Rev. Rul. 74-99, 1974-1 C.B. 132

Homeowners association, preserving appearance and maintaining common areas. A homeowners association, to qualify for exemption under section 501(c)(4) of the Code, (1) must serve a "community" which bears a reasonable recognizable relationship to an area ordinarily identified as governmental, (2) it must not conduct activities directed to the exterior maintenance of private residences, and (3) the common areas or facilities it owns and maintains must be for the use and enjoyment of the general public; Rev. Rul. 72-102 modified.

The Internal Revenue Service has been requested to clarify the circumstances in which an organization similar to the homeowners' association described in Rev. Rul. 72-102, 1972-1 C.B. 149, may qualify for exemption under section 501(c)(4) of the Internal Revenue Code of 1954.

The characteristics of the organization of homeowners described in Rev. Rul. 72-102 are generally typical of many such organizations formed in recent years that seek exemption under section 501(c)(4) of the Code and may be summarized as follows: The organization is formed by a commercial real estate developer as an integral part of a plan for the development of a subdivision. Membership in the association is required of all purchasers of lots in the development. Membership is open only to the developer (at least for such time as he owns property in the development) and those who purchase lots. The organization is supported by periodic assessments against the members and an unpaid assessment constitutes a lien on the property of the homeowner-member. The stated purposes of the organization are, generally speaking, to administer and enforce covenants for preserving the architecture and appearance of the given real estate development, and to own and maintain common green areas, streets, and sidewalks.

The foregoing format is spelled out in written documents which form a part of, and are inextricably tied to, enforceable contracts for the sale and purchase of private property. In the light of this combination of factors, the prima facie presumption is that these organizations are essentially and primarily formed and operated for the individual business or personal benefit of their members, and, as such, do not qualify for exemption under section 501(c)(4) of the Code. However, an organization of this kind may in certain circumstances overcome the presumption and qualify for recognition of exemption under section 501(c)(4).

Thus, notwithstanding the combination of characteristics which the organization in Rev. Rul. 72-102 has in common with many other homeowners' associations, it was considered to have established its qualification for recognition of exemption as an organization described in section 501(c)(4) of the Code. In reaching this conclusion Rev. Rul. 72-102 reads, in part, as follows: "For the purposes of section 501(c)(4) of the Code, a

neighborhood, precinct, subdivision, or housing development may constitute a community. For example, exempt civic leagues in urban areas have traditionally represented neighborhoods or other subparts of much larger political units. By administering and enforcing covenants, and owning and maintaining certain non-residential, non-commercial properties of the type normally owned and maintained by municipal governments, this organization is serving the common good and the general welfare of the people of the entire development."

Increasing experience with homeowners' associations of this general kind has demonstrated, however, that the Revenue Ruling does not delineate the bases for the favorable holding in the case clearly enough to prevent misconceptions as to its scope. Specific questions have been raised as to (1) the scope of the term "community" as used in the ruling; (2) whether an organization whose program includes activities devoted to exterior maintenance of private residences comes within the ambit of the ruling; and (3) the interpretation of the phrase "non-residential, non-commercial properties of the type normally owned and maintained by municipal governments."

One misconception generated by Rev. Rul. 72-102 is that the ruling appears unqualifiedly to equate a housing development with the term "community" within the meaning of section 501(c)(4) of the Code, thereby giving rise to the implication that any housing development may qualify as a community for exemption purposes regardless of any other attendant facts and circumstances in the case. Rev. Rul. 72-102 is hereby modified to reject its apparent acceptance of such a narrow definition of "community" for purposes of section 501(c)(4).

A community within the meaning of section 501(c)(4) of the Code and the regulations is not simply an aggregation of homeowners bound together in a structured unit formed as an integral part of a plan for the development of a real estate subdivision and the sale and purchase of homes therein. Although an exact delineation of the boundaries of a "community" contemplated by section 501(c)(4) is not possible, the term as used in that section has traditionally been construed as having reference to a geographical unit bearing a reasonably recognizable relationship to an area ordinarily identified as a governmental subdivision or a unit or district thereof.

A second feature of Rev. Rul. 72-102 that has been subject to misinterpretation is whether, consistent with the position taken in the Revenue Ruling, an organization whose program includes, but is not limited to, activities directed to exterior maintenance of private residences may qualify for recognition of exemption under section 501(c)(4) of the Code. In the given facts in the Revenue Ruling there was no mention of any exterior maintenance activity. One of the stated purposes of the organization in Rev. Rul. 72-102, however, is to enforce covenants for preserving the architecture and appearance of a

housing development. It has been contended that exterior maintenance activities may properly be justified and subsumed under that purpose.

Given the combination of factors discussed above surrounding the formation and operation of this type of homeowners organization, the exterior maintenance activities reinforce the prima facie presumption that the organization is operated essentially for private benefit. See Rev. Rul. 69-280, 1969-1, C.B. 152, in which exemption of an organization formed to provide maintenance of exterior walls and roofs of members' home is denied under section 501(c)(4) of the Code. See also Rev. Rul. 74-17, page 130, relating denial of exemption under section 501(c)(4) of an organization formed by unit owners in a condominium housing project to provide for the management, maintenance and care of all the areas and elements in the project that are owned in common by the unit owners.

Another aspect of Rev. Rul. 72-102 that has given rise to some misconception of the ruling's scope involves interpretation of the phrase "non-residential, non-commercial properties of the type normally owned and maintained by municipal government" in determining what kinds of common areas or facilities an exempt homeowners' association may own and maintain. The Revenue Ruling in reciting the areas and facilities owned and maintained by the organization speaks only of "common green areas, streets, and sidewalks." The Revenue Ruling was, by the quoted phrases, designed to indicate that the only areas and facilities encompassed were those traditionally recognized and accepted as being of direct governmental concern in the exercise of the powers and duties entrusted to governments to regulate community health, safety, and welfare. Thus, the Revenue Ruling was intended only to approve ownership and maintenance by a homeowners' association of such areas as roadways and parklands, sidewalks and street lights, access to, or the use and enjoyment of which is extended to members of the general public, as distinguished from controlled use or access restricted to the members of the homeowners' association, as appropriate and consistent with exemption for the association. Rev. Rul. 72-102 is modified accordingly.