LAW

Taxing Situation

The Rules Are Changing for Condominium Unit Owners' Organizations

By MARK J. BEGLANE, Esq.

This law was repealed a week after this article was published.

Condominium unit owners' organizations should be aware that on July 3, 2008, the governor signed into law "An Act Relative to Tax Fairness and Business Competitiveness." This act takes effect in Massachusetts for tax years beginning Jan.1, 2009 relative to income and excise taxes.

As far as condominium unit-owners' organizations are concerned, the act now makes unit owners' organizations file as the same form of entity for federal and Massachusetts income-tax purposes. Prior to the enactment of this new law, condominium associations filed federally as corporations and filed in Massachusetts as different business entities (i.e. unincorporated associations, trusts, corporations, etc.), depending upon the type of entity chosen for the unit owners' organization. Under federal law, unit owners' organizations must file corporate tax returns; however, the unit owners' organization is offered certain protection and exemptions under the Internal Revenue Code, sections 277 and 528, which eliminate and/or lessen the tax implications with regard to 'income' in the form of excess common fees and net worth.

Now, as a result of this new act, unit owners' organizations will be taxed as corporations at the state level in Massachusetts. The implications to unit owners' organizations are as follows:

Unit owners' organizations will now be subject to the Massachusetts excise tax and will have to file state Form 355, which is a significantly more detailed form than the previous Form 3M. This form will take longer and be more costly to prepare if done by a third party. Generally the new forms must be filed electronically.

The tax rate will jump from 5.3% on taxable income to 9.5% in 2009, but the rate will drop to 8.75% in 2010, 8.25% in 2011, and 8% after 2012. Thus, any taxable income will now be taxed in Massachusetts at 9.5%, not 5.3% for 2009.

The unit owners' organization will now have to pay a corporate excise tax based on the unit owners' organization's taxable property or net worth, which includes all property, operating accounts, and replacement and contingency reserve accounts, in addition to any property owned by the unit owners' organization. The tax rate on such property or net worth is 0.26%. Thus, an older unit owners' organization that has a large reserve account to cover replacement of large capital items such as roofs, parking lots, sidewalks, and siding will be taxed at 0.26% of the value of such accounts. For example, a condominium with a reserve account of $500,000 will be responsible to pay a corporate excise tax of $1,300 ($500,000 x 0.26%).

Unit owners' organizations must pay to the Commonwealth of Massachusetts a minimum tax of the greater of $456 or the sum of net income taxed at 9.5% for 2009 and excise tax at 0.26% of net worth or tangible property of the unit owners' organization.

Unit-owners' organizations must pay to the Commonwealth of Massachusetts a minimum tax of the greater of $456 or the sum of net income taxed at 9.5% for 2009 and excise tax at 0.26% of net worth or tangible property of the unit owners' organization.

Therefore, it will be prudent for the managing board of the unit owners' organization to budget for these increased taxes and costs, to prepare these forms, and to review their existing operating accounts, contingent accounts, reserve accounts, personal property, and real estate to determine if there are surpluses in such accounts or property, and to either dispose of such surpluses or spend down any surpluses to reduce future excise taxes.

Even though the new law taxes unit owners' organizations for maintaining large reserve accounts, it is still prudent for such organizations to maintain such accounts at levels necessary to have scheduled replacements done in a timely manner, so as to avoid having to assess unit owners' special assessments to cover these anticipated replacements or repairs, or to borrow money to accomplish such repairs or replacements. This is because the interest costs and financing costs for homeowners or associations to borrow to pay such costs to repair or replace the common elements exceeds the new tax rate imposed under the new act. ■

Mark J Beglane, Esq. is a shareholder with Bacon Wilson, P.C. He is a member of the firm's real estate department with special expertise in the areas of condominium law, zoning, land-use planning and development, and municipal law; (413) 781-0560; mbeglane@baconwilson.com