Internal Revenue Service

District
Director

Department of the Treasury

1100 Commerce St., Dallas, Texas 75242

Date: JAN 19 [redacted]

[redacted]

Person to Contact:
[redacted]

Telephone Number:
[redacted]

Refer Reply to:
[redacted]

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under section 501(c)(4) of the Internal Revenue Code.

The information you submitted indicates that you were incorporated [redacted], under the [redacted] Non-Profit Corporation Act. Your purposes, as stated in your Articles of Incorporation, are "to provide for maintenance, preservation and architectural control of the residential lots within [redacted], [redacted]"....."or any other areas created by the dedication of additional property to the subdivision by the developer and to promote the health, safety and welfare of the residents within the above-described property and any additions thereto as may hereafter be brought within the jurisdiction of the Association for this purpose....." The Articles of Incorporation were restated [redacted], with no material changes to the purposes of the organization.

Your application states that the organization (a) maintains and landscapes esplanades, entrances, setbacks and medians and common areas; (b) provides pest control for mosquitoes; (c) maintains and operates a swimming pool; (d) contracts for additional security services with [redacted]; (e) contracts with [redacted] to provide lighting to all common areas within the subdivisions; (f) enforces covenants and deed restrictions; and (g) provides and maintains a park and playground, volleyball and basketball courts, and a recreation center. The application states that the facilities are available to all members of the community and, "realistically does not restrict access to the general public."

[redacted] is a single-family residential development, located within the city limits of [redacted]. The development is served by [redacted]. Your application indicates that access to the development is restricted by gates and security guards, as evidenced by your contract for services with [redacted].

The organization is supported through member assessments, joint-use receipts, and interest income. Your application states that the association does not charge members separately for services performed and that the amounts are budgeted and included in annual assessments. Unpaid assessments will result in a lien on the property of the homeowner-member. No member may waive or otherwise escape liability for the assessments.

[redacted]

Your letter of [redacted] states that the Association owns the pool and other recreational assets; however the valuations of these assets are not reflected on the financial statements in accordance with generally accepted accounting principles. You have cited the Audit and Accounting Guide for Common Interest Realty Associations published by the American Institute of Certified Public Accountants, specifically Sections ..09 and ..10. These sections do not provide specific recommendations or guidelines but rather describe the prevalent industry practices followed by Common Interest Realty Associations (CIRAs) for recognizing common real property as assets. The financial statements of the Association indicate that the organization has chosen not to follow the guidelines of Sections 2.11, Personal Property, and ..13, Disclosure.

Section 501(c)(4) of the Internal Revenue Code provides exemption for:

> Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare...

Section 1.501(c)(4)-1(a)(2)(i) of the 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. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterment and social improvements."

> "(a)(1) In general. A civic league or organization may be exempt as an organization described in section 501(c)(4) if -

> (i) It is not organized or operated for profit; and

> (ii) It is operated exclusively for the promotion of social welfare."

Revenue Ruling 72-102, 1972-1, C.B. 149, describes an organization formed by a developer to preserve the appearance of a housing development and to maintain streets, sidewalks, and common areas for the use of the residents, which was found to be exempt under Internal Revenue Code section 501(c)(4). The rationale behind this decision was that the organization served the common good and general welfare of the entire community because it owned and maintained certain non-residential, non-commercial properties of the type normally owned and maintained by municipal governments. Administering and enforcing covenants for preserving the architecture and appearance of a housing development was incidental to the overriding public benefit.

Revenue Ruling 74-99, 1974-1, C.B. 131, clarifies Revenue Ruling 72-102. This ruling describes an organization that is formed by a commercial real estate developer as an integral part of a plan for the development of a subdivision. Membership in the association is required of all purchasers of lots in the development. Membership is open only to the developer and those who purchase lots. The organization is supported by periodic assessments of the members, and unpaid assessments will result in a lien on the property of the homeowner-member. The stated purposes of the organization are 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,

[redacted]

and sidewalks. The foregoing format is spelled out in written documents which form a part of, and are inextricably tied to, enforceable contracts for the sale and purchase of private property. In light of these factors, the prima facie presumption was that organizations such as these were essentially and primarily formed and operated for the individual business and personal benefit of their members, and, as such, did not qualify for exemption under section 501(c)(4) of the Code. Revenue Ruling 74-99 went on to describe how, in certain circumstances, an organization can overcome this presumption and qualify for recognition of exemption under section 501(c)(4).

In Rancho Santa Fe Association v. U.S., the development was found to be coextensive with the community it served, and therefore, the benefits bestowed by the association on the development benefit the general public within the requirements of the statute. Exemption under section 501(c)(4) was recognized.

In Flat Top Lake Association, Inc. v. U.S., the court held that while the homeowners association did confer benefits of a public welfare nature upon its own members, it did not provide tangible and concrete benefits of a public welfare nature to the public at large or a definable community. The association's property and facilities were limited to members and their guests. Exemption under section 501(c)(4) was denied.

Revenue Ruling 80-63, 1980-1 C.B. 116, states that a homeowners association that is not a community does not qualify for exemption under section 501(c)(4) if it restricts the use of its recreational facilities to members of the association.

Based on the information presented, we have concluded that you do not meet the requirements for exemption as a social welfare organization described in section 501(c)(4) of the Internal Revenue Code. As in Flat Top Lake Association, Inc., and as stated in your Articles of Incorporation, serving the private interests of your homeowner-members and promoting the health, safety and welfare of these members is your primary purpose. You do not possess the characteristics described in Revenue Ruling 74-99 to overcome the presumption of private benefit.

Unlike Rancho Santa Fe Association, your area is not coextensive with the community you serve. You are a subdivision within the city limits of [redacted]. [redacted] served by [redacted]. The fact that you are adjacent to other subdivisions and share recreational facilities supports this conclusion. Additionally, the Association does not oversee governance of the development, but contracts for these services with a management company.

As stated in Revenue Ruling 80-63, an organization that is not a community may not be exempt if it restricts the use of its recreational facilities and other areas to members of the association. Your facilities and other areas are restricted to members and their guests.

Accordingly, it is held that you are not entitled to exemption from Federal income tax as an organization described in section 501(c)(4), and you are required to file Federal income tax returns on Form 1120.

As a homeowners association, you may qualify for treatment under section 528, a

[redacted]

section of the Code created by the Tax Reform Act of 1976. In this letter we are not ruling on the question of whether you qualify for treatment under section 528. However, if you believe you qualify for such treatment, you should file Form 1120-H when due.

If you do not agree with these conclusions, you may, within 30 days from the date of this letter, file in duplicate a brief of the facts, law, and argument that clearly sets forth your position. If you desire an oral discussion of the issue, please indicate this in your protest. The enclosed Publication 892 gives instructions for filing a protest.

If you do not file a protest with this office within 30 days of the date of this report or letter, this proposed determination will become final.

If you agree with these conclusions or do not wish to file a written protest, please sign and return Form 6018 in the enclosed self-addressed envelope as soon as possible.

If you have any further questions, please contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely,

[redacted]

[redacted]
District Director

Enclosures:
Publication 892
Form 6018