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Condominiums: Incorporation of the Common Elements--A Proposal

John H. Bailery, III

Lawrence C. Ashby

NOTES

Condominiums: Incorporation of the Common Elements—A Proposal

I. INTRODUCTION

Few words conjure up greater visions of innovation than the term "condominium." Although many people are familiar with and have invested in condominium developments, few recognize the many serious problems implicit in the development and ownership of a condominium. In 1962, Congress enacted section 234 of Title II of the National Housing Act of 1961 authorizing the Federal Housing Authority (FHA) to insure mortgages on condominium dwellings.[1] Subsequently, the FHA prepared a model condominium statute to guide persons interested in condominium legislation which would qualify for section 234 insurance in a particular jurisdiction. As a consequence of these activities, there was a great surge of development and investment in condominiums as evidenced by the enactment of enabling legislation in 31 states during 1963.[2] Since that time, condominium development as a property ownership and management device has spread rapidly throughout the United States. As a result, all 50 states[3] have passed enabling legislation, which is predominantly modeled after the FHA Act. To date, the development of condominiums has been largely residential; however, it has been suggested that the condominium will be most extensively used in the commercial field.[4]

In order to increase the effective use of the condominium in both commercial and residential areas, this note proposes an alteration of present enabling act provisions relating to those areas and facilities which are owned in common by the residents. By incorporating the commonly owned elements into a separate legal entity, many of the existing problems will be relieved, if not completely resolved. Consequently, the condominium will become more useful to the developer and the owners. This note will consider, by way of comparison, the relevant existing statutory provisions and their

1. National Housing Act § 234, 12 U.S.C. § 1715y (1964). Section 234 was amended in 1964 to authorize the insurance of a mortgage which would finance the construction or rehabilitation of a condominium in addition to the sale of the units.

2. 1 A. FERRER & K. STECHER, LAW OF CONDOMINIUM 2 (1967).

3. Vermont, in 1968, was the last state to enact enabling legislation. VT. STAT. ANN. tit. 27, §§ 1301-28 (Supp. 1969).

4. 4 R. POWELL, REAL PROPERTY 765 (1968).

inherent problems and ambiguities. It will propose the method of incorporation of the common elements and examine the tort liability, tax, and security regulation consequences of establishing the new condominium regime.

II. THE TRADITIONAL CONDOMINIUM REGIME AND PROBLEMS UNDER THE ENABLING ACTS

A. The Traditional Condominium Regime

The condominium has as its principal goal the achievement of more concomitants of ownership for the multi-unit occupant than are now available to either renters or cooperators.[5] A condominium has been defined as ownership in fee simple of a single unit in a multi-unit structure coupled with ownership of an undivided interest in the land and in all other parts of the structure held in common with all other owners of individual units.[6] Laymen often confuse the condominium with the cooperative. Although the two forms of ownership have similar origins, they constitute two completely different and unique developments.[7] The basic distinction between the two is relatively simple: while the unit owner in a condominium holds a fee simple title to both his unit and an undivided interest in the common areas and facilities, the cooperator normally holds shares in the cooperative corporation which entitle him to lease an apartment in the building owned by the corporation and to use its common areas and facilities.

Many of the fundamental problems of condominium ownership arise in connection with the use and management of the common elements. By the most simplistic definition, the common elements encompass everything except that which constitutes the owner's separate interest in his individual unit. Normally, the common elements include the land on which the development sits, its structural components (halls, stairways, entrances, exits, basements, yards, gardens, parking areas, and storage spaces), lodging for janitors and management personnel, all central services (including heating, cooling, electrical service, water, etc.), elevators, and commercial facilities.[8]

5. Berger, *Condominium: Shelter On A Statutory Foundation*, 63 COLUM. L. REV. 987, 989 (1963). Condominium ownership also offers economic advantages over renting since high land costs are spread over many units, ownership equity is built up, and the landlord's profit is eliminated.

6. Kenin, *Condominium: A Survey of Legal Problems And Proposed Legislation*, 17 U. MIAMI L. REV. 148 (1962), *citing* P. RAMSEY, CONDOMINIUM: THE NEW LOOK IN CO-OPS 3 (1961).

7. For a complete discussion of the derivation and distinction between the 2 forms, see 4 R. POWELL, *supra* note 4, at 761.

8. The list, which is not exhaustive, was taken from the Federal Housing Administration's

Even this incomplete listing of common elements is sufficient to suggest the many possible problems which may arise in their daily use. The group of people that would come into contact with the common elements includes unit owners, their families and guests, management and maintenance personnel, trespassers, licensees, and invitees. In order to regulate successfully such a complex form of multi-unit living, the statutory foundation for the condominium must perform three basic functions: (1) it must provide a procedure for the establishment and dissolution of a condominium and for securing a uniform pattern of legal documentation; (2) it must accommodate existing legislation concerning taxation, liens, land-use control, and security regulations; and (3) it must anticipate possible judicial antagonism involving such matters as bars on partition and real covenants.[9] To carry out this task, the typical enabling act[10] provides for the creation and registration of three essential documents: the declaration (sometimes referred to as the master deed), the bylaws, and the individual unit deeds. Taken together, these documents should reflect an accurate description of the condominium regime, including a legal description of the property conveyed and the rights, duties, and liabilities of all parties.

1. *The Declaration.*—The declaration, or master deed, initiates the legal existence of the condominium upon execution and recordation and serves "roughly the same function for the condominium as the subdivision map and restrictive covenant serve in a tract development."[11] The declaration must contain a legal description of the entire property, the individual units, the common elements, and the limited common elements.[12] The declaration must also provide for the establishment of a managing organization and its bylaws, for the establishment of voting rights, and for the assessment of common expenses.[13]

2. *The Bylaws.*—The bylaws document the daily operating rules of the condominium and the managing organization. Among the items to be included are the election of an administrative board, the method of calling meetings, the regulation of common areas, the hiring of a manager, the financing of maintenance and repair expenses, and the

Model Condominium Law § 2(f) [hereinafter cited as FHA MODEL ACT], *cited in* A. FERRER & K. STECHER, *supra* note 2, at 585.

9. Berger, *supra* note 5, at 1003.

10. Unless otherwise indicated, all references in this section will be to the FHA Model Act since it has, in large part, been adopted in most states.

11. Berger, *supra* note 5, at 1004. *See also* Kenin, *supra* note 6, at 148 n.18.

12. FHA MODEL ACT § 11.

13. *Id.* § 11.

establishment of voting rights.[14] Under the traditional condominium concept, the usual managing organization is an unincorporated association composed of all the unit owners acting as a group in accordance with the declaration and bylaws.[15]

3. *The Unit Deed.*—The individual unit deed must comply with the local laws of conveyancing and should repeat or incorporate by reference the major provisions of the declaration. Of course, it must contain some legal description of the unit being conveyed and the percentage of undivided interest in the common areas and facilities appertaining to the unit.[16] Most statutes further provide that other desirable details may also be set forth in the unit deed so long as they are consistent with the declaration and the enabling legislation.

B. General Problems Arising Under The Enabling Acts

Although the condominium concept originated with the Romans, the modern statutory condominium creates essentially a "new estate" in real property; as such, it has raised a host of legal problems to be resolved as the new property concept is used and developed. Rather than analyze all the provisions of an enabling act, it will be more useful for the purpose of this note to describe various problems which arise under the acts with a view to their resolution under the proposal presented in Section III.

1. *Legal Description.*—One of the unique features of the condominium is that it conveys a real property interest in air space and thereby creates the unprecedented problem of satisfactorily describing the legal interest to be conveyed. In large part, this is simply a mechanical problem, but under today's recording statutes, failure adequately to resolve the problem could have serious consequences for the unit owner. Essentially, three different means have been used to describe the elevated block of air space often conveyed under a condominium regime: the survey method, the subdivision plat method, and the floor plan certification method.[17]

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14. *Id.* § 19.

15. *Id.* § 2(d). Only 4 states expressly provide that the association may incorporate pursuant to state law. *See* note 30 *infra.*

16. FHA MODEL ACT § 12.

17. Kenin, *supra* note 6, at 160-62. For examples of the survey method, see ILL. REV. STAT. ch. 30, § 305 (1969); MO. ANN. STAT. § 448.040 (Supp. 1969-70); R.I. GEN. LAWS ANN. § 34-36-13 (Supp. 1967); UTAH CODE ANN. § 57-8-13 (1953). For examples of the plat method, see ALA. CODE tit. 47, § 298 (Cum. Supp. 1967); CONN. GEN. STAT. REV. § 47-71(c) (Supp. 1967); GA. CODE ANN. § 85-1612b (Supp. 1968); HAWAII REV. LAWS § 514-13 (1968); MD. ANN. CODE art. 21, § 124(b) (1966). For examples of the floor plan method, see FLA. STAT.

The survey method requires the use of a long and detailed survey of each unit. The first step is to survey the land showing the location of all buildings and improvements. After this, separate surveys are made of each unit showing the elevation of the floor and ceiling surfaces above a datum plane, the dimensions of the inside surfaces of the perimeter walls, and their location with respect to the boundaries of the land projected vertically upward.[18] Finally, the declaration is prepared describing the whole property, but excepting each unit which is individually described by metes and bounds. While its chief advantage is accuracy, the survey method is both expensive and cumbersome.

The subdivision plat is similar to the legal description employed in the usual subdivision development. Obviously, a condominium plat would have to be a three dimensional drawing, but such a scheme would permit the individual units to be conveyed by a number rather than by the cumbersome metes and bounds description. The problem with the plat method is that the usual practice of local authorities is to require filing and approval before building. Consequently, there will almost always be some variation between the legal description in the plat and the actual boundaries due to changes and inaccuracies occuring during the construction of the condominium.

The floor plan certification method was adopted by the FHA Model Act and, perhaps, provides the best solution to the problem. Section 13 of the Act provides that a set of floor plans of the buildings showing the layout, location, apartment numbers, and the dimensions of the apartments shall be filed in the office of the recording officer with the declaration or prior to the first conveyance of an individual apartment. This method allows conveyance by number and avoids the formalized supervision accorded to the filing of a plat by local officials.

Even with these solutions, however, the legal description may prove inaccurate because of the almost universal problem of settlement of the building foundation. After the building settles, there will be a slight but nonetheless real encroachment upon the "air space" previously conveyed. While the probability of litigation is remote, some enabling acts have attempted to resolve the problem by providing that the actual boundaries shall be presumed to be correct regardless of

ANN. § 711.08(e) (1969); MASS. GEN. LAWS ANN. ch. 183A, §§ 8-9 (1969); PA. STAT. ANN. tit. 68, § 700.402 (1965). It is important to note that the differences in the methods of description are differences in degree and not in kind. Thus, although the terminology used by the various statutes often overlaps, the requirements may be definitely classified into the 3 described methods.

18. Kenin, *supra* note 6, at 160.

settling, lateral movement, or minor violations between boundaries shown on the plans and those of the property or unit.[19] It is also possible to provide for a new survey and corrective conveyances after the building has had a chance to settle.

2. *Materialmen's Liens.*—As a general rule, an unpaid mechanic or materialman may place a lien upon the premises which he has improved or serviced. This same rule is applicable when he improves or provides services to an individual unit of a condominium at the request of the owner. In such a case, his lien does not impair the title of adjoining units; however, it does extend to the unit owner's proportionate share in the common areas and facilities.[20] The problem becomes more complex in the case of a mechanic who has improved the common areas or facilities at the request of the managing authority. In the absence of a special provision, the lienor could presumably obtain a lien upon the entire property and thus cloud the titles of each unit. To meet this problem, the FHA Model Act provides that no lien shall arise or be effective against the property on which the development sits after the declaration is filed and while the property is subject to the Act.[21] Thus liens and encumbrances may arise only against the individual units and their adjoining common areas and facilities. With this limitation, liens are to be created in the same manner as liens presently created against any other real property subject to individual ownership. Consequently, an unpaid mechanic or materialman working for the association must file a lien upon each individual unit rather than upon the condominium as a whole. Each unit owner may then remove his unit and percentage of undivided interest in the common elements from the lien by paying his share of the amount due. Presumably, the amount allocated to each unit owner would be computed in accordance with the percentage of undivided interest allocated to the unit in the declaration.

The lien provision of the FHA Model Act, however, is not entirely satisfactory. It does not specify to whom the unit owner should make payment; that is, whether he should pay the association or the lienor directly. It is not clear whether common charges paid to the association before the lien was filed would help satisfy his share of the debt. Finally, even upon payment of his share, the removal of the lien does

19. *See, e.g.*, ALASKA STAT. § 34.07.450(1) (Cum. Supp. 1969); NEB. REV. STAT. § 76-810(2) (1966); R.I. GEN. LAWS ANN. § 34-36-13 (Supp. 1967); UTAH CODE ANN. § 57-8-13 (1953); WASH. REV. CODE ANN. § 64.32.010(1) (1966).

20. Berger, *supra* note 5, at 1022-23.

21. FHA MODEL ACT, § 9. For a full discussion of the lien problem, see Kenin, *supra* note 6, at 155-56, and Berger, *supra* note 5, at 1022-24.

not remove the owner's joint and several liability as an association member for the balance due. As a result of these problems, condominiums may find it difficult to obtain contractors to perform substantial work unless cash or some substitute security is made available.

3. *Individual Liability.*—Since the most common form of managing organization is an unincorporated association, the condominium offers the individual unit owner little protection against the acts of other owners or the condominium association. The members of the association will be held as the principals of any manager that the association hires and thus will be held jointly and severally liable for his contracts for goods and services. Consequently, a creditor may bring an action against any one of the unit owners for the entire amount due, forcing the defendant into a position of suing his neighbors for contribution.

A much more serious problem of joint and several liability arises from torts occurring in the common areas or during the use of common facilities. The unit owners will be jointly and severally liable for the tortious conduct of their servants or for injuries sustained in the common areas. Furthermore, the liability is unlimited since there is no separate or corporate entity recognized in the association. To the extent that liability insurance can adequately cover these contingencies, the problem would seemingly be solved. Insurance for the condominium, however, is a new field with unresolved problems of its own.[22] In addition, a judgment in excess of the policy amount or a lapse or failure of coverage poses a threat of individual liability which cannot be met by insurance.

4. *Double Taxation.*—A final problem facing the unit owners is the possibility of double taxation.[23] This is a substantial threat only for the condominium with rental property or other sources of income generated by the common areas or facilities. If the managing organization is found to be an association within the provisions of the Internal Revenue Code, such income might be taxed to both the association and the unit owners. Under the Treasury Regulations, even an unincorporated association will be taxed as a corporation if it has the following characteristics:

> (i) Associates, (ii) an objective to carry on business and divide the gains therefrom, (iii) continuity of life, (iv) centralization of management, (v) liability for corporate

22. *See* Seetion IV *infra* and accompanying notes.

23. Unless otherwise indicated, all references to taxation will be limited to a consideration of the federal tax consequences.

> debts limited to corporate property and (vi) free transferability of interests. Whether a particular organization is to be classified as an association must be determined by taking into account the presence or absence of each of these corporate characteristics . . . . An organization will be treated as an association if the corporate characteristics are such that the organization more nearly resembles a corporation than a partnership or trust.[24]

When the condominium association derives income from rental units, it might be difficult to refute the argument that the condominium falls within the Regulations' definition of an association taxable as a corporation. In such a situation, it more nearly resembles a corporation than a partnership or a trust, and an analysis of the listed characteristics indicates corporate taxability.

A condominium with rental property possesses the two characteristics deemed essential to the definition of an association: an objective to carry on business for profit and associates.[25] Management of the common elements generating income with the ultimate benefit going to the unit owners on a percentage basis would seem to meet these characteristics. It is equally clear that the condominium is designed to have continuity of life and that the unit owners' interests therein are freely transferable.[26] Further, a condominium of any size will have a designated managing group as suggested by the FHA Model Act; thus, there is also centralization of management.[27] The only association characteristic missing from the condominium regime is limited liability. While limited liability is an important consideration, a condominium possessing five of the six stated characteristics will probably be taxed as a corporation on income generated by the common areas and facilities. Additionally, unit owners may be taxed at dividend rates if the income is distributed to them.

Although the condominium is a desirable form of ownership combining the convenience of apartment living and the security of home ownership, these and other problems add an extra degree of risk to a condominium investment. The next section deals with a proposal for altering the traditional condominium regime in such a way as to provide some relief from the most formidable legal problem facing the consumer—unlimited, joint, and several liability.

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24. Treas. Reg. § 301.7701-2(a)(1) (1968).

25. Treas. Reg. § 301.7701-2(a)(2) (1968).

26. Treas. Reg. § 301.7701-2(b)(1) (1968); Treas. Reg. § 301.7701-2(e) (1968). The right of first refusal reserved to the managing organization does not defeat the free transferability requirement of the Code. Treas. Reg. § 301.7701-2(e)(2) (1968).

27. Treas. Reg. § 301.7701-2(c) (1968).

III. INCORPORATION OF THE COMMON ELEMENTS

A. The Basic Plan of Reform

In order to limit the liability of the unit owners for injuries sustained in the use of the common areas or facilities, it is proposed that the condominium be established in such a way that the common elements would be owned and operated by a separate corporate entity. Rather than hold title to the common elements in fee through unit deeds, the unit owners' undivided interest in the common elements would be evidenced by shares of a corporation holding title to the common elements. Thus, the developer would convey the common elements to the corporation reserving the right subsequently to convey fee simple title to each of the individual units.[28] The declaration and unit deeds would include a provision which makes ownership of a proportionate number of shares in the corporation an integral part of the unit and conveyable only with the fee simple title in the unit. As a result, each unit owner would hold a fee simple title to his individual unit and, by operation of the declaration and unit deed, a number of shares in the common element corporation equal to his share of the undivided interest in the common areas and facilities. The net effect is the same as the traditional condominium regime with respect to the unrestricted use of the common elements and the unit owners' undivided interest therein. The important difference, however, is that the unit owners' participation in the ownership of these elements is now indirect, with the interposition of a corporate entity. If properly capitalized and managed, the common element corporation should effectively limit the unit owners' liability for torts arising out of the common areas and facilities to the value of the corporation's assets; namely the value of the common elements and any accumulated income from rental units. The individual unit would be free from the possibility of satisfying a judgment against the managing organization. The interposition of a common element corporation would also eliminate the joint and several liability of the unit owners for contract and tort claims arising out of the common facilities and their management.

While such a scheme for reorganizing the condominium regime will require a number of amendments to the typical enabling act, the experience of at least one other country with condominiums indicates that the effort may well be worthwhile:

> [A] number of schemes of apartment ownership have been worked out in England.

28. For a discussion of the procedure establishing the common element corporation, see notes 48-53 *infra* and accompanying text.

> Under some the vendor holds the common parts as trustee for the flat owners; under others the common parts are transferred to a company, either limited by shares or guarantee, of which the purchasers of the apartments become the members. This seems to be the most successful arrangement. The unit owners form a board of directors, and the manager and secretary are usually persons experienced in the administration of apartment buildings, especially in the case of large buildings. The memorandum and articles of association of the company contain detailed provisions regarding the objects of the company, its membership, the procedure at members' meetings, the members' voting rights, the board of directors, the accounts, and similar matters. In this way not only the ownership but also the administration of the common elements are vested in the company. The company is liable on the vendor's covenants and is responsible for securing the performance of the individual apartment owner's covenants.[29]

It is important to distinguish this scheme of organization from the incorporated association expressly authorized under the enabling acts of a number of states.[30] Although only a few states permit the owners to incorporate their association, it has been suggested that "unit owners can probably avoid unlimited personal liability" in this manner.[31] In such a situation, however, the corporate form is said to be a matter of management convenience, and it is likely that courts will pierce the corporate veil to impose liability on the unit owners as stockholders in the association.[32] This is especially true where the association holds no substantial assets in its own right. Pursuant to the acts allowing the association to incorporate, the only association assets are the periodic assessments against the unit owners and any rental income. The one substantial asset, the property committed to the condominium regime, is still held solely by unit owners in their capacity as unit owners. Consequently, courts faced with an aggrieved plaintiff will be easily tempted to disregard the corporate entity. On the other hand, a condominium regime with a common element corporation provides a corporate entity with substantial assets (common areas and facilities) held in the corporate name. With this substantial capitalization and normal insurance coverage, the arguments for recognizing the corporate entity are difficult to refute. Physically dividing the legal title to the property between the unit owners and the corporation not only distinguishes those assets intended to fund liability for injury arising out of the common elements but also makes that fund directly available to the corporation.

29. 4 R. POWELL, *supra* note 4, at 787.

30. *See, e.g.*, FLA. STAT. ANN. § 711.12(1) (1969); IDAHO CODE ANN. § 55-1506 (Supp. 1969); MASS. GEN. LAWS ANN. ch. 183A, § 8(i) (1969); N.J. STAT. ANN. § 46 8A-27 (Supp. 1969).

31. Berger, *supra* note 5, at 1007.

32. *Id.*

B. Necessary Statutory Amendments

1. *Non-Partition Provisions.*—Probably the first step to implement the suggested reform is to secure several amendments to the typical enabling act. Most of the enabling acts contain a provision which prohibits the partition or any owner action partitioning or dividing the common areas and facilities.[33] Implicitly, this provision is intended only to prevent the fragmentation of the common elements and their subsequent separate ownership by the unit owners. Thus, incorporation of the common elements would not violate the policy behind this non-partition provision. After incorporation, the common elements would remain undivided, with the unit owners retaining ownership in the same proportion as required by the declaration. The better practice, however, would be to amend the current non-partition provisions to permit ownership of the common elements through proportional participation in a corporation. The shares of the corporation would be issued only to unit owners and would be transferable only with the fee simple title in the individual unit.

2. *Non-Separation Provisions.*—Another provision similar to non-partition provides that the percentage of the undivided interest in the common areas and facilities shall not be separated from the individual unit to which it appertains and shall be deemed to be conveyed or encumbered with the unit even though such interest is not expressly mentioned or described in the conveyance or other instrument.[34] The need for an amendment in this instance depends upon whether ownership of an undivided interest in the common elements through corporate shares is considered a separation from the fee simple title in the unit. Once again, from a policy standpoint, there is no reason why the unit and the interest in the common elements must be conveyed under the same instrument. So long as both are inseparable, ownership in fee coupled with ownership through shares should be sufficient safeguard to the nonseparation policy intended by this provision. An amendment, however, should be obtained if possible.

3. *Liens Against the Common Elements.*—Ordinarily, a lien must be placed upon each unit in order to collect for labor performed in the common areas or facilities.[35] Under the common element corporation, a provision should be added to the enabling acts allowing a direct lien upon the common elements held by the corporation. As each unit owner pays his proportional share of the unpaid amount, his

33. FHA MODEL ACT § 6(c).
34. FHA MODEL ACT § 6(b).
35. FHA MODEL ACT § 9.

shares would be removed from the lien.[36] This procedure would eliminate the cumbersome method of liening each unit in order to collect for work performed in the common areas. Of course, each unit owner would still be free to encumber his shares and the title to his unit for work performed directly for him.

4. *Characterization of Interest.*—In response to a conceptual problem concerning the nature of condominium ownership, many enabling acts provide that each unit, coupled with its undivided interest in the common areas and facilities, shall for all purposes constitute real property.[37] Under the proposed regime, an obvious difficulty arises since ownership in the common elements would be evidenced by corporate shares and not by deed. On the other hand, there is no doubt that a legislature could declare that such shares shall be treated as real property.[38] This is compatible with the relevant policy because the new regime merely poses a new ownership form of essentially the same interest in the same property. The shares are conveyable only with the fee title to the unit; thus they have no market value in themselves. The corporate entity represented by the shares presumably holds only real property and such personal property as is necessary for the management of the condominium. In fact, the corporate charter should expressly limit the activities of the common element corporation to operating and maintaining the common areas and facilities. Characterization of the shares in the common element corporation as real property is an important amendment for the unit owner in light of tax consequences on the sale of his unit. As such, it may critically influence the development of the new regime.[39]

5. *Separate Assessment.*—A significant stipulation in most enabling acts provides that each unit and its undivided interest in the common areas and facilities shall be deemed to be a parcel subject to separate assessment and taxation by each assessing authority for all types of taxes.[40] This provision enables the condominium owner under

36. The amendment should also clarify the procedure to be followed in making payment. That is, it should specify whether the unit owner should make payment to the corporation or directly to the lienor. In addition, unused assessments paid into the corporation prior to the lien should be expressly credited to the unit owner's share of the debt. These procedural clarifications would meet criticism already voiced against enabling legislation in this area. *See* Berger, *supra* note 5, at 1022-23.

37. FHA MODEL ACT § 4.

38. *See, e.g.*, INT. REV. CODE of 1954, § 1034(f) (providing that references to real property used by the taxpayer as his principal residence shall include stock held by the taxpayer in a cooperative housing corporation).

39. *See* notes 118-28 *infra* and accompanying text.

40. *See, e.g.*, FHA MODEL ACT § 22.

the traditional regime to take property tax deductions on his federal income tax return as a normal home owner. Absent a separate assessment provision, however, the question arises whether the unit owner would be able to take his share of the deduction should a blanket assessment be made on the condominium by local taxing authorities.[41] In addition to the requirement of separate assessment of unit owners on the value of their units, a provision would be necessary under the proposed regime requiring separate assessment and evaluation of the common areas and facilities owned by the corporation. Thus, local authorities would impose property taxes separately on each unit owner with respect to his unit and on the common element corporation with respect to the common areas and facilities. As a result, the unit owners and the corporation will be allowed their respective property tax deductions under the Internal Revenue Code.[42]

6. *Incorporation.*—Another amendment which is a prerequisite to the establishment of the proposed regime is a clarification of the managing organization's right to incorporate under the state's corporation law. To date, only a few states expressly allow incorporation of the association.[43] A simple statement to the effect that nothing contained in the enabling act shall prohibit any association of owners or the developer from incorporating the managing organization pursuant to state law for the purpose of the maintenance and operation of the common areas and facilities should suffice. The better course, perhaps, would be a provision expressly permitting conveyance of title to the common elements to the corporation so created. Such a conveyance would seem to be clearly possible so long as the property is transferred pursuant to state conveyancing law. Another provision which might be included in an amendment permitting incorporation would require adequate liability insurance as a prerequisite to de jure corporate status. Thus, a common element corporation holding title to substantial real property and carrying adequate liability insurance would be in a strong position to withstand an attack based upon disregard of the corporate entity.[44]

C. Altering the Basic Documents

After the enabling acts are appropriately amended, the developer must draft the three basic documents—the declaration, bylaws, and

41. *See* notes 120-22 *infra* and accompanying text.
42. INT. REV. CODE of 1954, § 164.
43. *See* note 30 *supra* and accompanying text.
44. *See* notes 31-32 *supra* and accompanying text.

unit deed—to reflect his intention to establish a common element corporation. In addition to the usual requirements of the enabling acts, the basic documents must be altered in a number of respects.

1. *Interest Conveyed.*—The current practice is to describe the interest conveyed to the purchaser as a fee simple title in his unit and also an undivided interest in the common elements described in the declaration, both interests passing under the same deed. Under the new regime, the declaration would provide that the units would be sold to one or more owners, each owner obtaining a fee simple title in his unit and a proportionate number of shares in the common element corporation based on the ratio of the fair market value of his unit to the total value of all units at the time of sale. The unit deed would indicate that the shares are conveyable only with the fee title in the unit. Consequently, pursuant to the enabling act, title to the shares would transfer by operation of law whenever the unit was conveyed. Thus there is no danger that the common element ownership would be alienated from the unit owners in the ordinary sale situation.[45]

2. *Voting Rights.*—The declaration sets forth the voting rights of the owners which are fixed, with only three exceptions,[46] by the proportionate value or floor space of each unit to the total value or floor space of all units.[47] Consequently, it would be a simple matter to provide that the unit owners' proportionate share in the profits, common expenses, and common areas and facilities, as well as their proportionate representation for voting purposes in shareholder meetings, shall be based on the number of shares issued with their unit deed. This number would be determined according to the proportionate value or floor space of each unit to the total value or floor space of all units.

3. *Bylaws.*—The bylaws under the new regime would be much the same as under the traditional condominium concept, reflecting only those changes made in the declaration. For example, the bylaws would

45. The possibility does exist, however, that the common elements could be forcibly alienated from the unit owners by a judgment creditor of the common element corporation. This would be an exceptional circumstance requiring a massive judgment which could not be satisfied by assessments or sale of part of the common areas or facilities. In such a situation, the effective operation of the condominium would terminate regardless of whether it was constituted under the traditional or proposed regime. Thus there is no practical difference between the 2 regimes with respect to the possibility of separating the common elements from the units.

46. CAL. CIV. CODE § 1353(b) (West Supp. 1970); MISS. CODE ANN. § 896-07(B.) (Supp. 1968); NEV. REV. STAT. § 117.040(2) (1968). California, Mississippi, and Nevada provide that voting rights shall be one vote per unit even though the owners do not hold equal interests in the common areas and facilities.

47. *See, e.g.*, FHA MODEL ACT § 11(6).

stipulate the normal operating rules of the managing organization, but voting rights would be established in terms of shares in the common element corporation. Lastly, property rights would be evidenced by both a unit deed and corporate shares.

D. The Common Element Corporation

1. *The Incorporated Developer.*—Following the enactment of a solid statutory foundation and the filing of the declaration, the next step is the creation of the common element corporation itself. The precise procedure of establishing the common element corporation is a difficult problem. Since a developer may incorporate his building project anyway, it is tempting to use this corporate shell for the common element corporation. For example, the developer may convey title to the entire property to a corporation whose stated purpose would be to develop and build a condominium and subsequently to hold title to and manage the common elements. The developer will initially be the sole shareholder in the corporation.[48] After filing the declaration in the usual manner and when ready to convey the first unit, the developer will cause the corporation to execute a unit deed to the buyer. As an inseparable part of the same purchase, the unit deed will provide for the issuance of the requisite number of corporate shares allocable to the unit conveyed. Thus, as each unit is sold, the corporation will receive cash and give in exchange a unit deed plus the number of shares allocable to the unit in question. After all the units are conveyed, the unit owners will hold the fee simple title to their individual units and their designated shares in the common elements.

The problem with this scheme is that the developer continues to own the stock originally issued to him and his profits are held by the common element corporation. At some point, the unit owners will want the developer to surrender his interest in the common elements which they have presumably bought out, and the developer will want to withdraw his profits. The corporation could arrange to redeem the developer's stock in exchange for the accumulated proceeds from the sales of units and shares to the unit owners. Perhaps, a periodic redemption could be effected with respect to the developer's shares as units are sold and income is accumulated. In any event, a single or serial redemption of the developer's shares would result in the developer receiving his profits and the unit owners' receiving sole and undivided

48. State law concerning qualifying shares and necessary number of incorporators may require additional nominal stockholders.

interest in the common elements still owned by the corporation. From a purely mechanical point of view, this scheme would be adequate to achieve the desired corporate framework; however, the tax consequences may prove undesirable to the developer. Since the unit purchasers buy from the corporation, the result is ordinary income to the corporation with a consequent corporate income tax.[49] Later, when the developer's shares are redeemed, the same funds are taxed again to the developer as a corporate distribution in redemption of its stock.[50] Of course, double taxation is also a problem for the usual real estate developer operating in a corporate form. Consequently, the possibility of double taxation will normally limit the use of this method of establishing the common element corporation to the developer operating in the corporate form for independent business reasons.

2. *The Individual Developer.*—An alternative method, which avoids the double taxation problem, poses a new problem in property law. Instead of building and managing the property through a separate corporate entity from the outset, the developer could, sometime prior to the sale of the first unit, transfer title to the common elements to a corporation and take in return enough shares to represent the total interest allocable to all the units. The developer would then hold, as an individual, title to each unit and the total outstanding shares in the common element corporation. As each unit is conveyed, the developer would simultaneously and as an inseparable part of the transfer convey the number of voting shares allocable to the unit. The proceeds of the sale would be taxable at ordinary rates to the developer as a "dealer" in real estate, but the tax at the corporate level would be eliminated. When all the units are sold, all the shares will have been transferred to unit owners who will then wholly own the common element corporation.

This alternative, however, postulates a deed of the common elements before the sale of any unit. In the past, the common elements have always been the "residue" of the total property after conveyance of all the units described in the unit deeds. Thus the common elements have never been legally described in a positive manner for conveyancing purposes. It is unlikely that a "residue" type of description will be adequate for a deed unless the units can be defined with a great degree

49. The sale of units and shares by the corporation would not ordinarily qualify for capital gains treatment since the property is held by the developer primarily for sale to customers in the ordinary course of his trade or business. INT. REV. CODE of 1954, § 1221.

50. If properly managed, the tax to the developer upon redemption of his shares may be calculated at capital gains rates, either as a substantially disproportionate redemption or as a termination of interest in the corporation. INT. REV. CODE of 1954, §§ 302(b)(2)-(3).

of accuracy. To a large extent, the same legal description problem exists under the traditional condominium regime. None of the three legal description methods commonly employed adequately distinguishes the common elements from the individual units. For example, it is not known with any legal certainty whether the interior walls and ceilings of a unit are common elements or unit elements.[51] The distinction becomes important in determining whether the unit owner or the total entity is liable for repairs or injuries in connection with these particular elements. While a number of solutions are available, the best answer seems to be a meticulous definition of what constitutes a unit in the declaration or even in the enabling act.[52] Perhaps, the basis of the distinction should be the use of the particular element; all areas subject to the private use of an owner would be unit elements, and all other areas would be left as common elements, including roofs, downspouts, and hallways. Assuming an adequate definition of those elements composing the units, the deed to the common element corporation could legally describe the common elements in the usual residue fashion. For example, the entire property could be described by metes and bounds and all improvements thereon. The deed would then exeept from the grant all the units designated by a numbered reference to a plat, survey, or floor plan, with reference to further definition in the previously filed declaration.[53]

3. *Conveyance by the Unit Owners.*—A third method of

51. The FHA Model Act, for example, merely lists the common elements without definition. FHA MODEL ACT § 2(f). *But see* note 52 *infra.*

52. The most detailed description now enacted appears in the California, Idaho, Mississippi, Nevada, and North Dakota statutes. The Mississippi statute partially provides: Unless otherwise expressly provided in the deeds, declaration of restrictions or plan, incidents of a condominium grant are as follows: (A.) The boundaries of the unit granted are the interior surfaces of the perimeter walls, floors, ceilings, windows and doors thereof, and the unit includes both the portions of the building so described and the air space so encompassed. The following are not part of the unit: bearing walls, columns, floors, roofs, foundations, elevator equipment and shafts, central heating, central refrigeration and central air-conditioning equipment, reservoirs, tanks, pumps and other central services, pipes, ducts, flues, chutes, conduits, wires and other utility installations, wherever located, except the outlets thereof when located within the unit. MISS. CODE ANN. § 896-07(A.) (Supp. 1968). Unfortunately, even this definition lacks clarity in determining liability for injuries or repairs connected with the described elements. With no reference to use or control, such a definition may work a hardship on the association for repairs or tort liability for injury in connection with such elements as utilities, which appear to be common elements even when located within the individual units.

53. Cautious practice requires that the developer's or the owners' attorney should work with the condominium's architect and engineer to devise a detailed definition of each common element and each element subject to individual ownership. The normally accepted use or control of the particular item should act as an appropriate definitional guideline. Insertion of the definitions in the declaration would resolve any dispute which might arise concerning property ownership or liability for injury or repairs.

establishing the common element corporation escapes double taxation, but like the others, poses a problem of its own. It is possible to complete the sales of units under the traditional regime with the developer conveying both the unit and an undivided interest in the common elements by means of a single deed. Then, the unit owners as a group could convey the unpartitioned common elements into a corporation in exchange for their allocable number of shares. Presumably, this method would be followed by existing condominiums which desire to convert to the common element corporation regime. The problem in each of these cases is that no conveyance is possible without the unanimous consent of the unit owners. If a single owner failed to join in the conveyance, the transfer would violate the nonpartition provisions of the enabling acts.

Of the three alternatives, the second seems to be the most practical. It avoids the double taxation problem and at the same time clearly defines the common and unit elements—a definition already much in need in the area of condominium law. There may be circumstances, however, where one of the other methods would be more desirable; namely, a previously incorporated project or the conversion of an existing regime.

IV. Tort and Liability Insurance Under the Common Element Corporation

Very likely, existing condominium laws in every state subject each unit owner to joint and several liability for tort or contractual judgments arising from causes of action related to the common elements. The basic principle upon which liability is predicated in the event of suit against the association or unit owners focuses upon liability of a principal for the activities of his agent. Such liability for the unit owners is potentially devastating in times of massive tort judgments. Numerous unsuccessful statutory attempts have been made to deal with this problem within the framework of the principal-agent relationship. It is submitted that the problem could best be solved by altering this relationship through the creation of a separate legal entity with sole responsibility for the operation and management of the common elements; namely, a corporation which owns the common elements as its principal asset.[54] Failures of existing statutes in this area

54. It has been suggested that "[i]ncorporation of the association, or of a management group, will probably not change the result, since the corporate entity is still in fact the agent of the owners and liability can be predicated on the basis of undisclosed or partially disclosed

have been threefold: (1) the extent of the individual unit owner's liability is undefined; (2) the plaintiff does not know who should be held responsible for injury incurred in connection with the common elements; and (3) there are no adequate provisions for judgment satisfaction.

A. Possible Sources of Noncontractual Liability For Unit Owners

Increased use of the residential condominium by real estate developers has given rise to many serious sources of liability connected with the common elements. Potential plaintiffs include the individual unit owner, members of his family, servants of the unit owner, visitors using condominium facilities, employees of the association, and, in some cases, unrelated third parties. An inexhaustive list of possible causes of liability includes the following: failure to maintain the common elements and appliances (hallways, stairs, elevators, heating and cooling plants); negligence on the part of maintenance personnel employed by the association; failure to provide workmen's compensation insurance for employees of the condominium association; failure to supervise adequately pools, playgrounds, golf courses,[55] and other recreational facilities; violation of statutory duties such as multiple dwelling laws, building codes, and fire ordinances; trespass or forcible entry and detainer situations where the unit owner is wrongfully dislodged or disturbed; auto accidents involving autos owned by the condominium; products liability from any vending machine products sold on the premises; and any nuisance, dangerous instrumentality, nondelegable duty, subrogation or indemnity suit.[56] Unlimited tort liability for the unit owner may result from a number of causes and may run to a number of parties.[57]

1. *Licensees and Invitees.*—As a general rule, an invited guest is but a mere licensee to whom the duty of care is limited to refraining from intentional or wilful injury. Normally, the association bears the

principals if necessary." 4 R. POWELL, *supra* note 4, at 863. By assuring a viable, adequately capitalized corporation with the common elements as its principal assets, this problem should not be insurmountable. *See* notes 30-32 *supra* and accompanying text.

55. Some statutes provide that the condominium's property does not necessarily have to be contiguous. This has given rise to numerous possible sources of expanded liability for unit owners. Conceivably, a marina, ski slope, or any number of such popular recreational facilities could be a part of the condominium development. *See, e.g.*, FLA. STAT. ANN. § 711.06(1)(a) (1969).

56. Rohan, *Perfecting the Condominium as a Housing Tool: Innovations in Tort Liability and Insurance*, 32 LAW & CONTEMP. PROB. 305, 308-09 (1967).

57. For a discussion of the various joint and several liability problems, see notes 77-95 *infra* and accompanying text.

duty of maintaining the the common elements and keeping them reasonably safe. In cases where the association may be engaged in active conduct, its duty is to exercise reasonable care.[58] This may become critical where the association owns an automobile or machinery. The condominium association's potential liabilty to the invitee[59] is a source of much concern. The association has little, if any, control over invitees beyond determining what businesses may be quartered in the development. By regulation of the condominium's rental property (for example, providing services only for residents of the development or prohibiting any rentals which would provide public services), the condominium may indirectly limit the scope of this risk. The duty owed to invitees is the exercise of reasonable care;[60] limiting the scope of the duty may provide slight consolation to the condominium. Probably, the obligation as to the condition of the premises could not be delegated to an independent contractor; consequently, the unit owners, through the association, would remain jointly and severally liable in the event of injury in connection with the common elements.[61]

2. *Employees.*—Another area of potential tort liability arises from actions of persons employed by the association to maintain or manage the common elements. If the association is found liable on master-servant principles in such instances, as would seem certain,[62] then it is likely that the unit owners would also be jointly and severally liable under the principle of respondeat superior.[63] In the absence of a specific statutory provision placing responsibility for the maintenance and repair of the common elements upon the association, such provision will ordinarily be included in the declaration or by-laws, or both.[64] A representative statutory provision is as follows: "The council of co-owners shall be required to make provision for maintenance of common elements, limited common elements where applicable, assessment of expenses . . . ."[65] Absent an express provision, it would seem unlikely that either the statute or the declaration provision would suffice to delegate to the association the ultimate legal responsibility which the owner and/or employer normally has.[66] It is possible that the

58. W. PROSSER, TORTS § 60, at 388-89 (1964).
59. *Id.* § 61, at 394.
60. *Id.* at 402.
61. *Id.* at 404-05.
62. *See generally id.* § 69 (1964).
63. *See* Rohan, *supra* note 56, at 309.
64. 4 R. POWELL, *supra* note 4, at 859.
65. ARIZ. REV. STAT. ANN. § 33-561(A) (Supp. 1969).
66. *See* Rohan, *supra* note 56, at 309.

association may find itself liable to the employee. Naturally, premiums for workmen's compensation insurance would be assessed as a common expense, but in the event of a failure of coverage, the unit owner would be liable through the association to the employee.

3. *Suit by the Unit Onwer.*—Finally, it is important to consider the individual unit owner's right of action against the association in the event he incurs injury in conjunction with the common elements. There are certainly more questions in this area than answers. Does the unit owner have a cause of action against the association since he himself is a member of that association? If the unit owner is injured by an object left in the hallway by his neighbor, does this limit the owner's cause of action to naming the neighbor as defendant, or is the association liable? If the owner's rights are limited, are his family's rights or those of his servants likewise restricted? The existing statutes provide scant comfort for these situations. Also, "[i]t cannot be seriously contended that these matters should be worked out on a project-by-project basis, or under the auspices of local [insurance] carriers. These issues go to the essence of the condominium unit owner's bundle of rights and obligations."[67] Statutory solutions have been propounded as the only satisfactory response to such problems. Another suggestion has been to provide for the unit owner's cause of action in the declaration and by-laws. But there is a possibility that any such attempt to restrict the unit owner's cause of action may be declared invalid as against public policy.[68]

B. Problems Under Existing Statutes

1. *Unlimited Liability for Unit Owners.*—Most condominium legislation evidently did not contemplate the potentiality of tort liability to third persons arising in conjunction with the common elements. The following examination of representative statutes will indicate the failure of most statutes to resolve satisfactorily either contractual or tort liability arising within the common element context.

One noteworthy attempt to limit the liability of the unit owner in the event of torts arising in connection with the common elements is provided by the Florida statute:

> (1) The liability of the owner of a unit for common expenses shall be limited to the amounts for which he is assessed from time to time in accordance with this law, the declaration and by-laws.

67. *Id.* at 307.
68. *Id.* at 308.

(2) The owner of a unit shall have no personal liability for any damages caused by the association on or in connection with the use of the common elements.[69]

The Florida statute has been interpreted by one authority as insulating the unit owner from tort liability except insofar as he incurs normal property-owner liability from injuries occurring on his own premises.[70] On its face, the statute would seem to accomplish this result.

Unfortunately, construing this section of the Florida law with a prior section stating that assessments shall be made for the common expenses[71] creates a definite ambiguity. It is not clear whether the statute relieving the unit owner of liability would prevail to keep a judgment creditor of the association from compelling an assessment of the individual unit owners for their proportionate shares of the judgment. At least one writer has suggested that the judgment creditor should be allowed to recover through assessment by the association against the individual unit owners.[72] Serious public policy questions are raised by a provision which unduly limits an injured party's right of recovery. It seems doubtful that the Florida legislature, despite a strong lobby favoring the condominium, would insulate the unit owners and limit liability solely to the condominium association. More probably, the intent of the statute was to preclude several liability for individual unit owners while preserving a cause of action against the association with a view toward satisfaction of the judgment by association assessment against the unit owners.

In at least one area, the scope of the unit owner's liability should be clear. Since ownership of the unit will be treated as an interest in realty, the unit owner's liability for injuries occurring within his individual unit should be the same as that of any homeowner. The Florida statute makes specific provision to this effect:

A unit owner shall be liable for injuries or damages resulting from an accident in his own unit to the same extent and degree that the owner of a house would be liable for an accident occurring within the house.[73]

69. FLA. STAT. ANN. § 711.18 (1969). A similar provision is contained in the Mississippi statute. MISS. CODE ANN. § 896-15 (Supp. 1968).

70. 4 R. POWELL, *supra* note 4, at 864. *See* note 73 *infra* and accompanying text.

71. FLA. STAT. ANN. § 711.14 (1969): "(1) Common expenses shall include the expenses of the operation, maintenance, repair, or replacement of the common elements, costs of carrying out the powers and duties of the association and any other expense designated as common expense by this law, the declaration or the bylaws. (2) Funds for the payment of common expenses shall be assessed against unit owners in the proportions or percentages of sharing common expenses provided in the declaration. (3) The common surplus shall be owned by unit owners in the shares provided in the declaration."

72. McCaughan, *The Florida Condominium Act Applied*, 17 U. FLA. L. REV. 1, 18 (1964).

73. FLA. STAT. ANN. § 711.18(2) (1969).

Although the provision is a simple one, and is probably implicit in the law of every state, sound legislative drafting would dictate an explicit statement of this policy in every condominium statute.

2. *Naming a Party Defendant.*—Not the least of the problems in existing condominium legislation is the procedure of naming the party defendant as well as providing necessary notice to interested parties. Most condominium statutes fail to identify the party defendant in the event of a suit arising from injury connected with the common elements.[74] In such cases, the authorities naturally agree that everyone who can be made a party ought to be joined; for example, the association, its board of managers, the managing agent, and the individual unit owners. The naming and serving of any one of these parties would no doubt render him subject to personal liability.[75] Some statutes do provide for service of process on the person designated therefor in the declaration for actions relating to two or more units or to the common elements.[76] The legal effect of such provisions with regard to joint and several liability is questionable. It seems probable that the primary responsibility would remain with the unit owners as a group.

3. *Joint and Several Liability.*—The problem of unlimited liability for individual unit owners in the event of a tort judgment for injuries arising out of the common elements is compounded when it is recognized that the unit owners as tenants in common will more than likely be held jointly and severally liable.[77] No state has specified whether joint and several liability will exist. Certainly, if there is joint and several liability in conjunction with unlimited liability, the single unit owner's position is extremely unattractive. It will become evident in the following discussion of various statutes that a basic question in this and the following section is whether a tort judgment can and should be assessed against the individual unit owners as a common expense.

Two states have made attempts to deal with the particular problem of joint and several liability without resolving the question of

74. The Florida statute attempting to relieve the unit owner of liability is an exception. *See* note 69 *supra* and accompanying text.

75. *See* 4 R. POWELL, *supra* note 4, at 863; Rohan, *supra* note 56; Kerr, *Condominium—Statutory Implementation*, 38 ST. JOHN'S L. REV. 1, 17 (1963).

76. The FHA MODEL ACT § 27 provides: "Service of process on two or more apartment owners in any action relating to the common areas and facilities or more than one apartment may be made on the person designated in the Declaration to receive service of process." *See also* D.C. CODE ANN. § 5-924(b) (1967).

77. *See generally* W. PROSSER, TORTS §§ 43-48 (3d ed. 1964).

unlimited liability. The FHA Model Act makes no provision for whom the judgment shall be rendered against, nor for its satisfaction. The statutes of Alaska[78] and Washington[79] provide that the association alone may be sued for a cause of action relating to the common elements. The Alaska statute provides:

> A cause of action relating to the common areas and facilities for damages arising out of tortious conduct shall be maintained only against the association of apartment owners and a judgment lien or other charge is a common expense.[80]

This statute does make it clear that the association, and not the individual unit owner, is the party to be sued for injuries incurred in connection with the common elements. Satisfaction of the judgment is yet another problem. Although the association may be held liable in the event of suit for injury arising in connection with the common elements, the unit owner may not be relieved of liability since the judgment lien may be satisfied by common expense assessment if the association does not have sufficient funds. The unit owner will be responsible for his pro rata share of this common expense just as he would be for any other expense:

> The common profits of the property shall be distributed among and the common expenses shall be charged to the apartment owners according to the percentage of the undivided interest in the common areas and facilities.[81]

Some statutes also provide that the unit owner cannot exempt himself from liability for contribution to such common expenses by waiving his use or enjoyment of the common elements:

> No apartment owner may exempt himself from liability for his contribution towards the common expenses of common areas or facilities by his waiver of the use or enjoyment of any of the common areas and facilities or by abandonment of his apartment.[82]

This provision would seem to assure joint liability under the Alaska and Washington statutes.

The statutes of Alaska and Washington apparently are attempts to accomplish two things. First, they make it clear who should be named defendant in a suit for injury relating to the common elements. Secondly, they solve the problem of joint and several liability for unit owners in favor of joint liability through the common expenses levied by the association. As far as the statutes go, they seem to be both

78. ALASKA STAT. § 34.07.260 (Supp. 1969).
79. WASH. REV. CODE ANN. § 64.32.240 (1966).
80. ALASKA STAT. § 34.07.260(6) (Supp. 1969).
81. *Id.* § 34.07.380.
82. *Id.* § 34.07.210.

adequate and responsive to serious problems. But they do not alter the basic relationship existing between the unit owner and the association, that of principal and agent. Thus the statutes do not restrict potential personal liability for unit owners.

Awareness of the problem of the individual unit owner's liability is evidenced by the development of the Virginia Horizontal Property Act.[83] Prior to 1966, the Virginia statute made the standard provision for liability of the individual unit owner for common expenses:[84]

> All co-owners are bound to contribute pro-rata toward the expenses of administration and of maintenance and repairs of the general common elements, and, in the proper case, of the limited common elements of the building, and toward any other expenses lawfully agreed upon by the council of co-owners.[85]

The statute did not resolve the question of whether a tort judgment is a common expense which may be assessed under "expenses of administration and of maintenance and repairs" or whether the expense might be one "lawfully agreed upon by the council of co-owners." This provision inherently retained all the problems of joint and several liability, including liability of the unit owner for torts caused by his fellow unit owner(s) in conjunction with their use of the common elements.[86]

This first Virginia "Horizontal Property Act" was enacted in 1962, and its first major revision occurred in 1966. The 1966 revision was directed at easing the unit owner's potential liability for his neighbor's torts arising in conjunction with the common elements. The provision is somewhat less than felicitously drawn and is not at all free from ambiguity. The 1966 revision added the following section:

> (1) The liability of the owner of an apartment for pro rata expenses shall be limited to the amounts for which he is assessed from time to time in accordance with this chapter, the master deed or lease and the bylaws.
> (2) The owner of an apartment shall not be personally liable with respect to the negligence of any other co-owner except insofar as the negligent co-owner is acting for the council of co-owners.[87]

The second subsection of the act would seem to be an effort generally to restrict the unit owner's liability and to render him free of liability when a co-owner is engaged in personal activity which does not involve the association as a whole. But a reading of this statute *in pari materia*

83. *Compare* VA. CODE ANN. §§ 55-79.1 to -79.38 (1969), *with* VA. CODE ANN. §§ 55-79.1 to -79.38 (Supp. 1968), the superseded statute.

84. FHA MODEL ACT § 9(b) is similarly worded.

85. VA. CODE ANN. § 55-79.13 (Supp. 1968).

86. *See* note 77 *supra* and accompanying text.

87. VA. CODE ANN. § 55-79.37 (1969).

with the remainder of the act (particularly the provision relating to the common expenses) would indicate the possibility that the subsection only limits the unit owner's liability until a judgment is finalized and becomes a common expense to be satisfied pro rata by all unit owners:

> as for torts of single unit owners acting on their own account *but involving the common elements or facilities*, the statute may mean there is no liability whatsoever on the part of fellow owners, or merely no liability until the judgment is made a common charge.[88]

Apparently, the statute was intended to eliminate several liability of unit owners in instances when tort judgments were rendered against the association for injuries incurred in connection with the common elements, absent responsibility by an individual owner.[89] The question of when the individual is personally responsible for torts arising in connection with the common elements will be much litigated. Joint liability appears to be implicit in the Virginia statute because of the penchant for "joint phraseology" on the part of the drafters: "The liability of the owner of an apartment for pro-rata expenses;"[90] "All co-owners are bound to contribute pro-rata toward the expenses;" "If a co-owner fails to contribute his share as set forth above."[91] It is singularly disturbing, however, that no specific mention is made of the precise nature of the individual unit owner's liability.

Perhaps the most interesting but difficult provision involving the nature of the unit owner's liablity is that of North Carolina:

> Any individual, corporation, partnership, association, trustee, or other legal entity claiming damages for injuries without any participation by a unit owner shall first exhaust all available remedies against the association of unit owners prior to proceeding against any unit owner individually.[92]

Clearly, the intent of this statute was to limit the personal liability of unit owners insofar as possible without completely denying a right of recovery to the injured party.[93] But the statute all but spells out several liability in the event the association is unable to satisfy a judgment against it. Certainly, there are numerous unanswered questions relating to the application of this statute:

> If a unit owner was personally negligent in connection with common elements or

88. *See* Rohan, *supra* note 56, at 310.

89. One authority seems to think otherwise in refering to the provisions under discussion: "This may imply unlimited personal liability for the torts of management personnel." Rohan, *supra* note 56, at 310.

90. VA. CODE ANN. § 55-79.37(1) (1969).

91. *Id.* § 55-79.13.

92. N.C. GEN. STAT. § 47A-26 (1966).

93. It has been noted that the Florida and Mississippi statutes seem to be attempts to cut off completely any personal liability. *See* note 69 *supra* and accompanying text.

facilities, is the entire section inapplicable or is it only inapplicable to the negligent person? Must a judgment creditor levy execution on the condominium in order to "exhaust" his remedies; and, if so, can a unit owner exonerate himself by paying his aliquot share of the judgment?[94]

Despite legislative attempts to meet the problem of joint and several liability for the unit owner when injuries are incurred in connection with the use of the common elements, this examination of the various provisions illustrates the serious problems which still exist in the area. Clearly, a statutory definition of the scope of potential liability for the unit owner is most difficult; however, there is a great need for more definitive answers.[95]

4. *Satisfaction of Judgment.*—In many states the party incurring injury in connection with the common elements will have two available courses to obtain compensation for his injuries. First, he may get a judgment against the association or the individual unit owners, or both, and proceed through normal enforcement channels provided by state judgment lien statutes. Thus, the judgment creditor could obtain a judgment lien against the property of the party or parties sued. Satisfaction of the judgment would be obtained by levy and execution sale if the owner failed to remove the lien.

An alternative method of satisfaction is for the judgment creditor to operate within the condominium statute. Assuming that a judgment went against the association, the judgment could be satisfied by the association through a common expense assessment against the unit owners. This assumes that the tort judgment is a valid common expense. It is questionable, however, whether the judgment creditor would be able to force the association to lien individual units to enforce the judgment. Also, the problem arises as to who could then foreclose upon such a lien. It seems reasonable to assume that the association would not foreclose against the unit owners. The source of the problem is that most statutes are directed at common expense assessments of relatively moderate amounts. In most instances of contractual liability, there would be no need of enforcement proceedings. Unfortunately, the statutory draftsmen in most states simply did not contemplate the possibility of massive tort judgments.

Under many statutes, assuming that a judgment creditor causes the association to lien various individual units for enforcement purposes, the individual owner may then proceed to discharge his

94. Rohan, *supra* note 56, at 310-11.

95. For a series of proposals within the existing statutory frameworks, see Rohan, *supra* note 56, at 311-12.

proportionate share of the lien. The FHA Model Act provides a representative delineation of the procedure:

> In the event a lien against two or more apartments becomes effective, the apartment owners of the separate apartments may remove their apartment and the percentage of undivided interest in the common areas and facilities appurtenant to such apartment from the lien by payment of the fractional or proportional amounts attributable to each of the apartments affected.[96]

The lien approach has adequately covered at least the most obvious problems which will arise in the area of expenses for mechanics' or materialmen's liens.[97] In all instances considered, a rather serious question as to the status of the common elements remains when a unit owner fails to satisfy his proportion of a judgment and refuses to pay off the lien. If all the common elements are encumbered, the lienor must determine reasonable methods and procedures of collecting upon the property short of foreclosure. A further problem that may arise is the reassessment of unit owners, who have already paid their individual assessments, for the unpaid balance.[98] The District of Columbia statute would seem to prohibit reassessment in this instance.[99]

The FHA Model Act provides that the common expenses shall include those expenses which are defined as common expenses by the Act, the Declaration, or the Bylaws, and also those expenses declared by the Association to be common expenses.[100] But, of course, the Model Act does not provide for the naming of a party defendant in the event of a liability suit; presumably, the association could be named. Since a tort judgment rendered against the association would no doubt be declared a common expense and enforced against the individual unit owners by assessment, it is likely that the injured party would initially join all the unit owners in order to avoid the procedural problem of satisfaction under the statute. Some states have attempted to deal with

96. FHA MODEL ACT § 9(b).

97. For a discussion of the mechanics' and materialmen's liens, *see* notes 20 & 36 *supra* and accompanying text.

98. Rohan, *supra* note 56, at 312.

99. The District of Columbia Code, D.C. CODE ANN. § 5-924 (1967), provides: "In the event of entry of a final judgment as a lien against two or more unit owners, the unit owners of the separate units may remove their unit and their percentage interest in the common elements from the lien thereof by payment of the fractional proportional amounts attributable to each of the units affected. Said individual payment shall be computed by reference to the percentage established pursuant to section 5-906. After such partial payment, partial discharge, or release or other satisfaction, the unit and its percentage interest in the common elements shall thereafter be free and clear of the lien of such judgment."

100. FHA MODEL ACT § 2(g).

this problem by providing that the association should be named party defendant in the event of suit connected with the common elements. It has not been determined if such a provision cuts off the injured party's normal remedies against the unit owners.

The Michigan Horizontal Property Act provides that "[S]uits against the co-owners shall be in the name of the condominium project. . . ."[101] While it does seem that such a provision would prevent suit against the unit owners individually and thus solve the joint and several liability problem, the statute fails to make clear whether a tort judgment is a common expense assessable against the unit owners. The Michigan statute does not contain a general provision for the determination of what is a common expense similar to the provision in the FHA Model Act.[102]

Conceivably, in the event of a determination that a tort judgment is a properly assessable common expense, the statutory provision for suit against the association would force a judgment creditor into the Horizontal Property Act for enforcement of his judgment.[103] The statute, however, provides only for common expense assessment in the event of liability for "maintenance and repair of the common elements of the condominium project according to the percentage allocated to such apartment in the master deed."[104] Even so, the tort judgment may be assessable:

> The by-laws shall also provide that expenditures affecting the administration of the project shall include all costs incurred in the satisfaction of any liability arising within, caused by or connected with the common elements or the administration of the project, and that receipts affecting the administration of the project shall include all sums received as the proceeds of, or pursuant to, any policy of insurance securing the interests of the co-owners against liabilities or losses arising within, caused by or connected with the common elements or the administration of the project.[105]

This provision substantiates the probability that the statute forces the injured party to bring his action against the association alone, since it provides that the proceeds of any liability insurance policy should go to the association to compensate for any loss. In the event that the insurance is insufficient to satisfy a judgment, the association may enforce its assessments by filing a lien against individual apartments.[106]

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101. MICH. STAT. ANN. § 26.50(22) (Supp. 1969).

102. *See* note 101 *supra* and accompanying text.

103. *See* note 106 *infra* and accompanying text.

104. MICH. STAT. ANN. § 26.50(15) (Supp. 1969).

105. *Id.* § 26.50(13).

106. *Id.* § 26.50(16) (Supp. 1969): "All sums assessed to a unit owner by the administering body which are unpaid constitute a lien on such unit . . . ."

But the foreclosure provision presents a possible incongruity when it fails to recognize that foreclosure may be in behalf of a third party:

> The lien may be foreclosed by suit by the administering body in the name of the condominium project on behalf of the other owners in the same manner as a real estate mortgage foreclosure.[107]

The problems and apparent conflicts indentified throughout the Michigan act are not unique; they are the result of a failure on the part of many early legislators to recognize the myriad problems inherent in the condominium.

C. *Liability Insurance Problems*

1. *Double Coverage.*—Present condominium regimes necessitate comprehensive liability insurance as well as casualty insurance. It is no small problem for the unit owner to coordinate his personal coverage with whatever coverage the association may have. Certainly, to the extent that the unit owners will be held jointly and severally liable for torts occurring in the common areas, the unit owner's coverage must necessarily be extensive. Duplication of coverage is all but inevitable.[108] An even more serious problem is guarding against gaps in the coverage. Most of the condominium statutes provide that the association may take out insurance upon the entire development, so long as the coverage is only for casualty loss.[109] Even casualty insurance coverage will more than likely be duplicated by the unit owner in order to cover himself. The Ohio statute provides that the board of managers shall insure individual unit owners "for such amount as it determines against liability for personal injury or property damage arising from or relating to the common areas and facilities . . . ."[110] This statute provides only slight consolation for the unit owner whose only guarantee of satisfactory coverage is that he may vote upon the extent of the coverage in association meetings.

2. *Maintenance Standards.*—When numerous owners are only

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107. *Id.*

108. Rohan, *supra* note 56, at 306.

109. A typical authorization for the association to acquire casualty insurance is provided by the New York statute, N.Y. REAL PROP. § 339-bb (McKinney 1968): "The board of managers shall, if required by the declaration, the by-laws or by a majority of the unit owners, insure the building against loss or damage by fire and such other hazards as shall be required, and shall give written notice of such insurance and of any change therein or termination thereof to each unit owner, without prejudice to the right of each unit owner to insure his own unit for his own benefit. The premiums for such insurance on the building shall be deemed common expenses, provided, however, that in charging the same to the unit owners consideration may be given to the higher premium rates on some units than on others."

110. OHIO REV. CODE ANN. § 5311.16 (Baldwin 1964).

indirectly concerned with the management of the area to be insured, liability safety standards may be difficult to enforce. For example, the association may be required to keep a lifeguard on duty at the pool or to provide satisfactory fencing of play areas. Most assuredly, it will be difficult to assess unit owners in sufficient amounts to assure that safety requirements are met. In any case, the unit owners will pay the added expense either through increased premium or increased expenditures for compliance. The possibility of lapse or suspension of coverage is quite real, particularly if the system of assessment for common expense is employed. Dissatisfaction of unit owners may create periodic failures of payment.

3. *Products Liability and Workmen's Compensation Insurance.*—Additional types of liability insurance coverage which the condominium may need include products liability and workmen's compensation insurance. If the condominium owns washing machines, vending machines, or food dispensers, it will be necessary to have appropriate products liability insurance coverage.[111] Workmen's compensation insurance is required by statute for all maintenance employees. Furthermore, an "Employer's Automobile Non-Ownership" policy may be necessary when the condominium manager or other employee uses his personal car in his duties.[112]

One noted authority has suggested that a master liability policy is the best solution to the myriad problems arising out of the joint and several liability of the unit owner.[113] The proposal includes a statutory requirement that each condominium acquire and maintain the master policy covering all common risks faced by individual unit owners. The policy would include a provision covering all acts of individual owners involving the condominium as well as intra-apartment negligence. There would be an owners' indemnification agreement for the managing agent, or the agent would be named as the insured. Unlimited liability would be restricted to the unit owner's personal conduct. In the event insurance coverage for a judgment is inadequate, the unit owner's liability would be limited to his pro rata share of the unpaid portion of the judgment with no reassessment. Suits involving collective negligence would name the association. Notice for all unit owners of pending litigation would be required, but the unit owner's

111. Rohan, *Cooperative Housing: The Treatment of Casualty Losses, Insurance & Project Termination*, 2 CALIF. W.L. REV. 70, 73 (1964).

112. *Id.* at 74.

113. Rohan, *supra* note 56, at 316; *see* Ellman, *Fundamentals of Condominium and Some Insurance Problems*, 1963 INS. L.J. 733, 738 (1963).

attorney could only participate if unlimited personal liability on the part of the unit owner is sought. In the latter instance, both the association and the unit owner would be joined as party defendants. After judgment, execution could go against the individual unit owner subjected to unlimited liability. On the other hand, execution against the association would be satisfied on a pro rata basis between all other owners. Lastly, there should be no subrogation of the carrier to claims against individual unit owners.

D. Incorporation of the Common Elements as a Solution

1. *Elimination of Principal-Agent Relationship.*—The problems of potential unlimited, joint and several liability for unit owners have not been adequately solved because the relationship of principal and agent between unit owner and association has remained undisturbed. The incorporation of the common elements should suffice to alter this relationship and relieve the problems.

2. *Limited Liability.*—The incorporation of the common elements should relieve the unit owner from the risk of unlimited liability for torts incurred in connection with the common elements. Where the common elements are concerned, the corporation alone would be rendered liable. Naturally, in the event of a judgment so massive that it could not be satisfied through insurance coverage or normal assessment channels, the corporation's liability would be the same as that of any other corporate entity, extending only to its assets. The corporation should plan for such a contingency through adequate insurance coverage.

3. *Elimination of Several Liability.*—The incorporation should solve any problem of joint and several liability by subjecting only the corporate entity to liability for injuries arising in the common elements. Problems of who should be sued would be eliminated. Furthermore, intra-unit disputes involving the common elements would be resolved through suit against the corporation. A basic problem of the existing association-type organization is its "conflict of interest;" the association is required to serve too many masters for different purposes and is not sufficiently isolated to function viably as an independent entity.

4. *More Effective Management.*—Relative to insurance considerations, the corporation should be a more effective entity because of its direct responsibility for the common elements. The insurer should find the corporation easier to deal with for the purposes of meeting necessary safety requirements and thereby reducing

premiums. Compliance with building codes and fire regulations should come easily to the corporation. Most importantly, such an arrangement should relieve any instances of duplication of insurance coverage between corporation and unit owner. The corporation would provide maximum insurance in its sphere over the common elements, and unit owners would have only their individual units to consider. In each instance, premiums should be reduced and coverage improved since the scope of the insurance would be more clearly defined.

V. TAX CONSEQUENCES UNDER THE COMMON ELEMENT CORPORATION

The tax consequences are important factors in determining whether any condominium is successful in achieving its principal goal of securing more concomitants of ownership for the multi-unit dweller than are available to the renter or cooperator. Consequently, taxation is an important consideration in determining the workability of the proposed condominium regime. This section examines, in turn, the taxation of the unit owner and the managing organization under the traditional regime and under the proposed common element corporation.

A. Taxation of the Unit Owner

A home owner usually enjoys several tax benefits which, although not available to a renter or cooperator, are allowed to some extent to a unit owner in a condominium. The advantages cited are usually five in number: the nonrecognition of gain on the sale or exchange of a unit; the deduction for payment of local property taxes; the deduction of interest paid on a mortgage; the deduction for uninsured casualty losses to his property; and the deduction for depreciation should a unit owner rent his property to another.[114]

1. *Nonrecognition on Sale or Exchange.*—Section 1034 of the Internal Revenue Code of 1954 provides that no gain shall be recognized upon the sale of property used by the taxpayer as his principal residence if, among other conditions, he reinvests in a new residence within one year and its purchase price exceeds or is equal to the adjusted sales price of the old residence.[115] The Internal Revenue

114. Note, *Condominium—Tax Aspects of Ownership*, 18 VAND. L. REV. 1832 (1965).

115. It is important to note that § 1034 requires that the unit sold was the principal residence of the taxpayer. Thus, nonrecognition would not be accorded to the sale of a unit used as a resort home by that taxpayer. INT. REV. CODE of 1954, § 1034.

Service has ruled that the benefit of section 1034 will be available to an individual selling or purchasing a condominium unit which was or will constitute his principal residence.[116] Whether the same tax advantage will be available under the proposed regime depends upon the Service's interpretation of the term "property" in section 1034(a). To the extent that the unit owner still holds his unit under a deed in fee simple, the previous Revenue Ruling should apply. Consequently, there will be at least a minimum nonrecognition available under the new regime based on the sale value of the unit apart from the price allocable to the sale of the shares in the common element corporation. The crucial question is whether the transfer of the shares will qualify for nonrecognition treatment. There is every reason to believe that they should and would be so treated by the Service. Section 1034(f) qualifies stock in a cooperative housing corporation for nonrecognition treatment and provides in part:

> For purposes of this section . . . references to property used by the taxpayer as his principal residence, and references to the residence of a taxpayer, shall include stock held by a tenant-stockholder . . . in a cooperative housing corporation . . . if—(1) in the case of stock sold, the house or apartment which the taxpayer was entitled to occupy as such stockholder was used by him as his principal residence, and (2) in the case of stock purchased, the taxpayer used as his principal residence the house or apartment which he was entitled to occupy as such stockholder.[117]

Since shares in the common element corporation constitute an inseparable part of the fee title in the unit, the policy manifested by section 1034(f) should apply with equal force to a transfer of shares in a common element corporation. This is particularly true since shares in a cooperative also represent ownership in the common areas and facilities. Thus, the new regime is a kind of hybrid for nonrecognition purposes. The Service could treat the sale of the unit as qualifying under section 1034(a) and the simultaneous transfer of the shares as qualifying by analogy under section 1034(f). Alternatively, the Service could simply rule that the term "property" in section 1034(a) embraced not only the unit, but all its inseparable parts, including the shares in the common element corporation. A final option, which is always available, is an amendment to section 1034 by adding a subsection expressly qualifying shares in the common element corporation for nonrecognition. Since there is no potentiality for taxpayer abuse and in light of a clear policy evidenced by the former Ruling and section 1034(f), it is unlikely that the Service would

116. Rev. Rul. 64-31, 1964-1 CUM. BULL. 300.
117. INT. REV. CODE of 1954, § 1034(f).

challenge a claim to the full benefit of section 1034 by a unit owner under the proposed regime. In any case, of course, the unit must qualify under the principal residence requirement imposed under section 1034.

2. *Deduction of Property Taxes.*—Section 164 allows a deduction for the payment of real property taxes to the taxpayer upon whom such taxes are imposed.[118] This deduction is also available to the unit owner in a traditional condominium regime provided he itemizes the deductions on his income tax return.[119] There are some problems involved, however, in securing this benefit even under the traditional regime. In order to qualify for the deduction, the unit owner must be the taxpayer upon whom the tax is imposed. Usually this requirement will present no problem since most enabling acts provide for separate assessment of each unit. Separate assessment provisions have been encouraged by the FHA since its regulations make separate assessment a prerequisite to FHA insurance.[120] Nevertheless, in some states it is possible that a condominium could be subjected to a blanket assessment upon the association rather than upon the individual unit owners. In such a situation, it is not clear whether the unit owner would still qualify for a deduction based upon his pro rata share of the taxes collected from the association. If the taxes are paid by a pro rata assessment upon the unit owners, it would seem that they are still persons upon whom the tax is imposed for all practical purposes.[121] The case is less clear, however, when the tax is paid by the association with accumulated income from rental property or other sources independent of the unit owners. In such a case, perhaps, the entire deduction would belong to the association.

Separate assessment is a necessary condition to establishing the proposed condominium regime;[122] consequently, there is no question

118. Treas. Reg. § 1.164-1 (1968). Seetion 164 also provides for the apportionment of the deduction between the buyer and seller of property during the taxable year. INT. REV. CODE of 1954, § 164(d).

119. Rev. Rul. 64-31, 1964-1 CUM. BULL. 300.

120. 24 C.F.R. §§ 234.273 -.274 (1969). Separate assessment is required by the FHA because it limits the unit owner's liability to those taxes assessed upon his property. If a blanket assessment were made upon the entire property, a unit owner could become liable for taxes due on another unit should its unit owner fail to pay.

121. Even where separate assessment is not carried out, the unit owner should be allowed the § 164 deduction if he can demonstrate that his share of the taxes were included in an assessment made on his unit by the managing organization. In such a case, the unit owner is in a situation analogous to the shareholder in a cooperative who is allowed a proportionate deduction for taxes under § 216 of the Internal Revenue Code of 1954.

122. *See* notes 40-42 *supra* and accompanying text.

upon whom local taxes would be imposed under the common element corporation system. The unit owners would qualify for the section 164 deduction to the extent of taxes imposed upon the individual units. When the corporation has gross income,[123] the deduction for taxes paid on the common elements would be taken on the corporate income tax return. If the corporation has no gross income, however, the question arises whether it can pass the deduction on to its shareholders on a pro rata basis. While logically the same argument (that the unit owners are in reality the persons upon whom the tax is imposed) would apply here as in the case of an owner under the traditional regime, the current Treasury Regulations seem to disallow the deduction on the common elements to the unit owners.[124] Unlike the traditional regime, the common element corporation holds legal title to the common areas and facilities; therefore, it would be the taxpayer upon whom the taxes would be imposed. Consequently, unless some special provision is made, the property tax deduction on the common elements may be lost.

The variety of Code provisions and Treasury Rulings concerning the taxability of homeowners, cooperators, and condominium owners evidences an intent to treat these forms of ownership alike.[125] In this regard, it is important to note a special provision relating to cooperatives which allows a deduction for taxes to be taken by the shareholders even though the tax is imposed upon the corporation:

> In the case of a tenant-stockholder, . . . there shall be allowed as a deduction amounts . . . paid or accrued to a cooperative housing corporation within the taxable year . . . to the extent that such amounts represent the stockholder's proportionate share of . . . the real estate taxes allowable as a deduction to the corporation under section 164 which are paid or incurred by the corporation . . . .[126]

This section provides relief from the precise predicament postulated under the common element corporation. Unfortunately, a unit owner under the common element corporation cannot qualify under section 216 because of the definitional provision which requires, among other things, that the corporation be of a nature that:

> each of the stockholders . . . is entitled, solely by reason of his ownership of stock in the corporation, to occupy for dwelling purposes a house, or an apartment in a building, owned or leased by such corporation . . . .[127]

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123. *See* notes 149-55 *infra* and accompanying text.

124. Treas. Reg. § 1.164-1(a) (1966): "In general, taxes are deductible only by the person upon whom they are imposed."

125. *See, e.g.*, INT. REV. CODE of 1954, §§ 1034(f), 216; Rev. Rul. 64-31, 1964-1 CUM. BULL. 300.

126. INT. REV. CODE of 1954, § 216(a)(1).

127. INT. REV. CODE of 1954, § 216(b).

This provision originated in the Internal Revenue Code of 1939 when there was little, if any, concern about the taxability of condominiums. A shareholder-unit owner under the proposed regime fails to meet this provision because: (1) the unit owner's right to occupy his unit is not based solely upon his stock ownership since he also holds a deed to his unit; and (2) the corporation does not own or lease the units. Even though it is clear that the proposed regime is a type of cooperative ownership of the common elements solely by unit owners, it is not possible to meet the literal definition of this section. Consequently, if the deduction is to be allowed to the shareholders, an amendment to section 216 is required or a revenue ruling is necessary to determine whether the deduction would be allowed by the IRS under this provision.[128]

3. *Deduction of Interest Payments.*—Section 163 provides for a deduction of all interest paid or accrued on indebtedness within the taxable year. Under both the traditional and the proposed condominium regimes, the unit owner will presumably negotiate his own mortgage. In either case, interest paid on the mortgage will be deductible under section 163 provided the taxpayer is the legal or equitable owner of the mortgaged property.[129] Clearly, the unit owner under the new regime is the equitable owner of his share of the common elements for the purpose of deducting that part of the mortgage price of his residence allocable to the purchase of shares in the common element corporation as well as to the purchase of the unit. If a proper amendment is obtained under section 216 qualifying the unit owner as a cooperator in the common elements,[130] the unit owner may also deduct interest on indebtedness incurred by the corporation in the acquisition, construction, alteration, rehabilitation, or maintenance of the common areas or facilities.[131] Of course, the unit owners would be allowed to take the deduction only when they are assessed for the interest payment.

128. Even though legal title to the common elements is in the corporation, the unit owners are the equitable owners and are in a position analogous to shareholders in a cooperative corporation. The IRS has ruled that a tenant-stockholder in a cooperative under a long-term lease may deduct his proportionate share of property taxes paid, even though legal title is in the lessor. Rev. Rul. 62-178, 1962-2 CUM. BULL. 91. Thus the Service has committed itself to allowing the deduction to be taken by the taxpayer who actually bears the burden of payment so long as he is in a position of practical ownership. In the case of a cooperative, the corporation as well as the stockholders may take the deduction for property taxes and interest. The double deduction probably would not be allowed in the case of a condominium. *See* note 153 *infra.*

129. Treas. Reg. § 1.163-1(b) (1966). The deduction has been expressly allowed to unit owners under the traditional condominium regime. Rev. Rul. 64-31, 1964-1 CUM. BULL. 300.

130. *See* notes 126-29 *supra* and accompanying text.

131. INT. REV. CODE of 1954, § 216(a)(2).

4. *Deduction of Uninsured Casualty Losses.*—Section 165 allows a deduction to the individual taxpayer for uninsured losses arising from fire, storm, theft, or other casualty in excess of 100 dollars. With respect to losses arising in connection with the owner's unit, the owner is clearly entitled to the deduction on his individual income tax return. The problem arises in connection with losses relating to the common areas and facilities.[132] One solution under the traditional condominium regime would be to divide the deduction proportionately among the unit owners. Such an allocation, however, could drastically reduce the total permissible deduction because each owner is allowed to deduct only that share of his loss in excess of 100 dollars. Thus, the deduction would be reduced by the amount of 100 dollars multiplied by the number of unit owners. If the cost of repairs is paid out of funds accumulated by the managing association, then the entire deduction could be taken by the association to offset any gross income. In this way, the deduction would be reduced by only 100 dollars.[133] Where the association has no gross income, however, the deduction must be divided among the owners, which incurs the greater reduction.

Losses incurred would differ in two major respects under the proposed condominium regime. Since the common areas and facilities are owned by a corporation, the losses deductible would not be subject to the 100 dollar limitation placed on losses sustained by individuals.[134] The common element corporation would be entitled to deduct the full amount of any uncompensated casualty loss on its corporate income tax return. In a situation where the corporation has no gross income, the question again arises whether the losses can be divided and deducted by the individual owners. Since the unit owners are the sole and equitable owners of the common areas and if the loss is paid by corporate assessment of the unit owners, there appears to be no reason why the loss should not be apportioned as is the practice under the traditional regime. There is no express authority for such a proposition, however, and similar to the deduction of property taxes,[135] a disallowance by the Service in such a case could pose a substantial stumbling block for the proposed system of condominium ownership.

A further problem faces the taxpayer under either system of condominium ownership with respect to the deduction for casualty

132. For a thorough review of the problem of casualty losses, see Note, *supra* note 114, at 1836.

133. The limitation to a single reduction assumes taxation as a partnership.

134. INT. REV. CODE of 1954, § 165(c).

135. *See* notes 118-28 *supra* and accompanying text.

losses. Assuming the deduction is properly allowed to the unit owner or the managing organization, it is not clear whether the loss is a capital loss under section 1231 or an ordinary loss deductible from ordinary income under section 165. Although a casualty loss to residential property has been held deductible from ordinary income,[136] the IRS continues to insist[137] that a casualty loss to residential property held more than six months in an involuntary conversion under section 1231 whether the loss is compensated or not.[138] If the Service is correct, the deduction would be allowed only to offset capital gains under section 1231. Although the problem is largely mitigated by insurance coverage of most casualty losses, this diversity of opinion leaves the manner of the deduction for uninsured losses to residential property very much in doubt.[139]

5. *Depreciation Deduction.*—Section 167(a)(2) permits as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear of property held for the production of income. Thus, if the unit owner were to convert his unit into rental property, he would be entitled to this deduction. The depreciation deduction should be equally available to the condominium owner under the proposed regime since nothing in section 167 depends upon the manner or form of the property's ownership. A similar deduction can be taken under section 167(a)(1) if the unit is used in the owner's "trade or business." The latter deduction is unlikely since most condominiums are now used by their owners almost exclusively for residential purposes. On the other hand, the deduction for rental property can be important to the owner who uses his unit as a resort home and rents part of the year. Presumably, the unit owner would be entitled to a depreciation deduction based upon the period of rental even though he occupied the unit during a part of the taxable year. The Code speaks of a reasonable allowance, and the Treasury Regulations state only that:

> No deduction for depreciation shall be allowed . . . on a building used by the taxpayer *solely* as his residence, or on furniture or furnishings therein . . . .[140]

Thus, the rented unit should qualify for the deduction even though occupied by the owner during part of the taxable year.

136. Mauer v. United States, 284 F.2d 122 (10th Cir. 1960).

137. The IRS has indicated that it will not acquiesce in the *Mauer* decision, *id.* Rev. Rul. 61-54, 1961-1 CUM. BULL. 398.

138. Treas. Reg. § 1.1231-1(e)(1) (1965).

139. *See generally* Note, *supra* note 114; Note, *Condominium and Cooperative Housing: Taxation by State and Federal Governments*, 21 U. FLA. L. REV. 529, 530 (1969).

140. Treas. Reg. § 1.167(a)-2 (1956) (emphasis added).

B. *Taxation of the Common Element Corporation*

The taxation of the managing organization is another important factor in measuring the success of any cooperative venture in multiple unit living. To the extent that the unit owners might become liable for a second tax at the corporate level, ownership in a condominium becomes less attractive. As previously indicated, there is a substantial threat of double taxation even under the traditional regime.[141] With careful tax management, however, taxation of the managing body should be reduced to a minimum under both the traditional and the proposed condominium regimes.

1. *Assessment Income.*—Although there are significant differences in the legal rights and duties of an unincorporated association, an incorporated association, and a common element corporation for non-tax purposes,[142] the Treasury Regulations rely upon factors that seemingly place all three condominium organizations in the position of being taxed as corporations on gross income.[143] While the result is somewhat less certain in the case of an unincorporated association,[144] an incorporated association and a common element corporation will be taxed on their gross income. The question then becomes what constitutes gross income to the managing body. Section 118 provides that in the case of a corporation, gross income does not include any contribution to capital. In further defining the exclusion provided for in section 118, the Treasury Regulations state:

> Thus, if a corporation requires additional funds for conducting its business and obtains such funds through voluntary pro rata payments by its shareholders, the amounts so received being credited to its surplus account or to a special account, such amounts do not constitute income, although there is no increase in the outstanding shares of stock of the corporation. In such a case the payments are in the nature of assessments upon, and represent an additional price paid for, the shares of stock held by the individual shareholders, and will be treated as an addition to and as a part of the operating capital of the company.[145]

Consequently, under any one of the three alternative managing organizations, the usual assessments against unit owners to meet normal operating expenses will clearly escape taxation as contributions

141. *See* notes 23-27 *supra* and accompanying text.

142. *See* notes 30-32 *supra* and accompanying text.

143. *See* notes 13-27 *supra* and accompanying text.

144. The only substantial distinction is the lack of limited liability that is not a mandatory requirement under the Treasury Regulations. Thus, where liability is limited to any extent under a state statute, there is almost certain taxation as a corporation. The Florida statute is a good example of limited liability that may well lead to corporate taxation. Note, *Condominium and Cooperative Housing: Taxation by State and Federal Governments, supra* note 139, at 534.

145. Treas Reg. § 1.118-1 (1956); *cf.* 874 Park Ave. Corp., 23 B.T.A. 400 (1931).

to capital. Presumably, assessments will be so managed as to balance projected expenses, but net surpluses may occur, presenting the condominium with an accumulation problem.[146] If the managing body collects substantial reserves over a period of years, the assessments may be treated as gross income and subjected to the accumulations tax.[147] Normally, however, the threat of excess accumulations will be offset by undercollections in particular years. Also, the tax consequences of surpluses will be minimized by the carryover and carryback provisions of the Code.[148] Thus the residential condominium meeting expenses out of assessments upon the unit owners should be able to avoid completely the possibility of a corporate tax even under a common element corporation structure.

2. *Rental Income.*—Most condominiums, however, will at some time, if not on a regular basis, receive gross income from rental of units acquired by right of first refusal.[149] Minimizing the burden of double taxation in this situation is a difficult problem for the managing body. Most likely, the rental income will be used to reduce the amount of assessments upon the unit owners. In such a situation, it is not clear whether the value of the reduced assessments is a "constructive dividend" to the shareholders; similarly, there is some question whether rental income can be offset by deducting the expenses of operating and maintaining other common areas and facilities as ordinary and necessary business expenses. If use of rental income to discharge such expenses gives rise to a constructive dividend, an ordinary and necessary business expense deduction would seem to be precluded. According to the Treasury Regulations, corporate payments for the benefit of shareholders may be taxed as constructive dividends when the income is set apart for them or credited to their accounts.[150] In the case of the common element corporation, the dividend would be treated as received when rental income is used to discharge debts that would otherwise be paid by assessments upon the owners. Characterization of such expenditures as a dividend results since the payments directly reduce the personal living expenses of the owners.

146. INT. REV. CODE of 1954, §§ 531-37.

147. Rev. Rul. 57-375, 1957-2 CUM. BULL. 110.

148. INT. REV. CODE of 1954, §§ 172(a)-(e); *see* Berger, *supra* note 5, at 1009.

149. The right of first refusal is a common provision found in either the declaration, by-laws, or unit deed and provides that a unit owner who wishes to sell must first offer his unit to the managing organization or other unit owners who are willing and able to buy at the price offered by the prospective purchaser. For a closer examination of the right of first refusal, see Note, *Right of First Refusal—Homogeniety in the Condominium*, 18 VAND. L. REV. 1810 (1965).

150. Treas. Reg. § 1.451-2 (1964).

While the constructive dividend argument has never been before the courts in the case of a condominium, in *Anaheim Union Water Co. v. Commissioner*,[151] the court held that a cooperative corporation could properly offset rental income by deducting expenditures in other common areas as ordinary and necessary business expenses. To be internally consistent with other provisions of the Code, however, this holding would preclude a dividend characterization of the reduced assessments. By definition,[152] a dividend (even a constructive dividend) is a distribution out of earnings and profits calculated after all proper deductions. If the corporation can offset rental income with a deduction for expenses in the common areas, there presumably would be no accumulated or current earnings and profits out of which to distribute a dividend. Thus the question of a constructive dividend turns on whether the corporation can properly take the ordinary and necessary business expense deduction with respect to its use of the rental income.[153]

Although the *Anaheim* decision resolved the issue in favor of the cooperative, the Seventh Circuit reached a contrary result on substantially the same question. In *Chicago & W.I.R.R. v. Commissioner*,[154] the court held that a corporation could not take an

151. 321 F.2d 253 (9th Cir. 1963).

152. INT. REV. CODE of 1954, § 316(a). Section 316(a) provides in relevant part: "[T]he term 'dividend' means any distribution of property made by a corporation to its shareholders—

(1) out of its earnings and profits accumulated after February 28, 1913, or

(2) out of its earnings and profits of the taxable year . . . without regard to the amount of the earnings and profits at the time the distribution was made.

Except as otherwise provided in this subtitle, every distribution is made out of earnings and profits to the extent thereof, and from the most recently accumulated earnings and profits."

153. It is important to note that the holding in *Anaheim* is not completely analogous to the condominium situation. Under the Internal Revenue Code's definition of a cooperative housing corporation, up to 20% of the corporation's gross income may be received from sources other than the stockholders. Thus the Code expressly allows a cooperative to avoid a substantial income tax by using deductions on residential space to offset up to 20% of its rental income from commercial units. INT. REV. CODE of 1954, § 216(b)(1)(D); Rev. Rul. 58-421, 1958-2 CUM. BULL. 112; Rev. Rul. 55-654, 1955-2 CUM. BULL. *See also* Aronsohn, *The Tax Position of The Homeowner*, N.Y.U. 26TH INST. ON FED. TAX 287, 307 (1968), *cited in*, Note, *Condominium and Cooperative Housing: Taxation by State and Federal Governments*, *supra* note 139.

Unfortunately, the same 20% leeway probably would not be allowed to the common element corporation even if an amendment permitted the unit owners to qualify under § 216(b)(2). The leeway provision postulates that payment from the shareholders will constitute taxable income to the corporation, that is, rental income. Therefore, unless payments by unit owners are treated as "rent" by the IRS, the 20% leeway will not be allowed to either the traditional or the proposed condominium regime.

154. 303 F.2d 796 (7th Cir.), *rev'd on rehearing*, 310 F.2d 380 (1962). After the first decision, Congress enacted § 281 of the Internal Revenue Code of 1954 granting special relief to terminal railroad corporations and their shareholders from the effect of the *Anaheim* and

ordinary and necessary business expense deduction for expenditures of rental income to the extent that such payments reduced assessments against shareholders. Thus it appears that the Seventh Circuit would find a condominium corporation taxable on its rental income without allowance for expenses on common areas used by the unit owners. As a logical extension of this holding, it seems that a constructive dividend might also be assessed against the unit owners.

In spite of the split between the Ninth and Seventh Circuits, the result of future litigation is very much in doubt. The constructive dividend argument was not before the court in *Anaheim* or *Chicago & W.I.R.R.*, but there is little defense to the argument that the personal living expenses of the shareholders are directly reduced by rental income in either case. Consequently, there is little tax advantage for the unit owners or the managing organization in renting commercial space in the common areas. Even in the event of a double tax, however, the unit owner derives some benefit from the use of rental income in that he must now pay only the tax on the value of the "dividends"[155] rather than pay in full the amount of the "dividend" to the corporation to meet expenses.

VI. SECURITIES REGULATION OF THE COMMON ELEMENT CORPORATION

Any type of joint venture must be examined with a view toward determining the state and federal securities regulation consequences. The expenses and problems of security registration might prove prohibitive to certain ventures. A residential condominium regime with its common elements in a separate corporation theoretically should not create significant securities regulation problems that are not already present in the traditional condominium regime. But the possibility does exist under both regimes that the development will be subject to regulation at the state and federal levels.

A. Regulation Under Federal Securities Law

1. *Rule 235.*—Although shares in a common element corporation meet the definition of "security" under the Securities Act

Chicago & W.I.R.R. decisions. Note, *Condominium: A Reconciliation of Competing Interests?* 18 VAND. L. REV. 1773, 1796 n.133 (1965).

155. The unit owner under the traditional condominium may be able to offset the constructive dividend by depreciating the cost of his fractional interest in the rented portions of the common areas. INT. REV. CODE of 1954, § 167; *see* Berger, *supra* note 5, at 1009; Note, *supra* note 114, at 1845. This possibility does not exist under the common element corporation since title to the rented areas and facilities is held solely by the corporate entity.

of 1933,[156] the SEC has regulated only those security interests with income-producing accoutrements.[157] Thus the condominium may be subjected to regulation in the event that profits from rental units or other common ventures accrue to unit owners or in the event that assessment collections and reserve accounts are invested for profit.[158] On the other hand, the SEC has adopted a policy of exempting security interests that represent a non-profit motivated investment in residential property. The SEC has recently amended Rule 235, which had previously applied only to cooperatives, to exempt the traditional condominium regime from federal regulations. The amended version of the rule provides, *inter alia*, that the exemption shall extend to:

> . . . a corporation each of whose members is entitled by reason of his membership in such corporation:
>
> . . .
>
> (2) To purchase a dwelling constructed or to be constructed by such corporation.
>
> (b) Such corporation shall not intend to be engaged in any business or activity other than the . . . management or construction of residential properties for its members, except to the extent that such business or activity is incidental to the . . . management or construction of such residential properties.
>
> (c) The securities shall be issued only in connection with the sale . . . of dwelling units to persons who are or thereupon become members of the corporation and shall be transferable by the purchasers only in connection with the transfer of such dwelling units . . . to other persons who are thereupon become [*sic*] such members.[159]

While it is obvious that the ruling was not drafted with the proposed regime in mind, the common element corporation very nearly satisfies the literal requirements of the SEC's regulation. At least in the case of the incorporated developer,[160] the unit owners purchase a dwelling constructed or to be constructed by the common element corporation. Whether a corporation that serves the same purpose, but which does not construct the dwellings, would qualify under this exemption is questionable. In this regard, it is important to note that the basic prerequisite for exemption is some assurance that the development is for residential purposes only. Although the unit owners now hold shares in the common element corporation representing their respective interests in residential property, the nature of the interest is very different from the normal security investment, regardless of whether the corporation is responsible for the construction. Consequently, the

156. Securities Act of 1933 § 2(1), 15 U.S.C. § 77b(1) (1964).

157. 4 R. POWELL, *supra* note 4, at 835.

158. *See* notes 174-76 *infra* and accompanying text.

159. Rule 235, 17 C.F.R. § 230.235 (1969).

160. *See* notes 48-50 *supra* and accompanying text.

policy of the Rule 235 exemption should carry over to the creation of a separate common element corporation by the developer or by the unit owners as a group.[161] Under the proposed regime, the shares in the common element corporation would be inseparable from the units and therefore not freely marketable. Thus, quite regardless of who constructs the units, the relevant securities regulation considerations, such as a fraudulent practice, speculation, and profit-motivated investment, are not applicable to the issuance of shares in the common element corporation. Nevertheless, a clarification of the present ruling seems necessary if the exemption is to be applied to a corporation which has not constructed the dwelling units. In any case, a "no action" letter should be obtained from the SEC before beginning sales under the proposed regime to resolve any doubts in this very complex area.

2. *Intra-State Exemption.*—Even if ruled to apply to the proposed regime, the Rule 235 exemption is expressly conditioned upon the absence of any profit-making intent. While this exemption is, perhaps, the most attractive possibility, there are two alternative exemptions which would apply regardless of the common element corporation's collateral business activities, such as rental pooling agreements.[162] The first alternative is the intra-state offering which exempts transactions in a security that is a part of an issue offered or sold only to persons residing in a single state.[163] Under existing regulations, however, the intra-state exemption is not attractive since a single nonresident purchaser would destroy the entire exemption requiring the registration of all shares and making prior sales voidable at the unit owner's option. The widespread use of condominiums as "second homes" makes the successful use of this exemption all the more unlikely.

3. *Private Offering Exemption.*—In terms of its successful implementation, the most attractive statutory exemption presently available is the private offering exemption.[164] If the shares in the common element corporation are viewed as separable from the units for securities regulation purposes,[165] they could then be offered privately

161. *Id.*

162. *See* notes 174-76 *infra* and accompanying text.

163. Securities Act of 1933 § 3(a)(11), 15 U.S.C. § 77c(11) (1964).

164. Securities Act of 1933 § 4(2), 15 U.S.C. § 77d(2) (1964).

165. For a discussion of the problems of separability, see note 34 *supra* and accompanying text. As a general rule, it is not favorable for the shares to be separable since the common element ownership should not be separated from unit ownership; however, this would tend to favor the exemption from federal and state securities regulation.

to those persons who actually purchase a condominium unit. Thus, even though the units are offered for sale to the public, the shares in the corporation would be part of a private offering to unit purchasers only. If it is determined that none of the exemptions will be available to the proposed condominium regime, the simplified and less expensive Regulation A registration should be considered.[166]

B. Regulation Under Blue Sky Laws

1. *State Regulation.*—Although condominiums are generally exempted from "security" regulation by the states, they are usually subject to some type of regulation, most commonly under the directives of a real estate commission. Basically, there are three approaches by which condominium developments are exempted from state blue sky regulation: (1) a provision that the real estate commission shall regulate condominiums; (2) a classification of the apartment and the undivided interest in the common areas as interests in realty;[167] and (3) a specific statement that the interests conveyed are not securities. The effective result of these provisions is the same: the development is subject only to real estate regulation. The condominium statutes of Washington[168] and Alaska,[169] however, specifically provide that sales to unit owners are not sales of securities. The Alaska provision is a simple one:

> "property" means the land, the building, all its improvements and structures, all owned in fee simple absolute or qualified or by way of a periodic estate, or in any other manner in which real property may be owned in the state, and all easements, rights, and appurtenanees belonging to it, none of which shall be considered as a security or as a security interest, and all articles of personalty intended for use in connection with it, which have been or are intended to be submitted to this chapter.[170]

Until recently, a controversial question in California was whether condominium developments were subject to the state's securities regulations.[171] The California legislature, however, has rendered the

166. Securities Act of 1933, Reg. A, 17 C.F.R. §§ 230.251 to -.262 (1969).

167. For examples of statutes which classify the unit and undivided interest in the common elements as real property for all purposes, see CONN. GEN. STAT. REV. § 47-73 (Supp. 1967); KAN. STAT. ANN. § 58-3104 (1964); OHIO REV. CODE ANN. § 5311.03(A) (Baldwin 1964); PA. STAT. tit. 68, § 700.201 (1965); WIS. STAT. ANN. § 230.73 (Supp. 1969). Two states provide that the units shall have the same incidents as real property: MD. ANN. CODE art. 21, § 120 (1966); UTAH CODE ANN. § 57-8-4 (1963).

168. WASH. REV. CODE ANN. §§ 64.32.030, 64.32.190 (1966).

169. ALASKA STAT. § 34.07.450(13) (Supp. 1969).

170. *Id.*

171. *See* Hoisington, *Condominiums and the Corporate Securities Law*, 14 HASTINGS L.J. 241 (1963).

question moot by determining that the Real Estate Commissioner should have regulatory authority over condominium developments.[172] Although most state statutes are silent as to the particular type of regulation, this recent provision, as well as those already discussed, would seem to indicate that the residential condominium development will normally be outside the purview of state blue sky laws.[173]

2. *Special Problems.*—A serious problem in the securities regulation area which the developer and unit owners must confront is the rental pool arrangement under which individual unit owners will contract to place their units in a pool for rental purposes when the units are unoccupied. In such instances, since the contract represents a common venture for a profit, the transaction may well be subject to state and federal securities regulation.[174] Naturally, the rental pool is feasible only when a substantial proportion of the unit owners will be absent from their units during the year. The potential securities law implications of such an arrangement include a separate management entity for supervision of the rentals and an objective to maximize profits.[175] Since the common element corporation would be a separate entity for management purposes and would have as its assets the common elements of the corporation, it might be subjected to regulation under this rationale. This would be particularly true if "the buyers' and sellers' frame of reference takes on a financial, as well as a housing or real property orientation."[176]

The second major area of difficulty involves the consequences of a failure to register. There may be serious delays and expenses involved in determining whether the development is subject to regulation, even if the regulatory authorities ultimately do not require registration.[177] Any such delays may have serious financial repercussions for the developer. The regulatory agency may require the developer to reconvey all units sold prior to registration.[178] Again, the financial repercussions could be critical. In any event, the major problem, if such registration

172. CAL. BUS. & PROF. CODE, § 11004.5 (West Supp. 1970).

173. A letter from the Florida Securities Commission has stated that it was not necessary to register either cooperatives or condominiums in Florida. 4 R. POWELL, *supra* note 4, at 836 n.29.

174. 4 R. POWELL, *supra* note 4, at 835; Rohan, *The Securities Law Implications of Condominium Marketing Programs Which Feature A Rental Agency or Rental Pool*, 2 CONN. L. REV. 1, 5-6 (1969).

175. *See* Rohan, *supra* note 174, at 4-5.

176. *Id.* at 5.

177. *Id.* at 7.

178. *Id.*

becomes widely accepted, will be a drastic reduction in the use of condominium developments.

VII. CONCLUSION

Although the establishment of a common element corporation will provide the unit owners with some relief from major legal problems, close examination clearly reveals that such a proposal is not a ready cure for the condominium's many drawbacks. Among the proposal's chief benefits is the elimination of unlimited, joint and several liability for the unit owners. At the same time, responsibility for liability and casualty insurance coverage will be more clearly defined with the consequent elimination of double coverage. A variety of procedural questions will also be resolved since the corporation will be directly responsible for the common areas and facilities as well as the conduct of employees. The normal residential condominium will be able to retain most of the tax advantages already available under the traditional regime. If an amendment or ruling is obtained, the property tax deduction on the common elements should also be allowed to the unit owners. Taxation of the common element corporation should be effectively eliminated by balancing assessments and income against expenses connected with the common areas and facilities. While a condominium with substantial rental income may be taxable on the rent received, this is true under the traditional as well as the proposed regime. The securities regulation aspects of establishing the proposed regime are no more prohibitive than under the traditional regime. Moreover, the residential condominium should have little trouble qualifying for an exemption under both federal and state statutes. Perhaps the most formidable obstacle confronting the new condominium regime is the numerous amendments under state and federal law necessary for its establishment. Only a great deal of time and effort will ultimately devise an adequate answer to the challenge that the condominium concept presents. The establishment of the common element corporation, however, will be a step in the right direction.

LAWRENCE CHARLES ASHBY

JOHN H. BAILEY, III