

# WHEN HOLLYWOOD KNOCKS

By: Gary A. Porter, CPA

It seems that everybody dreams of being a star. Apparently, that also includes homeowners associations. Several of our association clients, being located in and around the Los Angeles area, are regularly used as filming locations by various studio film crews for both television and movies.

For instance, if you want a very upscale equestrian community with beautiful tree lined streets, multi-million dollar homes, and equestrian trails winding through an idyllic oak-studded rolling landscape, then Hollywood often selects an exclusive gated community located in the west end of the San Fernando Valley. This gated association has had a film policy in place for more than twenty years, as it has been used by Hollywood numerous times over the last two decades, and has filming crews on site at least twice each year. This is somewhat ironic, as a number of celebrities selected this exclusive as their home for the privacy that it offers.

Or if you want a high-rise association located on the water, there is a Marina Del Rey association that offers the perfect setting, with extensive boat docks located right outside the association. A major movie was filmed at and around this location last year. Some CAI members got to see part of this filming, which was done in February during the West Coast Law Seminar at the Ritz Carlton in Marina Del Rey. Some filming also occurred at the hotel.

And if you want a high-rise, luxury, inter-city condominium association, there are several along the Wilshire Blvd. corridor. Many of these associations have been used in films over the years. Again, this is ironic in that several celebrities live in these high security associations just to avoid being hassled.

Recently, at a relatively new association located in Westlake Village, California, approximately forty miles northwest of Los Angeles, another association was bitten by the acting bug and joined that exclusive group of associations used by Hollywood as a filming location. This association was the site of a recent X-Files episode.

***“The association has always consciously made the decision to file Form 1120-H, to eliminate any risk of adverse tax consequence.”***

...

***“However, this all changed the minute the filming crew came on site. This was clearly an unintended consequence what was deemed to be a very smart move to grab some extra income and bolster the association’s budget. The result is that this filming activity placed the association in a high-risk category, subject to the much more stringent accounting and banking requirements that accompany Form 1120.”***

Yes, I’m talking about the one where the evil association president was able to summon up an evil spirit to keep his members in line and make them follow the rules. Great story line. And, in case you didn't notice, nice homes. This was the first filming experience for this particular association. This is an exclusive one hundred four lot planned development that, as a relatively new association, had the perfect look for what the director had in mind. Since a number of Hollywood personalities live in this area, someone had probably seen it and cataloged it as a potential filming site. This is nothing particularly new for the area, as this area is also the "Sherwood Forest" where the original Robin Hood movies were made in the 1940's.

Working through a talent agency, and upon a request, a deal was ultimately struck on a cost per day for filming within in the association common areas. I'm sure some residents were also bitten by the acting bug, but the filming really resulted in the homes and the common areas of the association being the only local stars. The rest of the crew was provided by Hollywood. Filming did stretch out for several days more than anticipated, so the related film fee income increased, as did the commissions paid to the agency.



## **When Hollywood Knocks (cont'd)**

It was these commissions paid to the talent agency that actually cause the association to be the subject of this article. The regular activities of this association include some significant recreational and fee-for-service activities. These have always been closely monitored with respect to the 60% and 90% tests of Internal Revenue Code (IRC) Section 528.

The 60% and 90% tests were established by Congress to prevent associations with extensive activities from masquerading as exempt homeowners associations, and receiving the benefits of IRC Section 528. The 60% of income test requires that 60% of all income be from exempt function purposes, such as dues and assessments from members. Non exempt function income consists of items such as interest income, fees-for-service, rental income, etc. The association has always met this test. However, filming fees are non exempt function income, so this was a new category to consider for the current year. Expenses related to the nonexempt function activities are considered to be nonexempt function expenditures. The 90% of expenditures test requires that 90% of expenditures by the association be for "the management, maintenance, care, and improvement of association common areas." Since this association has always had recreation and fee-for-service activities, they have been very close to failing the 90% test each year. This has always been a marginal area, so it has been monitored closely. The commissions paid to the Hollywood talent agency caused the association to fail the 90% test for the first time.

Most CPAs would say "so what?" Just file Form 1120 and you'll pay a lower tax anyway. But, this association has always had some difficulty in keeping its capital reserves funds strictly segregated from its operating bank accounts. As CPA's for this association we have continually recommended that they file Form 1120-H. While this has resulted in a higher tax rate, it has also resulted in a considerable margin of safety for the association that

completely mitigates against the failure to keep the operating and reserve funds strictly segregated. Various tax rulings require strict segregation of funds when filing Form 1120. Form 1120 is a viable option for this association, but only with a much higher degree of risk. The association has always consciously made the decision to file Form 1120-H, to eliminate any risk of adverse tax consequence. They felt that the minor extra tax paid was worth the peace of mind. I have met with this Board several times to explain the risks of Form 1120 versus Form 1120-H. This board, like most others, when fully apprised of the risks of Form 1120, has elected to file Form 1120-H and seek the comfort and safety of that form.

However, this all changed the minute the filming crew came on site. This was clearly an unintended consequence what was deemed to be a very smart move to grab some extra income and bolster the association's budget. The result is that this filming activity placed the association in a high-risk category, subject to the much more stringent accounting and banking requirements that accompany Form 1120. It is likely that the association will meet the 90% test next year, unless they have some more filming crews out.

By the way, for the record, this association is nothing like the association portrayed in the X-Files. They don't have an evil president and he doesn't have the ability to summon up a monster whenever he wants to keep some members in line. I admit to not being an X-Files fan, so I never saw this episode. I have heard from several people who did, and wondered if that was any kind of a new CAI policy. I assured them it wasn't. But, privately, I think I know some managers and board presidents who wish they could summon up an evil spirit at times.

**Note: A modified version of this article was published in CAI's "Ledger Quarterly," Summer 1999 Issue**

