Accounting for sales of timesharing interests in real estate; Issues paper (1981 April 10)

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ISSUES PAPER

ACCOUNTING FOR SALES OF TIMESHARING INTERESTS IN REAL ESTATE

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ACCOUNTING FOR SALES OF TIMESHARING INTERESTS IN REAL ESTATE

Background

1. A timesharing interest is the right to occupy a dwelling unit annually for a specified time period, usually one or two weeks. The right may be granted to an individual for a spcified number of years or in perpetuity. It is a property right associated primarily with resort property for recreational or vacation purposes.

2. Timesharing started in Europe in the 1960s and spread to the United States in the 1970s. It gained prominence as a marketing device in the mid 1970s, particularly as a method of selling condominium and hotel projects, because it enabled potential buyers of second homes to limit their investment to the cost of the right to occupy a vacation dwelling for a specific time period.

3. Developers of resort type property have found the sale of timesharing interests a profitable method of selling such property for use as vacation homes. In a typical timesharing project the developer or a related selling organization offers time intervals of one or more weeks at varying prices depending on the time of year selected and often arranges financing for purchasers of the interests. Sales may occur before the project is completed and available for use. Interval exchange organizations have developed through which owners of timesharing interests can exchange their intervals in a particular year for use of other intervals in the same project or for intervals in other projects.

<u>Types of Interests</u>

4. Timesharing projects are structured in one of two basic ways: as fee simple ownership interests or as right to use interests. Each type has several variations. The basic types are

a. <u>Fee simple ownership</u>. Fee simple ownership is an undivided interest in fee simple in a designated real estate project that gives the owner the exclusive right of occupancy for a designated period. Title is transferred through a deed. Such interests have all the normal attributes of real estate ownership. They can be sold, leased, mortgaged, and transferred by will. Purchasers of such interests may deduct from their taxable income a proportionate share of the real estate taxes.

b. <u>Right to use</u>. Right to use timesharing interests convey a right to occupancy without an ownership interest in the property. Purchasers obtain the right to use the property as a vacation home for a specified period during each year for a specified number of years. The developer or another party retains the ownership interest in the property, and full possession reverts to that party at the end of the contract period. The contract often prohibits the purchaser from selling the right to use interest.

5. The purchaser of a fee simple timesharing interest typically receives an undivided interest in the living unit based pro rata on the length of the period covered by the interest. The basic contract does not identify the specific occupancy period, which is established by a separate agreement.

6. The sale of a fee simple timesharing interest in a structure is similar to the sale of a condominium; both represent the sale of a fee simple interest in a house or multifamily building. In contrast with the traditional form of condominium interest, which represents an interest in a specific physical part of a building, a timesharing interest represents a share of time (interval) in a specific physical part of a building. Condominiums and timesharing interests have many common attributes, such as

- amenities or the developer's obligation to build amenities
- owners' associations supported by the developer in the formative years of the project
- management service provided by the developer
- maintenance fees

Sales of timesharing interests are sometimes governed by state laws for condominiums.

Scope of Paper

7. Although sales of timesharing interests in real estate in the United States are relatively new, the timesharing industry has grown rapidly bringing with it significant accounting issues. This paper addresses questions that have arisen on how to account for sales of such interests and as to the existing accounting literature applicable to such sales. The primary purpose of this paper is to ask the FASB to provide guidance on accounting for the sale of timesharing interests in real estate.

8. This paper covers accounting for sales of timesharing interests that represent (a) fee simple ownership of real estate and (b) right to use timesharing interests to the extent that they are deemed to be in substance sales-type leases under FASB Statement No. 13, as amended. The issues addressed in this paper relate to sales of timesharing interests of the types described in this paragraph.

Issues Addressed

9. The following are the issues addressed by the AICPA Real Estate Accounting Committee and the committee's advisory conclusions on those issues.

a. Are sales of timesharing interests sales of real estate?

   Advisory conclusion. Yes. Sales of timesharing interests are sales of real estate. They are essentially the same as sales of condominium units.

b. Should sales of timesharing interests in real estate be accounted for in accordance with the AICPA Industry Accounting Guide, <u>Accounting for Profit Recognition on Sales of Real Estate</u>, or in accordance with the AICPA Industry Accounting Guide, <u>Accounting for Retail Land Sales?</u>

<u>Advisory conclusion</u>. They should be accounted for in accordance with the profit recognition guide. Paragraph 27 of AICPA Statement of Position (SOP) 75-6, <u>Questions Concerning Profit Recognition on Sales of Real Estate</u>, an interpretation of that guide, states:

> The Guide was meant to apply to all sales of real estate, except retail lot sales covered by the AICPA Industry Accounting Guide, <u>Accounting for Retail Land Sales</u>, without regard to the nature of the seller's business.

Timesharing interests in a structure are not lot sales. Paragraphs 57 and 60 of the profit recognition guide deal with sales of partial interests in real estate and sales of units in condominium projects. Those paragraphs are particularly pertinent to sales of timesharing interests. In addition to the profit recognition guide, including the related statements of position, SOP 78-3, Accounting for Costs to Sell and Rent, and Initial Rental Operation of, Real Estate Projects and SOP 80-3, Accounting for Real Estate Acquisition, Development, and Construction Costs, should also apply to accounting for acquisition, development, construction, and selling costs of timesharing interests.