

NON-DEEDED VS. DEEDED TIMESHARING: Tax and Accounting Aspects

FEDERAL INCOME TAXATION

2000 ARDA Convention Workshop, April 2, 2000

This outline is not intended to provide specific tax advice and should not be used as such. The outline is for general information only. Any interested party should consult his/her own tax advisor.

I. NON-DEEDED VACATION CLUBS: GENERAL STRUCTURE IN USA

- A. **Developer transfers title** to land, improvements and furnishings to a not-for-profit corporation - - The "Club"
 - 1. Property-holding Club is intended to qualify as a "Timeshare Association" under Section 528 of the Internal Revenue Code for income tax exemption purposes.
 - 2. The transfer of the property to the Club should not be considered a taxable event.
- B. **Developer retains the right to sell** to consumers non-deeded vacation use of the facilities, coupled with a voting membership in the Club.

II. "WINDRIFTER" ISSUE

- A. **Deducting Expenses in Sale vs. Lease**
 - 1. In a **sale** transaction the developer immediately "writes off" a proportionate part of all acquisition and development costs, e.g., land and improvements.
 - 2. In a **lease** transaction the developer cannot immediately write off the costs of acquisition and development. Land cost is not deductible and improvements must be depreciated, generally over 27 ½ years.
- B. **Facts in "Windrifter"**- IRS Technical Advice Memorandum 7803005, September 30, 1977
 - 1. Fee title to the real property was retained by the developer.
 - 2. Full price was paid in the year of sale.
 - 3. Use of the property reverted to the developer upon expiration of the 40-year membership.
 - 4. Members had no right to extend or renew.
 - 5. The developer was the sole manager of the project.
 - 6. If the project was destroyed, the insurance proceeds went only to the developer.
 - 7. Developer was responsible for repairs or rebuilding.
 - 8. Memberships were subordinate to any later financing lien arranged by developer.
- C. **Fundamental Issue and Holding of Windrifter**
 - 1. **Issue:** "Whether the seller/developer transferred to the buyer/members all the benefits and burdens of ownership." Conclusion: The developer "never parted with the burdens and benefits of ownership."
 - 2. **Holding:** Therefore the Windrifter right-to-use membership was construed to be a **lease** – which is a transfer of an interest in real property for a specified term.

D. Windrifter Myths

Myth One: The entire sale price must be recognized as income in the year of sale even if only 10% downpayment was received.

Reality One: One of the stated facts in the Windrifter ruling was that the developer “received full payment . . . in the year of sale.” Because all of the purchase price was paid in the year of sale, Windrifter should not be construed as accelerating a stream of “rent” payments into the first year of the transaction.

Myth Two: Conveying an interest in real property effectively avoids the “Windrifter” problem.

Reality Two: In Windrifter the IRS construed the transaction as a **LEASE**, which is a conveyance of an interest in real property for a specified term. Therefore, the conveyance of an interest in real property does not, by itself, prevent the Windrifter result.

E. Preventing the Windrifter Result - 2 Requirements.

1. The developer/seller must transfer the material **benefits and burdens of ownership** of both the property and the Club:
 - a. power to decide: how to use, how to manage, whether to sell, encumber or rent, and whether to rebuild if destroyed,
 - b. right to receive the proceeds from destruction or sale,
 - c. responsibility for maintenance and repairs, and
 - d. power during life or at death to designate a new “owner.”
2. The **term of the use right** should generally be perpetual/permanent.

III. INSTALLMENT SALE ISSUE

A. Installment method of reporting income - IRC §453

1. Developer/seller pays income tax only as cash is collected from the buyer.
2. Generally good, as tax is paid when cash is available.

B. Installment sale means a disposition of property where at least one payment is to be received after the year of sale.

C. Myth: You can’t get installment sale treatment on the sale of a right-to-use.

Reality: The Internal Revenue Code provides that the installment method of reporting income may be used for the disposition of “a timeshare right to use or a timeshare ownership interest in residential real property.” Use of the installment method requires the payment of interest on the deferred tax, in either case.