

**BINDING PRIVATE RULING: BPR 135**

DATE: 07 February 2013

**ACT : INCOME TAX ACT NO. 58 OF 1962 (the Act)**  
**SECTION : SECTIONS 1(1), DEFINITION OF “GROSS INCOME”  
PARAGRAPH (h), 11(g) AND 11(h)**  
**SUBJECT : IMPROVEMENTS EFFECTED ON LAND IN TERMS OF A LONG  
TERM LEASE**

**1. Summary**

This ruling deals with the income tax consequences, for both the lessor and the lessee, resulting from a long term lease agreement in terms of which the lessee will be obliged to effect improvements on immovable property without any claim for either compensation for the improvements or for the removal thereof upon termination of the lease.

**2. Relevant tax laws**

This is a binding private ruling issued in accordance with section 78(1) and published in accordance with section 87(2) of the Tax Administration Act No. 28 of 2011.

In this ruling references to sections are to sections of the Act applicable as at 30 August 2012 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of the provisions of –

- section 1(1), definition of the term “gross income” paragraph (h);
- section 11(g); and
- section 11(h).

**3. Parties to the proposed transaction**

The Applicant: A subsidiary company incorporated in and a resident of South Africa that will acquire land from a fellow subsidiary company

The Co-Applicant: A company incorporated in and a resident of South Africa, that will lease the land from the Applicant and effect improvements thereon in accordance with contractual terms that will be embodied in a long term lease agreement

#### 4. Description of the proposed transaction

The Applicant intends to acquire a portion of a farm which has already been subdivided. The farm is owned by a fellow subsidiary company in relation to the Applicant, but it is subject to a perpetual lease in favour of a religious and charitable institution. The institution is approved by the Commissioner for the South African Revenue Service as a public benefit organization under section 30.

The subdivision will be sold to the Applicant at a nominal price because of the burden of the perpetual lease. The perpetual lease in respect of this portion is to be cancelled thereafter which will facilitate the conclusion of a long-term lease agreement between the Applicant and the Co-Applicant. The reason for this transaction is that the parties consider it inappropriate, on religious grounds, for the institution to undertake the development itself. The salient terms of the lease agreement will be as follows:

- The Applicant will lease the portion to the Co-Applicant for a 99 year period, but the Co-Applicant may (because of a provision of religious law which the parties consider would govern this transaction), terminate the lease at its option, though not for a period of 63 years from the date when the lease takes effect. Thereafter this option may be exercised at any time during subsequent three year cycles.
- The Co-Applicant will be obliged to effect improvements on the portion of land to a minimum specified value, by not later than a specified date. These improvements will be at the Co-Applicants own cost and comprise a commercial property.
- Neither the total value of the improvements, nor the date at which all improvements must be completed, is specified. The Co-Applicant is, therefore, entitled to effect improvements beyond the specified date and agreed minimum amount.
- The Co-Applicant will not be obliged to secure the Applicant's prior approval of the plans for the improvements. The Applicant must, however, approve a master development plan and the Co-Applicant must adhere to it. The Applicant must also consent to the commencement of construction, but may not withhold its consent unreasonably.
- The Co-Applicant must complete the construction within a construction period to be indicated in a time table to be submitted in terms of the lease agreement, which further provides that in submitting plans and specifications to the Applicant and Property Association (if any) for approval, the Co-Applicant must include an indication of the construction period required to complete the improvements and time table of material target dates for commencement of construction to practical completion of the improvements.
- The Co-Applicant will lease the improvements, once effected, to tenants for the duration of the lease.

- The Co-Applicant will not be entitled to any compensation for the improvements upon the lapsing, cancellation or expiry of the lease agreement.

#### **5. Conditions and assumptions**

This ruling is not subject to any additional conditions and assumptions.

#### **6. Ruling**

The ruling made in connection with the proposed transaction is as follows:

- The Applicant must include the fair and reasonable value of all improvements effected by the Co-Applicant in its gross income, as contemplated in paragraph (h)(ii) of the definition of "gross income" in section 1(1).
- The Applicant will be entitled to an allowance under section 11(h), determined by using the present value of the actual development costs arising out of the performance of the Co-Applicant's obligations under the lease agreement, discounted at the rate of 6 per cent over the 99 year period of the lease.
- The Co-Applicant will be entitled to an allowance over a 25 year term in respect of any expenditure actually incurred, as contemplated in section 11(g), if the improvements are occupied for the production of the Co-Applicant's income or the Co-Applicant derives income therefrom.
- In the event that the lease agreement is terminated before the expiry of the full 25 year term during which the section 11(g) allowance may be claimed, the unredeemed balance of the allowance at the termination date may be deducted by the Co-Applicant from its income under section 11(g)(vii).

#### **7. Period for which this ruling is valid**

This binding private ruling is valid for a period of 5 years from 30 August 2012.

Issued by:

**Legal and Policy Division: Advance Tax Rulings  
SOUTH AFRICAN REVENUE SERVICE**