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Serving Homeowners Associations, Condominiums and Cooperatives Since 1974

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Complexities of Community Association Taxation

Each year, condominiums, homeowners associations and housing cooperatives must file income tax returns. Commercial condominiums, housing cooperatives and homeowners associations with specific non-profit tax status must file using certain methods, which are discussed later. Most condominiums and homeowners associations can select each year from one of two methods – the corporate method (IRC Section 277, Form 1120) and the exempt method (IRC Section 528, Form 1120-H) – and many factors go into determining which method is best for the Association.

Corporate Method (IRC Section 277, Form 1120) - This method is for membership organizations, not just condominiums or homeowners associations. This method represents more risk and is more complex for tax planning because, under this method, all of the Association's income is potentially taxable. Under this method, the Association separates its membership income and expenses from the non-membership income and expenses. Membership income would be assessments and other income from members. Examples of non-membership income would be interest income and rental income. The Association only pays taxes on the non-membership income. In addition to any state taxes, the federal tax rate is graduated, starting at 15% for the first $50,000 of taxable income. There are many factors that must be considered when this method is used, including the Association's

replacement reserve program, if membership income exceeds membership expenses and decisions the Association has made during the year regarding any excess membership income.

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Has Your Association Received Income from an Easement?

There are different types of easement income and this income is potentially taxable for associations. There are temporary construction easements, where a local jurisdiction temporarily needs to use the Association's property for constructing street lights, traffic signals or road widening. Sometimes the easements are permanent because the street lights or traffic signals will be permanently installed on the Association's property or the Association's property will be taken to use for the road widening. If your Association has received easement income, please contact our office. Decisions the Association makes can impact on the tax treatment of this type of income and can save the Association thousands of dollars in income taxes. It is important for the Association to know what options are available as early as possible.

Complexities of Community Association Taxation – *continued*

Exempt Method (IRC Section 528, Form 1120-H) - This method is specifically for homeowners associations, but residential condominiums may also file using this method. The Association's income and expenses are tested to determine if the Association qualifies to file under this method. Income from members (called exempt function income under this method) is not taxable. Only income from non-members (called non-exempt function income) is taxable. Interest income and rental income would be two examples of taxable income under this method. While this method represents less risk to the Association, the federal tax rate is higher, at a flat 30% rate.

Some homeowners associations have obtained tax-exempt status with the IRS (IRC Section 501 (c)(4)). These associations must file as a non-profit organization using Form 990.

Housing cooperatives must file under IRC Subchapter T (Form 1120-C), which is specifically for cooperatives. Under this method, income and expenses are divided between patronage (income from members) and non-patronage. The Cooperative pays taxes on non-patronage income. One interesting fact about this method is that interest income generated on replacement reserves is generally considered patronage income and is not taxable.

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