Know of a Good Tax Shelter?

Time Sharing Deals Are Controversial But This Accountant Sees Some Real Tax Advantages

By Irving L. Blackman

Year after year clients bombard C.P.A.s with this question. My clients are not different. I really thought that when the top tax rate tumbled from 70% in 1981 to 50% in 1982, the broadside of tax shelter questions would subside. Not so.

First, let me make the most important point: No matter how good the deal works out as a tax shelter, if the deal does not have economic substance, you will be a loser in the long run. Pass it.

Okay, let’s assume you have found a deal that passes the economic substance test. If, in addition, the deal offers tax shelter that is a definite plus. In general, tax shelter means that after all the smoke clears, you wind-up with more overall dollars in-pocket, because of some peculiarity in the tax law, than you would have had in a nontax shelter deal. Deferring tax, investment credit, depreciation, and turning ordinary income into capital gains are time honored ways of accomplishing a tax shelter trick.

A simple example of the shelter promoter’s sales pitch goes like this— “You, Mr. Taxpayer, put up $10,000 . . .; my deal gives you a ‘5 to 1’ write off, or $50,000. Since you’re in a 50% tax bracket, you will save $25,000 in taxes . . . you only put up $10,000 . . . you’ll be $15,000 ahead go’n in.” My, my, how the suckers buy. Remember, the IRS is on the war path to knock out any tax shelter that does not comply with the tax law. Many tax shelter deals like this are kicked over by the examining agent.

. . . And that’s the second point—check out the tax validity of the deal with your professional advisor.

Recently, I examined a new real estate investment concept that offers true tax shelter (will stand up against an IRS attack). Here’s the story: You purchase “one week of time” of a particular room in a resort motel. Each room of property is divided into 52 separate weekly intervals and then sold with the underlying real estate ownership rights. Actually it is a condominium-like transaction for the room further divided into a specific time frame. Nevertheless, it is a real estate deal and subject to the real estate rules of the tax law.

The tax shelter charm is two-fold: first, the write-off is about 3 to 1; second, any sale of your real estate interest at a profit will result in favorably taxed capital gains treatment. The concept is called “time sharing” or interval ownership.” In order to accomplish its tax strokes, the concept takes advantage of the “at-risk” rules exception combined with the new depreciation rules (a 15-year life for real estate that became effective in 1981).

The at-risk rules prevent you from deducting any more than you have at risk in a deal. For example, if you put up $10,000 (or are liable for no more than $10,000) your deduction is limited to $10,000. Real estate is an exception. Say you put up $10,000 in cash and borrow $40,000 (via a mortgage on which you have no liability—the lender can look only to the property). Now your deductions can go as high as $50,000 even though you are at risk for only $10,000.

From a tax shelter standpoint, the interval ownership concept looks like a winner. Hats off to the Pettee Group, Inc. of Atlanta, Georgia for bringing it to my attention.