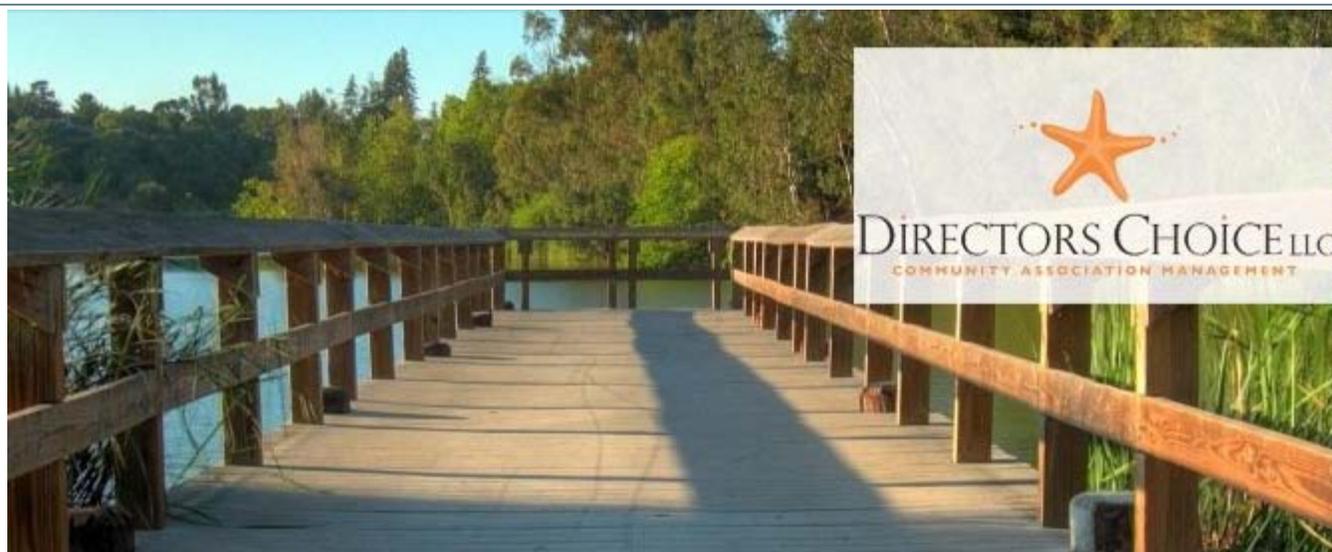


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## Directors Choice, LLC Newsletter

### March 2012 Tip of the Month

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Issue: #18

March/2012

Dear Janet,

To all of you who contacted your Florida Government regarding House Bill 319- thank you very much! The bill was not passed and we feel this is a win for Florida associations.

We also want to thank all of you who attended our Board Certification Course this month. We were so happy to meet all of you and hope that it was informative for you.

While we realize tax season has passed (for associations- unless you filed an extension) we still wanted to pass along a great article from Bob Titus with Ace Association Accounting. We have worked with him with several of our associations and have been very impressed with his knowledge.

We have also included another informative article from Mitch Drimmer with Association Financial Services. It contains some very interesting information about PUD and Condo Riders.

Happy Easter!

#### TIP OF THE MONTH



SPECIAL TAX TREATMENT FOR COMMUNITY ASSOCIATIONS

By **BOB TITUS, CPA, CAM, CMCA, AMS**  
**ACE Association Accounting**

**To the IRS, condominium associations, homeowners associations, and time-share associations are all called home-owners associations. The state of Florida has different statutes for these three types of associations; the IRS makes no distinction among the three and classifies all of them as homeowners associations.**

Although most community associations are formed as not-for-profit corporations, very few of them are tax-exempt organizations. They have to file and pay federal income taxes like all other corporations. However, there is a section in federal income tax law that gives special treatment to homeowners associations. This section is called section 528, and to receive the special treatment an association has to file Form 1120-H, U.S. Income Tax Return for Homeowners Association.

The special treatment an association receives under Section 528 is that practically all of the income it receives from association members, such as income for maintenance assessments, is tax exempt. Maintenance assessments are not reported on Form 1120-H as income because it is classified as exempt function income. Most other types of income received from members, with the exception of separate fees charged to members for services, are also classified as exempt function income.

Given this, most of the times the only other type of income an association receives is interest income. And interest income is taxable. Interest earned on operating funds and reserve funds is classified as non-exempt function income and is taxable. But an association does not have to pay taxes on the gross amount of interest income. It can deduct certain expenses that are connected to nonexempt function income. An allocated portion of accounting and management fees is commonly deducted on the tax return. Also, 100% of state income taxes and tax preparation fees are also deducted. In addition to these deductions, a \$100 specific deduction is allowed.

After deducting allowable deductions from gross interest income, taxable income for the association is arrived at. To compute the tax, a flat 30% tax rate is applied against the taxable income. This relatively simple computation is all done on the one-page Form 1120-H.

Although Form 1120-H is relatively easy to fill out, it has one drawback - the tax rate is 30%. This compares unfavorably to a tax rate of 15% on the first \$50,000 of taxable income when Form 1120, the form filed for regular corporations, is filed. Offsetting this drawback is the fact that filling out Form 1120 is a rather complex endeavor that requires the assistance of an experienced tax professional. A comparative analysis of the collective costs and risks of the two approaches would have to be made to determine which approach is most beneficial for your association.

**To qualify to file Form 1120-H, an association must pass an income test and an expenditure test. Most associations have no trouble passing these tests. To pass the income test, at least 60% of the in-come must be exempt function income. To pass the expenditure test, at least 90% of the expenditures must be for the management, maintenance and care of the association property.**

## PUD AND CONDO RIDERS

What are PUD & Condo Riders And How Can They Be Best Used.

By Mitchell Drimmer



Do you know what a PUD rider or what a Condo Rider is ? Well, it is a document that everybody signs when they purchase in a community association and it gives the community association an opportunity to notify the bank that the unit has stopped paying dues, and gives them (the bank) a chance to pay the assessments and add them to the loan. This is not to say that the bank MUST pay them but its fair warning that the fees are not being paid and allows the banks to do the right thing. Here is the language in the riders:

***"If Borrower does not pay condominium dues and assessments when due, then Lender may pay them. Any amounts disbursed by Lender under this paragraph F shall become additional debt of Borrower secured by the Security Instrument. Unless Borrower and Lender agree to other terms of payment, these amounts shall bear interest from the date of disbursement at the Note rate and shall be payable, with interest, upon notice from Lender to Borrower requesting payment."***

Follow this link to see what a PUD Rider looks like:

<http://forms.sc.egov.usda.gov/efcommon/eFileServices/eForms/RD3550-11.PDF>

Follow this link to see what a Condo Rider Looks like:

<https://www.efanniemae.com/sf/formsdocs/documents/ridersaddenda/pdf/3140.pdf>

I give a CEU class to Community Association Managers, and I always ask if anybody has ever heard of a PUD or Condo Rider, and of the many classes I have given not one manager has answered in the affirmative. Why have community association attorneys not been more attentive and advised management companies about this facility ?

Think of the riders as the same type of notice a lender would get from an insurance company should a borrower fail to pay insurance premiums, or if somebody fails to pay real estate taxes. The banks will always pony up this money to protect their collateral. So what we have here is a system by which the community association has a method to notify the lender much like an insurance company can, and give them the chance to pay up just like they would for insurance premiums or taxes.

This system by which the banks can and should be properly notified is never or seldom used. The legislature could have very easily utilize these riders as a starting point regarding safe harbor. Instead of trying to strip the associations from their rights to collect late fees, late interest, attorney and collection costs our legislature can simply utilize what already exists and require the banks to cover the costs of the maintenance of their collateral, and if they want to postpone foreclosure then that is their God given right. Associations would then never really have to engage a collection company or attorney to recover their money, and the banks would not have to try and strip associations from their rights to collect these costs. Associations are being taken advantage of because banks know they can get away with it, and they have lots of powerful friends in Tallahassee who will let them.

The Senate was alerted to this misguided legislation (HB319) and although it passed the house 114-1, it was stopped dead cold in the Senate. Somebody stepped up and informed the good Senators and leadership in the Senate of the

shenanigans in HB319, and SB680 was not allowed to see the light of day because it favored the banks and encouraged continued bad behavior by these first mortgage lenders. The Senate in all its wisdom said that "enough is enough" and prevented the banks from receiving another bailout on the backs of the people.

I don't know what is next, but associations should now move forward to foreclose and take title to their units, because the law is clear in that the associations can recover those costs when the banks come around for their property. Associations should take this intervening title and monetize the units through rental programs. Associations should be fair to the banks and notify them as per the PUD and Condo Riders. The riders are there for a purpose so lets use them.

*Mitch Drimmer is a licensed CAM and is the Vice President of Association Financial Services, an accredited collection agency, specialty finance, business process outsourcing, and specializing in community associations. For more information, visit [www.associationfinancial.com](http://www.associationfinancial.com) Tel: 305.677.0022 ex 804.*

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Directors Choice, LLC is a Naples, Florida based Community Association firm working with Condominium and Homeowners' Associations. We provide a full range of financial, consulting, and management services to our clients.

If you feel we can be of service to your association in any way, please contact us. We would love to speak with you.

**Best Regards,**  
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