

**IRS Private Letter Ruling 200720026-Association's Exempt Status Revoked
Due to Lack of Community Organization**

Cross Reference Data

Topical

Access

Adverse determination Exempt organizations Homeowners' association

Private benefit

Citation

IRC Sections-501(c)(4), 528

Case

-Commissioner v. Lake Forest Inc.

Regulations Sections-1.501(c)(4)-1 1.528-1, 5

Revenue Rulings---69-280, 72-102,74-17, 74-99

Summary

Homeowners' association previously exempt under IRC Section 501 (c) (4) had its exempt status revoked as a result of an on-site examination. The IRS explained that Organization's activities were operated on a cooperative basis and lacked the necessary requirements of an organization described for a community organization and were more like an operation for a private self-help enterprise. Association's Exempt Status Revoked Due to Lack of Community Organization

Uniform Issue List Information:

UIL No. 0501.04-01 -exempt organizations-exempt status-condominium association.

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.

Legend:

ORG = Name of Organization

Security Firm = Name of Security Firm

Related Firm = Name of the Related For Profit City, State = Location of ORG

ISSUE

Does the ORG qualify for tax exempt status under IRC section 501 (c)(4)

FACTS

ORG was created by the Related Firm ***** (Related Firm) in ***** Related Firm began to develop a ***** acre parcel of beach front property as a first rate, mixed-use vacation resort. The resort area was to consist primarily of a large hotel, several distinct groupings of condominiums (condos) and

the infrastructure and related facilities necessary to support the resort. Related Firm decided to create extensive common areas that were carefully landscaped to attract buyers to for these condos.

As the condominiums were built, Related Firm created individual condo associations for each distinctive grouping of condos. Related Firm referred to these associations as regimes. These traditional style condo associations were charged with the responsibility for maintaining the exterior of their structures and the care of the common areas closely associated with their condo territory.

To provide coordination between the individual associations and control the maintenance of the roads, streets, trails, lakes, and other landscaped areas, it was necessary for Related Firm to create the ORG to act as overseer to these areas and the individual associations.

ORG is funded with fees from the condo owners. The individual condo associations collect the fees and pass them along to ORG. ORG expends over 70% of the funds that they receive for the maintenance and care and landscaping of the common areas in the ORG ***** area.

Related Firm has retained control of the entire ORG project from It's inception by Installing favorable voting rights provisions into the organizational bylaws. The bylaws state that Related Firm receives two votes for every vote received by the other board members. The board consists of one representative from each condo association and a representative appointed by Related Firm.

In the Declaration of Covenants, dated June xx, 198X, Related Firm clearly states that the covenant covers the ***** acre parcel now owned and any and all land that may acquired by Related Firm and included in the ORG project. Article 1, section 1.1.7 of the covenant states that common areas are for the "common use and enjoyment of the owners and occupants of the development."

ORG incorporated on November 2, 199X in City, State. The purpose of the organization is to provide an entity for the operation of and administration of the mixed use, multi-phased, multi-regime residential and commercial community known as ORG.

ORG applied for exemption under IRC section 501(c)(4) and were denied by IRS Determinations in early, 20xx. The application was rejected based on the lack of public [access](#). ORG appealed the adverse determination and submitted evidence that the ORG area was in fact open to the public. IRS Appeals found in favor of ORG and granted tax exempt status.

Information contained on Form 1024:

Proposed Activities:

1. Maintain the general common areas of the residential community,
2. Make payment of common area utilities, insurance, street and lighting maintenance, landscaping and maintenance and repair of all association owned common property,
3. Publish a regular newsletter,
4. Conduct social, recreational and educational events in the community,
5. Provide a manned entry gate for traffic control, directions and assistance to both members as well as the public,
6. Within the association there is a hotel, restaurant, pools, lounge, shops and real estate office open to the general public. The common areas may include but are not limited to maintenance areas,

roads, streets, parking lots, parks, open areas, recreational amenities and walkways. The association does not maintain common areas or landscape for the shops, hotel, restaurant, lounge or pools. These areas are open to the general public.

Membership is mandatory. Each owner of every unit is a mandatory member. Membership begins with the purchase of a unit and ceases upon sale. There are no voluntary members and no membership certificate is issued.

Financial support consists of members' assessments, cable TV fees, and interest earned on reserve replacement funds.

ORG hires Security Firm, Inc. to provide security personnel and guards for the entrance into the ORG, ***** area. In section 4A of the security handbook, in reference to access control, the guards at the entrance have the authority to deny entry to anyone at any time.

Financial disbursements include repair and maintenance to the common/gated areas.

LAW

Treasury Regulation 1.501(c)(4)-1 (a)(2)(i) states; 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 community.

Treasury Regulation 1.501(c)(4)-1(a)(2)(ii) provides that social and recreational activities are not social welfare activities. However, if a substantial part of an organization's activities consists of social functions for the benefit, pleasure, and recreation of its members, it may qualify for exemption under IRC 501 (c)(4) if it is primarily engaged in social welfare activities.

Treasury Regulation 1.528-1: With regard to Homeowner's 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 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.

(b) Condominium The term "condominium" means an interest in real property consisting of an undivided interest in common in a portion of a parcel of real property (which may be a fee simple estate or an estate for years, such as a leasehold or subleasehold) together with a separate interest in space in a building located on such property. An interest in property is not a condominium unless the undivided interests in the common elements are vested in the unit holders. In addition, a condominium must meet the requirements of applicable state or local law relating to condominiums or horizontal property regimes.

(c) Residential real estate management association-Residential real estate management associations are normally composed of owners of single-family residential units located in a subdivision, development, or similar area. However, they may also include as members owners of multiple-family dwelling units located in such area. They are commonly formed to administer and enforce covenants relating to the architecture and appearance of the real estate development as well as to perform certain maintenance duties relating to common areas.

(d) Tenants-Tenants will not be considered members for purposes of meeting the source of income test under section 528(c)(1)(B) and section-1.528-5. However, the fact that tenants of members of a homeowners association are permitted to be members of the association will not disqualify an association under section 528(c)(1) if it otherwise meets the requirements of section 528(c) and these regulations. [Reg. section 1.528-1] Internal Revenue Code section 501(c)(4)(A) describes Civic Leagues as follows: Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

Internal Revenue Code section 501 (c)(4) (B) states that; Subparagraph (A) shall not apply to an entity unless no part of the net earnings of such entity inures to the benefit of any private shareholder or individual.

Internal Revenue Code section 528. Certain Homeowner's Associations

Commissioner v. Lake Forest, Inc., 305 F 2d 814 (4th Cir. 1962), the court held that a cooperative housing corporation was not exempt as a social welfare organization under section 501(c) (4) of the Code since its activities were of the nature of an economic and private cooperative undertaking.

Rev. Rul. 69-280 states that an organization that provides specified services for the member homeowners, such as exterior maintenance on walls and roofs, was not exempt under section 501(c) (4) of the code. The organization described in the ruling was performing services that its members would otherwise have to provide for themselves. It is a private cooperative enterprise for the economic benefit or convenience of the members.

In Commissioner v. Lake Forest, Inc., 305 F. 2d 814 (1962), it was held that a corporation that provided housing on a cooperative basis lacked the necessary requirements of an organization described in section 501 (c)(4) of the Code. The court held the operation to be a private self-help enterprise with only an incidental benefit to the community as a whole.

Similarly, in this case it was held that the organization is operated primarily for the private benefit of members and any benefits to the community were not sufficient to meet the requirement of the regulation that the organization be operated primarily for the common good and general welfare of the people of the community.

Rev. Rul. 72-102 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 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.

Rev. Rul. 74-17 holds that an organization formed by the unit owners of a condominium housing project to provide for the management, maintenance, and care of the common areas of the project, as defined by State statute, with membership assessments paid by the unit owners does not qualify for exemption under section 501(c)(4) of the Code.

By virtue of the essential nature and structure of a condominium system of ownership, the rights, duties, privileges, and immunities of the members of an association of unit owners in a condominium property derive from, and are established by, statutory and contractual provisions and are inextricably and compulsorily tied to the owner's acquisition and enjoyment of his property in the condominium. In addition, condominium ownership necessarily involves ownership in common by all condominium unit owners of a great many so-called common areas, the maintenance and care of which necessarily constitutes the provision of private benefits for the unit owners.

Since the organization's activities are for the private benefit of its members, it cannot be said to be operated exclusively for the promotion of social welfare. Accordingly, it does not qualify for exemption from Federal income tax under section 501(c)(4) of the Code.

GOVERNMENT'S POSITION

ORG was created by Related Firm ***** in *****. As more condominiums were built in the ORG controlled area, Related Firm created separate condominium associations for each specific grouping. Each association or "regime" as Related Firm called them was responsible for maintaining their own common areas. As more condominiums were built, it became necessary for Related Firm to create the Master Association to oversee the subordinate regimes and the maintenance of all common areas.

As a condominium association, or a master condominium association, the organization should never have received tax exempt status under any code section. In *Commissioner v. Lake Forest, Inc.*, the court set a clear precedent that organizations that operated on a cooperative basis lacked the necessary requirements of an organization described in section 501 (c)(4) of the Code. The court held the operation to be a private self-help enterprise with only an incidental benefit to the community as a whole.

Rev. Rut. 74-17 reiterates the points derived from *Lake Forest* and specifically states that condominium associations formed by the unit owners of a condominium housing project to provide for the management, maintenance, and care of the common areas of the project, as defined by State statute, with membership assessments paid by the unit owners does not qualify for exemption under section 501(c)(4) of the Code.

Rev. Rul. 74-17 further states that condominium ownership necessarily involves ownership in common by all condominium unit owners of a great many so-called common areas, the maintenance and care of which necessarily constitutes the provision of private benefits for the unit owners.

Based on the Declaration of Covenants and organization by-laws which are in effect, Related Firm ***** has maintained control of the entire ***** acre ORG project since its inception in ***** Related Firm Development controls the operation and activities of the ORG project by holding over *****% of the voting rights. These favorable voting rights allow Related Firm Development to assert a large measure of control on the subordinate associations.

As the ORG project has progressed over time, Related Firm ***** has enjoyed a private benefit from having control over the master association and, subsequently, the subordinate associations. This private benefit came in the form of serving Related Firm ***** commercial interests by having well-maintained roads, trails and immaculately landscaped areas which had to increase the ability of Related Firm to sell these condominiums.

IRC section 501(c)(4) specifically states that tax exempt status shall not apply to an entity unless no part of the net earnings of such entity inures to the benefit of any private shareholder or individual.

ORG ***** is not open to the general public, but is rather a closed, gated community where limited access to non-condominium owners may or may not be granted. As evidenced during the tour of the facilities and confirmed by reviewing the security manual used by the guards at the entrance gate, access is controlled by the organization and the guards have written policies on who to let in and the discretion on who to keep out.

The organization is clearly not operating within the spirit of a social welfare organization because they are not engaged in promoting in some way the common good and general welfare of the community.

TAXPAYER'S POSITION

The organization has signed the Form 6018-A agreeing to revocation of their tax exempt status. The organization has elected to file Forms 1120-H as required under code section 528 for the 200*, 200* and 200* tax years. The organization has provided these returns and the required payment checks to this office for filing.

CONCLUSION

The ORG does not qualify for exemption under section 501 (c)(4) of the code. The main reason for disallowing tax exempt status is that per Rev. Rul. 74-17, condominium associations do not qualify for exempt status under IRC section 501(c)(4).a

Secondary reasons for disallowing the continuance of tax exempt status is that there are two private benefit issues that would preclude exemption under IRC section 501 (c)(4).

First, the organization is a condominium association where the maintenance of common areas provides a private benefit to the individual condominium owners. As in Commissioner v. Lake Forest, Inc., this organization provides housing on a cooperative basis which the court held to be the operation of a private self-help enterprise with only an incidental benefit to the community as a whole. As such, the organization cannot qualify for exemption under code section 501(c) (4) because they are operated for the private benefit of the condominium owners and not for the common good and general welfare of the community or general public.

Second, the organization and entire ORG ***** remains under the control of ***** Related Firm ***** . This control in and of itself precludes exemption based on the obvious private and commercial benefit received by Related Firm ***** . Any ancillary benefits received by the community as a whole pale compared to the benefits enjoyed by Related Firm ***** .b

The developer of the ORG ***** area has retained voting control over the Master Association's Board of Directors, and as an extension the subordinate individual associations. As the developer has never relinquished control of the common areas, the maintenance of said common areas connotes a private benefit to the developer in relation to having immaculate facilities and grounds to assist in the sale of condominiums still being built. Based on the private benefit bestowed upon the developer, the organization cannot qualify for exemption because they are operated for the private benefit of the developer as well as the condominium owners and not for the common good and general welfare of the community or general public.

A third issue that would preclude exemption is the lack of public access to ORG ***** . The organization restricts access to the ORG ***** by allowing their gate guards to deny access to anyone they feel doesn't belong here. Such a policy is in stark contrast to the provisions in code section 501(c)(4). As there is no true open public access, the organization cannot qualify for exemption under code section 501(c)(4) because they are operated for the private benefit of the condominium owners and not for the common good and general welfare of the community or general public.

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: Organization's activities were operated on a cooperative basis and lacked the necessary requirements of an organization described for a community organization and were more like an operation for a private self-help enterprise. The ORG fails to meet the requirement for exemption under IRC 501(c)(4) and 528.b Section 1.501(c)(4)-1 of the Income Tax Regulations which states 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 community.

As a result of a recent audit of your organization's activities and Form 990 for the period ended December 31, 20xx, the operation is organized and operating solely as a condominium association which do not qualify for exempt status under IRC section 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 January 1, 20xx.

You are required to file Federal income tax returns on Form 1120.b These returns should be filed with the appropriate Service Center for all years beginning after December 31, 20xy. You have executed the Form 6018 agreeing to this revocation.

You are required to file Form 1120, U.S. Corporation Income Tax Return. 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:

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, Marsha A. Ramirez, Director, EQ Examinations.

Notes:

a This ruling relies on Rev. Rul. 74-17 as authority for homeowners' associations not qualifying for tax exempt status under IRC Sec. 501(c)(4).

b. This ruling states also that the association does not qualify under IRC Sec. 528 to file Form 1120-H. The ruling relies on 528(c)(1)(D) quoting that "no part of the net earnings of such organization inures to the benefit of any private shareholder or individual." The ruling states above: "the organization remains under the control of ***** Related Firm." "This control in and of itself precludes exemption based on the obvious private and commercial benefit received by Related Firm. Any ancillary benefits received by the community as a whole pale compared to the benefits enjoyed by Related Firm." The decision in the letter ruling also states: "As the ORG project has progressed over time, Related Firm ***** has enjoyed a private benefit from having control over the master association and, subsequently, the subordinate associations. This private benefit came in the form of serving Related Firm ***** commercial interests by having well-maintained roads, trails and immaculately landscaped areas which had to increase the ability of Related Firm to sell these condominiums. The writer of this ruling concludes that Related Firm enjoyed a private benefit, and as a result the organization does not qualify under IRC Sec. 528 to file Form 1120-H.

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.