

IRS Looks at Investment Loss Claim on Real Property

All of the following quotes are directly out of
IRS Publication 544 "Sale and Other Dispositions of Assets"

All non-IRS comments are in italics

The first step is to determine what you have. Based on IRS definitions, a timeshare is an asset and its disposition is subject to IRS regulations. NOTE: When it says ordinary gain or loss remember it is referring to adding to or subtracting from your gross taxable income.

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Capital Assets

Almost everything you own or use for personal purposes or investment is a capital asset.

Personal-use property. Property held for personal use is a capital asset. Gain from a sale or exchange of that property is a capital gain. Loss from the sale or exchange of that property is not deductible. You can deduct a loss relating to personal-use property only if it results from a casualty or theft.

Investment property. Investment property (such as stocks and bonds) is a capital asset, and a gain or loss from its sale or exchange is a capital gain or loss. This treatment does not apply to property used to produce rental income.

Noncapital Assets

A noncapital asset is property that is not a capital asset. The following kinds of property are not capital assets.

4. Real property used in your trade or business or as rental property, even if the property is fully depreciated.

Business assets. Real property and depreciable property used in your trade or business or as rental property. . . are not capital assets. The sale or disposition of business property is discussed in chapter 3.

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The first determination is whether the timeshare or property is held for personal or business rental use. Before you claim it as business rental use, you better have all the bills and receipts associated with the process and clearly showing your intent to rent the property, whether you were successful or not. It must be clear that rental was your intent for a reasonable period of time (consider going back at least one year).

If you can establish a proven track record of attempting to rent it, you can deduct any loss associated with it. If not, it is considered personal-use property and you can not deduct any loss.

Chapter 3 referred to above deals with determining if the gain or loss is to be reported as a capital gain or loss. Essentially, as a non-capital asset, any gain or loss is reported as regular income and not subject to the reduced capital gain tax percentage. A capital loss can be taken as a limited \$3,000 loss but a gain is taxed at a lower tax bracket.

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PROPERTY CHANGED TO BUSINESS OR RENTAL USE

You cannot deduct a loss on the sale of property you acquired for use as your home and uses as your home until the time of sale.

You can deduct a loss on the sale of property you acquired for use as your home but changed to business or rental property and used as business or rental property at the time of sale.

However, if the adjusted basis of the property at the time of the change was more than its fair market value, the loss you can deduct is limited.

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The word 'home' includes your timeshare or vacation property. If you bought the timeshare or property to use personally, or did use it personally at any time, you can change that use to business use, but you must divide any gain or loss by the amount of time it was used in each category. If your timeshare was used by you for 8 of the 12 years and you have proof of your attempt to rent it the other 6 years (no proof = personal use), 2/3 of everything is considered personal-use and only 1/3 is considered business use.

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Property Used Partly for Business or Rental

If you sell or exchange property you used partly for business or rental purposes and partly for personal purposes, you must figure the gain or loss on the sale or exchange as though you had sold two separate pieces of property.

Gain or loss on the business or rental part of the property may be a capital gain or loss or an ordinary gain or loss. Any gain on the personal part of the property is a capital gain. You cannot deduct a loss on the personal part.

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An example is in the Publication 544 that shows this computation. The final element was to show that even though a \$15,000 net loss was taken on the property, only \$2,380 was considered the actual loss because of the difference in personal (2/3) versus business (1/3) use. The personal portion of the loss is not deductible while the business portion has some limitations to its loss.

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Abandonments

The abandonment of property is a disposition of property. You abandon property when you voluntarily and permanently give up possession and use of the property with the intention of ending your ownership but without passing it on to anyone else.

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This is a tricky question. According to the IRS any transfer is considered disposition of ownership. Abandonment is literally, walking away and allowing the property to undergo foreclosure (which brings other questions and concerns into focus) or reclamation by the governing government (usually the county) for non-payment of taxes and assessments.

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Loss from abandonment of business or investment property is deductible as an ordinary loss. Even if the property is a capital asset. The loss is the property's adjusted basis when abandoned. This rule also applies to leasehold improvement the lessor made for the lessee that was abandoned.

You cannot deduct any loss from abandonment of your home or other property held for personal use.

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Again, if any loss is to be claimed, it must be a business property, not a personal-use property.

There are other references in Publication 544 to Fair Market Value at the time of disposition but that is treated in another whole article. Essentially, one thing implied in Publication 544, again, is that a FMV can be determined by the sale price received by the entity that receives the timeshare or property, but that has to go back to other publications to find that the time limit is considered 36 months.

Without a sale price, FMV is determined by purchase price and/or replacement price in most cases. So, if your purchase price for the property was \$20,000 and you did try to rent it but can only show records for 1/4 of the time you owned it, you can only consider \$5,000 as the business portion which can be taken as a loss against other income.

Another option is to donate to a federally authorized charity (nonprofit organization). Doing this falls under other guidelines and can end up with a much greater income deduction than a claim as a loss.