercial properties of the type normally owned and maintained by municipal government' in determining what kinds of common areas or facilities an exempt homeowners' association may own and maintain. The Revenue Ruling in reciting the areas and facilities owned and maintained by the organization speaks only of `common green areas, streets, and sidewalks.' The Revenue Ruling was, by the quoted phrases, designed to indicate that the only areas and facilities encompassed were those traditionally recognized and accepted as being of direct governmental concern in the exercise of the powers and duties entrusted to governments to regulate community health, safety, and welfare. Thus, the Revenue Ruling was intended only to approve ownership and maintenance by a homeowners' association of such areas as roadways and parklands, sidewalks and street lights, access to, or the use and enjoyment of which is extended to members of the general public, as distinguished from controlled use or access restricted to the members of the homeowners' association, as appropriate and consistent with exemption for the association. Rev. Rul. 72-102 is modified accordingly.

Rev. Rul. 74-99, 1974 WL 34793 (IRS RRU), 1974-1 C.B. 131

REVENUE RULING 72-102

Rev. Rul. 72-102, 1972 WL 30726 (IRS RRU); 1972-1 C.B. 149

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

(Also Section 170; 1.170-2.)

A nonprofit organization formed to preserve the appearance of a housing development and to maintain streets, sidewalks, and common areas for use of the residents is exempt under section 501(c)(4); however, contributions to the organization are not deductible under section 170 of the Code; Revenue Ruling 69-280 distinguished.

Advice has been requested whether the nonprofit organization described below qualifies for exemption from Federal income tax under section 501(c)(4) of the Internal Revenue Code of 1954.

The organization is a membership organization that was formed by a developer and is operated to administer and enforce covenants for preserving the architecture and appearance of a housing development, and to own and maintain common green areas, streets, and sidewalks for the use of all development residents. Prospective home buyers are advised that membership in the organization is required of all owners of real property within the housing development. The organization is supported by annual assessments and member contributions. Its activities are for the common benefit of the whole development rather than for individual residents or the developer.

Section 501(c)(4) of the Code provides for exemption from Federal income tax of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

Section 1.501(c)(4)-1(a)(2)(i) of the Income Tax Regulations provides that 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. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements.

For the purposes of section 501(c) (4) of the Code, a neighborhood, precinct, subdivision, or housing development may constitute a community. For example, exempt civic leagues in urban areas have traditionally represented neighborhoods or other subparts of much larger political units. By administering and enforcing covenants, and owning and maintaining certain non-residential, non-commercial properties of the type normally owned and maintained by municipal governments, this organization is serving the common good and the general welfare of the people of the entire development. Even though the organization was established by the developer and its existence may have aided him in selling housing units, any benefits to the developer are merely incidental. Also, even though the activities of the organization serve to preserve and protect property values in the community, these benefits that accrue to the property owner-members are likewise incidental to the goal to which the organization's activities are directed, the common good of the community. Therefore, it is held that the organization is exempt from Federal income tax under section 501(c)(4) of the Code. Contributions to it are not deductible by donors under the provisions of section 170(c)(2) of the Code.

Revenue Ruling 69-280, C.B. 1969-1, 152, which holds that a nonprofit organization formed to provide maintenance of exterior walls and roofs of members' homes in a development is not exempt under section 501(c)(4) of the Code, is distinguished because that organization was operated primarily and directly for the benefit of individual members rather than for the community as a whole.

Even though an organization considers itself within the scope of this Revenue Ruling, it must file an application on Form 1024, Exemption Application, in order to be recognized by the Service as exempt under section 501(c)(4) of the Code. The application should be filed with the District Director of Internal Revenue for the district in which is located the principal place of business or principal office of the organization. See section 1.501(a)-1 of the regulations.

Rev. Rul. 72-102, 1972 WL 30726 (IRS RRU), 1972-1 C.B. 149

REVENUE RULING 80-63

Rev. Rul. 80-63, 1980-10 I.R.B. 7, 1980 WL 129625 (IRS RRU), 1980-1 C.B. 116

26 CFR 1.501(c)(4)-1: Civic organizations and local associations of employees. (Also 1.501(c)(7)-l.)

Homeowners' associations. Answers are provided to specific questions as to whether the conduct of certain activities will affect the exempt status under section 501(c)(4) of the Code of otherwise qualifying homeowners' associations; Rev. Rul. 74-99 clarified.

The Internal Revenue Service has received several inquires asking whether the conduct of certain activities will affect the exempt status under section 501(c)(4) of the Internal Revenue Code of otherwise qualified homeowners' associations.

Section 501(c)(4) of the Code provides for exemption from federal income tax of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

Section 1.501(c)(4)-1(a)(2)(i) of the Income Tax Regulations provides that 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. An organization embraced within this section is one which is operated for the purpose of bringing about civic betterments and social improvements.

Rev. Rul. 72-102, 1972-1 C.B. 149, holds that certain nonprofit organizations of a type usually called homeowners' associations, which are formed to administer and enforce covenants for preserving the architecture and appearance of a housing development and to maintain streets, sidewalks, and other non-residential, non-commercial properties in the development of the type normally owned and maintained by a municipal government, may qualify for exemption under section 501(c)(4) of the Code.

Rev. Rul. 74-99, 1974-1 C.B. 131, modified Rev. Rul. 72-102, to make clear that a homeowners' association of the kind described in Rev. Rul. 72-102 must, in addition to otherwise qualifying for exemption under section 501(c)(4) of the Code, satisfy the following requirements: (1) It must engage in activities that confer benefit on a community comprising a geographical unit which bears a reasonably recognizable relationship to an area ordinarily identified as a governmental subdivision or a unit or district thereof; (2) It must not conduct activities directed to the exterior maintenance of private residences; and (3) It owns and maintains only common areas or facilities such as roadways and parklands, sidewalks and street lights, access to, or the use and enjoyment of which is extended to members of the general public and is not restricted to members of the homeowners' association.

Specific questions that have been raised and their answers are as follows:

Question 1.

Does Rev. Rul. 74-99 contemplate that the term 'community' for purposes of section 501(c)(4) of the Code embraces a minimum area or a certain number of howeowners?

Answer:

No. Rev. Rul. 74-99 states that it was not possible to formulate a precise definition of the term `community'. The ruling merely indicates what the term is generally understood to mean. Whethe a particular homeowners' association meets the requirements of conferring benefit on a community must be determined according to the facts and circumstances of the individual case. Thus, although the area represented by an association may not be a community within the meaning of that term as contemplated by Rev. Rul. 74-99, if the association's activities benefit a community, it may still qualify for exemption. For instance, if the association owns and maintains common areas and facilities for the use and enjoyment of the general public as distinguished from areas and facilities whose use and enjoyment is controlled and restricted to members of the association then it may satisfy the requirement of

serving a community.

Question 2.

May a homeowners' association, which represents an area that is not a community, qualify for exemption under section 501(c)(4) of the Code if it restricts the use of its recreational facilities, such as swimming pools, tennis courts, and picnic areas, to members of the association? Answer:

No. Rev. Rul. 74-99 points out that the use and enjoyment of the common areas owned and maintained by a homeowners' association must be extended to members of the general public, as distinguished from controlled use or access restricted to the members of the association. For purposes of Rev. Rul. 74-99, recreational facilities are included in the definition of `common areas'.

Question 3.

Can a homeowners' association establish a separate organization to own and maintain recreational facilities and restrict their use to members of the association?

Answer:

Yes. An affiliated recreational organization that is operated totally separate from the homeowners' association may be exempt. See Rev. Rul. 69-281, 1969-1 C.B. 155., which holds that a social club providing exclusive and automatic membership to homeowners in a housing development, with no part of its earnings inuring to the benefit of any member, may qualify for exemption under section 501(c)(7) of the Code.

Question 4.

Can an exempt homeowners' association own and maintain parking facilities only for its members if it represents an area that is not a community?

Answer:

No. By providing these facilities only for the use of its members the association is operating for the private benefit of its members, and not for the promotion of social welfare within the meaning of section 501(c)(4) of the Code.

Rev. Rul. 74-99 is clarified.

Rev. Rul. 80-63, 1980-10 I.R.B. 7, 1980 WL 129625 (IRS RRU), 1980-1 C.B. 116

Under present law, generally a homeowner association may qualify as an organization exempt from federal income tax (under Sec. 501(c)(4) of the Code) only if it meets three requirements (Rev Rul 74-99, 1974-1 C.B. 131). First, the homeowner's association must serve a “community” which bears a reasonably, recognizable relationship to an area ordinarily identified as a governmental subdivision or unit. Second, it must not conduct activities directed to the exterior maintenance of any private residence. Third, common areas or facilities that the homeowners association owns and maintains must be for the use and enjoyment of the general public.

If an organization fails any one of the requirements, (most fail because they provide benefits to members), then the organization may qualify under the provisions of IRC Sec 528. This section provides special tax relief to qualified homeowner associations by excluding certain portions of their income from taxation.

SECTION 528. —CERTAIN HOMEOWNERS ASSOCIATIONS

EXPLANATION OF THE REGULATIONS

For taxable years beginning after December 31, 1973, homeowners associations described in Section 528 of the Code may elect to be subject to the tax imposed by Section 528 and to be otherwise exempt from Federal income taxes. To be considered a homeowners association an organization must either be a condominium management association or a residential real estate management association and must meet a number of specific additional requirements.

For an organization to qualify as a homeowners' association, it must be organized and operated to provide for the acquisition, construction, management, maintenance, and care of association property. In addition, a homeowners association must meet both a source of income test (which generally requires that at least 60 percent of its gross income consists of membership, dues, fees, or assessments from members of the association) and an expenditure test (which generally requires that at least 90 percent of its expenditures be in furtherance of its exempt purposes). If an association meets the required tests and makes the election under Section 528, it will not be taxable on that portion of its income which consists of dues, fees, and assessments from its members. To the extent that a homeowners association does have taxable income, it will be taxed (with certain modifications described in Section 528 and these regulations) as a corporation taxable under Section 11.

ADDITIONAL CONSIDERATIONS

These regulations are needed in order to provide guidance to the public as well as government employees responsible for the implementation of Section 528 of the Internal Revenue Code of 1954.

Considering both the direct and indirect effects of these regulations, it is believed that they satisfactorily implement section 2101(a) of the Tax Reform Act of 1976. These regulations do not institute new recordkeeping or recording burdens. Evaluation of the effectiveness of the regulations after issuance will be based upon comments received from offices within the Internal Revenue Service and the Treasury Department, other governmental agencies, State and Local governments, and the public.

§1-528-1 Homeowners Associations

(a) In general, Section 528 only applies to taxable years of homeowners associations beginning after December 31, 1973. To qualify as a homeowners association, an organization must either be a condominium management association or a residential real estate management association. For the purposes of Section 528 and the regulations under that section, the term “homeowners association” shall refer only to an organization-described in Section 528. Cooperative housing corporations and organizations based on a similar form of ownership are not eligible to be taxed as homeowners associations. As a general rule, membership in either a condominium management association or a residential real estate management association is confined to the developers and the owners of the units, residences, or lots. Furthermore, membership in either type of association is normally required as a condition of such ownership. However, if the membership of an organization consists of other homeowners associations, the owners of the units, residences, or lots who are members of such other homeowners associations will be treated as the members of the organization for the purposes of the regulations under Section 528.

§ 1.528-3 Association Property

(a) Property owned by the organization. “Association property” includes real and personal property owned by the organization or owned as tenants in common by the members of the organization. Such property must be available for the common benefit of all members of the organization and must be of a nature that tends to enhance the beneficial enjoyment of the private residences by their owners. If two, or more facilities or items of property of a similar nature are owned by a homeowners association, and if the use of arty particular facility or item is restricted to fewer than all association members, such facilities or items nevertheless will be considered association property if all association members are treated equitably and have similar rights with respect to comparable items or facilities. Among the types of property that ordinarily will be considered association property are swimming pools and tennis courts. On the other hand, facilities or areas set aside for the use of nonmembers, or in fact used primarily by nonmembers, are not association property for the purposes of this section. For example, property owned by an organization for the purpose of leasing it to groups consisting primarily of nonmembers to be used as a meeting place or a retreat will not be considered association property.

(b) Property normally owned by a governmental unit. “Association property” also includes areas and facilities traditionally recognized and accepted as being of direct governmental concern in the exercise of the powers and duties entrusted to governments to regulate community health, safety and welfare. Such areas and facilities would normally include roadways, parklands, sidewalks, streetlights and firehouses. Property described in this paragraph will be considered association property regardless of whether it is owned by the organization itself, by its members as tenants in common or by a governmental unit and used for the benefit of the residents of such unit including the members of the organization.

(c) Privately owned property. “Association property” may also include property owned privately by members of the organization. However, to be so included the condition of such property must affect the overall appearance or structure of the residential units which make up the organization. Such property may include the exterior walls and roofs of privately owned residences as well as the lawn and shrubbery on privately owned land and any other privately owned property the appearance of which may directly affect the appearance of the entire organization. However, privately owned property will not be considered association property unless

(1) There is a covenant or similar requirement relating to exterior appearance or Maintenance that applies on the same basis to all such property (or to a reasonable Classification of such property);

(2) There is no pro rata mandatory assessment (at least once a year) on all members of the association for maintaining such property; and

(2) Membership in the organization is a condition of ownership of such property.

§1.528-8 Election to be treated as a homeowners association.

(a) General rule. An organization wishing to be treated as a homeowners association under section 528 and this section for a taxable year must elect to be so treated. Except as otherwise provided in this section, such election shall be made by the filing of a properly completed Form 1120-H (or such other form as the Secretary may prescribe). A separate election must be made for each taxable year.

(b) Taxable years ending after December 30, 1976. For taxable years ending after December 30, 1976, the election must be made not later than the time, including extensions, for filing an income tax return for the year in which the election is to apply.

(c) Revocation of exempt status. If an organization is notified after the close of a taxable year that its exemption for such taxable year under section 501(a) is being revoked retroactively, it may make a timely election under section 528 for such taxable year. Notwithstanding any other provisions of this section, such an election will be considered timely if it is made within 6 months after the date of revocation. The preceding sentence shall apply to revocations made after April 18, 1980. If the revocation was made on or before April 18, 1980, the election will be considered timely if it is made before the expiration of the period for filing a claim for credit or refund for the taxable year for which it is to apply.

(d) Effect of election —(1) Revocation. An election to be treated as an organization described in section 528 is binding on the organization for the taxable year and may not be revoked without the consent of the Commissioner.

(2) Exception. Notwithstanding paragraph (f)(1) of this section, an election under this section may be revoked prior to July 18, 1980. Such a revocation shall be made by filing a statement with the director of the Internal Revenue Service Center with whom the return of the organization for the year in which the revocation is to apply was filed. The statement shall include the following information.

(i) The name of the organization.

(ii) The fact that it is revoking an election made under section 528.

(iii) The taxable year for which the revocation is to apply.

§1.528-10 Special rules for computation of homeowner's association taxable income and tax.

(a) In general. Homeowner's association taxable income shall be determined according to the provisions of section 528(d) and the rules set forth in this section.

(b) Limitation on capital losses. If for any taxable year a homeowners association has a net capital loss, the rules of sections 1211(a) and 1212(a) shall apply.

(c) Allowable deductions —(1) In general. To be deductible in computing the unrelated business taxable income of a homeowners association, expenses, depreciation and similar items must not only qualify as items of deduction allowed by chapter 1 of the Code but must also be directly connected with the production of gross income (excluding exempt function income). To be “directly connected with” the production of gross income (excluding exempt function income), an item of deduction must have both proximate and primary relationship to the production of such income and have been incurred in the production of such income. Items of deduction attributable solely to items of gross income (excluding exempt function income) are proximately and primarily related to such income. Whether an item of deduction is incurred in the production of gross income (excluding exempt function income) is determined on the basis of all the facts and circumstances involved in each case.

Argument:

O was granted tax exempt status under IRC section 501(c)(4). The determination of that tax exempt status was based on the organizational documents and the organization's activities as they were presented at the time of filing the application. The primary purpose of the organization was to promote the improvement and advancement of the community. Since that time, the law has been clarified that this type of organization must open their property to the general public to be exempt under IRC 501. Responses from the organization state that the property is not open to the general public. The organization can elect to modify their tax exemption to a Section 528 organization.

CONCLUSION

It is therefore proposed that the tax exempt status of O be revoked. If the organization elects the Section 528 option, they would be required to file Form 1120-H-U.S Income Tax Return for Homeowners Associations. Otherwise, they will need to file Form 1120.

Practical Considerations

1. The existence of a security gate does not automatically mean that the property owned by the association is not accessible to the general public. While this is true in the vast majority of cases, there are two exceptions to this situation; (1) if the association is able to establish that it is a "community", then the "community" served exists behind the gates. The Association therefore meets the statutory requirement of serving a community, and has no obligation to further open the Association property to the "world-at-large," (2) if the Association occupies essentially the same geographic area as a recognized governmental entity, then the Association again meets the statutory requirement of serving a "community."

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.