

## RIGHT-TO-USE COMPARED TO DEEDED FEE

John Rogers Burk; ARDA Roundtable, April 27, 1997

- I. WHAT IS OWNERSHIP? "OWNERSHIP" of property includes several material elements:
  - A. Right-to-use.
  - B. Power to decide: how to use, how to manage, whether to sell, encumber or rent, and whether to rebuild if destroyed.
  - C. Right to receive the proceeds from destruction, sale or rent.
  - D. Right to exclude others.
  - E. Responsibility for maintenance and repairs.
  - F. Power during life or at death to designate a new "owner."
  
- II. IS REAL ESTATE "TITLE" RELEVANT TO OWNERSHIP? No; what is relevant is whether the elements of OWNERSHIP are granted and protected.
  - A. "Title" to the property can be held in a trust for the benefit of the beneficial owners (beneficiaries), or it can be held by a nonprofit corporation of which all of the "owners" are voting members.
  - B. Legal title is merely a fiction (but still carries the disadvantages) if the real elements of OWNERSHIP are materially restricted, subject to conditions, or may be cancelled by the developer or club without the consent of the "owner."
  
- III. WHAT ARE THE DISADVANTAGES OF A DEEDED INTEREST?
  - A. Direct personal liability of the person or entity which holds legal title.
  - B. The time, cost and difficulties of foreclosure.
  - C. Ancillary (foreign) probate when an out-of-state owner dies.
  - D. Clearing title upon condemnation, sale, or substituting another resort or unit(s).
  - E. Individual assessment of property taxes.
  - F. Delays in recording.
  
- IV. HOW ARE DEEDED INTEREST PROGRAMS FREQUENTLY MISLEADING TO PURCHASERS?
  - A. Traditional expectation of appreciation in value from "owning land."
  - B. Traditional expectation that a "deed" is permanent.
  - C. Substantial restrictions and conditions on OWNERSHIP and rights to cancel and reconvey may be buried in the documents. See II.B above.
  - D. The disadvantages of holding legal title are not disclosed.
  
- V. HOW ARE DEEDED INTEREST PROGRAMS FREQUENTLY MISLEADING TO THE DEVELOPER AND LENDER?
  - A. Believing there won't be a securities law violation in the grant of a fee interest.
  - B. Believing the Windrifter (lease) income tax consequences won't apply.
  - C. The developer may "bootstrap" itself into unnecessarily burdensome regulatory requirements.
  - D. Thinking that deeded interests sell better than non-deeded interests.
  - E. Thinking that non-deeded interests cannot be financed.
  - F. Assuming that state and federal statutes will not apply if the statutes are based on the sale of "services."

- VI. HOW DO YOU CONTROL INVENTORY IN A NON-DEEDED PROGRAM? The same way you control inventory in a deeded program - - someone has to reliably keep track of it.
- A. A County Recorder normally does not monitor the accumulated percentages of undivided interests sold in a unit or project.
  - B. An independent escrow company can close sales based on points or undivided interests established by recorded documents.
- VII. DOES SELLING A DEEDED FEE INTEREST PROTECT YOU AGAINST SECURITIES LAW VIOLATIONS? No
- A. A security is the expectation of profit based on the efforts of others. In the leading case where the U.S. Supreme Court established that definition, the seller was giving a warranty deed to real property, but the main motivation was expecting a profit from the sale of oranges by the seller/manager of the property.
  - B. If the purchase price or obligation is collected before title can be delivered and/or promised improvements can be delivered, the purchase money may be "at risk," and in California, Michigan and a few other states you may be guilty of selling a security, whether the interest is deeded or not.
- VIII. WHAT IS THE REAL ISSUE IN THE WINDRIFTER INCOME TAX MEMORANDUM, WHICH IS USUALLY OVERLOOKED? "Whether the seller [promoter] transferred to the buyer [member] all the benefits and burdens of ownership." See I above. Conclusion: Promoter "never parted with the burdens and benefits of ownership." CCH "IRS Letter Ruling Reports"; 30 Sep 1977; 7803005.
- A. **OWNERSHIP** title was retained by the promoter because the property reverted to the promoter upon expiration of the 40 year membership.
  - B. Members had no right to extend or renew.
  - C. The promoter locked itself in as sole manager of the project.
  - D. If the project was destroyed the insurance proceeds went only to the promoter.
  - E. Full price was paid in the year of sale.
  - F. Promoter was responsible for repairs or rebuilding.
  - G. Memberships were subordinate to any later financing arranged by promoter.
- IX. WHAT CAN YOU DO TO OVERCOME WINDRIFTER INCOME TAX CONSEQUENCES?
- A. Provide a term greater than 30 years, and
  - B. Turn over management to the "owners," and
  - C. Prorate the proceeds from destruction, condemnation or sale between the promoter and the owners based on the remaining term of the membership. OR
  - D. Sell a perpetual membership, whether deeded or based on a membership, and
  - E. Transfer the material elements of **OWNERSHIP**. See I and VIII above.
- X. WILL LENDERS LOAN ON A RIGHT-TO-USE VACATION PRODUCT? Yes; the same concerns exist and can be satisfied in a deeded fee, deeded right-to-use (including lease), and non-deeded vacation product.
- A. The experience and track record of the developer and its team.
  - B. A legal structure based on a recognized body of law.
  - C. A legal and practical mechanism for controlling inventory.
  - D. A legal and practical mechanism for insuring title to the membership and protection and priority of the security interest in the membership.

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