

SOUTH COAST HOMEOWNERS ASSOCIATION

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LAW AND LEGISLATIVE UPDATE MEETINGS

Thursday, January 9, 2003 – featuring four area association attorneys – James Smith, Karen Mehl, David Loewenthal and Jennifer Tice. All will speak to a particular issue such as new legislation for 2003, assessment collection policy modification, corporate status and suspension, etc. See the meeting notice mailed last month for further information.

Holiday Inn – Goleta/Santa Barbara
5650 Calle Real, Goleta
7:00 PM

Monday, February 3, 2003 – Attorney Karen A. Mehl will lead our meeting in discussing new legislation effective in 2003 and what may be in store for the future. Karen is a member of CAI's California Legislative Action Committee. Also she will review any new pertinent case law that will impact associations.

Quail Meadows West HOA Clubhouse
866 Whippoorwill, Santa Maria
7:00 PM

2003 MEMBERSHIP RENEWALS MAILED

Your 2003 membership invoice was mailed in early December. Dues remain at \$50 until January 31 when they will increase to \$60. Why? For those that renew in 2003, not only will you receive the 2003 Condominium Bluebook (retail - \$20) but you will also receive a new

reference book, *Questions and Answers about Community Associations* by Jan Hickenbottom, a \$30 value. So if you renew by January 31, our 2003 newsletters are free!

2003 CONDOMINIUM BLUEBOOKS

The 2003 Condominium Bluebooks are now in. If you would like additional copies above the one included in your membership, simply send a check for \$16 each for the additional copies you need or you may include payment with your dues invoice if you have not already paid. There are a number of significant changes in the Davis-Stirling Act this year.

BOOK REVIEW

Questions and Answers about Community Associations By: Jan Hickenbottom, PCAM

Those who have subscribed and read the *Los Angeles Times* will recognize Jan as the author of the Condo Q & A column which ran in the Sunday Real Estate section of the newspaper from 1989 – 2001. This book is nearly a 500-page reference of many of these columns which appeared in the paper during that period. Over 300 columns have been indexed and organized into 17 chapters. These columns cover the day-to-day issues that associations face regularly. There is a chapter on “Who is responsible?”. Other sections include “Board Matters”, “Parking, Pools and Pets” and “Governing Documents”. Some of the many columns include “Trees are Obstructing Owner’s Ocean View”, “Can Associations Prohibit Tape Recordings of Meetings”, “Services that Management Companies Perform” and “Board President Says He Hasn’t Read the CC&Rs”, etc.

Jan’s first book came out in 1991 and we have been eagerly waiting for the second edition. The good news for South Coast members is that one copy will be sent to each association and professional members that renews its membership for 2003. We have a limited number of extra copies available for \$26.00 each postpaid. Call first to make sure that we still have copies available. Copies are also available from the author:

Condo Consulting Services
PMB 263
4790 Irvine Blvd. #105
Irvine, CA 92620-1998

Jan has spoken to South Coast a couple times over the years. We’re hopeful that her schedule will allow for a return visit this spring. We’ll have a book signing and an informative program from one of the nation’s leading experts in association operations and management.

**PLEASE FEEL FREE TO MAKE COPIES FOR YOUR BOARD MEMBERS
SHARE THIS NEWSLETTER WITH YOUR ENTIRE BOARD OF DIRECTORS**

THANK YOU VERY “MULCH”?

By: Sarah Kitson, Director of Operations
Kitson Landscape Management

Editor's Note: In October, we had a South Coast meeting on “Getting the Most for your Landscape Dollar” with Sarah and local arborist, Karen Crisman. This meeting was very well attended and a lot of questions and discussion followed their presentations. Sarah’s family has operated Kitson Landscape Management for over 30 years in the Goleta Valley. Sarah is a graduate of Cal Poly – SLO and is an environmental horticulturalist.

Mulching is probably the best thing that you can ever do for your soil and overall health of your landscape. It is also one of the least expensive things that you can do to move towards sustainability in the garden. The definition of mulch is a material that is applied to the surface of the soil without physically incorporating it into the ground. If one is mixing a material into the soil, it is termed an “amendment”. Examples of an organic mulch include wood chips, leaves, grass clipping or even rice hulls. Not all mulches are organic. Inorganic mulches include gravel, plastic and fabric soil coverings.

Advantages to Organic Mulching:

- **Conserves Soil Moisture** – Mulch helps to reduce evaporation from the soil. This keeps water in the root zone of the plant and helps keep water bills down.
- **Reduces Soil Erosion** – Mulch improves water infiltration and penetration into the soil by preventing the soil surface from sealing or creating a hard pan. When mulch is present, it keeps dust to a minimum in the summer and mud away in the winter.
- **Improves Soil Fertility and Structure** – The decomposition and leaching of nutrients from mulch releases valuable nutrients into the soil increasing their availability to the plant. Mulch also increases soil biological activity, which in turns improves the soil structure.
- **Reduces Weeds** – When mulch is applied thick enough, it reduces weed seed germination by smothering them. Mulch does break down and if it is not replenished on a regular basis, weed growth will return.
- **Reduces Soil Compaction** – With heavy traffic, soil can become compacted and cause problems with gas exchanges and water and nutrient penetration into the root zone. However, with a thick layer of mulch over the soil, weight is dispersed and compaction is minimized.
- **Moderates Soil Temperatures** – Here in Goleta and Santa Barbara, we don’t have to worry *mulch* about soil extremes, but in other parts of the country, mulch aids in keeping the soil a more even temperature. In our area when there is overhead irrigation, mulch helps keep the soil from cracking in the sun and allows for protection of shallow roots.
- **Reduces Snail Activity** – Mulched surfaces are rough and discourage snail migration
- **Aesthetics** – Mulch makes a garden look tidy and more attractive by uniting the garden visually and giving it a more professional look.

Mulches do have their disadvantages, but as long as the right mulches are used correctly, the benefits far outweigh the downsides. Just remember the following tips and your garden will thank you:

- Keep mulch at about 2"-3" away from the trunks of trees and shrubs
- Don't use mulches that are super fine in texture or very bulky
- Make sure the organic mulch you are using has had time to "rest". Don't apply fresh green chips to newly planted areas; this action may induce nitrogen deficiencies

NEW CALIFORNIA LAWS EFFECTIVE JANUARY 1, 2003

Editor's Note: AB 2289 regarding new assessment collection procedures was covered in the October 2002 newsletter. SB 800 regarding home warranties and construction defects will be covered in a subsequent newsletter. These new laws will be covered in detail in our annual law and legislative update seminar. See page 1 for information.

AB 2417 – EXECUTIVE SESSION MINUTES

This bill adds a small section to the Davis-Stirling Act (Section 1363.05(c)) to require that "any matter discussed in executive session shall be generally noted in the minutes of the immediately following meeting open to the entire membership".

Executive sessions are limited to where the association board is discussing litigation, contracts with third parties, personnel matters or member discipline. Sometimes, board will try to hold executive sessions on financial matters such as the results of last year's audit or review or budget development. These financial matters are not covered by the executive session exception for open meetings.

SB 419 – STATE AGENCY OVERSIGHT OF COMMON INTEREST DEVELOPMENTS

The California Research Bureau has gone ahead with a study of whether common interest developments should be regulated by a state agency. Currently, no state agency has direct regulatory authority over associations except for the California Department of Real Estate during the sales process. A comprehensive study was issued in August 2002. It is available on the Internet at www.library.ca.gov.

SB 2032 – DISPLAY OF US FLAG – COMMON INTEREST DEVELOPMENTS

This bill, now signed into law, would prohibit any association governing document (CC&Rs, rules and regulations, etc.) from limiting or prohibiting the display of the flag of the United States, except as required for the protection of the public health or safety, in or on an owner's separate interest or within a portion of the common area used exclusively by the owner. An owner who is unlawfully prohibited from flying a flag of the United States shall recover all costs and attorneys' fees incurred in enforcing his or her right to do so.

A flag is defined as made of fabric, cloth or paper displayed from a staff or pole or in a window and does not mean a depiction or emblem of the flag of the United States made of lights, paint, roofing, siding, paving materials, flora, balloons, or any similar building, landscaping or decorative component.

Existing protocols relating to the proper display of the American Flag are not addressed by this legislation.

AB 555 – COMMON INTEREST DEVELOPMENT MANAGERS

This bill would require anyone, in order to be called a “certified common interest development manager” to have either passed an examination **or** achieved certification designated by a professional association of community association managers within the previous 5 years. This bill would require that anyone providing CID management services for compensation to disclose whether that person is a certified common interest development manager. One could not hold himself or herself out as a certified CID manager unless they meet these requirements.

Those sitting for a real estate broker’s exam would also be required to successfully complete a 3-unit semester course on California law relating to the management of community associations (after July 1, 2004).

Those sitting for a certified CID manager’s examination would be required to have completed at least 30 hours in instruction on the topics covered by the Davis-Stirling Act, personnel issues, risk management, property protection (including hazardous materials, vehicle code, FCC rules, etc.), understanding governing documents. In addition, instruction is required in financial issues, collection law, contract administration, management of maintenance programs, architectural standards, recreational programs, parliamentary procedure, owner/resident communications, board of director’s training, ethics and professional conduct.

The professional organization providing certification must have 200 “certificants” who are common interest development managers in California, have been in existence for a least 5 years, is qualified under 501(c) of the Internal Revenue Code and will certify a manager without requiring membership in the organization. (How many organizations qualify?)

Annual disclosures regarding manager certification, the organization providing the certification, if any, the location of the manager’s primary office and fidelity insurance information must be provided to the association.

This bill would also require that articles of incorporation filed after January 1, 1995 include a disclosure as to whether the managing agent is certified under this statute. Section 1365 would be amended to require disclosure of fidelity insurance coverage to members by the association.

AB 643 – REGISTRATION/INCORPORATION OF COMMON INTEREST DEVELOPMENTS

A new filing would be required by the Secretary of State’s office for all associations whether incorporated or not. This filing would provide the following information:

- That the association is formed to manage a common interest development
- The association’s name
- Street address of the association’s onsite office or if none, the responsible officer or managing agent of the association

- The address and either the daytime phone number or email address of the association president, other than the address, telephone number or email address of the association's onsite office or managing agent
- The name, street address and daytime telephone number of the association's managing agent, if any and whether the managing agent is "certified".
- The county and city in which the development is physically located
- If not in a city, the city closest to the association
- 9-digit zip code, front street and nearest cross street of the association's physical location
- Type of common interest development (condo, PD, etc.)
- The number of separate interests (units) in the association
- A fee not to exceed \$30

If there any changes in the above information during the 2-year periods between required filings, then the Secretary of State must be notified within 60 days of the change. Failure to file this information as required will result in the corporation's suspension.

The information regarding the association president noted above will only be made available for governmental purposes and only to members of the Legislature and the Business, Transportation and Housing Agency. All other information will be available for public inspection.

An additional disclosure under Civil Code Section 1368 (relating to sales and purchases of units) would require the seller to disclose whether the association is incorporated or not incorporated.

IS YOUR ASSOCIATION'S CORPORATE STATUS SUSPENDED?

- What Is suspension?**
- Why is this important?**
- How does suspension occur?**
- How do you find out?**
- How to return the association to active status?**
- Do we have to disclose?**

Editor's Note: This article is adapted from a paper that I presented to the California CPA Education Foundation's CIRA Accounting Conference last fall. I received much positive feedback that the information would be of interest to board members, not just accountants. - MG

What is suspension? – Every corporation formed in California, whether a mutual benefit corporation such as a homeowners association, a professional corporation or a major corporation, is registered with the California Secretary of State's office. Upon incorporation, the corporation is assigned a corporate number and is required to file a statement of officers on a biennial basis with the Secretary of State and to file tax returns with the Franchise Tax Board and pay taxes as required. Failure to meet these corporate filing obligations can

eventually lead to corporate suspension or revocation of powers by the California Secretary of State or the California Franchise Tax Board.

Some commentators have opined that 10% or more of California's homeowners associations are suspended. Some of these associations may only exist on paper (i.e. articles were filed to establish the association but the project has never been built). With over 30,000 homeowners associations in California, that means that 3,000 to 4,000 associations may be suspended. When I checked my associations this past summer, about 7% were suspended. South Coast member Gayle Cagianut, CPA from Ventura County went through her client list and found a similar percentage.

Why is this important? – Under California Revenue and Taxation Code (R&TC) Section 23304.1(a), “Every contract made in this state by a taxpayer during the time that the taxpayer's corporate powers, rights and privileges are suspended or forfeited pursuant to Section 23301, 23301.5 or 23775 shall, subject to Section 23304.5, be voidable at the instance of any party to the contract other than the taxpayer.” Section 23304.5 requires that a lawsuit be brought by the other party in order for the contract to be voided. This could be problematic for a suspended association in the following situations:

- a) A dispute arises in a maintenance contract (roofing, painting, landscaping, etc.) and cannot seem to be worked out other than through the courts. If the association's corporate powers are suspended, the other party could void the contract and/or the association has no ability to enforce the provisions of the contract since it is suspended.
- b) The association is involved in construction defect issues that lead to litigation. Should the corporation be suspended, it cannot pursue legal remedies permitted until the corporation is “revived”.
- c) The association is attempting to collect delinquent assessments from a homeowner. Liens could not be enforced or small claims could not be pursued if the association has its corporate powers suspended. The inability to secure the association's assessments during a suspension period could result in lost assessments by the association.
- d) Without corporate powers, the association may not be able to enforce any provisions of its governing documents.

How does suspension occur? – Listed below are several scenarios that have occurred in my practice that I believe are not unique but occur regularly:

- a) **Suspension soon after incorporation** – The association was incorporated by the developer's attorney in 1983 and suspended in 1985 for failure to file tax returns or pay the minimum tax. This 5-unit association was built, had a bank account with the manager's tax ID number. Mailing addresses had changed from the attorney to one or more of the owners to the manager over the years. Notices sent by the FTB may not have been received or returned to the FTB due to the change in address. The suspension was discovered when management changed in 1999.

b) Suspension due to failure to file Statement of Officers – As noted in the first scenario, association mailing addresses can change frequently. If the association uses an officer's mailing address or its management company's address as its mailing address, there is a strong possibility that the mailing from the Secretary of State will not be forwarded to the correct address when officers or managing agents change. Follow-up notices, penalty notices and suspension notices will likewise not be forwarded. This was a problem when the statement was an annual filing. Now that the statement is filed every two years, nonfiling will probably increase, resulting in more suspensions. Filing forms and requirements can be found at the Secretary of State's website – www.ss.ca.gov. Missing one filing but making the followup filings does not "revive" the corporation. The penalty for failure to file the nonprofit statement of officers is \$50 and is assessed through the Franchise Tax Board.

RECOMMENDATION – The Statement of Officers can be amended at any time during the two-year filing period at no cost. This form could be revised at the same time that signature cards are changed to reflect new officers, corporate mailing address change or change in agent for service of process. A fill-in form is available on the Secretary of State's website – www.ss.ca.gov

c) Suspension for failure to file form 199 – Association was suspended in 1987 because it had not filed a 199 form for 1986. 1986 was the last year that filing of the 199 was required of all nonprofit corporations regardless of revenues received. The \$25,000 minimum filing requirement was effective in 1987. In order to revive, the association had to file a 1986 Form 199 (in 2001!). My 1986 forms book was in storage so a colleague came to the rescue. The association did not have a 1986 income statement so we used a 1987 one. (The FTB suggested that the form be filled in with "zeroes")

d) Suspension for failure to file forms 100 and 199 and pay resulting penalties – While this can happen due to the address, officer or management changes noted above, it can also happen due to the negligence of the board or managing agent.

What happens when the tax returns are not filed. Demand notices and penalty notices are sent by the FTB. If no response is received, a series of letters threatening forfeiture of the corporation commence leading to the eventual suspension of the corporation.

These associations are going to incur federal late filing penalties as well as late payment and interest charges on any taxes due. Then the association must go through the revivor process with the Franchise Tax Board and Secretary of State.

How do you find out if an association is suspended? Some information from the Statement of Officers filing is maintained on a database on the Secretary of State's website – www.ss.ca.gov. Access "business filings" through the California Business Portal from the Homepage. From there enter into "California Business Search".

Enter the corporation's name or a portion of the name (if you are not sure of the exact name) to obtain name matches and corporate information. For example, I entered "Summerland Association" and 6 matches were returned. One of which was a suspended homeowners association, the Summerland Villas Homeowners Association. A "click" on the corporate name generated another report showing the corporation mailing address and the agent for service mailing address. It does not show when the corporation was suspended, just that it is suspended.

How do you return the association to active status? If your association is suspended, you need to get in touch with the Secretary of State and the Franchise Tax Board to determine what triggered the corporate suspension.

a) Secretary of State -

Officers@ss.ca.gov

Phone – 916-657-5448
1500 11th Street
Sacramento, CA 95814

My experience has been that you can get prompt email responses if you inquire why a corporation was suspended.

If the corporation was suspended by the Secretary of State simply because the Statement of Officers was not filed, you may revive the corporation by sending a letter to the Secretary of State along with the delinquent Statement of Officers and the payment of any fees or penalties imposed. The Secretary of State will send a "Notice of Revivor" to the association and notify the FTB.

b) Franchise Tax Board –

Phone - 800-852-5711
P. O. Box 942840
Sacramento, CA 94240-0000

My experience has been that speaking to one of the FTB Corporate telephone representatives has been fruitful in obtaining the information as to why the corporation was suspended.

The telephone representatives have information concerning why the FTB has suspended the corporation or whether the Secretary of State has suspended it. All required tax forms, tax payments, penalties and interest must be made under with the FTB Form 3557 "Application for Certificate of Revivor".

If the association is small, with little or no taxable income, the process is fairly straightforward and should not be too costly. I did have an FTB representative contact me earlier this year regarding the filing of a Form 100 for an association that had less than \$100 in nonmembership income in the year in question. The association is not required to file Form 100 when nonmembership income is less than \$100 (See Form 100 instructions and

Publication 1028 – Guidelines for Homeowners Associations.) He wanted to know my authority. I cited the above FTB publications and never heard back from him.

Some associations, like the one cited in my first example, are suspended for failure to pay the minimum tax. This is because California tax-exempt status was not requested during incorporation. Form 3500 must be filed and approved by the Franchise Tax Board to obtain this status. It is not an automatic election like the IRS Section 528 election. A brief questionnaire regarding association activities must be completed and 4 years' financial information and signed copies of the association's governing documents must be provided with the application. Upon qualification, the FTB will refund up to 4 years' minimum tax for associations that qualify. Most residential associations should have no trouble qualifying.

VI. Do CPAs have to disclose the suspension in financial statements? – While the Common Interest Realty Association Audit and Accounting Guide does not provide any specific guidance, it is my opinion that an audited or reviewed financial statement should disclose suspended status in the notes to the financial statements. An association without corporate powers could have its financial situation severely impacted if it cannot collect its assessments or sue for damages incurred. This is a very significant disclosure.

1099/INDEPENDENT CONTRACTOR REPORTING REQUIREMENTS

Each January, homeowner associations like other businesses are required to issue 1099-MISC forms to service providers for payments made during the preceding calendar year. Service providers can include accountants, attorneys, managers, gardeners, pool service, handyman, specialty contractors, painters, etc. 1099s are not required to be sent to providers who are incorporated. These businesses will usually have "corp" or "inc." in their name. Also, 1099s are not required if payments total less than \$600 during the year.

Information which must appear on the 1099 include the business or individual name, address, amount paid and taxpayer ID number (or social security number of the payee if an individual). Your accountant or property manager should be familiar with these filing requirements. If you are the person responsible for filing, forms are available from the IRS. The 1099s are required to be mailed to the payees by January 31 and to the IRS by February 28.

California's Employment Development Department (EDD) also has an ongoing independent contractor filing requirement. Form DE-542 is required to be filed within 20 days of contracting with an independent contractor with whom you will pay \$600 or more, if the contractor is an individual. For ongoing contractors, you may file in January and indicate that the amount to be paid is unknown at the time of filing. There are penalties imposed for not filing. For complete information concerning the EDD filing, see our December 2000 newsletter or email us for a copy of the article.

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