

IRS Private Letter Ruling 8028010-Exemption Status under 501 (c)(4)

Cross Reference Data

Topical

Community

Exempt organizations Tax- exempt status Unrelated business income

Citation

IRC Sections-501 (c)(4), 511 (a)(1) Regulations Section-1.513

Revenue Rulings-72-102,74-99, 80-63

Summary

Private Letter Ruling 8028010 clarifies a homeowners' association exemption status under IRC Sec. 501(c)(4).

- Restricting the general public's access to limited member facilities does not prevent exemption when considered in relation to the overall activities and services provided to the community.
- Income from administration and maintenance activities related to the association's exempt purpose is not considered unrelated business income.

Exemption Status under 501 (c)(4) Uniform Issue List Information:

UIL No. 0511.00-00

Tax on unrelated business income of charitable, etc., organizations.

National Office Technical Advice Memorandum Issues:

1. Whether X meets the requirements of Rev. Rul. 74-99,1974-1 C.B. 131, as a homeowners association, and otherwise qualifies for exempt status under section 501 (c)(4) of the Internal Revenue Code.
2. If X is to be determined to [be] exempt, whether the accounting, management and grass cutting services are includible in the computation of unrelated business income.

FACTS:

X was formed on . . . for the purpose of promoting the health, safety, and welfare of the residents of Y and enforcing any and all covenants, restrictions, and agreements applicable to Y X was recognized as exempt from federal income tax under section 501 (c)(4) of the Code on... .

The new town of Y occupies . . . acres and has a current population of approximately.... X's membership exceeds ... members and consists of the owners of detached and semi-detached homes, condominium units and apartment units within the town of Y Such owners are automatically members of X or have membership rights by virtue of the purchase or rental of their living units within Y.

X states that Y is operated in a manner similar to that of a township. The business and affairs of Y are determined by the nine-member Board of Directors of X, each member being elected for a term of three years.

X serves as agent for the various local homes corporations and condominiums within Y and, through contractual arrangements, provides them with certain management, accounting and maintenance services. X currently serves the approximately. . . residents of Y and will ultimately serve over ... residents upon the completion of Y The homes corporations and condominiums pay X a fee for services provided. X handles assessment, billing and collection, banking, financial statements, and related administrative services. X states that it provides no exterior maintenance of private residences, i.e., no roof or other exterior repairs are made and no grounds maintenance work or painting is performed. On behalf of certain of the local homes corporations within Y, X does make arrangements for the servicing of certain master television antenna systems within a very small number of townhouse units within Y These master antenna systems are located within the end units of the various rows of townhouses. X states that the service is not cable television and is provided as a benefit to the community and not for the personal or private benefit of individual members of X as it avoids the proliferation of television antenna on the roofs of townhouse units.

X owns and maintains common property and facilities totaling approximately . . . acres. This property consists of lakes, ponds, large park land areas, ball fields, roadways, parking areas, walkways, bike paths, a large outdoor amphitheater, community centers, swimming pools and tennis courts.

Services provided by X with respect to the common property it owns include:

1. Road maintenance and snow plowing;
2. Maintenance of trees, shrubs and open green space areas;
3. Provision of numerous recreational programs;
4. Maintenance of parks, lakes, and other recreational facilities.

X states that the great preponderance of its common areas and facilities are open and available to the general public-at-large. Such properties consist of lakes and parks known as A, B, C, and D, and comprise over 90% of the total acreage owned by X.. The general public participates in the following activities with respect to the above-named properties:

1. Fishing
2. Jogging on bike paths
3. Walking on bike paths
4. Biking on bike paths
5. Lawn theater concerts
6. Feeding ducks
7. Volleyball
8. Ball fields
9. Ice skating
10. Fourth of July celebration
11. Horseshoe pitching
12. Picnicking
13. Sunbathing
14. Playgrounds
15. Bird watching
16. Election polling places

Other activities sponsored by X that are open to the general public include holiday concerts in December, pre-school programs, and an ... celebration.

X owns and maintains three community centers, four swimming pools, and fourteen tennis courts, all of which are restricted to some extent in their use and are not fully open to the general public. X states that these properties comprise less than 10% of the property it owns and maintains.

LAW:

Section 501(c) (4) of the Code provides for exemption from federal income tax for an organization that is not organized for profit and is operated exclusively for the promotion of social welfare.

Section 1.501(c) (4)-1 (a) (2)(i) of the Federal 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.

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 nonresidential, 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 satisfy the following requirements: (1) It 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. 80-63, 1980-10 I.R.B. 7, clarifies Rev. Rul. 74-99. It answers in the negative whether Rev. Rul. 74-99 contemplates that the term 'community' embraces a minimum area or a certain number of homeowners. It also answers in the negative whether a homeowners' association, which represents an area that is not a community, qualifies for IRC 501(c)(4) exempt status if it restricts the use of its recreational facilities, such as swimming pools, tennis courts, and picnic areas, to its members.

Section 511 (a)(1) of the Code imposes a tax on the unrelated business taxable income of organizations described in section 501(c) of the Code.

Section 1.513-1 (a) of the Income Tax Regulations defines the term 'unrelated business taxable income' as the gross income derived from any trade or business regularly carried on by an exempt organization which is not substantially related (aside from the need of the organization for funds) to the exercise of the exempt function of that organization.

Section 1-513-1(d)(1) of the regulations provides that gross income derives from 'unrelated trade or business,' within the meaning of Code section 513(a), if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purposes for which exemption is granted. The presence of this requirement necessitates an examination of the relationship between the business activities which generate the particular income in question--the activities, that is, of producing or distributing the goods or performing the services involved--and the accomplishment of the organization's exempt purposes.

Section 1.513-1(d)(2) of the regulations provides that trade or business is 'related' to exempt purposes, in the relevant sense, only where the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than through the production of income); and it is "substantially related," for purposes of section 513 of the Code only if the causal relationship is a

substantial one. Thus, for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes. Where the production or distribution of the goods or the performance of the services does not contribute importantly to the accomplishment of the exempt purposes of an organization, the income from the sale of the goods or the performance of the service does not derive from the conduct of related trade or business. Whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances involved.

RATIONALE:

1. Whether X meets the requirements of Rev. Rul. 74-99 as a homeowners' association and otherwise qualifies for exempt status under section 501(c) (4) of the Code.

X contends that substantially all its common areas and facilities are for the use and enjoyment of the general public, and therefore, since it substantially complies with the requirements of Rev. Rul. 74-99, it should retain its exempt status under section 501 (c) (4) of the Code.

The general public is permitted to utilize common areas or facilities on land comprising over 90% of the total acreage owned by X. Most of the activities available are of a "free nature," that is, people do things at their own time and pace to meet individual needs and without any charge. These activities include picnicking, biking, jogging, walking, sunbathing, horseshoe pitching, fishing, etc. In addition, X estimates that the 1978 Fourth of July celebration attracted ... people; the ... celebration-... , the summer lawn theater program-... , and the December holiday program-... .

X restricts to some extent the use of its community centers, swimming pools and tennis courts. X states that such restrictions are imposed because of health, safety, and size considerations. The three community centers are open to the general public for meetings, various social activities, and numerous cultural and recreational activities. These activities occur throughout the entire year and include programs in music and dance, arts and crafts, physical and recreational, pre-schoolers and special interest areas such as cake decorating and workshops. The centers are also used as polling places on Election Day. X states that because of size limitations, and health and safety reasons, access other than for the above kinds of activities is limited to X's members.

The total use capacity of X's swimming pools, as determined by the county health and safety requirements, is .. - persons. Because of the size limitations, and health and safety reasons, X has restricted access to these pools to its members. However, the general public does participate in many pool activities through swimming meets and special events. X's tennis courts are available only to its members. We feel that X meets the requirement of Rev. Rul. 74-99 that it must serve a "community." Whether 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. See Rev. Rul. 80-63. Here, X serves the community of Y which has a current population of.... It appears that Y is operated in a manner similar to a township.

We also feel that X meets the requirement of Rev. Rul. 74-99 that the common areas or facilities it owns and maintains must be for the use and enjoyment of the general public. Rev. Rul. 80-63 holds that a homeowners' association, which represents an area that is not a community, does not qualify for

exemption under section 501 (c)(4) of the Code if it restricts the use of its recreational facilities to its members. Therefore, if a homeowners' association represents an area that is a community, it can be inferred from Rev. Rul. 80-63 that it can restrict the use of its recreational facilities to members. X represents an area that is a community. The general public is permitted to utilize X's common areas and facilities except for some restrictions to its community centers, swimming pools, and tennis courts. Based on the circumstances of this case, we feel that X meets the requirements of Rev. Rul. 74-99 and 80-63. Limited non-public access should not be fatal to section 501(c)(4) exemption when considered in relation to the overall activities and services provided by X vis-a-vis the public-at-large and the community which it serves.

2. Whether the accounting, management and grass cutting services are includible in the computation of unrelated business income.

X contracts with the various local homes corporations and condominiums within Y for certain management, accounting and maintenance services. More specifically, X handles assessment billing and collection, banking, financial statements, related administration services, grass cutting of common areas, and maintenance of master television antennae.

The purpose of X is to promote the health, safety, and welfare of the residents of Y and to enforce any and all covenants, restrictions, and agreements applicable to Y This purpose is similar to the purpose of the organization that was held to be exempt under section 501 (c)(4) of the Code in Rev. Rul. 74-99: '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.' X achieves its exempt purposes, in part, by performing the accounting, management and maintenance activities. We think It can reasonably be said that the performance of such activities contributes importantly to the accomplishment of X's exempt purposes.

CONCLUSIONS:

X is entitled to retain its status as exempt from federal income tax under section 501(c) (4) of the Code. Income from the performance of accounting, management and grass cutting services is not subject to the tax on unrelated business income imposed by section 511.

Note:

Note that this private letter ruling held: "Limited nonpublic access should not be fatal to Section 501 (c) (4)exemption when considered in relation to the overall activities and services provided. . ."

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.