HOA and Community Association Tax Returns:

Think you don't need to file an annual tax return?

Think again!

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"Don't be the Board member who got the IRS involved in your association..."

When meeting with a community association client (homeowner association, condo association, etc.), one of the first questions I ask is whether they've filed a tax return this year. Too often, the answer is no. Unfortunately, that's the wrong answer. I bet that at least 35% of all HOAs and condo associations fail to file annual tax returns – especially self-managed communities.

All community associations need to file an annual tax return

This is one of the most overlooked association responsibilities. Most board members think that since their associations are non-profit organizations, no tax returns need to be filed. That is not correct. For tax purposes, Georgia and the IRS treat community associations like corporations and require them to file federal and state tax returns. You may have to pay tax on net income not related to standard association activities.

While requirements vary based on the filing criteria that you choose, here are some examples of income streams that are normally not taxed (exempt) and taxable.

Association membership income is not taxable

- HOA dues and assessments
- Owner fines, like $25 for a pine straw violation
- Interest on late payments as well as late fees
- Resident clubhouse and facility rentals

Net outside income is generally taxable

- Bank account interest and dividends
- Guest fees, such as a charge to non-resident for playing tennis or using the pool
- Non-resident clubhouse or facility rentals, minus costs

How do we file?

Tax returns are due March 15th, or 75 days after the close of your tax year if your association is not on a calendar year basis. With an extension, you have up to six extra months to file. I won't get into the details here, but there are two possible IRS forms to use – 1120-H or 1120 – depending on some specific requirements listed below. Your best option is to review your association's situation with a qualified CPA.

What if we've never filed a tax return?

The sooner your association files back tax returns, the better. Just because previous boards may have failed to do this, that doesn't absolve you of the responsibility. Technically, you need to file tax returns for every year that has been missed. Since you may not have records that far back, focus on where you do have the information first and at least get something filed as soon as possible.

Here are some real examples of tax return filing challenges faced by community associations:

- Association A had not filed tax returns for about ten years. They asked three CPAs what to do, but only one provided the right answer – Association A had to file ten back returns. Just filing a few is not enough.
- Association B filed as a non-profit 501(c)(3) one year, then failed to file in subsequent years. Other than in rare exceptions, community associations are not considered non-profit organizations. Association B had to change their entity status with the IRS, re-file that return, and file all other back tax returns.
- Association C was paying income tax when they didn't have to. On the Federal return, they weren't offsetting outside income with expenses, which artificially inflated income. Also, they were paying Georgia net worth tax, something that associations are exempt from paying. Fortunately, the mistake was caught, and they were able to file an amendment to get that money back.

Choosing the right IRS form

Form 1120-H is geared toward community associations, but under the IRS rules, a community association must satisfy these requirements to use it:

- At least 60% of the association's gross income consists of "exempt function income." This includes membership dues, fees, or assessments of owners in the association.
- At least 90% of the association's expenses must consist of expenses to acquire, build, manage, maintain, or care for its property.
- No private shareholder or individual can profit from the association's net earnings except by acquiring, building, or managing association property, or by a rebate of excess membership fees.
- At least 85 percent of the units are used by individuals for residential purposes.

You can read complete details about Form 1120-H requirements by searching online for IRS Regulations section 528. IRS Code section 277 discusses the filing of form 1120.

Individual community associations vs. master associations

In some very large or mixed-use communities, the individual community and business associations roll up to a master association. The individual associations pay into the master association so the master association is also required to file an annual tax return.

Don't be the Board member who got the IRS involved in your association

If you hire a CPA with community association experience, filing tax returns (even back returns in most cases) is a pretty straightforward process. Get caught up and make annual tax returns an agenda item for the first board meeting of every year. Please let me know if you have specific questions. ■