

REVENUE RULING 70-604^{[1],[2]}

Cross Reference Data

Topical

Assessments
Excess member income
Form 1120
Rollover of income
Time-share developments

Citation

IRC Section-277
Case-Mission Heights homeowners Association, Inc., Plaintiff v. United States of America, Defendant
Regulations Section-1.277-1
GCM-34618
Technical Advice Memorandum-9539001
Other Rulings-98ARD 176-4, FSA 1992-0208-1

Summary

Revenue Ruling 70-604 holds that excess assessments by an association that are returned to members or applied to the following year's assessments are not taxable income to the association. A separate election to treat the excess assessments in this manner must be made by the owners/members each year. It may not be made by the board of directors.

Excess Assessments by an Association That Are Returned to Members or Applied to the Following Years' Assessments Are Not Taxable Income to the Association.

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.

Rev. Rul. 70-604

A condominium management corporation assesses its stockholder-owners for the purposes of managing, operation, 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^[3] by the stockholder-owners^[4] 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^[5] 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 the excess, in effect, has been returned to the stockholders-owners.

Practical Considerations

- [¹] Revenue Ruling 70-604 is one of the most powerful planning tools available. It is probably also one of the most abused in practice, primarily due to the brevity of the ruling itself. There is almost as much not stated as is stated. The most troublesome areas for practitioners are discussed in the notes below.
- [²] In Technical Advice Memorandum 9539001 (presented in Chapter 10), the IRS held that a time-share development could not utilize Revenue Ruling 70-604 because its management activities went beyond the mere maintenance of the common elements by providing lien and maid service and furnishing the individual apartment units. The IRS held that the time-share development's scope of activities far exceeded the scope of activities specified in Revenue Ruling 70-604. A logical conclusion may be drawn that any substantial variance of facts would preclude an association from using the ruling. Consequently, CIRAs should carefully follow the steps listed in this ruling as discussed in Practical Considerations 3, 4, and 5.
- [³] A separate election must be made each year. In addressing the manner of making the election under Revenue Ruling 70-604, Technical Advice Memorandum 9539001 states:
- The revenue ruling clearly contemplates an annual choice by the member-payers on the subject. Whether this is accomplished at an annual meeting or in some other fashion is not significant.
- [⁴] The election must be made by the owners/members. It may not be made by the board of directors.
- [⁵] This wording indicates year (singular, not plural); the rollover is to the succeeding tax year only. In the authors' opinion, the excess amount must be "used up" in the following year, or it will become taxable.
- How do you make the election? No guidance is given. However, if the election is not in writing, practitioners cannot document that an election was ever made.
 - When do you make the election? Again, no guidance is given. The election must be made prior to the filing the return (or practitioners have no basis for making the appropriate calculations on the return.) The authors recommend that the election be made prior to the end of the associations' tax year

Note: The IRS stated in 98ARD 176-4 that "...Rev. Rul. 70-604 is being reconsidered in light of certain abuses that have come to our attention." The authors believe that a revision to Rev. Rul. 70-604 could potentially be made in the future to remove some of the ambiguity that currently exists.