INTERPRETATION NOTE 105 (Issue 2)

DATE: 29 April 2024

ACT : INCOME TAX ACT 58 OF 1962
SECTION : SECTION 13*bis*
SUBJECT : DEDUCTIONS IN RESPECT OF BUILDINGS USED BY HOTEL KEEPERS

Contents

Preamble

In this Note unless the context indicates otherwise –

- **"annual allowance"** means the annual allowance granted in respect of the cost of erection of hotel buildings or the cost of effecting improvements to such buildings under section 13*bis*(1) at the rate of 2%, 5% or 20% depending on the circumstances;
- **"grading allowance"** means the annual grading allowance on hotel buildings or improvements to such buildings contemplated in section 13*bis*(2), (3) and (4);
- **"section"** means a section of the Act;
- **"the Act"** means the Income Tax Act 58 of 1962; and
- any other word or expression bears the meaning ascribed to it in the Act.

All interpretation notes referred to in this Note are the latest versions, unless indicated otherwise, available on the SARS website at **www.sars.gov.za**.

1. Purpose

This Note provides guidance on the interpretation and application of section 13*bis,* which provides for an allowance on any buildings used in the trade of hotel keeper.[1]

2. Background

Section 13*bis* provides an annual allowance on the cost of erection of buildings or improvements to such buildings used by the taxpayer in the trade of hotel keeper. [2]

The traditional concept of a hotel has changed in recent years. It is therefore necessary to consider the requirements of section 13*bis* as it applies to the modern concept of hotel-keeping.

Different write-off rates apply to buildings erected or improvements effected to buildings used in the trade of hotel keeper during specified legislated periods.

3. The law

Section 13*bis* is replicated in the **Annexure**.

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1 This Note does not deal with the depreciation allowance in section 12C(1)(*d*) or (*e*) applicable to machinery, implements, utensils or articles used by hotel keepers nor the wear-and-tear or depreciation allowance in section 11(*e*) as it applies to hotel keepers.

2 The grading allowance, while theoretically still available in some exceptional circumstances, is unlikely to be currently relevant as the buildings and improvements on which it was calculated are likely to have been fully written off by 2012.

4. Application of the law

4.1 Requirements of section 13*bis*

A taxpayer may deduct an annual allowance from income for years of assessment ending on or after 1 January 1964 if the following requirements are met:

- The taxpayer must incur a cost for the erection of the building or in effecting improvements to the building.
- The taxpayer must comply with the requirements in Table 1 (see below) as to when the erection of the building or the effecting of the improvements was commenced by the taxpayer, when the building was brought into use and how it was used during the year of assessment.

Under section 25BB(4) a company that is a REIT or a controlled company on the last day of the year of assessment may not claim a deduction under section 13*bis*.

Table 1 – Principal requirements of section 13*bis*(1)

Section 13*bis*(1)	**Erection of building by the taxpayer**	**Improvements**	**Additional requirement for buildings and improvements to buildings**
(*c*)	Commencing on or after 1 January 1964 and the building was brought into use no later than 30 June 1965.	• To a building the erection of which by the taxpayer commenced on or after 1 January 1964 and the building was brought into use no later than 30 June 1965; *and* • The improvements commenced no later than 30 June 1965.	During the year of assessment the building was *wholly or mainly* used by the taxpayer, or, if let, by the lessee, in carrying on therein the trade of hotel keeper.
(*d*)	Commencing on or after 1 January 1964 and the building was brought into use after 30 June 1965.	• To a building the erection of which by the taxpayer commenced on or after 1 January 1964, the building was	Applies to the *portion* of a building or improvements used during the year of assessment by the taxpayer or, if let, by the lessee, in carrying on therein

Section 13*bis*(1)	**Erection of building by the taxpayer**	**Improvements**	**Additional requirement for buildings and improvements to buildings**
		brought into use after 30 June 1965 and the improvements commenced on or after 1 January 1964; *or* • To a building the erection of which by the taxpayer commenced on or after 1 January 1964, the building was brought into use no later than 30 June 1965 and the improvements commenced on or after 1 July 1965.	the trade of hotel keeper.
(*e*)	N/A	Commencing on or after 1 January 1964 [other than improvements qualifying under paragraph (*c*) or (*d*), or the now deleted paragraph (*a*) or (*b*)].	Applies to the portion of building improvements used by the taxpayer or, if let, by the lessee, in carrying on therein the trade of hotel keeper.

The taxpayer referred to in section 13*bis* is the person who incurred the cost of erecting the building or effecting the improvements to the building. Unlike other building allowances, section 13*bis* does not require the taxpayer to be the owner of the building or improvements. The owner of a building or the lessee of a building, including a sub-lessee,[3] could qualify for the annual allowance depending on the facts of the case. Thus, a lessee incurring expenditure in effecting leasehold improvements could qualify for the annual allowance, but only to the extent that those improvements do not qualify for a deduction under section 11(*g*).[4]

As noted in Table 1, the requirement that the building be used "wholly or mainly" in carrying on the trade of hotel keeper by the persons indicated in that table, applies only to the older buildings or improvements contemplated in paragraph (*c*). Thus a building used 49% for hotelkeeping would not qualify for any annual allowance under paragraph (*c*), while one used 51% for that purpose would qualify in full (see **4.2.6** on the meaning of "wholly or mainly"). For buildings and improvements contemplated in paragraphs (*d*) and (*e*), the allowance is restricted to the portion of the building or improvements used in carrying on the trade of hotel keeper (see **5.3.1** and **5.3.2**). The taxpayer will need to take into account the implications of capital gains tax when buildings are used for a dual purpose.

Purchased buildings do not qualify for the annual allowance, since it is a requirement that the building must be erected.

4.2 Terms and concepts used in section 13*bis*.

4.2.1 Meaning of "building"

The word "building" is not defined in the Act. Its meaning has, however, been considered in a number of court cases. In *CIR* v *Le Sueur*, a case dealing with a special allowance granted to farmers, the minority judgment held as follows:[5]

> "I think it is correct to say generally that a building is a substantial structure, more or less of a permanent nature, consisting of walls, a roof and the necessary appurtenances thereto. The word "building"...is not used in any technical sense and the question of what appurtenances form part of a building…, is a question of fact which must in my view be determined objectively."

The word "permanent" is defined in the *Merriam-Webster Learner's Dictionary*[6] as –

> "lasting or continuing for a very long time or forever : not temporary or changing".

It is also defined in *the Free Dictionary* as follows:[7]

> "1. Lasting or remaining without essential change
>
> 2. Not expected to change in status, condition, or place."

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3 ITC 1568 (1993) 56 SATC 81 (T) and ITC 1453 (1988) 51 SATC 100 (T).

4 First proviso to section 13*bis*(1).

5 1960 (2) SA 708 (A), 23 SATC 261 at 273.

6 **www.learnersdictionary.com/definition/permanent** [Accessed 29 April 2024].

7 **www.thefreedictionary.com/permanent** [Accessed 29 April 2024].

It is therefore evident that the word "permanent" does not necessarily mean everlasting. In determining whether a building is "of a permanent nature" the following aspects must be considered: the nature of the building, the degree and manner of annexation and the intention of the person annexing it to a particular place.[8]

A building can sometimes be a movable or temporary structure and accordingly not be of a permanent nature. The relevant section must be considered in determining whether it applies to a building of a permanent nature, buildings that are movable or of a temporary nature, or both. If one considers the purpose of section 13*bis* (see **2**) and the purpose of proviso (*ii*) of section 11(*e*),[9] section 13*bis* applies to buildings of a permanent nature only.

Accommodation provided in the form of a tent will not constitute a structure of a permanent nature and will therefore not be classified as a building.

In ITC 1007,[10] a case dealing with an allowance for hotel buildings under the Income Tax Act 31 of 1941, the court refused to accept that a swimming pool, paddling pond and their tiled surrounds were buildings. The court did, however, note that it did not mean that these structures, a swimming pool, for example, could never qualify for the allowance. The court noted that it was possible for a swimming pool to be built into a building in such a way that it was part of the fabric of the building and in such a case it would be considered to be a building or an improvement to it. The example given was that of a pool built into, and in fact a part of, the sun-roof of a block of flats.

The determination of whether accessories, attachments or improvements to a building are part of the building depends on whether the attachment to the building is of a permanent nature and, if so, if the accessory or attachment is structurally integrated or otherwise permanently physically integrated into the building in such a manner that it has lost its own separate identity and character.[11] The assessment of these criteria is dependent upon the facts of each case. Factors to be considered in assessing if the attachment is permanent are, for example, the intention with which the accessory or attachment is attached, the nature of the accessory or attachment and the degree and manner in which it has been attached to the building.[12]

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8 These are the aspects which are considered in assessing whether a moveable asset accedes to immovable property (land) and, if it does, the owner of the immovable property becomes the owner of the previously moveable asset, assuming it was not already owned by such owner. See Van der Merwe, G. G. (2014). "Accession" *27* (Second Edition Volume) *LAWSA* [online] (My LexisNexis: 31 January 2014) in paragraph 184; *Pettersen & Others v Sorvaag* 1955 (3) SA 624 (A); *Macdonald Ltd v Radin NO & the Potchefstroom Dairies & Industries Co. Ltd* 1915 AD 454 and *Newcastle Collieries Co Ltd v Borough of Newcastle* 1916 AD 561 at 564. The issue of ownership through accession is not always the same as the issue whether a building is of a permanent nature, although there is a close overlap. Accordingly, it is submitted that in assessing whether a building is of a permanent nature, or whether a moveable asset has been permanently fixed to a building, the same elements are relevant.

9 Paragraph (ii) of the proviso to section 11(*e*) denies a deduction for buildings or other structures or works of a permanent nature.

10 (1962) 25 SATC 251 (N).

11 *SIR v Charkay Properties (Pty) Ltd* 1976 (4) SA 872 (A), 38 SATC 159; *CIR v Le Sueur* 1960 (2) SA 708 (A), 23 SATC 261 (A) at 275.

12 *Konstanz Properties (Pty) Ltd v WM Spilhaus and Co (WP) Ltd* 1996 (3) SA 273 (A).

In *CIR v Le Sueur*[13] the court considered whether the laying batteries used in poultry farming constituted part of the building. Ramsbottom JA held that –[14]

> "the laying batteries are valuable property… and it is therefore not at all unlikely that the purpose of the buildings is at least partly to protect the laying batteries, which according to the stated case are liable to rust, against the ravages of the weather. If then it can be said, as I think it can reasonably be said on the facts, that the buildings provide shelter not only for the poultry but also for the laying batteries, the latter clearly cannot be said to have lost their separate identity and to have become integral parts of the buildings in which they are housed.
>
> In my view therefore the laying batteries … do not for the purposes of para. 17(1)(*f*) of the Third Schedule to the Income Tax Act, form part and parcel of the buildings in which they are housed…".

In *SIR v Charkay Properties (Pty) Ltd*[15] the court considered whether the demountable partitions that were used in fourteen upper floors of a building, that contained no internal walls and were let as offices, were articles for purposes of the depreciation allowance under section 11(*e)* or constituted part of the building. Trollip JA held as follows:[16]

> "The nature of respondent's demountable partitions and the way in which they were mounted and used in respondent's building during the relevant years of assessment have been fully described above. According to that description they were only lightly, albeit rigidly, attached to the floors and ceilings; they could easily and inexpensively be detached and removed without causing any injury to themselves or the floors or ceilings; they could then be either stored or similarly mounted and attached in some other position to suit the tenants; indeed, their normal use and function was not for them to remain unmoved but to be shifted around; hence their mounting and attachment in a particular position could not be regarded, …, as being permanent; moreover, for the same reasons, it can be said that, while in position, they did not lose their identity or character as movable inner walls. Consequently, I do not think that they were structurally integrated or otherwise physically incorporated into the building permanently in such a way that they lost their own, separate identity and character, or, in the words used by Ramsbottom JA, that they were built into the fabric of respondent's building.
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> … True, the ordinary doors of a building or roof tiles are a part of it, although the doors are only attached by their hinges and the roof tiles by their own weight and both can easily be removed. None the less they are regarded as part of the building because they are structurally integrated or physically incorporated into it permanently; for although they are easily removable, the purpose and intention with which they are built into the building's fabric (and intention here is of importance) is that they should remain in those positions permanently. On the other hand, the demountable partitions are not only easily removable, but, according to their normal use, they are meant to be and are in fact moved about or removed from time to time."

External paving, fencing and landscaping do not form part of a building. Similarly, storm water drains and sewage pipes by their very nature are generally not structurally integrated to the building. Drains or pipes running from the building will be connected to the municipal sewage system but there is no integral or structural connection between storm water drains, sewage pipes, and the building itself. The storm water drains and sewage pipes are not structurally integrated or physically incorporated into

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13 1960 (2) SA 708 (A), 23 SATC 261 (A).

14 *CIR v Le Sueur* 1960 (2) SA 708 (A), 23 SATC 261 (A) at 275.

15 1976 (4) SA 872 (A), 38 SATC 159.

16 At SATC 169.

the building permanently in such a way that they have lost their own separate identity or character. They have not become a part of the fabric of the building. The water drainage systems operate separately to the structure of the building and has a separate function not related to the building structure.

The word "building" does not include the land upon which the structure stands.[17]

4.2.2 Meaning of "cost"

In *SIR* v *Eaton Hall (Pty) Ltd,* which dealt with the cost of a building and improvements to a building for purposes of the annual allowance, Trollip JA, who delivered the judgment of the court, said the following:[18]

> "The crucial words, common to each of these allowances, is therefore 'the cost to the taxpayer of any portion of a building'. (I shall henceforth, for brevity's sake, merely refer to 'any building' as meaning any portion thereof). What does that expression mean? Firstly, it is obvious from the context that 'the cost of any building' means the cost of erecting that building. Secondly, in the absence of any definition in the Act of such cost one must look at its ordinary meaning. The *Oxford English Dictionary* defines 'cost' as meaning: 'That which must be given or surrendered in order to acquire, produce, accomplish, or maintain something; the price paid for a thing.' Hence 'the cost to the taxpayer of the building' ordinarily means the price or consideration given or paid by him for the erection of the building. It does not, therefore, include expenses incurred by the taxpayer in connection with the erection of the building unless, of course, they are part of the price or consideration paid for the erection.
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> Thirdly, as counsel for the Secretary rightly pointed out, the use of the preposition 'of' instead of a phrase with a wider connotation, like 'in respect of', between 'cost' and 'any building', indicates that the connection between them must be direct and close; in other words, the expression comprehends the cost of erecting the building and nothing more. Fourthly, as a counsel for the Secretary again rightly contended, that limited connotation is also manifested by the use of the physical, identifiable, concrete object of 'any building' or 'any improvements' instead of the abstract, gerundive concept of 'building' or 'improving' a structure. Thus, 'the cost of building or improving' something is not as well delineated as 'the cost of any building or improvements'. The former might well cover certain expenses incurred incidentally in building or improving a structure, whereas under the latter the cost is delimited by the very physical nature of the building or improvements.
>
> All those considerations point in one direction, namely, that the ordinary, grammatical meaning of the words 'the cost to the taxpayer of any building' in those provisions is that such cost is limited to the price or consideration given or paid by the taxpayer for the erection of the building. Hence there is no need to invoke the aid of any of the other canons of construction or the authorities canvassed in the arguments of counsel for the parties to ascertain its true meaning.
>
> It follows that the interest paid by respondent on moneys borrowed to finance the cost of the new wing of its building is not covered by s 13*bis*(1)(*d*) or the other provisions granting the relevant allowances. It does not constitute part of the price or consideration given or paid by respondent for the erection of the new wing."

The cost of erecting a building and effecting improvements to it for purposes of section 13*bis* is therefore the actual cost incurred in erecting the building or in effecting the improvements and includes, for example, the cost of materials and labour, and service fees for architects, quantity surveyors and engineers. It does not include

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17 ITC 1619 (1996) 59 SATC 309 (C) at 314.

18 1975 (4) SA 953 (A), 37 SATC 343 at 347 – 348.

additional costs such as interest incurred on any debt used to fund the cost of erecting a building or effecting improvements to it. The cost incurred in acquiring the land on which the building is to be erected, together with the cost of preparing the land for erection of the building (demolition, levelling, excavation and similar costs) does not form part of the cost of the building under section 13*bis*.

A reasonable apportionment must be done between the cost of the building and the cost of the land if there is a single cost for land and building. The relative value of the land and the building is generally an appropriate method for apportioning a single cost between the land and the building. However, if a taxpayer's specific circumstances indicate that an alternative method of apportionment is more appropriate than a value-based one, the onus would be on the taxpayer to justify such alternative method. The appropriateness of the method applied is assessed on a case-by-case basis. Depending on the facts, if a value-based apportionment method is used, the use of specialised property valuation experts may be necessary in the determination of the value of the land in relation to the building erected on it. Municipal valuations can also potentially be used but there may be reasons why in a particular case they are not appropriate. For example, a municipal valuation may not provide the necessary distinction between the land and the building, especially when there are improvements or they may be outdated.

If the taxpayer is a vendor for VAT purposes and is entitled to a deduction of input tax under section 16(3) of the Value-Added Tax Act 89 of 1991, the amount of such input tax is excluded from "cost".[19]

In contrast to section 11(*e*), section 13*bis* uses the word "cost" rather than "value". Consequently, when a building or improvement is used in the trade of hotel keeper, without the taxpayer incurring any cost, no allowance will be granted.

4.2.3 "Erection of which was commenced by the taxpayer"

In ITC 1137[20] it was held that the determination of the date when the erection of a building commenced was to be taken as the date when the laying of the foundation commenced and not when the excavations for the foundation started. After examining various dictionary definitions, Van Winsen J concluded as follows:[21]

> "The underlying concept in all these definitions is the raising up of whatever is being erected. While the digging of trenches to take foundations is a necessary preliminary to the raising of the foundations themselves, I do not think that it could be said to be the commencement of the erection of the building which is to stand in those trenches. Excavation is preparatory to, but not part of, the process of erection."

Under section 102 of the Tax Administration Act 28 of 2011 the onus rests upon the taxpayer to prove the date on which the laying of foundations commenced.

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19 Section 23C(1).

20 (1969) 32 SATC 1(C).

21 At SATC 2.

4.2.4 Trade of a hotel keeper

In order for a taxpayer to qualify for the annual allowance, the taxpayer or the lessee must carry on the trade of hotelkeeping (see **4.1**).

Hotel keeper

The term "hotel keeper" is defined in section 1(1) to mean –

> "any person carrying on the business of hotel keeper or boarding or lodging house keeper where meals and sleeping accommodation are supplied to others for money or its equivalent".

Therefore, to constitute hotelkeeping, the taxpayer or the lessee[22] must –

- carry on the business of hotel keeper, boarding house keeper or lodging house keeper; and
- supply meals and accommodation to the patrons for consideration at the hotel, boarding house or lodging house concerned.

The business of a hotel keeper, boarding house keeper or lodging house keeper in its ordinary sense primarily involves the provision of accommodation, with or without food,[23] while the definition of "hotel keeper" goes further and makes the supply of meals compulsory. Whether a taxpayer is conducting a business of this nature must be determined on a case-by-case basis. For example, a taxpayer providing family and friends with accommodation and meals in the taxpayer's house on an *ad hoc* basis when they are visiting at no charge or a nominal cost would not be conducting a business of hotelkeeping. Another example, which would not constitute the business of hotelkeeping, is that of a construction company which temporarily provides accommodation and meals to its employees at cost for the duration of a particular building project. The provision of the meals and accommodation in this example is incidental to and part of its trade of construction. The construction company is not in the business of providing accommodation for consideration. Factors which may be relevant in determining whether a taxpayer is conducting a business of hotelkeeping include –

- size and location of the building;
- capital expenditure and turnover;
- real prospect of profit;
- an indication that the taxpayer dedicates a significant amount of time towards the goal of trading as a hotel keeper;
- whether the trade is carried on in a commercial manner, for example, adequate staffing and advertising;
- continuity of activities throughout the year and from one year to the next;
- absence of unwarranted interruptions of trade during the year of assessment which result in the building or improvements not being used for the purpose of providing accommodation to others in exchange for money.

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22 Depending on the facts of the case, the lessee could be the relevant taxpayer.

23 **www.dictionary.com/browse/lodging-house**; **www.dictionary.com/browse/board**; **www.dictionary.com/browse/hotel**; **www.dictionary.com/browse/boardinghouse.** [Accessed 29 April 2024].

Both meals **and** sleeping accommodation must be provided by the hotel keeper in the same premises. The hotel keeper need not necessarily prepare the meals but must supply them and derive consideration for such supply. For example, a hotel keeper could make use of an external caterer to supply the meals, pay the caterer and then bill the patrons for the meals. A taxpayer who lets a portion of the hotel premises to a third party for the purpose of operating a restaurant or fast-food outlet does not derive consideration for the supply of meals but rather derives rental income. While there is nothing to prevent a taxpayer from letting a portion of the premises in this way, such letting will not qualify the taxpayer as a hotel keeper. To qualify as a hotel keeper, it is necessary for the taxpayer to supply at least some meals, for example, breakfast.

The Act does not specify where the food must be prepared, how many meals must be provided, that patrons must consume the meals or that the food must be provided to patrons only. The food can therefore be prepared onsite or offsite provided it is made available to patrons of the hotel, boarding house or lodging house by the hotel keeper in the hotel, boarding house or lodging house. The meals must be available as an option to the patrons but it is not compulsory that the patrons take up this service and the meals can also be made available to people who are not staying at the establishment.

A situation in which patrons can telephonically order their meals from an external restaurant or fast-food outlet, have them delivered to the hotel and charged to their room number is considered to be a billing service and not the supply of meals by a hotel keeper.

A bed-and-breakfast establishment can qualify as a hotel because accommodation and a meal are provided.

A taxpayer operating a hotel, boarding house, or lodging house at which sleeping accommodation is offered without the provision of meals will not qualify as a hotel keeper.

Trade of hotel-keeping

As noted above, the taxpayer or the lessee must carry on the trade of hotel-keeping.

Trade is defined in section 1(1) and includes every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and the use of or the grant of permission to use any patent, design, trade mark, copyright or any other similar property. In ITC 770[24] it was held that this definition of trade should be widely construed and is obviously intended to embrace every profitable activity.

The test to be applied in determining whether a trade is being carried on is an objective test and if objective factors indicate that the taxpayer is trading, the trade requirement is satisfied. A taxpayer who meets the definition of “hotel keeper” must, amongst other requirements, be conducting the business of a hotel, boarding house or lodging house and will therefore be conducting a trade.

If the taxpayer did not derive any income in a particular year of assessment, it does not automatically mean that the taxpayer did not conduct a business or a trade in that year of assessment or that it did not trade for the purpose of earning income. In

[24] (1953) 19 SATC 216 (T).

ITC 777[25] the court held that a company that had unsuccessfully attempted to let its property did carry on a trade. If no income is earned, the question arises whether there is an intention to trade or to earn income with the result that more evidence may be required.

4.2.5 Meaning of "improvement"

Section 13*bis* does not define what constitutes an "improvement". The ordinary dictionary meaning of the word must therefore be considered. *The Shorter Oxford English Dictionary on Historical Principles* contains various meanings for the word but the following one is appropriate in the circumstances:[26]

> "6 An act of making or becoming better; an addition or alteration which increases the quality or value of something."

To constitute an improvement to a building, a number of court cases have held that the "extension, addition or improvements" must be "physically attached to" or "connected or integrated" with the building. In *African Detinning Works (Pty) Ltd v SIR*,[27] some years after a factory building was erected, concrete aprons were added around the building. The aprons were held not to form part of the building, since they were separate structures and not physically attached to the building and accordingly did not qualify as an improvement.

In determining whether an improvement to a building has been effected, the facts of each case must be considered.

Improvements must be distinguished from repairs.[28]

A taxpayer may decide to convert an existing building into a hotel. This situation allows a taxpayer to commence trading as a hotel keeper within a much shorter period in comparison to erecting a new building. In these circumstances, the taxpayer would not be entitled to the annual allowance on the purchase price of the building, since purchased buildings do not qualify, but the taxpayer may be entitled to an allowance provided the renovations constitute an improvement. Reference must be made to the facts of each case in determining whether something constitutes an improvement. A renovation project of this nature will often result in a building being wholly transformed for the use of hotelkeeping and will constitute an improvement, not a repair. The cost incurred in improving the building could exceed the cost of acquiring the building. The date on which an improvement is completed is important, because different rates apply to different years (see **5.2**).

4.2.6 Meaning of "wholly or mainly used" for a qualifying purpose

The phrase "wholly or mainly" used in section 13*bis*(1)(*c*) is not defined in the Act. The word "wholly" is, however, regarded as referring to 100% of an asset's usage, while "mainly" refers to the most part[29] or more than 50%[30] of an asset's usage for the qualifying purpose. In section 13*bis*(1)(*c*) the qualifying purpose is that the building

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25 (1953) 19 SATC 320 (T).

26 Stevenson, A. (2007). 6 ed, Oxford University Press.

27 1982 (1) SA 797 (A), 44 SATC 1.

28 See Interpretation Note 74 "Deduction and Recoupment of Expenditure Incurred on Repairs" for the distinction between repairs and improvements.

29 *Glen Anil Development Corporation Ltd v SIR* 1975 (4) SA 715(A), 37 SATC 319.

30 *SBI* v *Lourens Erasmus (Edms) Bpk* 1966 (4) SA 434(A), 28 SATC 233.

must be *wholly or mainly* used by the taxpayer, or if let, by the lessee, in carrying on the trade of hotel keeper.

The determination of whether a building is wholly or mainly used for a particular purpose is a question of fact. It is unnecessary that the building is used *wholly* for the required purpose, as long as the building is used *mainly* for that purpose.

In *Glen Anil Development Corporation Ltd v SIR* Botha JA stated the following:[31]

> "Section 103(2) uses the words 'solely or mainly for the purpose . . . ' In the *Oxford English Dictionary* 'mainly' is defined to mean 'for the most part; in the main; as the chief thing, chiefly, principally'. The word 'hoofsaaklik' is used in the Afrikaans text. … the onus was on the appellant to show that the transactions in question were not entered into solely or mainly for the purpose of utilizing the assessed loss or balance of assessed loss … That onus would be discharged if the appellant satisfied the court that the avoidance … was not a more important consideration in the mind of Dr Rubenstein (acting on the advice of his auditors) than the avoidance of estate duty and undistributed profits tax."

In *SBI v Lourens Erasmus (Edms) Bpk*[32] 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 practice, if more than 50% of a building, measured by floor space or volume, is used during the year of assessment for a qualifying purpose, the "wholly or mainly" requirement will be met. Depending on the facts of the particular case, it is possible that there may be circumstances in which an alternative method is more appropriate than floor space or volume.

5. The annual allowance

5.1 Determination of the annual allowance

The annual allowance is calculated at a specified rate a year (see **5.2**) of the cost (after set-off of the amounts referred to in **9** and after adjusting for the portion of cost a lessee might be entitled to under section 11(*g*) as referred to in **8.1**) to the taxpayer of the building erected by the taxpayer or the improvement to the building effected by the taxpayer. In order to claim the allowance, a taxpayer must meet all the requirements in **4.1**.

The annual allowance is not apportioned and will be allowed in full if the building or improvement is used as required (see **4.1**) for part of a year of assessment. Thus, the full annual allowance would be allowed when, during a year of assessment, the building or improvement is –

- brought into use;
- disposed of; or
- used for only part of such year in a manner that meets the requirements of section 13*bis*.

The annual allowance is unavailable on purchased buildings although improvements to such buildings can qualify if all the requirements of section 13*bis* are met.

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31 1975 (4) SA 715 (A), 37 SATC 319 at 325.

32 1966 (4) SA 434 (A), 28 SATC 233 at 245.

The aggregate of all deductions which may be allowed or deemed to have been allowed under section 13*bis* or any other section in respect of the cost to the taxpayer of the building or improvement may not exceed that cost.[33] The limitation includes, for example, those allowances deemed to have been allowed for years of assessment when the accruals and receipts of the taxpayer were not included in the taxpayer's income (see Example **5**).

Example 1 – Taxpayer erecting a hotel building

Facts:

N's year of assessment ends on 28 February.

N commenced the erection of a building in 2021 and upon completion, brought it into use on 23 May 2023. The building is used by N as a hotel to provide meals and accommodation to patrons of the hotel for consideration. N does not prepare the meals in the hotel building but sources them from an external restaurant. The cost of erecting the building was R3 million.

Result:

N is entitled to an annual allowance of 5% a year on the cost of the building because –

- the building was erected, not purchased, and brought into use after 4 June 1988 (see **4.1** for the date requirements and see **5.2** for applicable rates); and
- it is used by N to provide meals and accommodation to patrons for consideration, which constitutes the trade of hotel keeper.

N is entitled to the full 5% allowance in the year of assessment in which the building was brought into use in the trade of hotel keeper because the allowance is not subject to apportionment for a period of use of less than 12 months.

5.2 Rates at which the annual allowance is calculated

Table 2 – Rates [preamble and the second and third provisos to section 13*bis*(1)]

Section 13*bis(1)*	**Applies to**	**Rate**
Opening words	Buildings the erection of which commenced before 4 June 1988 and any improvements to such buildings commenced before that date.	2%
Second proviso	Buildings the erection of which commenced on or after 4 June 1988 and any improvements[34] commenced on or after that date.	5%
Third proviso	Portion of improvements commenced on or after 17 March 1993 to the extent that they do not extend the existing exterior framework of the building.	20%

[33] Section 13*bis*(5).

[34] Unless the improvement falls within the requirements of the third proviso.

In order to qualify for the 20% accelerated rate referred to in Table 2 above, the improvements must be confined within the existing exterior structure of the building. Additional floors which increase the height of the building may, for example, not be added nor may the width of the building be increased.

Improvements extending the exterior framework of the building will not qualify for the 20% accelerated rate, but may qualify for the annual allowance at the reduced rate of 2% or 5% depending on the date on which erection of the building or effecting of the improvements commenced.

Example 2 – Improvements effected to hotel buildings

Facts:

K (Pty) Ltd purchased an office building for R8 million. The building was converted for the use of hotelkeeping by undertaking extensive improvements. The cost of the improvements was R15 million and they were completed on 13 April 2023. The nature of the improvements was such that the entire interior of the building was converted to enhance its aesthetic appearance and improve its functionality, while its existing exterior framework remained unaltered. The company's year of assessment ends on 31 December.

Result:

K (Pty) Ltd will not be entitled to an annual allowance on the cost of the building (R8 million) under section 13*bis*, since it was purchased and not erected.

The annual allowance may be claimed at a rate of 20% a year on the cost of the improvements of R15 million because they were effected after 17 March 1993 and although extensive, they do not extend the existing exterior framework of the building. The improvements therefore fulfil the requirements of section 13*bis*(1)(*e*) (see **4.1**) read with the third proviso to the subsection (see Table 2 above). Although the improvements were brought into use during the year of assessment, the allowance is not pro-rated.

5.3 Buildings used for a dual purpose

5.3.1 Apportionment of the annual allowance when the building is used for hotelkeeping and another trade

Section 13*bis*(1)(*c*) deals with a building or improvement that is wholly or mainly (see **4.1** and **4.2.6**) used in the trade of hotel keeper. Provided the building is wholly or mainly used for that purpose, the annual allowance is calculated on the full cost of erecting the building or of effecting improvements to the building (after set-off of the amounts in **9**) and no apportionment is required for the portion of the building not used for that purpose.

Section 13*bis*(1)(*d*) deals with the use of only a portion of a building for hotelkeeping (see **4.1**). This situation would occur when, for example, a single floor of a multiple-storey building is used for purposes of hotelkeeping, while the other floors are used for other purposes such as offices or shops. In such event the annual allowance is available only on the portion of the building used for hotelkeeping. Accordingly, in calculating the annual allowance, the cost of erecting or improving the building must be apportioned between the part of the building used for hotelkeeping and the part used for other purposes, and the allowance would be based on the former.

Similar to section 13*bis*(1)(*d*), section 13*bis*(1)(*e*) applies to the portion of specified building improvements (see **4.1**) used for hotelkeeping. The cost of the improvements must be apportioned, with the annual allowance applying only to the portion of the improvements used for hotelkeeping. Some of the main differences between paragraphs (*d*) and (*e*) in relation to improvements, are that paragraph (*e*) applies to improvements to a building erected before 1 January 1964[35] and improvements to a purchased building, while section 13*bis*(1)(*d*) applies to improvements to a building the erection of which commenced on or after 1 January 1964.

Example 3 – Apportionment of the annual allowance when only a portion of the building is used for hotelkeeping

Facts:

Trust Z erected a building at a cost of R200 million. The erection of the building started on 1 January 2022 and it was brought into use during the 2023 year of assessment. Trust Z lets the building to different lessees who conduct independent trades in the respective hired spaces in the building. Only lessee B conducts the trade of hotel keeper. B uses 40% of the floor area of the building while the other lessees conducting non-hotelkeeping trades use the remaining 60%.

Result:

Trust Z is entitled to an annual allowance under section 13*bis*(1)(*d*) (see **4.1**) only on the portion of the building used by B.

The apportionment calculation is as follows:

	R
Cost of building	200 000 000
Less: Portion of building used for non-hotelkeeping (60% × cost)	(120 000 000)
Cost qualifying for the annual allowance	80 000 000

An annual allowance of R4 million (5% × R80 million) may therefore be claimed by Trust Z.

5.3.2 Apportionment of the annual allowance when the building is used for hotelkeeping and for domestic purposes

Taxpayers operating bed-and-breakfast establishments often provide boarding and lodging services from their private dwellings, meaning that such dwellings would be used for both trade and domestic purposes. In these circumstances, section 13*bis*(1)(*d*) and (*e*) read with section 23(*b*) require an apportionment of the annual allowance to be made between the portion of the building used to conduct the trade of hotelkeeping and the portion used for domestic purposes.

Section 13*bis* does not prescribe a method for apportioning the annual allowance. It is a factual inquiry and a taxpayer must justify the reasonableness of the apportionment. Generally, in calculating the annual allowance, the cost of a building can be apportioned by analysing and applying floor area according to its use. The portion of

[35] The improvement to the building, as opposed to the building itself, must have commenced on or after 1 January 1964.

the cost qualifying for the annual allowance is thus determined by multiplying the cost of the building by the qualifying floor area and dividing it by the total floor area.

When a taxpayer changes the use of a building from a private dwelling to that of hotelkeeping, "cost" for purposes of the annual allowance is the original cost incurred by the taxpayer in erecting the private dwelling. The value of the building on the date of change in use is irrelevant for purposes of calculating the annual allowance.

Example 4 – Apportionment of the annual allowance when part of a building is used for domestic purposes

Facts:

V operates a bed-and-breakfast establishment for consideration from V's private residence. V uses 60% of the floor area of the private residence for the provision of the bed-and-breakfast services. The remainder of the floor area of the private residence is used by V as a private dwelling. The house was erected by V at a cost of R900 000 in 1994. No improvements have been made to the dwelling. The market value of V's house on 1 January 2023 when V commenced providing bed-and-breakfast services was R5 million.

Result:

V is conducting the trade of hotel keeper, since the provision of bed-and-breakfast accommodation falls within the definition of "hotel keeper". The annual allowance may be claimed only on the portion of the private residence used for the purposes of the trade of hotel keeper. Any portion of the floor area used for private or domestic purposes is disregarded when determining the annual allowance. Section 13*bis*(1) requires the annual allowance to be calculated on the cost of erecting the building or the cost of effecting any improvements to the building. The original cost of the private residence to V of R900 000 must be used when determining the annual allowance. Since the building was erected on or after 4 June 1988, V is entitled to an annual allowance of 5% of the cost of R900 000, limited to the portion of the building used for hotelkeeping. V will therefore be entitled to an annual allowance of 5% × R900 000 × 60% = R27 000 commencing with the 2023 year of assessment under section 13*bis*(1)(*d*).

6. The grading allowance

For buildings and improvements which commenced on or after 1 January 1964[36] but before 4 June 1988,[37] section 13*bis*(2) and (4) provide that an additional allowance, colloquially known as the grading allowance, is available on buildings and improvements which qualified for the annual allowance under section 13*bis*(1). This allowance is therefore not available to new buildings or improvements.

The grading allowance is unlikely to be of relevance during years following approximately 2012 because it does not apply to the erection of a building commencing on or after 4 June 1988 or improvements commencing on or after that date.

[36] The grading allowance applies to buildings and improvements contemplated in section 13*bis*(1)(*c*) to (*e*). The erection of a building or the commencement of the improvements contemplated in these paragraphs had to be commenced on or after 1 January 1964.

[37] Section 13*bis*(9) provides that the grading allowance does not apply to any building the erection of which commenced on or after 4 June 1988 nor to any improvements effected on or after that date.

Accordingly, any buildings or improvements are by now likely to have been fully written off. For example, the lowest grading allowance of 2%, which applies to a one-star hotel (see below), would have resulted in a combined write-off of 4% (2% annual allowance plus 2% grading allowance), that is, a 25-year write-off. An improvement completed in a 1988 year of assessment to a one star hotel would therefore have been written off over 25 years, which would have ended in the 2012 year of assessment. It is, however, possible that a building or improvement which commenced before 4 June 1988 could have lost its rating and regained it later, at which point the hotel keeper could have resumed claiming the grading allowance but such situations are likely to be limited.

The rate of the grading allowance was fixed by the Minister of Finance up to a maximum of 8% a year on the "adjusted cost" of –

- any building erected or improvements effected to a building qualifying for an annual allowance under section 13*bis*(1)(*c*); or
- the relevant portion of the building or improvements qualifying for an annual allowance under section 13*bis*(1)(*d*) or (*e*).

The grading allowance was restricted to those hotels which were registered as a hotel under the now repealed Hotels Act 70 of 1965 during the year of assessment in which the allowance was claimed and graded by the board established under that Act on the last day of that year of assessment.

Section 13*bis*(3) contains a redundant proviso which provided for a one-year catch-up grading allowance on buildings and improvements completed by 31 December 1969. This additional allowance was granted because of delays in obtaining registration under the Hotels Act. Registration had to be completed by 31 December 1969 or within 12 months of completion, which meant that 31 December 1970 was the latest date by which registration was possible.

Adjusted cost refers to the cost to the taxpayer, reduced by any recoupment contemplated in section 13*bis*(6) and any portion of cost in respect of which the taxpayer qualified for a section 11(*g*) allowance (leasehold improvements).

The aggregate of the annual allowance and the grading allowance may not exceed the cost of the building and any improvements.[38]

The Hotels Act was repealed by the Tourism Act 72 of 1993 on 1 September 1993. In these circumstances section 12(1) of the Interpretation Act 33 of 1957 applied in respect of buildings and improvements on which the grading allowance was still being claimed on or after 1 September 1993. It provides as follows:

> "Where a law repeals and re-enacts with or without modifications, any provision of a former law, references in any other law to the provision so repealed shall, unless the contrary intention appears, be construed as references to the provision so re-enacted."

References in section 13*bis* to the Hotels Act must therefore be taken as references to the Tourism Act[39] for years of assessment following the repeal of the Hotels Act. Accordingly, the hotelkeeping business must be graded as required under the Tourism Act.

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38 Section 13*bis*(5).

39 The Tourism Act, 1993 was repealed by the Tourism Act 3 of 2014.

The regulations[40] setting out the rate of the grading allowance define the "first year of assessment" as the year of assessment in which the building is brought into use for the purposes of carrying on therein the trade of hotel keeper or the year of assessment in which improvements to a hotel building are completed. According to the regulations, the rate of the grading allowance in any year of assessment ended or ending on or after 28 February 1981[41] is as follows:

When that year of assessment is the first year of assessment or any of the nine years of assessment immediately succeeding the first year of assessment:

1-star	2%
2-star	3%
3-star	5%
4-star	6%
5-star	8%

When the year of assessment is a year of assessment following the ten years of assessment referred to above, the grading allowance is as follows:

1-star	2%
2-star	3%
3-star	3%
4-star	3%
5-star	–

7. Annual allowance when the taxpayer previously operated a tax-exempt trade

Section 13*bis*(3A) applies when the annual allowance or grading allowance is claimed and the building was used by the taxpayer in a previous year or years of assessment for carrying on any trade the receipts and accruals of which were not included in the taxpayer's income. For example, the taxpayer may have carried on a trade in a building outside South Africa before the introduction of the residence basis of taxation with the result that the non-South African source income was not included in the taxpayer's gross income.

Under these circumstances any deduction which could have been allowed during such previous year or years under section 13*bis* is for the purposes of section 13*bis* deemed to have been allowed during such previous year or years as if the receipts and accruals of such trade had been included in the taxpayer's income.

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40 Proclamation R535 of 21 April 1967 as amended by GNR 1071 *GG* 7593 of 22 May 1981 (the regulations).

41 Different rates applied for years of assessment ending on or before 29 February 1980 – see the regulations for details.

Example 5 – Building used to carry on non-taxable trade

Facts:

X erected a hotel building in Foreign Country Z at a cost of R100 million and brought it into use on 30 September 1998. For the three years of assessment ended 28 February 1999, 2000 and 2001, the receipts and accruals from the hotel were not included in X's gross income, since they were from a non-South African source. With the introduction of the residence basis of taxation with effect from years of assessment commencing on or after 1 March 2001, X included the receipts and accruals from the hotel in gross income and claimed the annual allowance.

Result:

X will be entitled to claim the annual allowance of R100 million × 5% = R5 million for 17 years of assessment, with the last allowance being claimed during the 2018 year of assessment. Under section 13*bis*(3A) X is deemed to have been granted the allowance during the 1999, 2000 and 2001 years of assessment for the purposes of determining the annual allowance and under section 13*bis*(5) the allowances available may not in aggregate exceed cost.

If X disposes of the hotel building in future, any recoupment under section 8(4)(*a*) will be limited to the actual allowances claimed of R5 million × 17 = R85 million.

8. Section 13*bis* and section 11(*g*)

Section 11(*g*) grants a deduction to a lessee who makes obligatory leasehold improvements to land or buildings used or occupied for the production of income or from which income is derived.[42] Under the first proviso to section 13*bis*(1), a taxpayer claiming an allowance on buildings[43] or improvements in the current or any previous year of assessment under section 11(*g*) is not permitted to also claim an annual allowance under section 13*bis*(1) on such portion of the cost of those buildings or improvements. The lessee would, however, be permitted to claim an annual allowance for voluntary improvements on the portion of the cost which does not qualify for a deduction under section 11(*g*).

Example 6 – Disqualification of obligatory expenditure allowable under section 11(*g*)

Facts:

X, a company with a financial year ending on 30 June, hired land from Y. Under the agreement of lease X was obliged to erect a hotel building to the value of R60 million. X commenced the erection of the building on 31 May 2022 and brought it into use on 1 July 2023. The building cost X R80 million. The remaining lease period on 1 July 2023 was 15 years.

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42 For consideration of section 11(*g*) see Interpretation Note 110 "Leasehold Improvements".

43 The erection of the buildings must have commenced on or after 1 July 1961.

Result:

X is entitled to an allowance under section 11(*g*) on the obligatory leasehold improvements of R60 million / 15 years = R4 million a year. Under the first proviso to section 13*bis*(1), X is not entitled to the annual allowance on the portion of the cost qualifying for deduction under section 11(*g*). X will, however, be entitled to an annual allowance on the non-obligatory portion of the cost of (R80 million – R60 million) × 5% = R1 million a year.

9. Recoupment

Section 8(4)(*a*) provides for the inclusion in income of the recovery or recoupment of, amongst others, the annual and grading allowances under section 13*bis.* The taxpayer may refrain from including the recovery or recoupment of these allowances in income if the taxpayer elects to apply section 13*bis*(6).

Section 13*bis*(6) potentially applies when –

- allowances have been claimed under section 13*bis*, section 13(1) or under the corresponding provisions of any previous Income Tax Act in respect of any building or any improvements (including any portion of such building or improvements); and
- those allowances have been recovered or recouped and that recovery or recoupment falls to be included in the taxpayer's income under section 8(4)(*a*).

Under these circumstances the taxpayer may elect to set off the recovery or recoupment against the cost of any building erected by the taxpayer which qualifies or will qualify for an allowance under section 13*bis,* referred to as the "replacement building", instead of applying section 8(4)(*a*) provided the requirements considered below are met.

The reference to section 13(1) accounts for the situation in which a taxpayer claimed allowances under that section on a building used in a process of manufacture and then converted the building to a hotel and claimed allowances under section 13*bis*. The allowances under section 13*bis* and section 13 would potentially be subject to recoupment under section 8(4)(*a*) on disposal of the hotel building.

The replacement building must be erected within 12 months of the event giving rise to the recovery or recoupment or within such further period as the Commissioner may allow. The cost of the replacement building must first be reduced by any portion of the cost in respect of which an allowance was granted under section 11(*g*), whether in the current or any previous year of assessment.

The use of the words "erects within" in section 13*bis*(6)(*a*) instead of "commences with the erection within" means that erection of the replacement building must be completed within the 12 month-period or such other period as the Commissioner may allow.

The amounts to be recouped are set off against the cost of erecting the replacement building after taking into account any allowances arising under section 11(*g*) in respect of the replacement building. To the extent that the recovery or recoupment exceeds the amount available for set-off after deducting the portion of cost in respect of which section 11(*g*) allowances were granted from the cost of erecting the replacement building, the excess is included in the taxpayer's income under section 8(4)(*a*). Any

excess amount is included in income in the year of assessment during which the replacement building is completed.

Section 13*bis*(6)(*b*) deals with the situation in which a building was used by a taxpayer for manufacturing purposes and annual allowances were claimed under section 13(1). The building was then disposed of and replaced with another building used in a process of manufacture and the taxpayer elected to reduce the cost of the replacement building under section 13(3) [the equivalent of section 13*bis*(6)] instead of suffering a recoupment under section 8(4)(*a*). Later, the building was converted to a hotel and allowances were claimed under section 13*bis*. Section 13*bis*(6)(*b*) provides that any allowances under section 13*bis* must be calculated on the reduced cost, that is, after the reduction under section 13(3).

A taxpayer seeking an extension to the 12-month period in which to erect the replacement building must apply to the Commissioner and provide the following in support of the application:

- Reasons for the delay
- Extent to which the building has been completed
- Architect's projection of how much more time is required to complete the erection of the replacement building
- A description of the size and design of the replacement building
- Any other information relevant to substantiating the request.

Example 7 – Deferral of recoupment

Facts:

B&B (Pty) Ltd (B&B) carries on the business of hotel keeper and has a financial year ending on the last day of February.

On 28 February 2021 B&B sold its hotel building on which it had claimed annual allowances of R10 million. These allowances were subject to potential recoupment under section 8(4)(*a*). B&B commenced the erection of a replacement building to be used in the trade of hotelkeeping at an estimated cost of R50 million.

For the 2021 year of assessment B&B elected to apply section 13*bis*(6)(*a*).

It was initially expected that the building would be completed by 28 February 2022, but owing to a shortage of building materials extensive delays were experienced. Consequently, B&B did not expect to complete the building by 28 February 2022. B&B was required to apply to SARS for an extension of time in which to complete the erection of the building because it was unable to complete the building within the 12-month period stipulated in section 13*bis*(6)(*a*). B&B applied to its local SARS branch for an extension to 31 December 2023 in which to complete the erection of the building, which was duly granted.

The building was completed on 30 November 2023 at a cost of R55 million.

Result:

Section 8(4)(a) – recoupment

In the absence of an election under section 13*bis*(6)(*a*), the capital allowances previously granted to B&B under section 13*bis*(1) would be recouped and included in its income under section 8(4)(*a*) in the 2021 year of assessment, which was when the building was sold.

Section 13bis(6)(a)

The effect of the election by B&B to apply section 13*bis*(6)(*a*) is to exclude the recoupment, which would have occurred in the 2021 year of assessment, from income. The recoupment is instead set off against the cost of the replacement building in the 2023 year of assessment.

Adjusted cost of the replacement building

The adjusted cost of the replacement building is as follows:

	R
Expenditure actually incurred in erecting the replacement building	55 000 000
Less: Recoupment of annual allowances under section 8(4)(*a*)	(10 000 000)
Adjusted cost of replacement building	45 000 000

The annual allowance will therefore be calculated on the adjusted cost of the replacement building of R45 million.

10. Effect of corporate restructuring rules (sections 41 to 47)

Section 45 potentially provides corporate roll-over relief for the transfer of assets between companies forming part of the same group of companies. In order to qualify for the roll-over relief the transaction must meet the requirements of the definition of "intra-group transaction" in section 41(1) and the other requirements of section 45.

Briefly, if roll-over relief applies and the transferor company disposes of a capital asset (for example, a building owned by the transferor company) which the transferee company acquires as a capital asset, the transferor company is, amongst other aspects, deemed to have disposed of that capital asset at base cost.

In addition, section 45(3) applies to a capital asset which constitutes an "allowance asset" as defined in section 45(1). A building in respect of which a deduction was allowable under section 13*bis* is an allowance asset. Section 45(3) provides, amongst other things, that if a transferor company transfers an allowance asset and the transferee company acquires it as an allowance asset –

- no allowance allowed to the transferor company for that asset will be recovered, recouped or included in the transferor company's income in the year of the transfer; and
- the transferor company and the transferee company are deemed to be one and the same person for purposes of determining the amount of any allowance to which the transferee company may be entitled and which may be recovered, recouped or included in the transferee company's income in respect of that asset.

The effect of the last bullet point is that the transferee company is treated as having met the requirement of erecting the building or effecting improvements actually erected or effected by the transferor company. In addition, if the transferee company continues to meet the requirements of section 13*bis*, future allowances claimable by the transferee company in respect of costs incurred by the transferor company will be limited to the remaining deduction under section 13*bis* to which the transferor company would have been entitled had it retained ownership and continued to use the asset as required under section 13*bis*.

If the transferor company meets the requirements for claiming the allowance in a particular year of assessment before transfer occurs, the transferor company and not the transferee company will claim the full allowance for that year of assessment even if the transferee company also met the requirements. The transferee company cannot claim the allowance for the same period, since the two companies are deemed to be one and the same person for purposes of determining the allowance. This principle applies irrespective of whether the transferee has the same or a different year of assessment.

The total of the deductions allowed or deemed to have been allowed under section 13*bis* and any other section for the transferor company and the transferee company on the building and any improvements transferred under section 45 may not exceed cost as initially determined under section 13*bis* for the transferor company. Costs incurred on improvements effected by the transferee company subsequent to the transfer may qualify for an allowance if the requirements of section 13*bis* are met.

The amount of any deduction claimed by the transferor company is potentially subject to recoupment in the transferee company even though it did not actually claim the deductions before the intra-group transaction. In addition, the amount of any deduction claimed by the transferee company is potentially subject to recoupment in the transferee company.

Section 42 (asset-for-share transactions), section 44 (amalgamation transactions) and section 47 (liquidation, deregistration and winding-up transactions) have similar provisions in relation to allowance assets.

11. Conclusion

Taxpayers incurring a cost in erecting or improving a building which they, or a lessee, use for the purposes of conducting the business of hotel keeper will qualify for the annual allowance on the cost incurred if the requirements of section 13*bis* are met. Section 13*bis* contains detailed requirements in relation to when the erection of the building or the effecting of the improvements was commenced by the taxpayer, when the building was brought into use and, depending on the preceding detail, whether it was wholly or mainly used, or to the extent it was used, by the taxpayer or lessee in carrying on the trade of hotelkeeping during the year of assessment.

The following should be noted in relation to the annual allowance:

- The definition of “hotel keeper” in section 1(1) requires the person concerned to conduct the business of a hotel, boarding house or lodging house in circumstances in which both meals and sleeping accommodation are supplied by that person for consideration.

- The building must be erected. Purchased buildings do not qualify for the annual allowance but improvements to purchased buildings could qualify.
- The annual allowance is granted on the cost to the taxpayer, after adjusting for deferred recoupments and amounts which may qualify for an allowance under section 11(*g*), of erecting a hotel building or of effecting improvements to such a building. There is no requirement that the taxpayer own the building or improvements. Thus the annual allowance applies to a taxpayer who erects a hotel building or effects improvements to such a building –
  - for own use as a hotel keeper;
  - as lessor when the lessee is a hotel keeper; or
  - as lessee to the extent that the building or improvements do not qualify for the leasehold improvements allowance under section 11(*g*).
- The annual allowance is available at different rates depending on when erection of the building or the improvements commenced.
- The annual allowance is not apportioned if the building or improvement is used as required for only part of the year.
- The annual allowance on dual-purpose buildings must be apportioned. For example, apportionment would be required when a building is used for both hotelkeeping and for domestic purposes.
- The aggregate of all deductions which may be allowed or deemed to have been allowed under section 13*bis* or any other section in respect of the cost to the taxpayer of the building or improvement may not exceed that cost. The limitation includes, for example, those allowances deemed to have been allowed for years of assessment when the accruals and receipts of the taxpayer were not included in the taxpayer's income.

An additional grading allowance was available but is unlikely to be relevant after 2012, since the relevant building or improvements should in most instances have been fully written off by that date.

The annual and grading allowances are subject to recoupment under section 8(4)(*a*) but this recoupment can be excluded from income under section 13*bis*(6)(*a*) at the election of the taxpayer by reducing the cost of erecting a replacement hotel building which qualifies for the annual allowance.

Annexure – The law

Section 13*bis*

13*bis*. Deductions in respect of buildings used by hotel keepers.—(1) Notwithstanding anything to the contrary contained in paragraph (ii) of the proviso to paragraph (*e*) of section *eleven*, there shall be allowed to be deducted from the income of any taxpayer for any year of assessment ending on or after the first day of January, 1964, an allowance equal to two per cent of the cost (after the set-off of any amount as provided in subsection (6)) to the taxpayer—

(*a*) . . . . . .

(*b*) . . . . . .

(*c*) of any building the erection of which was commenced by the taxpayer on or after the first day of January, 1964, and of any improvements (other than repairs) thereto commenced not later than the thirtieth day of June, 1965, if such building—

(i) was brought into use not later than the thirtieth day of June, 1965; and

(ii) was during the year of assessment wholly or mainly used by the taxpayer for the purpose of carrying on therein his trade of hotel keeper or was during such year let by the taxpayer and wholly or mainly used by the lessee for the purpose of carrying on therein the lessee's trade of hotel keeper;

(*d*) of such portion—

(i) of any building (other than a building in respect of the cost of which an allowance under the preceding provisions of this subsection is or was deductible from the income of the taxpayer for the current or any previous year of assessment) the erection of which was commenced by the taxpayer on or after the first day of January, 1964; or

(ii) of any improvements (other than repairs) to any building referred to in this paragraph, if such improvements were commenced on or after the first day of January, 1964; or

(iii) of any improvements (other than repairs) to any building referred to in paragraph (*c*), if such improvements were commenced on or after the first day of July, 1965,

as —

(*aa*) was during the year of assessment used by the taxpayer for the purpose of carrying on therein his trade of hotel keeper; or

(*bb*) was during such year let by the taxpayer and used by the lessee for the purpose of carrying on therein the lessee's trade of hotel keeper; or

(*e*) of such portion of any building improvements (other than repairs and other than improvements in respect of the cost of which, or of any portion thereof, an allowance under the preceding provisions of this subsection is or was deductible from the income of the taxpayer for the current or any previous year of assessment) commenced on or after 1 January 1964, as was during the year of assessment in question used by the taxpayer for the purposes of his trade of hotel keeper or was during the year of assessment in question let by the taxpayer and used by the lessee for the purposes of the lessee's trade of hotel keeper:

Provided that no allowance shall be made under this subsection in respect of such portion of the cost of any building the erection of which was commenced on or after the first day of July, 1961, or any improvements effected thereto, as has been taken into account in the calculation of any allowance to the taxpayer under paragraph (*g*) of section *eleven*, whether in the current or any previous year of assessment: Provided further that in the case of any such building the erection of which has or is commenced on or after 4 June 1988 and any such improvements which have or are commenced on or after the date the allowance under this subsection shall be increased to 5 per cent of the cost (after the setoff of any amount as provided in subsection (6)) to the taxpayer of such building or improvements: Provided further that to the extent to which any portion of any such improvements which have or are commenced on or after 17 March 1993 does not extend the existing exterior framework of the building, the allowance under this subsection shall be increased to 20 percent of the cost of such portion.

(1A) …

(2) In addition to any allowance under subsection (1), there shall be allowed to be deducted from the income of the taxpayer an allowance in respect of the cost (after the set-off of any amount as provided in subsection (6)) of any building or improvements referred to in paragraph (*c*) of subsection (1) or of any portion of any building or improvements referred to in paragraph (*d*) or (*e*) of subsection (1), provided such building (or a portion thereof), or the building (or a portion thereof) to which such improvements were effected, as the case may be, was during the year of assessment in question registered as an hotel under the Hotels Act, 1965, and such hotel was on the last day of such year graded by the board established under that Act: Provided that no allowance shall be made under this subsection in respect of such portion of the cost of any building or any improvements as has been taken into account in the calculation of any allowance to the taxpayer under paragraph (*g*) of section *eleven*, whether in the current or any previous year of assessment.

(3) The allowance under subsection (2) in respect of the cost (as reduced in terms of that subsection) of any building (or portion thereof) or of any improvements (or a portion thereof) shall be such percentage of such cost as may be fixed by the Minister of Finance by regulation under subsection (4) for the grade of hotel which is, in terms of a determination of the board referred to in subsection (2), applicable in respect of the hotel in question on the last day of the year of assessment: Provided that where such hotel is graded by the said board for the first time during any year of assessment (hereinafter referred to as the subsequent year) subsequent to any year of assessment (hereinafter referred to as the earlier year) during which such building (or the relevant portion thereof) or such improvements (or the relevant portion thereof) was or were used in carrying on the trade of hotel keeper, and the taxpayer is entitled to the said allowance in respect of the subsequent year, the allowance for the subsequent year (as determined in accordance with the said regulation) shall, if—

(*a*) such building (or the relevant portion thereof) or such improvements (or the relevant portion thereof), as the case may be, is or are completed not later than the thirty-first day of December, 1969; and

(*b*) where such hotel was not during the earlier year registered under the Hotels Act, 1965, it became so registered during the period ending on the thirty-first day of December, 1969, or the period of twelve months reckoned from the date of completion of such building (or the relevant portion thereof) or of such improvements (or the relevant portion thereof), as the case may be, whatever period ends later,

be increased by an amount equal to the allowance to which the taxpayer would have been entitled under the said regulation in respect of the said cost if such regulation had at all relevant times been in force and the grading of such hotel by the said board which was applicable on the last day of the subsequent year had also applied on the last day of the earlier year.

(3A) Where any building in respect of which any deduction of an allowance is claimed in terms of this section was during any previous financial year or years used by the taxpayer for the purposes of any trade carried on by such taxpayer, the receipts and accruals of which were not included in the income of such taxpayer during such year or years, any deduction which could have been allowed during such previous year or years in terms of this section shall for the purposes of this section be deemed to have been allowed during such previous year or years as if the receipts and accruals of such trade had been included in the income of such taxpayer.

(4) The Minister of Finance may make regulations prescribing the rates of the allowances under subsection (2) in respect of the various grades of hotels determined under the provisions of subsection (1) of section *fifteen* of the Hotels Act, 1965, and may in such regulations prescribe rates which vary according to the grade of hotel or the year of assessment for which any such allowance may be made: Provided that any rate so prescribed in respect of any year of assessment in respect of any grade of hotel shall not exceed eight per cent. of the cost or portion thereof on which the relevant allowance is to be calculated.

(5) The deductions which may be allowed or deemed to have been allowed in terms of this section and any other provision of this Act in respect of the cost of any building or improvement shall not in the aggregate exceed the amount of such cost.

(6) (*a*) If in any year of assessment there falls to be included in a taxpayer's income in terms of paragraph (*a*) of subsection (4) of section eight an amount which has been recovered or recouped in respect of any allowance made under the preceding provisions of this section or the provisions of subsection (1) of section thirteen, as applied by subsection (4) of that section, or the corresponding provisions of any previous Income Tax Act, in respect of any building or portion thereof or any improvements or portion thereof, so much of the amount so recovered or recouped as is set off against the cost of a further building as hereinafter provided shall, notwithstanding the provisions of the said paragraph, at the option of the taxpayer and provided the taxpayer erects within twelve months or such further period as the Commissioner may allow from the date on which the event giving rise to the recovery or recoupment occurred, any other building in respect of the cost of which an allowance is made under the preceding provisions of this section, not be included in the taxpayer's income for that year of assessment, but shall be set off against so much of the cost to the taxpayer of such further building erected by the taxpayer as remains after the deduction of any portion of that cost in respect of which an allowance has been granted to the taxpayer under paragraph (*g*) of section eleven, whether in the current or any previous year of assessment.

(*b*) Where any allowance has been made under the provisions of subsection (1) of section *thirteen*, as applied by subsection (4) of that section, in respect of the cost of any building, any amount which has in terms of subsection (3) of that section been set off against such cost, shall be set off against such cost in the calculation of any allowance made in respect thereof under the preceding provisions of this section.

(7) . . . . . .

7A) . . . . . .

(7B) . . . . . .

(8) . . . . . .

(9) The allowance under subsection (2) shall not be granted in respect of—

(*a*) any building the erection of which has or is commenced on or after 4 June 1988; and

(*b*) any improvements which have or are commenced on or after that date.

(10) . . . . . .

(11) . . . . . .