

Internal Revenue Service

Department of the Treasury

District  
Director

1100 Commerce St., Dallas, Texas 75242

Date: JAN 2 1997

Employer ID Number:

Person to Contact:

Telephone Number:

Refer Reply To:

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under section 501(c)(4) of the Internal Revenue Code.

The information submitted indicates that you were incorporated in [REDACTED]. Your purposes, as stated in Article III of the Articles of Incorporation, include:

1. To own, manage and control the common areas of subdivisions in the [REDACTED] area [REDACTED] and to do so for the use and benefit of the owners of lots within subdivisions of said area. To place reasonable limitations on the number of persons privileged to use said common areas for hunting and other purposes, on account of lot owner membership.
2. To provide for the adequate maintenance of private bridges, gates, and roadways within and leading to such subdivisions.
3. To own, manage and control culinary water facilities and the distribution of water to owners of subdivided lots within such subdivisions.
4. To negotiate for, promote, manage and control recreational facilities and opportunities for the use and benefit of such lot owners.
5. To make assessments for the maintenance of roadways, gates, water service, real property, taxes, insurance and other reasonable expenses incurred in the operation of the corporation.
6. To obtain through negotiation and agreement access to property in the area of [REDACTED] for the recreational use of the members of the corporation, and to grant grazing rights and other rights (not inconsistent with the enjoyment and use by its members) over property owned by it in exchange for the use by its members of other adjoining property for the recreational pursuits of its members.
7. The foregoing objects and powers are in addition to any other and further powers authorized by the [REDACTED].

8. The corporation shall have the power to take reasonable measures as may preserve the natural state of the common areas under its jurisdiction and control and to reduce the hazards of fire and other deteriorations thereto. It shall adopt and enforce reasonable rules and regulations governing the use of common areas and other property and facilities under its jurisdiction.

Article IV of the organizing document indicates membership in the corporation consists of the owners of subdivision lots in the above mentioned area. One voting membership is issued for each lot within the subdivision or development regardless of the number of individuals or parties having legal or equitable ownership interest in a specific lot. Memberships are appurtenant to the lots to which they are issued and shall be transferred as the legal or equitable ownership lots are transferred.

Section A, Part 3, of Protective Covenants [REDACTED] Subdivisions One and Two, County of [REDACTED], State of [REDACTED] provides:

"All common areas within the subdivision are private, and neither the declarant's recording of the plat nor any other act of declarant with respect to the plat shall be construed as a dedication to the public, but rather all such common areas shall be for the use and enjoyment of members of the association and the guests of such members, subject to the restrictions of [REDACTED] placed upon the use of said common areas and the rules and regulations of the association."

As stated in your application for consideration of tax exemption under section 501(c)(4) of the Internal Revenue Code, the activities of the corporation consist of the following:

Fire Committee - Insures fire hazards are kept to a minimum; trains volunteers; staffs the fire station and maintains firefighting equipment; and, allows [REDACTED] the right to use equipment to fight major fires.

Water Committee - Insures all lots have water; keep systems operational; control usage to eliminate waste; maintain spring areas; test water; install fire hydrants; and, install reducers to insure water pressure does not "blow out" lot owners water systems.

Road Committee - Keeps roads open and usable by grading and applying road base; keep curves free of obstructions; provide weed control for common areas; and, cut new roads when and where needed.

Land Use Committee - Insure lot owners do not destroy common areas or leased areas; work with the State to insure good herd control; and, limit use of off-road vehicles to prevent property destruction.

Security and Hunting Committee - Insure all lot owners entitled to keys have them; enforce speed controls, issue violation tickets, and impose penalties as provided; check cabins and lot areas to insure all are safe and free of vandalism; insure that all association boundaries are properly marked and posted; and, hire security forces registered with the State to enforce hunting regulations.

In Part II, item #14, page 4 of the application, you state: "We lease [REDACTED] acres of land for use of our members. This property is adjacent to

Association property and is used for recreational and hunting purposes."

In Schedule B, item #3, page 8 of the application, you state: "The property is restricted to only lot owners and their guests."

In responding to questions presented in our letter of [REDACTED] your letter dated [REDACTED] contains, in part, the following statements:

Page 2, Paragraph 2 - "All properties within [REDACTED] boundaries are for use and enjoyment of the lot owners located within the boundaries. This includes their invited guests."

Page 2, Paragraph 4 - "...[REDACTED] properties do not contain parks, lakes, swimming pools, churches, schools, business buildings, or a post office..."

Page 3, Paragraph 3 - "[REDACTED] provides a locked gate at the entrance to [REDACTED] properties. Keys are provided to all lot owners...utility providers...law enforcement providers ([REDACTED] [REDACTED] game control officers, and federal and state fire personnel)."

Page 3, Paragraph 4 - "[REDACTED] land area is normally a summer use area only. The common areas are not developed to include lakes, swimming pools, etc. There is a small open community center close to the fire station. As stated before, [REDACTED] property is not open to the general public outside of the [REDACTED] boundaries. The public is excluded via the Covenants as set by the land owners."

Page 3, Paragraph 5 - "The property boundaries are marked by paint in inaccessible areas and all areas are posted private property and no trespassing without penalties. All roads are gated and locked, including the main gate. The property is only reasonably accessible via the main gate from a road provided by [REDACTED] up to the gate. Security guards are posted at the gate during the hunting season. During the rest of the time, security personnel roam the area on foot, horse back, and ATV's where possible."

Section 501(c) of the Code describes certain organizations exempt from Federal income tax under section 501(a) and reads, in part, as follows:

"(4) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes."

Section 1.501(c)(4)-1 of the regulations provides, in part, as follows:

"(a)(1) In general. A civic league or organization may be exempt as an organization described in section 501(c)(4) if -

- (i) It is not organized or operated for profit; and
- (ii) It is operated exclusively for the promotion of social welfare."

"(a)(2)(i) An organization is operated exclusively for the promotion

of social welfare when it is primarily engaged in promoting, in some way, the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements \*\*\* The promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office. Nor is an organization operated primarily for the promotion of social welfare if its primary activity is operating a social club for the benefit, pleasure, or recreation of its members, or is carrying on a business with the general public in a manner similar to organizations which are operated for profit.\*\*\*"

Revenue Ruling 72-102, 1972-1, C.B. 149, describes an organization formed by a developer to preserve the appearance of a housing development and to maintain streets, sidewalks and common areas for the use of the residents, which was found to be exempt under Internal Revenue Code section 501(c)(4). The rationale behind this decision was that the organization served the common good and general welfare of the entire community because it owned and maintained certain non-residential, non-commercial properties of the type normally owned and maintained by municipal governments. Administering and enforcing covenants for preserving the architecture and appearance of a housing development was incidental to the overriding public benefit.

Revenue Ruling 74-99, 1974-1, C.B. 131, modified Revenue Ruling 72-102. It provides that in order to qualify for exemption under IRC 501(c)(4), a homeowners' association: must serve a "community" which bears a reasonable, recognizable relation to an area ordinarily identified as governmental; must not conduct activities directed to the exterior maintenance of private residences; and, the common areas or facilities it owns and maintains must be for the use and enjoyment of the general public.

According to this revenue ruling, a community within the meaning of section 501(c)(4) 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. The term "community" as used in section 501(c)(4) 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. 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.

Revenue Ruling 80-63, 1980-1 C.B. 116, held that no hard and fast rule can be applied as to what constitutes a "community", but that each case must be examined to determine whether the activities of the organization have sufficient community benefit to serve a social welfare purpose under IRC 501(c)(4). Although an area represented by an association may not be a community, if the association's activities benefit a community, it may still qualify for exemption. For instance, if the association owns and maintains common areas and facilities for the use and enjoyment of the general public as distinguished from areas and facilities whose use and enjoyment is controlled

and restricted to members of the association, then it may satisfy the requirement of serving a community.

Question 2 of Revenue Ruling 80-63, supra, asks whether a homeowners' association which represents an area that is not a community qualifies for exemption under Code section 501(c)(4) if it restricts the use of its recreational facilities to its members. The answer given is "no". The use and enjoyment of the common areas owned and maintained by a homeowners' association must be extended to members of the general public, as distinguished from controlled use or access restricted to the members of the association.

The Rancho Santa Fe Association v. U.S. court case involves a large, self-contained housing development which was held to be exempt under section 501(c)(4) of the Internal Revenue Code.

Rancho Santa Fe Association consists of approximately 3,000 members who are property owners within the development. The property contained in the development consists of 6,100 acres. The Association oversees the governance of the property within the development by enforcing the covenants and setting up various boards, including a planning board, a park board, a health board, a library board, and a recreation board. The Association provides private security protection by way of the Rancho Santa Fe Patrol. The Association also functions as a liaison between the community and the Board of Supervisors on issues which require the participation of larger governmental entities, such as maintenance of the rights-of-way and the sanitation system. Rancho Santa Fe has its own post office and zip code.

The Court determined that Rancho Santa Fe as a development constituted an independent community within the meaning of the statute. It was a housing development, significant in size and self-contained in orientation. It was not the ordinary residential grouping of tract homes, but was an independent community separated geographically from the central area of the city of San Diego of which Rancho Santa Fe was a sub-part. It had its own post office, zip code, and public school district.

The Flat Top Lake Association, Inc. v. U.S. court case involves Flat Top Lake, a housing development. It maintains and operates a lake and other recreational facilities for the pleasure and convenience of its members. Flat Top Lake lacks certain indicia of a community such as churches, schools, or stores. Entrance to the Associations' property and use of its facilities is strictly limited to members and their guests. It has a sign on its entrance that states: "Flat Top Lake Association, Private Property, Members Only." The Association does not meet the requirements of exemption set out in Internal Revenue Code section 501(c)(4).

You do not resemble Rancho Santa Fe, which is tax exempt. You have no parks, lakes, swimming pools, commercial properties, schools, churches, or post offices. You are not a community; you are a summer use area.

You are not a community as described in Revenue Rulings 72-102 and 74-99. Common areas are not for the use and benefit of the general public as required by Revenue Ruling 80-63. You are similar to the Flat Top Lake Association because:

- (1) the common areas maintained by the organization are for the sole

use and benefit of the association members and their guests;

(2) the Protective Covenants of [REDACTED] exclude members of the general public from use and benefits of the common areas;

(3) all roads are gated and locked, including the main gate (members are provided with keys; security guards are posted at the main gate or protect the property on foot, horse back, and all-terrain vehicles; and, all areas have been posted private property, no trespassing without penalty.

Accordingly, it is held that you are not entitled to exemption from Federal income tax as an organization described in section 501(c)(4), and you are required to file Federal income tax returns on Form 1120.

In this letter we are not ruling on the question of whether you qualify for treatment as a homeowners' association described in Internal Revenue Code section 528. However, if you believe you qualify for such treatment, you should file Form 1120-H when due.

If you do not agree with these conclusions, you may, within 30 days from the date of this letter, file in duplicate a brief of the facts, law, and argument that clearly sets forth your position. If you desire an oral discussion of the issue, please indicate this in your protest. The enclosed Publication 892 gives instructions for filing a protest.

If you do not file a protest with this office within 30 days of the date of this report or letter, this proposed determination will become final.

If you agree with these conclusions or do not wish to file a written protest, please sign and return Form 6018 in the enclosed self-addressed envelope as soon as possible.

If you have any further questions, please contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely,



Bobby E. Scott  
District Director

cc: [REDACTED]

Enclosures:  
Publication 892  
Form 6018