Real Estate Law & Conveyancing

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SOUTH AFRICA

- Buying a share doesn't avoid the duty

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Buying a share doesn't avoid the duty

Property deals are often structured as share or members' interest sales to keep things clean, quick and supposedly transfer duty free. Cue the shocked pause: "*But we didn't buy the property ... we only bought the shares*." Unfortunately, the South African Revenue Service has heard that line before and what looks like a neat paper transaction can still trigger transfer duty. This Alert covers when and why the Transfer Duty Act 40 of 1949 (Act) treats a share acquisition as a taxable property transaction, and how long-term leasehold structures fit into the picture. This is not a new development, the relevant provisions of the Act have been in place for many years but are frequently overlooked in structuring exercises.

Key statutory definitions

The Act adopts an extended definition of "*property*". In addition to land and real rights in land, the definition expressly includes a share or member's interest in a "*residential property company*". This deeming provision brings certain share transactions within the transfer duty net even where no transfer of immovable property is registered in the Deeds Office.

A company will constitute a "*residential property company*" where 50% or more of the **fair value** of its assets is attributable, directly or indirectly, to residential property, including through any controlled entities, and determined with reference to the specific inclusions and exclusions prescribed in the Act. A REIT, as defined in the Income Tax Act 58 of 1962, is expressly excluded from this definition.

The Act defines a "*company*" broadly to include any association, corporation or company (including a close corporation) or any body corporate.

Put differently, if you are acquiring shares in a company that owns a townhouse, a residential block or even a single flat, and that property makes up more than half of the company's value, the law is likely already treating your share deal as a property deal. That is usually the moment when clients pause and re-read the definitions.

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When does buying shares or a member's interest trigger transfer duty?

Section 2 of the Act imposes transfer duty on the acquisition of property by way of a transaction or in any other manner. Because a share or member's interest in a residential property company falls within the extended definition of "*property*" in section 1 of the Act, the acquisition of such a share or member's interest is treated as the acquisition of property for transfer duty purposes.

In these circumstances, transfer duty is calculated with reference to the **fair value** of the share or member's interest acquired. When determining fair value, the Act expressly requires that lease agreements and loan liabilities be disregarded.

A share price may be deliberately pitched low between group companies, family members or long standing business partners, with the assumption that a modest consideration will mean modest duty. The Act cuts through that thinking. For transfer duty purposes, it is not the deal price that matters, but the objective **fair value** of what is being acquired. Relabelling value or under-selling the shares does not change the tax outcome.

Relevant exemptions

The Act contains a closed list of exemptions in section 9. There is no general exemption for the sale of shares or members' interests in residential property companies, with the result that such transactions will ordinarily attract transfer duty unless a specific statutory exemption applies.

That line in the sand, however, raises another question: if exemptions are limited, does the nature of the property exposure itself make a difference, particularly where residential occupation is held through long-term leasehold arrangements rather than outright ownership?

Long-term leasehold structures: The nuanced position

Where a company owns residential property that is merely subject to lease agreements, the existence of those leases does not affect whether the company qualifies as a residential property company. Lease agreements are disregarded only at the valuation stage, once the applicability of transfer duty has already been established.

A more complex scenario arises where a company's exposure to residential property is derived from **registered long-term leasehold rights** rather than from ownership of the underlying land or buildings.

Two distinct situations must be distinguished:

Leasehold-only structures

Where the company's assets consist entirely of registered long-term leasehold rights over residential land, with no ownership of the underlying land or buildings: because leasehold rights are expressly excluded from the definition of "*property*" in the Act, the company holds no qualifying property for purposes of the residential property company definition. There is, accordingly, a credible argument that such a company falls outside the residential property company regime altogether, and that a sale of shares or member's interest in it does not attract transfer duty.

Mixed asset structures (leasehold and owned property)

Where the company holds registered long-term leasehold rights together with some traditionally owned residential property, the analysis changes. Leasehold rights are excluded from the definition of "*property*" and do not count towards the **numerator** in the statutory 50% threshold test.

However, they do form part of the **denominator,** being the aggregate fair market value of all the company's assets. The company will therefore only qualify as a residential property company if the fair value of its traditionally owned residential property alone exceeds 50% of the aggregate fair market value of all its assets, assessed as at the date of acquisition of the shares or member's interest.

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The key intuition shift is this: leasehold rights do not help you **because** they are property – they help you precisely because, for purposes of the Act, they are not. The more leasehold value sits alongside comparatively modest owned residential property, the less likely it is that the statutory threshold will be crossed.

Key takeaways

Start with the basics: if a company qualifies as a "*residential property company*", a sale of its shares or members' interests is treated much like a direct sale of the property itself and attracts transfer duty. And remember, creative pricing does not move the needle.

Only once that baseline is understood does the leasehold question become interesting. Long term leasehold structures do not offer a universal escape route, but they can be decisive in carefully balanced cases.

The correct analysis is therefore highly fact-specific. Clients considering the acquisition of shares or a member's interest in any company with residential property exposure, including through holding company structures or registered long-term leasehold arrangements, should seek specialist legal advice before concluding such transaction.

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