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Understanding private elitist HOAs as social welfare HOAs

(full 30 minute podcast vailable here)

(See disclaimer, page 10)

SYNOPSIS.

Data on HOA member demographics is scare but I've been able to uncover documents, 11 years apart, that lead one to believe that HOAs are elitist for the most part. A CAI survey showed 79% respondents with incomes over $50,000 and 86% with some college of more. US Census showed 24.4% and 44.9% respecively. A confirming study on a large-scale HOA showed 88.1% with some college or more and 76.4% with income over $45,000.

According to CAI's LSA (large-scale associations) category of 1,000 or more units, a Nevada CAI survey showed a mere 2.0% were LSAs. This emphasis by CAI on LSAs, a small minority of HOAs across the country, impacts all HOAs of every size in the state as a result of its intense lobbying efforts, its *one size fits all* policy.

These surveys are not consistent with the totality of social welfare HOAs as contained in the IRS databases of 36,532 organizations filing under (c)4. Just 10.8% (3,931) of these organizations met the criteria for "homeowner associations" under the IRS subcategories, a far contrast with the surveys. Analyzing the justification by the IRS for one large-scale HOA raised concerns about the (c)4 tax-exempt process.

The absence of any discussion by SCG, a large-scale HOA, of it's social welfare status and related activities is compelling. Based on my many years exposure to HOA legalities, I would hazard a guess that the board had advisers and assistance in

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preparing and filing its application. SCG has close ties to CAI by virtue of its directors being CAI members, its attorney and CAM being CAI members, and its accounting firm, Mansperger Patterson & McMullin, also being a CAI member.

Elitist HOAs

Data on HOA member demographics is scare but I've been able to uncover [2] documents, 11 years apart, that lead one to believe that HOAs are elitist for the most part.

Category	HOA Survey	US Census
Age 50+	61%	21%
Education: college + / some college	68% / 86%	24.4% / 51.8%
Minority	11%	24.8%
Incomes over $50,000	79%	44.9%

The first is a 2007 CAI survey shown above.[2]

HS graduate	7.6%
Technical school	3.3%
Some college	21.0%
College graduate	32.4
Professional certification	5.3%
Post graduate degree	29.9%
Other	1.4%

< $15,000	.4%
$15-$24,999	1.4%
$25-$44,999	6.0%
$45-$74,999	20.1%
$75-$99,999	23.2%
$100,000+	31.0%

The Hultsman[3] study is below.

One size does not fit all. There are 2 measurements of HOA types used here: by function and by size, either by population or income. I am addressing the top echelon of HOAs as there is no one type of HOA that fits all types with respect to size, or function or purpose.

In 2005 I classified HOAs by function[4] — residential, resort, retirement — which CAI adopted in its Large-Scale[5] paper in 2016. In 2017 I added a by size[6] scale, based on units from a CAI Nevada survey in 2011, showing.

Less than 200 78.5%
201 – 500 16.5%
501 – 1,000 3.5%
1,001 – 8,000 2.0%

[2] "Foundation for Community Association Research Tracking Poll ," Zogby International (2007). Submitted to CAI's Foundation for Community Association Research. The Zogby document is no longer available on the internet from CAI (May 24, 2021).
[3] Infra, n. 18.
[4] Analysis of 2005 CAI HOA survey,
[5] Infra n. 9.
[6] Understanding the reality of HOAs and their functions.

According to CAI's LSA category of 1,000 or more units, the Nevada data shows a mere 2.0% were LSAs. This emphasis by CAI on LSAs, a small minority of HOAs across the country, impacts all HOAs of every size in the state as a result of its intense lobbying efforts, its *one size fits all* policy.

Why are these private, de facto, authoritarian governments that deny member constitutional protections getting preferred IRS treatment and tax breaks? Over the years, HOAs have contributed to the *haves and have nots* division in America. Trying to understand this unequal application of the laws, I now discuss what the (c)4 tax exemption is all about and how it has been applied to homeowners associations.

Examining the HOA (c)4 exemption development

As a result of my investigations some 3 years ago I discovered that a number of larger homeowners associations (HOA) in Arizona were granted IRS tax-exempt status as a social welfare organization (SWO) under 501(c)4. According to the IRS (emphasis added),

"Homeowners' associations. A membership organization formed by a real estate developer to own and maintain common green areas, streets, and sidewalks and to enforce covenants to preserve the appearance of the development should show that it is operated for the benefit of all the residents of the community. The term community generally refers to a geographical unit recognizable as a governmental subdivision, unit, or district thereof. . . . If your organization isn't organized for profit and will be operated primarily to promote social welfare to benefit the community, it may qualify for exemption under section 501(c)(4)."[7]

How could that be, I wondered, and so this year I conducted a quick sampling of 10 "homeowner associations" across the country. I discovered that indeed a substantial number were acknowledged as an SWO. Of the 10 HOAs, 5 were in Arizona[8] and the others in MD, CA, TN, NJ and IL. The IRS code, L50, is described as "Homeowners & Tenants associations."[9] In Arizona only 2 were HOAs, Sun City Grand and Sun City, and 3 in other states.

Taking a broader perspective using the tax exempt (c)4 data from CAI's 2016 Community Next[10] survey on large-scale associations (with only 102 respondents), The

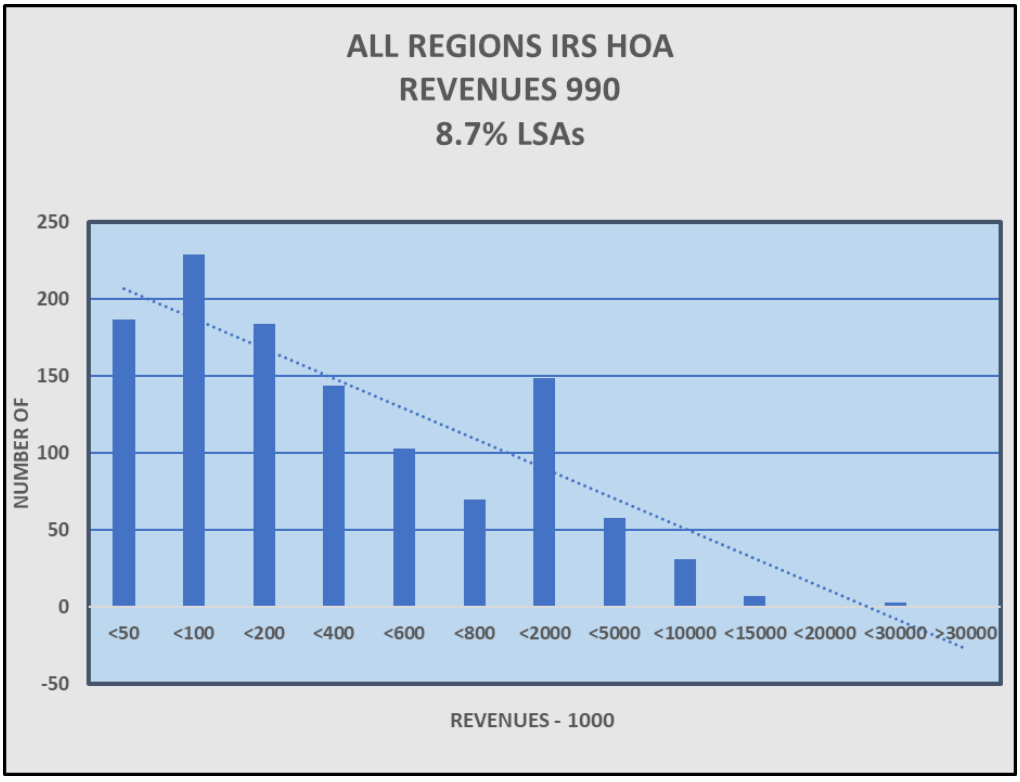
[7] IRS 557, Tax Exempt Status for Your Organization, Chapter 4, p. 47-48 (2021),
[8] The Arizona HOAs were Anthem, Sun City West Recreational Center, Sun City Recreation center, Sun City Grand, and Terravita in Scottsdale.
[9] *IRS Activity Codes (Jan. 2019). "L50 Homeowners & Tenants Associations Organizations that serve the interests of the community as a whole and provide services which meet the needs of people who own or rent apartments, condominiums, townhomes, mobile home parks or other housing complexes who are their members. Also included are complexes that are owned collectively by the people who live there."*
[10] Large Scale Associations CAI study, pp 89 -90 (2016)..

CAI data showed that 24.5% of the respondents filed form 990 that SWOs need to file, but looking at (c)4 categories, 30.4% were a SWO.

Looking further into this puzzlement at this time, I was surprised how few "HOAs" across the country were so designated by the IRS. Using the IRS BMF for (c)4 organizations, I Examined the IRS data base for social welfare organizations that fell under certain subcategories that applied to HOAs.[11] The findings are shown in the chart below, All Regions IRS HOA.

As there are many types of organizations that perform social welfare services to a community, the IRS has categorized these organizations into their major functions and coded them as NTEE codes.[12] The following are the stated mission statements on the HOA's IRS 990 form[13] and the NTEE assigned codes.

The CAI survey is not consistent with the totality of social welfare HOAs as contained in the IRS BMF Regional databases that contained 36,532 organizations filing under (c)4.[14] Just 10.8% (3,931) of these organizations met the criteria for "homeowner associations" under the IRS subcategories, a far contrast with the CAI survey of 102 respondents.



[11] Infra n. 6.
[12] Supra n. 5.
[13] Open990 (May 17, 2021).
[14] Exempt Organizations Business Master File Extract (EO BMF) | Internal Revenue Service (irs.gov).

This discrepancy is explainable on the basis that the CAI survey is not representative of al the HOAs. To be approved an HOA must satisfy the IRS' requirements as the basic IRS criteria for 501(c)4 classification[15] is,

To establish that your organization is operated primarily to promote social welfare . . . your application showing that your organization will operate primarily to further (in some way) the common good and general welfare of the people of the community (such as by bringing about civic betterment and social improvements).

An organization that restricts the use of its facilities to employees of selected corporations and their guests is primarily benefiting a private group rather than the community. It therefore doesn't qualify as a section 501(c)(4) organization. I was shocked and tried to reconcile this decision by the IRS with the ruling of the US Circuit Court where an WV HOA was seeking a tax exemption:

"Although it is unquestionably their right to do so, when a group of citizens elects, as have the inhabitants of Flat Top Lake, to separate themselves from society and to establish an entity that solely advances their own private interests [an HOA], no potential for general social advancement [benefit] is implicated. Wholly private activity, however meritorious, confers no such benefit which would render a compensatory exemption [tax break] appropriate."[16]

It is quite clear that private organizations would fail to survive the IRS requirements, yet HOAs are being allowed to be SWOs. Peter J. Reilly, CPA, tax expert on homeowner associations quoted nationally recognized authority on HOAs, Professor of political science at UIC, Evan McKenzie, questioning this logic.

"The logic of these rulings is pretty clear, I think. HOAs that offer no benefits to the larger community . . . shouldn't be able to file tax returns as if they were charitable institutions. But the recurring nature of these claims to 501 (c)4 status by gated communities highlights the inherent contradictions of private government."[17]

The above quotes get to the heart of the puzzlement, and as it applies to HOAs is an oxymoron or, using Orwell's term, "DoubleSpeak". That is, hold opposing thoughts or concepts and the same time. Along the way to accept HOAs as SWOs it appears that several rulings were issued by the IRS to "clarify" 1) what makes an organization a SWO, 2) what is a community and, 3) an expansion of HOAs as private membership organizations to encompass a community. All taking place in the 1969 – 1980 time frame,[18] but applied to HOAs rather lately in the 2008 - 2018, as far as I can determine.

[15] Supra n. 2 (The annual IRS 990 tax exempt filing is available to the public by request.)
[16] *Flat Top Lakes Assn v. United States of America,* 868 F. 2nd 108 (4th Cir. 1989).
[17] "Homeowner Association IRS Ruling Highlights Schizophrenic Nature Of Associations," Peter J. Reilly, Forbes (August 5, 2014). Quote was taken from a response to Reilly by McKenzie.
[18] 2003 EO CPE Text, IRS CPE (2003).

With the very broad definition of social wellness functions and activities, the IRS delineated just what type of SWO was acceptable for its exempt status, coded as NTEE. Of the 10 HOAs that I examined, I found 5 applicable to HOAs[19] that may or may not be recognized by the IRS as a bona fide HOA. Applying these distinctions to the 10 HOAs, about half using the term "HOA" or "community association passed review. Apparently, it's not so widely applicable to HOAs.

Accepting an HOA as a social welfare organization

It is evident that not all nonprofits calling themselves an HOA can qualify for IRS tax-exempt treatment as 501(c)4. What follows are the revised IRS criteria for (c)4 status and the arguments advanced, as I believe, for HOA's compliance. As simplified as I can make of this jumble of rulings, but listed to document the IRS HOA environment.

As I can determine, it came down to the Ruling, 80-63 (1980) that clarified a prior clarification Ruling, 74-99 (1974). The major points of 80-63 were related to the meaning of "community (emphasis added),

"The [IRS] *will not accept the position that an association's geographic area constitutes a "community" . . . without some showing that the association is . . . 'an active part of society [rather than] a private refuge for those who would live apart.'"*

A to-the-point clarification in 74-99 (a 1974 Ruling) is very important, and has not been overturned to my knowledge, but "hedged," defines what an HOA is as we generally know it — a developer built subdivision with restrictive CC&Rs. The Ruling adds:

"In the light of this combination of factors, the prima facie presumption is that these organization . . . do not qualify for exemption under section 501(c)(4) of the Code. . . .

The common areas or facilities it owns and maintains must be for the use and enjoyment of the general public.

The road to acceptance

In opposition to these Rulings, Gary A. Porter[20] — CPA, CAI member and former CAI president — has actively promoted and argued for HOAs as social welfare

[19] These are: N30, N50, S20, S22, and in addition to L50. They are described as a neighborhood association, recreation or fitness entity, a pleasure or social community, or community association or community foundation.

[20] Gary A. Porter profile: "*Mr. Porter served as Editor of CAI's Ledger Quarterly from 1989 through 2004 and is the author of more than 300 articles. In addition, he has had articles published in The Ledger Quarterly, The Practical Accountant, Common Ground and numerous CAI Chapter newsletters. He has been quoted or published in The Wall Street Journal, Money Magazine, Kiplinger's Personal Finance, and many major newspapers. Mr. Porter is a*

organizations. Setting the tone, among his activities in the 2008 – 2018 period he objects on the 3 latest Rulings, 72-102, 74-99 and 80-63[21] regarding a decision rejecting an HOA,

1. *"We thought that the public, as defined in Revenue Ruling 72-99, existed behind the guard gate and did not have to include 'the world at large'. Therefore public access existed at all times in the association.*
2. *"The equestrian center rented out stall space to anyone who wanted to rent such space, whether such individual was a member of the association or not. Therefore the general public did in fact have access to the two principle association common areas, consisting of the roads and the equestrian trails. We felt that there was, in fact, public access;*
3. *"The association also covered a geographical area that was virtually identical to the geographical area covered by a community services district . . . Per Revenue Ruling 74-99, whenever "a geographical unit bears a reasonably recognizable relationship to an area ordinarily identified as a governmental subdivision or unit or district thereof', then that association may also qualify for exemption under 501(c)(4)."*

Applying the IRS criteria to the 10 Arizona HOAs discussed above required first an examined of their governing documents, public websites, and their mission and purpose statements. Did these statements lend themselves to meeting the above IRS criteria for exempt status? Or did they meet the objections raised by Porter above? The IRS subcategory of social welfare entities are shown, reflecting the IRS holding.[22]

1. Terravita promotes itself as a Community Club and was categorized as a social and pleasure HOA N50.
2. Anthem admits to being a council in support of a wide community and was put into the neighborhood association category, S22
3. Sun City West Recreation Centers is obvious a recreation/fitness HOA under N30.
4. Sun City Recreation Center is also a N30.
5. Sun City Grand (SCG) is a true private community of members, but found to be S22.

Did Sun City Grand meet the criteria for HOA, 501(c)4 status?

The IRS process looks solely at the filed application for exemption as the basis for its Ruling, which can be upward of over 200 pages depending on the extent of exhibits required by the numerous schedules, such as copies of the governing documents, financials, HOA magazines, advertisements and public statements, etc. and programs

member of Community Associations Institute (CAI), and served as national president of CAI in 1998 – 1999."

[21] IRC Section 501 (c)(4) and Gated Associations, Gary A. Porter (2021).

[22] Supra n. 17.

demonstrating its community benefit services -- what was it doing. The IRS offers no justification for its Ruling in its "determination" letter.

Terravita is unquestionably a social club and qualifies as such with NTEE code, N50.

"[Sun City West] To provide recreational service/activities to the residents of sun city west and to operate and maintain and preserve facilities which enhance the recreational, social and leisure interests of the members. (N30, Community Recreational Facilities). [Sun City West is an unincorporated area in Maricopa County].

"[Sun City] The Recreation Centers of Sun City, Inc. provide activities to promote social welfare of the residents of Sun City, Arizona. (N30, Community Recreational Facilities). [Sun City is an unincorporated town in Maricopa County].

"Sun City Grand community association, inc. Has been formed for the purpose of owning, operating, maintaining, and preserving facilities which enhance the recreational, social, and leisure interests of the association and the surrounding community. (S22, Neighborhood, Block Associations). [SCG is a subdivision in the City of Superior].

*"Anthem community council, inc. Was organized to serve the common good and general welfare of the anthem community including perpetuating the sense of community life and spirit and being responsible for and involved in programs and activities which contribute positively to its residents and to the region of which it is a part. (**S22** Neighborhood, Block Associations)."* [Anthem is a master planned community].

It is clear from the above filed quotes Sun City and Sun City Grand are open for questioning as they are providing community benefits. Since Sun City is a corporation with the name "recreation centers" we can assume it qualifies as a (c)4. SCG was categorized as a Neighborhood, Block Association, as was Anthem, but unlike Anthem with questionable justification based on its mission/purpose statements in its application, as shown above. This apparent discrepancy needed further explanation.

SCG application concerns

In its application, SCG maintained in several instances that it allowed the public to use its facilities as community services to the public. The IRS require it to be substantial. However, take golf revenues for example. Golf constituted about 33% of the total SCG revenues, roughly $24 million, but public usage fees amounted to less than 1% ($277 thousand) of the total golf usage revenues of $7 million.

In addition to the above, on its application SCG stated that its mission was basically:

"*The Association provides for the common good and welfare of the community . . . benefitting both the Sun City Grand community and the surrounding community*." The

use of "community" didn't make sense. What was the board saying here? No where does the underlined phrase appear in its governing documents or vision statement or goals.

Additionally, SCG's vision statement is self-centered: "*Grand is the premiere active, age restricted community in Arizona.*" It's mission statement is also self-looking: "*Grand provides . . . in which everyone can choose to participate . . . [to] maximize our investments . . . in an active close-knit community.*" It can only be viewed as speaking about its members who invest in a SCG home.

The application contained a number of questionable and convoluted arguments suggesting what appears to be some confusion as just what SCG was asking for. In Schedule C it states that it is seeking exemption as a "homeowners association"; yet in Schedule L SCG — explicitly in its own words — denies seeking approval as an HOA but as a social welfare organization.

It seems that the heart of SCG's justification was based on the definition of community, and that SCG as indeed a private HOA, saw itself as actually the "surrounding community" or just "the community In short, SCG had to provide benefits to "the community" in order to obtain a tax exemption and it did so by claiming to provide community services to its own members as the "community" for tax exemption purposes.

This is an oxymoron and bespeaks of Orwell's DoubleSpeak — holding two opposing view at the same time. It's legal "word games" redefining traditional meanings to fit a desired outcome. It makes a mockery not only of the CC&Rs and the intent of private, contractual communities, but the intent of the IRS tax exemption program. Its 1974 Ruling, 74-99 held:

The [IRS] *will not accept the position that an association's geographic area constitutes a "community" . . . without some showing that the association is . . . 'an active part of society [rather than] a private refuge for those who would live apart.'"*

Furthermore, SCG consists of only 15% of Surprise and cannot be taken as a major community within Surprise.[23]

And as Prof. McKenzie stated in his frank, honest opinion, *"The logic of these rulings is pretty clear, I think. HOAs that offer no benefits to the larger community . . . shouldn't be able to file tax returns as if they were charitable institutions."*[24]

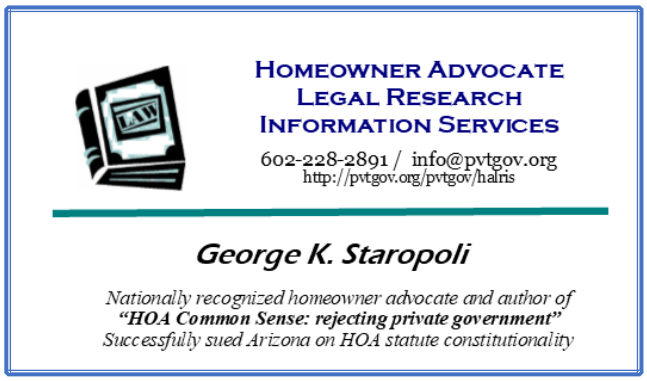
It appears that the IRS had accepted this reasoning and gave SCG its tax break as neighborhood block association based on the content of SCG's application. I raise this point based on Professor Wendy Hultsman's (ASU) 117 page Comprehensive study[25] for Sun City Grand, 3 years after the filing for exemption. In her report there is no mention of the social welfare status of SCG nor any discussion of contributions or services to the

[23] *Sun City Grand Comprehensive Long Range Study*, Dr. Wendy Hultsman, p. 67 (2018).
[24] *Supra* n. 15, McKenzie quote.
[25] *Id.*, p. 72.

greater community of Surprise. And furthermore, Hultsman advises SCG to get more involved with Surprise:

"*There are several opportunities to share the contributions of SCR [sic] residents' work in Surprise . . . Every community member who touches lives outside of SCG also brings awareness of Sun City Grand to Surprise residents. . . . Many residents have a wealth of knowledge and skills that can benefit others. It is a win-win for all!*"[26]

Consequently, the absence of any discussion by SCG, a large-sacle HOA, of it's social welfare status and related activities is compelling. Based on my many years exposure to HOA legalities, I would hazard a guess that the board had advisers and assistance in preparing and filing its application. SCG has close ties to CAI by virtue of its directors being CAI member, its attorney and CAM are CAI members, and its accounting firm, Mansperger Patterson & McMullin, is also a CAI member.



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[26] *Id.*