

BINDING PRIVATE RULING: BPR 092

DATE: 14 January 2011

The principle confirmed in this ruling has been reviewed. In addition, subsequent law changes occurred. This ruling should not be relied upon by anyone other than the Applicant(s)/class members to whom it was issued.

ACT : INCOME TAX ACT, NO. 58 OF 1962 (the Act)
SECTION : SECTION 8(5)(b)
SUBJECT : POSSIBLE RECOUPMENT OF RENTAL PAID ON THE SUBSEQUENT ACQUISITION OF THE LEASED PROPERTY BY THE LESSEE

1. Summary

This ruling deals with the question as to whether amounts previously allowed as rental deductions must be recouped in the hands of the lessee under the provisions of section 8(5)(b) where the leased property to be subsequently acquired by the lessee.

2. Relevant tax laws

This is a binding private ruling issued in accordance with section 76Q of the Act.

In this ruling legislative references to sections are to sections of the Act, applicable as at 30 June 2010 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

The ruling has been requested under the provisions of section 8(5)(b).

3. Parties to the proposed transaction

The Applicant: A South African company

The Co-Applicant: The holding company of the Applicant

4. Description of the proposed transaction

The Applicant is the wholly owned subsidiary of the Co-Applicant.

The Co-Applicant is the registered owner and lessor of immovable property (land), situated in South Africa, which is held as a capital asset. The Applicant is the lessee of the land.

All the buildings erected on the land are improvements effected by the Applicant. These improvements remain the property of the Applicant.

Since 1994 the Applicant had the indefinite right of use of the land and in return paid a stipulated rental per hectare per month, subject to an annual escalation.

The Applicant and the Co-Applicant (the Group) intend to enter into and conclude an agreement of sale in terms of which the land of the Co-Applicant will be sold and transferred to the Applicant for R1 (one Rand).

The Co-Applicant and the Applicant intend to transfer the land under section 45 as a capital asset.

The market value of the land to be transferred (excluding the buildings) is approximately R100 million while the Co-Applicant originally acquired the land at a cost of R35 million.

The rental paid by the Applicant to the Co-Applicant from 1994 to 2009 amounted to approximately R16 million. The rental was allowed as a deduction in the hands of the Applicant for income tax purposes.

The Applicant conducts a business in the buildings erected on the land. The Group decided to consolidate its business activities relating to the land into one entity. The Applicant is the main trading entity with customer relationships and it performs the relevant administrative functions. The proposed transaction will also be done to simplify the Group's current operating model.

The Applicant stated that the land is to be sold for R1 in order to consolidate the abovementioned activities into one entity with the minimum financial impact. The Applicant owes the Co-Applicant R200 million on loan account. If the land is transferred at market value, the balance will increase to R300 million. The Group does not predict the loan would be repaid by the Applicant in the foreseeable future or possibly at all. Therefore, the Group's intention is to minimise the financial impact of the proposed transaction by selling the land for R1 and not for market value.

The Applicant stated that it is not the intention of the parties that any amounts paid for the right of use of the land shall be taken into account in determining the purchase price of the land. The rental payments allowed as deductions were significantly less than the market value for the leasing of the land and it was submitted by the Applicant that it indicated that the rental payments had no bearing on the determination of the consideration to be paid for the land.

No allowances were claimed as deductions by the Applicant under section 11(g) in respect of any buildings erected by the Applicant on the land.

During the period of the lease, both the Applicant and the Co-Applicant have assessed losses.

5. Conditions and assumptions

This ruling is made subject to the conditions and assumptions that –

- the rental paid by the Applicant to the Co-Applicant since 1994 was not inflated but market related; and
- the market value of the land leased at the date of this ruling is approximately R100 million as indicated in the documentation submitted by the Applicant.

6. Ruling

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

- Having regard to the circumstances of the proposed transaction, the provisions of section 8(5)(b) are not applicable.

7. Period for which this ruling is valid

This binding private ruling is valid for the year of assessment in which the transfer under section 45 takes place provided the transfer takes place within three (3) years from 1 July 2010.

Issued by:

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