INDEX

Federal Taxation

Membership Organization
  IRS Code Section 277
  Tax Return Form 1120

Homeowners Association
  IRS Code Section 528
  Tax Return Form 1120H

Tax Exempt Organization
  Compared with Non-Profit Organization
  IRS Code Section 501(c) (4)
  Tax Return Form 990

Revenue Rulings

State Taxation

Franchise Tax

Sales Tax
  501(c) (4) Exemption
  Electricity and Gas
  Maintenance of Public Rights of Way
  Maintenance and Repair of Residential Property

Ad Valorem Taxation

Property Taxes
  Section 23.18 of Texas Property Tax Code

Business Personal Property
FEDERAL TAXATION:

Community associations are generally nonprofit corporations. A nonprofit corporation is limited in the manner in which it may distribute its profits. The Texas Nonprofit Corporations Act defines a nonprofit corporation as follows –

"Nonprofit corporation" means a corporation no part of the income of which is distributable to a member, director, or officer of the corporation.

The fact that they are nonprofit does not necessarily mean that they are tax exempt and even if they are tax exempt, all community associations are required to file tax returns whether or not they have taxable income.

Residential condominium associations, homeowners associations and time-share associations may elect to be taxed either under Internal Revenue Code §277 as a membership organization using form 1120, or under §528 as a homeowners association using form 1120H. The decision on which form to file will generally be based on the one that results in the lowest amount of tax payable.

Commercial associations do not have this option and are required to file under §277 as a membership organization using form 1120.

Those community associations (both residential and commercial) that have succeeded in obtaining tax exempt status under §501(c) (4) of the Internal Revenue Code are also required to file tax returns using form 990.

Under Internal Revenue Code §528 "exempt function income" means any amount received as membership dues, fees, or assessments from owners. This includes the amounts assessed for operating the association as well as the capital replacement assessment and any special assessments. All other income is taxable subject to a deduction of $100 and deductions for any expenses incurred in the production of the taxable income. The tax rate is a flat 30% of the taxable income (32% for time-share associations).

Under Internal Revenue Code §277 the association is taxed at regular corporate rates. Taxable non-membership income may only be reduced by expenses incurred in the production of such income, much like exempt function income under §528. For any assessments relating to capital replacements not to be taxable income (whether included in the regular assessment or levied by way of a special assessment) the amounts must be clearly intended for capital replacements, (painting is not a capital...
replacement0, must be separately
accounted for, separately maintained
and must be used for the purpose for
which they were levied.
Under §528 membership income deficits
(losses) are not carried forward to
subsequent years. Membership deficits
(losses) under §277 may be carried
forward to future years to offset
surpluses (profits).

The provisions of the Internal Revenue
Code §§277, 528, and 501(c) (4) are
attached. Tax filing forms 1120, 1120H
and 990 are available from the IRS web-

An information publication from the IRS
relating to tax exempt §501(c) (4)
organizations is also attached.

The Internal Revenue Service has also
issued several Revenue Rulings relating
to community associations, some of
which are attached. Revenue Ruling

70-604 allows associations to apply the
excess of membership income over
membership expense to the following
year’s assessments or to return the
excess membership income to the
association’s members. This is a useful
tool for associations filing under §277
and can reduce the association’s tax
liability. Ideally the decision to
implement Revenue Ruling 70-604
should be made by the members of the
association, not the Board, and should
be made prior to the tax return being
filed. Caution must be exercised when
making the decision and in its
implementation. If the decision is made
to refund the surplus, checks should be
issued and sent to the members. If the
decision is made to apply it to the
following year’s assessment, it must be
shown as income in the following year.

As in all matters involving the IRS,
advise the association to use the
services of a competent CPA.

The following table provides an overview of the tax filing options for community
associations

<table>
<thead>
<tr>
<th>COMMUNITY ASSOCIATIONS</th>
<th>TAX FILING OPTIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Condominium Association</td>
</tr>
<tr>
<td>Internal Revenue Code</td>
<td>§528</td>
</tr>
<tr>
<td>Form</td>
<td>1120H</td>
</tr>
<tr>
<td>Net Membership Income Tax Rate</td>
<td>0%</td>
</tr>
<tr>
<td>Net Non-Membership Income Tax Rate</td>
<td>30%</td>
</tr>
<tr>
<td>Net Operating Loss Carry Forward</td>
<td>No</td>
</tr>
</tbody>
</table>
Federal Taxation

Membership Organization

Internal Revenue Code Section 277

Sec. 277. Deductions incurred by certain membership organizations in transactions with members

(a) General rule

In the case of a social club or other membership organization which is operated primarily to furnish services or goods to members and which is not exempt from taxation, deductions for the taxable year attributable to furnishing services, insurance, goods, or other items of value to members shall be allowed only to the extent of income derived during such year from members or transactions with members (including income derived during such year from institutes and trade shows which are primarily for the education of members). If for any taxable year such deductions exceed such income, the excess shall be treated as a deduction attributable to furnishing services, insurance, goods, or other items of value to members paid or incurred in the succeeding taxable year. .......

Homeowners Association

Internal Revenue Code Section 528

Sec. 528. Certain homeowners associations

(a) General rule

A homeowners association (as defined in subsection (c)) shall be subject to taxation under this subtitle only to the extent provided in this section. A homeowners association shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes.

(b) Tax imposed

A tax is hereby imposed for each taxable year on the homeowners association taxable income of every homeowners association. Such tax shall be equal to 30 percent of the homeowners association taxable income (32 percent of such income in the case of a timeshare association).

(c) Homeowners association defined

For purposes of this section -

(1) Homeowners association

The term "homeowners association" means an organization which is a condominium management association, a residential real estate management association, or a timeshare association if -

(A) such organization is organized and operated to provide for the acquisition, construction, management, maintenance, and care of association property,

(B) 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 -
(i) owners of residential units in the case of a condominium management association,
(ii) owners of residences or residential lots in the case of a residential real estate management association, or
(iii) owners of timeshare rights to use, or timeshare ownership interests in, association property in the case of a timeshare association,

(C) 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 and, in the case of a timeshare association, for activities provided to or on behalf of members of the association,

(D) 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

(E) 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.

(2) Condominium management association
The term "condominium management association" means any organization meeting the requirement of subparagraph (A) of paragraph (1) with respect to a condominium project substantially all of the units of which are used by individuals for residences.

(3) Residential real estate management association
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.

(4) Timeshare association
The term "timeshare association" means any organization (other than a condominium management association) meeting the requirement of subparagraph (A) of paragraph (1) if any member thereof holds a timeshare right to use, or a timeshare ownership interest in, real property constituting association property.

(5) Association property
The term "association property" means -
(A) property held by the organization,
(B) property commonly held by the members of the organization,
(C) property within the organization privately held by the members of the organization, and
(D) property owned by a governmental unit and used for the benefit of residents of such unit.

In the case of a timeshare association, such term includes property in which the timeshare association, or members of the association, have rights arising out of recorded easements, covenants, or other recorded instruments to use property related to the timeshare project.

(d) Homeowners association taxable income defined
(1) Taxable income defined
For purposes of this section, the homeowners association taxable income of any organization for any taxable year is an amount equal to the excess (if any) of -
(A) the gross income for the taxable year (excluding any exempt function income), over
(B) the deductions allowed by this chapter which are directly connected with the production of the gross income (excluding exempt function income), computed with the modifications provided in paragraph (2).

(2) Modifications
For purposes of this subsection -
(A) there shall be allowed a specific deduction of $100,
(B) no net operating loss deduction shall be allowed under section 172, and
(C) no deduction shall be allowed under part VIII of subchapter B (relating to special deductions for corporations).

(3) Exempt function income
For purposes of this subsection, the term "exempt function income" means any amount received as membership dues, fees, or assessments from -
(A) owners of condominium housing units in the case of a condominium management association,
(B) owners of real property in the case of a residential real estate management association, or
(C) owners of timeshare rights to use, or timeshare ownership interests in, real property in the case of a timeshare association.

Tax Exempt Organization

Internal Revenue Section 501(c) (4)

Sec. 501. Exemption from tax on corporations, certain trusts, etc.

(a) Exemption from taxation
An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502 or 503.

(b) Tax on unrelated business income and certain other activities
An organization exempt from taxation under subsection (a) shall be subject to tax to the extent provided in parts II, III, and VI of this subchapter, but (notwithstanding parts II, III, and VI of this subchapter) shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes.

(c) List of exempt organizations
The following organizations are referred to in subsection (a):

(4)(A) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

(B) 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.
Other Section 501(c) Organizations

Introduction

This chapter contains specific information for certain organizations described in section 501(c), other than those organizations that are described in section 501(c)(3). Section 501(c)(3) organizations are covered in chapter 3 of this publication.

The Table of Contents at the beginning of this publication, as well as the Organization Reference Chart, may help you locate at a glance the type of organization discussed in this chapter.

501(c)(4) — Civic Leagues and Social Welfare Organizations

If your organization is not organized for profit and will be operated only to promote social welfare, you should file Form 1024 to apply for recognition of exemption from federal income tax under section 501(c)(4). The discussion that follows describes the information you must provide when applying. For application procedures, see chapter 1.

To qualify for exemption under section 501(c)(4), the organization's net earnings must be devoted only to charitable, educational, or recreational purposes. In addition, no part of the organization's net earnings may benefit any private shareholder or individual. If the organization provides an excess benefit to certain persons, an excise tax may be imposed. See Excise tax on excess benefit transactions under Public Charities in chapter 3 for more information about this tax.

Examples. Types of organizations that are considered to be social welfare organizations are civic associations and volunteer fire companies.

Nonprofit operation. You must submit evidence that your organization is organized and will be operated on a nonprofit basis. However, such evidence, including the fact that your organization is organized under a state law relating to nonprofit corporations, will not in itself establish a social welfare purpose.

Social welfare. To establish that your organization is organized exclusively to promote social welfare, you should submit evidence with your application showing that your organization will operate primarily to further (in some way) the common good and general welfare of the people of the community (such as by bringing about civic betterment and social improvements).

An organization that restricts the use of its facilities to employees of selected corporations and their guests is primarily benefiting a private group rather than the community. It therefore does not qualify as a section 501(c)(4) organization. Similarly, an organization formed to represent member-tenants of an apartment complex does not qualify, since its activities benefit the member-tenants and not all tenants in the community. However, an organization formed to promote the legal rights of all tenants in a particular community may qualify under section 501(c)(4) as a social welfare organization.

Political activity. Promoting social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office. However, if you submit proof that your organization is organized exclusively to promote social welfare, it may still obtain exemption even if it participates legally in some political activity on behalf of or in opposition to candidates for public office. See the discussion in chapter 2 under Political Organization Income Tax Return.

Social activity. If social activities will be the primary purpose of your organization, you should not file an application for exemption as a social welfare organization but should file for exemption as a social club described in section 501(c)(7).

Retirement benefit program. An organization established by its members that has as its primary activity providing supplemental retirement benefits to its members or death benefits to their beneficiaries does not qualify as an exempt social welfare organization. It may qualify under another paragraph of section 501(c) depending on all the facts.

However, a nonprofit association that is established, maintained, and funded by a local government to provide the only retirement benefits to a class of employees may qualify as a social welfare organization under section 501(c)(4).
**Tax treatment of donations.** Donations to volunteer fire companies are deductible on the donor's federal income tax return, but only if made for exclusively public purposes. Contributions to civic leagues or other section 501(c)(4) organizations generally are not deductible as charitable contributions for federal income tax purposes. They may be deductible as trade or business expenses, if ordinary and necessary in the conduct of the taxpayer's business. However, see *Deduction not allowed for dues used for political or legislative activities under 501(c)(6) — Business Leagues, Etc.* for more information.

**Specific Organizations**

The following information should be contained in the application form and accompanying statements of certain types of civic leagues or social welfare organizations.

**Volunteer fire companies.** If your organization wishes to obtain exemption as a volunteer fire company or similar organization, you should submit evidence that its members are actively engaged in fire fighting and similar disaster assistance, whether it actually owns the fire fighting equipment, and whether it provides any assistance for its members, such as death and medical benefits in case of injury to them.

If your organization does not have an independent social purpose, such as providing recreational facilities for members, it may be exempt under section 501(c)(3). In this event, your organization should file Form 1023.

**Homeowners' associations.** A membership organization formed by a real estate developer to own and maintain common green areas, streets, and sidewalks and to enforce covenants to preserve the appearance of the development should show that it is operated for the benefit of all the residents of the community. The term community generally refers to a geographical unit recognizable as a governmental subdivision, unit, or district thereof. Whether a particular association meets the requirement of benefiting a community depends on the facts and circumstances of each case. Even if an area represented by an association is not a community, the association can still qualify for exemption if its activities benefit a community.

The association should submit evidence that areas such as roadways and park land that it owns and maintains are open to the general public and not just its own members. It also must show that it does not engage in exterior maintenance of private homes.

A homeowners' association that is not exempt under section 501(c)(4) and that is a condominium management association, a residential real estate management association, or a timeshare association generally may elect under the provisions of section 528 to receive certain tax benefits that, in effect, permit it to exclude its exempt function income from its gross income.

**Other organizations.** Other nonprofit organizations that qualify as social welfare organizations include:

- An organization operating an airport that is on land owned by a local government, which supervises the airport's operation, and that serves the general public in an area with no other airport,

- A community association that works to improve public services, housing and residential parking, publishes a free community newspaper, sponsors a community sports league, holiday programs and meetings, and contracts with a private security service to patrol the community,

- A community association devoted to preserving the community's traditions, architecture, and appearance by representing it before the local legislature and administrative agencies in zoning, traffic, and parking matters,

- An organization that tries to encourage industrial development and relieve unemployment in an area by making loans to businesses so they will relocate to the area, and

- An organization that holds an annual festival of regional customs and traditions.
Rev. Rul. 70-604
1970-2 C.B. 9
Sec. 61

IRS Headnote

Excess assessments by a condominium management corporation, over and above the amounts used for the operation of condominium property, that are returned to the stockholder-owners or applied to the following year's assessments are not taxable income to the corporation.

Full Text

Rev. Rul. 70-604

A condominium management corporation assesses its stockholder-owners for the purposes of managing, operating, maintaining, and replacing the common elements of the condominium property. This is the sole activity of the corporation and its by-laws do not authorize it to engage in any other activity.

A meeting is held each year by the stockholder-owners of the corporation, at which they decide what is to be done with any excess assessments not actually used for the purposes described above, i.e., they decide either to return the excess to themselves or to have the excess applied against the following year's assessments.

Held, the excess assessments for the taxable year over and above the actual expenses paid or incurred for the purposes described above are not taxable income to the corporation, since such excess, in effect, has been returned to the stockholder-owners.
Rev. Rul. 75-370
1975-2 C.B. 25
Section 61 -- Gross Income Defined

IRS Headnote

Condominium management assessments; realty improvements. Special assessments collected by a nonexempt condominium management corporation from its unit owner-stockholders and accumulated in a separate bank account for replacement of the roof and elevators in the condominium are not includible in the corporation's gross income.

Full Text

Rev. Rul. 75-370

Advice has been requested whether, under the circumstances described below, assessments collected by a nonexempt condominium management corporation from its unit owner-stockholders and accumulated in a separate bank account for specific capital expenditures are includible by the taxpayer in its gross income under section 61 of the Internal Revenue Code of 1954.

The taxpayer, a condominium management corporation, was incorporated under the laws of state M by the unit owners of a condominium housing project to provide, among other things, the management, maintenance, and care of the common elements of the project. Every unit owner of the project must be a stockholder of the taxpayer and the only stockholders are condominium unit owners. Since under the laws of state M a condominium management corporation cannot own real property, the common elements of the real property of the condominium project must also be owned by the unit owners who each have an undivided interest therein. The corporation is not an exempt organization for Federal income tax purposes. Compare Rev. Rul. 74-17, 1974-1 C.B. 130. It is supported by periodic assessments against the unit owners. An unpaid assessment is a lien on the property of the unit owner-stockholder.

The by-laws of the management corporation require that any assessments must be approved at a stockholder meeting by a majority vote of the unit owner-stockholders. In January 1974, the unit owner-stockholders decided at their annual meeting to levy and collect two special assessments totalling 15x dollars a month for 3 years from each unit owner. The assessments will be deposited in two separate bank accounts and will not be commingled with the general assessment funds. The assessments, 10x dollars and 5x dollars a month respectively, can be used only to replace the roof and the elevators located in the common elements of the condominium project.

Section 61 of the Code and section 1.61-1(a) of the Income Tax Regulations provide, in part, that gross income means all income from whatever source derived, unless excluded by law.
Rev. Rul. 74-321, 1974-2 C.B. 16, holds that proceeds received by a farm production credit association in the form of insurance premiums from its member-borrowers and dividends from the insurance company providing the member-borrowers group credit life insurance are not includible in the association's gross income. The association was acting as an agent for its member-borrowers. It managed the program in accordance with the requirements set forth by the Federal Farm Credit Administration. It had only ministerial powers over the funds and could not divert them to its own purposes.

In the instant case, the taxpayer receives no benefit from the funds. They are specifically designated for the replacement of the roof and elevators located in the common elements of the real property of the condominium project for the sole benefit of the unit owners. The taxpayer has a fiduciary obligation to expend the funds collected in the manner approved by its unit owner-stockholders. The relationship between the taxpayer and its unit owner-stockholders insofar as the special assessments are concerned is one of agent and principal.

Accordingly, in the instant case, since the funds are received by the taxpayer as an agent for the unit owners to be used solely for the benefit of the unit owners, the special assessments are not includible in the taxpayer's gross income under section 61 of the Code.

However, this Revenue Ruling does not apply to the funds collected by a condominium management corporation to provide the services for which it was formed such as maintenance of common elements (painting, repairs, gardening, janitorial services and so forth). Thus, for example, funds accumulated to paint the common elements would not qualify under this Revenue Ruling.

Compare Rev. Rul. 75-371, page 52, which holds that the special assessment for the purchase of personal property owned by the condominium management corporation is a contribution to its capital under section 118 of the Code.

Association Management, Inc. 12
Rev. Rul. 75-371

1975-2 C.B. 52

Section 61 -- Gross Income Defined
Sec. 118

IRS Headnote

Condominium management assessments; personal property. Special assessments for the replacement of personal property, collected by a nonexempt condominium management corporation from its unit owner-stockholders and accumulated in a separate bank account, are contributions to capital.

Full Text

Rev. Rul. 75-371

Advice has been requested whether, under the circumstances described below, a special assessment collected by a nonexempt condominium management corporation from its unit owner-stockholders and accumulated in a separate bank account for a specific capital expenditure will qualify as a contribution to the capital of the corporation under section 118 of the Internal Revenue Code of 1954.

The taxpayer, a condominium management corporation, was incorporated under the law of state M by the unit owners of a condominium housing project to provide, among other things, the management, maintenance and care of the common elements of the project, including the swimming pool. Every unit owner of the project must be a stockholder of the taxpayer and the only stockholders are condominium unit owners. The corporation is not an exempt organization for Federal income tax purposes. Under the provisions of its charter, the corporation may own personal property. The corporation owns all the equipment and tools necessary to provide services to the unit owners and any other personal property located or used in the common elements of the project. The corporation is supported by periodic assessments against the unit owners. An unpaid assessment is a lien on the property of the unit owner-stockholder.

The by-laws of the management corporation require that any assessments must be approved at a stockholder meeting by a majority vote of the unit owner-stockholders. In January 1974, the unit owner-stockholders decided at their annual meeting in accordance with the bylaw requirements to levy and collect a special assessment of 2x dollars a month for 14 months from each unit owner. The assessment will be deposited in a special account and will not be commingled with the general assessment funds. The assessment will be used only to replace the outdoor furniture surrounding the swimming pool.
Section 61 of the Code and section 1.61-1(a) of the Income Tax Regulations provide, in part, that gross income means all income from whatever source derived, unless excluded by law.

Section 1.118-1 of the regulations provides that, in the case of a corporation, section 118 of the Code provides an exclusion from gross income with respect to any contribution of money or property to the capital of the taxpayer. If a corporation requires additional funds for conducting its business and obtains such funds through voluntary pro rata payments from its stockholders, the amounts so received being credited to its surplus account or a special account, such amounts do not constitute income, although there is no increase in the outstanding shares of stock of the corporation. But the exclusion does not apply to any money or property transferred in consideration of goods or services rendered.

In United Grocers, Ltd. v. United States, 308 F.2d 634 (9th Cir. 1962), aff'g. 186 F. Supp. 724 (N. D. Calif. 1960), the Court of Appeals held that monthly payments by the members of a nonprofit retail grocers' cooperative were made in consideration of, and in payment for, services rendered by the cooperative and not as contributions to capital. The court said the dominant factor in determining whether the amounts were contributions to capital or payment for goods or services was the motive or purpose and intent in making the contribution. See also Rev. Rul. 74-563, 1974-2 C.B. 38, in which special assessments to pave the parking lot of a homeowners association are capital contributions by the homeowner-members.

In the instant case the special assessment is specifically earmarked and segregated to replace the outdoor furniture surrounding the swimming pool. It is assessed pro rata upon each unit owner-stockholder. Moreover, the availability of various types of personal property, including outdoor furniture, adds to the attractiveness or usefulness of the condominium project and, therefore, enhances the value of a unit owner-stockholder's property. Since ownership of the taxpayer is inextricably and compulsorily tied to the acquisition and enjoyment of a unit owner's property, this enhanced value is sufficient to show the motive or purpose and intent for paying the special assessment is something other than a payment for services rendered by the taxpayer to its unit owner-stockholders.

Accordingly, the special assessment for replacing outdoor furniture is a contribution to the taxpayer's capital under section 118 of the Code.

With respect to regular assessments, section 61 of the Code defines gross income as all income, from whatever source derived, except as otherwise provided by law. Funds collected by a nonexempt organization by means of assessments for the purpose of normal operating expenses are taxable as ordinary income under section 61. Any funds accumulated as contingency reserves are also includible in the organization's gross income because the Internal Revenue Code does not provide for such accumulations without tax consequences.

However, a condominium management corporation may operate in such a manner as to qualify for the benefits of subchapter T (sections 1381 through 1388) of the Code, thereby permitting the corporation to accumulate funds for reasonable business needs.

If a condominium management corporation qualifies under subchapter T it may retain without paying tax thereon up to 80 percent of its otherwise taxable income received from its unit owner-stockholders. This is accomplished by distributing to the unit owner-stockholders qualified
patronage dividends as defined in section 1388 of the Code for which the corporation would receive a deduction. These patronage dividends may be paid 20 percent in cash and 80 percent in qualified written notices of allocation. Thus, 80 percent of the otherwise taxable income from the unit owner-stockholders could be retained in cash by the corporation for its reasonable business needs.

Further, the unit owner-stockholders who do not use their condominium unit in their trade or business for the production of income may exclude the patronage dividends from their gross income. See section 1.1385-1(c)(2)(i) of the regulations.

In addition, when a condominium management corporation receives annual assessments from its unit owner-stockholders in excess of its needs to meet actual expenses paid or incurred for such taxable year, such excess may be returned directly or indirectly to them. See Rev. Rul. 70-604, 1970-2 C.B. 9, which describes a condominium management corporation whose sole activity in accordance with its bylaws is the management, operation, maintenance, and replacement of the common elements of the condominium property. An annual meeting is held by the unit owner-stockholders of the corporation, at which time they decide what is to be done with any excess assessments not actually used for the purposes described above, i.e., they decide either to return the excess to themselves or to have the excess applied against the following year's assessments. The excess assessments for the taxable year over and above the actual expenses paid or incurred for the purposes described above are not taxable income to the corporation since such excess in effect has been returned to the unit owner-stockholders.

Also, compare Rev. Rul. 75-370, page 25, this Bulletin, which holds that special assessments collected by a condominium management corporation for the replacement of elevators and the roof are not includible in the corporation's gross income under section 61 of the Code because the corporation was acting merely as an agent with respect to the funds.
STATE TAXATION: FRANCHISE TAX

Every corporation chartered in Texas is subject to state franchise tax and must file an annual tax return and public information report. A homeowners association that is a nonprofit corporation organized and operated primarily to obtain, manage, construct, and maintain the property in or of a residential condominium or residential real estate development that is legally restricted for use as residences is entitled to an exemption from franchise tax if the individual owners of the lots, residences, or residential units have at least 51% voting control of the association. The exemption is not available if any of the property is used for any commercial activity, or if voting control is held by any single individual, family or by one or more developers, declarants, banks, investors, or other similar parties. The State of Texas Tax Code §171.082 is attached.

Franchise taxes are generally not significant, but failure to render the return can have significant consequences including forfeiture of the association’s corporate status. For this reason it is important that the association apply for exemption at the earliest possible time. Exemption forms can be obtained from the Texas Comptroller's on-line at http://www.window.state.tx.us/taxinfo/taxforms/ap-206.pdf If the association has obtained tax exempt status under §501(c) (4) of the Internal Revenue code, the association is entitled to exemption from franchise tax even if it is still under developer control and even if it contains commercial property.

STATE TAXATION: SALES TAX

§501(c) (4) Associations

All associations that have received §501 (c) (4) status from the Internal Revenue Service are entitled to exemption from the payment of sales tax. The exemption is found in §151.310 (a) (2) of the Texas Tax Code and applies to both residential and commercial associations. A Texas Sales and Use Tax Exemption certificate needs to be issued to every vendor. The certificate can be found on-line at http://www.window.state.tx.us/taxinfo/taxforms/01-3392.pdf A copy of the letter from the IRS should be attached to the certificate.

Gas and Electricity

§151.317 of the State of Texas Tax Code provides that gas and electricity are exempted from the State sales taxes when sold for residential use. Some utility companies have forms to apply for the exemption. If they don’t the general Texas sales and use tax exemption certificate should be used. The purchaser is the association. The seller is the utility company supplying the gas or electricity. The description of the items purchased should be completed by including the account numbers on the utility bills. The reason is that the gas or electricity is being used for residential
purposes in accordance with §151.317 of the Tax Code. §151.317 of the Tax Code is attached.

Maintenance of Public Rights of Way

Landscape maintenance is generally subject to sales tax, except when performed on property that is owned by the State or by a county, city, special district, or other political subdivision of the State. It is necessary that the maintenance of association owned property is separated from the maintenance of the public property and that separate contracts be entered into.

The amounts billed by the vendor under the contract for maintenance of the public property would be exempt from sales tax under §151.309 of the Texas Tax Code.

Maintenance and Repair of Residential Property

Maintenance and repair of residential property is excluded from sales tax by §151.0047 of the Tax Code. This includes the clubhouse of a homeowner's association that is restricted to use by the residents of the subdivision.
§ 171.082. EXEMPTION--CERTAIN HOMEOWNERS' ASSOCIATIONS. (a) A nonprofit corporation is exempted from the franchise tax if:

(1) the corporation is organized and operated primarily to obtain, manage, construct, and maintain the property in or of a residential condominium or residential real estate development; and

(2) the owners of individual lots, residences, or residential units control at least 51 percent of the votes of the corporation and that voting control, however acquired, is not held by:

(A) a single individual or family; or

(B) one or more developers, declarants, banks, investors, or other similar parties.

(b) For purposes of this section, a condominium project is considered residential if the project is legally restricted for use as residences. A real estate development is considered residential if the property is legally restricted for use as residences.

STATE OF TEXAS
TAX CODE
SUBTITLE E. SALES, EXCISE, AND USE TAXES
CHAPTER 151. LIMITED SALES, EXCISE, AND USE TAX

§ 151.0047. "REAL PROPERTY REPAIR AND REMODELING". (a) "Real property repair and remodeling" means the repair, restoration, remodeling, or modification of an improvement to real property other than:
   (1) a structure or separate part of a structure used as a residence;
   (2) an improvement immediately adjacent to a structure described by Subdivision (1) of this section and used in the residential occupancy of the structure or separate part of the structure by the person using the structure or part as a residence;

§ 151.309. GOVERNMENTAL ENTITIES. A taxable item sold, leased, or rented to, or stored, used, or consumed by, any of the following governmental entities is exempted from the taxes imposed by this chapter:
   (1) the United States;
   (2) an unincorporated instrumentality of the United States;
   (3) a corporation that is an agency or instrumentality of the United States and is wholly owned by the United States or by another corporation wholly owned by the United States;
   (4) this state;
   (5) a county, city, special district, or other political subdivision of this state; or
   (6) a state, or a governmental unit of a state that borders this state, but only to the extent that the other state or governmental unit exempts or does not impose a tax on similar sales of items to this state or a political subdivision of this state.

Amended by Acts 1993, 73rd Leg., ch. 719, § 1, eff. July 1, 1993.

§ 151.317. GAS AND ELECTRICITY. (a) Subject to Subsection (d), gas and electricity are exempted from the taxes imposed by this chapter when sold for:
   (1) residential use;

   (c) In this section, "residential use" means use:
   (1) in a family dwelling or in a multifamily apartment or housing complex or building or in a part of a building occupied as a home or residence when the use is by the owner of the dwelling, apartment, complex, or building or part of the building occupied; or
   (2) in a dwelling, apartment, house, or building or part of a building occupied as a home or residence when the use is by a tenant who occupies the dwelling, apartment, house, or building or part of a building under a contract for an express initial term for longer than 29 consecutive days.
AD VALOREM TAXES:

The Texas Tax Code provides that property owned by a qualified homeowner’s association must be appraised on the basis of a nominal value to avoid double taxation with property enhanced by the owner’s right to use the organization’s property as a member. To qualify the association must have owned the property on January 1 for the tax year in question. A copy of the relevant code provision is attached. The necessary form of application may be found on-line at - ftp://ftp.hcad.org/Forms/23.18NV.pdf

Commercial associations can obtain a similar result by applying for a green belt appraisal.

BUSINESS PERSONAL PROPERTY:

The Appraisal district has recently been requesting renditions from community associations relating to business personal property. The same reasoning applicable to double taxation of real should be applied to business personal property. In addition, it should be argued that the business personal property is not being used for the production of income. A sample letter to the Appraisal District is attached.
§ 23.18. PROPERTY OWNED BY A NONPROFIT HOMEOWNERS' ORGANIZATION FOR THE BENEFIT OF ITS MEMBERS. (a) Because many residential subdivisions are developed on the basis of a nonprofit corporation or association maintaining nominal ownership to property, such as swimming pools, parks, meeting halls, parking lots, tennis courts, or other similar property, that is held for the use, benefit, and enjoyment of the members of the organization, that nominally owned property is to be appraised as provided by this section on the basis of a nominal value to avoid double taxation of the property that would result from taxation on the basis of market value of both the property of the organization and the residential units or lots of the members of the organization, whose property values are enhanced by the right to use the organization's property.

(b) All property owned by an organization that qualifies as a nonprofit homeowners' organization under this section is appraised at a nominal value as provided by this section if:

(1) the property is held for the use, benefit, and enjoyment of all members of the organization equally;

(2) each member of the organization owns an easement, license, or other nonrevokable right for the use and enjoyment on an equal basis of all property held by the organization, even if the right is subject to a restriction imposed by the instruments conveying the right or interest or granting the easement or subject to a rule, regulation, or bylaw imposed by the organization pursuant to authority granted by articles of incorporation, declaration of covenants, conditions and restrictions, bylaws, or articles of association of the organization; and

(3) each member's easement, license, or other nonrevokable right to the use and enjoyment of the property is appurtenant to and an integral part of the taxable real property owned by the member.

(c) The chief appraiser, in appraising property owned by a member of a qualified nonprofit homeowners' organization who is entitled to the use and enjoyment of facilities owned by the organization, shall consider the enhanced value of the property resulting from the member's right to the use and benefit of those facilities.

(d) An organization qualifies as a nonprofit homeowners' organization under this section if:

(1) it engages in residential real estate management;

(2) it is organized and operated to provide for the acquisition, construction, management, maintenance, and care of property nominally owned by the organization and held for the use, benefit, and enjoyment of its members;

(3) 60 percent or more of the gross income of the organization consists of amounts received as membership dues, fees, or assessments from owners of residences or residential lots within an area subject to the jurisdiction and assessment of the organization;

(4) 90 percent or more of the expenditures of the organization is made for the purpose of acquiring, constructing, managing, maintaining, and caring for the property nominally held by the organization;

(5) each member owns an easement, a license, or other nonrevokable right for the use and enjoyment on an equal basis of all
property nominally owned by the organization even if the right is subject to a restriction imposed by the instruments conveying the right or interest or granting the easement or subject to a rule, regulation, or bylaw imposed by the organization pursuant to authority granted by articles of incorporation, declaration of covenants, conditions and restrictions, the bylaws, or articles of association of the organization;

(6) net earnings of the organization do not inure to the benefit of any member of the organization or individual, other than by acquiring, constructing, or providing management, maintenance, and care of the organization's property or by a rebate of excess membership dues, fees, or assessments; and

(7) it qualifies for taxation under Section 1301 of the Tax Reform Act of 1976, Section 528 of the Internal Revenue Code of 1954, as amended, entitled "Certain Homeowners Associations."

January 3, 2005

Harris County Appraisal District
Personal Property Division
Attn: Jim Robinson, RPA
P. O. Box 92207
Houston, Texas 77292

RE: ABC Condominium Association
1234 Main Street
Account #xxxxxxx

Dear Mr. Robinson:

Your request for Business Personal Property Rendition addressed to the ABC Condominium Association has been referred to us for our response.

The ABC Condominium Association is a non-profit condominium association as contemplated in Section 82.101 of the Texas Uniform Condominium Act.

Section 82.005 (b) of the Act provides that each Unit must be separately taxed and assessed, and no separate tax or assessment may be rendered against common elements for which a Declarant has not reserved development rights. The Declarant has not reserved any development rights and, accordingly, no separate tax or assessment may be rendered against the common elements.

Any business personal property is used for the common benefit of each of the Owners and not for the production of income.

In the circumstances the ABC Condominium Association should not be separately taxed in regard to any business personal property.

If you disagree with the foregoing, please advise us of the basis for your disagreement to enable us to investigate.

Sincerely,

Name of Manager
Association Management, Inc.
Managing Agent