TIMESHARE INCOME TAX BILL INTRODUCED

By: Gary A. Porter, CPA

H.R.1350 has been introduced to the 1st session of the 105th Congress. This is a bill introduced by Representative Clay Shaw of Florida, and has been referred to the Committee on Ways and Means of the House of Representatives for consideration. This bill would amend the Internal Revenue Code (IRC) of 1986 to allow timeshare associations to elect to be taxed as homeowners associations. This bill is the result of a concentrated legislative lobbying effort by the American Resort Development Association (ARDA) during the last year. This bill is the direct result of the failure to reach reasonable settlement positions between the Internal Revenue Service (IRS) and timeshare associations that were subjected to audit in Florida several years ago.

Approximately a dozen timeshare associations were selected for audit by the Jacksonville, Florida district office, the Internal Revenue Service (IRS). In 1995, the Jacksonville IRS office requested technical assistance from the IRS national office, which responded with the issuance of Technical Advice Memorandum (TAM) 9539001, which was issued in 1995 and was analyzed in the Winter, 1996 issue of *The Ledger Quarterly*. The TAM ruled adversely against the subject association on three specific matters. As a result of the issuance of the TAM, the Jacksonville District office of the IRS renewed its efforts to proceed with the audits already in progress and also to expand the audit arena to include all timeshare associations within their district. This appeared to be an all out attack against the timeshare industry.

By definition, a timeshare association cannot meet the residential test of IRC § 528, and therefore cannot make the election to file Form 1120-H. Timeshare associations are required to file Form 1120. Timeshare associations also fail to qualify under any other exempt section within the Code. The positions taken by the IRS were deemed to be far too aggressive and unreasonable by the industry, with the result being that no timeshare association could reasonably expect to avoid taxation of its reserve contributions as member income. This would have the effect of increasing the tax liability of timeshare associations by as much as 1,000% on a regular basis. The essence of the bill is that it proposes to amend IRC § 528 by modifying the language to specifically allow timeshare associations to make an election under IRC § 528 to file Form 1120-H at a flat tax rate of 32%.

This bill has gone through some metamorphosis since its initial draft. The initial draft called for making an election that was irrevocable for a five year period. The final bill, as written, provides for making an election annually, just as full ownership associations may do at the present time. This bill is being analyzed at the present time by the Joint Committee on Taxation (JCT) for its fiscal impact. The first draft of this bill was analyzed by the JCT and was determined to have an adverse effect to the federal government of $275,000,000 during its first five years. Such an analysis by the JCT effectively killed any possibility of that draft bill proceeding.

> ***"A proposed revision to IRC Section 528 will allow timeshare associations to file Form 1120-H."***

The fiscal analysis by the JCT must be seriously questioned, however, as a simple exercise in math will attest. The negative impact of $275,000,000 divided by five years equals a negative impact of $55,000,000 in tax revenues per year. Dividing this by the existing 1,450 timeshare associations in the United States indicates a loss of revenue to the government of approximately $38,000 per timeshare association. At a 34% tax rate (as proposed in the draft), this indicates that these associations are on average, generating a $112,000 of taxable interest income annually. Based upon statistics compiled by the industry as well as statistics available through the IRS, these numbers clearly do not bear any relation to reality. It can only be assumed that the analysis by the JCT may have been contrasting the revenue that would be paid if the bill were passed against the revenue that they think that the IRS could generate under its present audit posture of fully taxing as income all prepaid assessments and reserve contributions.

It will be interesting to watch the progress of this bill, which I believe should be supported in full. While this bill benefits timeshare associations, it neither helps nor hurts full ownership associations. Certain of the positions taken by the IRS do appear to be contrary to any reasonable interpretation of existing tax law, and a permanent legislative solution to this problem is preferable to an extended period and the heavy cost of fighting a tax court battle to attempt to get to the same conclusion.

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