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COMMON INTEREST DEVELOPMENTS [CIDs]
CID HOMEOWNERS' FEES AND THE ISSUE OF DOUBLE TAXATION
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INTRODUCTION

[N]o issue is likely to have more political fallout at the state and local level, to galvanize a constituency where once there was no constituency, than that of taxation/double taxation of community associations. And yet this issue is being all but ignored by policy makers.

"Double taxation" is the term used to describe the contention that homeowners' association ("HOA") membership fees should be tax deductible. HOA advocates assert that "the [fees] residents pay to their associations are the equivalent of property taxes because [the fees] go toward the maintenance of services and facilities ordinarily provided by local government." They argue that if "they are paying for their own trash removal, for maintenance of their own streets, and for upkeep of their own park, they should not have to pay property tax assessments for such services as public trash removal and street and park maintenance." According to such advocates, paying twice for services is unfair, and should be resolved by allowing "HOA residents to deduct some or all of their [fees] from their property tax bills."

This paper presents an introductory discussion of the impact of the proposed tax deduction for HOA membership fees, arguments for and against the proposal, an overview of the New Jersey Municipal Services Act, and the current state of the double taxation argument in California.

I. Individual and Association Tax Benefits

If HOA fees became tax deductible, individual members could enjoy considerable tax savings. According to a 1989 tax report, the average annual HOA membership fee was $867 while the actual fees paid by members vary widely from region to region. For example, in contrast to the average fees, "[i]n 1992 members of Leisure World, California, paid an annual HOA fee of $3,480." Contrasts on the other extreme include Ladue, Missouri, where HOA fees were $123.00 a year, and Olivette, Missouri, where they were only $67.00 a year. Depending on the individual member's tax status, deductibility of HOA fees could provide a significant tax advantage.

Currently, HOA's seek tax exemption status under section 528 of the Internal Revenue Code. "Section 528(b) imposes a tax of 30% on the associations income, but section 528(d)(3) allows the exclusion of 'exempt function income'; meaning any amount received as membership . . . fees from property owners in the association." This means that if individual homeowners were allowed to deduct their HOA fees, then there would never be any tax on monies spent by the HOA to increase the value of the common interest development.

II. Arguments Favoring and Opposing Tax Deductions For Homeowners' Association Membership Fees

Arguments in favor of eliminating double taxation focus on fairness and equity for the individual. Ben Lambert, a real estate attorney representing Community Associations Institute in New Jersey, contends that "[m]ost [homeowners'] associations were created so that municipalities would get all of the benefits but none of the burdens of large groups of homeowners. But if homeowners do not burden local governments with needs for services, than they should not be paying for those services." Similarly, Richard Fiore, chair of the California legislative Action Committee of the national Community Association Institute, agrees that "[t]here's a fairness . . . to this. A lot of homeowners are quite concerned because they've got to pay upkeep for private streets, road maintenance, green-area maintenance, et cetera and they're paying the same property tax they would otherwise be paying."

Critics of the HOA fees tax deduction proposal, however, contend there would be a serious loss of local government revenues in areas with large numbers of common interest developments. Using the Leisure World example mentioned above, a tax deduction of $3,480 for the twenty-thousand households in the common interest development could mean as much as a 69 million dollar loss from municipal coffers.

Other arguments against the HOA fee tax deduction proposal focus on the fairness and equity to the larger community (the community outside the common interest development). This argument takes the stance that "CID residents use public facilities [and services] . . . [and] benefit from the existence of such . . . which are essential to the overall environment in which their developments exist. For example, . . . [the] food supply arrives through public streets maintained by local property tax, and the public parks serve an important . . . social function of providing a place for people to gather and play." CID residents have access to all these places and services, while members of the community outside the CID do not have access to the private places supported by CID fees. "[P]rivate facilities enjoyed exclusively by CID owners are luxuries that they purchased and for which they are consequently expected to pay." An appropriate analogy would be that "[m]any people do not use public parks because they belong to health clubs or [do not] use public libraries because they . . . have access to superior research facilities. They pay for these assets in one way or another, but they are not permitted to avoid property tax liability as a consequence."

Author David J. Kennedy proposes that homeowners' associations should meet a test to qualify for a tax deduction subsidy. He suggests that HOA's should have to "prove that

they are bearing a cost and that there is greater social utility if government bears the cost in their stead." He asks whether "residential associations should enjoy an additional exemption from public responsibility when their expenditures carry no benefits to anyone else?" If a tax deduction would be permitted and with it the requirement the homeowners' associations pay for their own upkeep, the loss in tax revenue from wealthy CIDs would prevent the municipality from diverting funds to areas of greater need.

III. The New Jersey Municipal Services Act

New Jersey has addressed the issue of double taxation in its landmark Municipal Services Act. The Act, which became effective on January 1, 1991, requires "local governments to reimburse homeowners' associations for services that they are providing with funds from [homeowners' fees]." Services such as garbage removal, street sweeping, recycling pickup and street lighting must either be provided by the municipalities or the municipalities can choose to reimburse the homeowners' associations for the services. To ease the financial burden on local government, the law allowed reimbursement payments to be phased in over a five-year period. Beginning in 1991, towns will have to reimburse 20 percent of the services' cost each year until 100 percent begins in the fifth year. According to the Los Angeles Times, several other states are considering legislation similar to the Municipal Services Act, including Florida, Virginia, Connecticut and Pennsylvania.

IV. Double Taxation in California

According to James Beaver, counsel for the California Department of Real Estate, in California "[n]othing has happened . . . yet [in regard to double taxation] and I don't suspect it will in the near future with our cities and counties in such bad financial shape." Political scientist Evan McKenzie agrees, asking, "What would happen to Orange County, where 80 percent of the new housing over the last 15 years has been in common-interest developments, if a law like [New Jersey's Municipal Services Act] was passed there? They'd have to sell the courthouse in Santa Ana at an auction if they exempted property taxes for CID owners."

CONCLUSION

At this time, a tax deduction for homeowners' fees does not appear imminent in California, due to the precarious state of municipal finances in the post-Proposition 13 era. Yet, the issue continues to be a rallying cry for homeowners' association members who are disillusioned with the quality of local government services received for the amount of taxes paid.

SOURCE: http://w3.uchastings.edu/plri/96-97tex/cidhome.htm