



Form 1120-H

A special return for homeowners associations

By Kaye Alvarez, MS, EA, NTPIF

A simpler, one-page corporate return that homeowners associations and tax preparers may not be aware of is Form 1120-H, *U.S. Income Tax Return for Homeowners Associations*. Typically, corporations are required to complete a more complex, five-page tax return when reporting their annual earnings to the IRS (i.e., Form 1120, *U.S. Corporation Income Tax Return*, or 1120S, *U.S. Income Tax Return for an S Corporation*). This article will describe the benefits of and qualifications for using the special form for homeowners associations (HOAs), how to make the election to use it, and the information reported on Form 1120-H.



What is an HOA?

There are three types of HOAs eligible to use Form 1120-H. All three types are organized and operated to acquire, build, manage, maintain and care for property. The first type is condominium management associations, which engage in these activities for a condominium project with substantially all the units as homes for individuals. The second type is residential real estate management associations. They are involved in these endeavors for a subdivision, development or similar area where substantially all the lots or buildings are homes for individuals. The third and final type is timeshare associations. Timeshares have members who hold timeshare rights to use the association's property or who hold a timeshare ownership interest in the corporation's real property.

Note: Reg. §1.528-4 defines *substantially all* as 90% of net assets or 70% of gross assets. Some legal firms suggest 85% meets the substantially-all test. Courts have applied a facts-and-circumstances test that focuses on operating assets.

What are the benefits and disadvantages of using Form 1120-H?

Many HOAs operate as non-profit organizations, yet, regardless of their profit status, they are considered corporations for federal income tax purposes. This requires them to use Form 1120, unless they elect to use the shorter Form 1120-H, which allows HOAs to exclude their main function's income from gross income and focus their annual reporting on other

income earned and expenses related to that other income. Examples include interest, capital gains, rents, supplies, taxes or licenses. Another benefit is HOAs are not subject to alternative minimum tax when choosing Form 1120-H; therefore, filing this form may result in lower taxation than Form 1120. One obvious advantage to using this one-page form is that it's easier and less time-consuming to complete. As such, tax preparers can provide services to these clients at a lower cost than to other corporations. Additionally, Form 1120-H does not require a balance sheet and gives HOAs a \$100 standard deduction.

A disadvantage of using Form 1120-H is the tax rate. If there is any taxable income, condominium and real estate management associations pay a flat 30% tax rate and timeshare associations pay a 32% tax. These rates apply to both ordinary income and capital gains. Conversely, corporations reporting income on Form 1120 are subject to a 21% tax rate. HOAs that offer services to their tenants and have greater taxable income may find Form 1120 a better option, but for many HOAs, this higher tax rate does not impede them from using 1120-H. For example, an association that keeps its sinking funds in interest-bearing accounts may have \$400 in taxable interest and, after the \$100 standard deduction, will owe \$90 in taxes versus \$84 if filing Form 1120. Yet, if it uses Form 1120-H, the savings gained in tax preparation fees more than compensates the client when compared to the cost of preparing Form 1120. Furthermore, some say the audit potential for Form 1120-H is much lower than Form 1120.



Another drawback to Form 1120-H is that HOAs cannot claim a net operating loss (NOL) nor can they carry a previous year's loss to this form. However, the IRS's flexibility offsets this hindrance; in any given year, an HOA can choose whether it wants to use Form 1120 or 1120-H. So, if there is a loss or an NOL carryforward, the association can simply opt to use Form 1120 for that year. Plus, if an NOL loss is taken one year, a Form 1120-H can be used the following year without losing the ability to carry over that NOL to a Form 1120 in the third year. A final disadvantage is that certain expenses are not deductible on Form 1120-H (e.g., organizational costs and other expenses under part VIII, subsection B of the tax code). If an HOA has these types of expenses to deduct, it may want to consider filing Form 1120 instead.

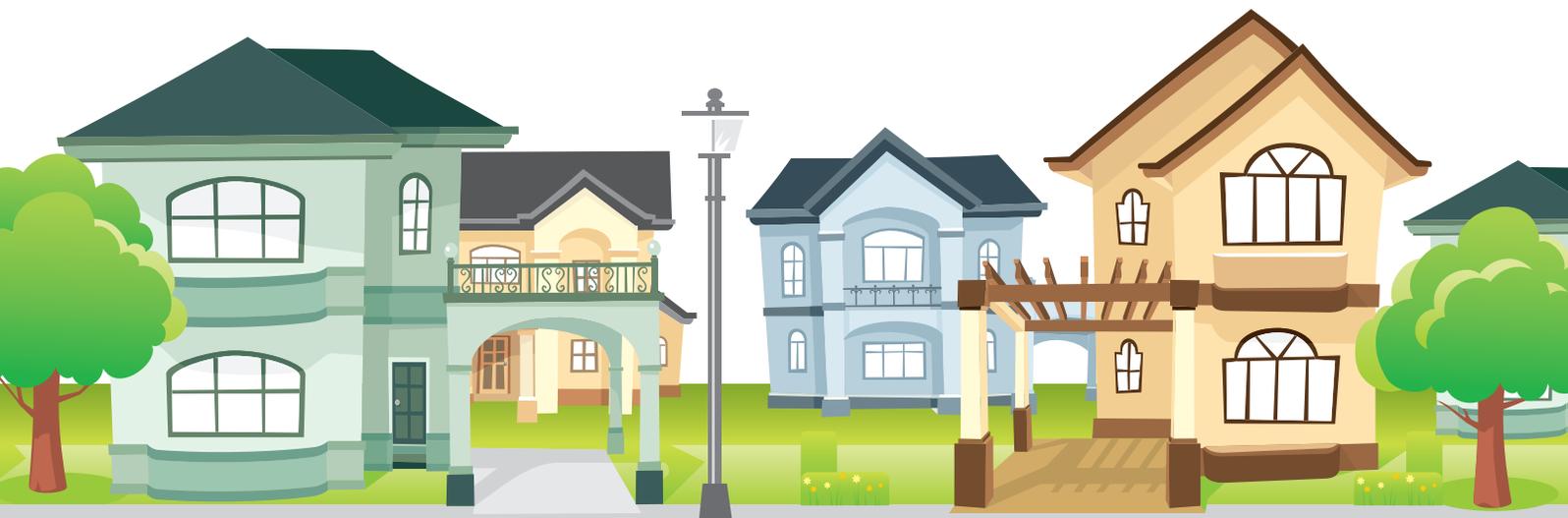
What is (and is not) function income?

For the purposes of §528, an HOA's function income is the income attributed to membership dues, fees or assessments received from owners of residential units or lots. These must come from the owners of the association, not customers. This includes monies collected to pay principal, interest and real estate taxes on the association's property or monies collected to maintain the property. Assessments or fees for a common activity qualify, but charges for personal services do not. Also not included are rent payments from nonmembers for temporary usage of the facilities (e.g., guest fees for pool usage, clubhouse rental, etc.), payments from members for special use of the

organization's facilities apart from the use generally available to all members, interest earned on amounts kept in a sinking fund, payments for work done on non-association property, members' payments for personal services (e.g., laundry, meal delivery, transportation, etc.), vending or laundry machine profits, parking fees and so on. For more details, see Reg. §1.528-9.

Do all HOAs qualify?

Not all HOAs qualify to use Form 1120-H, and tax-exempt associations under §501(a) are not eligible. If you look at the form on page 35, there is a section with line items labeled A through E underneath the name and address area. Particularly, items B and C inform the user of two requirements: 60% or more of the association's gross income must come from function income and 90% or more of the association's expenses must consist of costs to acquire, build, manage, maintain or care for the association's property. This encompasses management fees, legal costs, insurance, utilities and office expenses of the association. For timeshare associations, activities provided to or on behalf of members of the timeshare are also includable in the 90% expense category. A final requirement to use Form 1120-H is that no private shareholder, individual or owner can profit from the association's net earnings except when it is to acquire, build, manage or care for the association's property or to rebate excess membership dues, fees or assessments.



How do HOAs make the election to use Form 1120-H?

A qualifying HOA can make the election to use Form 1120-H by properly completing the form and submitting it by the due date, including the extension due date. An HOA makes the election in this way each year. The return is due on the fifteenth day of the fourth month after the end of the HOA's tax year. If the fiscal year ends June 30 or has a short year that ends anytime in June, the due date is the fifteenth day of the third month after the end of its tax year. The HOA planning to use Form 1120-H uses Form 7004 to file an automatic extension of time to file. There is an option to request a 12-month extension (see Reg. §301.9100-2 for more information). If the HOA does not file on time, it has no choice and must use Form 1120. An HOA may compute its tax using both 1120 and 1120-H forms and then chose to file the form that results in the lowest tax. Once the return is filed, the association cannot revoke the 1120-H without IRS consent.

What information do you provide on Form 1120-H?

Form 1120-H is a single page with six main parts. A copy of the form is on page 35, so you can follow along. The top section asks for basic information on the HOA including its name, address, tax identification number and start date. The second part, as mentioned above, includes line items labeled with A-E. You'll check the HOA type and list the HOA's function income and expenses. Line D is for reporting the HOA's total expenses (i.e., the total of both function and non-function expenditures the HOA had during the year). Line E is for reporting the HOA's tax-exempt interest, if any. The third part of the return, Gross Income, is for reporting the HOA's non-function income sources and adding up its total gross non-function income. Below that is the fourth section, Deductions, where you'll list the HOA's non-function expenses and total deductions, including the \$100 standard deduction.

The Tax and Payments portion of the return is where you'll calculate the HOA's tax and then deduct from that any taxes paid during the year or credited from the previous year. HOAs do not typically have taxes withheld from their income sources, but if they do, you'll show the amount withheld and write "backup withholding" on line 23. The IRS does not require Form 1120-H filers to make estimated tax payments;

however, since HOAs have the option to use Form 1120 or Form 1120-H each year, they may plan on using Form 1120 and send in estimated tax payments only to later decide Form 1120-H is the better option. Consequently, Form 1120-H provides a line item for estimated tax payments (23b) when applicable. The sixth and final section of the form is where the HOA officer and tax preparer sign the return.

Who signs the return and how are taxes due paid?

An HOA officer is authorized to sign the return. This can be the president, vice president, treasurer, assistant treasurer, chief accounting officer or any other representative of the association. The IRS does not allow HOAs to make tax payments with the tax return or with mail-in vouchers. HOAs must pay electronically using either the Electronic Funds Tax Payment System (EFTPS) or the Federal Tax Collection Service (TCS). With EFTPS, timely payments are ones that are submitted no later than 8:00 p.m. Eastern time, the day before the return is due, not including extensions. The TCS method can be used for same-day payments; however, financial institutions may charge fees for this method. Visit irs.gov/samedaywire for more information.

Summary

Associations that engage in little to no non-function income-producing activities may find Form 1120-H a more efficient means to meet their federal annual tax filing requirements. This form is simpler and takes less time than the five-page Form 1120. For the latest information and developments about Form 1120-H, visit irs.gov/form1120h. ■

References

1. www.irs.gov
2. Form 1120-H instructions
3. www.hoatax.com, Condo Association Tax Return Filing: What Your Association Must Know, Sundin & Fish, PLC
4. www.hoatax.com, HOA Taxes: Examining the Differences Between Form 1120-H and 1120, Sundin & Fish, PLC
5. www.hoatax.com, Form 1120-H: Tips & Tricks to Keep You Out of Trouble, Sundin & Fish, PLC

About the Author

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**U.S. Income Tax Return
for Homeowners Associations**

2017

Department of the Treasury
Internal Revenue Service

▶ Go to www.irs.gov/Form1120H for instructions and the latest information.

For calendar year 2017 or tax year beginning _____, 2017, and ending _____, 20

TYPE OR PRINT	Name	Employer identification number
	Number, street, and room or suite no. If a P.O. box, see instructions.	Date association formed
	City or town, state or province, country, and ZIP or foreign postal code	

Check if: (1) Final return (2) Name change (3) Address change (4) Amended return

A Check type of homeowners association: Condominium management association Residential real estate association Timeshare association

B Total exempt function income. Must meet 60% gross income test. See instructions **B**

C Total expenditures made for purposes described in 90% expenditure test. See instructions **C**

D Association's total expenditures for the tax year. See instructions **D**

E Tax-exempt interest received or accrued during the tax year **E**

Gross Income (excluding exempt function income)

1	Dividends	1		
2	Taxable interest	2		
3	Gross rents	3		
4	Gross royalties	4		
5	Capital gain net income (attach Schedule D (Form 1120))	5		
6	Net gain or (loss) from Form 4797, Part II, line 17 (attach Form 4797)	6		
7	Other income (excluding exempt function income) (attach statement)	7		
8	Gross income (excluding exempt function income). Add lines 1 through 7	8		

Deductions (directly connected to the production of gross income, excluding exempt function income)

9	Salaries and wages	9		
10	Repairs and maintenance	10		
11	Rents	11		
12	Taxes and licenses	12		
13	Interest	13		
14	Depreciation (attach Form 4562)	14		
15	Other deductions (attach statement)	15		
16	Total deductions. Add lines 9 through 15	16		
17	Taxable income before specific deduction of \$100. Subtract line 16 from line 8	17		
18	Specific deduction of \$100	18	\$100	00

Tax and Payments

19	Taxable income. Subtract line 18 from line 17	19		
20	Enter 30% (0.30) of line 19. (Timeshare associations, enter 32% (0.32) of line 19.)	20		
21	Tax credits (see instructions)	21		
22	Total tax. Subtract line 21 from line 20. See instructions for recapture of certain credits	22		
23	a 2016 overpayment credited to 2017 23a			
	b 2017 estimated tax payments 23b	c Total ▶	23c	
	d Tax deposited with Form 7004 23d		23d	
	e Credit for tax paid on undistributed capital gains (attach Form 2439) 23e		23e	
	f Credit for federal tax paid on fuels (attach Form 4136) 23f		23f	
	g Add lines 23c through 23f	23g		
24	Amount owed. Subtract line 23g from line 22. See instructions	24		
25	Overpayment. Subtract line 22 from line 23g	25		
26	Enter amount of line 25 you want: Credited to 2018 estimated tax ▶ Refunded ▶	26		

Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Signature of officer _____ Date _____ Title _____

May the IRS discuss this return with the preparer shown below? See instructions. <input type="checkbox"/> Yes <input type="checkbox"/> No
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Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check <input type="checkbox"/> if self-employed	PTIN
Firm's name ▶			Firm's EIN ▶	
Firm's address ▶			Phone no.	

For Paperwork Reduction Act Notice, see separate instructions.