

Tax Issues Facing Homeowners' Associations: Forms 1120-H, 1120, 1120-C and 990

TUESDAY, OCTOBER 27, 2020, 1:00-2:50 pm Eastern

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-Call Strafford Customer Service 1-800-926-7926 x1 (or 404-881-1141 x1)

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FOR LIVE PROGRAM ONLY

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TAX ISSUES FACING HOMEOWNER ASSOCIATIONS

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What is an HOA?

A form of privately owned real estate interests that also includes commonly owned property. Different types of associations represent different legal structures that determine how the commonly owned real estate is held. These different legal structures determine taxability of certain transactions. The three forms of legal structures are:

- Condominium associations
- Property owner associations
- Cooperative associations

What is an HOA?

Condominium associations - Title to common property is held in common by the condominium members. Only under extremely rare circumstances does the association have title to common property. Members typically hold title only to the airspace defining their “unit.” This impacts how real estate transactions are recognized for tax purposes.

What is an HOA?

Property owners association - Title to common property is held by the association. Members hold title to their own separate real estate parcels.

Cooperative associations - Title to all real estate is held by the association. Members generally have either membership shares or leases that define their “unit.”

Overview of possible tax filing methods

- Form 1120 as nonexempt membership organization
- Form 1120-C as nonexempt cooperative organization
- Form 1120-H as (partially) exempt homeowners association
- Form 990 as exempt organization under IRC 501(c)(3)
- Form 990 as exempt organization under IRC 501(c)(4)
- Form 990 as exempt organization under IRC 501(c)(7)
- Form 990 as exempt organization under IRC 501(c)(12)

Form 1120

- IRC 277 - Mandatory application for nonexempt membership organizations
- Treasury Regulations 1.277-1T
- IRC 118 - Capital reserves excluded from gross income
- Revenue Ruling 70-604
- Revenue Ruling 75-370
- Revenue Ruling 75-371
- High Tax Risk
- IRS tax audit activity

Treasury Regulations 1.277-1T

Member. The term “member” means any person (including the dependents, as defined in §1.152-1, **and guests**, as defined in §1.512(a)-3(c)(2)(iii)(b), of such a person) who has the privilege by reason of payment of dues or otherwise to obtain from the membership organization services, facilities, insurance, goods, or other items of value on a mutual, cooperative, or similar basis **whether or not such person owns stock in the organization or holds a certificate of membership and whether or not such a person is entitled to participate in the management of the organization.**

Treasury Regulations 1.277-1T

Net membership income. If for any taxable year membership income (determined under subparagraph (2) of this paragraph) exceeds membership deductions (determined under subparagraph (6) of this paragraph), **the taxable income of a membership organization for such taxable year is the excess of the organization's total gross income over its total deductions**

Treasury Regulations 1.277-1T

Net membership loss. If for any taxable year a membership organization has sustained a net membership loss (membership deductions exceed membership income), the taxable income of the organization for such taxable year is the excess of its nonmembership income (determined under subparagraph (4) of this paragraph) over its nonmembership deductions (determined under subparagraph (7) of this paragraph). **A net membership loss is not deductible in the taxable year in which it is incurred, but may be carried over to succeeding taxable years in the manner provided by paragraph (e) of this section.**

Treasury Regulations 1.277-1T

Change of status. If in any taxable year a membership organization ceases to operate as such an organization (as defined in paragraph (b)(1) of this section), a net membership loss sustained by such an organization in a prior taxable year may not be carried over to such a taxable year.

Treasury Regulations 1.277-1T

Net operating loss. Any amount treated as a net membership loss under section 277 and this section shall not qualify as a net operating loss (as defined in section 172(c)) and shall not be allowed as a net operating loss deduction in any year.

Revenue Ruling 70-604

- How should HOAs handle over-assessments?
- When to make the election
- Who makes the election?
- How to make the election
- Election options
 - Refund to members
 - Apply to following year assessment
- “Completing” the election
- Planning opportunities

Commercial Associations

- MUST file Form 1120
- Can Association make an Election under Rev Rul 70-604?
- Member deduction of assessments?
- Treatment of Association capital expenditures
- Pass through of Association deductions?

Form 1120-c Cooperative Organizations

- **Subchapter T of Code** - IRC sections 1381 - 1388
Mandatory application
- **Trump Village Section 3** - Established that Subchapter T precedes and pre-empts IRC 277
- **Puget Sound Plywood** - Established principles of operating on a cooperative basis
 - Subordination of capital
 - Democratic control
 - Sharing of fruits and increases

Form 1120-H Homeowner Associations

- Making the election - Timely filing of Form 1120-H
- Qualifying tests
 - 60% of revenue test
 - 90% expenditure test
 - 85% Residential test - Definition of association property
 - Inurement test
- Revoking the election
- Low tax risk
- When should an HOA file an 1120 versus an 1120-H?

Applying for Tax Exempt Status

- Form 1023 - For IRC 501(c)(3)
- Form 1024 - For IRC 501(c)(7) or 501(c)(12)
- Form 1024-A - For IRC 501(c)(4)

Form 1023 - Associations under IRC 501(c)(3)

- Very few qualify
- Must provide benefit to the public
- Relatively easy for 501(c)(4) associations to establish an additional 501(c)(3) organization
- File Form 1023 to apply for exempt status
- IRS “grants” exempt status

Form 1024 - Associations under IRC 501(c)(7)

- Must provide social or recreational activities for members
- Why most associations fail to qualify
 - A. Architectural controls
 - B. Roads serving private residences
- Limitations on Investment and nonmember income
- File Form 1024 to apply for exempt status
- IRS “recognizes” exempt status
- May “self-declare” exempt status

Form 1024 - Associations under IRC 501(c)(12)

- Must provide water services for members
- Very few associations qualify
- File Form 1024 to apply for exempt status
- IRS “recognizes” exempt status
- May “self-declare” exempt status

Form 1024-A - Associations under IRC 501(c)(4)

- File Form 1024-A to apply for recognition of exempt status
- IRS “recognizes” exempt status
- May “self-declare” exempt status
- Must provide benefit to a community
- What is a “community?” What is the “general public?”
- Public access - how much is enough?
- Gated associations

Form 1024-A – Important Tax Citations

- IRC 501(c)(4)
- Treasury Regulations 1.501(c)(4)
- Revenue Ruling 74-99
- Revenue Ruling 80-63
- Treasury Regulations 1.337-d(4)
- Rancho Santa Fe Association
- Flat Top Lake Association
- Ocean Pines Association

Form 1024-A – Other Considerations

- Refund claims for prior year taxes paid
- IRC 6033(j)
- Revenue Procedure 2019-5
- Amending prior forms 1120 or 1120-H
- Filing Form 990 for prior years

Form 1024-A – Discussion Items

- Which HOAs should consider applying for tax-exempt status?
- What is exempt income?
- What income is considered non-exempt?

Questions???

- What is association property?
- May an exempt association restrict access to recreation areas?
- How do timeshare associations figure in?
- What are fractional ownership associations?
- Can master associations elect IRC 528?
- More?