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# Frequently Asked Questions Regarding Form 1120-H

## **Why does my association have to pay taxes, I thought it was a non-profit?**

Although your association is a non-profit corporation, it is not a non-taxable non-profit. Only charities and other similar organizations are considered non-taxable by the government. The association is taxed under Internal Revenue Code (IRC) Section 528. This is a specific section of the IRC written for homeowner associations. This section defines the type of income the IRS considers taxable and non-taxable for the association.

## **What type of income does my association pay taxes on?**

The association will pay taxes on income sources that are considered non-exempt. (Assessments are considered exempt income and are not taxable). The most common type of income associations are taxed on is interest income earned on investments and is reported on line 2 of the return. Additionally, certain types of fees charged to individuals for services such as laundry machine income, key income, or rental income are also considered taxable. If the association had any of these types of income, they are shown on line 7 of the return.

## **Does my association get to deduct any expenses related to the production of the income?**

Yes. Form 1120-H automatically allows the association a \$100 deduction (Line 18 on the return). Additionally, the association is allowed to deduct a portion of certain expenses paid throughout the year against its taxable income. The most common deductions are listed below:

**State Taxes** If the association paid income taxes during the year, it is a deductible expense and will show on line 12 of the return.

**Management Fee** Throughout the year, the association paid a management company a fee to work for the association. The IRS allows a portion of those fees to be deducted against the income earned. The deductible amount is reported on line 15 and will be delineated on the schedule attached to the return.

**Tax Preparation Fee** The fee paid during the year for the preparation of taxes is also a deductible expense. The deductible amount is reported on line 15 and will be delineated on the schedule attached to the return.

**Other Deductible Expenses** If the association had any fees collected for other taxable items (laundry machine income, etc) the IRS allows a deduction for the expenses paid that were related to the production of the income. For example, if an association had a laundry facility, a portion of the total utility expense would be deductible against the income. Those deductions are reported on line 15 and will be delineated on the schedule attached to the return.

Dear Directors:

The enclosed 70-604 Election should be voted on and approved by the members of the association at your annual meeting. This Election provides the Association with a tax planning opportunity that could save the Association some money come tax time.

A Homeowner Association is a non-profit corporation but is still subject to tax on certain types of earnings. The assessments received from homeowners, in the form of assessments, are generally not taxable. However, an Association pays tax on the earnings from interest income, laundry machine income, key income, rental income, land sales, etc. Generally speaking, any source of income to the Association for per-use fees or derived from non-member sources are taxable. Associations that have approximately \$4,000 of income from these types of sources could see a benefit from passing the 70-604 Election.

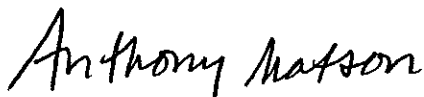
There are two ways for an Association to file their taxes with the Federal government. The Association can file Form 1120-H or Form 1120. Form 1120-H was designed for HOAs and is filed by 95% of all HOAs each year. Form 1120 is a standard corporation tax return that can be filed by an Association when it makes sense to. The benefit to filing Form 1120 is a reduced tax rate of 15% (on the first \$50,000 of taxable income) rather than a flat rate of 30% on Form 1120-H. On the surface, it would make sense that more Associations would file Form 1120, since it has a lower tax rate than Form 1120-H, but Form 1120 typically costs about \$500 more to prepare than Form 1120-H. The tax savings from filing Form 1120 needs to be greater than the additional cost of preparation to provide a benefit to the Association. Since most Associations would not save \$500 in taxes by filing Form 1120 there is no need to use this form.

If Form 1120 is filed, all earnings of the Association are subject to tax, even the income from assessments. **The 70-604 Election, which the IRS recommends be approved by the members of the association and made during the year for which it relates, allows the Association to carryover any excess income from assessments to the following year.** This Election is the key to filing Form 1120 as it carryovers the assessment income, leaving only the income derived from per-use fees and non-member sources as taxable amounts in the current year.

If the Election is passed, it does not mean Form 1120 needs to be filed. The Election is considered invalid if Form 1120-H is filed. By having the Election approved, your Association could file Form 1120 if it presents a savings opportunity.

Please return this Election to me after it has been signed. If you have any questions, please call me at (971) 235-9021. Thank you.

Sincerely,



Anthony Matson, CPA

**ASSOCIATION RESOLUTION FOR REVENUE RULING 70-604 ELECTION –  
EXCESS INCOME APPLIED TO THE FOLLOWING YEAR'S ASSESSMENTS**

**RESOLUTION OF ABC HOMEOWNER ASSOCIATION**

RE: EXCESS INCOME APPLIED TO THE FOLLOWING YEAR'S ASSESSMENTS  
REVENUE RULING 70-604

WHERE AS, ABC Homeowner Association, is an Oregon corporation duly organized  
and existing under the laws of the State of Oregon;

and

WHERE AS, the members desire that the corporation shall act in full accordance with the  
rulings and regulations of the Internal Revenue Service;

NOW, THEREFORE, the members hereby adopt the following resolution by and on  
behalf of ABC Homeowner Association:

RESOLVED, that any excess of membership income over membership expenses for the year  
ending December 31, 2008 shall be applied against the subsequent tax year member assessments  
as provided by IRS Revenue Ruling 70-604.

This resolution is adopted and made a part of the minutes of the meeting of

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

President

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

Secretary