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## Appendix 4P

### ***Mission Heights Homeowners Association, Inc., Plaintiff v. United States of America, Defendant*** [a](#)

U.S. District Court Case

#### Cross Reference Data

##### Topical

**Election re: excess income**

**Member income**

**Excess member income**

##### Citation

**IRC Sections—61—2A, 277—2F, 528—2K**

**Regulations Sections—1.277-1—5F, 1.528—5N**

**Revenue Ruling—70-604—6H**

**Other Rulings—98ARD 176-4, FSA 1992-0208-1—10H**

##### Summary

**In *Mission Heights Homeowners Association, Inc., Plaintiff v. United States of America, Defendant*, the Court held that the association was subject to tax on excess membership income on Form 1120 because it failed to make a timely election to file Form 1120-H (under IRC Sec. 528) and also failed to make an election under Rev. Rul. 70-604.**

US-DIST-CT, [96-2 USTC], U.S. District Court, So. Dist. Calif., *Mission Heights Homeowners Association, Inc., Plaintiff v. United States of America, Defendant*(**Aug. 28, 1996**)

[96-2 USTC] ***Mission Heights Homeowners Association, Inc., Plaintiff v. United States of America, Defendant*** U.S. District Court, So. Dist. Calif., Civ. 95-650-S (RBB), 8/28/96

Daniel J. Winfree, for plaintiff. Alan D. Bersin, United States Attorney, Robert H. Plaxico, Assistant United States Attorney, San Diego, Calif. 92189, George N. Harris, Jr., Department of Justice, Washington, D.C. 20530, for defendant.

#### **ORDER GRANTING UNITED STATES' MOTION FOR SUMMARY JUDGMENT AND DENYING PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT**

Schwartz, District Judge:

This matter came on for hearing on August 5, 1996. George N. Harris, Jr., Trial Attorney, Tax Division, U.S. Department of Justice, appeared on behalf of the United States of America. Daniel J. Winfree, Esq., appeared on behalf of Mission Heights Homeowners Association.

Upon consideration of the pleadings on file herein, in particular the recitation of facts contained in the government's motion for summary judgment which the plaintiff adopted as its own, and the arguments of counsel, the Court finds as follows:

- 1. Gross income is defined by federal law for purposes of federal taxation and, pursuant to 26 U.S.C. §61, gross income means all income from whatever source derived;**
- 2. The relevant statutes, cases, and secondary materials reveal a clear intention on the part of Congress that homeowners associations include all regular assessments received from the associations' members in gross income;**<sup>(1)</sup>

3. **Under federal law, homeowners associations have two options available to them to properly avoid paying taxes on their excess member assessment income. First, an association may elect to be treated as an exempt organization, pursuant to 26 U.S.C. §528, and thereby avoid paying taxes on member assessment income. Alternatively, an association may, pursuant to the administrative procedures enumerated in Revenue Ruling 70-604, 1970-2 C.B. 9, refund excess assessments to its members or apply such excess amounts to the members' subsequent year's assessments, thereby removing such amounts from income;**

4. The assessments received by Mission Heights Homeowners Association, from its members, were includible in gross income by the Association;

5. **The plaintiff did not make a timely Section 528 election. Likewise, it failed to follow the procedures identified in Revenue Ruling 70-604 so that it could exclude its excess assessments from income. In other words, the plaintiff neither refunded the excess assessment amounts to its members nor applied such amounts to the members' subsequent year's assessments.** <sup>b</sup>

Based on the foregoing premises

**IT IS HEREBY ORDERED that the United States' Motion for Summary Judgment is GRANTED and the plaintiff shall take nothing by way of its complaint;**

IT IS HEREBY FURTHER ORDERED that Mission Heights Homeowners Association's Motion for Summary Judgment is DENIED.

Case Footnotes:

(1) See, e.g., 26 U.S.C. §528; H.R. Report No. 94-658, 94th Cong., 2d Sess., reprinted in, 1976 U.S.C.C.A.N. 2897, 3222 (homeowners association taxed like any other corporation if it elects not to file under Section 528); *Concord Village, Inc. v. Comm.*, 65 T.C. 142 (1975), cross-appeals dismissed by agreement of parties, (9th Cir. 1977) (amounts placed in operating reserve accounts are includible in income); Revenue Ruling 75-371, 1975-2 C.B. 52 (regular, or general, assessments must be included in income citing 26 U.S.C. §61).

**Notes:**

<sup>a</sup> The association raised the novel argument that the assessments that the IRS was attempting to tax did not constitute income at all. This argument claimed that, because the association had virtually no control over the amount of money it collected for the benefit of its members or how the money was expended (both items being dictated by civil statute), the amounts collected did not meet the definition of income reached in the Supreme Court case *Commissioner v. Glenshaw Glass Co.* (1955) 348 U.S. 426 as "all items that are clearly realized accessions to wealth" (case not included in this *Guide*). The argument being that the association is merely holding the money in trust for the members. The IRS argued that ". . . the theory asserted by plaintiff in this case would result in reading entire sections out of the Internal Revenue Code. Further, a finding in the plaintiff's favor would contravene the Supreme Court's mandate that the term 'gross income' be broadly construed." The Court rendered a decision of summary judgment in favor of the Internal Revenue Service.

<sup>b</sup> Since a timely election to file Form 1120-H was not made, the association was forced to file Form 1120, resulting in the excess membership income being taxed because no election under Rev. Rul. 70-604 (Appendix 6H) was made. The election to either refund excess membership income or carry it over to the subsequent tax year must be made *before* the tax return is filed. If the election under Rev. Rul. 70-604 is not made, any excess member income *automatically* becomes taxable.

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