Preamble

In this Note unless the context indicates otherwise –

- “paragraph” means a paragraph of the Eighth Schedule;
- “Schedule” means a Schedule to the Act;
- “section” means a section of the Act;
- “the Act” means the Income Tax Act No. 58 of 1962;
- for the purposes of interpreting section 23A(2) –
  - “specified capital allowances” means the sum of the allowances referred to in sections 11(e) and (o), 12B, 12C, 12DA, 14bis and 37B(2)(a) on “affected assets”;
  - “net rental income” means the taxable income, as determined before deducting the specified capital allowances, derived from “rental income” as defined in section 23A(1); and
- any other word or expression bears the meaning ascribed to it in the Act.

1. Purpose

This Note provides clarity and guidance on the application of section 23A, which ring-fences specified capital allowances granted to a lessor for certain aircraft, ships, machinery, plant, implements, utensils and articles (“affected assets”)\(^1\) let under a lease that is not an “operating lease”.\(^2\)

2. Background

Before the introduction of section 23A in 1984, it was commonplace for certain taxpayers to acquire assets such as plant and machinery and aircraft for the purpose of letting in order to take advantage of capital allowances. The resulting accelerated capital allowances generated large assessed losses, which were used to shield other taxable income from taxation.

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\(^1\) The term “affected asset” is defined in section 23A(1).
\(^2\) As defined in section 23A(1).
Section 23A limits the deduction of the specified capital allowances to a lessor’s taxable income derived from the letting of “affected assets”, before taking into account the specified capital allowances. Any specified capital allowances not allowed because of the limitation are carried forward to the next year of assessment and, subject to any section 23A limitation, are available for set-off against any net rental income from the letting of affected assets. A loss attributable to capital allowances is thus ring-fenced, and cannot be set off against other taxable income earned by the taxpayer.

3. The law

Section 23A

23A. Limitation of allowances granted to lessors of certain assets.—(1) For the purposes of this section—

“affected asset” means—

(a) any machinery, plant, or aircraft which has been let and in respect of which the lessor is or was entitled to an allowance under section 12 or 14bis, whether in the current or a previous year of assessment, other than any such machinery, plant or aircraft let by him under an agreement of lease formally and finally signed by every party to the agreement before 15 March 1984; or

(b) any machinery, plant, implement, utensil, article, aircraft or ship which has been let and in respect of which the lessor is or was entitled to an allowance under section 11(e), 12B, 12C, 12DA or 37B(2)(a), whether in the current or a previous year of assessment, other than any such machinery, plant, implement, utensil, article, aircraft or ship let by him under an agreement of lease formally and finally signed by every party to the agreement before 19 November 1988,

but excluding any such asset let by the lessor under an operating lease or any such asset which was during the year of assessment mainly used by him in the course of any trade carried on by him, other than the letting of any such asset;

“operating lease” means a lease of movable property concluded by a lessor in the ordinary course of a business (not being a banking, financial services or insurance business) of letting such property, if—

(a) such property may be hired by members of the general public directly from that lessor in terms of such a lease for a period of less than one month;

(b) the cost of maintaining such property and of carrying out repairs thereto required in consequence of normal wear and tear, is borne by the lessor; and

(c) subject to any claim that the lessor may have against the lessee by reason of the lessee's failure to take proper care of the property, the risk of destruction or loss of or other disadvantage to such property is not assumed by the lessee;

“rental income” means income derived by way of rent from the letting of any affected asset in respect of which an allowance has been granted to the lessor under section 11(e), 12B, 12C, 12DA or 37B(2)(a), whether in the current or any previous year of assessment, and includes any amount—

(a) which is included in the income of that person in terms of section 8(4) in respect of an amount deducted in any year of assessment in respect of any affected asset; and

(b) derived from the disposal of any affected asset.
(2) Notwithstanding the provisions of sections 11(e) and (o), 12B, 12C, 12DA, 14bis and 37B(2)(a), the sum of the deductions which may be allowed to any taxpayer in any year of assessment under those provisions in respect of any affected assets let by him shall not exceed the taxable income (as determined before making the said deductions) derived by him during such year from rental income.

(3) For the purposes of subsection (2), where the taxpayer is entitled to any deduction which relates to rental income and other income derived by him, an appropriate portion of such deduction shall be taken into account in the determination of the taxable income derived by him from rental income.

(4) Any deduction which is disallowed under the provisions of subsection (2) shall be carried forward to the succeeding year of assessment and shall, subject to the provisions of this section as applicable in relation to that year, be deemed to be a deduction to which the taxpayer is entitled in that year.

4. Application of the law

4.1 Definitions

The definitions under section 23A(1) apply only for the purposes of section 23A and not for the purposes of interpreting the rest of the Act.

4.1.1 Affected asset

There are two categories of “affected asset”.

Category (a) – Section 12 or 14bis assets

Paragraph (a) of the definition of “affected asset” in section 23A(1) refers to any machinery, plant or aircraft which has been let and for which the lessor is or was entitled to an allowance under section 12 or 14bis, whether in the current or a previous year of assessment. Any machinery, plant or aircraft let under an agreement of lease formally and finally signed by every party to the agreement before 15 March 1984 is excluded.

Section 12 was repealed by section 16 of the Income Tax Act No. 129 of 1991. It granted an allowance for machinery or plant used in a process of manufacture or by hotelkeepers.

Section 14bis was repealed by section 50 of the Taxation Laws Amendment Act No. 31 of 2013. It granted a deduction for any aircraft acquired on or after 1 April 1965 but before 1 April 1995, or acquired on or after 1 April 1995 under an agreement signed by every party before 1 April 1995.

While sections 12 and 14bis will no longer result in allowances during a current year of assessment, they may have resulted in the carry-forward of excess allowances that will continue to be ring-fenced under section 23A(2).

Category (b) – Section 11(e), 12B, 12C, 12DA or 37B(2)(a) assets

Paragraph (b) of the definition of “affected asset” in section 23A(1) refers to any machinery, plant, implement, utensil, article, aircraft or ship which has been let and for which the lessor is or was entitled to an allowance under section 11(e), 12B, 12C, 12DA or 37B(2)(a), whether in the current or a previous year of assessment. Any asset let under an agreement of lease formally and finally signed by every party to the agreement before 19 November 1988 is excluded.
The word “entitled” is not defined in the Act and in such event it becomes necessary to consider the ordinary dictionary meaning. “Entitled” is defined in the Business Dictionary as –

“Having rights and privileges to something either by legal mandates or by policies set in place.”

An asset remains an affected asset even if a lessor failed to claim an allowance on it in a previous year of assessment, despite being entitled to do so. The key requirement is whether the lessor was entitled to the allowance.

The relevant provisions provide for allowances on the following types of assets:

- Section 11(e) – Machinery, plant, implements, utensils and articles [other than assets to which section 12B, 12C, 12DA, 12E(1) or 37B applies].
- Section 12B – Certain machinery, plant, implements, utensils and articles used in farming or production of renewable energy.
- Section 12C – Assets used by manufacturers or hotelkeepers, aircraft and ships, and assets used for storage and packing of agricultural products.
- Section 12DA – Rolling stock.
- Section 37B – Environmental expenditure.

**Overall exclusion**

Both categories (a) and (b) exclude –

- any asset let by the lessor under an operating lease; and
- any asset mainly used during the year of assessment by the lessor in the ordinary course of trade other than letting of such asset.

An asset will thus fall outside section 23A if it –

- falls under category (a) and is let under a lease agreement formally and finally signed by every party before 15 March 1984;
- falls under category (b) and is let under a lease agreement formally and finally signed by every party before 19 November 1988;
- is let under an operating lease by a lessor in the ordinary course of a business of letting (but not a banking, financial services or insurance business); or
- is used mainly in a non-letting trade (that is, an asset used more than 50% in a non-letting trade).

The facts and circumstances will determine whether a particular asset is used mainly in a non-letting trade. In SBI v Lourens Erasmus (Eiendoms) Bpk Botha JA held that the word "mainly" prescribed a purely quantitative standard of more than 50%.

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3 [www.businessdictionary.com/definition/entitled](http://www.businessdictionary.com/definition/entitled) [Accessed 9 October 2015].
4 1966 (4) SA 444 (A), 28 SATC 233 at 245.
In determining whether an asset has been used mainly in a non-letting trade, a comparison must be made between the period that the asset formed part of the trade of letting and the period it formed part of another trade. An asset will form part of a trade of letting as long as it was made available for letting. The fact that it was not actually let while made available for letting will not exclude it from the trade of letting.

The reference to allowances “in the current or a previous year of assessment” in the definition of “affected asset” has the effect that an asset, once classified as an “affected asset”, will always remain an “affected asset”. An asset written off in, say, three years, will still be an affected asset in year four even if no allowance is claimed in the fourth year. The implication is that allowances previously disallowed will continue to be ring-fenced against taxable income derived from the letting of fully-depreciated affected assets. At the same time, capital allowances on other affected assets may be set off against the rental income from a fully-depreciated affected asset.

4.1.2 Operating lease

An operating lease relates to a lease of movable property concluded by a lessor in the ordinary course of a business of letting, provided certain requirements are met. Any letting of assets in the business of banking, financial services or insurance is specifically excluded from the definition of “operating lease” and will be subject to potential limitation.

The words “a banking, financial services or insurance business” are not defined in the Act.

Collins English Dictionary$^5$ defines “banking” as –

“the business engaged in by a bank”.

The word “bank” is defined by the same dictionary$^6$ as –

“an institution offering certain financial services, such as the safekeeping of money, conversion of domestic into and from foreign currencies, lending of money at interest, and acceptance of bills of exchange”.

The term “financial services business” is wide and refers to the finance industry. Collins English Dictionary (above)$^7$ defines the word “financial” as –

“adj 1 of or relating to finance or finances. 2 of or relating to persons who manage money, capital, or credit”.

The noun “finance” is defined in the same dictionary$^8$ as –

“1 the system of money, credit, etc., esp. with respect to government revenues and expenditures. 2 funds or the provision of funds. 3 (pl) funds; financial condition. Vb 4 (tr) to provide or obtain funds, capital, or credit for. 5 (intr) to manage or secure financial resources”.

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The finance industry includes amongst others, debt factoring businesses, businesses carrying on the letting of assets, investment banks, credit-card providers, foreign exchange service providers, hedge funds and collective investment schemes.

In South Africa the Insurance business is regulated by the Financial Services Board Act No. 97 of 1990. This act does not provide a definition of the word “Insurance” or “Insurance business”.

The word “insurance” is also not defined in the Act. For income tax purposes, the insurance business is divided into long-term insurance and short-term insurance and is governed by the Long-Term Insurance Act No. 52 of 1998 and the Short-Term Insurance Act No. 53 of 1998. These two acts provide the definitions of “long-term insurance business” and “short-term insurance business” respectively as meaning –

“the business of providing or undertaking to provide policy benefits under long-term policies”

and

“the business of providing or undertaking to provide policy benefits under short-term policies”.

The Collins English Dictionary (above)\textsuperscript{9} defines the word “insurance” as –

“1a the act, system, or business of providing financial protection for property, life, health, etc., against specified contingencies, such as death, loss, or damage, and involving payment of regular premiums in return for a policy guaranteeing such protection. 1b the state of having such protection. ... 2 a means of protecting or safeguarding against risk or injury.”

For the purposes of section 23A it is submitted that the word “insurance” comprises short-term insurance business and long-term insurance business.

In order to qualify as an “operating lease”, all three requirements listed in the definition of that term must be met.

First, the definition requires that the asset in question “may” be hired by members of the general public for a period of less than one month. The question arises whether the word “may” is used in the obligatory sense of “must” or in the permissive sense. It is submitted that the word “may” was used in the definition in the sense of “permitted to” or “capable of”. Accordingly under the lessor’s general modus operandi the asset must be made available for hire for a period of less than a month. In making this determination, the terms on which the asset is advertised for hire will be a relevant factor, as will the standard-form lease agreement used for the pool of assets available for hire.

Although an asset is not automatically excluded from the definition when it is let for a period of one month or longer, an asset which is let on a fixed basis for a period of, say, six months, will be incapable of being let for a period of less than one month by reason of its extended lease period. By contrast, the position would be different in the case of a car-hire firm having a fleet of, say, 15 000 vehicles which it leases under a standard-form lease agreement providing for daily or weekly hire. If the occasional customer happens to hire a vehicle for, say, 40 days, such a contract would not cease to be an operating lease merely because the lease period exceeds one month.

\textsuperscript{9} \url{www.collinsdictionary.com/dictionary/english/insurance} [Accessed 1 October 2015].
The facts and method of operation of each lessor must be considered in determining whether an asset “may” be hired for a period of less than one month.

Furthermore, a lease entered into on the basis that the lessee is entitled to exercise options which will result in the asset being leased for consecutive terms continuously by the same lessee, will disqualify the lease as an operating lease. By implication, the property will not be available to the general public for a period of less than one month.

The term “members of the general public” means members of the community at large.10

The requirement that such property be capable of hire by members of the general public directly from the lessor under the lease for a period of less than one month means that the general public may not hire the property from a third party such as a sub-lessee. If members of the general public hire the property from third parties, the lease will not qualify for exclusion from section 23A even if the lease is for a period of less than one month. Thus, if A lets an aircraft to B who lets it to the general public, the lease concluded by A will not be regarded as an “operating lease”. See Example 1 in the Annexure.

A second requirement listed in the definition of an “operating lease” is that the lessor should bear any costs incurred for maintenance and repair of the property as a result of normal wear and tear. For more information on the meaning of repairs and maintenance, see Interpretation Note No. 74 dated 6 August 2013 “Deduction and Recoupment of Expenditure Incurred on Repairs”.

The final requirement listed in the definition of an “operating lease” is that the risk of destruction or loss of or other disadvantage to the property is not assumed by the lessee, unless the lessor has a claim against the lessee as a result of the lessee’s failure to take proper care of the property.

4.1.3 Rental income

The term “rental income” is defined in section 23A(1) as –

- income derived by way of rent from the letting of any affected asset for which an allowance has been granted to the lessor under section 11(e), 12B, 12C, 12DA or 37B(2)(a), whether in the current or any previous year of assessment;

and includes

- any recoupment under section 8(4) of an amount deducted in any year of assessment for any affected asset;11 and

- any amount derived from the disposal of any affected asset.12

10 CIR v Plascon Holdings Ltd 1964 (2) SA 464 (A), 26 SATC 101 at 109.
11 Paragraph (a) of the definition of “rental income”.
12 Paragraph (b) of the definition of “rental income”.
The term “rental income” must be read with section 23A(2), which refers to –

“taxable income (as determined before making the said deductions) derived by him during such year from rental income”.

(Emphasis added.)

A taxable capital gain is included in paragraph (b) of the definition of “taxable income” by section 26A. It is not the amount received or accrued on disposal of an affected asset that is included in taxable income, but the “taxable capital gain”. The amount received or accrued undergoes a reduction process under the Eighth Schedule, being reduced by the base cost of the asset, any recoupment under section 8(4), offsetting capital losses and the inclusion rate. For more information regarding capital gains tax, see the Draft Comprehensive Guide to Capital Gains Tax (Issue 5).

Since an assessed capital loss cannot reduce taxable income, it will not reduce the taxable income derived from rental income. It is unlikely that capital losses will arise on the disposal of affected assets, since any loss is more likely to qualify for a deduction under section 11(o).13 See Example 3 in the Annexure.

A lease premium received from the letting of assets described above will be regarded as rental income. In C: SARS v BP South Africa (Pty) Ltd Streicher JA stated the following:14

“However, whether a payment is made for the use of property or whether it is made for the right to use property the payment is a rental payment. In this regard I agree with the following statement by Lord Reid in Regent (supra):15

‘It was argued that a rent and a premium paid under a lease are paid for different things – that the premium is paid for the right but that the rent is for the use of the subjects during the year. I must confess that I have been unable to understand that argument. Payment of a premium gives just as much right to use the subjects as payment of a rent and an obligation to pay rent gives just as much right to the whole term of years as payment of a premium.”

A foreign exchange gain does not comprise rental income because it is not derived by way of rent. However, a foreign exchange loss will be allowed in the determination of net rental income from the letting of affected assets before allowing the capital allowances that are subjected to limitation under section 23A.

4.2 Limitation

Section 23A(2) limits the specified capital allowances on affected assets to a lessor’s net rental income from those assets.

The limitation is applied on an aggregate basis, and not on an asset-by-asset basis. Thus the sum of the specified capital allowances on all affected assets is limited to the sum of the net rental income derived from all such assets.

If the rental-related deductions (other than the specified capital allowances) exceed the rental income resulting in a net rental loss, no specified capital allowances on affected assets will be deductible. Should the rental income from affected assets

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13 For more information on section 11(o), see Interpretation Note No. 60 dated 10 January 2011 “Loss on Disposal of Depreciable Assets”.

14 2006 (5) SA 559 (SCA), 68 SATC 229 at 238.

15 Regent Oil Co Ltd v Strick (Inspector of Taxes) [1965] 3 All ER 174 (HL).
exceed the deductions, the specified capital allowances on affected assets will be allowed to the extent of the excess. See Example 2 in the Annexure.

4.3 **Appropriate apportionment**

Section 23A(3) applies when a lessor has incurred deductible expenditure relating to both rental income from affected assets and other income.

In these circumstances an appropriate apportionment must be made to determine the portion of the deductions relating to the rental income from affected assets.

The Act does not provide a specific formula for determining an appropriate allocation of expenditure.

An appropriate apportionment depends on the facts of each case and any fair and reasonable apportionment based on the merits of the case will be accepted.

Apportionment will, for example, be required, for general administrative overheads. Meyerowitz correctly makes the following further observation:16

“Where the affected asset itself is used to produce both rental and other income, then even the direct expenditure will have to be apportioned, eg in the ratio the respective incomes bear to one another, or in the ratio that the rental periods bear to the periods during which the affected asset is used to produce other income.”

4.4 **Carry-forward of disallowed capital allowances**

The specified capital allowances that have been disallowed under section 23A(2) are carried forward to the succeeding year of assessment under section 23A(4). The amount so carried forward is deemed to be a deduction to which the taxpayer is entitled in that succeeding year, subject once again to any limitation imposed by section 23A(2).

In other words, the capital allowances carried forward will be allowed only when there is sufficient net rental income from the letting of affected assets. Disallowed capital allowances are carried forward indefinitely until absorbed by any future net rental income except when the affected asset is sold. See Examples 2 and 3 in the Annexure.

4.5 **Sale of an affected asset**

Section 23A is not a deduction provision, but an anti-avoidance provision. Although the deduction of the specified capital allowances is limited under section 23A(2) and carried forward under section 23A(4), the deduction of the specified allowances remains determinable under the sections conferring those allowances.

Sections 12B(4)(d), 12C(3)(c), 12DA(5) and 37B(5) all contain a provision preventing a deduction for any asset that has been disposed of by the taxpayer during any previous year of assessment. Section 11(e) contains an ownership requirement for an allowance to be deductible for income tax purposes.

The carry-forward of an allowance under section 23A(4) is therefore prohibited when an asset is sold in a previous year of assessment.

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The definition of “rental income” in section 23A(1) includes any recoupment of capital allowances or taxable capital gain on the disposal of an affected asset.

This inclusion can create a circular effect as it is not possible to determine the recoupment without knowing the extent to which the specified capital allowances have been allowed, while it is also not possible to determine the allowable capital allowances without knowing the amount of “rental income” which includes any recoupment. In order to resolve this problem it is necessary to make the assumption in determining any recoupment that the taxpayer has been allowed all capital allowances on the affected asset in question. If this method results in an assessed loss after specified capital allowances, the excess must be carried forward under section 23A(4). See Examples 3 and 4 in the Annexure.

4.6 Assessed losses

Assessed loss arising in the current year of assessment

Any assessed loss incurred during a year of assessment (before deducting the specified capital allowances) from letting affected assets is not subject to ring-fencing under section 23A and is carried forward to the next year of assessment when it will be available for set-off against income from all sources.

On the other hand, a taxpayer will fall within the ring-fencing provisions of section 23A(2) when an assessed loss is created or increased by capital allowances. The term “assessed loss” is defined in section 20(2) as follows:

“(2) For the purposes of this section ‘assessed loss’ means any amount by which the deductions admissible under section 11 exceeded the income in respect of which they are so admissible.”

Section 11(x) provides a deduction for—

“any amounts which in terms of any other provision in this Part, are allowed to be deducted from the income of the taxpayer.”

Capital allowances fall under Part I of Chapter II of the Act and under normal circumstances can create an assessed loss. However, when section 23A(2) applies, the specified capital allowances may not exceed the lessor’s net rental income. It follows that the specified capital allowances cannot create an assessed loss and any disallowed amounts must be carried forward independently to the next year of assessment under section 23A(4) when they will be considered for deduction against net rental income for that year of assessment. See Example 5 in the Annexure.

Assessed loss brought forward from the previous year of assessment

Any specified capital allowances arising in the current year of assessment or brought forward from the previous year of assessment under section 23A(4) must first be deducted from, and limited to, any net rental income derived from the letting of affected assets, after which any balance of assessed loss must be set off. See the similar approach taken by the court in CIR v Zamoyski\textsuperscript{17} in relation to capital development expenditure (CDE) in the First Schedule to the Act. Such CDE is first deducted from taxable income from farming operations for that year before any balance of assessed loss from the previous year of assessment is set off.

\textsuperscript{17} 1985 (3) SA 145 (C), 47 SATC 50.
5. **Record-keeping**

Section 29 of the Tax Administration Act, No. 28 of 2011 imposes a duty on a person to retain the records, books of account or documents needed to comply with a tax Act for a period of five years from the date of the submission of a return. In the context of section 23A and related sections, taxpayers must retain all the information relating to affected assets, such as copies of lease agreements, the date of purchase, allowances previously allowed and accumulated allowances carried forward.

6. **Conclusion**

In summary –

- section 23A limits capital allowances claimed by a lessor under sections 11(e) and (o), 12B, 12C, 12DA, 14bis or 37B(2)(a) on any “affected asset” to the net rental income derived from the letting of those assets;
- the limitation does not apply to an asset let under an “operating lease”;
- in determining net rental income from letting affected assets, expenditure relating to both rental income and other income must be apportioned on some reasonable basis; and
- any specified capital allowances disallowed are carried forward to the succeeding year of assessment when they will again be considered for deduction, and subjected to limitation under section 23A(2).

Examples illustrating the practical application of section 23A are contained in the Annexure.
Annexure – Examples

Example 1 – Operating lease

Facts:
X and Y enter into a partnership. The partnership purchases an aircraft which is brought into use in the first year of assessment. The partnership enters into a lease agreement with a charterer who hires it out to the general public.

Result:
The lease is not an operating lease since the aircraft is not hired by the general public directly from the owner of the aircraft. Accordingly, the limitation under section 23A applies.

Example 2 – Limitation of allowances on affected assets

Facts:
Company A purchases two used manufacturing machines in year 1 and lets these from date of purchase. The following information relates to these machines for the first and second years of assessment:

<table>
<thead>
<tr>
<th>Machine A</th>
<th>Machine B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost</td>
<td>R 600 000</td>
</tr>
<tr>
<td>Rent received</td>
<td></td>
</tr>
<tr>
<td>Year 1</td>
<td>R 200 000</td>
</tr>
<tr>
<td>Year 2</td>
<td>R 180 000</td>
</tr>
<tr>
<td>Interest payable</td>
<td></td>
</tr>
<tr>
<td>Year 1</td>
<td>R 72 000</td>
</tr>
<tr>
<td>Year 2</td>
<td>R 75 000</td>
</tr>
<tr>
<td>Section 12C allowance (20%)</td>
<td>R 120 000</td>
</tr>
</tbody>
</table>

Result:

<table>
<thead>
<tr>
<th>Year 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rental income from affected assets (R 200 000 + R 150 000)</td>
</tr>
<tr>
<td>Less: Allowable deductions – interest (R 72 000 + R 91 200)</td>
</tr>
<tr>
<td>Net rental income</td>
</tr>
<tr>
<td>Less: Allowances – section 12C (R 120 000 + R 152 000)</td>
</tr>
<tr>
<td>Limited to net rental income [section 23A(2)]</td>
</tr>
<tr>
<td>Taxable income</td>
</tr>
</tbody>
</table>

Amount disallowed under section 23A(4) and carried forward to the succeeding year of assessment (R 272 000 – R 186 800) | R 85 200 |
Example 3 – Determination of carry-forward amounts on disposal of asset

Facts:
Company X owns a single aircraft which it acquired in year 1 at a cost of R100 000. The aircraft was let for a period of three years before being sold at the end of year 3. Company X’s net rental income from letting the aircraft before capital allowances was as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Rental income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 1</td>
<td>1 000</td>
</tr>
<tr>
<td>Year 2</td>
<td>5 000</td>
</tr>
<tr>
<td>Year 3</td>
<td>12 000</td>
</tr>
</tbody>
</table>

The aircraft qualified for the allowance under section 12C at the rate of 20% a year.

Determine –
- the section 12C allowances to which Company X is entitled in years 1 to 3;
- the allowances to be carried forward at the end of years 1 to 3; and
- the section 11(o) allowance or recoupment under section 8(4)(a) that arises in year 3 assuming that the aircraft was sold for R90 000 [scenario 1] or R80 000 [scenario 2].

Result:

### Years 1 and 2

<table>
<thead>
<tr>
<th></th>
<th>Year 1</th>
<th>Year 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net rental income</td>
<td>1 000</td>
<td>5 000</td>
</tr>
<tr>
<td>Less: Section 12C allowance [limited under section 23A(2)]</td>
<td>(1 000)</td>
<td>(5 000)</td>
</tr>
<tr>
<td><strong>Taxable income from letting</strong></td>
<td><strong>Nil</strong></td>
<td><strong>Nil</strong></td>
</tr>
</tbody>
</table>

### Calculation of section 12C allowances

<table>
<thead>
<tr>
<th>Clause</th>
<th>Year 1</th>
<th>Year 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Claimed – year 1</td>
<td>20 000</td>
<td></td>
</tr>
<tr>
<td>Less: Allowances Allowed</td>
<td>(1 000)</td>
<td></td>
</tr>
<tr>
<td>Carried forward to year 2</td>
<td>19 000</td>
<td></td>
</tr>
<tr>
<td>Claimed – year 2</td>
<td>20 000</td>
<td></td>
</tr>
<tr>
<td>Less: Allowances Allowed</td>
<td>(5 000)</td>
<td></td>
</tr>
<tr>
<td>Carried forward to year 3</td>
<td>34 000</td>
<td></td>
</tr>
</tbody>
</table>


## Year 3

### Scenario 1

Determination of recoupment

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cost</strong></td>
<td>100 000</td>
</tr>
<tr>
<td><strong>Less:</strong></td>
<td></td>
</tr>
<tr>
<td>Allowances allowed in year 1</td>
<td>1 000</td>
</tr>
<tr>
<td>Allowances allowed in year 2</td>
<td>5 000</td>
</tr>
<tr>
<td>Allowances brought forward</td>
<td>34 000</td>
</tr>
<tr>
<td>Allowances claimed in year 3</td>
<td>20 000</td>
</tr>
<tr>
<td><strong>Tax value</strong></td>
<td>40 000</td>
</tr>
<tr>
<td>Consideration received</td>
<td>90 000</td>
</tr>
<tr>
<td><strong>Recoupment</strong></td>
<td>50 000</td>
</tr>
</tbody>
</table>

### Tax computation

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net rentals before capital allowances</td>
<td>12 000</td>
</tr>
<tr>
<td>Recoupment</td>
<td>50 000</td>
</tr>
<tr>
<td><strong>Net rental income</strong></td>
<td>62 000</td>
</tr>
<tr>
<td><strong>Less:</strong></td>
<td></td>
</tr>
<tr>
<td>Capital allowances brought forward</td>
<td>(34 000)</td>
</tr>
<tr>
<td>Capital allowances – year 3</td>
<td>(20 000)</td>
</tr>
<tr>
<td><strong>Taxable income – year 3</strong></td>
<td>8 000</td>
</tr>
</tbody>
</table>

### Scenario 2

The recoupment under this scenario is R40 000 (amount received of R80 000 less tax value of R40 000).

### Tax computation

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net rentals before capital allowances</td>
<td>12 000</td>
</tr>
<tr>
<td>Recoupment</td>
<td>40 000</td>
</tr>
<tr>
<td><strong>Net rental income</strong></td>
<td>52 000</td>
</tr>
<tr>
<td><strong>Less:</strong></td>
<td></td>
</tr>
<tr>
<td>Capital allowances brought forward</td>
<td>(34 000)</td>
</tr>
<tr>
<td>Capital allowances – year 3</td>
<td>(20 000)</td>
</tr>
<tr>
<td>Loss on disposal of asset [section 11(0)]</td>
<td>(2 000 )</td>
</tr>
<tr>
<td>Amount to be carried forward under section 23A(4)</td>
<td>2 000</td>
</tr>
<tr>
<td><strong>Taxable income – year 3</strong></td>
<td><strong>Nil</strong></td>
</tr>
</tbody>
</table>

### Example 4 – Recoupment and taxable capital gain

#### Facts:

Company Y’s only asset is an aircraft which it acquired at a cost of R100 million in year 1. The company let the aircraft to a single lessee during years 1 to 5 before selling it for R110 million at the end of year 5.

The aircraft qualified for capital allowances of R20 million a year under section 12C. During years 1 to 4 the company was able to claim capital allowances of only R52 million because it had insufficient net rental income during those years. The balance of unclaimed capital allowances carried forward to year 5 under section 23A(4) amounted to R28 million \([\text{R}20 \text{ million} \times 4] – \text{R}52 \text{ million}\). In year 5 the company derived taxable income of R18 million from letting before capital allowances, recoupments and capital gains. Determine Company Y’s taxable income for year 5.
**Result:**

Cost of aircraft  
100 000 000  

*Less:* Capital allowances – claimed years 1 to 4  
(52 000 000)  

Capital allowances – brought forward and claimed in year 5  
(28 000 000)  

Capital allowances – current year  
(20 000 000)  

Tax value  
Nil  

Amount received or accrued on sale [paragraph 35(1)]  
110 000 000  

*Less:* Section 8(4)(a) recoupment [paragraph 35(3)(a)]  
(100 000 000)  

Proceeds  
10 000 000  

Base cost:  

Cost [paragraph 20(1)(a)]  
100 000 000  

*Less:* Capital allowances [paragraph 20(3)(a)(i)]  
(100 000 000)  

Base cost  
Nil  

Capital gain  
10 000 000  

Taxable capital gain (66,6% × R10 million)  
6 660 000  

**Tax computation – year 5**

Rental income  
18 000 000  

Recoupment  
100 000 000  

Taxable capital gain  
6 660 000  

Subtotal  
124 660 000  

*Less:* Unclaimed capital allowances brought forward  
(28 000 000)  

Capital allowances – current year  
(20 000 000)  

**Taxable income**  
76 660 000  

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**Example 5 – Assessed losses**

This example illustrates the carry-forward of an assessed loss calculated under section 20, as well as the carry-forward of capital allowances subject to the limitation in section 23A(2).

<table>
<thead>
<tr>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rental income</td>
<td>Other income</td>
<td>Rental income</td>
<td>Other income</td>
</tr>
<tr>
<td>(7 000)</td>
<td>3 000</td>
<td>9 000</td>
<td>(2 000)</td>
</tr>
<tr>
<td>Net income after deductions, but before section 11(e), (o), 12, 12B, 12C, 12DA, 14bis or 37B(2)(a)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Specified capital allowances subject to limitation in current year</td>
<td>(1 200)</td>
<td>(9 900)</td>
<td>(5 000)</td>
</tr>
<tr>
<td>Section 23A limitation brought</td>
<td>Nil</td>
<td>(1 200)</td>
<td>(2 100)</td>
</tr>
</tbody>
</table>
### Section 23A Limitation Carried Forward

<table>
<thead>
<tr>
<th>Section 23A limitation carried forward(^1)</th>
<th>(1 200)</th>
<th>(2 100)(^2)</th>
<th>(7 100)(^3)</th>
<th>Nil</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable income / (assessed loss) for current year</td>
<td>(7 000)</td>
<td>3 000</td>
<td>-</td>
<td>(2 000)</td>
</tr>
<tr>
<td>Assessed loss brought forward</td>
<td>-</td>
<td>(4 000)</td>
<td>(6 000)</td>
<td>(9 500)</td>
</tr>
<tr>
<td>Assessed loss carried forward</td>
<td>(4 000)</td>
<td>(6 000)</td>
<td>(9 500)</td>
<td>(3 600)(^4)</td>
</tr>
</tbody>
</table>

**Note:** Assessed loss – year 5

1. Capital allowances carried forward due to section 23A(2) limitations cannot create or increase an assessed loss.
2. R9 900 – R9 000 + R1 200 = R2 100
3. R5 000 + R2 100 = R7 100
4. R18 000 – R6 000 – R7 100 = R4 900 + R1 000 = R5 900 – R9 500 = R3 600