



# DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

TE:GE EO Examinations  
1100 Commerce St.  
Dallas, Texas 75242

501-04.00

**Date: July 10, 2012**

Release Number: 201349018

Release Date: 12/6/2013

**LEGEND**

ORG - Organization name

XX - Date Address = address

**Taxpayer Identification Number:**

**Form:**

**Tax Year(s) Ended:**

**Person to Contact:**

**Contact Numbers:**

**Telephone:**

**Fax:**

**ORG**

**ADDRESS**

## **CERTIFIED MAIL – RETURN RECEIPT REQUESTED**

Dear :

In a determination letter dated May 30, 20XX, you were held to be exempt from Federal income tax under section 501(c)(4) of the Internal Revenue Code (the Code).

Based on recent information received, we have determined you have not operated in accordance with the provisions of section 501(c)(4) of the Code. Accordingly, your exemption from Federal income tax is revoked effective March 1, 20XX. This is a final adverse determination letter with regard to your status under section 501(c)(4) of the Code.

We previously provided you a report of examination explaining why we believe revocation of your exempt status is necessary. At this time, we informed you of your right to contact the Taxpayer Advocate, as well as your appeal rights. On June 24, 20XX, you signed Form 6018-A, Consent to Proposed Action, agreeing to the revocation of your exempt status under section 501(c)(4) of the Code.

You are required to file Federal income tax returns for the tax period(s) shown above. If you have not yet filed these returns, please file them with the Ogden Service Center within 60 days from the date of this letter, unless a request for an extension of time is granted, or unless an examiner's report for income tax liability was issued to you with other instructions. File returns for later tax years with the appropriate service center indicated in the instructions of those returns.

You have the right to contact the Office of 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 a 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 contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely yours,

Nanette M. Downing,  
Director, EO Examinations

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Name of Taxpayer ORG. (EIN)		Year/Period Ended 02/28/20XX

**LEGEND**

ORG - Organization name      EIN - ein      XX - Date      Address - address  
 State - state      Estate - estate      Property - property      County - county  
 District - district      Treasurer - treasurer      RA-1 - 1<sup>st</sup> RA

**ISSUE:**

1. Whether ORG (ORG) is exempt from federal income tax under IRC 501(c)(4)?
2. Whether ORG qualifies as an exempt homeowners' association under IRC 528?

**FACTS:**

ORG is a homeowners' association recognized as an exempt organization under IRC 501(c)(4).

Since ORG had not filed an information return for numerous years, it received notice from the IRS dated 09/05/XX that its exempt status was inactive or had been terminated. On 05/30/XX ORG received notice from the IRS that a determination letter was issued in October 19XX that recognized it as exempt from Federal income tax and that it is currently exempt under section 501(c)(4) of the Internal Revenue Code.

The purposes of ORG, as set forth in its' Articles of Incorporation, are:

1. To promote and engage in programs for the recreation, welfare and education of the members and their families;
2. To do all acts and things needful and necessary to accomplish the aforesaid; and
3. To buy, hold, receive, sell, lease, mortgage and deal in all property, both personal and real that may be deemed necessary to promote our purposes.

Income received by the organization is primarily from dues and fees from members who own lots within and the ORG community. Expenses for the year include: insurance, lawn care, maintenance, utilities, publication of its community newsletter, bank fees, picnics & socials, meeting expenses, accounting and legal fees and charitable contributions.

Review of ORG's books and records identified the following information regarding use of its common areas:

**ORG Handbook & Directory -**

- The ORG Handbook & Directory (updated March 20XX) states that the community owns six pieces of property in ORG. They include "Property," two parcels of the Dock area, the ravine and marsh area where Address stops and starts up again, a narrow strip of land at the end of ORG Estates sign. The Community Association maintains these community areas. (Section 4, page 2)

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- ORG properties follow covenants that are a part of your deed and restrict the use of property for the benefit of the community. (Section 4, page 3)
- When locked, the gates at the Dock, Property and the lot at the end of Address have been very effective in discouraging trespassers. For this reason, it would be GREATLY appreciated if you would lock the gates once you are inside, again when you leave, and any time you see a gate left open. Keys to the gates are available from the ORG Treasurer. If your ORG dues are current, there is no charge for the first key. A second key will cost \$ Any additional keys beyond the second will cost \$ each." (Section 4, page 5)

#### **Board Meeting Minutes -**

- **April 26, 20XX** - "Concern has been voiced about trespassing at the dock area and tennis courts. The neighbor woke up and saw a roaring fire at the boat ramp area, she called the fire department and the police. Non-residents are using the area. It was suggested that we will give a key and a list of all the people living here to RA-1, who will have some of his Officers patrol the area and park in the dock area. The Officers will question everyone using our community property."
- **May 24, 20XX** - "Enhancement of security against trespassers on ORG property was suggested by County Police as follows:
  - Move no-trespassing sign at dock area to more visible location or add additional sign.
  - Add no-parking signs along road by tennis court to discourage some trespassers from parking there and to give police a reason to initiate conversation those parked there.
  - Advise all ORG members to obtain and use their ORG bumper sticker to let police know they are authorized to use ORG properties."

#### **"To Property" Newsletters -**

- "Persons who do not live in ORG have been enjoying the beautiful properties at the dock and Property. When asked to leave, some do, and others come back – even after dark. The Board has placed a letter on file with the District of the County Police authorizing them to enter our properties to remove persons not authorized to use them. The police will call one of the Board members to identify whether the persons are residents or non-residents. If legal action is necessary, one of the Board members will be available to testify if needed, but the police are very willing to assist us in this matter."
- "To assist the police in patrolling our properties, and to avoid embarrassment of our good residents, please note that it is very important for all residents to have a ORG bumper sticker on all their vehicles. These are available at no cost, other than being a ORG member in good standing, from Treasurer, Treasurer. If the police do not see a ORG sticker on a vehicle parked at or near the dock, tennis court or point, they will assume there are trespassers involved. Not having the ORG bumper sticker offers the police an opportunity to open conversation and ultimately determine whether the persons are on the property legally or not."
- "In case you haven't noticed, the gate and fence have been replaced at Property and the locks at both Property and boat dock have been repaired/replaced."
- "Members of the ORG Association, in good standing, are entitled to ORG Bumper stickers and keys to the gates at the dock and Property. These are available from our treasurer, Treasurer. The first key is free, the second is \$ and the third or more are all \$ each. The ORG bumper stickers are free and are important if using the dock area or parking along the

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road adjacent to either the dock or Property since they identify the vehicle as belonging to a ORG member. The Board has officially authorized the County Police to assist in the control of non-resident trespassers and the absence of a ORG bumper sticker will initiate a conversation by the police to determine if the owner should not be using the property. Vehicles with ORG stickers will not be questioned and will therefore save the officer's and your time. It is suggested that you obtain stickers for all your vehicles, your boat and trailer. Please make the effort to obtain the stickers and keys at your earliest convenience."

**Correspondence –**

- In a letter issued to the County Police Department, District Station (June 7, 20XX), the organization "requests assistance, as required, for the removal of illegal trespassers on ORG Association property. The two properties that attract the most trespassers are the dock/tennis court area and the beach/picnic area at the east end of Address. We will continue to ask trespassers to vacate the areas whenever we see them. We have problems with repeat offenders who return after dark as well as during the day. We have asked all association members to place an issued blue 'ORG' bumper sticker on each of their cars for identification as residents who may be parked on or near the properties and who are legally using the properties. Vehicles without the 'ORG' sticker can reasonably be suspect as trespassers. While there are "No Trespassing" and "No Parking" signs at these locations, some will be moved and others added to make them more visible to all."

**LAW:**

**IRC 501(c)(4)(A)** provides for the recognition of exemption from federal income tax of civic leagues or organizations not organized for profit, but operated exclusively for the promotion of social welfare.

**IRC 501(c)(4)(B)** states that subparagraph (A) shall not apply to an entity unless no part of the net earnings of such entity inures to the benefit of any private shareholder or individual.

**Tax Reg. 1.501(c)(4)-1(a)(1)** provides that a civic league or organization may be exempt as an organization described in section 501(c)(4) if it is not organized or operated for profit and it is operated exclusively for the promotion of social welfare.

**Tax Reg. 1.501(c)(4)-1(a)(2)(i)** provides, in part, 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 betterments and social improvements.

**Tax Reg. 1.501(c)(4)-1(a)(2)(ii)** states, in part, that an organization is not operated primarily for the promotion of social welfare if its primary activity is operating a social club for the benefit, pleasure, or recreation of its members, or is carrying on a business with the general public in a manner similar to organizations which are operated for profit.

In **Rev. Rul. 72-102, 1972-1 CB 149**, it is stated that a nonprofit organization formed to preserve the appearance of a housing development and to maintain streets, sidewalks, and

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common areas for use of the residents is exempt under section 501(c)(4). The organization described is a membership organization that was formed by a developer and is operated to administer and enforce covenants for preserving the architecture and appearance of a housing development, and to own and maintain common green areas, streets, and sidewalks for the use of all development residents. Prospective home buyers are advised that membership in the organization is required of all owners of real property within the housing development. The organization is supported by annual assessments and member contributions. Its activities are for the common benefit of the whole development rather than for individual residents or the developer. Further stated, for the purposes of section 501(c)(4) of the Code, a neighborhood, precinct, subdivision, or housing development may constitute a community.

**Rev. Rul. 74-99, 1974-1 CB 131**, which modifies Rev. Rul. 72-102, provides that a homeowners association, to qualify for exemption under section 501(c)(4) of the Code,

- (1) 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.

Revenue Ruling 74-99 also states that Revenue Ruling 72-102 "...was intended only to approve ownership and maintenance by a homeowners' association of such areas 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, as distinguished from controlled use or access restricted to the members of the homeowners' association...."

In Flat Top Lake Association, Inc. Plaintiff v. United States of America, Defendant, 86-2 USTC it is held that "A homeowners' association was not entitled to exempt status as a civil league or organization under Code Section 501(c)(4). The association did not provide benefits of a public welfare nature to the public or a definable community because the association's facilities were restricted to the use of its members."

**IRC 528** imposes a tax equal to 30% of a homeowners' association's taxable income tax for each taxable year.

**IRC 528(c)(1)** defines, in part, the term "homeowners association" as an organization which is a residential real estate management association if –

1. Such organization is organized and operated to provide for the acquisition, construction, management, maintenance, and care of association property,
2. 60 percent or more of the gross income of such organization for the taxable year consists solely of amounts received as membership dues, fees, or assessments from owners of residences or residential lots in the case of a residential real estate management association,

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3. 90 percent or more of the expenditures of the organization for the taxable year are expenditures for the acquisition, construction, management, maintenance, and care of association property,
4. No part of the net earnings of such organization inures (other than by acquiring, constructing, or providing management, maintenance, and care of association property, and other than by a rebate of excess membership dues, fees, or assessments) to the benefit of any private shareholder or individual, and
5. Such organization elects (at such time and in such manner as the Secretary by regulations prescribes) to have this section apply for the taxable year.

**Tax Reg. 1.528-2** provides that in order to qualify it must be organized and operated primarily for the purposes of carrying on one or more exempt functions of a homeowners' association. The exempt functions of a homeowners' association are the acquisition, construction, management, maintenance, and care of association property. For example, maintenance of association property includes the painting and repairing of such property as well as the gardening and janitorial services associated with its upkeep. Similarly, the term "construction" of association property includes covenants or other rules for preserving the architectural and general appearance of the area. The term also includes regulations relating to the location, color and allowable building materials to be used in all structures.

**Tax Reg. 1.528-9** provides that exempt function income consists solely of income attributed to membership dues fees or assessments of owners of residential units or lots. Examples of exempt function income provided include: removing trash, removing snow from public areas, paying principal and interest on debts incurred for the acquisition of association property, paying real estate taxes on association property, and maintaining association property.

**Tax Reg. 1.528-6** provides examples of qualifying expenditures which may be included in the computation of the 90% expenditure test. These examples include: paving of streets, street signs, security personnel, legal fees, upkeep of tennis courts, swimming pools, recreation rooms, replacement of common buildings, facilities, air conditioning, insurance premiums on association property, accounting fees, improvement of private property to the extent it is association property, real estate and personal property taxes imposed on association property by a state or local government, and both current operating and capital expenditures on association property. Qualifying expenditures do not include transfers or investments of funds to be held to meet future costs or excess assessments which are either rebated to members or applied against the members' following year's assessments.

**IRC 528(c)(3)** states that the term "residential real estate management association" means any organization meeting the requirements of subparagraph (A) of paragraph (1) with respect to a subdivision, development, or similar area substantially all the lots or buildings of which may only be used by individuals for residences.

**Tax-Reg, §1.528-1(c)** provides, in part, that residential real estate management associations are normally composed of owners of single-family residential units located in a subdivision, development, or similar area. They are commonly formed to administer and enforce covenants relating to the architecture and appearance of the real estate development as well as to perform certain maintenance duties relating to common areas.

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**IRC 528(c)(5)** states, in part, that association property includes property held by the association, property commonly held by the members of the organization and property within the organization privately held by the members of the organization.

**Tax-Reg, §1.528-3(a)** also states, in part, that "Association property" includes real and personal property owned by the organization or owned as tenants in common by the members of the organization. Such property must be available for the common benefit of all members of the organization and must be of a nature that tends to enhance the beneficial enjoyment of the private residences by their owners. If two or more facilities or items of property of a similar nature are owned by a homeowners association, and if the use of any particular facility or item is restricted to fewer than all association members, such facilities or items nevertheless will be considered association property if all association members are treated equitably and have similar rights with respect to comparable items or facilities. Among the types of property that ordinarily will be considered association property are swimming pools and tennis courts. On the other hand, facilities or areas set aside for the use of nonmembers, or in fact used primarily by nonmembers, are not association property for the purposes of this section. For example, property owned by an organization for the purpose of leasing it to groups consisting primarily of nonmembers to be used as a meeting place or a retreat will not be considered association property.

**IRC 528(d)**, for purposes of this section, defines a homeowners' association's taxable income of any organization for any taxable year as an amount equal to the excess (if any) of the gross income for the taxable year (excluding any exempt function income), over the deductions allowed by this chapter which are directly connected with the production of the gross income (excluding exempt function income), computed with modifications which include a specific deduction of \$100 and disallowance of net operating loss deductions allowed under section 172, and part VIII of subchapter B (relating to special deductions for corporations).

**IRC 528(d)(3)** states, in part, that the term "exempt function income" means any amount received as membership dues, fees, or assessments from owners of real property in the case of a residential real estate management association.

**Tax Reg, §1.528-8(a)** states that an organization wishing to be treated as a homeowners association under section 528 for a taxable year must elect to be so treated by filing a properly completed Form 1120-H (or such other form as the Secretary may prescribe). A separate election must be made for each taxable year.

**Tax Reg. §1.528-8(e)** states that if an organization is notified after the close of a taxable year that its exemption for such taxable year under section 501(a) is being revoked retroactively, it may make a timely election under section 528 for such taxable year. Notwithstanding any other provisions of this section, such an election will be considered timely if it is made within 6 months after the date of revocation. The preceding sentence shall apply to revocations made after April 18, 1980. If the revocation was made on or before April 18, 1980, the election will be considered timely if it is made before the expiration of the period for filing a claim for credit or refund for the taxable year for which it is to apply.



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**Tax Reg. §1.528-8(e)(f)** states that an election to be treated as an organization described in section 528 is binding on the organization for the taxable year and may not be revoked without the consent of the Commissioner.

**Tax Reg. 1.6012-2(a)** states that a corporation in existence during any portion of a taxable year is required to file Form 1120 return.

**TAXPAYERS POSITION:**

POSITION #1:

To be determined

POSITION #2:

To be determined

**GOVERNMENT'S POSITION:**

POSITION #1:

The limitation on access to common areas maintained by ORG solely to its membership involves primarily the exercise of private property rights for private benefit and is therefore inconsistent with community benefit. Since your recreational areas are not open for the use and enjoyment of the general public and are carried on for the limited benefit of your members and their guests, you are, therefore, operating for the private benefit of your members, and not for the benefit of the general welfare of a community. Therefore, you do not qualify for exemption from Federal income tax as an organization described in section 501(c)(4) of the Code.

POSITION #2:

Since ORG does not qualify for exemption under IRC 501(c)(4), consideration for qualification as a non-exempt homeowners' association under IRC 528 was made. In order to meet requirements under this code section, an organization must meet five requirements two of which include: % or more of the organization's gross income for the taxable year must consist solely of amounts received as membership dues, fees, or assessments and % or more of expenditures for the taxable year are for the acquisition, construction, management, maintenance, and care of association property. In the tax period ending February 20XX, ORG received % of its income from membership dues and fees and thus meets the income requirement. However, only % of ORG's expenses were used for the acquisition, construction, management, maintenance, and care of its properties. As a result, ORG does not meet the requirements under IRC 528 for the taxable fiscal year ending February 20XX. (Refer to Exhibits 1-1 and 1-2 attached).

**CONCLUSION:**

POSITION #1:

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Beginning with fiscal year ending February 29, 20XX, ORG shall be revoked as an organization exempt from income tax under IRC 501(c)(4), social welfare and civic league organizations.

POSITION #2:

ORG does not qualify as a homeowner's association under IRC 528 because it does not meet the % expenditure requirements as set forth under IRC 528(c)(1). Therefore, ORG will be required to file Form 1120, U.S. Corporation Income Tax Return.