Revenue Ruling 70-604

The original text of IRS Revenue Ruling 70-604 is shown below.

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

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.

See Below:

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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 adoption of the Resolution for Revenue Ruling 70-604 Election.

Most associations file an 1120H, which is specifically designed for HOA's, whereas the 1120 is designed for corporations. By adopting the election, the association has the option to carryover any excess income without paying taxes on membership income when filing an 1120.

Approval of the resolution for the revenue ruling election 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 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 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%. This tax form 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.