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**Commercial Condominium Associations
- Business/Tax Considerations***

The so called "mixed-use" development template has gained enormous popularity in recent years. Many real estate developers have used (and are continuing to use) a commercial condominium regime to establish the real estate ownership rights of the various participants in such mixed-use development projects. Additionally, the condominium regime provides substantial flexibility to the developer in terms of partitioning (and repartitioning as necessary) the project into various economic units without being required to continuously make new public filings. The condominium regime is also extremely useful in accommodating the most commonly encountered financing vehicles in the commercial real estate development industry, i.e., equity, secured-debt, mezzanine-debt, and more.

1. **Need for CCA.** The use of the commercial condominium regime requires the establishment of one or more "commercial condominium associations" (CCAs) for the management/maintenance of the common elements of the mixed-use project. In order to carry out its intended purposes, CCAs are funded through assessments and funds collected from the project participants.

2. **Income Problem.** In most instances, the funds collected by the CCAs are not expended during the tax/accounting period in which such funds are collected. Hence, a question arises as to the taxability of such funds. In other words, if such funds remain on hand at the end of a tax period will the IRS view such funds as income and, therefore, tax such funds in the hands of the CCA? As is true in many instances dealing with federal tax law, the answer to this question ultimately depends on the type of entity selected by the developer to establish the CCA in the first place, and whether the CCA is deemed to be engaged in a trade or business.

3. **Trade or Business.** To the extent a CCA is determined to be engaged in a "trade or business", the funds on hand at the end of a tax period are highly likely to be deemed income for federal tax purposes. Whether or not a CCA is deemed to be engaged in a trade or business is a question which requires analysis of the surrounding facts and circumstances in each instance.

*This summary is intended to provide general information regarding the subject matter addressed. It is not legal advice and cannot be relied upon as such. For legal advice, please contact one of our firm's attorneys.

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4. **Corporation Format.** If the CCA is formed under applicable state law as a corporation, it is most likely to be subjected to the normal rules applicable to a C corporation. That is, any taxable income of the CCA will be taxed at the entity level and then again to the extent distributed to the shareholders (with some limitations and exceptions). In most cases, the CCA will not be eligible to make an S election (to avoid double-taxation feature of a C corporation) due to its ownership make-up (ineligible shareholders).

Partnership Format. If the CCA is formed as a limited partnership, it will be subjected to the rules of Subchapter K of the Internal Revenue Code (Code). This essentially means that the CCA will be treated as a pass-through for tax purposes and any income and other tax attributes would be taken into consideration by the partners on their tax returns.

Trust Format. If the CCA is setup as a trust (other than a business trust), the underlying provisions of the trust instrument will determine its taxability. The Code and the Treasury Regulations contain certain factors which are applied to the provisions of the trust instrument and the surrounding facts and circumstances to determine whether the trust should be taxed as an association (corporation) or a partnership (pass-through).

Exemption from Taxation. Unlike residential condominium associations which may apply for exemption treatment under Section 528 of the Code, in general, the CCAs may not organize as tax-exempt entities under the Code. Several states, including Texas and New York, generally deny the CCAs tax-exemption from applicable state and local taxes. However, some taxpayers having organized entities similar to a CCA and have petitioned the IRS for tax exemption under Section 501(c)(4) of the Code. The published authorities in this area seem to indicate that a high burden is placed on the taxpayers to establish a "social welfare" aspect of the CCA before a favorable treatment may be granted under Section 501(c)(4).

Conclusion. The CCAs are a necessary aspect of a commercial development where the ownership structure is based on a commercial condominium regime. A developer must take into consideration the tax consequences associated with the formation and operation of a CCA prior to selecting an entity format for the CCA. With adequate planning, and depending on the surrounding facts and circumstances, a developer may be able to diminish the amount of funds of the CCA being subjected to income tax and, in some instances, may be able to avoid it altogether.