

EXCESS INCOME AND TAXES GARY PORTER CPA

<https://www.garyportercpa.com/books/tax-articles/147-revenue-ruling-70-604-guide>

There are only three options with respect to the tax treatment of homeowner association excess membership income on Form 1120, U.S. Corporate Income Tax Return:

A) The association, if it does not making an election under Revenue Ruling 70-604, would **pay tax on 100% of the net membership income**, in addition to the net non-membership (mostly interest) income. Obviously, this is an undesirable option, and would preferably be avoided by properly making an election under Revenue Ruling 70-604 as indicated below.

B) The association can make an election under Revenue Ruling 70-604 to **apply the excess** of membership income over membership expenses **to the following year's assessments**, or

C) The association can make an election under Revenue Ruling 70-604 to **refund the excess** of membership income over membership expenses to the members of the Association. (This option is the least desirable, and may be in conflict with certain state statutes).

It is important to note that **the association can NOT make an election** under revenue ruling 70-604 **to transfer any excess member income to reserves as a capital contribution**. The principal reason for this is that such an election will fail to meet the requirements of Internal Revenue Code Section 118 various interpretive rulings and cases of that Code section. See number 9 below. A full discussion of this issue can be found at www.homeownersassociationtaxes.com

(6) The election under revenue ruling 70-604 **MUST** be made before the tax return is filed. It **SHOULD** be made before the tax year has ended. It **COULD** be made before the tax year even starts. ... I recommend that to expose itself to the minimum risk of losing the benefit of this election, the Association make the election prior to the end of the fiscal year for which the election is to apply.

(9) An association can NOT make an election under revenue ruling 70-604 to transfer any excess member income to reserves as a capital contribution. FSA (Field Service Announcement) 1992-0208-1 ruled directly on this issue, noting that a transfer of excess revenues to reserves does not meet the two criteria specified in the ruling; refund to members or carryover to the next tax year. The principal reason for this is that such an election will fail to meet the requirements of Internal Revenue Code IRC Section 118 various interpretive rulings and cases of that Code section. The biggest hurdle here is that IRC Section 118 requires advance notice to the members of the capital nature of their assessment before it will qualify as a contribution to capital under IRC Section 118. There are also other requirements to qualify as capital contributions. This subject is so extensive that it requires a completely separate discussion, which is located at www.garyportercpa.com.

One conclusion that can be drawn from the above is that any association with extensive activities other than maintenance of the common areas will not qualify to make an election under revenue ruling 70-604

<https://associationtaxes.com/>

Form 990

501(c)(12) - Associations qualifying for exemption under IRC Section 501(c)(12) are extremely rare. The authors have personally worked with only one such association and are aware of only two others by virtue of discussions with other tax practitioners. These associations all qualify by **operating as a mutual water company** and providing domestic water to the residents of the association.

Reserves as Capital Contributions

<https://associationtaxes.com/?view=article&id=19:reserves-as-capital-contributions&catid=12:articles>

The basic structure of the Internal Revenue Code is that all receipts are considered income under IRC Section 61, unless exempted from income by another section of the Code. IRC Section 118, "Contributions to the Capital of a Corporation," exempts capital contributions from income.

The **PURPOSE** of the assessment is described in IRC Section 263 as "Any amount paid out for new buildings or for permanent improvements or benefits made to increase the value . . ." and "Any amount expended in restoring property . . ." That pretty much describes the majority of reserve funds expended by associations. But it also includes additions to or replacements of personal property. It DOES NOT include monies expended or set aside for painting or contingencies.