

Fractional ownership a legal minefield

THE concept of fractional ownership is usually used in the real estate industry as a vehicle whereby a person acquires the use and participates in the capital growth of immovable property. Typical examples include an interest in a holiday apartment at the coast or a home on a golf estate.

The purchase of a fractional interest will generally involve the sale of shares in a company that confers on the purchaser the use of the underlying property that is owned by the company. What is often not considered by promoters or developers of a fractional ownership scheme are the tax consequences when the use in the underlying property is disposed of.

One of the questions arising from the transaction is whether the supply of the fractional interest (the share) constitutes a supply of fixed property as defined in the Value Added Tax Act, 1991.

Fixed property is defined as "land together with improvements thereto, a unit as defined in the Sectional Titles Act, any share in a share-block company which confers a right to or interest in the use of immovable property; and in relation to a property time-sharing scheme, any time sharing interest as defined in the Property Time-sharing Control Act, and any 'real right' in any such land, unit, share or time-sharing interest".

To the extent that the supply of a share in a fractional ownership company confers a right or an interest in the use of immovable property as contemplated in the Share Blocks Control Act, the Sectional Titles Act or the Property

Time-Sharing Control Act, such supply would constitute fixed property for value-added tax (VAT) purposes, provided the seller is a vendor.

The debate on whether the interest in a fractional ownership scheme falls within the ambit of the Share Blocks Act, the Sectional Titles Act or the Property Time-sharing Control Act, will not be considered here as this debate is still alive and well among legal commentators, the South African Revenue Service (SARS) and real estate professionals, with conflicting points of view.

SARS, in the VAT Guide for Fixed Property transaction, is of the view that the supply of shares in a fractional ownership scheme constitutes fixed property regardless of whether the share or interest in a fractional ownership scheme falls within the ambit of the Share Blocks Act, the Sectional Titles Act or the Property Time-sharing Control Act. SARS's view is based on the fact that the supply of the use of immovable property constitutes a right in or to immovable property as contemplated in the definition of fixed property.

To the extent that one is not dealing with the supply of land or the supply of a share in a share-block company or an interest in a property time share, or a sectional title unit, the right in or to land must constitute a real right to fall within the ambit of the definition of fixed property.

A personal right creates rights and obligations between two persons and is binding between those persons. A real right, on the other

hand is a right or duty linked to the land or part thereof and real rights are binding and enforceable against the owner and his successors-in-title.

A share in the company denotes a claim to part of the share capital of the company and does not refer to the right of ownership in any part of the assets of the company. Furthermore, section 91 of The Companies Act, 1973 provides that a share that any member has in a company is movable property. The shareholder in its legal relationship with the company acquires:

- Rights, mainly the right to dividends when they have been declared and the right to participate in the distribution on liquidation; and

- Duties, mainly to honour the articles.

In the case of a company owning the fractional ownership property, it is considered that the company has a real right in respect of the property and it is considered that the right of the shareholder to use the property owned by the company is a personal right, as this is binding on the shareholders and the company, thereby creating rights and duties between those two parties.

If this is true the shareholder merely has a personal right in respect of a fractional ownership property and unless it can be said that the share or interest falls within the ambit of the Sectional Titles Act, the Share Blocks Control Act or the Time Sharing Act, such interest is unlikely to constitute fixed property as defined, and therefore not subjected to VAT.

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To the extent that the property (the share) does not fall within the ambit of the Vat Act, the transfer of the property and the acquisition thereof by the purchaser may fall within the ambit of the Transfer Duty Act, 1949 to the extent that the purchaser acquires a share or member's interest in a residential property company.

To the extent that the fractional ownership company holds residential property of which the fair value of the property is more than 50% of the aggregate fair market value of all the assets of the company, it is considered that the acquisition of a share in the fractional ownership company would be subject to transfer duty.

It follows that fractional ownership schemes provide many uncertainties that are yet to be settled in our law.

In particular, consideration needs to be given to the following:

- Whether the supply of a share or interest in a fractional ownership scheme constitutes the supply of fixed property;
- Whether the supply of an interest in a fractional ownership scheme constitutes an exempt supply for VAT purposes;
- Whether the shares in a fractional ownership company will fall within the ambit of the Sectional Titles Act, the Share Blocks Control Act or the Time Sharing Act; or
- Whether the supply will result in the payment of transfer duty as contemplated in the Transfer Duty Act.

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