

HOAs and taxes: Still confusing to most
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Brett Hersh - Let's Talk Taxes , journal-news.net

If you own a home in a planned community or development, there is a good chance you are a member of a homeowners association. One perplexing aspect of HOA management is the tax-reporting requirements of the IRS. I have discussed this topic several times in the past. Still, it continues to generate more calls and Web visits than any other topic. Some common questions our office receives are, "Must our HOA file a tax return?" "What return must it file?" and "What happens if we haven't filed for a number of years?" Today, I'll revisit some of these basic questions and, hopefully, clarify some of the confusion associated with taxes and your HOA's reporting requirements.

For federal tax purposes, homeowners associations are treated as corporations. This is true even if an HOA was created as an association or a nonprofit corporation with its respective state. The only exception is the rare instance that the HOA has filed for recognition and been accepted as a nonprofit by the IRS. Such recognition is expensive, relatively difficult to obtain and most often requested by filing Form 1024 with the IRS and utilizing Tax Code section 501(c)(4).

Corporations are generally required to file Form 1120, U.S. Corporation Income Tax Return, annually. Filing Form 1120 has several distinct disadvantages for an HOA. First, Form 1120 is fairly complex and requires a level of bookkeeping sophistication many HOAs lack. A second disadvantage of filing Form 1120 is all of the HOA's "income" is taxable. Basically, this means any funds collected and not spent - for example, funds set aside for road maintenance or replacement - during the year may be subject to corporate income tax. A third disadvantage of Form 1120 for an HOA is it may subject the HOA to making estimated tax payments, another burden for the often overburdened treasurer.

The Tax Code gives many HOAs the ability to avoid Form 1120 by making a special election. Section 528 allows homeowner associations that meet certain requirements to bypass Form 1120 by filing Form 1120-H, an income tax form specifically designed for homeowner associations. Form 1120-H is a one-page form that is much easier to complete than the many page, multiple-schedule Form 1120. Although most HOAs qualify, each must meet certain requirements to utilize this election. To file Form 1120-H, at least 60 percent of the HOA annual revenue must be exempt-function income. Exempt-function income includes membership dues, assessments, fees and interest on those fees. Also, 90 percent of the HOA's expenditures must be for management, maintenance, acquisition and construction of association property.

If the HOA qualifies to file Form 1120-H, only its "nonexempt" income is taxable. Nonexempt income includes interest and dividends, rental income from property owned by the association and laundry/vending machine income. The HOA is allowed to deduct expenses directly related to the generation of nonexempt income but must have written records to prove the deductions. Form 1120-H allows for a \$100 deduction from

nonexempt income to arrive at taxable income. The HOA's taxable income is then subject to a flat tax rate of 30 percent - 32 percent for timeshare associations.

Filing Form 1120-H is an election that must be made each year. The election is made by filing Form 1120-H by its due date - the 15th day of the third month after the end of the HOA's tax year. A six-month extension to file can be obtained by filing Form 7004. Once made, the election cannot be revoked without IRS consent.

If Form 1120-H is not filed within 12 months of its due date - including extensions - the HOA may lose the opportunity to file Form 1120-H for that tax year. The HOA must then file the longer and more complex Form 1120. The HOA also may be required to pay penalties for late filing and late payment of any tax due.

This column has, hopefully, clarified some of the confusion surrounding a homeowners association's income tax filing requirements.

Please remember, this or any column does not constitute or replace the advice of a qualified professional. If you have any questions regarding your taxes or would like assistance in preparing your tax returns, please feel free to call our office at 304-267-2594 to speak with a tax professional.

- Brett Hersh is the owner of HBS Tax and an enrolled agent with the IRS. Hersh is licensed to prepare all tax returns and represent taxpayers before the IRS. He also is a trainer for Lorman Education and Dave Ramsey's endorsed provider for accounting and tax services for the region. He can be reached at 304-267-2594 or at <http://www.hbsbusiness.com>