

***301** TAXATION OF TIMESHARES - ACQUISITION, USE, AND DISPOSITION ISSUES

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While the purchase of a timeshare interest in a vacation property can be relatively straightforward, there are many tax issues associated with timeshare ownership that prospective buyers, current owners, and tax advisors may overlook.

From their origins in the ski resorts of the French Alps in the 1960s, timeshare ownership interests in vacation properties have now become the fastest-growing segment in the travel industry. [\[FN1\]](#) Timeshare interests permit owners to use vacation properties for a designated period each year in exchange for a purchase price plus a yearly fee. Today, more than two million U.S. households own timeshares in vacation properties throughout North America. The recent growth in timeshare ownership is likely to continue, in large part because of demand fueled by aging baby-boomers with more disposable income and leisure time. The timeshare industry has also benefited from the participation of well-known hoteliers, including Four Seasons, Hilton, Hyatt, Marriott, Regent, and Ritz-Carlton. While the purchase of a timeshare interest in a vacation property can be relatively straightforward, there are many tax issues associated with timeshare ownership that prospective buyers, current owners, and tax advisors may overlook. This article discusses tax implications associated with the acquisition, use, and disposition of timeshare ownership interests. [\[FN2\]](#) Case law and tax-planning opportunities are also reviewed.

***302** What is a Timeshare Interest?

Timeshare interests most often exist in one of three forms: (1) fee simple ownership interests in underlying real estate--the most common ownership form in the U. S.; [\[FN3\]](#) (2) lease arrangements that permit ownership rights for a specified period ("right to use"); or (3) "point" system, whereby purchasers buy points rather than an interest in an underlying condominium or timeshare unit (e.g., Disney Vacation Club). The first type of timeshare interest includes a deed to the property that captures all attendant rights to deeded ownership (e.g., title and title insurance protection, right to rent, assign, sell, contribute, bequeath, or otherwise transfer interest to a third party). In contrast, under a lease timeshare arrangement, ownership rights may exist, but only for a stipulated period, after which the developer secures title to the property. Point systems are frequently structured as right-to-use lease arrangements with a definitive expiration date. This article focuses on tax issues associated with acquisition, use, and disposition of deeded timeshare interests, since deeded interests are the most common ownership form in the U.S., with nearly 80% of all timeshares being sold in that manner. [\[FN4\]](#) In most timeshare developments, deeded timeshare interests are sold in one-week increments. Therefore, to be "fully occupied," a given unit will typically be sold for 50 one-week intervals, allowing two weeks for maintenance. [\[FN5\]](#)

Acquisition of Timeshare Interests

Many factors influence whether ownership of a timeshare interest will be a positive experience, including, for example, cost of the timeshare interest, owner's overall financial situation, type of interest being acquired, timeshare location and amenities, expectations of owner(s), and ultimate purpose for which the timeshare interest is acquired. All prospective buyers should perform a careful assessment of both the financial and non-financial aspects ***303** associated with timeshare ownership. [\[FN6\]](#) A listing of key timeshare selection criteria is presented in Exhibit 1 below.

Factors affecting choice of vacation home and choice of resort

1. Frequency, timing, and duration of vacations.
2. Desire to return to the same place each year.
3. Hobbies (fishing, skiing, sight-seeing, shopping, surfing, night life, hiking).
4. Family size (and size of unit).
5. Cost of timeshare and alternatives.
6. Exchange network.
7. Ability to plan vacations in advance (particularly if interested in an exchange).
8. Resort location (proximity to transportation, health care, grocery stores, activities).
9. Unit location within resort.
10. Resort rating.
11. Financial health of project.
12. Developer (and whether developer will have a long-term interest in the property).
13. Management organization (if different from developer).
14. Maintenance cost (and changes therein over the past 5-10 years) and coverage.
15. Existence of amenities and whether additional fees are charged for use (pool, tennis courts, etc.).
16. Taxes.
17. Occupancy (number of people allowed per room, number of owners per unit, number of units per building).
18. Rental and resale services.
19. Financing.
20. Weather.
21. Adequate reserves for maintenance and replacement.
22. If not yet constructed, infrastructure issues (roads, utilities).

When contemplating the purchase of a timeshare interest, it is important that a prospective buyer understand how the purchase agreement ***304** establishes his or her use of the timeshare unit. Most purchase agreements establish the use of the timeshare interest in one of four ways: (1) fixed time (owner has the use of the unit for the same period each year); (2) floating time (owner and developer use a reservation system to determine the period of use); (3) open use (owner can use the unit anytime it is available, not to exceed the owner's allotted usage time); or (4) point system (owner can trade in "points" to establish usage). [\[FN7\]](#) The tax treatment associated with acquisition, use, and disposition of deeded timeshare interests is the same regardless of the usage arrangement.

When contemplating a timeshare purchase, it is also advisable for prospective buyers or their advisors to estimate the annual after-tax cost of owning the timeshare interest. This type of calculation is helpful in (1) deciding whether the prospective buyer can afford the timeshare interest and (2) comparing different timeshare interests to determine the "fairness" of the pricing structure. [\[FN8\]](#) In new timeshare developments, it is estimated that 50% to 60% of the timeshare purchase price reflects developer marketing costs (e.g., advertising, sales commissions, brochures, free meals, and accommodations for prospective buyers). For that reason, it is advisable that all prospective buyers investigate the timeshare resale market since substantial discounts may be available relative to the pricing structure offered by the developer.

When comparing the annual after-tax costs of different timeshare interests, prospective buyers or their advisors need to be sure that the usage arrangement, location, unit size, basic amenities, and other items are comparable or reasonably so. Sample calculations of the annual after-tax cost of a deeded timeshare interest (for both cash and financed purchases) are included in Exhibit 2 below. For purposes of the examples, it is assumed that the timeshare interest is purchased strictly for personal use. Such an assumption yields the most conservative after-tax estimates. As indicated in Exhibit 2, the deductibility of mortgage interest expense (if any) and property taxes can meaningfully affect the annual after-tax cost of the timeshare interest. For purposes of the after-tax cost calculations, information concerning the estimated property tax component can be obtained from the timeshare broker. Details concerning the circumstances under which interest expense incurred to purchase timeshare interests and property tax payments are deductible are provided in the next section.

***305** Exhibit 2

After-tax annual cost of timeshare acquired for personal use [\[FNa1\]](#)

[FNa1]. Analysis adapted from Espinoza, "Are Two Homes Better Than One?" Money, (August 1999), p.102.

Fact Pattern:

- In January Year 1, Taxpayer X purchased a deeded timeshare interest at a vacation resort permitting four weeks' use any time during the year (i.e., floating-usage arrangement) for \$50,000 (\$12,500 per week). Taxpayer X paid \$20,000 down and financed the remainder with a \$30,000 mortgage over seven years. Assume a 31% marginal tax rate and a mortgage interest rate of 10.25%.

	Cash Purchase	Financed Purchase
Annual expenses:		
1. Mortgage payments	\$ -0-	\$6,023
2. Real estate taxes	280	280
3. Association fees	1,200	1,200
4. Total annual expenses	\$1,480	\$7,503
Annual federal income tax savings:		
5. Mortgage interest	-0-	2,950
6. Real estate taxes	280	280
7. Total tax-deductible expenses (5 + 6)	280	3,230
8. Tax savings (7 x marginal tax rate)	87	1,001
9. Annual after-tax outlay (4 - 8)	\$1,393	\$6,502

Finally, prospective buyers who are considering financing their timeshare acquisitions should realize that many mortgage lenders prefer not to make loans on timeshare interests, since the value of these interests can be unstable and highly dependent on property maintenance and overall market conditions. If a mortgage is obtained to finance the timeshare acquisition, the interest rate will likely be higher than the rate charged on a traditional mortgage obtained to finance the acquisition of a primary residence. Many prospective buyers will likely find that one of the easiest sources of financing for timeshare acquisitions is through the property's developer. Most timeshare interests are financed over a five- to ten-year period.

*306 Use of Timeshare Interests

The tax treatment associated with the use of timeshare vacation properties ultimately hinges on the extent to which the property is used for personal versus rental use. One of three situations can occur in connection with the use of timeshare properties: (1) timeshare interest is used for personal purposes (personal-use property), (2) timeshare interest is used for both personal and rental purposes (mixed-use property), or (3) timeshare interest is used for rental purposes (rental-use property). [FN9] As discussed

in greater detail below, fewer deductions are permitted to owners who use timeshare properties for personal purposes. Mixed-use properties--those used for extensive personal and rental use--give rise to the most complex tax treatment. The greatest opportunity for deductions rests with timeshare properties that are rental property for tax purposes. However, in practice and as discussed below, few timeshare interests can actually qualify for rental-property status. Both the Code and Regulations provide guidance concerning tax issues associated with the use of timeshare properties. Exhibit 3 summarizes these issues and the usage discussion that follows.

Section 280A governs the tax treatment of "vacation homes," which can include deeded interests in timeshare real estate properties. By definition, the typical timeshare interest in real property cannot qualify as a taxpayer's "primary residence" for tax purposes, since a given taxpayer is permitted contractual use of the property for only a portion of the year, usually a few weeks. Accordingly, the vacation-home rules of Section 280A govern the tax issues associated with the use of most timeshare arrangements.

Personal-use timeshare interests

The tax treatment is quite straightforward for taxpayers who own timeshare interests and use them exclusively for personal purposes. Only qualifying mortgage interest expense and property taxes are deductible in connection with personal-use timeshare property. No deduction is available for other expenses including utilities, repairs and maintenance, and depreciation. Interest expense paid or accrued on outstanding indebtedness incurred to buy the timeshare may be deductible as "qualified residence interest" under Section 163(h)(3) provided: (1) the timeshare interest is considered a

*307 Exhibit 3

Tax Treatment Associated with Timeshare Use

	Personal-use Timeshare	Mixed-use Timeshare	Rental-use Timeshare
1. Criteria	(1) Unlimited personal use, and (2) Rented at FMV for less than 15 days/year for all unit owners combined	(1) Rented at FMV for 15 days or more/year and (2) Personal use greater of (a) 14 days/year or (b) 10% of rental days for all unit owners combined	(1) Rented at FMV for 15 days or more/year, and (2) Not used for personal use for more than greater of (a) 14 days/year or (b) 10% of rental days for all unit owners combined
2. Rental income recognized?	No	Yes (Form 1040 - Schedule E)	Yes (Schedule E)
3. Deductible expenses?	Yes Interest and property taxes	Yes - allocation between rental and personal use required (1) Rental expenses (in order) (a) Interest and taxes (b) Expenses not	Yes, allocation between rental and personal use required (1) Rental expenses (in order) (a) Interest and taxes (b) Expenses not

		affecting basis (e.g., utilities, maintenance) (c) Expenses affecting basis (e.g., depreciation)	affecting basis (e.g., utilities and maintenance) (c) Expenses affecting basis (e.g., depreciation)
		(2) Personal Expenses - Interest and taxes	(2) Personal expenses - taxes
4. Type of expense deduction	Itemized deductions (Form 1040 - Schedule A)	(1) Rental expenses - deduction for AGI (Schedule E) (2) Personal expenses (a) Interest - itemized deduction (Schedule A) assuming second residence (b) Taxes-itemized deduction (Schedule A)	(1) Rental expenses - deduction for AGI (Schedule E) (2) Personal expenses Taxes - itemized deduction (Schedule A) No interest deduction since not a second residence
5. Rental loss permitted?	No	No, but excess rental deductions may be carried over to future years	Yes, but may be limited by passive activity loss rules, hobby loss rules

***308** second residence, [\[FN10\]](#) and (2) the taxpayer's aggregate acquisition indebtedness to purchase primary and secondary residences does not exceed \$1 million. Interest paid or accrued on a home equity loan used to purchase a timeshare property may also be qualified residence interest, provided the home equity loan used to purchase the timeshare does not exceed \$100,000. [\[FN11\]](#) If a timeshare property is purchased with a consumer loan obtained through a bank or credit union, for example, none of the applicable interest expense is deductible for federal income tax purposes. [\[FN12\]](#) Finally, any points paid to secure a qualified mortgage in connection with the purchase of a timeshare interest are deductible ratably over the life of the loan. [\[FN13\]](#)

In addition to potential interest deductions, taxpayers who use timeshare properties exclusively for personal purposes may also deduct the applicable portion of any annual fee directly attributable to the payment of real property taxes under Section 164(a)(1). [\[FN14\]](#) Typically, the timeshare management group conveys this information to each owner as part of an annual statement. [\[FN15\]](#) To the extent available, both the interest and tax payments are taken as deductions from adjusted gross income (AGI) and reported on Schedule A (Itemized Deductions) of Form 1040. [\[FN16\]](#) The tax benefit associated with interest and property tax deductions for timeshares may be reduced for high-income taxpayers if they are subject to the itemized deduction phase-out as required by Section 68(a) or the individual alternative minimum tax (AMT) imposed under Section 55.

On occasion, timeshare owners may rent out their units for a few days each year. While rental income can help defray the cost of timeshare ownership, ***309** it can also complicate the timeshare owner's tax situation. Under Section 280A(g), vacation properties rented at fair market value (FMV) to an unrelated party for less than 15 days per year are considered used for personal purposes. If the property is rented for less than 15 days per year, no rental income is reported for tax purposes, and no expenses directly associated with the rental activity are deductible (i.e., no deduction for utilities, repairs, maintenance, depreciation, etc.). This tax treatment is often referred to as the "tax-free rent rule." Few timeshare owners are likely to qualify for the tax-free rent situation since Section 280A(g) determines compliance with the less-than-15-days per year rental requirement based on the number of rental days for the entire "dwelling unit," not a given timeshare owner's portion of the unit. Accordingly, for a given timeshare owner to qualify for the tax-free rent rule, all owners of a given unit must rent out the unit for less than 15 days per year combined. Consequently, if a given timeshare owner uses his or her timeshare property for personal purposes, and derives rental income from the property during the year but does not qualify for tax-free rent under the 15-day rule, the timeshare is likely to be classified as

"mixed-use property" for tax purposes, resulting in a significantly more complicated tax profile for the timeshare owner.

Mixed-use timeshare interests

Under Section 280A, vacation properties, including timeshare interests, rented at FMV to an unrelated party for 15 days or more per year and used for personal purposes for more than the greater of: (1) 14 days per year or (2) 10% of the total days rented, are mixed-use properties. When determining the rental and personal use of a timeshare interest for purposes of the 15-day and 14-day/10% cutoffs, the use of all owners of a given timeshare unit must be combined under Section 280A(d)(2)(A), and Prop. Regs. 1.280A-3(f)(3) and (4). [\[FN17\]](#) Mixed-use timeshare properties--those used for extensive personal and rental use--give rise to the most complex tax treatment. When a timeshare interest is classified as mixed-use property, owners are (1) required to allocate expenses between personal and rental use and (2) prevented from deducting a loss in connection with the rental activity. These restrictions exist to prevent owners from converting what are otherwise personal expenses into deductible business expenses. The process that must be used in allocating expenses between personal and rental use for mixed-use timeshare ***310** properties is delineated in Prop. Reg. 1.280A-3(f)(5). Under the Regulations, timeshare owners must allocate their expenses based on the mix of combined personal and rental use by all owners of a given unit during the year. Consequently, the intended result of such an allocation scheme is to have all owners of a given unit allocate expenses between personal and rental use in the same manner for a given year (e.g., 40% rental, 60% personal for all owners). In practice, however, it may be difficult to obtain information about the personal and rental use of all owners of a timeshare unit during the year, particularly for timeshare interests that are part of a large development. Therefore, in the absence of this information, a reasonable approach is to allocate expenses between personal and rental use based on a given owner's personal and rental use percentages for the year (e.g., two weeks rented, two weeks personal use by a given owner results in a 50/50 allocation). [\[FN18\]](#) Of course, the percentages used in allocating expenses between personal and rental use will likely vary from year to year for a given timeshare owner.

Once the allocation percentages are established, the expenses allocated to rental use must be deducted against rental income in a particular order as required by Prop. Reg. 1.280A-3(d). The allocable portion of expenses attributed to rental use must be offset against a timeshare owner's rental income in the following order: (1) expenses otherwise deductible independent of the rental activity (i.e., qualifying mortgage interest and property taxes); (2) expenses attributable to the rental activity that do not result in an adjustment to the property's basis (e.g., advertising, utilities, repairs and maintenance, commissions paid for the collection of rent, insurance premiums, etc.); and (3) expenses attributable to the rental activity that result in a basis adjustment (i.e., depreciation). In total, the allocable portion of expenses attributed to the rental use cannot exceed the rental income for the year (i.e., no rental loss deduction available per Prop. Reg. 1.280A-3(d)(1)). The ordering process associated with rental-use expenses combined with the no-loss restriction makes it less likely that timeshare owners can deduct ***311** expenses other than interest and taxes, such as depreciation. Any expenses allocable to rental use that are not deductible in the current year may be carried over for future use against subsequent rental income, under Section 280A(c)(5).

Rental income from a mixed-use timeshare property and the allocable portion of expenses attributed to rental use are reported on Schedule E (Supplemental Income and Loss) of Form 1040. The portion of property taxes allocated to personal use (as opposed to rental use) may be taken as an itemized deduction on Schedule A without restriction. The portion of mortgage interest allocated to personal use may be taken as an itemized deduction on Schedule A provided the timeshare owner's personal use is sufficient to have the timeshare qualify as a second residence (i.e., personal use exceeds the 14-day/10% cutoff). According to Temp. Regs. 1.163-10T(p)(3)(iii) and (p)(6), to be able to deduct the personal-use portion of mortgage interest, the requirement that personal use exceed the greater of 14 days or 10% of rental days is determined using only the timeshare owner's rental days, not the combined rental days of all owners of a given unit. [\[FN19\]](#)

Exhibit 4 below provides a detailed example of the allocation of expenses between personal and rental activities for a mixed-use timeshare property. The example assumes that a timeshare owner rents the timeshare unit for one week during the year and uses the timeshare for personal purposes for three weeks during the year. In addition, the example assumes that 84% of the timeshare purchase price is allocated to buildings (depreciable over 27.5 years) and 16% is allocated to the underlying land

(nondepreciable asset). No significant value is assigned to timeshare furnishings. [\[FN20\]](#) As the example illustrates, all expenses must be allocated between personal and rental use, rental-use expenses must be deducted in the proper order, and no loss may result from the rental activity for mixed-use timeshare property. Under Section 280A(c)(5), excess deductions not available in the current year because of the no-loss rule may be carried over and used in future years to the extent that rental income exceeds current year rental expenses. The example also indicates that the personal-use portion of interest and taxes may be taken as itemized deductions.

***312** Exhibit 4

Expense Allocation Example for Mixed-Use Timeshare Property

Fact Pattern:

- In January Year 1, Taxpayer X purchased a deeded timeshare interest at a vacation resort permitting four weeks use any time during the year (i.e., floating usage arrangement) for \$50,000 (\$12,500 per week). Taxpayer X paid \$20,000 down and financed the remainder with a \$30,000 mortgage at 10.25% over seven years.
- Of the \$50,000 purchase price, \$42,000 is allocated to Taxpayer X's share of the buildings, and \$8,000 is allocated to Taxpayer X's share of the underlying land.
- In Year 1, Taxpayer X used the timeshare unit personally for three weeks (21 days) and rented the unit for one week (seven days) for a weekly rental of \$1,400. Total rental days for all owners of the unit were in excess of 15 days for Year 1. Taxpayer X paid the resort management group a \$135 fee for arranging the rental.
- Taxpayer X also paid an annual maintenance fee of \$1,200, with \$280 of the fee attributed to Taxpayer X's share of real property taxes. For Year 1, Taxpayer X's annual mortgage interest expense was \$2,950, and utilities and maintenance costs associated with the four-week usage period were \$600.

Allocation:	Rental	Personal
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Rental income, net of rental fee	Form 1040	Form 1040
Expenses:	Schedule E	Schedule A N/A
	\$1,265	
(1) Mortgage interest -- Note 1	738	
(\$2,950 x 7/28 days)		
(\$2,950 x 21/28 days)		\$2212
Property taxes		
(\$280 x 7/28 days)	70	
(\$280 x 21/28 days)		210
(2) Utilities and maintenance		
(\$600 x 7/28 days)	150	Note 2
(3) Depreciation	307	Note 2

(\$42,000 x .03485 x 7/28		
days) Note 3		
Net income/loss from rental	\$ 0	

- Notes:
1. The interest and property tax allocation reflects the IRS-approved approach (page 310, note 18). Also, allocations are made using taxpayer's personal/rental use percentages, not personal/rental use percentages of all owners since, in practice, such information is difficult to obtain.
 2. Utilities, maintenance, and depreciation expense attributed to the personal-use portion of the timeshare interest are not tax deductible.
 3. Depreciation expense for the rental-use portion is calculated

using 27.5 year Modified Accelerated Cost Recovery System (MACRS) life, straight-line method, mid-month convention, but limited to \$307 because of the "no loss" rule for mixed-use property.

***313** Rental-use timeshare interests

Under Section 280A, vacation properties, including timeshare interests, which are rented at FMV to an unrelated party for 15 days or more per year and are not used for personal purposes for more than the greater of: (1) 14 days per year or (2) 10% of the total days rented, are rental-use property for tax purposes. If the above criteria are met, then all rental income from the property must be included in the taxpayer's gross income for the year and all eligible expenses attributable to the taxpayer's rental activity (including interest, taxes, utilities, repairs, maintenance, and depreciation) may be taken as deductions from gross income, even if a loss from the rental activity results for the year. Interest expense attributable to personal use of the timeshare is not deductible, since the timeshare does not qualify as a second residence under Section 280A(d) (i.e., to qualify as a second residence, personal use must be more than the greater of 14 days or 10% of rental days). Unlike personal interest expense, property taxes attributable to the personal-use portion of a rental-use timeshare are deductible as an itemized deduction since there is no requirement that personal use exceed a threshold to deduct real property taxes.

In practice, few timeshare interests are likely to qualify for rental-use tax treatment, since Section 280A(d)(2)(A) and Prop. Reg. 1.280A-3(f)(3) stipulate that the 14-day/10% cap on personal use must consider not only the personal use of the taxpayer and his or her family, but also the personal use of "... any other person who has an interest in such unit...." Accordingly, in determining whether a timeshare unit has been used for personal purposes for not more than the greater of 14 days per year or 10% of the rental days for the year, the personal use of all owners of a given unit must be combined. [\[FN21\]](#) In the instance of a given timeshare owner who derives rental income from the property, but the combined personal use of all owners of the unit exceeds the 14 day/10% cap, the timeshare interest is classified as mixed-use property and subject to the limitations discussed above.

Finally, in the unlikely event that a timeshare interest meets the criteria for classification as rental-use property, certain restrictions exist to limit the deductibility of losses otherwise generated from the rental activity during the tax year. [\[FN22\]](#) In particular, the passive activity loss rules of Section 469 and ***314** the hobby loss rules of Section 183 can limit the deductibility of losses stemming from a rental-use timeshare property. [\[FN23\]](#) The passive activity loss rules limit the deductible loss to the extent of the taxpayer's passive income for the year (i.e., passive income from rental activities, limited partnership interests, etc.). [\[FN24\]](#) Any unused passive loss is carried over to future years and is deductible against passive income generated in those tax years, provided the taxpayer continues to own the timeshare interest. The hobby loss rules may also apply to limit the deductible loss stemming from a rental-use timeshare if the taxpayer is not engaged in the rental activity for profit. Under Section 183(d), a taxpayer is presumed engaged in the activity for profit if the activity resulted in a profit in at least three of five consecutive years. [\[FN25\]](#)

Other Usage Issues

Several other tax issues also relate to the usage of timeshare interests. First, the classification of a timeshare interest as personal-use, mixed-use, or rental-use property can change from year to year, depending on the combination of personal- and rental-use days for the year. Consequently, the tax treatment associated with use of a timeshare interest can vary from year to year accordingly. As discussed previously, the two most likely usage classifications for timeshare interests are as personal-use or mixed-use property. Therefore, it is possible for a timeshare interest to be classified as mixed-use property in one year and personal-use property in another because of extensive rental and personal use in one year but not another. For the reasons discussed above, it is unlikely that most timeshare interests would be classified as rental-use property. If the classification of a timeshare interest varies from year to year, it is important for owners or their advisors to track any ***315** depreciation allowed in connection with the mixed-use classification. Of course, such depreciation, when available, reduces the owner's adjusted basis in the timeshare interest, and therefore affects the gain or loss (if any) on disposition. Second, on occasion, and particularly for older developments, timeshare owners may be assessed a flat

fee, payable either as a one-time payment or as annual payments spread over several years, for major repairs or upgrades to the timeshare property. Timeshare owners may have the right to approve special assessments in advance. Such an assessment is not deductible as an expense in the year of payment, but rather is a capitalized expenditure that increases the timeshare owner's tax basis in the timeshare interest. In addition to special assessments, the portion of any annual maintenance fee paid by a timeshare owner and allocated to capital reserves or used for capital improvements also increases the taxpayer's basis in the timeshare interest. Ultimately, these basis increases may be recoverable either through future depreciation, if the timeshare owner meets the usage requirements discussed previously, or on sale of the timeshare interest.

Third, and finally, most large timeshare developments permit timeshare owners to participate in a "timeshare exchange" program. The two largest timeshare exchange programs are run by Resort Condominium International and Interval International. Membership in these exchange programs entitles participants to "trade" their timeshare usage, i.e., the owner of a timeshare interest can exchange his or her "week" for a week's use of an equivalent unit in another location. An annual, nondeductible membership fee (roughly \$100) plus a nondeductible per-exchange fee (roughly \$100) must be paid to the exchange program to participate. Of course, such exchange programs give timeshare owners considerable flexibility with respect to vacation alternatives. No income must be recognized for tax purposes by a given timeshare owner who participates in an exchange program and uses a different timeshare property, since the timeshare owner's economic position remains unchanged. [\[FN26\]](#)

Disposition of Timeshare Interests

Taxpayers who own deeded timeshare interests have the right to dispose of the interests in any manner they choose. As discussed below and summarized in Exhibit 5, the tax treatment associated with disposition of timeshare interests depends on the type of disposition undertaken by the taxpayer.

*316 Exhibit 5

Tax treatment of timeshare dispositions

Method of disposition	Tax treatment
Sale of personal-use timeshare	Losses on personal use asset not deductible, gains taxed at preferential capital gains rate.
Sale of mixed-use timeshare	<ul style="list-style-type: none"> • Personal-use portion - losses nondeductible, gains taxed at preferential capital gains rate. • Rental-use portion - net Section 1231 losses deductible as ordinary losses, gains taxed at preferential capital gains rate assuming no depreciation recapture.
Sale of rental-use timeshare	Net Section 1231 losses deductible as ordinary losses, gains taxed at preferential capital gains rate assuming no depreciation recapture. Previously disallowed passive activity losses used to increase loss or reduce gain on disposition.
Gift	<ul style="list-style-type: none"> • Gift tax assessed on donor if gift exceeds \$10,000 per recipient, \$20,000 per recipient if gift splitting elected. • Recipient takes donor's adjusted basis in the property (increased by any previously disallowed passive activity losses) for purposes of gain calculation on disposition by recipient. • Recipient takes as basis fair market value on date of gift

for purposes of loss calculation on disposition by recipient if property had declined in value when held by donor.

- For transfers between spouses, including transfers pursuant to divorce, recipient spouse takes a carryover basis.

Bequest	<ul style="list-style-type: none">• Included in estate of decedent, possibly subject to estate tax.• Beneficiary gets fair market value at date of death (or alternative valuation date) as basis in property.
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Charitable contribution	Deduction equal to FMV on date of gift, less ordinary income otherwise recognized on sale (i.e., depreciation recapture).
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Foreclosure	<ul style="list-style-type: none">• Ordinary loss deduction if rental use elevated to trade or business.• Nondeductible capital loss if personal use.• Gain recognized if mortgage balance exceeds basis.
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Abandonment	Loss not deductible.
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***317** Sale of timeshare interest

Clearly, the most common type of disposition involves sale of a timeshare interest to an unrelated party. It is well recognized in the timeshare marketplace that owners should not expect significant appreciation or returns on their timeshare interests. [\[FN27\]](#) In fact, because of the loosely knit resale market and the high cost paid by owners to acquire their timeshare interests, many owners actually incur losses on sale of their interests. Some timeshare developments offer resale programs to assist owners in the sale of their interests, charging a commission (often approaching 30%) for brokering the sales transaction. In addition, there are real estate brokers who specialize in the sale of timeshare vacation properties. It is often recommended that, before listing a timeshare property for sale, owners take note of the commission to be charged, whether any long-term exclusive listing arrangements are included in the contract, whether references are available from previous sellers, what percentage of listings are actually sold, and what the average ratio of sales price to asking price is on past sales. As an additional precaution, it is also recommended that timeshare sellers refrain from paying an advance fee for brokering the sale since some owners have been unable to sell their interests despite payment of an up-front fee. [\[FN28\]](#) Finally, the Internet now provides new, non-traditional opportunities for timeshare owners to dispose of their interests. Several auction sites, including eBay.com, Amazon.com, and Yahoo.com accept timeshare interests for sale. The Timeshare Users' Group (timeshare-users-group.com) and the American Resort Development Association (arda.org) also facilitate timeshare sales. When a timeshare interest is sold, the owner's gain or loss for tax purposes is calculated by subtracting the adjusted basis of the interest from the selling price, net of commission. The adjusted basis consists of the property's original cost (including acquisition costs) plus any assessments or fees for capital improvements paid during ownership, less any depreciation taken on the property. The resulting treatment of the gain or loss depends on whether the timeshare interest is classified as personal-use, mixed-use, or rental-use property at the time of sale. [\[FN29\]](#) For a personal-use timeshare interest, any realized loss on sale is nondeductible for tax purposes ***318** since the timeshare interest is a personal-use capital asset. Any gain realized on the sale of a personal-use timeshare interest is characterized as a capital gain, since the timeshare is a capital asset to the owner under Section 1221. Capital gains recognized on the sale of timeshare interests held for more than one year are eligible for the preferential tax rate (10%/20%) on long-term capital gains. Since, by definition, a timeshare interest cannot qualify as a principal residence for tax purposes, taxpayers are ineligible for the principal residence gain exclusion available under Section 121 (\$500,000 exclusion for married-filing-joint taxpayers). For a mixed-use timeshare interest, the owner is disposing effectively of two assets--the personal-use portion of the timeshare interest and the rental-use portion of the interest. Accordingly, the owner must allocate not only the sales price (net of commissions) to the two assets on disposition, but must also track the basis of the two assets separately. Depreciation expense, which reduces the adjusted basis of

property, may be taken in connection with rental activities, but not in connection with personal use of the timeshare property. On disposition, the allocation of the sales price and original cost between personal and rental uses should be performed based on the relative number of rental versus personal days during the timeshare ownership period.

In the event that both portions of a mixed-use timeshare interest are sold at a loss, the loss on the personal-use portion is a nondeductible capital loss. The loss recognized on disposition of the rental-use portion of the asset is initially characterized as a Section 1231 loss, but may eventually be treated as an ordinary loss for tax purposes, depending on the outcome of the netting process required under Section 1231. [FN30] Of course, it is in a taxpayer's interest generally to recognize ordinary losses as opposed to capital losses since the deductibility of capital losses is restricted. If a gain is recognized on disposition of the personal-use portion of the timeshare interest, the gain is characterized as a capital gain for tax purposes and is eligible for the preferential tax rate on long-term capital gains, provided the timeshare interest has been held for more than one year. Finally, in the event that the rental-use portion of the interest is sold at a gain, the gain is initially characterized as Section 1231 gain, and may eventually be treated as a capital gain, depending on the outcome of the Section 1231 netting process. Under limited *319 circumstances, it is possible that certain timeshare owners may be required to characterize a small portion of the gain recognized on sale of the rental-use portion of the timeshare interest as ordinary income under the Section 1245 and Section 1250 depreciation recapture provisions. [FN31]

The tax treatment associated with the sale of rental-use timeshare interests is the same as the treatment required for the rental-use portion of a mixed-use timeshare interest discussed above. That is, in the event that a loss is recognized on sale, the loss is characterized initially as a Section 1231 loss, and may eventually be treated as an ordinary loss depending on the outcome of the Section 1231 netting process. For rental-use timeshare interests sold at a gain, the gain is initially characterized as a Section 1231 gain and is potentially eligible for capital gain treatment depending on the outcome of the Section 1231 netting process. Also, as with the rental-use portion of mixed-use timeshare interests sold at a gain, some of the Section 1231 gain may have to be recharacterized as ordinary income under the depreciation recapture provisions of Sections 1245 and 1250.

In addition to the gain/loss treatment just discussed, sellers of rental-use timeshare interests may also deduct on sale any previously disallowed passive activity losses incurred in connection with rental use of the timeshare interest. These previously disallowed passive losses are available to reduce the gain or increase the loss recognized on disposition of the rental-use timeshare interest in an otherwise taxable transaction, as provided in Section 469(g)(1).

Finally, timeshare owners are essentially prevented from converting a personal-use timeshare property to a rental-use property prior to sale to avail themselves of ordinary loss treatment on disposition. In the case of such conversions, a taxpayer must use as adjusted basis the lesser of (1) the property's adjusted basis or (2) the property's FMV at date of conversion. Consequently, for timeshare interests that have declined in value, taxpayers must use FMV at conversion as the adjusted basis, and are therefore prohibited from deducting losses incurred prior to conversion.

*320 Gift of timeshare interest

On occasion, timeshare owners may choose to dispose of their interests by making a gift of the property to another taxpayer. In the event of a gift to someone other than a spouse, the transfer is eligible for the \$10,000 annual gift exclusion under Section 2503(b)(1) before any federal gift tax is imposed or before the taxpayer must use a portion of his or her \$220,550 unified credit amount for 2000. [FN32] Transfers to a spouse would not be subject to any federal gift tax because of the unlimited marital deduction available under Section 2523(a). [FN33] In the event that a donee disposes of a timeshare interest at a gain, the donee takes a carryover basis in the timeshare interest from the donor, increased by any previously disallowed passive activity losses. See Sections 1015(a) and 469(j)(6)(A). If a donee disposes of a timeshare interest at a loss, the donee's income tax basis will be FMV at the date of gift if the timeshare interest had declined in value while owned by the donor, under Section 1015(a). [FN34] Finally, timeshare owners who seek to give away their interests to any willing taker may get information about interested parties from the web site that facilitates such transfers: <http://timeshareusa.com/timesharedump.htm>.

Charitable contribution of timeshare interest

Timeshare owners may also dispose of their interests by donating them to a qualified charity. Written appraisals are required to support charitable donations in excess of \$5,000. The owner is allowed a charitable deduction for income tax purposes equal to the FMV of the interest at the time of gift, less any ordinary income (i.e., depreciation recapture) that would have been recognized had the timeshare interest been sold. See Section 170(e)(1). Many charities may decline to accept a timeshare donation because of the attendant obligation to pay annual fees until the property is sold.

***321** Bequest of timeshare interest

For taxpayers who die owning timeshare interests, the value of such interests at the date of death (Section 2031) or at the six-month alternate valuation date (Section 2032) will be included in the decedent's gross estate and will be potentially subject to federal estate tax. A taxpayer who dies in 2000, and who has not previously used any of his or her unified credit (\$220,550), can transfer assets, including timeshare interests, at death to a non-spouse or non-charity in the amount of \$675,000 or less before any federal estate tax is imposed. [\[FN35\]](#)

For income tax purposes, an heir who is bequeathed a timeshare interest takes the value at which the interest was included in the decedent's gross estate as his or her basis for income tax purposes, as provided in Section 1014. Consequently, if the timeshare interest had appreciated in value prior to the decedent's death, the appreciation permanently escapes income taxation. If the timeshare interest had depreciated in value prior to the decedent's death, the loss in value would be permanently "lost" and therefore unavailable to the heirs. Similarly, if the timeshare interest had been classified as a rental-use property during the original owner's period of ownership, any previously disallowed rental losses would be lost to heirs to the extent that the heirs receive a stepped-up basis for income tax purposes on the death of the original owner under Section 469(g)(2).

Foreclosure on or abandonment of timeshare interest

While not common, some timeshare owners may be involved in situations in which a mortgage lender forecloses on a timeshare for non-payment of interest and principal, or the owner, because of the inability to sell the timeshare interest, chooses to abandon the interest. In the event of foreclosure, the best possible result for tax purposes is for the timeshare owner to take an ordinary loss deduction, provided the owner had been engaged in rental of the timeshare sufficient to elevate the rental activity to a trade or business. [\[FN36\]](#) Otherwise, in the event of insufficient rental activity, the loss would be characterized as a capital loss and would be deductible provided the timeshare interest is not classified as personal use. If the timeshare owner's foreclosed mortgage amount exceeds the owner's adjusted basis in the ***322** property, the owner must recognize gain on foreclosure, despite the fact that no cash was received. The characterization of the gain depends on the type of timeshare interest.

For owners who want to dispose of their timeshare interests, but who are unsuccessful in selling their interests, one option may be to determine if the timeshare developer will accept a "deed in lieu of foreclosure." Such an arrangement effectively permits the owner to abandon the interest. The owner receives no cash on disposition and no loss is deductible for tax purposes. But the owner is no longer responsible for annual maintenance payments. While some timeshare developers prefer not to get the timeshare interest back, the owner, through a quitclaim deed, may surrender rights to the property. Proper legal documentation supporting the quitclaim transaction must be prepared and a recording fee must be paid to the local recorder of deeds.

Tax Planning Opportunities

Since deeded timeshare interests fundamentally involve property ownership rights, the standard tax planning strategies that apply to property transactions also apply to timeshare interests (e.g., accelerate deductible expenses, monitor alternative minimum tax implications of transactions for high-income taxpayers, etc.). Beyond these traditional tax planning strategies, there are also several other tax planning issues that are of particular importance to timeshare owners. For example, in connection with the acquisition of timeshare interests, many owners will opt to purchase the interest without obtaining a mortgage. In the event of such an arrangement, taxpayers should consider purchasing the interest with a credit card that carries some type of rebate privilege (e.g., frequent flyer miles, cash back). Of course, this strategy assumes that the purchaser will not incur credit card financing charges, which are

nondeductible expenses.

As discussed previously, the tax treatment associated with the use of timeshare interests hinges on whether the interest is classified as personal-use, mixed-use, or rental-use property. It is essential from a tax-planning perspective for timeshare owners who rent out their units to keep meticulous records of both rental and personal activity, as well as the related expenses. In addition, timeshare owners or their advisors should track the adjusted basis of the timeshare property over time, adjusting for capital improvements and depreciation. Tracking the basis calculation is particularly important for timeshare interests classified as mixed-use property since the owner has two adjusted bases--a basis for the personal-use portion, and a separate basis for the rental-use portion of the timeshare interest. In ***323** the event that a timeshare interest is disposed of either by sale or by gift, the timeshare owner's adjusted basis computation will affect not only the gain or loss computation on sale, but also the carryover basis to potential donees.

In addition, timeshare owners or their advisors should be sure to track any unused (i.e., nondeductible) rental expenses (stemming from the "no loss" rule for mixed-use property) and any carryover rental losses (stemming from the passive activity loss limitation). These unused expenses and carryover losses are potentially available to offset future rental income and, in the case of carryover passive activity losses, may offset realized gain on disposition of the timeshare interest in an otherwise taxable transaction. The excess rental expenses and the suspended passive activity losses are available to the extent that the timeshare interest remains classified as either mixed-use or rental-use property, respectively. For that reason, timeshare owners should manage the personal use of the timeshare property during ownership, and particularly during the final year of ownership, to control the tax treatment on disposition and to permit deductibility of previously disallowed expenses and losses. Finally, some timeshare owners may operate under the mistaken belief that they can contribute one year's use of a timeshare interest to a qualified charity (while still owning the underlying interest) and receive a charitable contribution deduction for income tax purposes. Such "right-to-use" contributions are nondeductible for tax purposes, as delineated in [Rev. Rul. 89-51, 1989-1 CB 89](#).

Conclusion

While the purchase of a timeshare can be quite straightforward, there are many complexities associated with timeshare ownership that may be overlooked by prospective buyers, current owners, and their tax advisors. Having an understanding of these complexities will help make timeshare ownership an enjoyable and potentially profitable experience, which should be a matter of interest to all current and prospective timeshare owners.

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[\[FN1\]](#). A Consumer's Guide to Vacation Ownership, American Resort Development Association, <http://www.arda.org>.

[\[FN2\]](#). This article focuses on tax issues associated with ownership in timeshare real estate properties, not timeshare interests in other asset types including, for example, private airplanes and yachts. Moreover, this article does not discuss whether timeshares acquired as investments provide reasonable rates of return. For a comprehensive discussion of investment-related concerns, readers are referred to Ziobrowski and Ziobrowski, "Resort Timeshares as an Investment," *The Appraisal Journal* (October 1997), pp. 371-380.

[\[FN3\]](#). Timeshare acquisitions in foreign countries typically consist of right-to-use properties since the right to deeded ownership is restricted to citizens of the particular country in question. See Hetzer, "Timeshares: Their Time Has Come," *Business Week*, 4/14/97. For example, "Mexican law prohibits outright ownership of real property by foreigners within 50 kilometers of the coast." (Martin, "Timeshare Dealers Could Turn Your Mexican Vacation into a Trap," *San Antonio Business Journal*, 7/2/99, p.28.)

[\[FN4\]](#). The Resort Timeshare Industry in the United States 1997: A Survey of Projects with Active Marketing and Sales Programs, <http://timeshare-users-group.com>.

[\[FN5\]](#). Because timeshare interests are most frequently sold in one-week intervals, the term "interval ownership" is often used to denote the property interest.

[\[FN6\]](#). Strauss, *Time-Share Condominiums: To Buy or Not to Buy* (Vantage Press, Inc., 1995); Rejnis and Walter, *Buying Your Vacation Home for Fun & Profit* (Dearborn Financial Publishing, Inc., 1996).

[\[FN7\]](#). Many timeshare properties also permit "bonus time" usage, an arrangement whereby owners can use unoccupied units nightly as essentially hotel rooms for a stipulated charge.

[\[FN8\]](#). While the range varies considerably, the average cost of a one-week, deeded timeshare interest in the U.S. in 1997 was \$10,325, with average yearly maintenance costs of \$360. See note 4, *supra*.

[\[FN9\]](#). While not common, a timeshare property could also be classified as "investment property" if the timeshare interest is neither rented nor used personally by the owners. Given such a circumstance, interest, taxes, and maintenance costs incurred in connection with the property could be classified as investment expenses, and potentially deductible as itemized deductions.

[\[FN10\]](#). Interestingly, a taxpayer who owns more than one second residence (e.g., owns three, four, or five residences) may designate, each year, a different residence as his or her "second residence." Mortgage interest on a timeshare property used exclusively for personal purposes may be deductible as an itemized deduction for a given year as long as the taxpayer designates the timeshare property as the second residence for that year. Also, multiple weeks of ownership at the same timeshare property represented by a single deed may constitute a single residence for tax purposes.

[\[FN11\]](#). Under Sections 163(h)(3)(B)(ii) and 163(h)(3)(C)(ii), the \$1 million limit on acquisition debt and the \$100,000 home-equity loan limit are reduced to \$500,000 and \$50,000, respectively, for married taxpayers filing separate returns.

[\[FN12\]](#). Section 163(h)(1).

[\[FN13\]](#). Section 461(g).

[\[FN14\]](#). Any applicable portion of personal property taxes assessed by states on the value of timeshare furnishings are also deductible under Section 164(a)(2).

[\[FN15\]](#). For most timeshares, the portion of the annual fee attributable to real property taxes tends to be small. Accordingly, for most personal-use timeshares, the most significant itemized deduction resulting from timeshare ownership is interest expense on qualified borrowings (i.e., home mortgage and home equity loans).

[\[FN16\]](#). While not a routine occurrence, uninsured casualty losses associated with timeshare interests used for personal purposes are also deductible as itemized deductions under Section 165(c)(3).

[\[FN17\]](#). Under Prop. Reg. 1.280A-1(e)(1), "personal use" of a timeshare property includes use by the owner, co-owners, family members of the owner and co-owners (brother, sister, spouse, ancestor, or lineal descendant), anyone with whom the owner exchanges use of the timeshare, and anyone who rents the property for less than FMV.

[\[FN18\]](#). Over the years, considerable controversy has existed with respect to the formula used for allocating expenses between personal and rental use for mixed-use vacation properties. In particular, the IRS has maintained the view, consistent with Prop. Reg. 1.280A-3(d)(3)(iii), that expenses, including interest and taxes, are to be allocated between personal and rental use based on total usage days (not 365 total available days during the year). In contrast, several court cases including [Bolton, 694 F.2d 556, 51 AFTR2d 83- 305 \(CA-9, 1983\)](#), ruled that mortgage interest and taxes should be allocated to rental use based on total days in the year, thereby resulting in a smaller rental-use allocation and a larger personal-use allocation. The more conservative approach for timeshare owners is to allocate all expenses,

including interest and taxes, between personal and rental use based on total usage during the year.

[\[FN19\]](#). Some taxpayers may assert that the portion of interest allocated to personal use should be treated as investment interest expense rather than qualifying mortgage interest expense. To claim such a deduction, the taxpayer would have to demonstrate that the timeshare was held for investment purposes (in anticipation of appreciation) rather than for personal use. Such a position would be difficult to sustain for most timeshares and most timeshare owners, if the timeshare interest is used personally or held for rent.

[\[FN20\]](#). In practice, it will likely be difficult to obtain information that would permit an allocation of the timeshare purchase price to furnishings. At best, most timeshare owners can reasonably expect to allocate the purchase price between buildings (depreciable over 27.5 years under MACRS) and land (non-depreciable).

[\[FN21\]](#). The requirement that personal use of all owners for a given timeshare unit be combined for purposes of the 14 day/10% personal use cap is consistent with the requirement that the rental use of all owners of a given timeshare unit be combined for purposes of the less-than-15-day rental requirement for purposes of the "tax-free rent" rule discussed earlier in the article.

[\[FN22\]](#). Expectationally, the only way a timeshare interest would qualify as rental-use property would be for the timeshare ownership to be divided among a small number of owners, who then agree to limit their combined personal use to not more than 14 days per year or 10% of total rental days. This situation is clearly not the norm for the vast majority of timeshare owners.

[\[FN23\]](#). For a comprehensive discussion of issues relating to the availability of loss deductions on timeshare rental properties and restrictions relating thereto, readers are referred to Bohman and Bohman, "The [Income Tax Treatment of Vacation Homes: Interplay with the Passive Activity Loss Rules](#)," [16 J. of Real Est. Tax'n 218 \(Spring 1989\)](#), and Poswolsky, "Understanding Vacation Home Rules," [174 Journal of Accountancy \(July 1992\)](#), pp. 76-83.

[\[FN24\]](#). Under Section 469(i), if a taxpayer "actively participates" in the rental of the property (e.g., arranges for tenants, oversees maintenance, etc.), the taxpayer may qualify for the rental real estate exception, which permits up to \$25,000 per year in passive rental losses to be deducted in the current year, even in the absence of passive income. As a related point, timeshare owners who rent their units for a maximum of seven days per year are not engaged in a rental activity, and are therefore ineligible for the \$25,000 loss deduction ([TAM 9505002](#) and Temp. Reg.1.469-1T(e)(3)(ii)(A)).

[\[FN25\]](#). See also [Lukens, 945 F.2d 92, 68 AFTR2d 91-5754 \(CA-5, 1991\)](#) and Ames, TCM 1990-87.

[\[FN26\]](#). To the extent that a timeshare owner participates in the exchange program, the use of an owner's unit by someone else participating in the exchange program constitutes "personal use" time for purposes of the personal use cutoffs (i.e., 14-day/10%).

[\[FN27\]](#). For a complete analysis, see Ziobrowski and Ziobrowski, note 2, supra.

[\[FN28\]](#). Some states prohibit brokers from collecting advance fees as discussed in Matas, "Time-share Listing Fees Spark Suit," [The Wall Street Journal, 3/11/98](#).

[\[FN29\]](#). When classifying a timeshare interest as personal-use, mixed-use, or rental-use at the time of sale, taxpayers need to look to the substance of their timeshare transactions. For example, it may be difficult for a taxpayer to sustain the position that a timeshare interest is mixed-use if there has only been one year of rental activity immediately prior to the year of sale.

[\[FN30\]](#). The Section 1231 netting process requires a taxpayer, in a given year, to net out (1) gains and losses from long-term business-use casualties and (2) gains and losses from sales, exchanges, and involuntary conversions of Section 1231 assets. If a net Section 1231 loss results, the loss will be treated as an ordinary loss for tax purposes. If a net Section 1231 gain occurs, the gain will be treated

as long-term capital gain, provided none of the gain has to be characterized as ordinary income under the "lookback" provision of Section 1231(c).

[\[FN31\]](#). Depreciation recapture under Section 1250 would occur for timeshare owners who purchased their interests prior to 1987 and took accelerated depreciation on the portion of the purchase price allocated to the building. No Section 1250 depreciation recapture would be required for interests acquired by individuals after 1986 since only straight-line depreciation is available for real property. For timeshare interests sold after 5/6/97, some portion of the gain may have to be classified as "unrecaptured Section 1250 gain" and therefore taxed at a maximum rate of 25%. Depreciation recapture under Section 1245 would occur only on the sale of timeshare interests when a portion of the purchase price had been allocated to depreciable furnishings with some depreciation taken.

[\[FN32\]](#). Married taxpayers are eligible to make the gift-splitting election under Section 2513(a)(1), which effectively doubles the annual exclusion to \$20,000 per donee. Also, the \$220,550 unified credit is the amount available for transfers occurring in 2000 under Section 2505. The credit amount is scheduled to increase over the next five years, eventually reaching \$345,800 for years 2006 and after. Also, taxpayers or their advisors should be aware that several states impose gift taxes on gratuitous transfers and, in some instances, state gift tax is imposed even when no federal gift tax is due.

[\[FN33\]](#). In the event of transfers of timeshare interests to a spouse or ex-spouse pursuant to divorce, the transfer is not subject to gift tax. The recipient spouse takes a carryover basis in the property under Section 1041(b)(2).

[\[FN34\]](#). Some modifications to these basis calculations may be necessary in some instances including, for example, when gift tax has been paid by the donor, when the donee has made capital improvements to the property, etc.

[\[FN35\]](#). Even if no federal estate tax is due, some estates may still owe state transfer taxes since not all 50 states "piggyback" directly onto the federal transfer tax system. For additional information, see Craig, "State Wealth Transfer Taxes," 14 Journal of State Taxation 1 (Panel, Fall 1995).

[\[FN36\]](#). Murtaugh, TCM 1997-319.
27 J. Real Est. Tax'n 301, 2000 WL 1679004 (W.G.&.L.)
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