

BINDING PRIVATE RULING: BPR 272

DATE: 11 April 2017

ACT : INCOME TAX ACT 58 OF 1962 (the Act)
SECTION : SECTIONS 1(1) – DEFINITION OF “TRADING STOCK”, 8(4)(a), 11(a), 22, 23(g), 23H AND 24J
SUBJECT : DEDUCTION OF EXPENDITURE INCURRED TO ACQUIRE LAND DEVELOPMENT RIGHTS

1. Summary

This ruling determines the income tax consequences arising out of expenditure incurred by the Applicant to acquire rights to develop land on another person’s property at the Applicant’s own risk and to exploit it for its own account.

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 28 of 2011.

In this ruling references to sections are to sections of the Act applicable as at 13 December 2016. 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 –

- section 1(1) – definition of “trading stock”;
- section 8(4)(a);
- section 11(a);
- section 22;
- section 23(g);
- section 23H; and
- section 24J.

3. Parties to the proposed transaction

The Applicant: A listed company incorporated in and a resident of South Africa

Holdco: A company incorporated in and a resident of South Africa, the landowner

Propco: A subsidiary of Holdco, a special purpose vehicle, incorporated in and a resident of South Africa, which will take ownership of the land from Holdco

- Subco A: A company incorporated in and a resident of South Africa, and a wholly owned subsidiary of Holdco
- Purchasers: The eventual acquirers of the residential units to be developed

4. Description of the proposed transaction

The Applicant is a residential property developer. It proposes to enter into an agreement to acquire rights to develop land owned by Propco that will allow the Applicant to build and sell rights to occupy residential sectional title units. The entire project will take place over a ten-year period.

The Applicant's usual *modus operandi* is to acquire land, develop it and sell residential units for profit, the property being held as trading stock.

In this instance the land cannot be sold by the shareholders of Holdco for religious reasons and the Applicant must therefore acquire the land tenure in terms of a 99-year lease.

The proposed steps to implement the proposed transaction are as follows:

- a) Propco, having acquired the land from Holdco, will grant the right to develop the land in terms of a development rights agreement (the DRA) to Subco A, a fellow subsidiary.
- b) Subco A will cede to the Applicant the right to develop residential units on the land and to market them at the Applicant's risk and for its account, for which the Applicant will agree to pay Subco A various amounts on the occurrence of various events.
- c) In order to give the Applicant security of tenure, Propco will also enter into a 99-year lease with the Applicant (the Township Lease), which will be registered against the title deed.
- d) The residential units held under sectional title will be disposed of to Purchasers in the following manner:
 - i) Once the Applicant has constructed the residential units, the Applicant will, subject to certain terms and conditions, be entitled to:
 - (aa) call on Propco to cancel *pro tanto* the Township Lease with the Applicant in respect of the unit and to conclude a 99-year lease directly with the Purchaser in respect of the residential unit; and
 - (bb) receive payment of the purchase price from the Purchaser.
 - ii) The Purchaser's 99-year lease will be registered against the title deed of the unit.
 - iii) At the end of the 99-year period, the lessee will be entitled to renew the lease for a further 99-year period, against payment to Propco of 3,5% of the then fair value of the unit.

- e) In due course, the Township Lease which the Applicant would have concluded with Propco will lapse and be replaced by the leasehold titles concluded between Propco and Purchasers of the units.
- f) The consideration for the rights in terms of the DRA requires an initial amount at signature date and payment in instalments of the balance, as the residential units are sold, described as "15% plus VAT of the amount (excluding VAT) payable by a Unit Purchaser for the Leasehold Title in respect of a Unit" subject to stipulated minimum amounts payable by set annual dates, and a stipulated maximum amount. If there is a shortfall at any of the annual dates, it must be made good by the next date, and if there is a surplus it may be deducted from the minimum amount due by the following date.
- g) The DRA also permits the Applicant an early redemption discount if payment is made in full on or before a certain date in the future, in which case the reduced amount payable is specified. If the early redemption payment occurs after that date, the amount payable is calculated by reference to an interest rate.

5. Conditions and assumptions

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

6. Ruling

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

- a) The payments which the Applicant will make to Subco A in terms of the DRA will be deductible under section 11(a) read with sections 22 and 23(g).
- b) Section 23H is not applicable to the deductions mentioned in (a).
- c) Should the Applicant exercise its right to pay the early redemption discounted amount, there will be a recoupment under section 8(4)(a) in respect of the discount received.
- d) The obligation to make payments in terms of the DRA will not constitute an "instrument" under section 24J. Section 24J will therefore not be applicable to the payment arrangement.

7. Period for which this ruling is valid

This binding private ruling is valid for a period of 10 years from 13 December 2016.