Background information on tax exempt Homeowners Associations

IRC Section 501 was established by congress to provide a taxing scheme for non profit organizations. Two specific subsections of IRC Section 501 that can potentially apply to homeowners associations are Sections 501(c)(4) and 501(c)(7).

IRC Section 501(c)(4) deals with "Social Welfare" organizations that serve a public benefit. Few homeowners associations will qualify under this section, but for those that do, the tax savings can be substantial. While the benefits of this section are generous, the qualification criteria are very stringent. The tax savings for most associations comes from the fact that interest income earned by an association exempt under this section is not taxable income. In addition, in some states, tax exempt associations become exempt from state sales tax. For those associations, the sales tax savings can be even larger than the income tax savings. Associations exempt under this section file Form 990 and are relieved of the tax risks associated with filing Form 1120.

IRC Section 501(c)(7) deals with "Recreational" organizations. The primary type of organization that qualifies for exemption under this section is a country club. Again, very few homeowners associations will qualify for exemption under this section because of the stringent qualification requirements. Contrasted to IRC Section 501(c)(4), associations exempt under IRC Section 501(c)(7) are not completely tax exempt. They will pay taxes on their interest income, and on most net non member income. Associations exempt under this section file Form 990 and are relieved of the tax risks associated with filing Form 1120.