

IRS Letter Ruling 200709035

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

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 operate for the benefit of the general public. Based upon information obtained during the examination, the Association is operated exclusively for the benefit of its members.

IRS Letter Ruling 200709035 (March 15, 2008)

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: * * *.

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, Marsha A. Ramirez Director, EO Examinations

Form 886A(Rev.4-68)

Department of the Treasury - Schedule Number

Internal Revenue Service or Exhibit

***** Explanation of Items *****

Name of Taxpayer	Year/Period Ended
ORG	12/31/20XX

Legend

ORG = Organization name

XX = Date

XYZ = State

City = city

CO-1 = Company

CO-2 = 2nd company

ISSUES

Does ORG continue to qualify for tax exempt status under Internal Revenue Code section 501(c)(4)?

FACTS

The ORG (ORG) was incorporated May 21, 19XX in the State of XYZ. The ORG is not gated, nor does it enforce any covenant for preserving the architecture and appearance of a particular area.

The Articles of Incorporation shows the purposes for which the ORG was organized as:

- To promote and develop the common good and welfare of the residents within the community, such community being defined as that certain area of the City of City, known as the CO-1,
- To promote and develop good fellowship, neighborliness, and civic responsibility among the members of the corporation including, but not limited to, discussion and collective pursuit of problems of civic interest.

The By-laws identify the purposes of this ORG to be to preserve, protect, and advance the interests of the neighborhood in which its members reside, to disseminate information of interest to those residents, and to promote fellowship among its members.

The By-laws recognize the streets and blocks which make up the member residences which adult residents reside on. Membership is voluntary for all residents in the area covered by the ORG. The ORG provides its members with an annual directory, monthly newsletters, participation in neighborhood events and activities. The ORG has formed a ***** Operations committee to act as liaison, arrange maintenance and periodic inspection of the ***** area behind member's homes.

For the tax year ended December 31, 20XX, the ORG provided members with monthly informative newsletters and an annual telephone directory. The monthly newsletter provides members with property care tips, crime watch report, advertisements geared toward homeowners and the ORG agenda. The monthly newsletter is also used to keep members aware of the ORG events and activities, which promote fellowship and encourage non-member resident owners to join. The ORG holds a Spring and Fall General Membership meeting, Boot Scootin' Progressive Party, Easter Egg Hunt, the 4th of July Parade, Tree Lighting with Santa Claus, and annual Halloween Party. The ORG requires foods and candy as fee for admittance to the events held, while other activities may require members to pay for events held off-site. The conducting these activities and member benefits make up about *****% of the organization total expenses.

The ORG also offers crime watch patrol open to the ORG members. The ORG has an agreement with a neighboring homeowner ORG to provide the crime watch patrol. The ORG employs off-duty police officers in City Police cars to patrol in the designated Crime Watch area. The patrol officers' schedule varies, with special emphasis on known peak crime hours. The operation of the crime watch program makes up about % of the ORG expenses. In 19XX the ORG formed the CO-2 to address growing crime in the area. As a result the ORG started Crime watch patrol. The ORG had about 405 participants on the program. The ORG charged \$ per month in dues for the service. Benefits limited to paying participants include:

- Voice mail system - each member has an access code,
- Extra attention to their home while on a trip (such as checking windows and doors for anything unusual, and removing flyers and hiding newspapers and mail,
- Direct access to patrolling officers and off-duty voice mail message via dedicated cell phone,
- Member alert to recent crime in the area,
- Crimes watch member signage for home exterior.

Officers are available approximately 100 hours a week to address other problems and concerns such as:

- Medical emergency assistance
- Investigation of suspicious persons
- Investigation of unknown parked vehicles
- “Open garage door” alerts
- Overseeing personal safety for late-night home arrival

—Stopping vandalism in progress.

LAW

Section 501(c)(4) of the Code provides for the exemption from Federal income tax of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

Section 1.501(c)(4)-1(a)(2)(i) of the Regulations states 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 betterment and social improvements.

Revenue Ruling 77-273, 1977-2 CB 194, A nonprofit organization that provides security services for residents and property owners of a particular community, who agree to voluntarily donate money at a specified hourly rate to defray the cost of the services, is carrying on a business with the general public in a manner similar to organizations operated for profit and does not qualify for exemption under section 501(c)(4) of the Code.

Revenue Ruling 69-280, 1969-1 C.B. 152 concluded that an organization that provides maintenance of exterior walls and roofs of members' homes in a housing development does not qualify for tax-exempt status under IRC section 501(c)(4). The organization was operating primarily for the benefit of individual members rather than the community as a whole.

In **Commissioner v. Lake Forest, Inc., 305 F. 2d 814 (1962)**, it was held that the organization, a housing cooperative for World War II veterans and others, did not meet the requirements for tax-exempt status under IRC section 501(c)(4). The court found that the organization was not operating exclusively for “social welfare” purposes, but as a private economic enterprise. The court also determined that the organization was organized and operated for the benefit or convenience of its members by performing services that its members would otherwise have to provide for themselves.

Section 528(c)(1) defines the term “homeowners ORG” to mean an organization, which is a residential real estate management ORG organized and operated to provide for the acquisition, construction, management, maintenance, and care of ORG property. The homeowners ORG must receive at least 60 percent of its gross income from amounts received as membership dues, fees, or assessments, and at least 90 percent of its expenditures must be from the acquisition, construction, management, maintenance, and care of the ORG property on behalf of members of the ORG.

The taxable income of a homeowners ORG for any taxable year is an amount equal to the excess (if any) of the gross income for the taxable year (excluding any exempt function income), over the deductions allowed directly connected with the production of the gross income (excluding exempt function income).

Under section 528, the term “exempt function income” is any amount received as membership dues, fees, or assessments from owners of real property in the case of a residential real estate management ORG. There shall be allowed a specific deduction of \$100. No net operating loss is deductible.

Section 1.528-1 of the Regulations states to qualify as a homeowners association an organization must either be a condominium management association or a residential real estate management association. 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 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.

GOVERNMENT'S POSITION

An organization that limits its service to certain property owners, operated to serve the individual interest of its members rather than the community as a whole by providing social activities, security patrol and disseminating information useful to its members, is not a social welfare organization exempt under section 501(c)(4). A social welfare organization must be operated for the benefit of the general public by providing a community benefit to qualify for exemption under section 501(c)(4). Generally, social welfare organization, which operates as an exempt homeowners association, owns and maintains certain common areas open to the public. The Treasury Regulations extend tax-exempt status to those exempt homeowners' associations that are primarily engaged in promoting 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 betterment and social improvements.

ORG has not shown its activities primarily serve the community rather than the private interest of its members. The security patrol services the ORG provides to property owners on a regular basis is similar to organizations operated for profit. The fact that security patrol services are provided does not satisfy the requirements of the regulations that an organization be primarily engaged in promoting the common good and general welfare the community. 1

ORG is similar to the organizations in Revenue Rulings 69-280 and 77-273, because the ORG activities and services are for the benefit of its members. Most of the ORG member dues are used for patrol services for private residents. An organization of this type described in the rulings is essentially a mutual, self-interest type of organization. ORG's income is used to provide direct economic benefits to its members and any benefit to the larger community is minor and incidental. As in *Commissioner v. Lake Forest, Inc.*, ORG's benefits are neither intended for the public at large, rather for the private interest of property owners paying for a particular service.

ORG is similar to organizations describe under section 528 of the Code. The activities and support are of those of a traditional homeowners' ORG as described in section 528.

TAXPAYER'S POSITION

Unknown

CONCLUSION

Since the benefits provided by the ORG are limited to its members, you are not operated exclusively for the promotion of social welfare within the meaning of section 501(c)(4) of the Code.

As a result of our examination of your Form 990 for the period ended December 31, 20XX, we have determined that your organization no longer qualifies as an exempt homeowners ORG described in IRC section 501(c)(4). We are proposing that the Corporation's exempt status be revoked as of January 1, 20XX. Form 1120-H, U.S. Income Tax Return for Homeowners ORG, should be filed for the fiscal years ended December 31, 20XX, 20XX and all future years.

Practical Considerations

1. In the authors' experience a number of associations were granted exempt status under IRC Section 501(c)(4) that failed to meet either the service to the community or public benefit requirements of IRC Section 501(c)(4). Examinations of associations exempt under this section routinely result in discovery of these facts and revocation of exempt status.

2. The IRS is incorrect on this matter. The Association would be technically required to file Form 1120 under the provisions of IRC Section 277, but may make an election under IRC Section 528 to file Form 1120-H. The other issue noted here is that the IRS indicated the Association should file Forms 1120-H for two years, when the period for making an election to file such Form has already expired. It is the authors' experience that the IRS will routinely demand filing of Forms 1120-H for prior years after the time for making an election has expired.

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 is 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.