

*If Associations are Non Profit, why are we subject to any tax?*

During our most recent annual meeting, the subject of tax liability and tax status for the Associations was raised. Since the Association's CPA was not in attendance, we sought his input and have published some comments here for your consideration.

One of the most common misconceptions of HOAs is that non-profit means no taxes. Piney Creek Recreational Association is a 501(c)(7) corporation which classifies it as a tax exempt social/recreational organization. These organizations are exempt from paying tax on income related to the purpose for which the organization exists ("exempt function income") but are taxed on any unrelated business taxable income ("UBTI"). The reason PCR exists is to provide and maintain recreational amenities for its members. Membership fees and related collection fees are examples of exempt function income. Earning interest at the bank, receiving money from a utility company in exchange for an easement or receiving a gain on the sale of a foreclosed home are examples of UBTI and are taxable.

Piney Creek Maintenance falls under Internal Revenue Code 528. Section 528 specifies a series of provisions which, if met, allows them the option to file either Federal form 1120 or 1120-H. Form 1120 is a standard corporate income tax return (e.g. General Motors files this form). Any net income (or operating surplus) is taxed at 15% up to \$50,000 but HOAs rarely have income larger than that. Form 1120-H is specifically for HOAs and does not tax the HOA on any income related to the purpose for which the Association exists. Income is taxed at a flat 30% on the 1120-H. The reason why the majority of HOA returns are filed using form 1120-H despite the higher tax rate is that form 1120-H is far less complex to prepare (and less expensive to have prepared) and the majority of HOAs do not have taxable income thereby making the difference in tax rates a non-issue.