SARS
South African Revenue Service

INTERPRETATION NOTE 107 (Issue 2)

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ACT	**:**	**INCOME TAX ACT 58 OF 1962**
SECTION	**:**	**SECTION 13*quin***
SUBJECT	**:**	**DEDUCTION IN RESPECT OF COMMERCIAL BUILDINGS**

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Preamble

In this Note unless the context indicates otherwise –

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

1. Purpose

This Note provides guidance on the interpretation and application of section 13*quin* which provides for an allowance on any new and unused buildings or any new and unused improvements to any building, owned and wholly or mainly used by a taxpayer for purposes of producing income in the course of that taxpayer's trade.

2. Background

Historically, allowances have generally been granted for movable assets used by a taxpayer in any form of trade which produces income. The general wear-and-tear allowance in section 11(*e*) historically and currently excludes an allowance in respect of buildings, or other structures or works of a permanent nature. In contrast to movable assets, before the introduction of section 13*quin*, the availability of an allowance on buildings or structures of a permanent nature greatly depended on the type of trade or business activities in which the building or structure was used. Taxpayers who did not undertake trades covered by specified depreciation regimes, for example, mining and manufacturing, were generally not entitled to any depreciation for their buildings and structures of a permanent nature despite their business usage. There was no policy rationale for excluding commercial buildings that were not used within the specified trades from an allowance because all buildings have a limited useful life. Accordingly, section 13*quin* was introduced to grant an allowance on commercial buildings used by taxpayers in the production of income in trades that fell outside other available depreciation regimes.[1]

Section 13*quin* provides for an allowance on any new and unused buildings or new and unused improvements effected to existing buildings that are used by the taxpayer wholly or mainly for the purpose of producing income in the course of a trade, other than the provision of residential accommodation.

The heading to section 13*quin* refers to a "[d]eduction in respect of commercial buildings". Although the term "commercial building" is not used in the wording of section 13*quin,* it provides a useful description of the type of buildings which may qualify for the allowance. A commercial building is considered to be a building that is used in commerce, for example, in a business which relates to the buying and selling of goods and services for profit. Some examples of buildings used in business activities

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[1] *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2007* at page 45. See *Guide to Building Allowances* for various capital allowances provide in the Act to owners and lessees for the erection of buildings or the effecting of improvements to buildings.

are office buildings, warehouses, retail stores and shopping malls.

3. The law

The relevant section of the Act is quoted in the **Annexure**.

4. Application of the law

4.1 Requirements of section 13*quin*

In order to qualify for this allowance the building or improvement to a building must –[2]

- have been contracted for and construction, erection or installation must have commenced on or after 1 April 2007;[3]
- be new and unused;
- be owned by the taxpayer; and
- be wholly or mainly used by the taxpayer during the year of assessment for the purpose of producing income in the course of a trade, other than the provision of residential accommodation.

All of these requirements must be met in order to qualify for the allowance under section 13*quin.*

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

Section 13*quin*(1) refers to a building owned by the taxpayer or an improvement to a building owned by the taxpayer. However, it is submitted that the section was also intended to apply to a part of a building owned by a taxpayer or an improvement to part of a building owned by a taxpayer [see section 13*quin*(7)(*a*) and **4.6**] and therefore a reference to a "building" will include "part of a building".

4.1.1 Meaning of "building"

The word "building" is not defined in the Act but has been considered in a number of court cases from which several general principles have emerged.

Normally a building is a substantial structure, more or less of a permanent nature, consisting of walls, a roof and the necessary appurtenances (accessories).[5]

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".

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[2] Section 13*quin*(1).

[3] Section 13*quin* inserted by section 28(1) of the Taxation Laws Amendment Act 35 of 2007 deemed to have come into operation on 1 April 2007.

[4] The term "controlled company" is defined in section 25BB(1) as a company that is a subsidiary, as defined in IFRS, of a REIT.

[5] *CIR v Le Sueur* 1960 (2) SA 708 (A), 23 SATC 261 at 273.

[6] **www.learnersdictionary.com/definition/permanent** [Accessed 16 August 2023].

It is also defined as –[7]

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

It is therefore evident that the word "permanent" does not necessarily mean everlasting. Factors to be considered in determining whether a building is "of a permanent nature" include the nature of the building, the degree and manner of its 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 the purpose of section 13*quin* (see **2**) and paragraph (ii) of the proviso to section 11(*e*) are considered,[9] section 13*quin* applies to a building of a permanent nature only.

The facts of a particular case must always be considered in deciding whether a building is of a permanent nature, but generally speaking, when assessed in terms of the factors mentioned above, buildings such as portable bungalows, rondavels, huts, sheds and prefabricated structures used on construction sites, will not be regarded as buildings of a permanent nature. In ITC 370[10] it was held that the wood-and-iron buildings originally constructed of old material that were used by a taxpayer to carry on business as a general dealer were buildings of a permanent nature, since they were attached to the soil and used for permanent purposes of the business.

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 whether 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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[7] **www.thefreedictionary.com/permanent** [Accessed 16 August 2023].

[8] These are the aspects which are considered in assessing whether a movable asset accedes to immovable property (land) and, if it does, the owner of the immovable property becomes the owner of the previously movable asset (assuming it was not already owned by such owner). See WA Joubert "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 issue as whether a building is of a permanent nature, however, there is a close overlap. Accordingly, it is submitted that in assessing whether a building is of a permanent nature, or whether a movable asset has been permanently fixed to a building, the same elements are relevant.

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

[10] (1936) 9 SATC 313 (U).

[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 ITC 1007,[13] 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.

In *CIR v Le Sueur*[14] the court considered whether the laying batteries used in poultry farming constituted part of the building. Ramsbottom JA held that –[15]

> "… 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*[16] 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 that –[17]

> "…[t]he 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

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[13] (1962) 25 SATC 251 (N).

[14] 1960 (2) SA 708 (A), 23 SATC 261 (A).

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

[16] 1976 (4) SA 872 (A), 38 SATC 159 (A).

[17] *SIR v Charkay Properties (Pty) Ltd* 1976 (4) SA 872 (A), 38 SATC 159 (A) at 169.

> 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 for purposes of section 13*quin*. 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 the building permanently in such a way that it has lost its own separate identity or character. It has 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.

A building also does not include the land upon which the structure stands.[18]

4.1.2 Meaning of "improvements"

Section 13*quin* also allows for a deduction relating to any new and unused improvements to any building owned by the taxpayer if the other requirements of the section are met.

The word "improvement" is not defined in the Act for purposes of section 13*quin*[19] and must be given its ordinary grammatical meaning. It is described in the *New Oxford Thesaurus of English*,[20] as –

> "[d]evelopment, upgrade, change for the better, refinement, enhancement, furtherance, advancement, forwarding; boost, augmentation, raising; correction, rectification, rectifying, upgrading, amelioration, rally, recovery, upswing, breakthrough".

It has been held in a number of court cases that to constitute an improvement to a building the "extension, addition, improvement" must be physically attached to, connected or structurally integrated with the building. For example, in *SIR v Charkay Properties (Pty) Ltd*[21] the majority held that, at the very least, for an article to form part of a building it must have been structurally integrated or otherwise physically incorporated into the building. There was also a case in which concrete aprons were added around a factory building a number of years after the factory had been built. The aprons were held not to form part of the building as they were separate structures and not physically attached to the building and accordingly did not qualify as an improvement.[22]

Reference must be made to the facts of each case in determining whether something constitutes an improvement.

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

19 The word "improvements" is defined in section 13(9) for the purposes of section 13 only. It is not defined under section 13*quin* nor section 1(1).

20 P Hanks, first published (2000) Oxford University Press Inc, New York.

21 1976 (4) SA 872 (A), 38 SATC 159.

22 *African Detinning Works (Pty) Ltd v SIR* 1982 (1) SA 797 (A), 44 SATC 1. Although this case dealt with a specific definition in section 13(9), it is relevant to section 13*quin* because that definition referred to any extension, addition or improvement to a building and section 13*quin* refers to any improvement to any building.

An improvement must be distinguished from a repair.[23]

4.1.3 The building or improvement to a building must have been "contracted for" on or after 1 April 2007

The taxpayer must have contracted for the building or improvement to a building on or after 1 April 2007 and construction, erection or installation must have commenced on or after that date. The date the building or improvement to a building is contracted for is the date that the parties agreed to all the terms governing the particular contract, including conditions, and have concluded a valid contract. The date of conclusion of a contract is a factual question determined on the facts of each case. SARS agrees with the view that the date of conclusion is not the date that any condition becomes unconditional or effective.[24]

4.1.4 The construction, erection or installation must have commenced on or after 1 April 2007

The courts have held that the date when erection of a building or improvements commences is the date when the laying of the foundation begins. The clearing and levelling of the site and the conducting of excavations in preparation for the laying of the foundation have been held not to form part of the erection phase.[25]

Section 13*quin* does not require that the taxpayer must personally have constructed, erected or installed the building or improvement in order to claim the allowance. Accordingly, the building or improvement may, for example, be acquired by the taxpayer from a third party, such as a property developer, provided the construction, erection or installation of the building or improvement commenced on or after 1 April 2007[26] and the other requirements, for example, that it is new and unused, are met.

4.1.5 The building or improvement to a building must be "new and unused"

The building or improvement, as appropriate, must be new which means recently built. The building or improvement must also be unused and will not qualify for the allowance if it was previously used for any purpose by any person. Whether a building or improvement is new and unused is a factual enquiry based on the facts of each case. If the allowance is claimed only on an improvement, only the improvement needs to be new and unused. If a taxpayer erected a building which was immediately mothballed[27] for some years, it would be unused but not new in the latter years.

The assessment whether a building or improvement to a building is new and unused is made when the taxpayer becomes the owner of the building or improvement to a building. For example, if a taxpayer acquires a new and unused building during a year of assessment, the building will be considered to have met the "new and unused" requirement for purposes of section 13*quin* in the year of acquisition and in subsequent years of assessment. A taxpayer who claims the section 13quin allowance on a new and unused building is not precluded from claiming a further allowance on an

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[23] See Interpretation Note 74 "Deduction and Recoupment of Expenditure on Repairs" for the distinction between repairs and improvements.

[24] D Davis *et al Juta's Tax Library* [online] (Jutastat e-publications: 2022) in Commentary on Income Tax – section 13.

[25] ITC 1137 (1969) 32 SATC 1 (C).

[26] Effective date of section 28(1) of the Revenue Laws Amendment Act 35 of 2007.

[27] That is, kept aside for possible future use.

improvement on the same building in subsequent years provided the improvement is "new and unused".

See **4.1.6** for situations in which an improvement on land or to buildings by a lessee is deemed to be owned by the lessee and to be the cost of a new and unused building or improvement contemplated in section 13*quin*.

If a building is purchased, the purchaser will not be entitled to a deduction under section 13*quin* if the building is no longer new and unused from the perspective of the purchaser. Whether the building is still new and unused depends on how long the previous owner held it and whether it was used. Even if the building doesn't meet the requirement of being "new and unused", improvements effected by the purchaser to the building could, subject to meeting all the requirements of the section, qualify for the allowance. Whether a building or an improvement is new and unused is a factual enquiry based on the facts of each case.

Example 1 – New and unused building

Facts:

Company C completed building an office block on 30 June year 1. A lease agreement for 75% of the office block was concluded with Company Z before construction was completed and Company Z took occupation on 1 August year 1.

Company C sold the office block to Company D on 1 September year 1.

Result:

Company D will not qualify for an allowance under section 13*quin* because although the building is still new, it was used by Company Z before Company D acquired it.

4.1.6 Owned by the taxpayer

Ownership is not defined in the Act. However, general common law principles apply. Under the common law principle of *superficies solo cedit* (owner by accession), buildings or other structures affixed or attached to land become the property of the owner of the land. A taxpayer wanting to claim an allowance under section 13*quin* must therefore be the owner of the land on which the building is erected or the improvements are effected. This requirement is relevant in the context of section 13*quin* as it deals with buildings of a permanent nature and such buildings will be permanently attached to the land (see **4.1.1**).

The acquisition of land, or a building and the land on which it is situated, occurs by means of a deed of transfer from one person to another and is effected by the process of registration in the Deeds Office.[28] A building purchased by the taxpayer but not yet transferred into that taxpayer's name, would not be owned by the taxpayer. Entering into an unconditional contract to transfer ownership does not mean the purchaser is the owner as the registration process with the necessary authority is required for transfer of ownership to occur.

[28] Section 16 of the Deeds Registries Act 47 of 1937 provides that "Save as otherwise provided in this Act or in any other law the ownership of land may be conveyed from one person to another only by means of a deed of transfer executed or attested by the registrar ….".

Land and buildings may be co-owned, that is jointly owned by two or more persons. A building that is co-owned by a taxpayer qualifies as a building owned by the taxpayer[29] and the taxpayer would therefore be able to claim the section 13*quin* allowance on the proportional share of the cost of the building actually incurred by that taxpayer.

A taxpayer may also own a building under sectional title.[30] Although sectional title ownership is common for residential properties, it is a method of ownership which is also used for commercial properties. A unit in a sectional title scheme gives its owner or holder, sole ownership of the relevant section of the scheme and joint ownership of an undivided share in the common property. Although a unit is deemed to be land under the Sectional Titles Act,[31] it is submitted that to the extent a unit relates to a building or part of a building, the deeming to be land is ignored for purposes of section 13*quin.*

A taxpayer will not qualify for a deduction under section 13*quin* on a building or an improvement effected and in respect of which the taxpayer has the right of use or occupation but does not own, for example, a leased building or a building to which the taxpayer has the right of use through shares in a share block scheme or timeshare participation. Accordingly, a lessee that erects improvements on land or to a building owned by the lessor will not qualify for a deduction under section 13*quin* but may, depending on the facts, qualify for a deduction or a partial deduction under section 11(*g*).[32]

A lessee who undertakes obligatory improvements on a leased property as envisaged under section 12N[33] and incurs expenditure in so doing, is deemed to be the owner of such improvements for purposes of, amongst others, section 13*quin,* provided the requirements of section 12N are met.[34] Section 12N(1)(*e*) requires the lessee to use or occupy the building for purposes of earning income or to derive income from it. The expenditure incurred by the lessee to complete the improvement on land or to a building is deemed to be the cost to the lessee of any new and unused building or of any new and unused improvements to a building contemplated in section 13*quin*(1).[35]

4.1.7 "Wholly or mainly used" for a qualifying purpose

As noted above, the building or improvement to the building must be wholly or mainly used for the purpose of producing income in the course of a trade, other than the provision of residential accommodation.

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.

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[29] D Davis *et al Juta's Tax Library* [online] (Jutastat e-publications: 2022) in Commentary on Income Tax - section 13*quin*.

[30] See Binding Private Ruling 169 dated 9 May 2014 "Commercial Building Allowance".

[31] Section 3(4) of the Sectional Titles Act 95 of 1986.

[32] See Interpretation Note 110 "Leasehold Improvements" for more detail.

[33] Under a Public Private Partnership, on leased property owned by the government in the national, provincial or local sphere of government or certain government owned exempt entities, or an obligation under the Independent Power Producer Procurement Programme administered by the Department of Energy, section 12N(1).

[34] See Interpretation Note 119 "Deductions in respect of Improvements to Land or Buildings not Owned by a Taxpayer".

[35] Section 13*quin*(1A).

In *Glen Anil Development Corporation Ltd v SIR* Botha JA stated the following:[36]

> "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*[37] 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 section 13*quin* "mainly" is also interpreted to mean "more than 50%". Therefore, the building or improvement will potentially qualify for the allowance if it is used more than 50% during the year of assessment for the purpose of producing income, other than income from the provision of residential accommodation. This is referred to in this Note as a qualifying purpose.

The provision of residential accommodation refers to the provision of a place for someone to live in such as a house, flat, hostel or hotel room whether that accommodation is of a temporary or permanent nature.[38]

Often buildings or improvements are used for a dual purpose, for example, in a shopping centre which has flats on the top level. In such a situation there is a dual purpose of income from the rental of commercial space and income from the rental of residential accommodation. It is also possible that a building could be used partly for purposes of producing income and partly for purposes in which no income is produced. The purposes of producing income from the provision of residential accommodation or producing no income are not qualifying purposes.

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.

Example 2 – Wholly or mainly used for a qualifying purpose

Facts:

Company C built an office block which it occupies for purposes of providing advisory services to clients. The total floor space of the office block is 1 000 square metres.

The office block includes a small apartment of 45 square metres which is occupied by the building's caretaker.

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[36] 1975 (4) SA 715(A), 37 SATC 319 at 325.

[37] 1966 (4) SA 434(A), 28 SATC 233 at 245.

[38] See Interpretation Note 105 "Deductions in respect of Buildings used by Hotelkeepers" and Interpretation Note 106 "Deductions in respect of certain Residential Units" for more detail.

Result:

Irrespective of whether Company C charges the caretaker rent, the apartment constitutes the provision of residential accommodation which is not a qualifying purpose under section 13*quin.*

The whole office block, excluding the area of the apartment, is used for purposes of producing income from advisory services which is a qualifying purpose under section 13*quin.* The qualifying floor space is therefore 955 square metres (1 000 square metres – 45 square metres).

The office block has therefore been used 95,5% (955/1000) for a qualifying purpose. The building is accordingly "wholly or mainly", that is, more than 50%, used for a qualifying purpose and will qualify for an allowance under section 13*quin* assuming the other requirements of the section are met. If the other requirements of the section are met, the whole building qualifies for the allowance, no apportionment based on use for a qualifying purpose is required.

Example 3 – Wholly or mainly used for a qualifying purpose

Facts:

Company A built a building which contained six floors. The bottom two floors contain office premises and retail space and the top four floors contain residential apartments. Each of the six floors is the same size.

During the year of assessment Company A let office premises and retail space equal to one floor. The other office premises and retail space were available for hire but Company A had not been successful in finding suitable tenants. Similarly, all the residential apartments were available for rental, but Company A managed only to rent out apartments which when combined represented space of one floor during the year of assessment.

Result:

The four floors of residential apartments represent the part of the building which is being used for the purposes of producing income from residential accommodation. The fact that apartments making up three floors in space were not successfully let during the current year of assessment does not impact on the fact that all four floors comprising residential apartments were used for the provision of residential accommodation. The provision of residential accommodation is not a qualifying purpose under section 13*quin.*

The two floors of office premises and retail space are used for purpose of producing income which is a qualifying purpose under section 13*quin.* The fact that office premises and retail space making up one floor in space were not successfully let during the current year of assessment does not impact on the fact that the two floors comprising office premises and retail space were used for a qualifying purpose.

However, the facts must always be considered. For example, the view expressed here may change if the apartments or offices were not successfully let for an extended period or their intended use changed.

The building was therefore used 33,33% (2 floors / 6 floors) for a qualifying purpose. The building is, accordingly, not "wholly or mainly", that is, more than 50%, used for a qualifying purpose and will not qualify for an allowance under section 13*quin*.

4.1.8 Purposes of producing income in the course of trade

The allowance may be claimed only if the building or improvement is wholly or mainly used for purposes of producing income in the course of the taxpayer's trade. Both the purpose of producing income requirement (see **4.1.7**) and the trade requirement[39] must be met in a year of assessment before the allowance may be claimed.

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[40] it was held that this definition 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.

If the taxpayer did not derive any income in a particular year of assessment, it does not automatically mean that the taxpayer did not trade in that year of assessment or that it did not trade for the purpose of earning income. In ITC 777[41] the court held that a company that had unsuccessfully attempted to let its property did carry on a trade. If no income is earned, it can practically raise more questions regarding whether there is an intention to trade or to earn income and more evidence may be required. The onus would be on the taxpayer to satisfy SARS that it traded in that year of assessment.

Section 13*quin* contains a restriction when determining whether the building is wholly or mainly used for qualifying purposes. The use of the building or improvement for purpose of producing income from the provision of residential accommodation is specifically excluded from a qualifying purpose (see the consideration of a qualifying purpose in **4.1.7**).

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39 The meaning of carrying on a trade is addressed in Interpretation Note 33 "Assessed Losses: Companies: The 'Trade' and 'Income from Trade' Requirements".

40 (1953) 19 SATC 216 (T).

41 (1953) 19 SATC 320 (T).

4.2 The determination of cost and calculation of the allowance

The allowance is calculated at a rate of 5% a year of the cost of the building or improvement to the building. The allowance is not apportioned if the building or improvement is used for only part of the year.

The cost is the lesser of the actual cost to the taxpayer or the arm's length direct cost under a cash transaction of the acquisition, erection or improvement of the building on the date on which the transaction for the acquisition, erection or improvement was concluded.[42]

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".[43]

The court in *SIR v Eaton Hall (Pty) Ltd* considered the meaning of "cost to the taxpayer of the building" and held that –[44]

> "[f]irstly … from the context … '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*. … the use of the preposition 'of' instead of a phrase with a wider connotation, like 'in respect of' … 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. … '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."

(Emphasis added.)

If the taxpayer purchased the building, the cost of the building is the cost to the taxpayer of purchasing the building, that is, the purchase price paid to the seller. If part of a building is acquired without erecting or constructing it, there is a deemed cost for the part or the improvement acquired – see **4.6.**

The cost of a building for purposes of section 13*quin* does not, for example, include –

- the cost of the land on which the building is erected (the purchase of land and buildings will require an apportionment);
- the costs related to the preparation of the land for the erection of the building;[45]

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[42] Section 13*quin*(2).

[43] Section 23C(1).

[44] 1975 (4) SA 953 (A), 37 SATC 343 at 347 to 348.

[45] See **4.1.4.** Levelling of the site and excavations for the foundation have been held not to form part of the erection phase.

- costs incurred to obtain a rezoning in order to permit a higher building height which are incurred in connection with the erection of the building but are not part of the cost of the building;[46] or
- interest incurred on any financial instrument used to fund the acquisition, erection or improvement of the building.[47]

Costs that are directly and closely connected with the erection of the building such as architect and civil engineering fees are included in the cost of the building.[48]

The cost of an improvement to any building which qualifies for a deduction must be determined by applying the same principles.

As noted above, the cost of the building does not include the land upon which the building stands. A reasonable apportionment must therefore be done between the cost of the building and the cost of the land if there is a single cost for land and buildings. 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 it may be outdated.

Example 4 – Allowance claimed on erection of a commercial building

Facts:

Individual A's year of assessment ends on 28 February.

Individual A contracted on 1 May year 1 to have a four-storey building erected. Construction of the building was completed on 31 May year 2 at a cost of R4 million. The first three floors of the building were designed as office space while the top floor comprised a number of penthouse apartments. The building was brought into use by 30 September year 2 and Individual A was successful in letting all the office space and apartments before the end of February year 3.

[46] 1975 (4) SA 953 (A), 37 SATC 343 at 347 to 348.
[47] 1975 (4) SA 953 (A), 37 SATC 343 at 347 to 348.
[48] 1975 (4) SA 953 (A), 37 SATC 343 at 348.

Result:

Year 3 of assessment

Three-quarters of the building is used to produce income in the course of the taxpayer's trade other than the provision of residential accommodation. The building is accordingly "wholly or mainly", that is, more than 50%, used for a qualifying purpose. The building is also new (recently constructed) and unused (the taxpayer is the first person to use the building).

Individual A therefore qualifies for the section 13*quin* allowance and will be entitled to an annual allowance of R4 million × 5% = R200 000.

4.3 Deeming provision

A special deeming rule under section 13*quin*(3) deems a taxpayer to have been allowed a deduction under section 13*quin* on a building or improvement in a previous financial year if the taxpayer qualifies for a deduction under section 13*quin* in a current year of assessment and if during that previous financial year –

- the taxpayer brought the building or improvement into use for the first time for the purposes of the taxpayer's trade; and
- the receipts and accruals from that trade were not included in income.

The amount of the deduction which is deemed to have been allowed for purposes of section 13*quin* is the amount which would have been allowed in that previous year and any subsequent year in which the building or improvement was used by the taxpayer if the receipts and accruals of that trade had been included in the taxpayer's income.

The total deductions, including these deemed deductions, available in respect of a building are limited to cost (see **4.5**).

The recoupment provision under section 8(4)(*a*) does not apply to the deduction which is deemed to have been allowed under section 13*quin*(3).[49]

Example 5 – Deeming provision

Facts:

Company A used a building that was purchased new and unused from a property developer, solely for the purposes of producing income. During years 1 to 5 Company A's income was exempt from tax. Subsequently, Company A's income was taxable. Company A qualified for a deduction under section 13*quin* from year 6 onwards.

Result:

For purposes of calculating the allowance to which Company A is entitled from year 6 onwards, the 5% allowance is deemed to have been allowed for years 1 to 5 when Company A's income was exempt. Company A may therefore actually claim the 5% allowance in years 6 to 20. No deduction is available from year 21 onwards because the total cost limitation was reached in year 20 (see **4.5**).

[49] Section 8(4A).

4.4 Disposal of building

Once a taxpayer disposes of a building in a year of assessment, no allowance under section 13*quin* can be claimed by that taxpayer in respect of that building in a subsequent year of assessment.[50] This prohibition reinforces the ownership requirement (see **4.1**) as once a taxpayer has disposed of the building, that taxpayer can no longer claim the section *13quin* allowance on it. It also, for example**,** prevents a taxpayer from claiming the allowance on a building for a number of years, disposing of it, reacquiring that building at a later stage and, after reacquiring it, again claiming an allowance under section 13*quin* on it.

4.5 Limitations

No deduction is allowable under section 13*quin* for the cost of a building or improvement if any of that cost has qualified or will qualify for deduction from the taxpayer's income as a deduction of expenditure or an allowance for expenditure under any other section of the Act.[51] Examples of other deductions or allowances a taxpayer may qualify for in respect of a building or improvement are an allowance for investment and training for industrial policy projects,[52] an allowance for buildings used in a process of manufacture,[53] an allowance for buildings used by hotel keepers,[54] or an allowance for the erection or improvement of buildings in urban development zones.[55]

The aggregate of all deductions which may be allowed or deemed to have been allowed under section *13quin* or any other section in respect of the cost to the taxpayer of the building or improvement may not exceed that cost.[56] Therefore, 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 its income (see **4.3**).

4.6 Part acquisition

To the extent a taxpayer acquires a part of a building on or after 21 October 2008,[57] without erecting or constructing it, the cost of acquiring that part for purposes of section 13*quin* is deemed to be –

- 55% of the acquisition price incurred by the taxpayer, in the case of the part being acquired;[58] and
- 30% of the acquisition price incurred by the taxpayer, in the case of an improvement being acquired.[59]

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50 Section 13*quin(*4).
51 Section 13*quin*(5).
52 Section 12I. See Interpretation Note 86 "Additional Investment and Training Allowances for Industrial Policy Projects" for more detail.
53 Section 13. See *Guide to Building Allowances* in paragraph 2.2 for more detail.
54 Section 13*bis.* See Interpretation Note 105 "Deductions in respect of Buildings used by Hotelkeepers" for more detail.
55 Section 13*quat*. See *Guide to the Urban Development Zone (UDZ) Allowance* for more detail.
56 Section 13*quin*(6).
57 Section 13*quin*(7) was inserted by section 30(1) of the Taxation Laws Amendment Act 60 of 2008 and deemed to have come into effect on 21 October 2008 and applicable in respect of a part or improvement acquired on or after that date.
58 Section 13*quin*(7)(*a*).
59 Section 13*quin*(7)(*b*).

The reference to "a part of a building" includes, for example, the acquisition of a sectional title unit from a developer that relates to part of a building.[60] In a sectional title scheme, the acquisition of an improvement could include additions to the common property such as the upgrading of the reception area on the ground floor if they were not acquired through erection or construction.

The purpose of the limitation on cost to 55% of the acquisition price of such a unit is to ensure that the allowance is not calculated on the cost of the land, which would be included in the acquisition price of the unit. In the absence of section 13*quin*(7) which deems the cost of part of the building or improvement itself to be equal to the amounts calculated as indicated above, the acquisition price would have needed to be adjusted to exclude a portion in respect of the land (see **4.2**) .

5. Section 13*quin* allowance and an intra-group transaction

Section 45 of the Act 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 an "intra-group transaction" in section 45(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 capital assets which constitute an "allowance asset" as defined in section 41(1). A building in respect of which a deduction was allowable under section 13*quin* is an allowance asset. Section 45(3) provides, amongst others, that if a transferor company transfers an allowance asset and the transferee company acquires it as an allowance asset then –

- 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 "new and unused" requirement in section 13*quin.* In addition, if the transferee company continues to meet the other requirements of section 13*quin* (for example, continued to use the asset wholly or mainly for the purposes of producing income, other than residential accommodation) 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*quin* to which the transferor company would have been entitled had it retained ownership and continued to use the asset as required under section 13*quin*.

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[60] Depending on the facts, a unit in a sectional title scheme can relate to part of a building or a whole building.

If the transferor company meets the requirements for claiming the allowance in a particular year of assessment before transfer occurred, 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*quin* and any other section for the transferor company and the transferee company on the asset transferred under section 45 may not exceed cost as initially determined under section 13*quin 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*quin* 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.

6. General recoupment provision

Under section 8(4)(*a*) there must be included in a taxpayer's income (subject to certain exceptions) all amounts allowed to be deducted or set off in the current or any previous year of assessment that have been recovered or recouped during the current year of assessment.

Section 8(4)(*a*) will apply on the disposal of the building if it is disposed of for an amount in excess of its tax value.[61] In summary, the amount of the recoupment will be equal to the amount for which the building is disposed of (limited to the cost of the building) less its tax value. In limited circumstances the recognition of the recoupment may be deferred.[62]

The recoupment provision under section 8(4)(*a*) does not apply to the deduction which is deemed to have been allowed under section 13*quin*(3).[63]

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[61] Tax value means the amount remaining after reducing the cost of the building by the cumulative deductions under section 13*quin* and other sections on that asset.

[62] See section 8(4)(*e*).

[63] Section 8(4A). See **4.3** for the treatment of the deeming provision under section 13*quin*(3).

7. Conclusion

Section 13*quin* provides for an allowance on any new and unused building or new and unused improvement effected to an existing building if the building or improvement is wholly or mainly used by the taxpayer during the year of assessment for the purposes of producing income in the course of a trade, other than residential accommodation. In the context of section 13*quin* "mainly" is interpreted to mean "more than 50%". The building or improvement must be owned by the taxpayer and it must have been contracted for on or after 1 April 2007. The construction, erection or installation of the building or improvement must also have commenced on or after this date.

In the context of section 13*quin* a building owned by the taxpayer or an improvement to a building owned by the taxpayer includes a building and a part of a building owned by the taxpayer.

The allowance available under section 13*quin* is equal to 5% per year of the cost of the building or improvement. Cost is the lesser of actual cost or cost in an arm's length transaction. Once a building has been disposed of, the taxpayer is not entitled to a deduction under section 13*quin*.

The total deductions available under section 13*quin* and other sections on a building or improvement are limited to cost. This includes deductions which, although not allowed under section 13*quin* in previous years of assessment, are specifically deemed to have been allowed for purposes of section 13*quin*. Once a taxpayer has disposed of a building, that taxpayer will not be entitled to a deduction under section *13quin* in respect of that building during any subsequent years of assessment.

If a transferor company transfers an allowance asset in an intra-group transaction that meets the requirement of section 45 and the relief applies, the transferor company and the transferee company are deemed to be one and the same person with regards to calculating the amount of any deduction to which the transferee company is entitled and the amount of the recoupment if, for example, the transferee company disposes of the building. Similar provisions are contained in sections 42, 44 and 47.

The deductions claimed under section 13*quin* are subject to potential recoupment under section 8(4)(*a).* The deductions deemed to have been claimed under section 13*quin*(3) are not subject to recoupment under section 8(4)(*a*).

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Annexure – The law

Section 13*quin*

13*quin*. Deduction in respect of commercial buildings.—(1) There shall be allowed to be deducted from the income of the taxpayer an allowance equal to five per cent of the cost to the taxpayer of any new and unused building owned by the taxpayer, or any new and unused improvement to any building owned by the taxpayer, if that building or improvement is wholly or mainly used by the taxpayer during the year of assessment for purposes of producing income in the course of the taxpayer's trade, other than the provision of residential accommodation.

(1A) For the purposes of this section, if a taxpayer completes an improvement as contemplated in section 12N, the expenditure incurred by the taxpayer to complete the improvement shall be deemed to be the cost to the taxpayer of any new and unused building or of any new and unused improvement to a building contemplated in subsection (1).

(2) For the purposes of this section the cost to a taxpayer of any building or improvement shall be deemed to be the lesser of the actual cost to the taxpayer or the cost which a person would, if he had acquired, erected or improved the building under a cash transaction concluded at arm's length on the date on which the transaction for the acquisition, erection or improvement of the building was in fact concluded, have incurred in respect of the direct cost of the acquisition, erection or improvement of the building.

(3) Where any building or improvement in respect of which any deduction is claimed in terms of this section was during any previous financial year brought into use for the first time 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, any deduction which could have been allowed in terms of this section during such year or any subsequent year in which such asset was used by the taxpayer 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) No deduction shall be allowed under this section in respect of any building that has been disposed of by the taxpayer during any previous year of assessment.

(5) No deduction shall be allowed under this section in respect of the cost of a building or improvement if any of that cost has qualified or will qualify for deduction from the taxpayer's income as a deduction of expenditure or an allowance in respect of expenditure under any other section of this Act.

(6) 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.

(7) For the purposes of subsection (1), to the extent that the taxpayer acquires a part of a building without erecting or constructing that part—

(a) 55 per cent of the acquisition price, in the case of a part being acquired; and

(b) 30 per cent of the acquisition price, in the case of an improvement being acquired,

is deemed to be the cost incurred by that taxpayer in respect of that part or improvement, as the case may be.