

INTERNAL REVENUE SERVICE

DEPARTMENT OF THE TREASURY

10 MetroTech Center

625 Fulton Street

Brooklyn, NY 11201

Number: **200531026**

Release Date: 8/05/2005

TE:GE:EO

UIL: 501.07-00

Date: February 14, 2005

Legend:

X = Organization

D = Date of Revocation

P = Audit Period

Person to Contact:

Identification Number:

Contact Telephone Number:

In Reply Refer to: TE/GE Review Staff

EIN:

Dear \_\_\_\_\_ :

This is a Final Adverse Determination as to your exempt status under section 501(c)(7) of the Internal Revenue Code.

Our adverse determination was made for the following reasons:

“X” fails to meet the requirement for exemption under 501(c)(7). IRC 501(c)(7), as changed by the Tax Reform Act of 1969 provides for the exemption of clubs organized and operated for pleasure, recreation, and other non-profitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

As a result of a recent examination of your organization’s activities and Form 990 for the period ended “P”, it was determined that the organization administers and enforces homeowner’s restrictions for preserving the architecture and appearance of the housing development. Your organization has the authority of a homeowner’s association with the right to design the streets, as well as limit the height, size and exterior appearance of the residences. Revenue Ruling 75-494, 1975-2 CB 214, holds that a club that administers and enforces covenants for the preservation of the architecture and appearance of the housing development is not operated exclusively for pleasure, recreation and other non-profitable purposes as required by section 501(c)(7) of the Code.

Based on the above, we are revoking your organization's exemption from Federal Income Tax under section 501(c)(7) of the Internal Revenue Code effective “D”.

You are required to file Federal Income Tax returns on Form 1120-H. These returns should be filed with the appropriate Service Center for all years beginning after “P”. You have executed the Form 6018 agreeing to this revocation.

You are required to file Form 1120-H, U.S. Income Tax Return for Homeowner Associations. If the association does not elect to use Form 1120-H, it must file the applicable income tax return (Form 1120, etc.). Form 1120-H must be filed by the 15<sup>th</sup> 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: Internal Revenue Service, Office of the Taxpayer Advocate.

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 yours,

R. C. Johnson  
Director, EO Examinations

12 pages



DEPARTMENT OF THE TREASURY  
Internal Revenue Service

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone: (

Fax:

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear

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.

Letter 3610 (04-2002)  
Catalog Number 34801V

R1-1

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,

R. C. Johnson  
Director EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Form 6018  
Report of Examination  
Envelope

Form 886-A  
(REV. JAN. 1994)

EXPLANATION OF ITEMS

SCHEDULE NUMBER OR  
EXHIBIT

NAME OF TAXPAYER

YEAR/PERIOD ENDED

**Issue:** Does an organization that is both a Homeowner's Association and a Pool Association continue to qualify under section 501(c)(7) and can that organization be changed to qualify under section 501(c)(4).

**Facts:**

was incorporated in the State of on February 5<sup>th</sup>. was originally organized on March 10, . In February, decided the pool association property over to the homeowners association. On August 4, was granted exempt status as an organization described in section 501(c)(7) of the Internal Revenue Code. In the application for exemption, clearly showed that they were a homeowner's association who owned a swimming pool, tennis court and greens that were being maintained by the homeowner's association.

On December 21, the Board of Directors for the net and on December 27, he Board of Directors of the met at separate meetings. Both Boards approved a proposed plan of merger between the two associations. On January 24, members of both associations approved the actions of their respective Boards of Directors. The Articles of Merger were filed and Certificate of Merger was issued on April 19, with being the surviving corporation. These amendments appear to never have been filed with the Internal Revenue Service.

In the monthly board meeting minutes for January, March and April the association is enforcing the homeowner's restrictions. Two homes were found to violate homeowner's restrictions pertaining to trailers in driveways or yards, and one home was found to have incomplete painting after more than 12 months. During the same time frame, the association operated a members only club with property which included a pool, club house and greens (the same property that was being maintained when they were initially approved for their exemption).

**Law:**

Section 501(c)(7) of the Code provides for exemption from Federal income tax of clubs organized and operated exclusively for pleasure, recreation, and other non-profitable purposes providing no part of the net earnings inures to the benefit of any private shareholder. A club otherwise entitled to exemption will not be disqualified because it raises revenue from members through the use of club facilities or in connection with club activities. Internal Revenue Manual sub section 4.76.16.4 does allow for the membership to be restricted to homeowners in a specific housing development.

Revenue Ruling 75-494, 1975-2 CB 214, (January 01, 1975) outlines the qualifications required in order to be classified as a social club. Question 2 of the ruling asks will a club fail to qualify for exemption under section 501(c)(7) of the Code if it administers and enforces covenants for preserving the architecture and appearance of the housing development. The answer was yes, a club which administers and enforces covenants for the preservation of the architecture and appearance of the housing development is not operated exclusively for pleasure, recreation, and other non-profitable purposes as required by section 501(c)(7) of the Code.

Revenue Ruling 80-63, 1980-1 CB 116, (Jan. 01, 1980) clarifies Revenue Ruling 74-99. The Internal Revenue Service has received several inquiries asking whether the conduct of certain activities will affect the exempt status under section 501(c)(4) of the Internal Revenue Code of otherwise qualified homeowners' associations.

Section 501(c)(4) of the Code provides for exemption from federal income tax of 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 for the purpose of bringing about civic betterments and social improvements.

Form 886-A (REV. JAN. 1994)	<b>EXPLANATION OF ITEMS</b>	SCHEDULE NUMBER OR EXHIBIT
NAME OF TAXPAYER		YEAR/PERIOD ENDED

Revenue Ruling 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 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.

Revenue Ruling 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, 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.

May a homeowners' association, which represents an area that is not a community, qualify for exemption under section 501(c)(4) of the Code if it restricts the use of its recreational facilities, such as swimming pools, tennis courts, and picnic areas, to members of the association? No. Rev. Rul. 74-99 points out that the use and enjoyment of the common areas owned and maintained by a homeowners' association must be extended to members of the general public, as distinguished from controlled use or access restricted to the members of the association. For purposes of Rev. Rul. 74-99, recreational facilities are included in the definition of "common areas".

Can a homeowners' association establish a separate organization to own and maintain recreational facilities and restrict their use to members of the association? Yes. An affiliated recreational organization that is operated totally separate from the homeowners' association may be exempt. See Rev. Rul. 69-281, 1969-1 C.B. 155, which holds that a social club providing exclusive and automatic membership to homeowners in a housing development, with no part of its earnings inuring to the benefit of any member, may qualify for exemption under section 501(c)(7) of the Code.

In *Flat Top Lake Association v. United States*, 868 F.2d 108 (4<sup>th</sup> Cir. 1989), the court concluded that a homeowners' association that encompassed a very large area but restricted use of its facilities to its members does not qualify for exemption under IRC 501(c)(4).

#### Government's Position:

Based on the Revenue Rulings and court case cited above, qualify for exemption under either section 501(c)(4) or 501(c)(7).

as it is presently constituted does not

#### Conclusion:

The organization does not continue to qualify for exemption as an organization described in 501(c)(7) of the Internal Revenue Code. In addition, the organization does not qualify for exemption as an organization described in 501(c)(4) of the Internal Revenue Code. Thus, the exempt status of the organization can not be changed to 501(c)(4). Consequently, the organization's exempt status is being revoked effective January 1, 2003. If you agree to the above, we are requesting that either an 1120-H or an 1120 be filed for 2003. Even though Letter 361U states otherwise, please file that return with me and I will process it.

#### Organization Position:

On January 10, 2003, we received the signed Form 6018-A Consent to Proposed Action from the Tax Payer. Also received was the 1120-H prepared by the tax preparer.