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Making the Revenue Ruling 70-604 Election

Written by [Gary Porter](#)

Revenue Ruling 70-604 states that “a meeting is held each year by the **stockholder-owners** of the corporation at which *they decide* what is to be done with any excess assessments...”.

This wording is generally interpreted literally to mean that only the members can make the election. The board of directors cannot make the election. This interpretation places the election approval process directly in conflict with state law (for at least every state in which I have researched this issue), which prescribes that only the board of directors may make decisions regarding disposition of association funds; the members cannot do so. That’s why directors were chosen to represent them.

Associations continually tell me that they can’t get a quorum of members to make a legal vote, or that they have difficulty getting the members to approve an election under Revenue Ruling 70-604. The follow-up question is, “Can’t we just have the Board of Directors make the election?”

The answer is probably yes, but that depends on how much risk you want to take or how much money you want to spend fighting the IRS on this issue. An argument made out of context to the IRS that “the board must make the election because only they have the authority to do so” is a losing one. (If you don’t believe me, just ask any IRS agent.)

The IRS interprets this Ruling very literally to mean that **the stockholder-owners must make the decision**, because that’s what the Ruling says. The IRS is bound by the Internal Revenue Code and Federal Court cases, but is not bound by state law, non-judicial precedent, or any other precedent except those of their own making. The IRS must follow its own Revenue Rulings whenever they apply to a given situation.

The IRS doesn’t care what state law stipulates, or who has the actual authority to make a decision regarding the disposition of association funds. They only care what their Ruling says, and it says “stockholder-owners,” not directors. However, the phrase as stated by the IRS makes sense **ONLY** if the members have the authority to determine the disposition of association funds.

It takes only a subtle change in interpretation to change the face of the argument entirely. When working under Revenue Ruling 70-604, pay careful attention to the subtleties of phrasing: “A meeting is held each year by the stockholder-owners of the corporation at which they decide what is to be done with any excess assessments . . .” The phrase “they decide” clearly implies that the stockholder-owners have the authority to make the decision. In fact, they don’t. The IRS was simply unaware of this aspect of association governance at the time the Ruling was issued.

I discussed this issue several years ago with the national office of the IRS, and they conceded that their only interpretation was a literal one, meaning the members had to make the election. I suggested an alternate interpretation: “A meeting is held each year by the **individuals in the association who have the authority to make the decision** (the board of directors) at which they decide what is to be done with any excess assessments...” The IRS agreed that my interpretation had merit because the Ruling has no basis if the individuals making the election do not also have the authority to determine the disposition of association funds.

Winning an argument with the IRS isn’t done by telling them that their Revenue Ruling is wrong. Winning the argument is done by showing them how their Revenue Ruling really conforms to the facts. The board makes the election because they are empowered to do so, *and that’s what the Revenue Ruling says* (in substance, not literally).

Having now discussed the issues, what is an association to do? Well, do you want to comply with what the IRS requires and have the members make the election, or would you prefer to fight them and have the board of directors make the election?

The fact is, you can take a simple action to satisfy both state law and IRS requirements.

I recommend to clients that the members make the election, usually at the annual meeting, although any legal vote of the members will suffice. Then, have the Board ratify that election at their first meeting after the annual meeting. That way, you’re covered no matter how you interpret the ruling.

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Gary Porter, CPA, RS, PRA, has been working in the community association industry for more than 30 years. As a CPA, he has performed thousands of association audits, and prepared thousands of association income tax returns. He has specialized in the preparation of tax exemption applications, and has successfully taken more than 80 associations tax exempt, at a cumulative tax savings of millions of dollars. He is the primary author of PPC's "Guide to Homeowners Associations" and "Homeowners Association Tax Library," which serve as the principal guides used by CPAs within the community association industry.

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