

# HOAMCO

HOMEOWNERS ASSOCIATION MANAGEMENT COMPANY

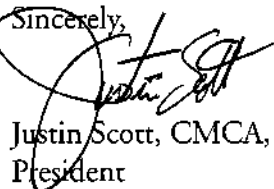
## Community, Quality of Life, and Homeowners Association Management Company

The challenges we face as association volunteers and professionals will not get easier in the coming years. There will be financial challenges as properties age and legal challenges from an increasingly litigious society. There will be more legislation to contend with and more regulation. The importance of continuing education for both professionals and volunteers is at an all-time high.

With the increase of regulations, we often lose sight of the Community. We need to see the big picture—communities need vision but not a narrow view. As associations, we must focus not only on the quality of the property, but also on the quality of life. People may move to a community because of its amenities. They stay when it is their home. Take the challenge to be reasonable when enforcing rules and covenants—build a community that is indeed a community.

**As president of Homeowners Association Management Company, I would like to express my appreciation to each of our clients. I would also like to thank our staff of certified professionals for a job well done. As we enter into 2003, we will continue to provide services unsurpassed in the field of Association Management.**

Sincerely,



Justin Scott, CMCA, AMS®  
President

## Beware of Potential Budgeting Pitfalls

### *Ignoring the Aging Process*

Funds must be budgeted and set aside to compensate for the aging process. As each component of the physical plant ages, it costs more to operate and maintain. In the short term, that means increasing the repair and maintenance budget to address the increasing demands of an older structure. For the long-term needs of the association, the board must establish adequate replacement reserve funds. Failure to provide for these increased expenditures will leave the association with deferred maintenance needs and lead to reactive, crisis management.

### *Reducing the Budgeted Amount Before it is a Reality*

It is important not to reduce a line item in anticipation of changes that might reduce the costs. The budgeted amount should be reduced once the cost-reduction program is successful and ongoing. For example, if retrofitting light fixtures with an energy-saving device should reduce the electricity consumption in the community, wait to see the actual savings achieved before reducing the budget by the estimated amount.

### *Not Defining Standards*

Because the budget is a financial plan to accomplish goals and meet the standards of the community, then ignoring the standards can be disastrous. If the budget is prepared

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# Six Questions (And Answers) To Survive Tax Time

By Howard A. Goldklang, CPA, MBA

Regardless of whether your association uses a professional accountant or has its own accounting staff, ...you should have working knowledge of your association's tax issues.

To point you in the right direction, here are six frequently asked questions and answers.

## 1. Under which method should an association file its income-tax return?

Community associations usually have two methods of filing their income taxes: the corporate method, using Form 1120, or the tax-exempt method using Form 1120-H. This is an annual decision, which means that each year an association may choose to file using either method (regardless of how it has filed in the past). Some associations have tax-exempt status under section 501c of the Internal Revenue Code, although this is rare and relatively hard to obtain.

*Corporate (Form 1120).* Under the corporate method, associations file subject to Internal Revenue Code Section 277. Membership and non-membership income and expenses are separated. While both membership and non-membership income is potentially taxable, if membership expenses are equal to or greater than membership income, an association is taxed only on its non-membership income, such as interest and rental fees. Graduated rates are used beginning at 15 percent. Certain other requirements related to replacement reserves and excess membership income must be met, and reserves must be accounted for separately and be capital in nature. Painting, contingency, and general operating reserves aren't considered to be capital in nature.

*Tax-exempt (Form 1120-H).* Under the tax-exempt method, associations file using Internal Revenue Code Section 528. An association must meet certain tests related to its revenues and expenses, and all of its non-exempt revenue is taxed at 30 percent. Some examples of non-exempt revenue are interest and rental income. Under this method, there are no tax consequences related to replacement reserves or excess membership income.

*Cooperatives (Form 1120, Subchapter T).* Cooperatives file under Subchapter T, Internal Revenue Code Sections 1381-1388. Under Subchapter T, which is similar to section 277, income and expenses are allocated between patronage and non-patronage sources. However, unlike under Section 277, interest income is considered to be patronage income, which is non-taxable. Examples of non-patronage income are rental income on a unit and rental income on a roof space—both of which are taxable. Because of the complexities involved, cooperatives should consult a tax professional for more information on the specifics of filing under Subchapter T.

2. Is employee lodging provided by an employer taxable? Internal Revenue Code Regulations require that these three tests be met in order for lodging furnished by an employer to be excluded from an employee's income:

- The lodging is furnished on the premises of the employer.
- The lodging is furnished for the convenience of the employer.
- The employee is required to accept such lodging as a condition of employment.

If any of these tests are not met, the lodging is considered taxable wages to the employee.

## 3. When is an association required to send 1099s to vendors?

The Internal Revenue Service requires that associations file a 1099 Form for any individual paid more than \$600 for services provided to the association during the year. The association is not required to send 1099s to corporations. However, payment for legal services (over \$600) must be reported.

## 4. Should an association make estimated tax payments?

For associations that anticipate a tax bill of at least \$500, estimated tax payments must be made on a quarterly basis. For a calendar year, association payments are due by the fifteenth of April, June, September, and December. To avoid an underpayment penalty, each installment must be 25 percent of the lesser of either the current year's tax or the prior year's tax. If the prior year's tax was zero, or the prior year consisted of fewer than 12 months, then the estimated payments must equal the current year's tax.

Federal estimated payments must be submitted with the original Form 8109 at the association's bank. State payments should be mailed to the state with payment coupons.

## 5. Are bonuses subject to payroll taxes?

Holiday and other bonuses given to employees are supplemental wages and are subject to payroll taxes. If the bonuses are gifts of nominal value, such as a ham, turkey, or other merchandise, the value of the gift is not included in the income of the employee, and the association is not liable for payroll taxes related to the gift. However, if an association decides to pay a holiday in other pay or gift certificates that are readily convertible to cash, the bonus must be included in the employee's income. Regardless of the amount, payroll taxes must be withheld and paid.

Some associations solicit contributions from homeowners to fund bonuses for employees. These contributions also have tax implications. Once the bonus contributions are deposited into an association bank account, the control of funds is given from the individual homeowner to the association. If the bonuses are paid from the association bank account, they are required to be included in each employee's income and are subject to payroll taxes. To be tax-exempt, the bonuses need

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to be given from the individual homeowners directly to the employees.

#### 6. What other activities or transactions typically have tax implications?

Other areas that may have potential tax implications for associations include the sale of a unit, renting a previously vacant association-owned unit, settlement of warranty claims, and legal settlements. Alert your association's professional accountant should any of these issues arise.

*Howard A. Goldklang is founder and president of Goldklang, Cavanaugh, and Associates, PC, in Fairfax, Virginia. He wrote this article for the March/April 2001 edition of "Community Management."*

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## Community-Building Concepts

*By Robert A. Felix, CMCA, PCAM*

Successful communities require competent leadership if they're going to survive, prosper, strengthen, and flourish. Distinguished from other places to live, successful communities are measured far beyond their value of "hard goods"—the sticks and bricks, the quality of the facilities. Although necessary and important to developers and homebuyers, as the community matures and secures its identity, hard goods give way to the importance of managing lifestyle.

In the long run, successful communities are measured according to their value of "soft goods." Just what are soft goods? They include relationships among neighbors, respect for diversity within the community, participation by homeowners as stakeholders in building and maintaining community unity, a focus on civility, and a value and respect afforded the elected and hired leadership within the community.

How does a community go from emphasizing its hard goods to encouraging its soft goods? The key is for managers and leaders to concentrate on building a sense of community.

The concept of successful communities is based on the premise that builders develop a sound development plan, follow that plan from the beginning, retain control throughout the development process, and turn the development over to community management in a timely manner. The community programs, governance, and communication the developer establishes and encourages are critical.

What can management specifically do to encourage residents to appreciate their community and help it thrive? Here are a few ideas:

- Use the concept of neighborhood guidelines rather than rules and restrictions.

- Emphasize homes, not units.
- Promote stakeholders (including renters) instead of property owners.
- Emphasize village concepts, not compound environments.
- Include every resident in every program. Don't isolate certain populations, such as renters.
- Create neighborhood programs and community-wide events that bring people together.
- Promote the idea that community meetings are celebrations and opportunities to share in the governance process.
- Build fun into the programs. Create opportunities for residents to have input and use their varied talents.
- Establish courtesy in customer-related programs, covenant enforcement, and notifications.
- Appreciate volunteers on a regular basis, and consider forming a committee to oversee an annual recognition program.
- Create opportunities for communication using all available techniques and technological advances.
- Choose a community charity to support.
- Encourage civility in all activities and meetings.
- Develop welcome packages and hold new resident orientations.

Developers can do much to build community as well. They can start by considering the following questions when establishing the proper level and type of management to fit the service needs of the community:

- What are the key aspects of the leadership model between the developer and the community that we want to capture and secure in the future?
- How do we define successful community management?
- What do we hope to accomplish through community management?
- What issues and services do we plan on handling through community management?
- How can we build community value through management and community leadership?
- What level of service do we expect to perform through management?
- What are the community's hard and soft goods, and how will management enhance and preserve them?

Community building is far from a new concept. However, it has reached a new and exciting emphasis in today's marketplace. In fact, it is so critical to the success of communities that it can't be overemphasized or begun too early in the development and management process.

*Robert A. Felix is general manager of Sun City Vistoso, in Sun City, Arizona. He wrote this article for the March/April 2001 edition of "Community Management."*

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without first considering these items, then they will be determined by the budget. This usually lowers the standards to meet the budget and not the other way around of raising the budget to meet the needs of the community. Once this happens, the results are deferred maintenance needs that affect the entire community. Any budgetary savings may be lost in lower resale values. And, the association should never base a budgeted line item on the lowest bidder. All too often, the lowest bidder cannot perform the expected service level and the expected savings are not achieved.

### ***Not Planning for Contingencies***

Hurricanes, harsh winters, unexpected repair, building code changes—they all create the possibility of expense overruns. Association leaders should make sure each budgetary category is realistic, including a reasonable contingency amount.

### ***Basing the Budget on Political Considerations***

Sometimes budgets are created and adopted to make sure the assessment rate does not increase. It may be a result of trying to “look good” to the membership or

another person having an agenda of “holding down the fees.” For whatever reasons, when budgets are prepared and adopted based upon political considerations, they are the forerunner to financial and community crises. Most major components of the budget, such as maintenance, utilities, insurance, and reserves are not discretionary items and cannot be arbitrarily reduced without lowering standards, deferring necessary repairs, or depleting replacement reserve funds. Budgets must be based upon acceptable community standards and cost realities.

### ***Not Having an Ongoing Budget Process***

The budget process does not stop after approval. In fact, that is just the beginning of the cycle. The assumptions used to create the budget need to be reviewed each month in comparison to actual amounts. The budget is not just an exercise in estimating future revenue and expenses, but it is an information tool to review and improve performance. It is a guide for decision-making and is instrumental in planning for the future.

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