

## **HOAMCO – Best Practices**



### **IRS Revenue Ruling 70-604**

*REMINDER* – The IRS Revenue Ruling needs to be approved by the membership in order to provide the option of filing either an 1120 or 1120H on a yearly basis. Background information is below, along with sample documents that will assist you in approving the item. If you have questions regarding this option for your community, please refer to how this ruling was handled for your associations last year.

#### **Background**

Revenue Ruling 70-604 pertains to the HOA filing a 1120 tax form that will allow the association to carryover excess membership income over membership expenses to the next year without paying income tax on the excess. As part of the ruling, the membership must vote to approve the revenue ruling.

Most associations file an 1120H, which is specifically designed for HOA's, whereas the 1120 is designed for corporations. By approving the revenue ruling, the association has the option to carryover any excess income without paying taxes, and would therefore have the option of filing an 1120 with the revenue ruling option.

Approval of the revenue ruling by the membership allows the association the option of filing whichever form (1120 or 1120H) is most cost-effective to the association. If the resolution is not approved, then the association will not be able to take advantage of Revenue Ruling 70-604, and will therefore be open to paying higher taxes on any excess income.

Below is a general description for each form:

Form 1120H – Section 528 (referred to as tax-exempt). This form was designed for homeowners' associations and there is no risk that any member assessments will be taxed as income, other than any fees for services. The Association will pay a fixed rate of 30%. Only non-exempt income is taxed if certain tests are met regarding revenues and expenses. Non-exempt income usually includes non-member income and such as interest and rental income.

Form 1120 – Section 277 (referred to as corporate). The association will pay taxes based on corporate rates from 15% - 39%. The tax form was designed for homeowners' associations and carries a considerably higher tax risk of adverse tax consequences in the event of an IRS audit. Due to the complexity of the tax rules, the IRS, in an audit, may attempt to treat member operating and reserve assessments as taxable income.

**SAMPLE VERBIAGE FOR BALLOT**

The purpose of this ballot is to vote for the approval of IRS Revenue Ruling 70-604. This Ruling will allow the Association to apply excess of membership income over membership expenses for the year end 2007 to the subsequent tax year member, and requires approval of the membership.

By having the ruling approved by the membership, the association will have the **option** of filing whatever tax form (1120 or 1120H) is most cost-effective to the association. If this ballot item is not approved, then the association will not be able to take advantage of Revenue Ruling 70-604 if filing form 1120, and will therefore be subject to paying higher taxes on any excess income.

Please place one (1) vote either **in favor** of the IRS Revenue Ruling 70-604, or one (1) vote **not in favor** of the IRS Revenue Ruling 70-604. **Any ballot with more than (1) vote will be deemed invalid for purposes of calculating this vote.**

*(double-check straight vs. cumulative voting for your association.)*

\_\_\_\_\_ Yes, I am in favor of approving IRS Revenue Ruling 70-604 for tax year \_\_\_\_\_ for the \_\_\_\_\_ Association.

\_\_\_\_\_ No, I am not in favor of approving the IRS Revenue Ruling 70-604 for tax year \_\_\_\_\_ for the \_\_\_\_\_ Association.

**RESOLUTION OF THE DIRECTORS  
OF  
\_\_\_\_\_ ASSOCIATION**

**IRS REVENUE RULING 70-604**

The undersigned Directors of the \_\_\_\_\_, an \_\_\_\_\_ non-profit corporation (the "Association") hereby consent to and adopt the following resolution as the action of the Board of Directors of the Association, and hereby direct that this written consent to such resolution be filed with the minutes of the proceedings of the Board of the Association.

**WHEREAS**, the members of the \_\_\_\_\_ desire that the corporation shall act in full accordance with the rulings and regulations of the Internal Revenue Service;

**WHEREAS**, the membership approved that any excess membership income over membership expenses for the year end \_\_\_\_\_ be applied to the subsequent tax year, pursuant to IRS Revenue Ruling 70-604.

**NOW THEREFORE, IT IS RESOLVED**, that the Association shall apply IRS Revenue Ruling 70-604 to tax year ended \_\_\_\_\_.

DATED: \_\_\_\_\_, 200\_\_.

BY: \_\_\_\_\_  
President

ATTESTED: \_\_\_\_\_  
Secretary