Internal Revenue Service

Department of the Treasury

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Person to Contact:
[redacted]
Telephone Number:
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[redacted]

Refer Reply To:
CC:DOM:P&SI:7
General Information Letter
Date:
June 19, 2000

re: Section 528 and exempt function income

Dear [redacted]:

We received your letter, dated March 3, 1999, in which you request general information regarding timeshare unit foreclosures by a timeshare association (Association) under § 528 of the Internal Revenue Code. This letter does not constitute a ruling and merely provides general information. A general information letter calls attention to well-established interpretations or principles of tax law without applying them to a specific set of facts.

You inquired about the income tax consequences to a timeshare association that elects to be a § 528 association, that either forecloses on the unit of a non-paying member or the member voluntarily deeds the unit to the Association in lieu of foreclosure. You also inquired about the income tax consequences to the Association when the Association sells the unit. You indicated that typically, the Association will contact its membership and state that this unit is available at a named price, plus the current year maintenance fee. Other times, the Association will sell the unit to a friend of a member or a non-member. You have specifically requested that we answer the following questions: Can the annual maintenance fees that have not been collected prior to the foreclosure or deed in lieu of foreclosure be considered the Association's basis in the sold unit? Is the sale of the unit by the Association taxable to the Association if it is sold to a member? Is the sale of the unit by the Association taxable to the Association if it is sold to a non-member? For these questions, we will assume that there is no mortgage on the unit.

Section 528(a) provides that a homeowners association (as defined in § 528(c)) will be subject to Federal income tax only to the extent provided in § 528. A homeowners association will be considered an organization exempt from income taxes for the purpose of any law that refers to organizations exempt from income taxes.

Section 528(b) provides that a tax is hereby imposed for each taxable year on the homeowners association taxable income of every homeowners association. The tax will be equal to 30 percent of the homeowners association taxable income (32 percent of the income in the case of a timeshare association).

Section 528(d)(1) defines the term "homeowners association taxable income." For purposes of § 528, the homeowners association taxable income of any organization for any taxable year is an amount equal to the excess (if any) of the gross income (excluding the exempt function income) of the homeowners association over the deductions directly connected with producing that gross income (excluding the exempt function income). The deductions allowed for purposes of computing homeowners association taxable income are the deductions generally allowed for computing taxable income, as modified by § 528(d)(2). See § 1.528-10 of the income tax regulations.

Section 528(d)(3) provides, in part, that for purposes of § 528(d), the term "exempt function income" means any amount received as membership dues, fees, or assessments from owners of timeshare rights to use, or timeshare ownership interests in, real property in the case of a timeshare association.

Section 1.528-9(a) of the regulations provides, in part, that it is not necessary that the source of income be labeled as membership dues, fees, or assessments for the income to be exempt function income. What is important is that such income be derived from owners of residential units or residential lots in their capacity as owner-members rather than in some other capacity such as customers for services.

Section 1.528-9(c) of the regulations provides examples of receipts by homeowners associations that do not constitute exempt function income. These examples include amounts received from persons who are not members of the association and interest earned on amounts set aside in a sinking fund.

When a § 528 timeshare association either forecloses on the unit of a non-paying member or the member voluntarily deeds the unit to the Association in lieu of foreclosure and the Association sells the unit, the Association is acting in order to collect annual timeshare maintenance fees from the non-paying member. Generally, annual timeshare maintenance fees qualify as exempt function income as defined in § 528(d)(3). Therefore, the annual maintenance fees in these situations that have not been collected prior to the foreclosure or deed in lieu of foreclosure can be considered the Association’s basis in the sold unit.

Furthermore, the Association may sell the unit either to an Association member or non-member and the sale of the unit will only be taxable to the Association to the extent that the amount received from the sale exceeds the amount of the unpaid

maintenance fees (exempt function income). Additionally, § 528(a) provides that a homeowners association (as defined in § 528(c)) will be subject to Federal income tax only to the extent provided in § 528 and § 528 does not extend a bad debt deduction to the production of exempt function income. Therefore, in situations like this the Association may not claim a § 166 bad debt deduction to the extent that the amount the Association receives for the unit is less than the amount of unpaid maintenance fees.

Although this letter is a general information letter, not a private letter ruling, we hope the above information proves helpful.

Sincerely yours,

Joseph H. Makurath
Senior Technician Reviewer, Branch 7
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)