

community health, safety and welfare. Such areas and facilities would normally include roadways, parklands, sidewalks, streetlights and firehouses. Property described in this paragraph will be considered association property regardless of whether it is owned by the organization itself, by its members as tenants in common or by a governmental unit and used for the benefit of the residents of such unit including the members of the organization.

(c) *Privately owned property.* Association property may also include property owned privately by members of the organization. However, to be so included the condition of such property must affect the overall appearance or structure of the residential units which make up the organization. Such property may include the exterior walls and roofs of privately owned residences as well as the lawn and shrubbery on privately owned land and any other privately owned property the appearance of which may directly affect the appearance of the entire organization. However, privately owned property will not be considered association property unless:

(1) There is a covenant or similar requirement relating to exterior appearance or maintenance that applies on the same basis to all such property (or to a reasonable classification of such property);

(2) There is a pro rata mandatory assessment (at least once a year) on all members of the association for maintaining such property; and

(3) Membership in the organization is a condition of ownership of such property.

[T.D. 7692, 45 FR 26321, Apr. 18, 1980]

§ 1.528-4 Substantiality test.

(a) *In general.* In order for an organization to be considered a condominium management association or a residential real estate management association (and therefore in order for it to be considered a homeowners association), substantially all of its units, lots or buildings must be used by individuals for residences. For the purposes of applying paragraph (b) or (c) of this section, and organization which has attributes of both a condominium management association and a residential

real estate management association shall be considered that association which, based on all the facts and circumstances, it more closely resembles. In addition, those paragraphs shall be applied based on conditions existing on the last day of the organization's taxable year.

(b) *Condominium management associations.* Substantially all of the units of a condominium management association will be considered as used by individuals for residences if at least 85% of the total square footage of all units within the project is used by individuals for residential purposes. If a completed unit has never been occupied, it will nonetheless be considered as used for residential purposes if, based on all the facts and circumstances, it appears to have been constructed for use as a residence. Similarly, a unit which is not occupied but which has been in the past will be considered as used for residential purposes if, based on all the facts and circumstances, it appears that it was constructed for use as a residence, and the last individual to occupy it did in fact use it as a residence. Units which are used for purposes auxiliary to residential use (such as laundry areas, swimming pools, tennis courts, storage rooms and areas used by maintenance personnel) shall be considered used for residential purposes.

(c) *Residential real estate management associations.* Substantially all of the lots or buildings of a residential real estate management association (including unimproved lots) will be considered as used by individuals as residences if at least 85% of the lots are zoned for residential purposes. Lots shall be treated as zoned for residential purposes even if under such zoning lots may be used for parking spaces, swimming pools, tennis courts, schools, fire stations, libraries, churches and other similar purposes which are auxiliary to residential use. However, commercial shopping areas (and their auxiliary parking areas) are not lots zoned for residential purposes.

(d) *Exception.* Notwithstanding any other provision of this section, a unit, or building will not be considered used for residential purposes, if for more

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than one-half the days in the association's taxable year, such unit, or building is occupied by a person or series of persons, each of whom so occupies such unit, or building for less than 30 days.

[T.D. 7692, 45 FR 26322, Apr. 18, 1980; T.D. 7692, 45 FR 24879, May 23, 1980]

§ 1.528-5 Source of income test.

An organization cannot qualify as a homeowners association under section 528 for a taxable year unless 60 percent or more of its gross income for such taxable year is exempt function income as defined in § 1.528-9. The determination of whether an organization meets the provisions of this section shall be made after the close of the organization's taxable year.

[T.D. 7692, 45 FR 26322, Apr. 18, 1980]

§ 1.528-6 Expenditure test.

(a) *In general.* An organization cannot qualify as a homeowners association under section 528 for a taxable year unless 90 percent or more of its expenditures for such taxable year are qualifying expenditures as defined in paragraphs (b) and (c) of this section. The determination of whether an organization meets the provisions of this section shall be made after the close of the organization's taxable year. Investments or transfers of funds to be held to meet future costs shall not be taken into account as expenditures. For example, transfers to a sinking fund account for the replacement of a roof would not be considered an expenditure for the purposes of this section even if the roof is association property. In addition, excess assessments which are either rebated to members or applied against the members' following year's assessments will not be considered an expenditure for the purposes of this section.

(b) *Qualifying expenditures.* Qualifying expenditures are expenditures by an organization for the acquisition, construction, management, maintenance, and care of the organization's association property. They include both current operating and capital expenditures on association property. Qualifying expenditures include expenditures on association property despite the fact that such property may produce income

which is not exempt function income. Thus expenditures on a swimming pool are qualifying expenditures despite the fact that fees from guests of members using the pool are not exempt function income. Where expenditures by an organization are used both for association property as well as other property, an allocation shall be made between the two uses on a reasonable basis. Only that portion of the expenditures which is properly allocable to the acquisition, construction, management, maintenance or care of association property, shall constitute qualifying expenditures.

(c) *Examples of qualifying expenditures.* Qualifying expenditures may include (but are not limited to) expenditures for:

- (1) Salaries of an association manager and secretary;
- (2) Paving of streets;
- (3) Street signs;
- (4) Security personnel;
- (5) Legal fees;
- (6) Upkeep of tennis courts;
- (7) Swimming pools;
- (8) Recreation rooms and halls;
- (9) Replacement of common buildings, facilities, air conditioning, etc.;
- (10) Insurance premiums on association property;
- (11) Accountant's fees;
- (12) Improvement of private property to the extent it is association property; and
- (13) Real estate and personal property taxes imposed on association property by a State or local government.

[T.D. 7692, 45 FR 26322, Apr. 18, 1980]

§ 1.528-7 Inurement.

An organization is not a homeowners association if any part of its net earnings inures (other than as a direct result of its engaging in one or more exempt functions) to the benefit of any private person. Thus, to the extent that members receive a benefit from the general maintenance, etc., of association property, this benefit generally would not constitute inurement. If an organization pays rebates from amounts other than exempt function income, such rebates will constitute inurement. In general, in determining whether an organization is in violation of this section, the principles used in