INTERPRETATION NOTE 53 (Issue 3)

DATE: 18 March 2020

ACT : INCOME TAX ACT 58 OF 1962
SECTION : SECTION 23A
SUBJECT : LIMITATION OF ALLOWANCES GRANTED TO LESSORS OF AFFECTED ASSETS

CONTENTS

Preamble

In this Note unless the context indicates otherwise –

- **"affected asset"** means an affected asset as defined in section 23A(1) (see **4.1.1**);
- **"operating lease"** means an operating lease as defined in section 23A(1) (see **4.1.2)**;
- **"paragraph"** means a paragraph of the Eighth Schedule;

- **"rental income"** means rental income as defined in section 23A(1) (see **4.1.3**);
- **"Schedule"** means a Schedule to the Act;
- **"section"** means a section of the Act;
- **"the Act"** means the Income Tax Act 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, 14*bis* 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"; and
- any other word or expression bears the meaning ascribed to it in the Act.

All guides and interpretation notes referred to in this Note are available on the SARS website at **www.sars.gov.za**. Unless indicated otherwise, the latest issues of these documents should be consulted.

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").

2. Background

Section 23A limits the deduction of specified capital allowances on affected assets to a lessor's taxable income derived from the letting of these 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 deduction against any net rental income from the letting of affected assets. Disallowed capital allowances are thus ring-fenced, and cannot be deducted against other taxable income earned by the taxpayer.

3. The law

Section 23A is quoted in the **Annexure**.

4. Application of the law

4.1 Definitions [section 23A(1)]

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". Both categories are subject to an overall exclusion (see below).

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 14*bis*, whether in the current or a previous year of assessment, excluding 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.

Sections 12[1] and 14*bis*,[2] which have both been repealed, granted an allowance for machinery or plant used in a process of manufacture or by hotelkeepers and for certain aircraft.[3]

While sections 12 and 14*bis* will no longer give rise to 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, excluding any asset let under an agreement of lease formally and finally signed by every party to the agreement before 19 November 1988.

The word "entitled" is not defined in the Act and in such event it becomes necessary to consider its ordinary dictionary meaning. It is defined in *BusinessDictionary.com* as –[4]

> "2 Having rights and privileges to something either by legal mandates or by policies set in place."

A lessor is therefore entitled to an allowance under the specified sections in a current or previous year of assessment if the requirements of those sections were met. The lessor need not necessarily have claimed the allowance but must have been entitled to it.

The specified sections 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), 12U or 37B applies] used for purposes of trade.
- 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.

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1 Section 12 was repealed by section 16 of the Income Tax Act 129 of 1991.
2 Section 14*bis* was repealed by section 50 of the Taxation Laws Amendment Act 31 of 2013.
3 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.
4 **www.businessdictionary.com/definition/entitled** [Accessed 10 March 2020].

- Section 12DA – Rolling stock used directly and wholly or mainly for the transportation of persons, goods or things in the production of income.
- Section 37B(2)(*a*) – Environmental treatment and recycling assets used in a process that is ancillary to a process of manufacture or similar process.

Overall exclusion

Despite meeting the requirements of category (a) and category (b) (see above), the following assets are not affected assets:

- any asset let by the lessor under an operating lease (see **4.1.2**); or
- any asset mainly used during the year of assessment by the lessor in the ordinary course of trade other than letting of such asset.

  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*[5] Botha JA held that, in the context of an exemption for the previously applicable undistributed profits tax, the word "mainly" prescribed a purely quantitative standard of more than 50%. In the context of this exclusion, "mainly" is also interpreted to mean more than 50%.

  In determining whether an asset has been used mainly during a year of assessment 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.

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

- was entitled to an allowance under section 12 but is let under a lease agreement formally and finally signed by every party before 15 March 1984;
- was entitled to an allowance under section 11(*e*) but 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).

An affected asset qualifying to be written off in, for example, three years under the specified allowance provision, but with a carry-forward under section 23A(4), will still be an affected asset in year four provided the requirements of the definition continue to be met, even if no allowance is claimable under the specified allowance provision 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 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.

5 1966 (4) SA 444 (A), 28 SATC 233 at 245.

4.1.2 Operating lease

An "operating lease" means a lease of movable property concluded by a lessor in the ordinary course of a business (excluding a banking, financial services or insurance business) of letting such property, provided certain requirements, which are discussed below, are met.

The exclusion from the definition of "operating lease" of letting of assets in carrying on the business of banking, financial services or insurance means that such activities will not fall within the first overall exclusion in the definition of an affected asset (see "Overall Exclusion" in **4.1.1**).

The expression "a banking, financial services or insurance business" is not defined in the Act.

CollinsDictionary.com defines "banking" as –[6]

> "the business engaged in by a bank".

The word "bank" is defined by the same dictionary as –

> "1 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 expression "financial services business" is wide and refers to the finance industry. *CollinsDictionary.com* defines "financial" as –[7]

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

The word "finance" is defined in the same dictionary 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".

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.

The word "insurance" is also not defined in the Act. The *CollinsDictionary.com* defines "insurance" as –[8]

> "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"

In South Africa the insurance business is regulated by, amongst others, the Financial Sector Regulation Act 9 of 2017 and the Insurance Act 18 of 2017 (Insurance Act). The Insurance Act defines "insurance business" as meaning –

6 **www.collinsdictionary.com/dictionary/english/banking** [Accessed 10 March 2020].
7 **www.collinsdictionary.com/dictionary/english/financial** [Accessed 10 March 2020].
8 **www.collinsdictionary.com/dictionary/english/insurance** [Accessed 10 March 2020].

> "life insurance business or non-life insurance business conducted or regarded as being conducted in the Republic, and includes reinsurance business".

Long-Term insurance is governed by the Long-Term Insurance Act 52 of 1998 and short-term insurance by the Short-Term Insurance Act 53 of 1998. These two acts have been amended by the Insurance Act but the definitions of "long-term insurance business" and "short-term insurance business" are still effective and are defined respectively as meaning –

> "(*a*) in respect of a registered insurer, the business of providing or undertaking to provide policy benefits under long-term policies;
>
> (*b*) in respect of a licensed insurer, life insurance business as defined in section 1 of the Insurance Act"

and

> "(*a*) in respect of a registered insurer, the business of providing or undertaking to provide policy benefits under short-term policies;
>
> (*b*) in respect of a licensed insurer, non-life insurance business as defined in section 1 of the Insurance Act".

For income tax purposes, the insurance business is also divided into long-term insurance and short-term insurance under section 29A and section 28. For the purposes of section 23A it is submitted that "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 requirement

The first requirement in the definition requires that the asset in question "may" be hired by members of the general public directly from the lessor 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 by members of the general public 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 with a car-hire firm having a fleet of, for example, 15 000 vehicles which it leases under a standard-form lease agreement providing for daily or weekly hire. If the occasional customer hires 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. 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 be unavailable to the general public for a period of less than one month.

The expression "members of the general public" means members of the community at large.[9]

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 a third party, 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".

Example 1 – Operating lease

Facts:

Company X purchased an aircraft which was brought into use in the first year of assessment. Company X entered into a lease agreement with a charterer who hired it out to the general public.

Result:

The lease is not an operating lease because the aircraft is not hired by the general public directly from the owner of the aircraft. Therefore, the overall exclusion from the definition of an affected asset of any asset let by a lessor under an operating lease is inapplicable.

Second requirement

A second requirement listed in the definition of "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 74 "Deduction and Recoupment of Expenditure Incurred on Repairs".

Third requirement

The third requirement listed in the definition of "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.

9 *CIR v Plascon Holdings Ltd* 1964 (2) SA 464 (A), 26 SATC 101 at 109.

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;[10] and
- any amount derived from the disposal of any affected asset.[11]

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 may be reduced by certain amounts under the Eighth Schedule, being the base cost of the asset, any recoupment under section 8(4), offsetting capital losses and the inclusion rate. The taxable income derived from rental income therefore includes "the taxable capital gain" from the disposal of an affected asset. For more information regarding capital gains tax, see the *Comprehensive Guide to Capital Gains Tax*.

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*).[12]

See **Example 3** under **4.5.**

A lease premium[13] received from the letting of assets described above is regarded as rental income for the purposes of the definition of "rental income" in section 23A. 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

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10 Paragraph (*a*) of the definition of "rental income".
11 Paragraph (*b*) of the definition of "rental income".
12 For more information on section 11(*o)*, see Interpretation Note 60 "Loss on Disposal of Qualifying Depreciable Assets".
13 For more information on lease premiums, see Interpretation Note 109 "Lease Premiums".
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).

> 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 is not rental income because it is not derived by way of rent. The definition of rental income (see **4.1.3**) includes only specified items and foreign exchange gains is not one of those items. However, a foreign exchange loss is allowed in the determination of net rental income from the letting of affected assets before allowing the capital allowances that are subject to limitation under section 23A. Section 23A(2) refers to taxable income from rental income and, depending on the facts, permits a number of deductions and allowances including foreign exchange losses.

4.2 Limitation [section 23A(2)]

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 affected 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 exceed the deductions, the specified capital allowances on affected assets will be allowed to the extent of the excess. See **Example 2** under **4.4.**

4.3 Appropriate apportionment [section 23A(3)]

An apportionment 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 apportionment 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 [section 23A(4)]

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 to any limitation imposed by section 23A(2).

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[16] See *Meyerowitz on Income Tax* 2007–2008 in 12.160.

Accordingly, 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.

Example 2 – Limitation of allowances on affected assets

Facts:

Company A purchased two used manufacturing machines in year 1 and let them from date of purchase. The machinery qualified for the allowance under section 12C at the rate of 20% per year of assessment. The following information relates to these machines for the first and second years of assessment:

		Machine A R	Machine B R
Cost		600 000	760 000
Rent received	Year 1	200 000	150 000
	Year 2	180 000	120 000
Interest payable*	Year 1	72 000	91 200
	Year 2	75 000	86 000
Section 12C allowance (20%)		120 000	152 000

* interest is payable on the debt used to purchase the machines

Result:

	R	R
Year 1		
Rental income from affected assets (R200 000 + R150 000)		350 000
Less: Allowable deductions – interest (R72 000 + R91 200)		(163 200)
Net rental income		186 800
Less: Allowances – section 12C (R120 000 + R152 000)	(272 000)	
Limited to net rental income [section 23A(2)]	(186 800)	(186 800)
Taxable income		**Nil**
Amount disallowed under section 23A(2) and carried forward under section 23A(4) to the succeeding year of assessment (R272 000 − R186 800)		85 200
Year 2		
Rental income from affected assets (R180 000 + R120 000)		300 000
Less: Allowable deductions – interest (R75 000 + R86 000)		(161 000)
Net rental income		139 000
Less: Allowances – section 12C (R120 000 + R152 000 + carry-forward of R85 200)	(357 200)	
Limited to net rental income [section 23A(2)]	(139 000)	(139 000)
Taxable income		**Nil**
Amount disallowed under section 23A(2) and carried forward under section 23A(4) to the succeeding year of assessment (R357 200 − R139 000)		218 200

4.5 Sale of an affected asset

The definition of "rental income" in section 23A(1) includes any recoupment of capital allowances under section 8(4) and a 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 addition, the calculation under section 23A is not done on an asset-by-asset basis. In order to resolve these problems it is necessary to make the assumption in determining any recoupment and taxable capital gain that the taxpayer has been allowed all capital allowances potentially available on the affected asset in question up to the date of sale. If this method results in an excess of allowances available under the specified allowance provisions in the current year of assessment and the carry-forward from the previous year of assessment under section 23A(4) above net rental income, the excess must be carried forward under section 23A(4). See **Example 3** (Scenario 2) below.

Example 3 – Determination of carry-forward amounts on disposal of asset

Facts:

Company X owns a ship which it acquired in year 1 at a cost of R10 million. The ship was let for a period of three years before being sold at the end of year 3.

The ship qualified for capital allowances of 20% (R2 million) per year of assessment under section 12C. During years 1 and 2 the company was able to claim capital allowances of only R600 000 (100 000 in year 1 and R500 000 in year 2) because it had insufficient rental income during those years. The balance of the unclaimed capital allowances carried forward to year 3 under section 23A(4) amounted to R3,4 million [(R2 million × 2) − R600 000]. In year 3 the company's net rental income from letting the ship before capital allowances was R1,2 million.

Assume that the ship was sold at the end of year 3 for

a) R9 million [scenario 1]; or

b) R8 million [scenario 2].

Result:

Year 3 R

Scenario 1

Determination of recoupment*

Cost of ship		10 000 000
Less:	Allowances allowed in year 1	(100 000)
	Allowances allowed in year 2	(500 000)
	Allowances brought forward from year 2	(3 400 000)
	Allowances claimed in year 3	(2 000 000)
Tax value		4 000 000
Consideration received		9 000 000
Recoupment		5 000 000

* Assume full deduction of capital allowances claimed up to the disposal for the purpose of calculating the recoupment.

Calculation of capital gain or capital loss on disposal	R
Amount received or accrued on sale [paragraph 35(1)]	9 000 000
Less: Section 8(4)(*a*) recoupment [paragraph 35(3)(*a*)]	(5 000 000)
Proceeds	4 000 000

Base cost calculation	
Cost [paragraph 20(1)(*a*)]	10 000 000
Less: Capital allowances [paragraph 20(3)(*a*)(i)]	(6 000 000)
Base cost	4 000 000

Capital gain (proceeds of R4 million less base cost of R4 million) Nil

Tax computation	R	
Net rentals before capital allowances		1 200 000
Recoupment [section 8(4)(*a*)]		5 000 000
Net rental income		6 200 000
Less: Capital allowances brought forward	(3 400 000)	
Capital allowances – year 3	(2 000 000)	(5 400 000)
Taxable income		800 000

Scenario 2

The recoupment under this scenario is R4 million [amount received of R8 million less tax value of R4 million (see calculation in scenario 1 above)].

Calculation of capital gain or capital loss on disposal	R
Amount received or accrued on sale [paragraph 35(1)]	8 000 000
Less: Section 8(4)(*a*) recoupment [paragraph 35(3)(*a*)]	(4 000 000)
Proceeds	4 000 000

Base cost calculation	
Cost [paragraph 20(1)(*a*)]	10 000 000
Less: Capital allowances [paragraph 20(3)(*a*)(i)]	(6 000 000)
Base cost	4 000 000

Capital gain (proceeds of R4 million less base cost of R4 million) Nil

Tax computation	R	
Net rentals before capital allowances		1 200 000
Recoupment [section 8(4)(*a*)]		4 000 000
Net rental income		**5 200 000**
Less: Capital allowances brought forward	(3 400 000)	
Capital allowances – year 3	(2 000 000)	(5 400 000)
Subtotal		(200 000)
Amount to be carried forward under section 23A(4)		200 000
Taxable income		**Nil**

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 20% (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 [(R20 million × 4) − R52 million]. In year 5 the company derived taxable income of R18 million from letting before capital allowances, recoupments and capital gains.

Result:

	R
Determination of tax value and recoupment*	
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
Consideration	110 000 000
Recoupment [section 8(4)(*a*)]	100 000 000

* Assume full deduction of capital allowances claimed up to disposal for purpose of calculating the recoupment.

Calculation of capital gain or capital loss on disposal	R
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 (80% × R10 million)	8 000 000

Tax computation – year 5	R	R
Rental income		18 000 000
Recoupment		100 000 000
Taxable capital gain		8 000 000
Net rental income		126 000 000
Less: Capital allowances brought forward	(28 000 000)	
Capital allowances – year 3	(20 000 000)	(48 000 000)
Taxable income		**78 000 000**

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 available for set-off against taxable income from all sources and trades in that year of assessment and, to the extent carried forward, to subsequent years of assessment.

On the other hand, a taxpayer will fall within the ring-fencing provisions of section 23A(2) when an assessed loss would, absent the provisions of section 23A, be created by or increased by the specified 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 or increase 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.

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).

	Year 1		**Year 2**		**Year 3**		**Year 4**	
	Rental income	**Other income**	**Rental income**	**Other income**	**Rental income**	**Other income**	**Rental income**	**Other income**
Net income after deductions, but before section 11(*e*), (*o*), 12, 12B, 12C, 12DA, 14bis or 37B(2)(*a*)	(7 000)	3 000	9 000	(2 000)	(2 000)	(1 500)	18 000	1 000

	Year 1		Year 2		Year 3		Year 4	
	Rental income	**Other income**	**Rental income**	**Other income**	**Rental income**	**Other income**	**Rental income**	**Other income**
Specified capital allowances subject to limitation in current year[1]	(1 200)		(9 900)		(5 000)		(6 000)	
Section 23A limitation brought forward	Nil		(1 200)		(2 100)		(7 100)	
Section 23A limitation carried forward[1]	(1 200)		(2 100)[2]		(7 100)[3]		Nil	
Taxable income / (assessed loss) for current year	(7 000)	3 000	-	(2 000)	(2 000)	(1 500)	4 900	1 000
Assessed loss brought forward		-		(4 000)		(6 000)		(9 500)
Assessed loss carried forward		(4 000)		(6 000)		(9 500)		(3 600)[4]

Note: Assessed loss – year 5

1. Capital allowances carried forward owing 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

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 carried forward from the previous year of assessment must be set off against any remaining taxable income. See the similar approach taken by the court in *CIR v Zamoyski*[17] in relation to capital development expenditure in the First Schedule to the Act. Such capital development

[17] 1985 (3) SA 145 (C), 47 SATC 50.

expenditure is first deducted from taxable income from farming operations for that year of assessment before any balance of assessed loss from the previous year of assessment is set off.

5. Record-keeping (section 29 of the Tax Administration Act)

Section 29 of the Tax Administration Act 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.[18] 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

Section 23A limits capital allowances claimed by a lessor under sections 11(*e*) and (*o*), 12B, 12C, 12DA, 14*bis* 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" or any asset mainly used during the year of assessment by the lessor in the ordinary course of trade other than letting of such asset. The exclusion from an affected asset, and therefore section 23A, for assets leased under an operating lease does not apply to letting of assets in carrying on the business of banking, financial services or insurance.

In determining net rental income from letting affected assets, expenditure relating to both rental income and other income must be apportioned on a reasonable basis.

Any specified capital allowances disallowed are carried forward to the succeeding year of assessment when they will again be considered for deduction, subject to limitation under section 23A(2).

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[18] See section 32 of the Tax Administration Act 28 of 2011 for circumstances in which the five-year period is extended.

Annexure – 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 14*bis*, 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, 14*bis* 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.