

# Guide to Building Allowances

Income Tax



South African Revenue Service

# Guide to Building Allowances

## Preface

This guide provides general guidance on building allowances available to owners and lessees of buildings. It does not go into the precise technical and legal detail that is often associated with tax and should not, therefore, be used as a legal reference. It 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 is also not a binding general ruling under section 89 of Chapter 7 of the Tax Administration Act. Should an advance tax ruling be required, visit the SARS website for details of the application procedure.

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

All guides, practice notes and interpretation notes referred to in this guide are available on the SARS website at [www.sars.gov.za](http://www.sars.gov.za). Unless indicated otherwise, the latest issue of these documents should be consulted.

For more information, assistance and guidance you may –

- visit the **SARS website**;
- contact the SARS National Contact Centre –
  - if calling locally, on 0800 00 7277;
  - if calling from abroad, on +27 11 602 2093 (only between 8h00 and 16h30 South African time);
- have a virtual consultation with a SARS consultant by making an appointment via the **SARS website**;
- visit your nearest SARS branch office, preferably 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](mailto:policycomments@sars.gov.za).

## Leveraged Legal Products

### SOUTH AFRICAN REVENUE SERVICE

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## Glossary

In this guide unless the context indicates otherwise –

- “**First Schedule**” means the First Schedule to the Act;
- “**section**” means a section of the Act;
- “**the Act**” means the Income Tax Act 58 of 1962; and
- any word or expression bears the meaning ascribed to it in the Act.

## 1. Introduction

This guide provides guidance on the application and interpretation of the various building allowance provisions available to owners and lessees of buildings under the Act for the erection or, sometimes, purchase of buildings or the effecting of improvements to buildings.

## 2. Building allowances under the Act

### 2.1 The meaning of certain concepts

#### 2.1.1 “Building”

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

Normally a building is a substantial structure, more or less of a permanent nature, consisting of walls, a roof and the necessary appurtenances (accessories).<sup>1</sup>

The word “permanent” is defined in the Merriam-Webster Learner’s Dictionary<sup>2</sup> as –

“lasting or continuing for a very long time or forever: not temporary or changing”.

It is also defined as –<sup>3</sup>

“1. Lasting or remaining without essential change:

2. Not expected to change in status, condition, or place”.

It is evident therefore that the word “permanent” does not necessarily mean everlasting. In determining if a building is “of a permanent nature” the following aspects must be considered: the nature of the building, the degree and manner of annexation and the intention of the person annexing it to a particular place.<sup>4</sup>

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<sup>1</sup> *CIR v Le Sueur* 1960 (2) SA 708 (A), 23 SATC 261.

<sup>2</sup> [www.learnersdictionary.com/definition/permanent](http://www.learnersdictionary.com/definition/permanent) [Accessed 18 August 2022].

<sup>3</sup> [www.thefreedictionary.com/permanent](http://www.thefreedictionary.com/permanent) [Accessed 18 August 2022].

<sup>4</sup> These are the aspects which are considered in assessing whether a movable asset accedes to immovable property (land) and, if it does, the owner of the immovable property becomes the owner of the previously movable asset (assuming it was not already owned by such owner). See WA Joubert “Accession” 27 (Second Edition Volume) *LAWSA* [online] (My LexisNexis: 31 January 2014) in paragraph 184; *Petterson & Others v Sorvaag* 1955 (3) SA 624 (A); *Macdonald Ltd v Radin NO & the Potchefstroom Dairies & Industries Co. Ltd* 1915 AD 454 and *Newcastle Collieries Co Ltd v Borough of Newcastle* 1916 AD 561 at 564. The issue of ownership through accession is not always the same issue as whether a building is of a permanent nature, however, there is a close overlap. Accordingly, it is submitted that in assessing whether a building is of a permanent nature, or whether a movable asset has been permanently fixed to a building, the same elements are relevant.

A building can sometimes be a movable or temporary structure and accordingly not be of a permanent nature. The relevant section must be considered in determining whether it applies to a building of a permanent nature, buildings that are movable or of a temporary nature, or both. If one considers, for example, the purpose of section 13quin in contrast to the purpose of proviso (ii) of section 11(e),<sup>5</sup> it is apparent that section 13quin applies to building of a permanent nature only.

The facts of a particular case must always be considered in deciding whether a building is of a permanent nature, however, generally speaking, when assessed in terms of the factors mentioned above, buildings such as portable bungalows, rondavels, huts, sheds and prefabricated structures used on construction sites, will not be regarded as buildings of a permanent nature. In ITC 370<sup>6</sup> it was held that the wood and iron buildings, originally constructed of old material, that were used by a taxpayer to carry on business as a general dealer were buildings of a permanent nature since it was attached to the soil and used for permanent purposes of the business.

The determination of whether accessories, attachments or improvements to a building are part of the building depends on whether the attachment to the building is of a permanent nature and, if so, if the accessory or attachment is structurally integrated or otherwise permanently physically integrated into the building in such a manner that it has lost its own separate identity and character.<sup>7</sup> The assessment of these criteria is dependent upon the facts of each case. Factors to be considered in assessing if the attachment is permanent are, for example, the intention with which the accessory or attachment is attached, the nature of the accessory or attachment and the degree and manner in which it has been attached to the building.<sup>8</sup>

In ITC 1007,<sup>9</sup> a case dealing with an allowance for hotel buildings under the Income Tax Act 31 of 1941, the court refused to accept that a swimming pool, paddling pond and their tiled surrounds were buildings. The court did, however, note that it did not mean that these structures, a swimming pool, for example, could never qualify for the allowance. The court noted that it was possible for a swimming pool to be built into a building in such a way that it was part of the fabric of the building and in such a case it would be considered to be a building or an improvement to it. The example given was that of a pool built into, and in fact a part of, the sun-roof of a block of flats.

In *CIR v Le Sueur*<sup>10</sup> the court considered whether the laying batteries used in poultry farming constituted part of the building. Ramsbottom JA held that –<sup>11</sup>

“... the laying batteries are valuable property... and it is therefore not at all unlikely that the purpose of the buildings is at least partly to protect the laying batteries, which according to the stated case are liable to rust, against the ravages of the weather. If then it can be said, as I think it can reasonably be said on the facts, that the buildings provide shelter not only for the poultry but also for the laying batteries, the latter clearly cannot be said to have lost their separate identity and to have become integral parts of the buildings in which they are housed.

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<sup>5</sup> Proviso (ii) denies a deduction under section 11(e) for buildings or other structure or works of a permanent nature.

<sup>6</sup> (1936) 9 SATC 313 (U).

<sup>7</sup> *SIR v Charkay Properties (Pty) Ltd* 1976 (4) SA 872 (A), 38 SATC 159; *CIR v Le Sueur* 1960 (2) SA 708 (A), 23 SATC 261 (A) at 275.

<sup>8</sup> *Konstanz Properties (Pty) Ltd v WM Spilhaus and Co (WP) Ltd* 1996 (3) SA 273 (A).

<sup>9</sup> (1962) 25 SATC 251 (N).

<sup>10</sup> 1960 (2) SA 708 (A), 23 SATC 261 (A).

<sup>11</sup> *CIR v Le Sueur* 1960 (2) SA 708 (A), 23 SATC 261 (A) at 275.

In my view therefore the laying batteries ... do not for the purposes of para. 17(1)(f) of the Third Schedule to the Income Tax Act, form part and parcel of the buildings in which they are housed...”

In *SIR v Charkay Properties (Pty) Ltd*<sup>12</sup> the court considered whether the demountable partitions that were used in fourteen upper floors of a building that contained no internal walls and were let as offices were articles for purposes of the depreciation allowance under section 11(e) or constituted part of the building. Trollip JA held that –<sup>13</sup>

“...[t]he nature of respondent’s demountable partitions and the way in which they were mounted and used in respondent’s building during the relevant years of assessment have been fully described above. According to that description they were only lightly, albeit rigidly, attached to the floors and ceilings; they could easily and inexpensively be detached and removed without causing any injury to themselves or the floors or ceilings; they could then be either stored or similarly mounted and attached in some other position to suit the tenants; indeed, their normal use and function was not for them to remain unmoved but to be shifted around; hence their mounting and attachment in a particular position could not be regarded, ..., as being permanent; moreover, for the same reasons, it can be said that, while in position, they did not lose their identity or character as movable inner walls. Consequently, I do not think that they were structurally integrated or otherwise physically incorporated into the building permanently in such a way that they lost their own, separate identity and character, or, in the words used by Ramsbottom JA, that they were built into the fabric of respondent’s building.

... True, the ordinary doors of a building or roof tiles are a part of it, although the doors are only attached by their hinges and the roof tiles by their own weight and both can easily be removed. None the less they are regarded as part of the building because they are structurally integrated or physically incorporated into it permanently; for although they are easily removable, the purpose and intention with which they are built into the building’s fabric (and intention here is of importance) is that they should remain in those positions permanently. On the other hand, the demountable partitions are not only easily removable, but, according to their normal use, they are meant to be and are in fact moved about or removed from time to time.”

A building does not include the land upon which the structure stands,<sup>14</sup> external paving, fencing or landscaping.

### 2.1.2 “Wholly or mainly used”

The determination whether a building or improvement is wholly or mainly used for a particular purpose tends to be a question of fact. It is unnecessary that the building be used wholly for the required purpose, as long as the building is used mainly for that purpose. In practice, if more than 50% of a building, measured by floor space or volume, is used for the required purpose 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.

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<sup>12</sup> 1976 (4) SA 872 (A), 38 SATC 159 (A).

<sup>13</sup> *SIR v Charkay Properties (Pty) Ltd* 1976 (4) SA 872 (A), 38 SATC 159 (A) at 169.

<sup>14</sup> ITC 1619 (1996) 59 SATC 309 (C) at 314.

### 2.1.3 “Process of manufacture”

A process of manufacture covers those cases in which raw materials are converted into a product suitable for use. According to case law, it must be a complete process and it must produce an object or thing “essentially different” from the materials which went into its making. See Practice Note 42 dated 27 November 1995<sup>15</sup> for a list of processes of manufacture and processes similar to a process of manufacture. This is not a closed list.

### 2.1.4 “Erection of which was commenced”

The courts have held that the date when erection of a building or improvements commences is the date when the laying of the foundation begins. The clearing and levelling of the site and the conducting of excavations in preparation for the laying of the foundation have been held not to form part of the erection phase.<sup>16</sup>

### 2.1.5 “Improvements”

The word “improvement” is not defined in the Act<sup>17</sup> and must be given its ordinary grammatical meaning. It is described in the New Oxford Thesaurus of English,<sup>18</sup> as –

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

Reference must be made to the facts of each case in determining whether something constitutes an improvement. An improvement must be distinguished from repairs.<sup>19</sup>

For the purpose of section 13<sup>20</sup> only, “improvements” is defined in section 13(9) as follows:

“ **‘[I]mprovements’**, in relation to any improvements commenced on or after the first day of April, 1971, means 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;”

It has been held in a number of court cases that to constitute an improvement to a building the “extension, addition or improvement” must be physically attached to, connected or structurally integrated with the building. For example, some years after a factory building was built, concrete aprons were added around the building. The aprons were held not to form part of the building as they were separate structures and not physically attached to the building and accordingly did not qualify as an improvement.<sup>21</sup>

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<sup>15</sup> “Income Tax: Processes of Manufacture, Processes Similar to a Process of Manufacture and Processes Not Regarded as Processes of Manufacture or Processes Similar to a Process of Manufacture”.

<sup>16</sup> ITC 1137 (1969) 32 SATC 1 (C).

<sup>17</sup> Except in section 13(9) – see below.

<sup>18</sup> P Hanks, first published (2000) Oxford University Press Inc, New York.

<sup>19</sup> Interpretation Note 74 “Deduction and Recoupment of Expenditure on Repairs” for the distinction between repairs and improvements.

<sup>20</sup> See the discussions below for section specific reference to “improvements”.

<sup>21</sup> *African Detinning Works (Pty) Ltd v SIR* 1982 (1) SA 797 (A), 44 SATC 1.

### 2.1.6 “Cost”

The court in *SIR v Eaton Hall (Pty) Ltd* considered the meaning of “cost to the taxpayer of the building” as ordinarily meaning the “price or consideration given or paid by him for the erection of the building... It does not, therefore, include expenses, incurred by the taxpayer in connection with the erection of the building unless, of course, they are part of the price or consideration paid for the erection.”<sup>22</sup> It does not include the cost of the land on which the building is erected nor the preparation of the land for the erection<sup>23</sup> nor additional costs such as transfer duties or interest incurred on any financial instrument used for the erection or effecting improvements. Costs that are directly and closely connected with the erection of the building such as architect and civil engineering fees are included.

As noted above, the cost of the building does not include the land upon which the building stands. A reasonable apportionment must therefore be done between the cost of the building and the cost of the land if there is a single cost for land and buildings. The relative value of the land and the building is generally an appropriate method for apportioning a single cost between the land and the building. However, if a taxpayer’s specific circumstances indicate that an alternative method of apportionment is more appropriate than a value-based one, the onus would be on the taxpayer to justify such alternative method. The appropriateness of the method applied is assessed on a case-by-case basis. Depending on the facts, if a value-based apportionment method is used, the use of specialised property valuation experts may be necessary in the determination of the value of the land in relation to the building erected on it. Municipal valuations can also potentially be used but there may be reasons why in a particular case they are not appropriate, for example, a municipal valuation may not provide the necessary distinction between the land and the building especially when there are improvements or it may be outdated.

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”.<sup>24</sup> The specific facts of the case need to be considered in determining whether the taxpayer is entitled to any deduction of input tax.

## 2.2 Allowance on buildings or improvements to buildings used in a process of manufacture, research and development or similar process (section 13)

### 2.2.1 Requirements to be met before the allowance may be claimed

Depending on the date of commencement of the erection of the building or improvements to the building, the building must be wholly or mainly used by the taxpayer or the lessee during the year of assessment for the purpose of carrying on in the building any process of manufacture, research and development<sup>25</sup> or any process which is of a similar nature in the course of the taxpayer’s or lessee’s trade, but specifically excluding trades of mining or farming, in order for the building or improvements to qualify for the allowance (see **2.2.2** and **2.2.3** for the detailed requirements).

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<sup>22</sup> 1975 (4) SA (A), 37 SATC 343 at 347 to 348.

<sup>23</sup> See **2.1.4**. Levelling of the site and excavations for the foundation have been held not to form part of the erection phase.

<sup>24</sup> Section 23C(1).

<sup>25</sup> Applicable to buildings in which research and development is being conducted on or after 1 April 2012.



Whether a building or improvements to a building meet these requirements is a question of fact which must be determined on a case-by-case basis. For example, if a taxpayer incurred expenditure in erecting a building which was mainly used in a process of manufacture notwithstanding that a portion of the building such as the offices, change rooms and cafeteria were not used in that process, the building would be eligible for the allowance. No allowance would, however, be granted for any changes subsequently made to the offices, change rooms or cafeteria as the changes would not improve the industrial capacity of the building and would therefore not constitute an improvement (see **2.1.5**).

The taxpayer is not required to be the owner of the building or improvement provided the taxpayer incurs the cost of the building or improvement and the building or improvement is used as required (see **2.2.2** and **2.2.3**). Therefore, if, for example, a lessee erects a building which accedes to land owned by a lessor or effects improvements to a building owned by a lessor, the lessee may qualify for the allowance.

Notwithstanding that ownership of the building or improvement is not a requirement in section 13, under section 12N(1) a lessee who effects obligatory improvements on a leased property as envisaged under section 12N is deemed to be the owner of such improvements for purposes of, amongst others, section 13. The expenditure incurred by the lessee to complete the improvement contemplated under section 12N is deemed to be the cost of the building or improvement to the lessee for the purposes of the section 13 allowance.<sup>26</sup>

In order to qualify for the allowance the requirements must be met in each year of assessment. Notwithstanding that a building may have qualified for an allowance in a previous year of assessment, if a taxpayer never uses that building as required during a particular year of assessment, for example, the taxpayer uses the building in another trade but at no stage during that year is it wholly or mainly used in a process of manufacture, research and development or similar process, the taxpayer will not qualify for the allowance and may not claim it.

The allowance may be denied under other sections of the Act, for example:

- Section 25BB(4) provides that a company that is a REIT<sup>27</sup> or a controlled company<sup>28</sup> on the last day of the year of assessment may not claim a deduction under section 13.
- Section 23G denies a lessor a deduction under, amongst other, section 13 if the receipts and accruals of the lessee or sub-lessee in relation to a sale and leaseback arrangement do not constitute income.

## **2.2.2 Qualifying buildings**

A taxpayer may deduct an annual allowance from income for a building the erection of which commenced on or after 15 March 1961 if all of the following requirements are met:<sup>29</sup>

- The taxpayer –
  - erected the building;
  - purchased a used building from a seller that was entitled to the allowance under section 13 because (i) the seller had erected the building and used it as required (see below) or (ii) the seller had purchased the building from the person in (i) or a subsequent owner of that building, provided that the building

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<sup>26</sup> Paragraph (d) of the proviso to section 13(1).

<sup>27</sup> See section 1(1).

<sup>28</sup> See section 25BB(1).

<sup>29</sup> Section 13(1)(b), (d) and (dA).

had been used by all previous sellers and the subsequent owner, as required;  
or

- purchased a building that had never been used.
- The building was wholly or mainly used by the taxpayer or, if the building is let, by the tenant or the subtenant, during the year of assessment for the purpose of carrying on in the building a process of manufacture, research and development<sup>30</sup> or any process which is of a similar nature in the course of the taxpayer's, tenant's or subtenant's trade, but specifically excluding the trades of mining or farming.

For example, A erected the building and used it as required before selling the building to B who used it as required before selling it to C and C then used it as required before selling it to D. A, B, C and D would be entitled to an allowance on the building under section 13. A erected the building and used it as required, B purchased the used building from A (the person who erected it and had been entitled to an allowance under section 13) and from C's and D's perspective all previous sellers and subsequent owner had used the building as required and had been entitled to the allowance.

In contrast, if B purchased the building unused from A and used it as required before the subsequent sales to C and D who all used it as required, only B would qualify for the allowance having purchased a building which had never been used and using it as required. Although C purchased a used building from someone who was entitled to an allowance under section 13, it was not because B had erected it and although B had purchased it from A (the person who erected the building), the building had not used by A (the previous seller) as required. A did not use the building and D did not acquire the used building from someone who had been entitled to the allowance in the circumstances discussed above.

### **2.2.3 Improvements commenced on or after 1 April 1971**

Any improvements to any building if the improvements commenced on or after 1 April 1971 and that building was wholly or mainly used by the taxpayer or, if the building is let by the taxpayer, by the tenant or sub-tenant, during the year of assessment for the purpose of carrying on in that building any process of manufacture or any other process which is of a similar nature in the course of the taxpayer's, tenant's or subtenant's trade, but specifically excluding the trades of mining or farming.<sup>31</sup> This will apply irrespective of whether the building was erected by the taxpayer or purchased, and if purchased, whether the seller was entitled to the allowance or the building was unused.

Improvements to buildings wholly or mainly used by the taxpayer in carrying on research and development do not qualify for the allowance.

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<sup>30</sup> Applicable to buildings in which research and development is conducted as required on or after 1 April 2012.

<sup>31</sup> Section 13(1)(f).

## 2.2.4 Calculation of the allowance

The annual allowance is calculated at a 'specified rate' per year (see below) of the 'adjusted cost' (see below) to the taxpayer of the building or improvement. In order to claim the allowance, a taxpayer must meet all the requirements in **2.2.2** or **2.2.3** as appropriate.

The specified rate varies depending on when the erection of the building or qualifying improvements commenced. In the case where the taxpayer purchased the building and meets the requirements discussed in **2.2.2** and **2.2.3**, the specified rate is still based on the date of erection of the building and not on the date of purchase.

Date on which the erection of the building or improvements commenced	Other requirements	Specified rate
(a) On or after 15 March 1961 but not later than 31 December 1988.		2%
(b) On or after 1 January 1989	The building or improvement did not qualify for the increased 10% allowance (see below) in the now repealed paragraph (c) of the proviso to section 13(1)	5%

"Adjusted cost" is cost (see **2.1.6**) less any –

- recovery or recoupment of the allowance on another building or improvement that the taxpayer elected to set off against the cost of the building or improvements (see **2.2.6**);
- the portion of the cost of any building the erection of which commenced on or after 1 July 1961 or any improvements effected to it as has been taken into account in the calculation of the allowance for leasehold improvements under section 11(g) in the current or previous year of assessment;<sup>32</sup> and
- the initial allowance, if applicable, which was previously available under the now repealed section 13(7) for certain buildings and improvements. The initial allowance of 17,5% of the cost of qualifying buildings and improvements was previously available under the now repealed section 13(7) for buildings and improvements used as required if, amongst other requirements, the erection thereof commenced between 1 July 1985 and 31 December 1988 and the building or improvement was completed and brought into use by 31 December 1989.

<sup>32</sup> Paragraph (a) of the proviso to section 13(1).

The increased 10% allowance (see (c) in the table above) was available in respect of building and improvements commenced on or after 1 July 1996 but not later than 30 September 1999 and brought into use on or before 31 March 2000.

A taxpayer must have incurred a cost or be deemed to have incurred a cost for purposes of the Act in order to qualify for the allowance. If a taxpayer, for example, acquires a building by way of donation without paying any consideration for it, that taxpayer will not be entitled to the allowance, since the taxpayer has not incurred any cost.

The building or improvements to the building need not be used for the full year of assessment in order for the allowance to be granted. The allowance on a building that is used for part of a year of assessment is allowed in full and is not prorated for the number of months used during the year of assessment.

### **Example 1 – Improvements to buildings**

*Facts:*

Company A, a manufacturer, commenced improvements to a building which was mainly used in a process of manufacture during September 2020 at a cost of R80 000 of which R60 000 was used to enlarge the existing storage rooms used for manufactured goods and the balance of R20 000 to improve the facilities for staff, such as new offices and a canteen. These alterations were brought into use on 1 November 2020.

*Result:*

To constitute an 'improvement' as defined for purposes of section 13, the particular alteration must have been effected for the purpose of increasing or improving the industrial capacity of the building. Therefore, the allowance will only be allowed on the enlargement of the existing storage rooms at 5% of cost, that is, R3 000 (5% of R60 000) per year of assessment. The new offices and the canteen do not constitute an improvement as defined for purposes of section 13 and therefore will not qualify for the allowance.

### **Example 2 – Sale of a building that qualifies for an allowance**

*Facts:*

Company B, a manufacturer with a February year-end, erected a factory building at a cost of R400 000. Erection commenced on 1 April 1988 and the building was completed and brought into use on 1 December 1988. Company B commenced improvements to the building on 1 June 1996 at a cost of R200 000 which were completed and brought into use on 1 August 1996.

Company B sold the building on 1 March 2014 to Company C for R800 000. Company C uses the building for the purpose of manufacture and has a February year-end.

*Result:*

The allowances that Company B and Company C are entitled to claim on buildings for the years of assessment ended 28 February 1989 to 28 February 2021 assuming they continue to use the building as required each year are as follows:

**Company B**

	R
Cost of factory building	400 000
Less: Initial allowance (17,5% × R400 000)	<u>( 70 000)</u>
	<u>330 000</u>

The allowance on the factory building for each year of assessment (28 February 1989 to 28 February 2014) must be based on the cost less the initial allowance, that is, R330 000.

The allowance is calculated as follows:

$$2\% \times R330\,000 = R6\,600$$

The allowance on the improvements to the factory building for each year of assessment (28 February 1997 to 28 February 2014) is calculated as follows:

$$5\% \times R200\,000 = R10\,000$$

**Company C**

As the rate of the allowance for a building that is purchased follows the date on which the erection of the building commenced, both the building (which qualified for 2% on the original construction cost) and the improvements to the building (which qualified for 5% on the cost of improvements) will only qualify for the allowance of 2% on cost of purchase once acquired and used as required by Company C.

For the 2015 to 2021 years of assessment Company C may claim an annual allowance calculated as follows:

$$2\% \times R800\,000 = R16\,000.$$

**2.2.5 Limit on the allowance**

The aggregate of the allowances allowed under section 13(1) or deemed to have been allowed under section 13(1A) may not exceed the cost of the building or improvements less the sum of any recoupment not included in income (see **2.2.6**), the aggregate of the leasehold improvement allowance under section 11(g) and the initial allowance previously allowed under section 13(7), or any previous legislation in respect of those amounts.<sup>33</sup>

Section 13(1A) applies when the allowance is claimed and the building was used by the taxpayer in a previous year or years of assessment for carrying on any trade the receipts and accruals of which were not included in the taxpayer's income. For example, the taxpayer may have carried on a trade in a building outside South Africa before the introduction of the residence basis of taxation with the result that the non-South African source income was not included in the taxpayer's gross income. Any deduction which could have been allowed during such previous year or years under section 13 is for the purposes of section 13 deemed to have been allowed during such previous year or years as if the receipts and accruals of such trade

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<sup>33</sup> Section 13(2).

had been included in the taxpayer's income. It is therefore taken into account in determining the limit on the allowance.

In addition, if the taxpayer lets the building and within two years of the commencement of the lease the lessee, any sub-lessee or a connected person to the lessee or sub-lessee held the asset, the amount which qualifies for a deduction is further limited as specified in section 23D.

### **2.2.6 Recoupment**

The allowances on buildings and improvements available under section 13 or the corresponding provisions of a previous Income Tax Act are subject to recoupment under section 8(4)(a) on recovery or recoupment, for example, the disposal of the building (see 3). The taxpayer, however, has an option under section 13(3) to prevent the recoupment from being included in the taxpayer's income. If elected by the taxpayer, the recoupment will not be included in the taxpayer's income but will be set off against the cost of a further building, provided the taxpayer purchases or erects the further building within 12 months or any longer period which the Commissioner may allow from the date on which the event giving rise to the recovery or recoupment occurred. The further building purchased or erected must itself qualify for the allowance in order for this option to be exercised. Should the taxpayer not erect or purchase any other building, the amount of the recoupment will be taxed in the year of accrual.

This set-off is limited to the amount of the cost of the building less the portion of cost in respect of which an allowance has been granted in the current or previous year of assessment for leasehold improvements under section 11(g).<sup>34</sup>

The recoupment provision under section 8(4)(a) does not apply to the deduction which is deemed to have been allowed under section 13(1A) (see 2.2.5).<sup>35</sup>

## **2.3 Allowance on any permanent shipbuilding structure [section 13(8)]**

The provisions of the Act governing the allowance and its recoupment as discussed in 2.2 are extended to any permanent shipbuilding structure the erection of which was commenced by the taxpayer on or after 1 January 1996 and any improvements thereto, if that structure was wholly or mainly used during the year of assessment for the purposes of the shipbuilding trade.

For the purpose of the allowance under section 13 a "shipbuilding structure" is defined in section 13(9) as follows:

“ **[S]hipbuilding structure**’ means any launching way, fitting-out quay or craneway which is not part of a building.”

## **2.4 Allowance on buildings used by hotel keepers (section 13bis)**

Section 13bis provides for an allowance on the erection of buildings or improvements to such buildings used by the taxpayer in the trade of hotel keeper, or if let, then used by the lessee in the trade of hotel keeper.

For more information on the requirements and the calculation of the allowance under section 13bis see Interpretation Note 105 "Deduction In Respect Of Buildings Used By Hotelkeepers".

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<sup>34</sup> Section 13(3).

<sup>35</sup> Section 8(4A).

## 2.5 Allowance on commercial buildings (section 13quin)

Section 13quin provides for an allowance on any new and unused buildings or improvements that are owned and wholly or mainly used by the taxpayer for the purposes of producing of income in the course of that taxpayer's trade, other than the provision of residential accommodation.

For more information on the requirements and the calculation of the allowance under section 13quin see Interpretation Note 107 "Deduction In Respect Of Commercial Buildings".

## 2.6 Allowance on the erection or improvement of buildings in urban development zones (section 13quat)

Section 13quat provides for an allowance on the cost of erection, extension, addition or improvement of any commercial or residential building or part of that building within an urban development zone which is owned by the taxpayer and is used solely for purposes of that taxpayer's trade.

For more information on the requirements of and the calculation of the allowance under section 13quat see the *Guide to the Urban Development Zone Tax Incentive*.

## 2.7 Allowance on residential buildings

### 2.7.1 Residential units under a housing project (section 13ter)

A residential building annual allowance and a residential building initial allowance were available under section 13ter to a taxpayer who erected residential units on or after 1 April 1982 and before 21 October 2008 under a housing project.

Section 13ter was not repealed and continues to apply to those units erected between the specified dates. Any residential unit acquired, or the erection of which commenced, on or after 21 October 2008 may qualify for an allowance under section 13sex (see 2.7.2) provided all the requirements of that section are met.

For the purpose of section 13ter the term "housing project" is defined as follows:

“ **[H]ousing project**’ means any project for the erection of a building or buildings in the Republic consisting of or including at least five residential units;”

For the purpose of section 13ter the term "residential unit" is defined as follows:

“ **[R]esidential unit**’ means any self-contained residential accommodation consisting of more than one room (but excluding any hostel, hotel or similar accommodation), the erection of which was commenced by the taxpayer on or after 1 April 1982 and before 21 October 2008 and which was erected under a housing project of the taxpayer—

- (a) in order to be let to a tenant for the purpose of deriving a profit for the taxpayer; or
- (b) in order to be occupied by a *bona fide* full-time employee of the taxpayer.

If a company is mainly engaged in providing housing facilities for the employees of its sole or principal shareholder or another company the shares of which are wholly held by its sole or principal shareholder, the employees will be deemed to be employees of the company mainly engaged in so providing housing facilities.<sup>36</sup>

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<sup>36</sup> Section 13ter(11).

**(a) The residential building initial allowance**

A residential building initial allowance of 10% of the cost of the residential unit (excluding any cost that has or will qualify as a deduction or allowance under any other provisions of the Act, whether in the current, any previous or any subsequent year of assessment)<sup>37</sup> is available in the year of assessment in which the residential unit is for the first time let to a tenant for the purpose of deriving a profit or occupied by a *bona fide* full-time employee of the taxpayer, provided that at the end of that year of assessment at least five units in the housing project have been let or occupied as required.<sup>38</sup> If less than five units are let or occupied as required, the allowance is delayed and made available in the year in which at least five of those units are let or occupied as required.<sup>39</sup>

**(b) The residential building annual allowance**

A residential building annual allowance is available at a rate of 2% of the cost of the residential unit (excluding any cost that has or will qualify as a deduction or allowance under any other provisions of the Act, whether in the current, any previous or any subsequent year of assessment)<sup>40</sup> for the period in which it so qualifies. This allowance is first granted in the year of assessment in which the residential building initial allowance is granted on the residential unit concerned.<sup>41</sup> Thereafter it is available in each succeeding year of assessment until the year of assessment during which the residential unit ceases to be available either for letting to a tenant for the purposes of making a profit or occupied by a *bona fide* full-time employee. The allowance is not available during the year of assessment and each succeeding year of assessment in which the residential unit ceases to be available as set out above.

**Example 3 – Claiming an allowance under another provision of the Act**

*Facts:*

Taxpayer A erects 5 residential units for R10 000 each under a housing project for occupation by employees. An allowance of R6 000 per unit has been allowed as a deduction under section 11(*t*).

*Result:*

The following costs will qualify for the allowance under section 13*ter*:

	R
Cost of units (R10 000 × 5)	50 000
Less: Allowance under section 11( <i>t</i> ) (R6 000 × 5)	<u>(30 000)</u>
Costs that qualify for allowance purposes under section 13 <i>ter</i>	<u>20 000</u>

<sup>37</sup> Section 13*ter*(9).

<sup>38</sup> Section 13*ter*(5).

<sup>39</sup> Section 13*ter*(5).

<sup>40</sup> Section 13*ter*(5).

<sup>41</sup> Section 13*ter*(6).



#### **Example 4 – Allowances on residential units erected under a housing project**

##### *Facts:*

Company D erected a block of flats consisting of 10 residential units at a cost of R1 200 000 per unit. 4 units were completed and let during the year of assessment ended 29 February 2008. 2 units were completed and occupied by permanent employees of Company D during year of assessment ended 28 February 2009. The remaining 4 units were completed and occupied by permanent employees of Company D during the year of assessment ended 28 February 2010. The current year of assessment is 2021.

##### *Result:*

#### **2008 Year of assessment**

Company D may not claim the residential building initial allowance or the residential building annual allowance since less than 5 units were let to tenants during the 2008 year of assessment.

#### **2009 Year of assessment**

A residential building initial allowance of R720 000 [10% of (R1 200 000 × 6 units)] may be claimed.

A residential building annual allowance of R144 000 [2% of (R1 200 000 × 6 units)] may be claimed.

#### **2010 Year of assessment**

A residential building initial allowance of R480 000 [10% of (R1 200 000 × 4 units)] may be claimed.

A residential building annual allowance of R240 000 [2% of (R1 200,000 × 10 units)] may be claimed.

#### **2011 – 2021 Year of assessment**

A residential building annual allowance of R240 000 [2% of (R1 200 000 × 10 units)] may be claimed, provided all the requirements of the section are met.

#### **(c) Requirements to be met before the allowance may be claimed**

In order to qualify for the residential building initial allowance or the residential building annual allowance all of the requirements included in the definitions of “housing project” and “residential unit” (see 2.7.1) must be met.

In addition, the taxpayer must have commenced the erection of the residential unit between 1 April 1982 and 21 October 2008 (see above). The taxpayer is not required to own the land on which the residential unit is built, however, a taxpayer who does not own the premises cannot claim any allowance in respect of the portion of the cost of the residential unit on premises not owned by the taxpayer, unless the taxpayer is entitled to occupation of those premises for at least 10 years after the date of commencement of the erection of those units.<sup>42</sup>

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<sup>42</sup> Section 13ter(4).

Under section 12N(1) a lessee who effects obligatory improvements on a leased property as envisaged under section 12N<sup>43</sup> is deemed to be the owner of such improvements for purposes of, amongst others, section 13*ter*. This means that in calculating the allowances under section 13*ter*, the lessee is treated as owning the underlying property directly. The expenditure incurred by the lessee to complete the improvements is deemed to be the cost to the lessee of a residential unit for the purposes of the section 13*ter* allowance.<sup>44</sup>

Costs may only include the cost of erecting the building and do not include amounts such as the purchase price of the land, transfer costs and furniture.

The allowance may be denied under other sections of the Act, for example, section 25BB(4) provides that a company that is a REIT<sup>45</sup> or a controlled company<sup>46</sup> on the last day of the year of assessment may not claim a deduction under section 13*ter*.

#### **(d) Limitation on the allowance**

The aggregate of the residential building initial allowance, the residential building annual allowance and the allowance deemed to have been allowed section 13*ter*(6A) (see below) may not exceed the cost of the residential unit (excluding any cost that has or will qualify as a deduction or allowance under any other provisions of the Act, whether in the current, any previous or any subsequent year of assessment), or the relevant portion thereof if the allowance is calculated only on a portion of the cost.<sup>47</sup>

Section 13*ter*(6A) applies when any allowance is claimed under section 13*ter* and the building was used by the taxpayer in a previous year or years of assessment for carrying on any trade the receipts and accruals of which were not included in the taxpayer's income. Any deduction which could have been allowed under section 13*ter* during such previous year or years is, for the purposes of section 13*ter*,<sup>48</sup> deemed to have been allowed during such previous year or years as if the receipts and accruals of that trade had been included in the taxpayer's income. It is therefore taken into account in determining the limit on the allowance. The deemed deduction is not subject to recoupment under section 8(4)(a) (see **(e)** below).<sup>49</sup>

#### **(e) Recoupment**

A recoupment will occur in the year of assessment when the residential unit is no longer available for letting to a tenant for purposes of making a profit or is no longer available for occupation by a *bona fide* full-time employee.<sup>50</sup> The amount which must be included in the taxpayer's income is the amount of the residential building initial allowance granted to the taxpayer less one-tenth of that amount for each completed period of one year, but not exceeding 10 years, from the date the unit was first let or occupied as required to the date on which it is used or dealt with such that it ceases to be available for letting or occupation as required.<sup>51</sup> In addition, the residential building annual allowance may not be claimed during

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<sup>43</sup> Section 12N will apply if a lessee undertakes obligatory improvements on leased property under a public private partnership, or to leased property owned by the government in the national, provincial or local sphere or any entity exempt under section 10(1)(cA) or (f).

<sup>44</sup> Section 13*ter*(2A).

<sup>45</sup> See section 1(1).

<sup>46</sup> See section 25BB(1).

<sup>47</sup> Section 13*ter*(10).

<sup>48</sup> Excluding section 13*ter*(7)(a) which provides for a recoupment of the residential building initial allowance when the building ceases to be available for letting or occupation by an employee.

<sup>49</sup> Section 8(4A).

<sup>50</sup> Section 13*ter*(7).

<sup>51</sup> Section 13*ter*(7)(a).

that year of assessment and any succeeding year of assessment during which the unit is not available for letting or occupation as required.<sup>52</sup>

The taxpayer is thus permitted to retain the benefit of one-tenth of the residential building initial allowance for every completed year, up to a maximum of 10 years, during any unbroken period from the date on which the unit was first let or occupied as required.

The allowances available under section 13*ter* are generally subject to recoupment under section 8(4)(a) on, for example, disposal of the residential unit (**see 3**). However, the general recoupment provisions of section 8(4)(a) and the scrapping allowance provisions of section 11(o) do not apply to the amount of the residential building initial allowance which is included in income as mentioned above, whether it be in the current or any previous year of assessment.<sup>53</sup> This ensures that no portion of the residential building initial allowance is recouped and included in income more than once. To the extent the initial building allowance is not recouped under section 13*ter* it can potentially be recouped under section 8(4)(a).

The recoupment provision under section 8(4)(a) does not apply to the deduction which is deemed to have been allowed under section 13*ter*(6A) (**see (d)** above).<sup>54</sup>

#### **Example 5 – Recoupment when section 13*ter* requirements are not met**

##### *Facts:*

Taxpayer A erected a residential building, consisting of 8 units, at a cost of R500 000 each. All units were completed on 1 April 2009 and let as from that date. On 1 June 2018 two of the units were occupied by family members at no cost.

##### *Result:*

#### **Year of assessment ended 28 February 2019**

A residential building initial allowance was claimed on all of the units in the year of assessment ended 28 February 2009. During the year of assessment ended 28 February 2017 two of the units were no longer let for the purpose of deriving a profit or occupied by *bona fide* full-time employees, therefore, an amount must be included in Taxpayer A's income under section 13*ter*.

The residential building initial allowance claimed for the year of assessment ended 29 February 2009 on the 2 units no longer used as required was calculated as follows:

$$\begin{aligned} &= (500\ 000 \times 2) \times 10\% \\ &= R1\ 000\ 000 \times 10\% \\ &= R100\ 000 \end{aligned}$$

	R
Residential building initial allowance claimed for 2 units during 2009	100 000
Less: $1 / 10 \times 100\ 000 \times 9$ completed years	<u>(90 000)</u>
Amount to be included in income	<u>10 000</u>

Taxpayer A can continue claiming the annual building allowance on the 8 units that are still let as required but may not claim the allowance in respect of the 2 units occupied by family members.

<sup>52</sup> Section 13*ter*(7)(b).

<sup>53</sup> Section 13*ter*(8).

<sup>54</sup> Section 8(4A).

## **2.7.2 Allowance for certain residential units (on or after 21 October 2008) (section 13sex)**

Before 21 October 2008 various provisions in the Act allowed for deductions relating to residential buildings, for example, sections 11(t) and 13ter and paragraph 12(5) of the First Schedule. Section 13sex replaced these provisions and brought in one simplified and comprehensive provision for low-cost housing in respect of residential units and improvements acquired or the erection of which commenced on or after 21 October 2008.

Section 13sex provides for an allowance on new and unused residential units or new and unused improvements to a residential unit, owned by the taxpayer which are used solely for the purpose of trade and an additional allowance on that residential unit if it qualifies as a low-cost residential unit.

The allowance is subject to section 36, which means that section 36 takes precedence for the deduction of expenditure incurred in a mining operation for the acquisition, erection, construction, improvement or laying out of housing for residential occupation by the mining operation's employees and the furniture for such housing.

For more information on the requirements and the calculation of the allowance under section 13sex see Interpretation Note 106 "Deduction In Respect Of Certain Residential Units".

## **2.7.3 Allowance on the sale of low-cost residential units on loan account (section 13sept)**

An allowance under section 13sept was introduced to offer relief to employers wishing to transfer ownership of low-cost residential housing to their employees by making use of interest-free loan financing. The section came into operation on 21 October 2008 and applies to a unit disposed of on or after that date and before the year of assessment ending on or before 28 February 2022. Section 13sept is subject to section 36.

A "residential unit" is defined in section 1(1) as follows:

“ '[R]esidential unit' means a building or self-contained apartment mainly used for residential accommodation, unless the building or apartment is used by a person in carrying on a trade as an hotel keeper;”

### *Self-contained apartment*

The term "self-contained apartment" is not defined in the Act. According to *Lexico.com*, "self-contained" means –<sup>55</sup>

*“(of accommodation) having its own kitchen and bathroom, and typically its own private entrance.*

*‘a group of self-contained flats’ ”.*

The word "apartment"<sup>56</sup> is described by *Lexico.com* as –

*“[a] suite of rooms forming one residence; a flat” or “[a] set of private rooms in a very large house”.*

<sup>55</sup> <https://www.lexico.com/definition/self-contained> [Accessed 18 August 2022].

<sup>56</sup> <https://www.lexico.com/definition/apartment> [Accessed 18 August 2022].

The facts of a specific case are critical. A unit which constitutes a section in a sectional title scheme under the Sectional Titles Act 95 of 1986 will constitute a self-contained apartment.<sup>57</sup> However, if a taxpayer owns a building which contains some apartments which have not been sectionalised under the Sectional Titles Act 95 of 1986, and are therefore not capable of separate ownership in their own right, the building and not the individual apartments must be assessed to determine whether it meets the definition of a residential unit.

#### *Mainly used*

As noted above, the building or self-contained apartment must be used mainly for residential accommodation. The determination of whether a building or self-contained apartment is mainly used for residential accommodation is a question of fact.

In the context of section 13sept and the meaning of residential unit, “mainly” is also interpreted to mean “more than 50%”. Therefore, the building or self-contained apartment will potentially qualify as a residential unit if it is used more than 50% during the year of assessment for residential accommodation.

#### *Residential accommodation*

*Lexico.com* describes “residential”<sup>58</sup> as follows:

*“Designed for people to live in.”*

*Lexico.com* describes “accommodation”<sup>59</sup> as follows:

*“A room, group of rooms, or building in which someone may live or stay.”*

The provision of residential accommodation therefore refers to the provision of a place for someone to live in such as a house, flat, hostel or hotel room<sup>60</sup> regardless of whether that accommodation is of a temporary or permanent nature.

A residential unit would have sleeping, catering and ablution facilities.<sup>61</sup>

#### *Exclusions from residential unit*

A building or self-contained apartment that is used by a person in carrying on a trade as a hotel keeper is excluded from the definition of “residential unit”. A hotel keeper is defined in section 1(1) and means any person carrying on the business of hotel keeper or boarding or lodging house keeper where meals and sleeping accommodation are supplied to others for money or its equivalent.<sup>62</sup>

If an employee rents out a room of the unit acquired to a third party without providing meals, the unit would still qualify as a residential unit.

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<sup>57</sup> Depending on the facts, a section in a sectional title scheme can relate to part of a building or a whole building.

<sup>58</sup> <https://www.lexico.com/definition/residential> [Accessed 18 August 2022].

<sup>59</sup> <https://www.lexico.com/definition/accommodation> [Accessed 18 August 2022].

<sup>60</sup> See the definitions of “accommodation” and “residence” in [www.merriam-webster.com/dictionary/accommodation](http://www.merriam-webster.com/dictionary/accommodation); [www.macmillandictionary.com/dictionary/british/accommodation](http://www.macmillandictionary.com/dictionary/british/accommodation) and [www.macmillandictionary.com/dictionary/british/residence](http://www.macmillandictionary.com/dictionary/british/residence). [Accessed 18 August 2022].

<sup>61</sup> D Clegg and R Stretch *Income Tax in South Africa* [online] (My LexisNexis: August 2017) in paragraph 11.5.19.

<sup>62</sup> See Interpretation Note 105 “Deductions in respect of Buildings used by Hotelkeepers” for more detail.

**(a) The allowance**

The allowance is equal to 10% of any amount owing to the taxpayer by the employee on the low-cost residential unit at the end of the taxpayer's year of assessment. The allowance is permitted for a maximum period of 10 years.<sup>63</sup>

**(b) Requirements to be met before the allowance may be claimed**

A taxpayer will qualify for the allowance provided all of the following requirements are met:

- There must be a disposal of a "low-cost residential unit" as defined in section 1(1) to the taxpayer's employees or the employees of an "associated institution" as defined in the Seventh Schedule to the Act to the taxpayer.<sup>64</sup>
- The sale must not be subject to any conditions other than that upon termination of employment or failure to repay the loan amount for a period of three months, the employee must dispose of the low-cost residential unit to the taxpayer (or an associated institution in relation to the taxpayer) for an amount equal to the actual cost (other than borrowing or finance costs but including the cost of the land) of the low-cost residential unit to the employee.<sup>65</sup>
- The employee must not pay interest to the taxpayer on the amount owing to the taxpayer.<sup>66</sup>
- The taxpayer must sell the low-cost residential unit for an amount that is not greater than the actual cost to the taxpayer of that unit (including the land on which it is erected). In determining the taxpayer's actual cost for this purpose no account must be taken of borrowing and finance charges.<sup>67</sup>

**Example 6 – Allowance on the sale of a low-cost residential building**

*Facts:*

An employer erects a house for R100 000 on land costing R20 000. In year 1 the employer disposes of the house to an employee for R120 000 on a non-interest bearing loan account provided by the employer, repayable over 20 years. The employee repaid an amount of R6 000 during year 2. The amount of the outstanding loan was R120 000 at the end of year 1 and R114 000 at the end of year 2.

*Result:*

The employer is entitled to the following allowances under section 13sept:

**Year 1**

The employer may claim a deduction calculated at 10% of R120 000 = R12 000.

<sup>63</sup> Section 13sept(2).

<sup>64</sup> Section 13sept(1).

<sup>65</sup> Section 13sept(3)(a).

<sup>66</sup> Section 13sept(3)(b).

<sup>67</sup> Section 13sept(3)(c).

## Year 2

The employer may claim a deduction calculated at 10% of R114 000\* = R11 400.

\* R120 000 – R6 000

(See below for discussion on the recoupment).

### (c) Limitations

The disposal of the low-cost residential unit by the taxpayer may be subject to only a limited set of conditions. If these conditions are met, the employee must dispose of the low-cost unit to the taxpayer (or an associated institution) for an amount equal to the actual cost to the employee of the unit and the land. These conditions arise –

- upon termination of employment; or
- consistent failure for at least 3 months to pay the amount owing to the taxpayer.<sup>68</sup>

No other rights of reacquisition are permitted under the section.

Save for the above-stated conditions, the deed of sale may not contain any other condition. An employee will therefore have all the rights attached to ownership, for example the employee is entitled to sell the unit to any third party (provided that the employee still repays the loan), mortgage it or let it. The employer may also not register a bond on the unit to secure payment of the interest-free loan.

An employment relationship between the taxpayer and the employee or the associated institution and the employee is a requirement and the termination of employment would be set out in the relevant contract of employment. Should the employee move from the employer to an associated institution of the employer, the employer will still be entitled to claim the allowance as if the employer was always the original employer.

The allowance is available only if the loan is interest free, since the allowance effectively compensates the employer for the interest foregone on the interest-free loan.<sup>69</sup> The term “interest” is not defined in section 1(1) and therefore bears for purposes of section 13*sept* the common law meaning of compensation for the use of money. Since the employee receives an interest-free loan from the employer, the employee will be taxed on same as a fringe benefit.<sup>70</sup>

The taxpayer may not dispose of the low-cost residential unit to the employee for an amount that exceeds the actual cost (other than borrowing or finance costs) to the taxpayer of the unit and the land on which the unit is erected.<sup>71</sup> In determining the taxpayer's actual cost for this purpose no account must be taken of borrowing and finance charges.<sup>72</sup> The cost of erection as well as costs directly and closely connected with erection such as architects' and civil engineering fees qualify to be included. Costs may include transfer costs if the building was acquired by the taxpayer.

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<sup>68</sup> Section 13*sept*(3)(a).

<sup>69</sup> Section 13*sept*(3)(b).

<sup>70</sup> Paragraph 11 of the Seventh Schedule.

<sup>71</sup> Section 13*sept*(3)(c).

<sup>72</sup> Section 13*sept*(3)(c).

### **Example 7 – Limitations**

*Facts:*

An employer disposed of a low-cost residential unit to an employee for R150 000 on interest-free loan account. The amount of R150 000 represented the direct cost of the unit to the employer. The sale was subject to a condition that the employee must sell the low-cost residential unit to the employer should the employee leave the employ of the employer within a period of 5 years. The employee repaid R20 000 in year 1, R10 000 in year 2 and R15 000 in year 3. The employee effected improvements to the residence at a cost of R40 000 during year 3 and financed these with a short-term loan from a bank. The employee resigned in year 4 and the employment relationship was terminated.

*Result:*

In year 4 the employer must purchase the low-cost residential unit from the employee for R190 000, representing the actual cost of the low-cost residential unit to the employee (R150 000 original cost + R40 000 cost of improvements). The employer is not required to reimburse the employee for the interest incurred on the short-term loan.

### **(d) Recoupment**

Deductions claimed will be recouped every time any part of the loan capital is repaid to the taxpayer. The recoupment is limited to the lesser of –

- the amount so paid;<sup>73</sup> or
- the amount allowed as a deduction in the current year and any previous year of assessment.<sup>74</sup>

In line with the purpose of the recoupment provision, to the extent an amount is recouped under section 13sept it will not be regarded as an amount previously allowed as a deduction when calculating the amount of the recoupment that arises when a further amount is subsequently repaid. See Example 11.

### **Example 8 – Recoupment of the deduction for the sale of a low-cost residential building**

*Facts:*

An employer erects a house for R100 000 on land costing R20 000. In year 1 the employer disposes of the house to an employee for R120 000 on a non-interest bearing loan account provided by the employer, repayable over 20 years. In year 2 the employee repays R25 000 of the loan. No further repayments are made by the employee in year 3

*Result:*

The employer will have the following tax consequences for years 1 to 3:

#### **Year 1**

The employer may claim a deduction calculated at 10% of R120 000 = R12 000.

<sup>73</sup> Section 13sept(4)(a).

<sup>74</sup> Section 13sept(4)(b).



**Year 2**

The employer may claim a deduction calculated at  $10\% \times (R120\,000 - R25\,000) = R9\,500$ . However, of the R25 000 repaid only an amount of R21 500 is recouped in year 2 (R12 0000 allowed in year 1 + R9 500 allowed in year 2).

**Year 3**

The employer may claim an allowance of  $10\%$  of R95 000 = R9 500.

**Example 9 – Recoupment of the deduction for the sale of a low-cost residential building***Facts:*

An employer erects a house for R100 000 on land costing R20 000. In year 1 the employer disposes of the house to an employee for R120 000 on a non-interest bearing loan account provided by the employer, repayable over 20 years. In year 2 the employee repays R15 000 of the loan. The employee also repaid R30 000 in year 3.

*Result:*

The employer will have the following tax consequences for years 1 to 3:

**Year 1**

The employer may claim a deduction calculated at  $10\%$  of R120 000 = R12 000.

**Year 2**

The employer may claim a deduction calculated at  $10\% \times (R120\,000 - R15\,000) = R10\,500$ .

The repayment of R15 000 is less than the amounts previously claimed as a deduction of R22 500 (R12 0000 allowed in year 1 + R10 500 allowed in year 2). Therefore, the amount of the recoupment which must be included in income is R15 000.

**Year 3**

The employer may claim a deduction calculated at  $10\% \times (R120\,000 - R15\,000 - R30\,000) = R7\,500$ .

The repayment of R30 000 is greater than the amounts previously claimed as a deduction (net of previous recoupments under section 13*sept*) of R15 000 (R12 0000 allowed in year 1 + R10 500 allowed in year 2 – R15 000 section 13*sept* recoupment in year 2 + R7 500 allowed in year 3). Therefore, the amount of the recoupment which must be included in income in year 3 is R15 000.

## 2.8 Allowance on farm buildings used in farming operations<sup>75</sup>

Section 26 provides that the taxable income of any person carrying on pastoral, agricultural or other farming operations shall, in respect of those operations, be determined in accordance with the Act but subject to the provisions of the First Schedule. Under paragraph 12(1)(f) of the First Schedule a taxpayer who incurs expenditure on the erection of, or extensions, additions or improvements to, buildings used in connection with the taxpayer's farming operations, other than those used for domestic purposes, may qualify for a deduction of that expenditure. The term "farming operations"<sup>76</sup> is not defined in the Act. The question whether a person is carrying on farming operations is one of fact and is determined on a case-by-case basis.

The building so erected must be brought into use directly in connection with the farming operations.

There is no limit on the qualifying amount of the expenditure claimed on any one building. The deduction is claimed against farming income in the year in which the expenditure is incurred which is not necessarily the same year as the year in which the building is brought into use. If the total expenditure during a year of assessment in respect of matters in paragraph 12(1)(c)-(i) exceeds taxable income (before the deduction of that expenditure) derived from farming operations, the amount of that excess is included in income in that year of assessment (therefore it prevents an assessed loss from farming arising as a result of those deductions) and is carried forward and deemed to be incurred in the next succeeding year of assessment for purposes of paragraph 12(1)(c)-(i).

The erection of or extension, addition or improvement (other than repairs) to any building used for domestic purposes does not qualify for a deduction under paragraph 12(1)(f). Before 21 October 2008 farmers, subject to the limitation in paragraph 12(5), qualified under paragraph 12(1)(f) for the deduction of expenditure incurred in the erection of, or extensions, additions or improvements (other than repairs) to, any buildings used for domestic purposes by persons employed by the farmer. As from 21 October 2008 farmers can potentially claim a deduction under section 13sex for expenditure incurred on new and unused residential units or improvements to such units (see **2.7.2**).

Deductions allowed to a farmer under paragraph 12(1)(f) of the First Schedule are not subject to taxation under section 8(4)(a) if recovered or recouped. However, a recoupment will occur in the year of assessment when a building in relation to which a deduction was granted under paragraph 12(1)(f) of the First Schedule in the current or a previous year of assessment is used for domestic purposes by any person other than an employee<sup>77</sup> of that farmer.<sup>78</sup> The amount which must be included in the farmer's income is the amount of the deduction less one-tenth of that amount for each completed period of one year, but not exceeding 10 years, during which the building was used by the farmer in connection with his farming operations other than for the domestic purposes of persons who are not his employees. In addition, any disposal of assets on which a deduction has been allowed under paragraph 12(1) or (1A) and which has become a movable asset is recouped under the provisions of paragraph 12(1B) or (1C) (see those paragraphs for detail).

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<sup>75</sup> Paragraph in this section of the Note refers to a paragraph of the First Schedule.

<sup>76</sup> See Interpretation Note 69 "Game Farming" for a discussion on farming operations.

<sup>77</sup> As defined in *Paragraph 12(4)(a)*.

<sup>78</sup> *Paragraph 12(6) of the First Schedule*.

## **2.9 Allowance on buildings in special economic zones**

Section 12S provides for an allowance of 10% of the cost of any new and unused building owned by a 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 for purposes of producing income within a special economic zone [as defined in section 12R(1)] in the course of its trade, excluding the provision of residential accommodation.

## **3. General recoupment provision**

A recoupment means that what was once allowed as a deduction is added back to the taxpayer's income. Under section 8(4)(a) there must be included in a taxpayer's income (subject to certain exceptions)<sup>79</sup> all amounts allowed to be deducted or set off in the current or any previous year of assessment that have been recovered or recouped during the current year of assessment.

For example, section 8(4)(a) will generally apply on the disposal of a building, which qualified for a deduction under section 13quin, for an amount in excess of its income tax value (cost less amount claimed as a deduction). This general recoupment provision is in addition to any recoupment provision specifically provided for within a particular deduction or allowance section. For commentary on the specific recoupment provisions see the relevant section of this guide.

Section 8(4)(a) does not apply to farming expenditure that was allowed as a deduction under paragraph 12(1) of the First Schedule.

## **4. Capital gains tax**

The sale of a building could trigger capital gains tax. For a discussion of capital gains tax and its implications, see the *Comprehensive Guide to Capital Gains Tax*.

## **5. Corporate restructuring rules**

The tax consequences discussed above may differ if a taxpayer applies any of the corporate restructuring rules contained in section 41 to 47. For example, depending on the facts, a capital gain which might otherwise arise on transfer could be deferred until such time that the transferee disposes of the relevant asset. In addition, a transferor company and the transferee company are often deemed to be one and the same person for purposes of determining the amount of any allowance to which the transferee company may be entitled and which may be recovered, recouped or included in the transferee company's income in respect of that asset. Refer to the relevant corporate rule if applicable.

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<sup>79</sup> See section 8(4)(a) for details of which deductions fall within the ambit of section 8(4)(a).

## 6. Objection and appeal

A taxpayer who has claimed a deduction or allowance discussed in this guide and who is not satisfied with an assessment issued by SARS, for example, when an adjustment has been made by SARS to the allowance claimed in the taxpayer's return of income, may object to the assessment.<sup>80</sup>

The objection must –

- be lodged using the prescribed form;
- state the grounds on which the objection is lodged; and
- reach the Commissioner within 30 business days after the date of issue of the assessment.

The Commissioner will either –

- allow the objection;
- disallow the objection; or
- allow the objection in part and disallow the other part.

A taxpayer has a right to appeal against the disallowance of an objection that is disallowed in full or in part. The appeal must be delivered to the Commissioner within 30 business days from the date of the disallowance of the objection.

Further information on the objection and appeal procedures is set out in the *Dispute Resolution Guide: Guide On The Rules Promulgated In Terms Of Section 103 Of The Tax Administration Act, 2011* and Interpretation Note 15 “Exercise Of Discretion In Case Of Late Objection Or Appeal”.

## 7. Retention of records

Section 29(1) of the Tax Administration Act 28 of 2011 provides that a person must keep the records, books of account or documents (hereinafter collectively referred to a “records”) that –

- enable the person to observe the requirements of a tax Act;
- are specifically required under a tax Act or by the Commissioner by public notice; and
- enable SARS to be satisfied that the person has observed these requirements.

The records should be retained by the person for a period of five years *from the date of submission of the return*.<sup>81</sup> Since building allowances tend to be claimed in tax returns over extended periods of up to 50 years, it means taxpayers must retain proper records of the cost of buildings and the allowances claimed for those extended periods and the five years beyond.

Section 30(1) of the Tax Administration Act provides that the records referred to in section 29 must be kept or retained in –

- their original form in an orderly fashion and in a safe place;
- the form, including electronic form, as may be prescribed by the Commissioner in a public notice; or

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<sup>80</sup> Section 104 of the Tax Administration Act.

<sup>81</sup> Section 29(3)(a) of the Tax Administration Act.

- a form specifically authorised by a senior SARS official.

These records should be available for inspection purposes by a SARS official to verify compliance with the requirements as explained above, or for purposes of an inspection, audit or investigation.<sup>82</sup>

Records which are relevant to an audit or investigation of which the person has been notified of or is aware of, or an objection or appeal that the person has lodged, must be retained until the audit or investigation is concluded, or until the assessment or the decision becomes final in the case of an objection or appeal.<sup>83</sup> This is required even if it means the five year period referred to above is exceeded.

## 8. Conclusion

The Act currently makes provision for the following building allowances:

- Section 13 – Buildings used in a process of manufacture, research and development or a similar process
- Section 13(8) – Permanent shipbuilding structures
- Section 13*bis* – Buildings used by hotel keepers
- Section 13*quin* – Commercial buildings
- Section 13*quat* – Buildings in urban development zones
- Section 13*ter* – Residential units (erection of which commenced on or after 1 April 1982 and before 1 October 2008)
- Section 13*sex* – Residential units (erection of which commenced on or after 1 October 2008)
- Section 13*sept* – Deduction for the sale of low-cost residential buildings to employees on loan account
- Paragraph 12(1)(f) of the First Schedule – Buildings used in farming operations other than those used for domestic purposes
- Section 12S – Building in special economic zones

Some of the sections which make provision for building allowances or deductions contain their own recoupment provisions. The general recoupment provisions of section 8(4)(a) will also apply in most but not all cases.

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<sup>82</sup> Section 31 of the Tax Administration Act.

<sup>83</sup> Section 32 of the Tax Administration Act.