Ocean Pines Ass'n v. Comm'r, 135 T. C. 276 (2010) (United States Tax Court, 2010)

In *Ocean Pines Ass'n v. Comm'r*, the U. S. Tax Court ruled that a homeowners association's income from operating exclusive parking lots and a beach club, restricted to members, was subject to unrelated business income tax. The court found these activities did not promote community welfare as they were not accessible to the general public, a requirement for maintaining tax-exempt status under section 501(c)(4). This decision underscores the importance of public access for tax-exempt activities and clarifies the scope of the unrelated business income tax for similar organizations.

Parties

Ocean Pines Association, Inc. (Petitioner, Appellant) v. Commissioner of Internal Revenue (Respondent, Appellee). Ocean Pines Association, Inc. was the plaintiff at the trial level and the appellant before the Tax Court. The Commissioner of Internal Revenue was the defendant at the trial level and the appellee before the Tax Court.

Facts

Ocean Pines Association, Inc. (the Association), a homeowners association in Maryland, was recognized as tax-exempt under section 501(c)(4) of the Internal Revenue Code. It operated facilities within the Ocean Pines community, including recreational facilities open to both members and nonmembers. Additionally, it owned and operated a beach club and two parking lots in Ocean City, approximately eight miles from Ocean Pines. These facilities were exclusively for Association members and their guests during certain times of the day and year. The Association's members were required to pay fees for using the parking lots and the beach club's swimming, gym, and shower facilities. The Association leased the parking lots to third parties outside these member-exclusive hours. The Internal Revenue Service (IRS) determined that the income from the parking lots and beach club operations was subject to unrelated business income tax (UBIT) because these activities were not substantially related to the promotion of community welfare, the basis of the Association's tax exemption.

Procedural History

The IRS issued a notice of deficiency to the Association on November 29, 2007, asserting deficiencies in income tax and additions to tax for the taxable years 2003 and 2004. The Association petitioned the U. S. Tax Court for a redetermination of the deficiencies. The parties submitted the case to the Tax Court without trial under Rule 122 of the Tax Court Rules of Practice and Procedure. The IRS conceded that the revenue from leasing the parking lots to third parties during certain hours was exempt from UBIT as rent from real property under section 512(b) and also conceded the Association was not liable for late-filing additions to tax under section

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6651(a)(1). The remaining issues were whether the operation of the parking lots and the beach club was substantially related to the promotion of community welfare and whether the parking lot income qualified as rent from real property under section 512(b)(3).

Issue(s)

1. Whether the operation of the parking lots and the beach club by Ocean Pines Association, Inc. is substantially related to the promotion of community welfare under section 501(c)(4)?

2. Whether the revenue received by Ocean Pines Association, Inc. from its members for parking on its two parking lots is exempt from unrelated business income tax as rent from real property under section 512(b)(3)?

Rule(s) of Law

1. Section 501(c)(4) of the Internal Revenue Code exempts from federal income tax civic leagues or organizations operated exclusively for the promotion of social welfare. An organization is considered operated exclusively for the promotion of social welfare if it is primarily engaged in promoting the common good and general welfare of the people of the community (26 C. F. R. 1. 501(c)(4)-1(a)(2)).

2. Section 511(a)(1) imposes a tax on the unrelated business taxable income of organizations exempt under section 501(c)(4). Section 512(a)(1) defines unrelated business taxable income as the gross income derived from any unrelated trade or business regularly carried on by the organization, less allowable deductions, with modifications provided in section 512(b).

3. Section 512(b)(3)(A)(i) excludes “rents from real property” from unrelated business taxable income. Section 1. 512(b)-1(c)(5) of the Income Tax Regulations specifies that payments for the use or occupancy of space in parking lots do not constitute rent from real property if services are rendered to the occupant.

Holding

1. The operation of the parking lots and the beach club by Ocean Pines Association, Inc. is not substantially related to the promotion of community welfare because these facilities are not open to the general public. Therefore, the income from these operations is subject to unrelated business income tax.

2. The revenue received by Ocean Pines Association, Inc. from its members for parking on its two parking lots does not qualify as rent from real property under section 512(b)(3) because the Association provides services to its members in operating the parking lots, as defined by section 1. 512(b)-1(c)(5) of the Income Tax Regulations. Therefore, this income is subject to unrelated business income tax.

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Reasoning

The Tax Court's reasoning for the first issue was based on the requirement that activities must be open to the general public to promote community welfare as defined under section 501(c)(4). The court cited *Flat Top Lake Association, Inc. v. United States*, which held that a homeowners association that restricts the use of its facilities to its members does not promote the welfare of the community. The court concluded that the beach club and parking lots, being accessible only to Association members and their guests, did not meet this requirement.

For the second issue, the court relied on legislative history and the regulations. The House Ways and Means Committee report and the Senate Finance Committee report on the Revenue Act of 1950 and the Tax Reform Act of 1969 indicated that income from operating a parking lot was not exempt from UBIT as rent from real property. The court also interpreted section 1. 512(b)-1(c)(5) of the Income Tax Regulations to mean that the services provided by the Association in operating the parking lots for its members were primarily for the convenience of the occupants and not usually or customarily rendered in connection with the rental of space for occupancy only. Therefore, the income did not qualify as rent from real property.

The court also considered the Association's argument that its membership should be considered the general public, but rejected this based on *Flat Top Lake Association, Inc. v. United States*, which held that a homeowners association operating for the exclusive benefit of its members does not serve the broader concept of social welfare.

Disposition

The Tax Court held that the income from the operation of the parking lots and the beach club by Ocean Pines Association, Inc. was subject to unrelated business income tax. The court directed that a decision would be entered under Rule 155.

Significance/Impact

The decision in *Ocean Pines Ass'n v. Comm'r* is significant for homeowners associations and other organizations exempt under section 501(c)(4) because it clarifies the scope of activities that may be considered unrelated business income. The ruling emphasizes the importance of public access for tax-exempt activities and highlights that income from facilities restricted to members may be subject to UBIT. This case has been cited in subsequent cases and legal literature to support the principle that tax-exempt organizations must ensure their activities are substantially related to their exempt purpose and open to the general public to avoid UBIT. The decision also reaffirms the interpretation of the "rents from real property" exception under section 512(b)(3), particularly regarding the operation of parking lots.

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