IRS Revenue Ruling 70-604

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 membership income when filing form 1120.

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 rate of 21%. 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.