SOUTH AFRICAN REVENUE SERVICE

DRAFT GUIDE TO INCOME TAX BENEFITS IN SPECIAL ECONOMIC ZONES

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South African Revenue Service

SARS
At Your Service

Draft Guide to Income Tax Benefits in Special Economic Zones

Preface

This guide provides general guidance on the special income tax treatment in special economic zones (SEZs). The guide is restricted to the application of the SEZ legislation as it relates to the income tax incentives applicable to such zones. It does not consider the value-added tax and customs incentives available to qualifying companies operating within an SEZ.

This guide is not an "official publication" as defined in section 1 of the Tax Administration Act 28 of 2011 and accordingly does not create a practice generally prevailing under section 5 of that Act. It does not consider the technical and legal detail that is often associated with taxation and should, therefore, not be used as a legal reference.

It is also not a binding general ruling issued under section 89 of the TA Act. Taxpayers requiring an advance tax ruling should visit the SARS website at **www.sars.gov.za** for details of the application procedure.[1]

This guide is based on the legislation as at time of issue.

For more information, assistance and guidance you may –

- visit the **SARS website**;;
- contact the SARS National Service Centre –
  - if calling locally, on 0800 00 7277;
  - if calling from abroad, on +27 11 602 2093 (only between 8am and 4pm South African time);
- have a virtual consultation with a SARS consultant by making an appointment via the **SARS website**;
- visit your nearest SARS service centre, after making an appointment via the **SARS website**; or
- contact your own tax advisor or tax practitioner.

Comments on this guide may be e-mailed to **policycomments@sars.gov.za**.

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[1] For further commentary, see the *Comprehensive Guide to Advanced Tax Rulings*.

Contents

Glossary

In this guide unless the context indicates otherwise –

- **"Advisory Board"** means the Special Economic Zones Advisory Board established under section 7 of the SEZ Act;
- **"DTI"** means the Department of Trade and Industry;
- **"DTI's policy on development of SEZ"** means the Department of Trade and Industry Policy on the development of special economic zones (2012);
- **"IDZ"** means an Industrial Development Zone;
- **"IDZ Regulations"** means the Industrial Development Zone Programme Regulations published under Government Notice (GN) R1224 in *Government Gazette (GG)* 21803 of 1 December 2000;
- **"IDZ operator"** means a company holding a valid IDZ provisional IDZ operator permit or IDZ operator permit as defined in the IDZ Regulations;
- **"licensee"** means the holder of a special economic zone license issued under section 23(6) of the SEZ Act;
- **"Minister"** means the Minister responsible for the DTI;
- **"OECD Model Tax Convention"** means the Model Tax Convention on Income and on Capital of the Organisation for Economic Co-operation and Development, 10 ed (2017), OECD Publishing;
- **"operator"** means the holder of a special economic zone operator permit under section 32(4) of the SEZ Act;
- **"PFMA"** means the Public Finance Management Act 1 of 1999;
- **"qualifying company"** means a qualifying company as defined in section 12R(1);
- **"Republic"** means the Republic of South Africa;
- **"section"** means a section of the Act;
- **"SEZ"** means a "special economic zone" as defined in section 1 of the SEZ Act that is approved for the purposes of section 12R by the Minister of Finance under section 12R(3);
- **"SEZ Act"** means the Special Economic Zones Act 16 of 2014;
- **"SEZ Board"** means the board of directors of an individual special economic zone entity appointed under section 25 of the SEZ Act;
- **"SEZ Regulations"** mean the regulations made under section 41 of the SEZ Act proclaimed under Proc. R6 in *Government Gazette* 39667 of 9 February 2016;
- **"SIC Code"** means version 7 of the Standard Industrial Classification Code as issued by the Statistics South Africa;
- **"TA Act"** means the Tax Administration Act 28 of 2011;
- **"the Act"** means the Income Tax Act 58 of 1962;
- **"VAT"** means value-added tax; and
- any other word or expression bears the meaning ascribed to it in the Act.

All guides, interpretation notes, rulings, forms, and returns referred to in this guide are the latest issues available on the **SARS website** or on eFiling at **www.sarsefiling.co.za**, unless the context indicates otherwise.

1. Introduction

The South African government introduced the IDZ regime in 2003 as a means of promoting investment, growth and job creation in the South African manufacturing sector, as well as to promote the development of the regions demarcated as IDZs. The main focus of the IDZ regime was to attract foreign direct investment and to promote the exportation of value-added commodities. Some of the tax incentives provided to taxpayers under the IDZ regime included –

- relief from customs duty and VAT; and
- additional allowances on the cost of any manufacturing asset used in an industrial policy project under section 12I.

The developments in national economic policies and strategies, as well as the formation of the trade coalition between Brazil, Russia, India, China and South Africa (BRICS) led to a policy review of the IDZ regime in 2007. The main limitation of the IDZ regime was that an IDZ could only be designated adjacent to a sea port or international airport, which led to the exclusion of other regions in the Republic that had industrial potential but did not meet the requirements of an IDZ. Other challenges experienced with the IDZ regime identified by the DTI can be summarised as follows:

- Lack of coordinated planning arrangements
- Insufficient guidance related to governance arrangements
- Dependence on government funding
- Lack of targeted investment promotion measures
- Insufficient marketing and inadequate coordination across government agencies

This policy review by the DTI created the foundation for the creation of SEZs. The DTI's policy on the development of SEZ describes SEZs as follows:

> "Special Economic Zones are geographically designated areas of a country set aside for specifically targeted economic activities, supported through special arrangements (which may include laws) and support systems that are often different from those that apply in the rest of the country."

The DTI's "*Special Economic Zones Tax Incentive Guide*"[2] states the SEZs intend to –

- expand the focus of strategic industrialisation to cover diverse regional development needs and context;
- provide a clear, predictable and systematic planning framework for the development of a wider array of SEZs to support industrial policy objectives, the Industrial Policy Action Plan, National Development Plan and the National Growth Plan;
- clarify and strengthen governance arrangements, and expand the range and quality of support measures beyond the provisions of infrastructure; and

[2] **www.thedti.gov.za/industrial_development/docs/SEZ_Guide.pdf** [Accessed 5 July 2024].

- provide a framework for predictable financing to enable long-term planning.

The SEZ Act[3] was introduced to, amongst others, provide for the designation, promotion, development, operation and management of SEZs. The SEZ Act defines[4] an SEZ. According to this Act an SEZ is an economic development tool to promote national economic growth and export by using certain support measures to attract targeted foreign and domestic investments and technology.[5] The purpose of establishing an SEZ includes –[6]

- facilitating the creation of an industrial complex, having strategic national economic advantage for targeted investments and industries in the manufacturing sector and tradable services;
- developing infrastructure required to support the development of targeted industrial activities;
- attracting foreign and domestic direct investment;
- providing the location for the establishment of targeted investments;
- enabling the beneficiation of mineral and natural resources;
- taking advantage of existing industrial and technological capacity;
- promoting integration with local industry and increasing value-added production;
- promoting regional development;
- creating decent work and other economic and social benefits in the region in which it is located, including the broadening of economic participation by promoting small, micro and medium enterprises and co-operatives, and promoting skills and technology transfer; and
- the generation of new and innovative economic activities.

It was announced in the 2012 Budget Review[7] that certain tax incentives would be considered for the SEZs. A company that meets the requirements (see **4** and **5**) may qualify for a special taxation dispensation (see **3**).[8]

3 The SEZ Act came into effect on 9 February 2016.
4 Section 1 of the SEZ Act which defines a special economic zone to mean an area designated as the special economic zone under section 23(6).
5 Section 4(1) of the SEZ Act.
6 Section 4(2) of the SEZ Act.
7 National Treasury. (2012). Budget Review 2012.
8 See Regulation 7 of the Regulations under the SEZ Act.

1.1 Transitional provisions from the industrial development zone to special economic zone regime

Section 39 of the SEZ Act provides for the following transitional provisions from the IDZ regime to the SEZ regime:

- Any designation of an IDZ under the IDZ Regulations, which was in force immediately before the promulgation of the SEZ Act, will remain in force and must be regarded as a designation of a SEZ under the SEZ Act.[9]
- Any IDZ operator permit issued under the IDZ Regulations, which was in force immediately before the promulgation of the SEZ Act, will remain in force and must be regarded as an SEZ operator issued under the SEZ Act.[10]
- Any IDZ enterprise approved to be located in an IDZ under the IDZ Regulations before the SEZ Act came into operation, must be regarded as a business approved to be located within an SEZ, provided the IDZ enterprise comply with sections 24(4)[11] and 38(3)[12] of the SEZ Act.[13]
- The IDZ operator has three years within which to ensure that it complies with the SEZ framework and regulations as per the SEZ Act, failing which the IDZ operator's permit will be rescinded.[14]
- An outstanding application for the designation of an IDZ or issuing of an IDZ operator permit under the IDZ Regulations which has not been finalised by the commencement date of the SEZ Act, must be dealt with as an application submitted under the SEZ Act.[15]

A company, which qualified to claim the VAT and customs incentives available under the IDZ regime before the promulgation of the SEZ Act, will be able to continue to claim these incentives, as section 39(2) of the SEZ Act states that all existing IDZs that were in force before the implementation of the SEZ Act are deemed to be designated special economic zones after the promulgation of the SEZ Act.[16] This deeming provision applies for purposes other than the application of section 12R and section 12S.

9 Section 39(2) of the SEZ Act.
10 Section 39(3) of the SEZ Act.
11 The section provides that The Minister may, after consultation with the Minister of Finance, prescribe the type of service and business that may be located in a special economic zone in order to achieve the purpose of special economic zones set out in section 4.
12 The section provides that the Special Economic Zone Board may, after considering the recommendations of the operator, approve the application of a business to locate within that special economic zone, with or without conditions.
13 Section 39(4) of the SEZ Act.
14 Section 39(5) of the SEZ Act.
15 Section 39(6) of the SEZ Act.
16 Section 39(2) of the SEZ Act.

Example 1 – Transitional provisions from the IDZ to the SEZ regime

Facts:

Company Z commenced trading within the designated Richard Bay IDZ in 2006. The SEZ Act was promulgated by the Minister of Trade and Industry in 2016, and the Minister of Finance approved the six special economic zones, that included Richards Bay IDZ, on 6 July 2018.

Result:

Section 39 of the SEZ Act provides that all former IDZs will be deemed SEZs and all the applications approved under the IDZ regime before the effective date of the SEZ Act must be treated as though they were made under the SEZ regime. Company Z will only be able to claim the reduced corporate tax rate under section 12R and the accelerated building allowance under section 12S from 6 July 2018, provided Company Z meets the requirements of a qualifying company as defined, and does not conduct any excluded activities.

2. Overview of the special economic zones

The five role players, namely –

- the Minister;
- the Advisory Board;[17]
- the DTI;
- the Licensee; and[18]
- the Operator,[19]

each execute a vital role in the planning, development and management of SEZs to advance the government's industrialisation, regional development, export promotion and job creation initiative.

2.1 The responsibilities of the role players

The Minister bears the ultimate responsibility for the development and implementation of the policy, strategy and programmes aimed at ensuring the effective development and regulation of the SEZs. The SEZ Advisory Board advises the Minister on the policy for the designation, promotion, development, operation and management of an SEZ,[20] and also determines an SEZ strategy and programmes to best support government's economic and industrial development policies. The SEZ Advisory Board is also responsible for –[21]

- monitoring the implementation of the SEZ policy and strategy and reporting to the Minister on an annual basis on the implementation of such policy and strategy;
- considering an application for designation as an SEZ and recommending to the Minister whether or not to approve the application and grant an SEZ licence to the applicant;

[17] Defined in section 1 of the SEZ Act.
[18] Defined in section 1 of the SEZ Act.
[19] Defined in section 1 of the SEZ Act.
[20] Section 5 of the SEZ Act.
[21] Section 11 of the SEZ Act.

- considering an application for an operator permit and recommending to the Minister whether or not to approve the application;
- considering an application for the transfer of an operator permit and recommending to the Minister whether or not to approve such application with or without any condition;
- liaising with an SEZ Board and an operator on the implementation of the SEZ strategic plans;
- reporting in the prescribed manner to the Minister on progress relating to the development of SEZ's;
- advising the Minister on minimum norms and standards required for the provision of a one-stop shop in an SEZ;
- advising the Minister on initiatives to market SEZs; and
- assessing and reviewing the success of SEZs in achieving the purpose referred to in section 4 of the SEZ Act.

The DTI's responsibilities include the overall facilitation and coordination of the SEZ regime. The DTI is also tasked with providing –

- secretariat support for the Advisory Board,[22]
- technical support to provinces, municipalities, other government departments and zones regarding the planning, development, and management of SEZs;[23] and
- specialised support functions for the development and operation of SEZs to other government agencies and departments aimed at promoting co-operation, coordination and liaison.[24]

A "licensee" is defined as the holder of an SEZ licence issued under section 23(6) of the SEZ Act,[25] and is responsible for the governance and management of a designated SEZ (see **2.5**).

The SEZ Board will in turn appoint an operator under section 31 of the SEZ Act (see **2.5**), whose responsibilities, on behalf of the SEZ Board are to – [26]

- implement the strategic plan for that SEZ within the framework of the SEZ strategy;
- make improvements to that SEZ and its facilities according to the written agreement contemplated in section 34(1) of the SEZ Act;
- provide or facilitate provision of infrastructure and other services required for that SEZ to achieve its strategic and operational goals;
- provide adequate demarcation of the SEZ from any applicable customs territory for the protection of revenue;
- make provision for the movement of conveyances, vessels and goods entering or leaving that SEZ;

[22] Section 17 of the SEZ Act.
[23] **www.thedti.gov.za/industrial_development/docs/SEZ_Guide.pdf** [Accessed 5 July 2024] paragraph 6.1.1 at 20.
[24] **www.thedti.gov.za/industrial_development/docs/SEZ_Guide.pdf** [Accessed 5 July 2024] paragraph 6.1.1 at 20.
[25] Section 1 of the SEZ Act.
[26] Section 35 of the SEZ Act.

- provide adequate security for all facilities in the SEZ;
- adopt rules and regulations for businesses within the SEZ in order to promote their safe and efficient operation;
- maintain adequate and proper accounts and other records in relation to the SEZ's business;
- report in the manner prescribed or required on the activities, performance and development of the SEZ to the Minister, and as required under any other legislation;
- promote the SEZ as a foreign and domestic direct investment destination, in consultation with the Advisory Board;
- recommend to the SEZ Board whether or not to approve an application by a business to locate within the SEZ under section 38 of the SEZ Act;
- apply to the Minister for finance and support measures contemplated in section 21 of SEZ Act in the form and manner prescribed;
- facilitate a single point of contact or one-stop shop that delivers the required government services to businesses operating in the SEZ in order to provide simplified procedures for the development and operation of that SEZ and for setting up and conducting business in that SEZ; and
- undertake any other activity within the scope of this Act to promote the effective functioning of the SEZ.

2.2 Categories of special economic zones

SEZs are divided into four different categories, which are elaborated on below.[27]

A free port

This is a duty-free area adjacent to a port of entry where imported goods may be unloaded for value-adding activities within the SEZ for storage, repackaging or processing, subject to customs import procedures.[28]

Free trade zones

These are duty free areas offering storage and distribution facilities for value-adding activities within the SEZ for subsequent export.[29]

Industrial development zone

This is a purpose-built industrial estate that leverages domestic and foreign fixed direct investment in value-added and export-oriented manufacturing industries and services.[30]

Sector development or specialised zones

These are zones focused on the development of a specific sector or industry through the facilitation of general or specific industrial infrastructure, incentives, technical and business services primarily for the export market.[31]

[27] Section 24(2) of the SEZ Act.
[28] Section 24(5)(*a*) of the SEZ Act.
[29] Section 24(5)(*b*) of the SEZ Act.
[30] Section 24(5)(*c*) of the SEZ Act.
[31] Section 24(5)(*d*) of the SEZ Act.

The DTI's policy on the development of SEZs provides that despite the SEZs falling into the respective four categories, the categories were designed to complement each other. More than one category can thus be incorporated into a single zone plan.

2.3 Types of businesses and services that may apply to locate within a special economic zone

Paragraph 9(1) of the SEZ Regulations lists the types of service or business eligible to apply to be located within an SEZ. This includes –

- a business conducting manufacturing activities;
- a business performing internationally tradable services; or
- a business providing warehousing and distribution and logistics services.

Under paragraph 9(2) a company that is excluded under paragraph 9(1) from being eligible to apply to locate in an SEZ may apply to be located in an SEZ provided that –

- such business or service provides services or sells goods that support the businesses located in the SEZ; and
- the number of services or businesses, together with the area they occupy in the SEZ does not exceed the number and area provided for in the Guidelines issued by the Minister.[32]

A business or service that has been approved to locate within an SEZ will not automatically qualify for the support measures in paragraph 7 but must meet all the eligibility requirements.[33]

2.4 Special economic zone fund

The development of an SEZ is a capital-intensive exercise that requires significant resources, and a clear financing framework to facilitate long-term planning. Thus, the Minister, in concurrence with the Minister of Finance, may establish an SEZ fund from the budget allocated to the DTI by Parliament to support the promotion and development of SEZs.[34] The DTI's policy on the development of an SEZ states that the purpose of the SEZ fund is to support the planning and development of SEZs, and all the monies distributed from the fund should be allocated in support of –[35]

- feasibility studies;
- start-up costs;
- site preparation;
- infrastructure development;
- business development and performance improvement;
- business incubators;
- skill development; and

[32] Section 40 of the SEZ Act.
[33] Paragraph 9(3) of the SEZ Regulations.
[34] Section 20(1) of the SEZ Act.
[35] SEZ Regulations (4)(2).

- initiatives to support industrialisation and economic growth and achieve the purpose of an SEZ as identified in the SEZ policy[36] and strategy.[37]

The SEZ fund must be administered and managed in accordance with the PFMA. The Minister must establish an adjudication committee, chaired by the Director-General,[38] to consider applications for monies from the SEZ Fund, and such committee shall make recommendations to the Minister.[39] Any money in the Fund, which is not required for immediate use, may be invested in accordance with an investment policy approved by the Minister that complies with the requirements of the PFMA and may be withdrawn when required.

2.5 Application for designation of an area as a special economic zone

Designation of certain areas as SEZs takes place by means of special designation by the Minister on his or her own accord,[40] or on application to the Minister for such designation acting alone or jointly by –[41]

- national government;
- a provincial government;
- a municipality;
- a public entity; or
- a public-private partnership.

The applicant must demonstrate that the designation of an area as an SEZ will further enhance the national government's industrial development objectives,[42] and fulfil the requirements under section 23(2) and section 23(3) of the SEZ Act. The Minister may, after considering the recommendation of the Advisory Board[43] and after consultation with the Minister of Finance, publish the possible designation of an SEZ by notice in the *Government Gazette* for the public to make comments within a period of 30 days. Upon approval of the application to designate an area as an SEZ, the Minister must issue an SEZ licence to the applicant.[44]

The approved applicant will be a "licensee" as defined in section 1 of the SEZ Act and is required upon designation of an area as an SEZ to –[45]

- establish an entity that will be responsible for the management of the SEZ;[46] and
- provide the entity with the resources and means necessary to manage and operate the SEZ, including the transfer of ownership or control of land comprising the area designated as an SEZ.[47]

36 Section 5 of the SEZ Act.
37 Section 6 of the SEZ Act.
38 Section 1 of the SEZ Act.
39 SEZ Regulations (3)(2).
40 Section 24(1) of the SEZ Act.
41 Section 23(1) of the SEZ Act.
42 Section 4(2) of the SEZ Act.
43 Section 1 of the SEZ Act.
44 Section 23(6)(*b*) of the SEZ Act.
45 Section 25(1) of the SEZ Act.
46 Section 25(1)(*a*) of the SEZ Act.
47 Section 25(1)(*b*) of the SEZ Act.

If the management licensee is a national or provincial government or a public entity[48] licensee, then such an entity must be established as a national government business enterprise or a provincial government business enterprise as contemplated in section 1 of the PFMA.[49] If the management licensee is a municipality or a municipal entity, the management entity must be established as a municipal entity as contemplated in section 1 of the Municipal Systems Act,[50] and if the management licensee is a public-private partnership, the management entity must be established as a company.[51]

Each licensee is required to appoint an SEZ Board,[52] which will be responsible for the efficient governance and management of the business affairs of that SEZ management entity, and also the development and implementation of a long-term plan to ensure that the targeted industries are developed.[53]

The SEZ Board may appoint an operator (see **2.1**) to develop, operate and manage an SEZ.[54] The appointed operator must apply to the Minster for an SEZ operator permit,[55] and the Advisory Board will consider the application made by the operator.[56] The Minister may, after considering the recommendation of the Advisory Board, issue a person with an operator permit, with or without conditions.[57] Any person who intends to conduct a business in an SEZ must apply to the SEZ Board, to locate the business in the designated SEZ.[58] The application should be done under section 38(2) of the SEZ Act and the SEZ Board may, after considering the recommendation of the operator, approve the application of a business to locate within that SEZ, with or without conditions.[59]

The role of the DTI is to focus on the designation, management and financing of SEZs, and it is therefore vital that an approved management entity ensure that it complies with requirements set out in section 12R in order to be eligible for the SEZ income tax incentives (see **4** and **5**).

2.6 Designated special economic zones and their effective dates

The Minister of Finance designated, by notice in *Government Gazette* 41758 of 6 July 2018, the following SEZs that were approved under section 12R(3):

- Coega Special Economic Zone[60]
- Dube Tradeport Special Economic Zone[61]
- East London Special Economic Zone[62]

48 Section 1 of the SEZ Act.
49 Section 25(2) of the SEZ Act.
50 Section 25(3) of the SEZ Act.
51 Section 25(4) of the SEZ Act.
52 Section 25(5), read with definition of “Special Economic Board” in section 1 of the SEZ Act.
53 Section 25(5) of the SEZ Act.
54 Section 31 of the SEZ Act.
55 Section 32(2) of the SEZ Act.
56 Section 32(3) of the SEZ Act.
57 Section 32(4) of the SEZ Act.
58 Section 38(1) of the SEZ Act.
59 Section 38(3) of the SEZ Act.
60 GN 694.
61 GN 695.
62 GN 696.

- Maluti-a-Phofung Special Economic Zone[63]
- Richards Bay Special Economic Zone[64]
- Saldanha Bay Special Economic Zone[65]

The Minister designated, by notice in the *Government Gazette*, the following SEZs that are not yet approved by the Minister of Finance under section 12R(3):

- Atlantis Special Economic Zone[66]
- Nkomazi Special Economic Zone[67]
- OR Tambo Special Economic Zone[68]
- Musina-Makhoda Special Economic Zone[69]
- OR Tambo International Airport SEZ extended to Tshwane Automotive Hub SEZ[70]

2.7 Withdrawal of designation

The designation of an area as an SEZ may be withdrawn by the Minister[71] after considering the recommendation for such withdrawal by the Advisory Board[72] and publishing such intention in the *Government Gazette*, if the purpose of the SEZ as envisaged in section 4 of the SEZ Act is no longer enhanced.[73] The Minister must, before withdrawing a designation, inform the affected licensee, the SEZ Board, the operator, and businesses located within the affected SEZ of the intention to withdraw the designation, and provide the reasons to support the withdrawal and afford the affected licensee, the SEZ Board, the operator and the businesses 30 days to submit written comments to the Minister as to why the SEZ designation should not be withdrawn.[74] Although section 30(3) of the SEZ Act states that the lawful activities of any business that entered into a written agreement with the operator will not be affected by the withdrawal of the SEZ designation, such a business will be precluded from claiming the income tax incentives available under the Act, as such a business will not be considered a qualifying company, as required (see **4**).

3. Special economic zones incentives

A company that meets the definition of a “qualifying company” under section 12R(1) will, if all the necessary requirements under the Act are met, qualify for the following tax benefits:

- VAT and customs relief for businesses or enterprises located in a custom controlled area within a designated SEZ, if the necessary approvals and registration are obtained from SARS.

63 GN 697.
64 GN 698.
65 GN 699.
66 GN 212 *GG* 41982 of 19 October 2018.
67 GN 286 *GG* 42323 of 22 March 2019.
68 GN 1170 *GG* 42703 of 13 September 2019.
69 GN 179 *GG* 41287 of 1 December 2017.
70 GN 170 *GG* 42956 of 17 January 2020.
71 Section 30(1) of the SEZ Act.
72 Section 1 of the SEZ Act.
73 Section 30 of the SEZ Act.
74 Section 30(2) of the SEZ Act.

- The employment tax incentive (ETI).[75]
- An additional investment allowance under section 12I(2).[76]

  Under this section a company may, subject to certain limitations and requirements,[77] in addition to any other deduction allowable under the Act, deduct an amount equal to –

  - 100% of the cost of any new and unused manufacturing asset[78] used in an industrial policy project[79] with preferred status that is located within an SEZ;[80] or
  - 75% of the cost of any new and unused manufacturing asset used in an industrial policy project other than an industrial policy project with preferred status that is located within an SEZ.[81]
- A reduced corporate income tax rate of 15% for a qualifying company on condition that such qualifying company does not conduct an excluded activity.[82]
- An accelerated building allowance under section 12S.

The reduced corporate income tax rate of 15%[83] as well as the accelerated building allowance under section 12S apply from 6 July 2018, which is the date the SEZs were approved by the Minister of Finance by promulgation in the *Government Gazette*.[84] If a qualifying company's year of assessment ended on or before 30 June 2018, the SEZ income tax incentives will not be available for the 2018 year of assessment, but will be available to such a qualifying company only from the 2019 year of assessment. The effective date for section 6(*a*)(ii) of the Employment Tax Incentive Act[85] is 1 August 2018 as stated in the *Government Gazette*.[86] See **1.1** for the transitional provisions between the IDZ and SEZ regimes.

[75] See *Guide to Employment Tax Incentive* for more detail on the ETI. For an employee to be considered a "qualifying employee", section 6(*a*)(ii) of the ETI Act requires that an employee must be employed by an employer that is a qualifying company as contemplated in section 12R and that such an employee renders services to that employer mainly within that special economic zone in which the qualifying company that is the employer, carries on a trade.

[76] See IN 86 "Additional Investment and Training Allowances for Industrial Policy Projects" for more detail.

[77] See section 12I for various limitations and requirements.

[78] See definition in section 12I(1).

[79] See definition in section 12I(1).

[80] Section 12I(2)(*a*)(ii).

[81] Section 12I(2)(*b*)(ii).

[82] Section 12R(4)(*a*) and (*b*).

[83] Rates and Monetary Amounts and Amendment of Revenue Laws Act 19 of 2022, section 6.

[84] GN 637, read with GG 41759 of 6 July 2018.

[85] Paragraph 9(2)(*a*) and (*b*) of the SEZ Regulations.

[86] GN 637, read with GG 41759 of 6 July 2018.

Example 2 – Promulgation of SEZ and the effective date of the designation of the zone

Facts:

Company V is a company, registered and incorporated in the Republic, which previously carried on a trade from 2010 within an IDZ by manufacturing electronic appliances. Company V's trading operations are currently provided from a fixed place of business in the designated and approved East London SEZ. The company's year of assessment ends on 31 May.

Result:

If Company V meets the requirements of a qualifying company under section 12R, the company will still not be eligible to claim the SEZ income tax incentives under sections 12R and 12S for the 2018 year of assessment as its year of assessment ends before the promulgation of the designated SEZs on 6 July 2018. Company V may claim the SEZ income tax incentive in the 2019 year of assessment if the all the necessary requirements are met.

4. Special economic zones (section 12R)

Section 12R came into operation on 9 February 2016 and ceases to apply to any year of assessment commencing on or after 1 January 2031.[87]

Section 12R allows for the special taxation dispensation linked to the SEZ Act. It contains the definition of a "qualifying company" (see **4.1**).[88] "SIC Code"[89] is also defined and refers to a specific version of the Standard Industrial Classification Code in order to provide certainty.

The section also contains specific listed activities (see **4.2.1** and **4.2.2**) and transactions with connected persons[90] (see 4.2.3) that disqualify a company from being a qualifying company.

Section 12R(1) defines the term "special economic zone" as follows:

> "a special economic zone as defined in the Special Economic Zones Act that is approved for the purposes of this section by the Minister of Finance under subsection (3);"

Section 12R(3) provides that the Minister of Finance must consider the financial implications for the Republic before approving an SEZ designation. The phrase "for purposes of this section" in section 12R(3) implies that the Minister of Finance must declare an intended zone to be a designated special economic zone for the purpose of section 12R. Thus, the income tax incentives under section 12R and section 12S cannot be claimed by a company before the Minister designating an SEZ since these incentives are only available to companies carrying on a trade within a designated SEZ.

87 Section 12R(5).
88 Section 12R(1).
89 Section 12R(1).
90 See definition in section 1(1). See also IN 67 "Connected Person" for more detail.

4.1 Definition of "qualifying company"

The defined term "qualifying company" means –

- a company incorporated in the Republic or any part of it[91] or has its place of effective management in the Republic;[92]
- the company carries on of a trade within a designated SEZ;[93]
- the trade is carried on from a fixed place of business situated within a designated SEZ;[94]
- the company derives not less than 90% of its income from carrying on of such a trade within one or more designated and approved SEZs;[95] and
- the company was carrying on any trade before 1 January 2013 in a location subsequently approved as a zone under section 12R(3);[96] or
- the company commenced on or after 1 January 2013, the carrying on, in a location approved or subsequently approved as a zone under section 12R(3), of any trade not previously carried on by that company or any connected person in relation to that company in the Republic;[97] or
- the company commenced on or after 1 January 2013, the carrying on, in a location approved or subsequently approved as a zone under section 12R(3) of any trade and that trade –[98]
    - comprises of the production of goods not previously produced by that company or any connected person in relation to that company in the Republic;[99] or
    - utilises the use of new technology in that company's production processes;[100] or
    - represents an increase in the production capacity of that company in the Republic.[101]

A qualifying company must comply annually with the requirements contained in the definition to claim the reduced corporate tax rate.[102] These requirements are briefly considered below.

91 Section 12R(1) paragraph (a)(i) of the definition.
92 Section 12R(1) paragraph (*a*)(ii) of the definition.
93 Section 12R(1) paragraph (*b*) of the definition.
94 Section 12R(1) paragraph (*c*) of the definition.
95 Section 12R(1) paragraph (*d*) of the definition.
96 Section 12R(1) paragraph (*e*)(i) of the definition deemed to have come into operation on 1 January 2019 and applicable for years of assessment ending on or after that date.
97 Section 12R(1) paragraph (*e*)(ii) of the definition deemed to have come into operation on 1 January 2019 and applicable for years of assessment ending on or after that date.
98 Section 12R(1) paragraph (*e*)(iii) of the definition deemed to have come into operation on 1 January 2019 and applicable for years of assessment ending on or after that date.
99 Section 12R(1) paragraph (*e*)(iii)(*aa*) of the definition deemed to have come into operation on 1 January 2019 and applicable for years of assessment ending on or after that date.
100 Section 12R(1) paragraph (*e*)(iii)(*bb*) of the definition deemed to have come into operation on 1 January 2019 and applicable for years of assessment ending on or after that date.
101 Section 12R(1) paragraph (*e*)(iii)(*cc*) of the definition deemed to have come into operation on 1 January 2019 and applicable for years of assessment ending on or after that date.
102 Rates and Monetary Amounts and Amendment of Revenue Laws Act 19 of 2021, section 6.

4.1.1 "Company"

The term "company" is defined widely in section 1(1) and includes –

- any association, corporation, or company (other than a close corporation) incorporated or deemed to be incorporated under any law in force in the Republic or in any part of it or any body corporate formed or established or deemed to be formed or established by or under any law;[103]
- any association, corporation or company incorporated under the law of any country other than the Republic or any body corporate formed or established under such law;[104]
- any co-operative;[105]
- any association (not being an association referred to in paragraphs (*a*) or (*f*)) formed in the Republic to serve a specific purpose, beneficial to the public or a section of the public (colloquially referred to as a public benefit organisation);[106]
- any portfolio comprised in any investment scheme carried on outside the Republic that is comparable to a portfolio of collective investment scheme in participation bonds or a portfolio of a collective investment scheme in securities in pursuance of any arrangement under which the public are invited or permitted to contribute to and hold participatory interests in that portfolio through shares, units or any other form of participatory interest or any portfolio of a collective investment scheme in property that qualify as a real estate investment trust (REIT) that meets the relevant requirements;[107] or
- close corporation,[108]

but does not include a foreign partnership.

Although a qualifying company has to fall within the definition of a "company" under section 1(1), not all entities listed in the definition of "company" will meet the requirements under section 12R(1). For instance, the definition of "company" includes reference to a body corporate, a public benefit organisation and collective investment schemes that will likely not meet the requirements of a qualifying company under section 12R(1)(*a*)-(*d*) and will not meet the definition of a "qualifying company".

4.1.2 Incorporated or has a place of effective management in the Republic

A qualifying company must either be incorporated or deemed to be incorporated under any law[109] in force or previously in force in the Republic or in part of it or have its place of effective management in the Republic.[110] Interpretation Note (IN) 6 "Resident: Place of Effective Management (Companies)" states the following regarding the general principle of a company's place of effective management:[111]

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[103] Paragraph (a) of the definition of a "company" under section 1(1).
[104] Paragraph (*b*) of the definition of a "company" under section 1(1).
[105] Paragraph (c) of the definition of a "company" under section 1(1).
[106] Paragraph (*d*) of the definition of a "company" under section 1(1).
[107] Paragraph (*e*) of the definition of a "company" under section 1(1). A "REIT" is defined in section 1(1).
[108] Paragraph (*f*) of the definition of a "company" under section 1(1).
[109] Section 1 of the Interpretation Act 33 of 1957 defines "law" as "any law, proclamation, ordinance, Act of Parliament or other enactment having the force of law".
[110] Section 12R(1)(*a*)(i) and (ii).
[111] At paragraph 4.1.

> "….is the place where key management and commercial decisions that are necessary for the conduct of its business as a whole are in *substance* made."

The place where the company's key management and commercial decisions are made must be assessed with reference to that company's day-to-day activities and not where, for example, the board of directors meets. The place where key management and commercial decisions are made would therefore depend on the business activities and nature of the taxpayer. Should the business operations or activities be conducted in more than one location, then the place with the strongest economic *nexus* must be determined.[112] Therefore, the specific facts and circumstances of each case must be evaluated when determining whether a company has its place of effective management in the Republic.

It is a factual question whether a company is incorporated as envisaged.

4.1.3 "Carries on a trade"

Under paragraph (*b*) of the definition of "qualifying company", the company must carry on a trade in an SEZ designated by the Minister and approved by the Minister of Finance after consultation with the Minister as required under section 12R(3). The word "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 as defined in the Patents Act or any design as defined in the Designs Act or any trade mark as defined in the Trade Marks Act or any copyright as defined in the Copyright Act or any other property which is of a similar nature".

The Court held in *Burgess v CIR*[113] that:

> "It is well-established that the definition of trade, which I have quoted above, should be given a wide interpretation. In ITC 770(1953) 19 SATC 216 at p 217 Dowling J said, dealing with the similar definition of 'trade' in Act 31 of 1941, that it was 'obviously intended to embrace every profitable activity and . . . I think should be given the widest possible interpretation.'"

The term "trade" covers a wide spectrum of activities, but it does not include all activities that might produce a source of income. The mere watching over investments will, for example, not constitute carrying on of a trade.[114]

The qualifying company's trade must be carried on within one or more designated and approved SEZs. Thus, a company must operate and conduct income-producing activities within a designated and approved SEZ. The mere fact that a company is located within an SEZ would not automatically qualify that company to be classified as a qualifying company as it is still required to conduct a trade within a designated and approved SEZ. The facts and circumstances of each case should be considered to ascertain if a person is carrying on a trade within a designated and approved SEZ.

4.1.4 "Fixed place of business"

Under paragraph (*c*) of the definition of "qualifying company" the trade must be carried on from a fixed place of business. The phrase "fixed place of business" is not defined in the Act and

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112 See IN 6 "Resident – Place of Effective Management (Companies)" in 3.3.

113 1993 (4) SA 161 (A), 55 SATC 185 at 196.

114 See IN 33 "Assessed losses: Companies: The 'Trade' and 'Income' from Trade Requirements" for more detail meaning of trade.

as such the words should be given their ordinary dictionary meaning having regard to the context in which they are used.

The *Oxford Dictionary* defines the term "fixed"[115] as follows:

> "4. definitely and permanently placed:"

BusinessDictionary.com defines the phrase "place of business"[116] as follows:

> "An office or location where main business transactions are executed and its records are stored. It is necessary to have a place of business filed to the secretary of state for establishing a business."

Black Law's Dictionary defines the phrase "place of business"[117] as follows:

> "The location where a business is actually located; where most of the business activities, as well as their records are kept."

The commentary on Article 5 of the OECD Model Tax Convention states the following regarding the phrase "fixed place of business":[118]

> "The paragraph defines the term 'permanent establishment' as a fixed place of business, through which the business of an enterprise is wholly or partly carried on. This definition, therefore, contains the following conditions:
>
> - the existence of a "place of business", i.e. a facility such as premises or, in certain instances, machinery or equipment;
> - this place of business must be "fixed", i.e. it must be established at a distinct place with a certain degree of permanence;
> - the carrying on of the business of the enterprise through this fixed place of business. This means usually that persons who, in one way or another, are dependent on the enterprise (personnel) conduct the business of the enterprise in the State in which the fixed place is situated."

A "fixed place of business" should thus be interpreted to include an unchanging and established premises, facility, installations or place with a degree of permanence whereby a company carries on a trade on a continuous basis. It is further a place where, amongst others –

- that business is conducted through one or more offices, shops, factories, or other similar structures;
- that fixed place of business is suitably staffed with on-site managerial and operational employees of that company who conduct the primary operations of that business; and
- that fixed place of business is suitably equipped for conducting the primary operations of that business.

The qualifying company itself must therefore have a physical presence within the designated and approved SEZ. If a company conducts different trades, its main trade must be conducted from a fixed place of business situated within a designated and approved SEZ. The facts and circumstances of each case will be considered to determine whether the company is carrying on a trade from a fixed place of business within a designated and approved SEZ.

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115 **www.dictionary.com/browse/fixed/** [Accessed 5 July 2024].
116 **www.businessdictionary.com/definition/place-of-business.html** [Accessed 5 July 2024].
117 **www.thelawdictionary.org/place-of-business/** [Accessed 5 July 2024].
118 At 117.

It is irrelevant whether a company owns or leases the "fixed place of business" as the distinctive factor is whether the company holds a right of use or occupation to the fixed place of business to carry on a trade.

Example 3 – Carry on a trade from a fixed place of business

Facts:

Company V is a company registered and incorporated in the Republic that carries on a manufacturing trade from a designated IDZ. In July 2018 Company V relocated its manufacturing operations outside the now designated and approved SEZ due to its economic feasibility. However, the warehousing and distribution of the manufactured products and management operations of Company V is conducted from the SEZ.

Result:

Paragraph (*c*) of the definition of "qualifying company" in section 12R(1) requires the trade of the company to be conducted from a fixed place within an SEZ. The main trade activity of Company V is that of manufacturing from which it derives its gross income. As the main trade activity of Company V is conducted outside the SEZ it will not meet the requirement in paragraph (*c*) of the definition of "qualifying company" and will consequently be disqualified as a "qualifying company".

Example 4 – Qualifying company meeting requirements of section 12R(1) annually

Facts:

Company RS carries on the trade of manufacturing gardening equipment within a designated and approved SEZ. Company RS had to relocate its manufacturing operations due to the expiry of its lease agreement, and consequently located to new premises outside a designated and approved SEZ a few days before the end of its year of assessment.

Result:

A return of income (an ITR 14 in the case of a company) is completed for either a year of assessment or any other period. The trade of Company RS was conducted for most part of the year of assessment in a designated and approved SEZ and for a short period outside of an SEZ, therefore its fixed place of business changed from an SEZ to a non-SEZ. Section 12R(1)(*c*) of the definition of "qualifying company" requires the trade of a company be conducted from a fixed place of business situated from within an SEZ. Since the trade of Company RS was partly conducted from an SEZ and the exceptions under section 12R(1)(*e*) are not applicable Company RS will not be regarded as a qualifying company for that year of assessment in which it relocated. Consequently, Company RS will not qualify to apply the reduced corporate income tax rate for that year of assessment.

4.1.5 "90% of the income must be from a trade carried on within one or more special economic zones"

Under paragraph (*d*) of the definition of "qualifying company" 90% of the company's income must be from a trade carried on within on or more SEZs. This requirement is explained as follows in the *Explanatory Memorandum*:[119]

> "In order to qualify for income tax incentives, one of the requirements is that a company should not have less than 90 per cent of its income derived from the carrying on of business or provision of services within SEZ. This requirement is aimed at ensuring that business profits qualifying for the lower business tax rate should arise from the productive activities of the qualifying company. There is still a risk that profits may be artificially shifted from fully taxable connected persons to the qualifying company."

(Emphasis added)

"Income" is defined as the amount remaining of gross income after deducting any income that is exempt under the Act.[120] "Gross income" is defined as the total amount in cash or otherwise received or accrued to a resident, but excludes the receipts and accruals of a capital nature.[121] Gross income includes all sources of income, that is, from trade as well as passive income such as interest or dividends. Since South Africa has a residence basis of tax, all income received or accrued from within or outside the Republic must be included in gross income.

The word "income" in section 12R(1)(*d*) is used in conjunction with the words "*is derived from the carrying on of a trade within one or more special economic zones*". The word "income" should therefore not be interpreted in the defined meaning but having regard to the context and the purpose for introducing the incentive. The *Explanatory Memorandum* makes it clear that the income must be from carrying on business or the provision of services within an SEZ. This means that only income derived from the productive activities of a qualifying company in one or more SEZs must be considered for the purposes of section 12R(1)(*d*) and not income as "defined" in the Act. In other words, passive and non-trade related income, for example, interest income or dividends, must be excluded when the threshold of 90% of income from trade is determined.[122]

The trade of a taxpayer may extend over a wide geographical area in the Republic through the operation of branches or divisions, which may be conducted in both designated and outside designated and approved SEZs. Paragraphs (*b*), (*c*) and (*d*) of the definition of "qualifying company" refer to the trade conducted within a designated and approved SEZ. Therefore, when determining the income threshold of a taxpayer, certain trade activities of a taxpayer, while being conducted within a designated and approved SEZ, may constitute an excluded activity under section 12R(4). Some trade activities might also be conducted outside a designated and approved SEZ. The effect of such activities is that the 90% threshold is determined by taking into account the proportion of the income received and accrued from the carrying on an eligible trade within one or more of the designated and approved SEZs and apportioning this amount to the total income received by or accrued to the company. If the portion of the company's income comprising income from one or more SEZs is equal to 90%

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119 *Explanatory Memorandum on the Taxation Amendment Bill, 2015.*

120 Section 1(1).

121 Section 1(1).

122 See *Western Platinum Limited v C:SARS* [2004] 4 All SA 611 (SCA)*;* 67 SATC 1 in which the Supreme Court of Appeal confirmed the principle that when a class privilege is considered a strict interpretation should be applied.

or more, the company will meet the requirement under paragraph (*d*) of the definition of "qualifying company".

Example 5 – Determination of the 90% income threshold which include passive income

Facts:

Company H, a new company, is registered and incorporated in the Republic and carries on the trade of manufacturing flat screen televisions within a designated and approved SEZ. Company H also provides management services and hold shares as investment. All of Company H's trading operations are conducted from a fixed place of business within a designated and approved SEZ. Company H's income from manufacturing forms 85% of its total income and the remaining 15% comprises of management fees and dividend income.

Result:

Paragraph (*d*) of the definition of "qualifying company" in section 12R(1) requires that at least 90% of the income of that company be derived from carrying on a trade within one or more designated and approved SEZ's. The main trade conducted by Company H is the manufacturing of flat screen televisions, and as the income derived from this trade is only 85% of its total income it will not qualify under paragraph (*d*) of the definition of "qualifying company".

Example 6 – Determining of the 90% income threshold

Facts:

Company X is a company registered and incorporated in the Republic and carries on the trade of manufacturing and installing air conditioners. Due to the local and export demand, the manufacturing activities are split between Coega and East London designated and approved SEZs, while a branch in the OR Tambo SEZ is used exclusively for warehousing and retailing. The income received or accrued from the designated and approved Coega and East London SEZs constitutes 75% and 20%, respectively of the total income of Company X. The warehousing and retailing branch contribute 5% to the total income of Company X.

Result:

Paragraph (*d*) of the definition of "qualifying company" in section 12R(1) requires that at least 90% of the income of that company be derived from carrying on a trade within one or more designated and approved SEZs. Company X trades from three designated and approved SEZs. However, the manufacturing activities are conducted from only two of the SEZs, that is, Coega and East London, while the OR Tambo is used only for warehousing and retailing. Therefore, for purposes of determining whether Company X meets the requirements under section 12(1)(*d*), the income derived from the Coega and East London SEZs will be considered, and as it constitutes 95% (75% income from the Coega SEZ, plus 20% income from the East London SEZ) of the total income of Company X, it will meet the income threshold requirements under paragraph (*d*) in section 12R(1).

4.1.6 Carrying on of a trade before 1 January 2013 in a location subsequently approved as a zone under section 12R(3)

Paragraph (*e*) of the definition of "qualifying company" was introduced to align the provision of the SEZ tax regime with the overall policy objective of the SEZ programme. The DTI policy document[123] provides for existing businesses that were already operating in an established IDZ before the introduction of the SEZ regime as follows:[124]

> "Existing businesses already set up or functioning in an existing IDZ in South Africa before the commencement of the SEZ Act, however their eligibility to the SEZ incentive package will be contingent on them meeting the incentive criteria. Relocations of existing businesses into SEZs will not be eligible."

Paragraph (*e*)(i) requires that a company should have carried on a trade before 1 January 2013 in a location that is subsequently approved for purposes of section 12R as an SEZ (see **1.1**) by the Minister of Finance. This provision allows for existing companies, before the designation and approval of an area as an SEZ, to qualify for the income tax incentives if they are located in an area that is subsequently approved for the purpose of section 12R.

Example 7 – Carrying on of a trade before 1 January 2013 in a location subsequently approved as a zone under section 12R(3)

Facts:

Company O is a company registered in 2006 and incorporated in the Republic and carries on the trade of manufacturing stationery. It is located within the East London IDZ, which is also its fixed place of business. On 6 July 2018 the Minister of Finance approved the East London IDZ as an SEZ. Company O continued with its manufacturing activities from the approved East London SEZ, from where it derived more than 90% of its income from trade.

Result:

Company O will meet the requirement under section 12R(1)(*e*)(i) as it was carrying on a trade before 1 January 2013 in a location that is subsequently approved for purposes of section 12R as an SEZ. Company O will be regarded as a qualifying company if it meets the other requirements under section 12R, and will therefore be eligible for the income tax incentives.

4.1.7 Carrying on of a trade on or after 1 January 2013 not previously carried by such company or a connected person

Paragraphs (*e*)(ii) and (iii) of the definition of "qualifying company" were introduced to give effect to the overall policy objective to enhance job creation, economic growth and attracting foreign and domestic investment. The purpose of the additional requirements is to distinguish between existing and new businesses to counter the potential unintended consequences of old or existing business merely relocating to an SEZ to claim the income tax incentives, which is primarily aimed at attracting new or expanding the capacity of existing manufacturing business.[125]

[123] Policy document titled "DTI's Policy on Development of SEZ".
[124] *Explanatory Memorandum on the Taxation Amendment Bill, 2019*.
[125] *Explanatory Memorandum on the Taxation Amendment Bill, 2019.*

Under paragraph (*e*)(ii) of the definition, a company will be a qualifying company if it –

- commenced the carrying on a trade on or after 1 January 2013;
- in a location that is approved or subsequently approved as a zone under section 12R(3) (see **1.1**); and
- the trade was not previously carried on by that company or any connected person[126] in relation to that company in the Republic.

This requirement provides specifically for the establishment of a new trade in a location that is approved or subsequently approved as an SEZ. It prevents existing companies or connected persons to such companies to simply re-locate to a location that is approved or subsequently approved as an SEZ and continue to carry on a similar trade as previously conducted outside the designated and approved SEZ by such companies.

An existing company will not meet the requirements under paragraph (*e*)(ii) of the definition of "qualifying company" if that company –

- conducted its trade outside a designated and approved SEZ and subsequently re-locates within a designated and approved SEZ on or after 1 January 2013, only to continue with the same trade as previously conducted; or
- carries on a trade on or after 1 January 2013 within a designated and approved SEZ, which is the same trade previously conducted by any connected person in relation to that company in the Republic.

A company or a connected person to that company that previously conducted the same trade within the Republic is disqualified as a qualifying company. This disqualification, however, does not apply to a trade conducted outside of the Republic or a new trade.

Example 8 – Continuation of trade under a new company in a designated SEZ

Facts:

Company Q is a company registered and incorporated in the Republic during January 2014 and carried on the trade of manufacturing furniture from a factory situated in the Richards Bay Industrial Area. In January 2017 Company Q is voluntarily liquidated and the shareholders form a new company, Company P. Company P is located in the designated and approved Richards Bay SEZ, which is also its place of effective management. The new Company P manufactures office furniture and all of its income is derived from this trade.

[126] See definition in section 1(1) and IN 67 "Connected Persons" for more detail.

Result:

Paragraph (*e*)(ii) of the definition of "qualifying company" requires the trade of the company commences in a designated and approved SEZ on or after 1 January 2013 and that the trade must not be previously conducted by that company or a connected person to that company. Company P commenced with the trade in a designated and approved SEZ after 1 January 2013. The shareholders of Company P and Company Q are the same and therefore they will be considered to be connected persons.[127] The trade conducted previously by Company Q and currently by Company P is the manufacture of furniture. Although a different type of furniture is manufactured, the trade is considered to be the same as that of Company Q. Therefore, Company P will not meet the requirements under paragraph (*e*)(ii) of the definition of "qualifying company" as it continued with the same trade conducted by Company Q in a designated and approved SEZ.

Example 9 – Conducting a new trade on or after 1 January 2013 in a designated SEZ

Facts:

Company Z manufactures school uniforms for the major retail outlets, and due to the demand for school shoes establishes Company V in 2014 to assist in meeting these manufacturing demands. Company V commenced carrying on of the trade of manufacturing school shoes on 1 January 2015 within the designated and approved Coega SEZ. Company V is regarded as a connected person in relation to Company Z under paragraph (d) of the definition of "connected person" in section 1(1).

Result:

Paragraph (*e*)(ii) of the definition of "qualifying company" requires that the trade of a company commences in a designated and approved SEZ on or after 1 January 2013 and that the trade must not be previously conducted by that company or a connected person to that company. Company V commenced with the trade of manufacturing school shoes in a designated and approved SEZ after 1 January 2013. Companies V and Z are connected persons under the definition of "connected person" in section 1(1). Although the trades conducted by Companies V and Z relate to the school industry, each is a separate and distinct new trade. Company V will therefore meet the requirements under paragraph (*e*)(ii) of the definition of "qualifying company".

4.1.8 Trade conducted on or after 1 January 2013 – production of goods not previously produced, the use of new technology in the production process or there is an increase in the production capacity

Paragraph (*e*)(iii) of the definition of "qualifying company" requires that a company commenced on or after 1 January 2013 the carrying on, in a location that is approved or subsequently approved by the Minister of Finance as an SEZ (see **1.1**), of any trade and that trade comprises of –

- the production of goods not previously produced by that company or any connected person in relation to that company in the Republic;[128] or

[127] Definition of "connected person" under section 1(1)(*d*).
[128] Section 12R(1)(*e*)(iii)(*aa*).

- the use of new technology in that company's production processes;[129] or
- an increase in the production capacity of that company in the Republic.[130]

The *Explanatory Memorandum*[131] explains the policy rational for paragraph (*e*)(iii) of the definition of "qualifying company" as follows:

> "On the other hand, the current income tax provisions for qualifying companies operating within an SEZ does not expressly make a provision for a requirement that only a new company or an expansion of an existing company may qualify for income tax benefits. Lack of this requirement in the tax legislation results in unintended result that old, existing, and re-located businesses could unjustifiably benefit for income tax benefits that are only aimed at attracting new and expanded manufacturing businesses."

(Emphasis added)

Production of goods not previously produced by that company or a connected person to such a company.

A company commencing trade on or after 1 January 2013 in a location that is approved or subsequently approved by the Minister of Finance under section 12R(3), and produces goods not previously produced by such a company or any connected person in relation to such a company in the Republic, may be a "qualifying company" under paragraph (*e*)(iii)(*aa*) of the definition of "qualifying company".

The phrase "production of goods" is not defined in the Act and thus bears the ordinary meaning of words used in the context.

Dictionary.com defines the words "production" and "goods", respectively, as follows:

> "1 The act of producing; creation; manufacture. [132]
>
> "3. articles of commerce; merchandise."[133]

The words "production of goods" therefore involve the activities of a company that use raw materials or components to produce a different end product. The principles applied by the courts to determine whether a process of manufacturing[134] is conducted can provide some guidance in determining whether a company is producing goods as envisaged in paragraph (*e*)(iii)(*aa*) of the definition of "qualifying company". The facts of each case will have to be considered.

The general principles to determine whether a "process of manufacture" is conducted have been summarised by Corbett JA, who delivered a dissenting judgment in *SIR v Safranmark* (*Pty*) *Ltd*:[135]

> "(1) The term "process of manufacture'', in the [context of s 12], denotes an action or series of actions directed to the production of an object or thing which is essentially different from the materials or components which went into its making.

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129 Section 12R(1)(*e*)(iii)(*bb*).

130 Section 12R(1)(*e*)(iii)(*cc*).

131 *Explanatory Memorandum on the Taxation Amendment Bill, 2019.*

132 **www.dictionary.com/definition/production** [Accessed 5 July 2024]**.**

133 **www.dictionary.com/definition/goods** [Accessed 5 July 2024].

134 See Practice Note 42 "Income Tax: Process of Manufacture, Process similar to a Process of Manufacture and Processes not regarded as Process of Manufacture or Process Similar to a Process of Manufacture".

135 1982 (1) SA 113 (A), 43 SATC 235 at 240-241.

> (2) The requirement of "essential difference" necessarily imports an element of degree; and there are no fixed criteria — nor is there any precise universal test — whereby it can be determined whether or not a change in the materials or components wrought by the process, be it as to the nature, form, shape or utility of the materials or components, has brought about an essential difference. This must be decided on the individual facts of each case.
>
> (3) When deciding whether a particular activity does or does not fall within the ambit of a "process of manufacture" the ordinary, natural meaning of that phrase in the English language must not be lost sight of. And in this connection analogies can be misleading. Thus to analyse and extract from a process or operation which indubitably amounts to a process of manufacture general criteria or attributes and to conclude that another process to which the same general criteria apply or which exhibits similar general attributes is, therefore, also a process of manufacture may lead to results not intended by the legislature, particularly where it would be inaccurate or unrealistic in normal parlance to describe the latter process as a process of manufacture."

In *SIR v Hersamer (Pty) Ltd* [136] the court held:

> "In Income Tax case no. 1052…Van Winsen J … concluded that, 'the article claimed to have resulted from a process of manufacture must be essentially different from the article as it existed before it had undergone such process'. With this statement I do not disagree. But it must be recognised that the term "essentially" obviously imports an element of degree into the determination of the sufficiency of the change that must be effected for a process to be one of 'manufacture'. As a result of being processed, a change may take place in regard to the nature or form or shape or utility, etc. of the previous article or material or substance. There can be no fixed criteria as to when any such change can be said to have effected an essential difference. It is a matter to be decided on the particular facts of the case under consideration."

The term "goods" implies tangible or corporeal things. The production of intangible or incorporeal property will thus not meet the requirement of the definition in paragraph (*e*)(iii)(*aa*). LAWSA[137] explains the distinction between corporeal and incorporeal things as follows:

> "The distinction between corporeals (*res corporales*) and incorporeals (*res incorporales*) is derived from Roman law. Material objects which could be felt or touched, such as land, clothes, furniture, gold and silver, were given as examples of corporeal things. Abstract concepts, namely objects having no physical existence but having a pecuniary value, like rights of various kinds (including rights of inheritance, personal rights and all real rights with the exception of ownership), were classified as incorporeals. Roman-Dutch writers such as Voet, Van der Keessel and the Frisian Huber followed the Roman law distinction between corporeals and incorporeals scrupulously. Other writers such as Grotius and Van Leeuwen adopted a slightly wider definition of corporeals so as to include not only material objects that could be touched but also physical objects such as gases which could be perceived by any of the senses."

(Footnotes omitted)

Paragraph (*e*)(iii)(*aa*) of the definition of "qualifying company" does not require a company to establish a new trade within a designated SEZ, as is essential under paragraph (*e*)(ii). It rather requires additional goods to be produced that were not previously produced by such company or any connected person in relation to such company in the Republic. A company will thus not meet the requirements under paragraph (*e*)(iii)(*aa*) of the definition of "qualifying company" if that company –

- carried on a trade before 1 January 2013;

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136 1967 (3) SA 177 (A), 29 SATC 53 at 64.

137 Van Der Merwe, C. G. (2002). Things. In W.A. Joubert (Ed.), *The Law of South Africa* (*LAWSA),* Volume *27.* 2ed. (para 46). Butterworths.

- conducted its trade on or after 1 January 2013 within a designated and approved SEZ and produces goods that was previously produced by that company or by any connected person in relation to that company in the Republic; or
- conducted its trade on or after 1 January 2013 outside a designated SEZ and subsequently re-locates within a designated and approved SEZ and only produces goods that were previously produced by that company or by any connected person in relation to that company in the Republic.

The question whether the company produces goods not previously produced is determined by the facts of each case. The production of goods previously produced by a company or connected persons to such companies within the Republic is affected by paragraph (*e*)(iii)(*aa*) of the definition of "qualifying company". It does not exclude the production of goods by a company or a connected person outside of the Republic.

Example 10 – Production of goods not previously produced by that company or connected person – paragraph (e)(iii)(*aa*)

Facts:

Company ZE is a company registered and incorporated during July 2014 in the Republic. Company ZE carries on the trade of manufacturing of motor vehicle rims from a factory situated in the Bloemfontein light commercial business district. During October 2018 Company ZE re-located to a fixed place of business within the designated and approved Maluti-a-Phofung SEZ. In addition to the manufacturing of motor vehicle rims, the company also started manufacturing motor vehicle brake pads.

Result:

Company ZE will meet the requirements under paragraph (*e*)(iii)(*aa*), as the manufacturing of motor vehicle brake pads in addition to the motor vehicle rims falls within the ambit of "production of goods not previously produced" by Company ZE in the Republic.

Utilises new technology in production processes

Paragraph (*e*)(iii)(*bb*) of the definition of "qualifying company" stipulates that a company commencing trade on or after 1 January 2013 within a location approved, or subsequently approved as a zone under section 12R(3) by the Minister of Finance, must utilise new technology in the production process. The phrases "new technology" and "production process" are not defined in the Act and as such the words should be given their ordinary dictionary meaning having regard to the context in which they are used.

Dictionary.com defines the words "new", "technology", "production" and "process", respectively, as follows:

> *New*
>
> "1. of recent origin, production, purchase, etc.; having but lately come or been brought into being:"[138]
>
> *Technology*
>
> "4. a scientific or industrial process, invention, method, or the like."[139]

[138] **www.dictionary.com/browse/new** [Accessed 5 July 2024].
[139] **www.dictionary.com/browse/technology** [Accessed 5 July 2024].

Production

"3. Economics. the creation of value; the producing of articles having exchange value."[140]

Process

"1. a systematic series of actions directed to some end:"[141]

The requirement of the use of new technology requires that the company must change its pre-existing techniques and use the machinery and equipment in its production processes that, for example, improve energy efficiency and cleaner production technology. The production process will be the manufacturing process of the qualifying company that leads to the final product. Existing technology that is merely upgraded or updated to a newer or latest version will not constitute "new technology" for purposes of paragraph (*e*)(iii)(*bb*). Whether the taxpayer has introduced new technology will depend on whether, amongst others, the production process of the qualifying company has changed, by amongst others, improved production time, reduced costs, improved product quality or improved product longevity. The facts of each case will be assessed to determine whether this requirement has been met.

A company will not meet the requirements under paragraph (*e*)(iii)(*bb*) of the definition of "qualifying company" if that company –

- carried on a trade before 1 January 2013; or
- carries on its trade on or after 1 January 2013 within a designated and approved SEZ and does not include the utilisation of new technology in its production process; or
- conducted its trade on or after 1 January 2013 outside a designated SEZ and subsequently re-locates within a designated and approved SEZ and does not include the utilisation of new technology in its production process.

Example 11 – A company utilises new technology in its production processes [paragraph (*e*)(iii)(*bb*)]

Facts:

Company AW is a company registered and incorporated in the Republic and carries on the trade, from 1 September 2015, of manufacturing customised wooden doors from a factory situated in the designated and approved East London SEZ. The doors are manufactured from lengths of imported exotic wood. Company AW acquires the latest laser cutting technology to assist in the precise measurement cutting of the wooden door panels from lengths of timber to reduce wastage and maximise the use of the full length of the wood. This technology also results in an improved energy efficiency. Company WA derives 96% of its income from manufacturing of the wooden doors.

[140] **www.dictionary.com/definition/production** [Accessed 5 July 2024].
[141] **www.dictionary.com/definition/process** [Accessed 5 July 2024].

Result:

Company AW meets the requirements under paragraph (*e*)(iii)(*bb*) of the definition of "qualifying company" as it was carrying on a trade on or after 1 January 2013 within location, approved or subsequently approved for purposes of section 12R as a zone, and the technology it utilises in its production process comprises new technology. Company AW will be regarded as a qualifying company if it also meets the other requirements under section 12R and will be eligible for the SEZ income tax incentives.

Represents an increase in the production capacity of that company in the Republic

Paragraph (*e*)(iii)(*cc*) of the definition of "qualifying company" provides that a company that commenced carrying on a trade or after 1 January 2013 within a location approved or subsequently approved as a zone under section 12R(3) by the Minister of Finance, must increase its production capacity within the Republic to qualify for the tax incentive.

The phrase "increase in production capacity" is not defined in the Act and as such the ordinary meaning of the words requires consideration.

The *Dictionary.com* defines the words "increase" and "production", respectively, as follows:

> *Increase*
>
> "to make greater, as in number, size, strength, or quality; augment; add to:"[142]
>
> Production
>
> "3. *Economics*. the creation of value; the producing of articles having exchange value."[143]

The *Financial Dictionary* defines the word "capacity" as follows:

> "The theoretical maximum number of products a company can produce at a given time."[144]

A qualifying company is therefore required to increase its production capacity. However, the provision does not indicate how the increase in production capacity should be measured. A company bears the onus to prove[145] that it has increased its production capacity to meet the requirements under paragraph (*e*)(iii)(*cc*) of the definition of "qualifying company". The facts of each case will therefore have to be considered.

Although SARS cannot be prescriptive in how the increase in production capacity is implemented, examples include, amongst others –

- the introduction of new or additional manufacturing equipment or expanding on existing manufacturing lines; or
- employing additional employees as a result of the additional manufacturing capacity introduced.

A company will, however, not meet the requirement of increasing its production capacity if it merely increases its production hours by introducing an additional working shift. In this case the original production capacity remained the same as the company did not acquire additional equipment and appointment of additional employees to increase its production capacity.

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142 **www.dictionary.com/definition/increase** [Accessed 5 July 2024].
143 **www.dictionary.com/definition/production** [Accessed 5 July 2024].
144 **www.financial-dictionary.thefreedictionary.com/capacity** [Accessed 5 July 2024].
145 Section 102 of the TA Act.

Example 12 – Increase in the production capacity [paragraph (*e*)(iii)(*cc*)]

Facts:

Company SQ, a company registered and incorporated in the Republic on 1 April 2016, carries on the trade of manufacturing tyres for heavy duty vehicles from a factory situated in the designated and approved Richards Bay SEZ. Due to a high demand for heavy duty vehicle tyres, Company SQ acquired additional machinery for three manufacturing lines operating form 1 November 2018 to manufacture more tyres. Additional employees were employed as a consequence of introducing the additional three manufacturing lines, but there was no need to increase manufacturing and warehousing floor space as the current space was adequate to accommodate the proposed increase in production.

Result:

Paragraph (*e*)(iii)(*cc*) of the definition of "qualifying company" requires that a company conducts a trade on or after 1 January 2013 in a zone designated and approved as an SEZ, and that there is an increase in the production capacity of that company in the Republic. Company SQ will meet the requirement of carrying on a trade on or after 1 January 2013 within a location, approved or subsequently approved as an SEZ. The introduction of the additional three manufacturing lines has increased the manufacturing capacity. Therefore, Company SQ will meet the requirement under paragraph (*e*)(iii)(*cc*) of the definition of "qualifying company".

4.2 Disqualifying activities

Although a company may meet the requirements of the definition of "qualifying company" in section 12R(1), it might, under section 12R(4), be disqualified if that company conducts –

- any of the listed activities;[146]
- any activity classified in the SIC Code which the Minister of Finance may designate by notice in the *Government Gazette*;[147] or
- transactions concluded with connected persons that result in more than 20% of either, the deductible expenditure incurred, or the income received or accrued to that company.[148]

However, a qualifying company may still be eligible to claim the accelerated building allowance under section 12S even if such a company conducts a trade, activity, or exceeds the 20% limitation threshold under section 12R(4)(*c*) (see **5.2**).

4.2.1 Listed activities under section 12R(4)(*a*)

Section 12R(4)(*a*) lists the activities under section C "Manufacturing" in the SIC Code that disqualify a qualifying company. These activities are the following:

- Distilling, rectifying and blending of spirits (SIC Code 1101)
- Manufacture of wines (SIC Code 1102)
- Manufacture of malt liquors and malt (SIC Code 103)

[146] Section 12R(4)(*a*).
[147] Section 12R(4)(*b*).
[148] Section 12R(4)(*c*).

- Manufacture of tobacco products (SIC Code 12)
- Manufacture of weapons and ammunition (SIC Code 252)
- Manufacture of bio-fuels if that manufacture negatively impacts on food security in the Republic

Section 12R(4)(*a*) refers to "any of the following activities" and does not limit the extent of the activities to allow the operation of a qualifying company to include a listed activity. A company that conducts any of the listed activities, irrespective of the extent of the activity, will not be regarded as a qualifying company under section 12R. It is irrelevant that the activity may not constitute the main trade of the company or is incidental to the main trade. The company is disqualified even if the listed activity is conducted in an area that is not designated and approved as an SEZ.

Example 13 – Trade conducted by a qualifying company which does not constitute a disqualifying activity.

Facts:

Company DG is a qualifying company that produces refined sugar from its sugar cane plants. In the manufacturing process the sucrose is removed from the sugar cane and then crystalized and centrifuged by removing the raw sugar from the raw molasses. After the sugar is dried, refined and packaged the blackstrap molasses, which is a by-product of the manufacturing process of the refined sugar, is stored in large containers. No further processing of the molasses takes place, and it is sold in its unrefined state to be used in the production of industrial alcohol (ethanol-based) and yeast.

Result:

The distilling, rectifying, and blending of spirits is a listed activity under section 12R(4)(*a*)(i), however, SIC Code 1101 specifically excludes the manufacturing of ethanol alcohol. Company DG does not undertake a process of distilling, rectifying, or blending the molasses into industrial alcohol, and will therefore not be conducting a listed activity as envisaged under SIC Code 1011.

Example 14 – Trade conducted by a company which includes a disqualifying activity

Facts:

Company SB is a qualifying company that carries on the trade of manufacturing bottled water, and also manufactures a small amount of boutique wines. The manufacture of wines is conducted outside the designated and approved SEZ and constitutes 10% of the company's income. Company SB is a resident company with a fixed place of business within a designated and approved SEZ.

Result:

The manufacturing of wines is a listed activity under section 12R(4)(*a*)(ii), SIC Code 1102. Although Company SB may meet the requirements of a "qualifying company" as defined section 12R(1), it will be disqualified due to conducting a listed activity. Company SB will not be regarded as a qualifying company.

4.2.2 Activities designated by the Minister of Finance as disqualifying activity – section 12R(4)(*b*)

Section 12R(4)(*b*) provides that a "qualifying company" under section 12R may be disqualified from participating in the income tax incentive if it conducts an activity classified in the SIC Code which the Minister of Finance may designate by notice in the *Government Gazette*. Even if the activities listed in the *Government Gazette* may constitute ancilliary activities to the main business of the company, it would be disqualified from participating in the income tax incentive. The categories of disqualifying activities recorded in the *Government Gazette*[149] are –

- wholesale and retail, trade, repair of motor vehicles and motor cycles;
- transportation and storage;
- accommodation and food service activities;
- information and communication;
- financial and insurance activities;
- real estate activities;
- professional, scientific and technical activities;
- administration and support activities; and
- other service activities.

The list of non-manufacturing activities designated by the Minister under section 12R(4) in the *Government Gazette* relate mainly to ancillary activities that support the main trade of a qualifying company. Section 12R(4)(*a*) and (*b*) refer without any limitation or qualification to "a company that conducts any activity" and "is not a qualifying company". In applying the rules of interpretation, a qualifying company may thus be disqualified if it conducts a disqualified activity under section 12R(4)(*b*), even if it is only an ancillary activity to the main trade of the company.

Such a literal and strict interpretation creates an absurdity as some of the activities listed in the *Government Gazette* are essential to or undertaken as part of most business processes. The case of *Natal Joint Municipal Pension Fund v Endumeni Municipality*[150] held that in the case of an absurd or ambiguous result a sensible and businesslike interpretation taking into account the purpose of the legislation should be adopted.

It is further important when giving words and expressions their ordinary meaning, to consider the context in which such words or expressions are contained. Since the purpose of the SEZ regime is to promote investment in certain under-capitalised manufacturing and industrial sectors and thereby create jobs, a businesslike interpretation must be adopted. Such an approach would mean that if an activity designated in the *Government Gazette* is ancillary to

[149] GN 446 and GG 39930 of 15 April 2016. See the complete list of activities in the **Annexure**.
[150] 2012 (4) SA 593 (SCA) at 603-604.

the manufacturing or industrial process undertaken by the qualifying company, the company would not be disqualified from the income tax incentive under section 12R(4)(*b*). However, if any designated activity under section 12R(4)(*b*) is a separate income-earning activity that is conducted on a continuous basis, that activity would result in the disqualification of that company as a qualifying company.

Therefore, a qualifying company will be disqualified under section 12R if it conducts any activity listed in the *Government Gazette* as a separate trade or secondary product. If that activity is, however, an integral part of the manufactured product or ancillary to protect or transport the final product, it will not be disqualified. The facts of each case will be considered in this regard.

Example 15 – Ancillary trade conducted by a company which is a listed activity in the *Government Gazette*

Facts:

Company M, a qualifying company under section 12R, carries on the trade of manufacturing electronic appliances in a designated and approved SEZ. Company M also manufactures the package material in which the final manufactured product is transported. Customers are invoiced for the final product and not separately for the cost of packaging.

Result:

The activity of packaging is listed as an excluded activity in *Government Gazette* 39930. The packaging activity is a necessary activity in support of the manufacturing trade of Company M and is not conducted as a separate income-earing activity. Since the packaging activity is ancillary to the income-earning activity Company M will not be disqualified from participating in the income tax incentive by virtue of the application of section 12R(4)(*b*).

Example 16 – Excluded activity conducted by a qualifying company as a separate income-earning activity

Facts:

Company D, a qualifying company under section 12R(1), carries on the trade of manufacturing motor vehicles in a designated and approved SEZ. Company D owns and operates a fleet of customised trucks to transport the vehicles it manufactures for export to the harbour, which is several hundred kilometres away. On the return trip Company D, on behalf of other motor vehicle manufacturers situated in the SEZ, transports vehicles imported by such other companies for a fee.

Result:

The activity of land transport is listed as a designated activity in *Government Gazette 39930*.[151] The activity by Company D of transporting the vehicles it manufactures to the harbour will be considered a necessary activity in support of its manufacturing activity and will not be disqualified from participating in the income tax incentive under section 12R. However, the activity of transporting vehicles imported by other vehicle manufacturers is not a necessary activity in support of its manufacturing activity and will be considered as one of the dual-trades of Company D. Company D will be disqualified as a qualifying company under section 12R as it conducts a designated activity as envisaged under section 12R(4)(*b*) and is therefore not entitled to the income tax incentive for that year of assessment.

4.2.3 Transactions concluded with connected persons that result in more than 20% of either the deductible expenditure incurred or the income received or accrued to that company

Section 12R(4)(*c*) was inserted in the Act by the Taxation Laws Amendment Act 25 of 2015[152] and aims to restrict possible profit-shifting between connected parties[153] to benefit from the lower income tax rate in an SEZ. The section is an anti-avoidance provision and prohibits transactions between a qualifying company and any affected connected person if –[154]

- more than 20% of expenditure that is deductible under the Act; or
- more than 20% of the income of that company is received or accrued; and relates to transactions with any connected person[155] to that company, if –
  - that connected person is either a "resident"[156] as defined; or
  - a non-resident company and the transactions is attributable to a permanent establishment within the Republic.

Section 12R(4)(*c*) applies to transactions concluded with any connected person that is a resident or a connected person that is a non-resident but has a permanent establishment in the Republic. A transaction between a resident and non-resident connected person is subject to transfer pricing rules,[157] therefore such a transaction is not included under the section 12R(4)(*c*) anti-avoidance measures. In determining whether transactions with a connected person meet the requirements, it is essential to consider the following definitions in section 1(1):

- "Connected person"[158]
- "Resident"[159]

[151] *GG* 39930, Section H: Land transport and transport via pipelines, Division 49.

[152] Section 12R(4)(*c*) came into effect on the date the SEZ Act came into operation. However, it was subject to the SEZ being designated as an SEZ for the purpose of section 12R, which date is the 6 July 2018.

[153] *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2015.*

[154] *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2015.*

[155] Section 1(1).

[156] Section 1(1).

[157] Section 31.

[158] See definition in Annexure. See also IN 67 "Connected Person" for more detail.

[159] See definition in Annexure. See also IN 3 "Definition in relation to a Natural Person – Ordinarily Resident" as well as IN 4 "Resident: Definition in relation to a Natural Person – Physical Presence Test" for more detail.

- "Permanent establishment".[160]

Article 5 of the Model Tax Convention on Income and Capital Gain of the OECD defines a "permanent establishment" as –

> "a fixed place of business through which the business of the enterprise is wholly or partly carried on".

For a consideration of the phrase "fixed place of business" (see **4.1.4**) Article 5(2)[161] of the OECD Model Tax Convention includes the following examples of permanent establishments:

- A place of management
- A branch
- An office
- A factory
- A workshop
- A mine, an oil or gas well, a quarry or any other place of extraction of natural resources

The facts of each case will dictate whether the connected person to the qualifying company is either a resident or has a permanent establishment within the Republic to which the transactions may be attributable.

(a) Calculation of deductible expenditure incurred on transactions between connected persons

Section 12R(4)(*c*)(i) aims to restrict possible profit-shifting between connected parties[162] to benefit from the tax incentives in a designated and approved SEZ. Under this provision a company will not be a qualifying company if more than 20% of the expenditure that is deductible under the Act is incurred on transactions with connected persons in relation to the company. The wording of section 12R(4)(*c*)(i) specifically refers to "deductible expenditure" as opposed to "expenditure deducted". The limitation of the section will be applicable when 20% or more of all expenditure incurred is deductible under the Act by the qualifying company, in contrast to the expenditure actually claimed by the qualifying company as a deduction. It is thus irrelevant whether the qualifying company actually claimed as a deduction the expenditure incurred. Section 12R(4)(*c*)(i) is concerned only with the question whether the qualifying company was entitled to claim a deduction that it incurred relating to the transaction with a connected person. The normal tax principles in determining whether expenditure is deductible should be applied. Expenditure of a capital nature will thus not be considered in determining the 20% limitation. Although section 11(*a*) provides for the deduction of expenditure and losses, the latter (losses) will not be included when the limitation is determined because section 12R(4)(*c*)(i) refers only to expenditure and not losses.

In determining whether the 20% threshold on expenditure incurred has been met, all transactions with connected persons will be aggregated for that year of assessment.

Transactions with connected persons may include transactions that are capital in nature. The issue is whether to include either the total amount of the capital expenditure in the year of assessment it is incurred or if the expenditure incurred is for an allowance asset, then the

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[160] See definition in section 1(1).
[161] At 31.
[162] *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2015.*

allowance for the year of assessment must be calculated when determining the total value of transactions with connected persons. In this regard the interpretation of the phrase "expenditure that is deductible under this Act is incurred" in section 12R(4)(*c*)(i) is relevant.

Firstly, the phrase refers to "expenditure that is deductible". Section 11(*a*) expressly excludes from deductibility any expenditure incurred that is of a capital nature. Therefore, any expenditure that may disqualify for deduction under section 11(*a*) would be excluded when determining the aggregate value of transactions conducted with connected persons. Secondly, the phrase refers to "deductible under this Act" meaning that the expenditure must qualify for deduction under the Act. Certain capital expenditure may qualify for an allowance under section 11(*e*) or an alternative section depending on the specific nature and purpose of the capital asset. An allowance, based on a rate or expected useful life of the asset is determined for each qualifying year of assessment and the allowance for that year of assessment is then claimed as a deduction. The annual allowance is therefore the amount that qualifies for deduction and is the amount that must be taken into consideration when determining the total amount of transactions conducted with connected persons and not the capital cost of the asset.

Example 17 – Determining the deductible expenditure threshold between connected persons [section 12R(4)(*c*)(i)]

Facts:

Sub G and Sub H are both wholly owned subsidiaries of Company Z. Sub H is a qualifying company and is therefore eligible for income tax incentives relating to companies operating within a designated and approved SEZ. During the 2019 year of assessment Sub H's total deductible expenditure incurred was R10 million. Of the total amount of expenditure incurred, R3,5 million related to transactions conducted with Sub G for the acquisition of components that are fitted into the final products manufactured by Sub H. No portion of this expenditure is capitalised. All three entities mentioned are resident in the Republic for tax purposes.

Result:

The total percentage expenditure incurred by Sub H to Sub G amounts to 35% (R3,5 million ÷ R10 million × 100) of Sub H's deductible expenditure for the 2019 year of assessment. Sub H and Sub G are in the same group of companies and will consequently be regarded as "connected persons" as per the definition in section 1(1). Sub H thus incurred more than 20% of deductible expenditure from a transaction with a connected person. Therefore, Sub H will be disqualified as a qualifying company under section 12R(4)(*c*)(i).

(b) Calculation of income received or accrued relating to transactions between connected persons

Section 12R(4)(*c*)(ii) limits the income received or accrued to a qualifying company on transactions with connected persons to 20% of the company's income. In the absence of this limitation there would be opportunity for profit-shifting between the parties to benefit from the lower corporate income tax rate in an SEZ.

The income referred to in section 12R(4)(*c*)(ii) is similarly to the position under paragraph (*d*) of the definition of "qualifying company" in section 12R(1) (see **4.1.5**). Income in this context therefore does not bear the defined meaning in section 1(1) and includes only the income derived from carrying on of a trade by a qualifying company within one or more designated and approved SEZs. It therefore excludes non-trade income.

Only transactions with a connected person that constitute income derived from the carrying on of its trade with a connected person is taken into consideration when determining whether the 20% income threshold has been exceeded by a qualifying company.

The effect of the application of section 12R(4)(*c*)(ii) is that a company will be disqualified as a "qualifying company" for the year of assessment if it exceeds the 20% income threshold applicable to transactions conducted with connected persons. Consequently, the company will not be eligible to apply the lower corporate income tax rate applicable in a designated and approved SEZ.

Example 18 – Restriction on income between connected parties

Facts:

Sub A and Sub B are both wholly owned subsidiaries of Company P. Sub B is a qualifying company under section 12R(1) and is therefore eligible to apply the reduced corporate income tax rate available to companies operating within a designated and approved SEZ. During the 2023 year of assessment the total income derived by Sub B was R30 million. This amount includes transactions concluded with Sub A made up of R5 million for trading stock purchases and R1,6 million as a recoupment under section 8(4)(*k*) for an asset donated to Sub A. All three entities mentioned are resident in the Republic for tax purposes.

Result:

Sub B and Sub A being a subsidiary of Company P meet the definition of "group of companies" as defined in section 1(1) and will consequently be regarded as connected persons as per the definition in section 1(1). The total percentage income derived by Sub B in relation to transactions with Sub A is 22% [(R5 million + R1,6 million) ÷ R30 million × 100]. However, the deemed inclusion in the income of Sub B under section 8(4)(*k*)(i) does not constitute a transaction for purposes of section 12R(4)(*c*)(ii) as the recoupment arises from a tax fiction. After excluding the deemed recoupment the total percentage income derived by Sub B in relation to transactions with Sub A is 16,67% (R5 million ÷ R30 million × 100). Although Sub B and Sub A are regarded as connected persons, the percentage of income derived between these connected persons is 16,67%. Sub B will not be disqualified as a qualifying company under section 12R(4)(*c*)(ii) as the percentage is less than 20% of its income from transactions with any connected person. Sub B will therefore be regarded as a qualifying company for purposes of section 12R, and will qualify to apply the reduced corporate income tax rate for the 2023 year of assessment if all the other requirements of section 12R are met.

Example 19 – Sale of building situated within an SEZ to a connected person

Facts:

Sub F is a 90% owned subsidiary of Company P, and a qualifying company under section 12(R)(1). During the 2022 year of assessment Sub F's income amounted to R25 million from carrying on of a trade in a designated and approved SEZ. Of that amount, R10 million was received from Company P for the purchase of a building owned by Sub F. Sub F and Company P are in the same group of companies and are consequently regarded as "connected persons" as defined in section 1(1). Both mentioned entities are resident in the Republic for income tax purposes.

Result:

Although Sub F and Company P are considered to be connected persons, the proceeds in the amount of R10 million received by Sub F from Company P do not constitute income received and accrued from carrying on of a trade by Sub F, and will not be included in the anti-profit shifting provision under section 12R(4)(*c*)(ii). Sub F will therefore be regarded as a qualifying company for purposes of section 12R, and will qualify to apply the reduced corporate income tax rate in the 2022 year of assessment.

5. Deduction in respect of buildings in special economic zones (section 12S)

Section 12S came into operation on 9 February 2016 and ceases to apply to any year of assessment commencing on or after 1 January 2031.[163]

Section 12S sets out the requirements that a "qualifying company" as defined in section 12R, read with the SEZ Act, have to meet to qualify for the accelerated building allowance.

5.1 Application of the law

An accelerated building allowance may be claimed under section 12S by a qualifying company (see **4.1**) on a building if all the following requirements are met:

- The building is owned by the qualifying company
- The building or improvement to the building is new and unused
- The building or improvement is wholly or mainly used for purposes of producing income in the course of the qualifying company's trade or the provision of services
- The building is situated within a designated and approved SEZ
- The qualifying company does not provide residential accommodation in such building

Section 12S(1) stipulates that a "qualifying company" may claim the allowance notwithstanding section 12R(4) (see **4.2**). The phrase "notwithstanding section 12R(4)" means that section 12R(4) should be disregarded for purposes of section 12S. The accelerated building allowance will thus be available to any "qualifying company" as defined in section 12R(1) that carries on a trade within a designated and approved SEZ, even if such an activity falls within the listed disqualifying activities listed under section 12R(4)(*c*).

Section 12S(5) prohibits the deduction of any building that has been disposed of by the qualifying company during any previous year of assessment. Section 12S(6) provides that a deduction may not be allowed under any other section of the Act on the cost of a building or improvement if any of that cost has qualified or will qualify for deduction from the qualifying company's income as a deduction of expenditure or an allowance on expenditure under section 12S(6). Section 12S(6) will, however, not apply to the deduction of expenditure or allowances under any other section before the company became a qualifying company under section 12R. The qualifying company will therefore have to continue to claim any part of the

[163] See section 12S(10).

remaining deductions or allowances not claimed on the building and/or improvement under the section it used prior to becoming a qualifying company.

Section 12S distinguishes between a new and unused building and a new and unused improvement to any building. The building and improvement will therefore be assessed separately when determining whether the requirements of section 12S have been met. The accelerated building allowance may therefore apply to any new and unused improvement while the building to which the improvement has been effected may qualify for an allowance under another section.

Example 20 – New and unused improvement while the existing building qualifies for an allowance under another section

Facts:

Company BC, a qualifying company purchased a building for the amount of R2 million on 20 February 2014. Company BC claimed a section 13*quin* allowance on the cost of the building for the past five years amounting to R 500 000 (R2 million × 5% × 5 years). On 6 July 2018 the area in which Company BC operates was declared an SEZ. Company BC incurred an amount of R 600 000 to introduce certain improvements to its building on 1 September 2018. Company BC's year of assessment ends on the last day of February.

Result:

Section 12S(6) states that no deduction will be allowed under any other section of the Act relating to the cost of a building used by a qualifying company in carrying on its trade within an SEZ. The deduction must be claimed under section 12S and not under another section of the Act. However, since the building was used by the company before the company attained qualifying company status, the building is not new and unused for purposes of section 12S and will thus not qualify for the building allowance under section 12S. Company BC can continue claiming the remainder of the tax cost of the building under section 13*quin*. However, Company BC will under section 12S be able to claim R60 000 (R600 00 × 10%) as an allowance for the new and unused improvements to the building.

Example 21 – Building on which section 13*quin* allowances were claimed is used for the purpose of carrying on a trade within an SEZ.

Facts:

Company R, a qualifying company purchased a building for the amount of R1 million on 3 March 2015. Company R claimed the section 13*quin* allowance on the cost of the building for three years amounting to R150 000. On 6 July 2018 the area in which Company R operates was declared an SEZ.

Result:

Section 12S(6) states that no deduction will be allowed under any other section of the Act relating to the cost of a building used by a qualifying company in carrying on its trade within an SEZ. The deduction must be claimed under section 12S and not another section of the Act. However, since the building was used by the company before the company attained qualifying company status, the building is not new and unused for purposes of section 12S and will thus not qualify for the section 12S deduction. Company R can continue claiming the remainder of the cost of the building under section 13*quin*.

A qualifying company that does not meet the requirements under section 12S to qualify for the accelerated building allowance may still be eligible to claim a building allowance under section 12N (see **5.3**) or section 11(*g*) (see **5.4**) if the specific requirements under these sections are met.

Certain concepts relevant to the application of section 12S will be considered below.

5.1.1 "Building"

The word "building"[164] is not defined in the Act, but the meaning has been considered in numerous court cases. In the case of *CIR* v *Le Sueur*[165] it was held as follows:

> "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 'building' in para 17(1)(*f*) of the Third Schedule to the Act is not used in any technical sense, and the question what appurtenances form part of a building for the purposes of that paragraph, is a question of fact which must in my view be determined objectively."

A building is normally a substantial structure with a degree of permanent nature, consisting of walls, a roof and the necessary appurtenances.

In the case of the *Konstanz Properties (Pty) Ltd v WM Spilhaus and Co (WP) Ltd*[166] it was concluded that the intention with which the accessory is attached, the nature of the accessory and the manner in which it has been attached to the building are factors to be considered to establish whether the accessories or attachments to a building are of a permanent nature or not. Anything attached to the building of a permanent nature will be considered part of it, if it 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.[167] The question whether the accessories or attachments to a building are of a permanent nature is dependent upon the facts of each case.

A building does not include the land upon which the structure stands,[168] external paving, fencing or landscaping.

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[164] See *Guide to Building Allowances*, IN 105 "Deductions in respect of Buildings used by Hotelkeepers" and IN 107 "Deduction in respect of Commercial Buildings" for more detail on the meaning of building.

[165] 1960 (2) SA 708 (A), 23 SATC 261.

[166] 1996 (3) SA 273 (A).

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

[168] ITC 1619 (1996) 59 SATC 309 (C) at 314.

5.1.2 "Owned"

The word "owned" is not defined in either the SEZ Act or section 12S, and as such the 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 qualifying company must therefore be the owner of the land on which the building is erected or the improvements effected or deemed to be the owner of the improvements under section 12N (see **5.3**) to claim the building allowance under section 12S.

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.[169] If a building is purchased by the taxpayer but not yet transferred into the taxpayer's name, the building or property would not be considered owned by the taxpayer for purposes of section 12S. 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. 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[170] and the taxpayer would therefore be able to claim the section 12S allowance on the proportional share of the cost of the building actually incurred by that taxpayer. A qualifying company will not qualify for a deduction under section 12S on a building or an improvement if the qualifying company is not the owner, or only has a right of use or occupation of the building under any lease agreement.

5.1.3 "Improvement"

Section 12S does not define what constitutes an "improvement" and therefore the ordinary dictionary meaning of the word must be considered. The *New Oxford Thesaurus of English*[171] dictionary describes the word "improvement" as follows:

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

In section 13(9) the term "improvements" is defined for the purpose of determining whether a taxpayer qualifies for the allowance on buildings which are used for the process of manufacturing. The term "improvements" is defined in section 13(9) for that purpose as –[172]

> "any extension, addition or improvements (other than repairs) to a building which is or are effected for the purpose of increasing or improving the industrial capacity of the building".

The expression "extension, addition or improvements" has been held in a number of court cases to mean physically attached to, connected or integrated with the building. In the case of *African Detinning Works (Pty) Ltd v SIR*[173] concrete aprons were added around the building some years after a factory building was 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

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169 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 ….".

170 D Davis et al *Juta's Tax Library* [online] (Jutastat e-publications: 30 November 2015) in Commentary on Income Tax – section 13*quin*.

171 Hanks, P. (2000). Oxford University Press Inc.

172 Section 13 deals with buildings and improvements used in the trade of manufacturing. It is noted that there are different definitions of "improvements" in other capital allowances in the Act. However, the definition contained in section 13(9) is useful for the purposes of section 12S.

173 1982 (1) SA 797 (A), 44 SATC 1.

accordingly did not qualify as an improvement. An improvement must, however, be distinguished from repairs.[174] It is consistent in both the dictionary meaning and in the definition of "improvement" in section 13(9) that the improvement must not constitute a repair, and the improvement can either enhance the aesthetic appearance or improve the functionality of the building by increasing its capacity or efficiency.

Should either of these requirements be fulfilled, then the cost of the improvement will be considered for the allowance under section 12S. The facts and circumstances of each case will be considered to ascertain if any new and unused improvement to a building owned by a qualifying company qualifies for the allowance.

5.1.4 "New and unused"

The phrase "new and unused"[175] is not defined in the Act and thus the ordinary dictionary meaning should be ascribed to these words.

Dictionary.com dictionary defines the word "new" and "unused", respectively, as follows:

> *New*
>
> "1 of recent origin, production, purchase, etc.; having but lately come or been brought into being:" [176]
>
> *Unused*
>
> "1. not used; not put to use:"[177]

A new or unused building means that the building has not been used for any other purpose, be it residential or commercial, before being purchased or erected by the qualifying company for purposes of section 12S. The allowance can only be deducted from the year of assessment in which the building or part of the building is brought into use by the taxpayer, not the year of assessment in which the expenditure is incurred or when the building or part of the building is complete. The assessment regarding 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.

5.1.5 "Wholly or mainly used"

A building or an improvement to the building must be wholly or mainly used for the purpose of producing income by the qualifying company within a designated and approved SEZ and in the course of the company trade, other than the provision of residential accommodation. The word "wholly" is regarded as referring to 100% of a particular asset's usage, while the word "mainly" refers to the more than 50%[178] of a particular asset usage. 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 within a designated and approved SEZ by the qualifying company. The determination of whether a building is wholly or mainly used for a particular purpose is based on the facts and circumstances of each case. In practice, if more than 50% of a building, measured by floor space or volume, is used during

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[174] See IN 74 "Deduction and Recoupment of Expenditure on Repairs" for the distinction between repairs and improvements.

[175] See IN 106 "Deduction in respect of Certain Residential Units" and IN 107 "Deduction in respect of Commercial Buildings" for more detail on the meaning of new and unused.

[176] **www.dictionary.com/en/definition/new** [Accessed 5 July 2024].

[177] **www.dictionary.com/en/definition/unused** [Accessed 5 July 2024].

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

the year of assessment for the purpose of producing income within a designated and approved SEZ, and in course of the qualifying company's trade, other than residential accommodation, the "wholly or mainly" requirement will be met. Depending on the facts of a particular case, it is possible that there may be circumstances in which an alternative method is more appropriate than floor space or volume. It is unnecessary that the building be used *wholly* for the qualifying purpose, as long as the building is used *mainly* for that purpose for a qualifying company to be eligible to claim the accelerated allowance under section 12S.

Example 22 – Building within an SEZ that is used for a dual purpose

Facts:

Company T is a "qualifying company" as defined under section 12R(1) and has a year of assessment ending 31 December. The company erected a building on land it owns in a designated SEZ and the erection of the building was completed at the end of September 2021. The total cost incurred of R210 million comprised R10 million for the purchase of the land and R200 million for the erection of the building. The company uses the newly erected building for the purpose of conducting its trade in the designated and approved SEZ. Company T uses 75% of the building to conduct its trade and the remaining 25% is used for administrative purposes.

Result:

Company T is a "qualifying company" that conducts a trade in a designated and approved SEZ, therefore the building allowance under section 12S will be available as follows:

- The cost of erecting the building and not the cost of the land will qualify for the accelerated building allowance of 10% under section 12S(2).
- The building allowance will be determined for the full year of assessment and not apportioned for the period after the building was brought into use.
- The building is considered to be used "wholly or mainly", that is, more than 50%, for the purpose of producing income within an SEZ, therefore the allowance will not be apportioned to disallow the portion of the building that is used for administrative purposes.

5.1.6 Residential accommodation

Section 12S(2) provides that the building allowance available to a qualifying company in an SEZ does not include residential accommodation.

A qualifying company that provides residential accommodation is thus not entitled to claim the accelerated building allowance on such a building.

The phrase "residential accommodation"[179] is not defined in the Act and thus the ordinary dictionary meaning of each word should be ascribed to the phrase.

[179] See IN 106 "Deduction in respect of Certain Residential Units" for more detail on the meaning of residential unit and accommodation.

Cambridge Dictionary defines the word "residential" and "accommodation", respectively, as follows:

Residential

"A residential building is one in which people live:"[180]

Accommodation

"a place to stay or live:"[181]

Residential accommodation refers to the provision of a place for someone to live in or stay, such as a room, building, house, flat, or hostel. It is possible that a building could be used by a qualifying company partly for purposes of producing income and partly for purposes in providing residential accommodation to any person. As stated previously (see **5.1**), the accelerated building allowance will be available to any "qualifying company" as defined in section 12R(1) that carries on a trade within a designated SEZ, even if such an activity falls within the listed disqualifying activities listed under section 12R(4)(*c*). This includes short-term residential accommodation.[182] However, section 12R(2) makes provision for the specific exclusion of residential accommodation to prevent, for instance, hotels, guest houses and bed and breakfast businesses to qualify for the incentive as this will be contrary to the purpose of the establishment of the SEZs, which is to promote investment, growth and job creation in the South African manufacturing sector. The qualifying company may still qualify for the allowance under section 12S if either the nature of the qualifying company's business, or location of the qualifying company's fixed place of business require the qualifying company to provide certain employees with temporary rooms to fulfil their job descriptions.

Example 23 – Building within an SEZ that is partly used for residential accommodation

Facts:

Company R, a "qualifying company" as per the definition under section 12R, erects a building at a cost of R10 million. The company decides to use the newly erected building for a dual purpose whereby 75% of the building is used for the housing of equipment related to the company's manufacturing trade. The remaining 25% of the building will be used to provide accommodation to the company's employees as there must always be a specified number of employees on site at all times.

Result:

Company R is a qualifying company as per the requirements in section 12R. The provision of residential accommodation to any person is strictly excluded from qualifying for the accelerated building allowance. Company R will be allowed to claim the full accelerated building allowance under section 12S(2), as the provision of accommodation to employees is merely incidental to Company R trade and in the production of income or the provision of services, and Company R does not provide residential accommodation as a separate trade.

[180] **www.dictionary.cambridge.org/dictionary/english/residential** [Accessed 5 July 2024].

[181] **www.dictionary.cambridge.org/dictionary/english/accommodation** [Accessed 5 July 2024].

[182] GN 446 and GG 39930 of 15 April 2016. Section I: Accommodation and food service activities**:** Division 55: Short term accommodation activities. See the complete list of activities in the Annexure.

5.1.7 Cost

In the case of *SIR* v *Eaton Hall (Pty) Ltd*[183] Trollip JA stated the following:

> " '[T]he 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'. 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. Thirdly…, 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."

The cost[184] related to the erection of a building and improvements for purposes of section 12S is therefore the actual cost incurred in erecting the building or effecting the improvements and includes the cost of materials and labour. It does not include additional costs such as interest incurred on any financial instrument used to fund the erection or effecting of the improvements. The cost incurred in acquiring the land on which the building is erected, together with the cost of preparing the land for erection of the building (demolition, excavation etc) does not form part of the cost of the building under section 12S. 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".[185]

5.2 The determination of cost of the building or improvement

The allowance under section 12S is calculated at a rate of 10% a year of the cost (see **5.1.7**) of the new and unused building or any new and unused improvement to any 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 qualifying company; 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.[186]

The aggregate of all deductions that may be allowed or deemed to have been allowed under section 12S or any other provision regarding the cost of the building or improvement may not exceed that cost.[187]

183 1975 (4) SA 953 (A), 37 SATC 343.
184 See IN 105 "Deductions in respect of Buildings used by Hotelkeepers" for more detail on the meaning of cost.
185 Section 23C(1).
186 Section 12S(4).
187 Section 12S(7).

Example 24 – Determination of cost of the building or improvement

Facts:

Company NX, a qualifying company entered into a sale agreement with Company XC, a connected person, to purchase a new and unused building erected within a designated and approved SEZ. The purchase price of the building as agreed by Company NX and Company XC amounted to R30 million, which included R7 million for the land the building was erected on, R20 million for the building and R3 million for finance and interest charges. The arm's length direct cost under a cash transaction of the acquisition and erection of the building would have amounted to R18 million if Company NX and Company XC were not regarded as "connected persons" as defined in section 1(1).

Result:

The cost of the building is the lesser of the actual cost to Company NX, or the arm's length direct cost under a cash transaction of the acquisition and erection of the building and excludes the R7 million for the land, and R3 million for the finance and interest charges respectively, as these amounts are not included in the determination of the cost of a building. The actual cost of the building is regarded to be R20 million, but if the transaction was concluded on an arm's length direct cost under a cash transaction of the acquisition, erection of the building basis, and not between connected persons the cost would have been R18 million. Subsequently the cost of the building for purposes of determining the building allowance available for Company NX is R18 million.

5.3 Interaction between section 12N and section 12S

The ownership requirement, which is a prerequisite before a qualifying company may claim the building allowance, may in certain instances create a barrier to accessing the allowance. The ownership of land and/or buildings or improvements to them by a company operating in an SEZ may vary depending on the category of the designated and approved SEZ.[188] If the building or improvement is not owned by the qualifying company, section 12S(3) provides for the interaction between section 12N and the building allowance under section 12S(2). Section 12N[189] effectively deems the taxpayer (lessee) that holds a right of use or occupation of land or a building,[190] and that effects improvements to such land or buildings under –

- a Public Private Partnership,[191] or
- an agreement in terms of which the right of use or occupation is granted, if the land or building is owned by –
    - the government of the Republic in the national, provincial or local sphere;[192] or;
    - any entity of which the receipts and accruals are exempt from tax under section 10 (1)(*c*A) or (*t*);[193] or

[188] Section 24 of the SEZ Act lists the different categories of SEZ's.
[189] See IN 119: "Deductions in respect of Improvements to Land or Buildings not Owned by a Taxpayer" for more detail on sections 12N and 12NA.
[190] Section 12N(1)(*a*).
[191] Section 12N(1)(*b*)(i).
[192] Section 12N(*b*)(ii)(*aa*).
[193] Section 12N(*b*)(ii)(*bb*).

- the Independent Power Producer Procurement Programme administered by the Department of Energy;[194] and
- incurs expenditure to effect improvements under the right of use or occupation;[195] and
- uses or occupies the land or building in the production of income or derives income from the land or building,

to be the owner of such improvements.

This concession allows a taxpayer (lessee) that is not the owner of the land or buildings or any improvements to them to claim the special capital allowances[196] in the Act under which ownership is a requirement. Section 12S(2) expressly requires a qualifying company to be owner of any new and unused building or improvements to them, hence the need for section 12S(3). Further, section 12S(3) states that the expenditure incurred by a qualifying company to effect the improvements as contemplated in section 12(N), must be deemed to be the cost to the qualifying company of any new and unused building or of any new and unused improvement to a building contemplated in section 12S(2). Thus, if the qualifying company fulfils all the requirements under section 12N, an accelerated allowance of 10% of the expenditure incurred by a qualifying company to effect the improvements to the building may be claimed for a year of assessment.

Example 25 – Interaction between sections 12N and 12S

Facts:

Company R, a qualifying company entered into a lease agreement with Company W (lessor) to lease the latter's building, which is located in a designated and approved SEZ. The lease agreement allows Company R to effect improvements to the building by constructing an additional wing which it will utilise in conducting its trade as a manufacturer of communication equipment. The lease agreement with the lessor does not qualify as a Public Private Partnership agreement (lessor being a private entity) as envisioned in section 12N. Company W (the lessor) is neither a tax exempt entity under section10 (1)(*c*A) or (t), nor any sphere of the government of the Republic, nor does the company meet the requirements of the Independent Power Producer Procurement Programme administered by the Department of Energy.

[194] Section 12N(*b*)(iii).

[195] Section 12N(1)(*c*) which specifically refer to expenditure incurred to effect improvements contemplated in section 12N(1)(*b*).

[196] Sections 11D, 12B, 12BA 12C, 12D, 12F, 12I, 12S, 13, 13*ter*, 13*quat*, 13*quin*, 13*sex* or 36, and for the purposes of the Eighth Schedule to the Act.

Result:

Since Company W is not an exempt entity under section 10(1)(*c*A) or (t) or the agreement to effect the improvements is not under a Private Public Partnership, the requirements of section 12N(1) will not be met. Accordingly, Company R as the lessee of the building will be precluded from claiming the section 12S allowance as it will not be deemed to be the owner of the improvements. Company W, the lessor, despite being the owner of the improvements under property law cannot claim the section 12S allowance as it did not incur the cost of effecting the improvements and does not meet the requirements of the definition of a "qualifying company".

5.4 Section 11(*g*) and paragraph (*h*) of the definition of "gross income" in section 1(1)

A qualifying company that has an obligation under a lease agreement to effect improvements to the lessor's land or buildings situated in an SEZ may qualify for a deduction under section 11(*g*) if all the requirements are met. The lessor that has a right to receiving the benefit of the improvement must include it under paragraph (*h*) of the definition of gross income.

Interpretation Note 110 "Leasehold Improvements" explains the interaction between section 11(*g*) and paragraph (*h*) of the definition of gross income as follows:

> "Paragraph (*h*) and section 11(*g*) are complementary to each other. Section 11(*g*) provides for the deduction of an allowance for the expenditure actually incurred by the lessee in meeting an obligation under an agreement, which grants the right of use or occupation of the land or buildings, to effect improvements on such land or to such buildings used or occupied for the production of income or from which income is derived.
>
> A lessee who voluntarily effects improvements to a leased property will not be allowed to deduct any of the expenses incurred under section 11(*g*). Section 11(*g*) requires that the lessee must have an obligation under the agreement granting the right of use or occupation to effect improvements to potentially qualify for an allowance. This also means the lessor must have a legally enforceable right to demand the improvements. It should be apparent from the lease agreement that there is a clear and unambiguous obligation on the lessee. In *ITC 1188* there was no enforceable obligation to build and the court held that the fact that the lessor was entitled to terminate the right of occupation if the building was not erected did not create a legally enforceable obligation to erect the building. The lessee was not therefore entitled to an allowance under section 11(*g*)."

More detailed considerations of leasehold improvements are available in IN 110.

5.5 Disallowance of deduction

Section 12S(8) provides that the Commissioner may, notwithstanding sections 99 and 100 of the TA Act, disallow all deductions otherwise provided for under section 12S if a qualifying company is guilty of fraud or misrepresentation or non-disclosure of material facts with regard to any tax, duty or levy administered by the Commissioner.

The subsection specifically refers to the phrase "any tax". The term "tax" is defined in section 1 of the TA Act is as follows:

> **"tax"**, for purposes of administration under this Act, includes a tax, duty, levy, royalty, fee, contribution, penalty, interest and any other moneys imposed under a tax Act;"

The term “guilty” indicates that if a qualifying company, based on the specific facts of the case, is found guilty in any court of law, which include a tax court, to have committed fraud, misrepresentation or non-disclosure of material facts with regard to “any tax” as defined, duty or levy administered by the Commissioner, the Commissioner may disallow all allowances previously claimed, as well as all future allowances still available under section 12S. The period of limitation for issuance of assessments and the provisions relating to the finality of assessments under sections 99 and 100, respectively, of the TA Act cannot be relied on by a qualifying company in such an instance. An additional assessment would be issued under section 12S(9) to disallow the building allowance previously allowed to a qualifying company, which may trigger the provision under Chapter 16 of TA Act which deals with understatement penalties and interest may also be levied.

Example 26 – Disallowance of building allowance under section 12S(8)

Facts:

Company R, a qualifying company incurred cost in the amount of R10 million to erect a new building within a designated SEZ. Company R claimed the section 12S allowance on the cost of the building for five years amounting to R500 000. A VAT audit was completed by SARS and it was concluded that Company R charged certain goods at 0% for VAT purposes, but should have charged the standard 15% as the goods did not fall within the ambit of section 11 of the Value-Added Tax Act, 1991. Company R was found guilty of misrepresentation of material facts by a tax court after the matter could not be resolved by way of dispute resolution between the Commissioner and Company R. Three of the five years’ income tax assessments have prescribed.

Result:

Company R committed misrepresentation of material facts with regards to any tax, duty or levy administered by the Commissioner, and thus the Commissioner may disallow the amount of R500 000, which was claimed by the qualifying company under section 12S in all previous years of assessment, as sections 99 and 100 of the TA Act may be disregarded. Company R will be disqualified to claim any future allowance under section 12S.

6. Interaction between the farming provisions under the First Schedule and the special economic zone provisions

Section 26(1) stipulates that the taxable income of any person carrying on pastoral, agricultural or other farming operations shall, in so far as the income is derived from such operations, be determined in accordance with the Act but subject to the First Schedule to the Act. If a qualifying company carries on pastoral, agricultural or other “farming operations” as defined within a designated and approved SEZ, the qualifying company should determine the taxable income derived from such farming operations in accordance with the First Schedule. The taxable income from farming operations is combined with the taxable income from other sources to arrive at the taxpayer’s taxable income for the year of assessment.

A qualifying company will still be able to claim the building allowances available and apply the reduced corporate tax rate of 15% if it carries on pastoral, agricultural or other farming operations, if all of the necessary requirements under the Act are met.[197]

See IN 79 "Produce held by Nursery Operators" for a detailed consideration on the meaning of pastoral, agricultural or other farming operations.

Example 27 – Interaction between the farming provisions and the SEZ provisions

Facts:

Company R, a qualifying company under section 12R cultivates and produce cucumbers throughout the year by making use of permanently structured greenhouses or hot houses, situated within a designated SEZ. Company R incurred a cost of R1 million to erect the new and unused greenhouses or hot houses.

Result:

Company R is conducting farming operation, as the cultivating and producing of cucumbers fall within the definition of "pastoral, agricultural or other farming operations", and thus the provisions of the First Schedule to the Act will apply to determine the taxable income of Company R as envisaged in section 26(1). Company R will be entitled to claim 10% of the R1 million of the cost incurred to erect the new and unused greenhouses or hothouses, which are wholly or mainly used for the purpose of producing income by Company R as envisaged under section 12S. Company R will also be entitled to apply the reduced corporate tax rate of 15% after determining its taxable income from its farming operations in combination with the taxable income from other sources for the year of assessment.

Section 12S(6) prohibits the deduction under section 12B or paragraph 12 of the First Schedule to the Act.

[197] Depending on the facts of each case a qualifying company may qualify for a deduction under paragraph 12(1)(*f)* of the First Schedule to the Act if such a qualifying company carries on pastoral, agricultural or other farming operations as defined within a designated SEZ.

Annexure – The law

Definition of "company" in section 1(1)

"company" includes—

(*a*) any association, corporation or company (other than a close corporation) incorporated or deemed to be incorporated by or under any law in force or previously in force in the Republic or in any part thereof, or any body corporate formed or established or deemed to be formed or established by or under any such law; or

(*b*) any association, corporation or company incorporated under the law of any country other than the Republic or any body corporate formed or established under such law; or

(*c*) any co-operative; or

(*d*) any association (not being an association referred to in paragraph (a) or (f)) formed in the Republic to serve a specified purpose, beneficial to the public or a section of the public; or

(*e*) any—

(i) . . . . . .

(ii) portfolio comprised in any investment scheme carried on outside the Republic that is comparable to a portfolio of a collective investment scheme in participation bonds or a portfolio of a collective investment scheme in securities in pursuance of any arrangement in terms of which members of the public (as defined in section 1 of the Collective Investment Schemes Control Act) are invited or permitted to contribute to and hold participatory interests in that portfolio through shares, units or any other form of participatory interest; or

(iii) portfolio of a collective investment scheme in property that qualifies as a REIT as defined in the listing requirements of an exchange, as defined in section 1 of the Financial Markets Act and licensed under section 9 of that Act, where those listing requirements have been approved in consultation with the Director-General of the National Treasury and published by the appropriate authority, as contemplated in section 1 of the Financial Markets Act, in terms of section 11 of that Act or by the Financial Sector Conduct Authority; or

(*f*) a close corporation,

but does not include a foreign partnership;

Paragraph (*d*) of the definition of "connected person" in section 1(1)

"Connected person" means—

(*d*) in relation to a company—

(i) any other company that would be part of the same group of companies as that company if the expression "at least 70 per cent of the equity shares in" in paragraphs (*a*) and (*b*) of the definition of "group of companies" in this section were replaced by the expression "more than 50 per cent of the equity shares or voting rights in";

(ii) . . . . . .

(iii) . . . . . .

(iv) any person, other than a company as defined in section 1 of the Companies Act that alone or together with any connected person in relation to that person, holds, directly or indirectly, at least 20 per cent of—

(*aa*) the equity shares in the company; or

(*bb*) the voting rights in the company;

(v) any other company if at least 20 per cent of the equity shares or voting rights in the company are held by that other company, and no holder of shares holds the majority voting rights in the company;

(vA) any other company if such other company is managed or controlled by—

(*aa*) any person who or which is a connected person in relation to such company; or

(*bb*) any person who or which is a connected person in relation to a person contemplated in item (*aa*); and

(vi) where such company is a close corporation—

(*aa*) any member;

(*bb*) any relative of such member or any trust (other than a portfolio of a collective investment scheme) which is a connected person in relation to such member; and

(*cc*) any other close corporation or company which is a connected person in relation to—

(i) any member contemplated in item (aa); or

(ii) the relative or trust contemplated in item (*bb*); and

Paragraph (*h*) of the definition of "gross income"

(*h*) in the case of any person to whom, in terms of any agreement relating to the grant to any other person of the right of use or occupation of land or buildings, or by virtue of the cession of any rights under any such agreement, there has accrued in any such year or period the right to have improvements effected on the land or to the buildings by any other person—

(i) the amount stipulated in the agreement as the value of the improvements or as the amount to be expended on the improvements; or

(ii) if no amount is so stipulated, an amount representing the fair and reasonable value of the improvements;

Definition of "permanent establishment" in section 1(1)

"permanent establishment" means a permanent establishment as defined from time to time in Article 5 of the Model Tax Convention on Income and on Capital of the Organisation for Economic Co-operation and Development: Provided that in determining whether a qualifying investor in relation to a partnership, trust or foreign partnership has a permanent establishment in the Republic, any act of that partnership, trust or foreign partnership in respect of any financial instrument must not be ascribed to that qualifying investor;"

Definition of "resident" in section 1(1)

"resident" means any—

(*a*) natural person who is—

(i) ordinarily resident in the Republic; or

(ii) not at any time during the relevant year of assessment ordinarily resident in the Republic, if that person was physically present in the Republic—

(*aa*) for a period or periods exceeding 91 days in aggregate during the relevant year of assessment, as well as for a period or periods exceeding 91 days in aggregate during each of the five years of assessment preceding such year of assessment; and

(*bb*) for a period or periods exceeding 915 days in aggregate during those five preceding years of assessment,

in which case that person will be a resident with effect from the first day of that relevant year of assessment: Provided that—

(A) a day shall include a part of a day, but shall not include any day that a person is in transit through the Republic between two places outside the Republic and that person does not formally enter the Republic through a "port of entry" as contemplated in section 9 (1) of the Immigration Act, 2002 (Act No. 13 of 2002), or at any other place as may be permitted by the Director General of the Department of Home Affairs or the Minister of Home Affairs in terms of that Act; and

(B) where a person who is a resident in terms of this subparagraph is physically outside the Republic for a continuous period of at least 330 full days immediately after the day on which such person ceases to be physically present in the Republic, such person shall be deemed not to have been a resident from the day on which such person so ceased to be physically present in the Republic; or

(*b*) person (other than a natural person) which is incorporated, established or formed in the Republic or which has its place of effective management in the Republic,

but does not include any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the governments of the Republic and that other country for the avoidance of double taxation: Provided that where any person that is a resident ceases to be a resident during a year of assessment, that person must be regarded as not being a resident from the day on which that person ceases to be a resident …

Activities to which section 12R does not apply

Notice in terms of Section 12R of the income Tax Act, 1962 regarding activities to which section 12R does not apply

Section G: Wholesale and retail, trade, repair of motor vehicles and motor cycles

Section 45: Commission trade, except of motor vehicles and motor cycles: sale, maintenance and repair of motor vehicles and motor cycles; retail of automotive fuel

Section 46: Wholesale trade, except of motor vehicles and motor cycles

Section 47: Retail trade, except of motor vehicles and motor cycles

Section H: Transportation and storage

Division 49: Land transport and transport via pipelines

Division 50: Water transport

Division 51: Air transport

Division 52: Warehousing and support activities for transportation; activities of travel agencies

Division 53: Postal and courier activities

Section I: Accommodation and food service activities

Division 55: Short term accommodation activities

Division 56: Food and beverage service activities

Section J: Information and communication

Division 61: Telecommunications

Division 62: Computer programming, consultancy and related activities

Division 63: Data processing, hosting and related activities

Section K: Financial and insurance activities

Division 64: Financial intermediation, except insurance and pension funding

Division 65: Insurance and pension funding, except compulsory social security

Section L: Real Estate Activities

Division 68: Real estate activities

Section M: Professional, scientific and technical activities

Division 69: Legal and accounting activities

Division 70: Management consultancy activities

Division 71: Architectural and engineering activities; technical testing and analysis

Division 72: Scientific research and development

Division 73: Advertising; market research and public opinion polling

Division 74: Photographic activities

Section N: Administrative and support activities

Division 77: Renting of machinery and equipment, without operator, and of personal and household goods

Division 78: Activities of employment placement agencies; temporary employment agency activities

Division 79: Travel agency activities

Division 60: Security and investigation activities

Division 81: Combined facilities support activities and cleaning activities

Division 82: Packaging activities; debt collection services: credit rating agency activities: photocopying, document preparation and other specialized office support activities

Section S: Other Service Activities

Division 95: Repair of personal household goods; repair of computers and communication equipment

Section 10(1)(*c*A)

(*c*A) the receipts and accruals of—

(i) any institution, board or body (other than a company as defined in the Companies Act, any co-operative, close corporation, trust or water services provider) established by or under any law and which, in the furtherance of its sole or principal object—

(*aa*) conducts scientific, technical or industrial research;

(*bb*) provides necessary or useful commodities, amenities or services to the State (including any provincial administration) or members of the general public; or

(*cc*) carries on activities (including the rendering of financial assistance by way of loans or otherwise) designed to promote commerce, industry or agriculture or any branch thereof;

(ii) any association, corporation or company contemplated in paragraph (a) of the definition of "company" in section 1, all the shares of which are held by any such institution, board or body, if the operations of such association, corporation or company are ancillary or complementary to the object of such institution, board or body:

Provided that such institution, board, body or company—

(*a*) has been approved by the Commissioner subject to such conditions as he may deem necessary to ensure that the activities of such institution, board, body or company are wholly or mainly directed to the furtherance of its sole or principal object;

(*b*) is by law or under its constitution—

(i) not permitted to distribute any of its profits or gains to any person, other than, in the case of such company, to the holders of shares in that company;

(ii) required to utilize its funds solely for investment or the object for which it has been established; and

(iii) required on dissolution—

(*aa*) where the institution, board, body or company is established under any law, to transfer its assets to some other institution, board or body which has been granted exemption from tax in terms of this paragraph and which has objects similar to those of such institution, board, body or company; or

(*bb*) where the institution, board or body is established by law, to transfer its assets to—

(A) some other institution, board or body which has been granted exemption from tax in terms of this paragraph and which has objects similar to those of such institution, board, body or company; or

(B) to the State:

Provided further that—

(*a*) where the Commissioner is satisfied that any such institution, board, body or company has during any year of assessment failed to comply with the provisions of this paragraph, he may withdraw his approval of the institution, board, body or company with effect from the commencement of that year of assessment;

(*b*) where the institution, board, body or company fails to transfer, or take reasonable steps to transfer, its assets as contemplated in paragraph (b) (iii) of the first proviso, the accumulated net revenue which has not been distributed shall be deemed for the purposes of this Act to be an amount of taxable income which accrued to such institution, board, body or company during the year of assessment contemplated in paragraph (a); and

(*c*) . . . . . .

Section 10(1)(*t*)

(*t*) the receipts and accruals—

(i) of the Council for Scientific and Industrial Research;

(ii) of the South African Inventions Development Corporation;

(iii) of the South African National Roads Agency Limited incorporated in terms of section 3 of the South African National Roads Agency Limited and National Roads Act, 1998 (Act No. 7 of 1998);

(iv) . . . . . .

(v) of the Armaments Corporation of South Africa Limited, contemplated in section 2 (1) of the Armaments Corporation of South Africa, Limited Act, 2003 (Act No. 51 of 2003);

(vi) of any company during any period during which all the issued shares of such company are held by the Corporation referred to in subparagraph (v), if the operations of such company are conducted in pursuance of, or are ancillary or complementary to, the objects of the said Corporation;

(vii) of any traditional council or traditional community established or recognised or deemed to have been established or recognised in terms of the Traditional Leadership and Governance Framework Act, 2003 (Act No. 41 of 2003), or any tribe as defined in section 1 of that Act;

(viii) . . . . . .

(ix) of any water services provider;

(x) of the Development Bank of Southern Africa established on 23 June 1983;

(xi) . . . . . .

(xii) . . . . . .

(xiii) . . . . . .

(xiv) . . . . . .

(xv) . . . . . .

(xvi) of—

(*aa*) the compensation fund established by section 15 of the Compensation for Occupational Injuries and Diseases Act, 1993 (Act No. 130 of 1993);

(*bb*) the reserve fund established by section 19 of the Compensation for Occupational Injuries and Diseases Act, 1993 (Act No. 130 of 1993); and

(*cc*) a mutual association licensed in terms of section 30 of the Compensation for Occupational Injuries and Diseases Act, 1993 (Act No. 130 of 1993), to carry on the business of insurance of employers against their liabilities to employees, if the compensation paid by the mutual association is identical to compensation that would have been payable in similar circumstances in terms of that Act;

(xvii) of the National Housing Finance Corporation established in 1996 by the National Department of Human Settlements:

Provided that any entity contemplated in this paragraph must comply with such reporting requirements as the Commissioner may determine;

Section 11(*g*)

(*g*) an allowance in respect of any expenditure actually incurred by the taxpayer, in pursuance of an obligation to effect improvements on land or to buildings, incurred under an agreement whereby the right of use or occupation of the land or buildings is granted by any other person, where the land or buildings are used or occupied for the production of income or income is derived therefrom: Provided that—

(i) the aggregate of the allowances under this paragraph shall not exceed the amount stipulated in the agreement as the value of the improvements or as the amount to be expended on the improvements or, if no amount is so stipulated, an amount representing the fair and reasonable value of the improvements;

(ii) any such allowance shall not exceed for any one year such portion of the aggregate of the allowances under this paragraph as is equal to the said aggregate divided by the number of years (calculated from the date on which the improvements are completed, but not more than 25 years) for which the taxpayer is entitled to the use or occupation;

(iii) if—

(*aa*) the taxpayer is entitled to such use or occupation for an indefinite period; or

(*bb*) the taxpayer or the person by whom such right of use or occupation was granted holds a right or option to extend or renew the original period of such use or occupation,

the taxpayer shall for the purposes of this paragraph be deemed to be entitled to such use or occupation for such period as represents the probable duration of such use or occupation;

(iv) the aggregate of the allowances under this paragraph in respect of any building or improvements referred to in section 13(1) or 27(2)(b) shall not exceed the cost (after the deduction of any amount which has been set off against the cost of such building or improvements under section 13 (3) or section 27 (4)) to the taxpayer of such building or improvements less the aggregate of the allowances in respect of such building or improvements made to the taxpayer under the said section 13(1) or 27(2)(b) or the corresponding provisions of any previous Income Tax Act;

(v) . . . . . .

(vi) the provisions of this paragraph shall not apply in relation to any such expenditure incurred if the value of such improvements or the amount to be expended on such improvements, as contemplated in paragraph (h) of the definition of "gross income" in section 1, does not for the purposes of this Act constitute income of the person to whom the right to have such improvements effected has accrued;

(vii) if during any year of assessment the agreement whereby the right of use or occupation of the land or buildings is granted is terminated before expiry of the period to which that taxpayer was entitled to the use or occupation, as contemplated in paragraph (ii) or (iii), so much of the allowance which may be allowed under this paragraph, which has not yet been allowed in that year or any previous year of assessment, shall be allowable as a deduction in that year of assessment;

Section 12N

12N. Deductions in respect of improvements not owned by taxpayer.—(1) If a taxpayer—

(*a*) holds a right of use or occupation of land or a building;

(*b*) effects an improvement on the land or to the building in terms of—

(i) a Public Private Partnership;

(ii) an agreement in terms of which the right of use or occupation is granted, if the land or building is owned by—

(*aa*) the government of the Republic in the national, provincial or local sphere; or

(*bb*) any entity of which the receipts and accruals are exempt from tax in terms of section 10 (1) (cA) or (t); or

(iii) the Independent Power Producer Procurement Programme administered by the Department of Energy;

(*c*) incurs expenditure to effect the improvement contemplated in paragraph (b); and

(*d*) . . . . . .

(*e*) uses or occupies the land or building for the production of income or derives income from the land or building,

the taxpayer must, for the purposes of any deduction contemplated in section 11D, 12B, 12C, 12D, 12F, 12I, 12S, 13, 13*ter*, 13*quat*, 13*quin*, 13*sex* or 36, and for the purposes of the Eighth Schedule, be deemed to be the owner of the improvement so completed.

(2) (*a*) When the right of use or occupation terminates, the taxpayer must be deemed to have disposed of the improvement to the owner of the land or building on the later of the date when—

(i) the right of use or occupation terminated; or

(ii) the use or occupation ended.

(*b*) If the right of use or occupation terminates and the taxpayer—

(i) continues to use or occupy the land or building; or

(ii) renews the right of use or occupation,

the renewed right of use or occupation must be deemed to be the same right of use or occupation as the right of use or occupation previously held by the taxpayer.

(3) This section does not apply if the taxpayer—

(*a*) is a person carrying on any banking, financial services or insurance business; or

(*b*) enters into an agreement whereby the right of use or occupation of the land or building is granted to any other person, unless—

(i) the land or building is occupied by that other person and that other person is a company that is a member of the same group of companies as that taxpayer in terms of such an agreement;

(ii) the cost of maintaining the land or building and of carrying out repairs thereto required in consequence of normal wear and tear is borne by the taxpayer; and

(iii) subject to any claim that the taxpayer may have against the other person by reason of the other person's failure to take proper care of the land or building, the risk of destruction or loss of or other disadvantage to the land or building is not assumed by that other person.

Section 12R

12R. Special economic zones.—(1) For the purposes of this section—

"qualifying company" means a company—

(*a*) (i) incorporated by or under any law in force in the Republic or in any part thereof; or

(ii) that has its place of effective management in the Republic;

(*b*) that carries on a trade in a special economic zone designated by the Minister of Trade and Industry in terms of the Special Economic Zones Act and approved by the Minister of Finance after consultation with the Minister of Trade and Industry for the purposes of this section (2) by notice in the *Gazette*;

(*c*) if the trade contemplated in paragraph (*b*) are carried on from a fixed place of business situated within a special economic zone; and

(*d*) if not less than 90 per cent of the income of that company is derived from the carrying on of a trade within one or more special economic zones;

• (e) that—

(i) the company was carrying on any trade before 1 January 2013 in a location subsequently approved as a zone under section 12R(3);

• (ii) commenced on or after 1 January 2013, the carrying on, in a location approved or subsequently approved as a zone under section 12R, of any trade not previously carried on by that company or any connected person in relation to that company in the Republic ; or

• (iii) commenced on or after 1 January 2013, the carrying on, in a location approved or subsequently approved as a zone under section 12R of any trade and that trade —

• (*a*) comprises of the production of goods not previously produced by that company or any connected person in relation to that company in the Republic ;

• (*b*) utilises the use of new technology in that company's production processes ; or

• (*c*) represents an increase in the production capacity of that company in the Republic .

"SIC Code" means version 7 of the Standard Industrial Classification Code issued by Statistics South Africa;

"special economic zone" means a special economic zone as defined in the Special Economic Zones Act that is approved for the purposes of this section by the Minister of Finance under subsection (3);

"Special Economic Zones Act" means the Special Economic Zones Act, 2014 (Act No. 16 of 2014).

(2) ……

(3) The Minister of Finance must approve a special economic zone for purposes of this section after taking into account the financial implications for the State should a special economic zone be approved under this section.

(4) Notwithstanding a qualifying company being located in a special economic zone—

(*a*) subsection (2) and section 12S do not apply to any qualifying company that conducts any of the following activities classified under "Section C: Manufacturing" in the SIC Code:

(i) Distilling, rectifying and blending of spirits (SIC Code 1101);

(ii) Manufacture of wines (SIC Code 1102);

(iii) Manufacture of malt liquors and malt (SIC Code 103);

(iv) Manufacture of tobacco products (SIC Code 12);

(v) Manufacture of weapons and ammunition (SIC Code 252);

(vi) Manufacture of bio-fuels if that manufacture negatively impacts on food security in the Republic; and

(*b*) a company that conducts any activity classified in the SIC Code, which the Minister of Finance may designate by notice in the Gazette is not a qualifying company ;or

(*c*) a company is not a qualifying company if—

(i) more than 20% of expenditure that is deductible under the Act; or

(ii) more than 20% of the income of that company is received or accrued;

in respect of transaction with any connected person in relation to that company if that connected person—

(*aa*) is a resident; or

(*bb*) is not a resident and those transactions are attributable to a permanent establishment of that connected person in the Republic;

(5) This provision ceases to apply in respect of any year of assessment commencing on or after 1 January 2031; or

Section 12S

12S. Deduction in respect of buildings in special economic zones.—(1) For the purposes of this section, "qualifying company" means a qualifying company as defined in section 12R, notwithstanding section 12R(4).

(2) A qualifying company may deduct from the income of that qualifying company an allowance equal to ten per cent of the cost to the qualifying company of any new and unused building owned by the qualifying company, or any new and unused improvement to any building owned by the qualifying company, if that building or improvement is wholly or mainly used by the qualifying company during the year of assessment for purposes of producing income within a special economic zone, as defined in section 12R (1), in the course of the taxpayer's trade, other than the provision of residential accommodation.

(3) If a qualifying company completes an improvement as contemplated in section 12N, the expenditure incurred by the qualifying company to complete the improvement must be deemed to be the cost to the qualifying company of any new and unused building or of any new and unused improvement to a building contemplated in subsection (2).

(4) For the purposes of this section the cost to a qualifying company of any building or improvement must be deemed to be the lesser of the actual cost to the qualifying company or the cost which a person would, if that person 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.

(5) No deduction may be allowed under this subsection in respect of any building that has been disposed of by the qualifying company during any previous year of assessment.

(6) A deduction may not be allowed under any other section of this Act in respect of the cost of a building or improvement if any of that cost has qualified or will qualify for deduction from the qualifying company's income as a deduction of expenditure or an allowance in respect of expenditure under this section.

(7) 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 may not in the aggregate exceed the amount of such cost.

(8) The Commissioner may, notwithstanding the provisions of section 99 and 100 of the Tax Administration Act disallow all deductions otherwise provided for under this section if a qualifying company is guilty of fraud or misrepresentation or non-disclosure of material facts with regard to any tax, duty or levy administered by the Commissioner.

(9) The Commissioner may, notwithstanding the provisions of sections 99 and 100 of the Tax Administration Act, raise an additional assessment for any year of assessment where a deduction that has been allowed in any previous year must be disallowed in terms of subsection (8).

(10) This provision ceases to apply in respect of any year of assessment commencing on or after 1 January 2031.

Section 26

26. Determination of taxable income derived from farming.—(1) The taxable income of any person carrying on pastoral, agricultural or other farming operations shall, in so far as it is derived from such operations, be determined in accordance with the provisions of this Act but subject to the provisions of the First Schedule.

(2) In the case of any person who has discontinued carrying on pastoral, agricultural or other farming operations and is still in possession of any livestock or produce, or has entered into a "sheep lease" or similar agreement relating to livestock or produce, which has been taken into account and in respect of which expenditure under the provisions of this Act or any previous Income Tax Act has been allowed in the determination of the taxable income derived by such person when such operations were carried on, the provisions of this Act, but subject to the provisions of paragraphs 1, 2, 3, 4, 5, 6, 7, 9, or 11 of the First Schedule, shall continue to be applicable to that person in respect of such livestock or produce, as the case may be, until the year of assessment during which he disposes of the last of such livestock or produce, notwithstanding the fact that such operations have been discontinued.

First Schedule –Computation of taxable income derived from pastoral, agricultural or other farming operations

2. Every farmer shall include in his return rendered for income tax purposes the value of all livestock or produce held and not disposed of by him at the beginning and at the end of each year of assessment.

3. (1) Subject to the provisions of sub-paragraphs (2) and (3), the value of livestock or produce held and not disposed of at the end of the year of assessment shall be included in income for such year of assessment, and there shall be allowed as a deduction from such income the value of livestock or produce, as determined in accordance with the provisions of paragraph 4, held and not disposed of at the beginning of the year of assessment, reduce, or any portion thereof, is so held and not disposed of.

(2) For the purposes of subparagraph (1), the value of livestock or produce held and not disposed of at the end of any year of assessment by any person who discontinued farming operations during such year, shall be included in his income for such year and for all subsequent years of assessment so long as such livestock or produce, or any portion thereof, is so held and not disposed of.

(3) Any livestock which is the subject of any "sheep lease" or similar agreement concerning livestock, and any produce which is the subject of a similar agreement, shall be deemed to be held and not disposed of by the grantor of such lease or agreement.

4. (1) The values of livestock and produce held and not disposed of at the beginning of any year of assessment shall, subject to the provisions of sub-paragraph (2), be deemed to be—

(*a*) in the case of a farmer who was carrying on farming operations on the last day of the year immediately preceding the year of assessment, the sum of—

(i) the values of livestock and produce held and not disposed of by him at the end of the year immediately preceding the year of assessment; and

(ii) the market value of livestock or produce—

(*aa*) acquired by such farmer during the current year of assessment otherwise than by purchase or natural increase or in the ordinary course of farming operations; or

(*bb*) held by such farmer otherwise than for purposes of pastoral, agricultural or other farming operations, which such farmer during such year of assessment commenced to hold for purposes of pastoral, agricultural or other farming operations; or

(*b*) in the case of any person commencing or recommencing farming operations during the year of assessment, the sum of—

(i) the value of any livestock or produce held and not disposed of by him at the end of the day immediately preceding the date of such commencement or recommencement; and

(ii) the market value of livestock or produce (other than livestock or produce to which sub-item (i) refers)—

(*aa*) acquired by such person during the year of assessment otherwise than by purchase or natural increase or in the ordinary course of farming operations; or

(*bb*) held by such person otherwise than for purposes of pastoral, agricultural or other farming operations, which such person during such year of assessment commenced to hold for purposes of pastoral, agricultural or other farming operations.

(2) . . . . . .

(3) . . . . . .

9. The value to be placed upon produce included in any return shall be a fair and reasonable value.