South African Revenue Service

INTERPRETATION NOTE 106

DATE: 20 December 2018

ACT : INCOME TAX ACT 58 OF 1962
SECTION : SECTION 13*sex*
SUBJECT : DEDUCTION IN RESPECT OF CERTAIN RESIDENTIAL UNITS

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Preamble

In this Note unless the context indicates otherwise –

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

All binding private rulings and interpretation notes referred to in this Note are available on the SARS website at www.sars.gov.za**.** Unless indicated otherwise, the latest issue of these documents should be consulted.

1. Purpose

This Note provides guidance on the interpretation and application of section 13*sex* which provides for an allowance on any new and unused residential unit or improvements to a residential unit used for the purpose of trade and an additional allowance on that residential unit if it qualifies as a low-cost residential unit.

2. Background

Before 21 October 2008 various provisions in the Act allowed for deductions relating to residential buildings, for example, sections 11(*t*) and 13*ter* and paragraph 12(5) of the First Schedule. Section 13*sex*[1] replaced these provisions and brought in one simplified and comprehensive provision for low-cost housing from 21 October 2008.

Section 13*sex* is subject to section 36,[2] 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.

3. The law

The relevant sections of the Act are quoted in the **Annexure**.

4. Application of the law

4.1 Requirements of section 13*sex*

A taxpayer may deduct an allowance of 5% of the cost to the taxpayer of any new and unused residential unit, or any new or unused improvement to a residential unit, if the following requirements are met –[3]

- the unit or improvement was acquired, or the erection commenced, on or after 21 October 2008;
- the unit or improvement is owned by the taxpayer;

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1 Introduced by section 31(1) of the Revenue Laws Amendment Act 60 of 2008 and deemed to have come into operation on 21 October 2008.

2 The section deals with the calculation of the redemption allowance and the unredeemed balance of capital expenditure in connection with mining operations.

3 Section 13*sex*(1).

- the unit or improvement is used by the taxpayer during the year of assessment solely for the purposes of the taxpayer's trade;
- the unit is situated in the Republic; and
- the taxpayer owns at least 5 residential units in the Republic that are used by the taxpayer for the purposes of trade.

An additional allowance of 5% of the cost of a residential unit is allowable if that residential unit constitutes a low-cost residential unit and the taxpayer qualifies for a deduction in respect of that unit under section 13*sex*(1)[4] (refer above).

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 is governed by section 36. The allowance and additional allowance under section 13*sex* are therefore unavailable if the expenditure on the residential unit constitutes capital development expenditure as defined under section 36(11).

Under section 25BB(4) a company that is a REIT or a controlled company[5] on the last day of the year of assessment may not claim a deduction, amongst others, under section 13*sex.*

4.1.1 Meaning of "residential unit"

Residential Unit

A residential unit is defined in section 1(1) and means a building or a self-contained apartment mainly used for residential accommodation and excludes a building or apartment used by a person in carrying on a trade as a hotel keeper.

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).[6]

The word "permanent" is defined in the *Merriam-Webster Learner's Dictionary*[7] as –

> "lasting or continuing for a very long time or forever: not temporary or changing".

It is also defined as –[8]

> "1. Lasting or remaining without essential change:
>
> 2. Not expected to change in status, condition, or place".

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4 Section 13*sex*(2).

5 The term "controlled company" is defined in section 25BB(1) as a company that is a subsidiary, as defined in IFRS, of a REIT.

6 *CIR v Le Sueur* 1960 (2) SA 708 (A), 23 SATC 261 at 273.

7 **www.learnersdictionary.com/definition/permanent** [Accessed 26 November 2018].

8 **www.thefreedictionary.com/permanent** [Accessed 26 November 2018].

It is therefore evident that the word "permanent" does not necessarily mean everlasting. Factors to be considered in determining whether a building is "of a permanent nature" include the nature of the building, the degree and manner of its annexation and the intention of the person annexing it to a particular place.[9]

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 the purpose of section 13*sex* (see **2**) and the purpose of paragraph (ii) of the proviso to section 11(*e*),[10] section 13*sex* applies to buildings 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, but, 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[11] 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 they were 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.[12] 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.[13]

In ITC 1007,[14] 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

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9 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; *Pettersen & 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.

10 Paragraph (ii) of the proviso to section 11(*e*) denies a deduction under section 11(*e*) for buildings or other structures or works of a permanent nature.

11 (1936) 9 SATC 313 (U).

12 *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.

13 *Konstanz Properties (Pty) Ltd v WM Spilhaus and Co (WP) Ltd* 1996 (3) SA 273 (A).

14 (1962) 25 SATC 251 (N).

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*[15] the court considered whether the laying batteries used in poultry farming constituted part of the building. Ramsbottom JA held that –[16]

> "… 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.
>
> 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*[17] 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 –[18]

> "…[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."

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15 1960 (2) SA 708 (A), 23 SATC 261 (A).

16 *CIR v Le Sueur* 1960 (2) SA 708 (A), 23 SATC 261 (A) at 275.

17 1976 (4) SA 872 (A), 38 SATC 159 (A).

18 *CIR v Charkay Properties (Pty) Ltd* 1976 (4) SA 872 (A), 38 SATC 159 (A) at 169.

External paving, fencing and landscaping do not form part of a building for purposes of section 13*sex*. In addition, a building does not include the land upon which the structure stands.[19]

Self-contained apartment

The definition of residential unit also refers to "self-contained apartment". This term is not defined in the Act. The method of attributing meaning to the words used in legislation involves, as a point of departure, examining the language of the provision at issue, the language and design of the statute as a whole and its statutory purpose.[20] Following this principle, regard must be had to the ordinary grammatical meaning of the word.

The word "self-contained" is described in the *Oxford Dictionaries*,[21] as –

> "(of a thing) complete, or having all that is needed, in itself".

The word "apartment"[22] is described as –

> "[a] suite of rooms forming one residence; a flat" or "[a] set of private rooms in a very large house".

The facts of a specific case are critical. A flat which constitutes a section in a sectional title scheme under the Sectional Titles Act 95 of 1986 will often constitute a self-contained apartment.[23] 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. See Example 5.

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 *Glen Anil Development Corporation Ltd v SIR* Botha JA stated the following:[24]

> "Section 103(2) uses the words 'solely or mainly for the purpose . . . ' In the *Oxford English Dictionary* 'mainly' is defined to mean 'for the most part; in the main; as the chief thing, chiefly, principally'. The word 'hoofsaaklik' is used in the Afrikaans text. … the onus was on the appellant to show that the transactions in question were not entered into solely or mainly for the purpose of utilizing the assessed loss or balance of assessed loss … That onus would be discharged if the appellant satisfied the court that the avoidance … was not a more important consideration in the mind of Dr Rubenstein (acting on the advice of his auditors) than the avoidance of estate duty and undistributed profits tax."

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19 ITC 1619 (1996) 59 SATC 309 (C) at 314.

20 See *Chetty t/a Nationwide Electrical v Hart & another* 2015 (6) SA 424 (SCA).

21 **https://en.oxforddictionaries.com/definition/self-contained** [Accessed 26 November 2018].

22 **https://en.oxforddictionaries.com/definition/apartment** [Accessed 26 November 2018].

23 Depending on the facts, a section in a sectional title scheme can relate to part of a building or a whole building.

24 1975 (4) SA 715(A), 37 SATC 319 at 325.

In *SBI v Lourens Erasmus (Edms) Bpk*[25] Botha JA held that, in the context of an exemption for the previously applicable undistributed profits tax, the word "mainly" prescribed a purely quantitative standard of more than 50%.

In the context of section 13*sex* "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.

A building or apartment could be used for a dual purpose, for example, residential accommodation and offices. In practice, if more than 50% of a building, measured by floor space or volume, is used during the year of assessment for residential accommodation, the "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.

Example 1 – Residential unit mainly used for residential accommodation

Facts:

Company C built an office block which it occupies for purposes of providing advisory services to clients. The total floor space of the office block is 1 000 square metres.

The office block includes a small apartment of 45 square metres in which the building's caretaker lives.

Result:

The apartment is used for residential accommodation which means the office block is used 4,55% (45/1000) for residential accommodation. Accordingly, the office block will not qualify as a residential unit because it is not mainly, that is, more than 50%, used for residential accommodation. The building is assessed as a whole and the apartment would not qualify as a "self-contained apartment". Company C owns the building and therefore the building is assessed against the definition of a "residential unit". The apartment is owned by Company C as part of the building it owns, it has not been sectionalised under the Sectional Titles Act 95 of 1986 and therefore is not capable of separate ownership in its own right. Accordingly, the apartment is not assessed to determine whether it meets the definition of a residential unit.

Example 2 – Residential unit mainly used for residential accommodation

Facts:

Company A built a building which contained six floors. The bottom two floors contain office premises and retail space and the top four floors contain residential apartments. Each of the six floors is the same size. Construction was completed during the current year of assessment.

[25] 1966 (4) SA 434(A), 28 SATC 233 at 245.

During the year of assessment Company A let only one floor as office premises and retail space. The other office premises and retail space were available for hire but Company A had been unsuccessful in finding suitable tenants. Similarly, all the residential apartments were available for hire but Company A managed only to let apartments which, when combined, represented space of one floor during the year of assessment.

Result:

The four floors of residential apartments represent the part of the building which is considered to be "used for residential accommodation". The fact that apartments making up three floors were not successfully let during the current year of assessment does not change the fact that all the apartments were available for hire as residential accommodation, that Company A was actively trying to let them and that the apartments are therefore considered to be used for residential accommodation. However, the facts must always be considered. For example, the view expressed here may change if the apartments were not successfully let for an extended period or their intended use changed.

The two floors of office premises and retail space are not used for residential accommodation.

This means the building was used 66,66% (4 floors / 6 floors) for residential accommodation. The building is, accordingly, "mainly", that is, more than 50%, used for residential accommodation and qualifies as a residential unit under section 13*sex*.

Example 3 – Residential unit mainly used for residential accommodation

Facts:

Company C purchased a flat which constituted a unit in a sectional title scheme under the Sectional Titles Act 95 of 1986. The flat had two bedrooms, a lounge, a kitchen and a bathroom.

The flat was located near the company's head office and was used to accommodate employees participating in a long-term secondment program as part of the company's skills development program.

Result:

The flat is a self-contained apartment which is solely used for residential accommodation. Accordingly, the flat qualifies as a residential unit because it is mainly, that is, more than 50%, used for residential accommodation.

Residential accommodation

The word "residential"[26] is described as –

> "[d]esigned for people to live in".

The word "accommodation"[27] is described as –

> "[a] room, group of rooms, or building in which someone may live or stay".

[26] **https://en.oxforddictionaries.com/definition/residential** [Accessed 26 November 2018].

[27] **https://en.oxforddictionaries.com/definition/accommodation** [Accessed 26 November 2018].

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[28] whether that accommodation is of a temporary or permanent nature.

A residential unit would have sleeping, catering and ablution facilities.[29]

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.

4.1.2 Meaning of "low-cost residential unit"

"Low-cost residential unit" is defined in section 1(1) as –

> (*a*) an apartment qualifying as a residential unit in a building located within the Republic, where—
>
> (i) the cost of the apartment does not exceed R350 000; and
>
> (ii) the owner of the apartment does not charge a monthly rental in respect of that apartment that exceeds one per cent of the cost; or
>
> (*b*) a building qualifying as a residential unit located within the Republic, where—
>
> (i) the cost of the building does not exceed R300 000; and
>
> (ii) the owner of the building does not charge a monthly rental in respect of that building that exceeds one per cent of the cost contemplated in subparagraph (i) plus a proportionate share of the cost of the land and the bulk infrastructure:
>
> Provided that for the purposes of paragraphs (*a*) (ii) and (*b*) (ii), the cost is deemed to be increased by 10 per cent in each year succeeding the year in which the apartment or building is first brought into use.

The definition distinguishes between a building and an apartment, both of which must qualify as a residential unit (**4.1.1**).

One of the requirements included in the definition of "low-cost residential unit" is that the monthly rental charged by the owner may not exceed 1% of the cost of the apartment or, in the case of a building, 1% of the cost of the building plus a proportionate share of the cost of the land and the bulk infrastructure. Cost for the purpose of calculating the maximum monthly rental that may be charged in order to meet that part of the definition is deemed to be increased by 10% in each year succeeding the year in which the building or apartment is first brought into use.

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[28] See the definitions of "accommodation" and "residence" in **www.merriam-webster.com/dictionary/accommodation**; **www.macmillandictionary.com/dictionary/british/accommodation** and **www.macmillandictionary.com/dictionary/british/residence**. [Accessed 26 November 2018].

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

Example 4 – Low-cost residential units: individual apartments

Facts:

Company A acquired 6 residential apartments in buildings located in different parts of South Africa in 2016. The cost of Apartment 1, 2 and 3 was R375 000 per apartment and the cost of Apartment 4, 5 and 6 was R340 000 per apartment. The apartments were let to various tenants at a rent of R3 200 per apartment in 2016 and R3 600 per apartment in 2017.

Result:

The apartments each constitute a residential unit because each apartment is a self-contained apartment which is mainly used for residential accommodation and Company A is not a hotel keeper.

Apartment 1, 2 and 3 do not qualify as low-cost residential units because their cost of R375 000 exceeds the maximum amount of R350 000.

The cost of Apartment 4, 5 and 6 (R340 000 per apartment) does not exceed the maximum amount of R350 000. In addition, the monthly rental of R3 200 in 2016 and R3 600 in 2017 is less than the maximum monthly rental (see note 1 below) permitted under the definition of "low-cost residential unit". Accordingly, Apartment 4, 5 and 6 qualify as low-cost residential units.

Note 1:

For purposes of determining the maximum monthly rental which may be charged for Apartment 4, 5 and 6, the cost of the apartments are deemed to be increased by 10% in each year succeeding the year in which the apartments are first brought into use. Therefore, the maximum monthly rental for Apartment 4, 5 and 6 in:

- 2016 is R3 400 (1% of R340 000)
- 2017 is R3 740 [1% of R374 000 (R340 000 plus 10%)]
- 2018 is R4 114 [1% of R411 400 (R374 000 plus 10%)]

Example 5 – Low-cost residential units: building comprising residential apartments

Facts:

In 2016 Company A constructed a residential apartment building on land it owned in South Africa. The residential apartment building comprised 10 apartments at a cost of R350 000 each. The total cost of the building was R5 million [cost of apartments (10 × R350 000) + cost of other areas forming part of the building, such as the reception area and stairways. (R1,5 million)]. The cost of the land and bulk services was R2 million. Company A did not sectionalise the apartments under the Sectional Titles Act.

The apartments were let to various tenants at a rental charge of R3 500 in 2016 and R3 800 in 2017.

Result:

Company A owns the entire building and therefore the building as a whole must be assessed against the definition of "residential unit. The individual apartments are owned by Company A as part of the building it owns. The apartments have not been sectionalised under the Sectional Titles Act 95 of 1986 and therefore are not capable of separate ownership in their own right. Accordingly, the apartments are not assessed to determine whether each apartment meets the definition of "residential unit". The building as a whole constitutes a residential unit in 2016 and 2017 because it was used 100% for residential purposes, which means the building was mainly used for residential accommodation, and Company A is not a hotel keeper.

The building will not constitute a low-cost residential unit because its cost of R5 million exceeds the maximum cost of R300 000. It does not matter that the cost of the individual apartments does not exceed the maximum cost for a self-contained apartment of R350 000 because the building, not the apartments, is the residential unit.

4.1.3 Meaning of "improvement to a residential unit"

The allowance under section 13*sex* can also be claimed on any new and unused improvement to a residential unit if the other requirements of the section are met.

The word "improvement" is not defined in the Act for purposes of section 13*quin*[30] and must be given its ordinary grammatical meaning. It is described in the *New Oxford Thesaurus of English*,[31] 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".

The Appellate Division in *African Detinning Works (Pty) Ltd v SIR*[32] held that in order to constitute an improvement to a building the "extension, addition or improvements" must be physically attached to, connected or integrated with the building. In this case 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. Accordingly, the aprons did not qualify as an improvement to the building. In *SIR v Charkay Properties (Pty) Ltd*[33] the majority held that, at the very least, for an article to form part of a building it must have been structurally integrated or otherwise physically incorporated into the building.

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30 The word "improvements" is defined in section 13(9) for the purposes of section 13 only. It is not defined under section 13*sex* nor under section 1(1).

31 P Hanks, first published (2000) Oxford University Press Inc, New York.

32 1982 (1) SA 797 (A) 44 SATC 1. Although this case dealt with a specific definition in section 13(9), the principles are relevant to section 13*sex* because that definition referred to any extension, addition or improvement to a building and section 13*sex* refers to an improvement to a residential unit.

33 1976 (4) SA 872 (A), 38 SATC 159.

An improvement must be distinguished from a repair.[34]

In ITC 617[35] various court cases were reviewed from which the following principles emerged relating to repairs and improvements:

- Repair is restoration by renewal or replacement of subsidiary parts of the whole. Renewal as distinguished from repair is reconstruction of the entirety, meaning by the entirety not necessarily the whole but substantially the whole subject matter under discussion.
- For repairs effected by renewal it is not necessary that the materials used should be identical with the materials replaced.
- The test for distinguishing repairs from improvements is – has a new asset been created resulting in an increase in the income-earning capacity or does the work undertaken merely represent the cost of restoring the asset to a state in which it will continue to earn income as before?

4.1.4 The residential unit or improvement to a residential unit must have been acquired, or the erection must have commenced, on or after 21 October 2008

Section 13*sex* was inserted by the Revenue Laws Amendment Act 60 of 2008. The section was deemed to have come into effect on 21 October 2008 and applies only to residential units or improvements to residential units, acquired, or the erection of which commenced, on or after 21 October 2008.

Whether a residential unit or an improvement to a residential unit was acquired, or whether its erection commenced, on or after 21 October 2018 must be determined on a case-by-case basis.

Section 13*sex* does not require that the taxpayer must personally have constructed the residential unit or the improvement to a residential unit in order to claim the allowance. Accordingly, the residential unit or the improvement to a residential unit may, for example, be acquired by the taxpayer from a third party, such as a property developer, provided that it was acquired on or after 21 October 2008 and that the other requirements, for example, that it is new and unused, are met.

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.[36]

4.1.5 The residential unit or improvement to a residential unit must be "new and unused"

In order to qualify for the allowance, the residential unit or improvement to the residential unit, as appropriate, must be new and unused. Whether a residential unit or an improvement to a residential unit is new and unused is a factual enquiry based on the facts of each case. If the allowance is claimed only on an improvement, only the improvement needs to be new and unused.

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[34] See Interpretation Note 74 "Deduction and Recoupment of Expenditure on Repairs" for a discussion of the meaning of repairs and improvements.

[35] (1946) 14 SATC 474 (U).

[36] ITC 1137 (1969) 32 SATC 1 (C).

"New" means that the residential unit or improvement to the residential unit must have been recently erected or effected. The residential unit or improvement to the residential unit must therefore be newly built. If a taxpayer erected a residential unit which had been immediately mothballed[37] for some years, it would be unused but not new.

Unused means the residential unit or improvement to the residential unit must not have been previously used for any purpose by any person. The residential unit or improvement to the residential unit will therefore not qualify for the allowance if it has been previously used for any purpose.

The assessment regarding whether a residential unit or improvement to a residential unit is new and unused is made when the taxpayer becomes the owner of the residential unit or improvement to the residential unit. For example, if a taxpayer acquires a new and unused residential unit during a year of assessment, the residential unit will be considered to have met the "new and unused" requirement for that taxpayer for purposes of section 13*sex* in the year of acquisition and in subsequent years of assessment.

See **4.1.6** for situations in which an improvement on land or to buildings by a lessee is deemed to be owned by the lessee and to be the cost of a new and unused residential unit or improvement contemplated in section 13*sex*.

If a residential unit is purchased, the purchaser will not be entitled to a deduction under section 13*sex* if the residential unit is not new and unused from the purchaser's perspective. Whether the residential unit is still new and unused depends on how long the previous owner held it and whether it was used. Even if the residential unit does not meet the requirement of being "new and unused", improvements effected by the purchaser to the residential unit could be "new and unused" and, subject to meeting all the requirements of the section, qualify for the allowance.

Example 6 – New and used building

Facts:

Company D purchased a residential apartment building from Company C on 1 September year 1.

Company C completed construction of the residential apartment building on 30 June year 1 and at the time of the sale to Company D 75% of the apartments had been let to tenants for various lease periods and monthly rentals.

Result:

Company D will not qualify for an allowance under section 13*sex* because although the building is still new, it was used by Company C and various tenants before Company D acquired it.

[37] That is, kept aside for possible future use.

4.1.6 Owned by the taxpayer

Ownership is not defined in the Act and therefore general common law principles apply. Under the common law principle of *superficies solo cedit* (owner by accession), buildings or other structures affixed or attached to land become the property of the owner of the land. A taxpayer wanting to claim the allowance under section 13*sex* therefore has to be the owner of the land on which the residential unit is erected or the improvements are effected. This requirement is relevant in the context of section 13*sex* as it deals with buildings of a permanent nature and such buildings will be permanently attached to the land (see **4.1.1**).

The acquisition of land, or a building and the land on which it is situated, occurs by means of a deed of transfer from one person to another and is effected by the process of registration in the Deeds Office.[38] A residential unit purchased by the taxpayer, but not yet transferred into its name is not owned by the taxpayer. Parties entering into an unconditional contract to transfer ownership does not mean the purchaser is the owner as the registration process with the necessary authority is required for a transfer of ownership. Acquisition of ownership through transfer is required and not the acquisition of mere possession.

Land and buildings may be co-owned, that is jointly owned by two or more persons. A building that is co-owned by a taxpayer qualifies as a building owned by the taxpayer[39] and the taxpayer would therefore be able to claim the section 13*sex* allowance on the proportional share of the cost of the building actually incurred by that taxpayer.

A taxpayer may also own a building or self-contained apartment under sectional title.[40] A unit in a sectional title scheme gives its owner or holder sole ownership of the relevant section of the scheme and joint ownership of an undivided share in the common property. Although a unit is deemed to be land under the Sectional Titles Act,[41] it is submitted that to the extent a unit relates to a building or part of a building, the deeming to be land is ignored for purposes of section 13*sex.*

A residential unit that the taxpayer does not own but to which the taxpayer has the right of use or occupation does not qualify for the allowance, for example, a leased building or a building to which the taxpayer has the right of use through shares in a share block scheme or timeshare. Accordingly, a lessee that erects improvements on land or to a building owned by the lessor will not qualify for a deduction under section 13*sex* but may, depending on the facts, qualify for a deduction or a partial deduction under section 11(*g*).

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38 Section 16 of the Deeds Registries Act 47 of 1937 provides that "Save as otherwise provided in this Act or in any other law the ownership of land may be conveyed from one person to another only by means of a deed of transfer executed or attested by the registrar ….".

39 D Davis *et al Juta's Tax Library* [online] (Jutastat e-publications: 30 November 2015) in Commentary on Income Tax - section 13*quin*. The principle of joint ownership is equally applicable to section 13*sex.*

40 See Binding Private Ruling 169 dated 9 May 2014 "Commercial Building Allowance". The principle of ownership under sectional title is equally applicable to section 13*sex.*

41 Section 3(4) of the Sectional Titles Act 95 of 1986.

A lessee who undertakes obligatory improvements on a leased property as envisaged under section 12N[42] and incurs expenditure in so doing, is deemed to be the owner of such improvements for purposes of, amongst others, section 13*sex*, provided the requirements of section 12N are met.[43] Section 12N permits the allowance on the improvements to be calculated as if the lessee owns the underlying property directly, provided the lessee uses or occupies the property for the production of income or derives income from it. The expenditure incurred by the lessee to complete the improvements is deemed to be the cost to the lessee of any new and unused residential unit or of any new and unused improvements to a residential unit for the purposes of section 13*sex*.[44]

The taxpayer does not have to erect the residential unit to claim the allowance. The residential unit may be acquired by the taxpayer from a third party, such as a property developer, provided the residential unit is new and unused when the taxpayer becomes the owner of the building (see **4.1.5**).[45]

4.1.7 Used solely for the purposes of a trade

Section 13*sex*(1)(*a*) requires that the residential unit or improvement to a residential unit must be used by the taxpayer solely for the purposes of a trade carried on by the taxpayer. Solely means the residential unit or improvement to the residential unit must be used only for the trade and for nothing else. The allowance is therefore not available for a residential unit should that residential unit be partly used for the purposes of trade and partly for other non-trade purposes, such as when the owner also resides in the residential unit. No apportionment will take place. The allowance may be available for other residential units owned by the taxpayer if all of the requirements of section 13*sex* are met for those units.

Trade is defined in section 1(1) and includes every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and the use of or the grant of permission to use, as defined, any patent, design, trade mark, copyright or any other similar property.

In ITC 770[46] it was held that this definition should be widely construed and is obviously intended to embrace every profitable activity.

The test to be applied to determine whether a trade is being carried on is an objective test and if objective factors indicate that the taxpayer is trading, the trade requirement is satisfied.

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42 Under a Public Private Partnership, on leased property owned by the government in the national, provincial or local sphere of government or certain government owned exempt entities or an obligation under the Independent Power Producer Procurement Programme administered by the Department of Energy - see section 12N(1).

43 See section 12N for consequences when the right of use or occupation terminates and section 12N(3) for specific exclusions from the section.

44 Section 13*sex*(1).

45 D Davis *et al Juta's Tax Library* [online] (Jutastat e-publications: 30 November 2015) in Commentary on Income Tax – section 13*quin*. This is also applicable to section 13*sex* which uses the same wording in this regard.

46 (1953) 19 SATC 216 (T). See also *Burgess v CIR* 1993 (4) SA 161 (A), 55 SATC 185.

If the taxpayer did not derive any income in a particular year of assessment, it does not automatically mean that the taxpayer did not trade in that year of assessment. In ITC 777[47] the court held that a company that had unsuccessfully attempted to let its property did carry on a trade. If no income is earned, it can practically raise more questions regarding whether there is an intention to trade or to earn income and more evidence may be required. The onus would be on the taxpayer to satisfy SARS that it traded in that year of assessment.

4.1.8 Residential unit concerned and five residential units in total situated in the Republic

The residential unit or improvement to a residential unit must be situated in the Republic in order to qualify for the allowance. In addition, the taxpayer is required to own at least five[48] residential units in the Republic which are used for the purposes of a trade carried on by the taxpayer. The residential units can be in different places within the Republic.

If a taxpayer acquires one residential unit per year for five years, the allowance on all five will commence when the fifth unit is available for occupation. When the number of residential units owned by the taxpayer falls below five, for example, if during the year of assessment a taxpayer that owned 5 residential units used for purposes of trade, sold one of the residential units or no longer used it for purposes of trade, the remaining 4 residential units will no longer qualify for the allowance from the subsequent year of assessment.

In order for the allowance to be claimed on an improvement to a residential unit, the minimum threshold of owning five residential units must also be met.

4.2 The determination of cost and calculation of the allowance

The allowance is calculated at a rate of 5% a year on the cost of the residential unit[49] or the improvement to the residential unit with an additional 5% if that residential unit qualifies as a low-cost residential unit.[50] The allowance is not apportioned if the residential unit or improvement to a residential unit is brought into use for part of the year.

The allowance is granted for the first time in the year the residential unit is brought into use for the purposes of trade provided all the requirements of the section have been met (see **4.1**).

The cost is the lesser of the actual cost to the taxpayer or the arm's length direct cost under a cash transaction for the erection or acquisition of the residential unit or the improvement to it, as appropriate, on the date on which the transaction for the acquisition or improvement was concluded.[51]

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47 (1953) 19 SATC 320 (T).

48 Section 13*sex* replaced section 13*ter* for acquisitions and erections commenced on or after 21 October 2008. Section 13*ter* made provision for an allowance on the erection of residential units under a "housing project" with a minimum threshold of five residential units. This requirement carried over to section 13*sex*.

49 Section 13*sex*(1).

50 Section 13*sex*(2).

51 Section 13*sex*(3).

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".[52] The specific facts of the case need to be considered in determining whether the taxpayer is entitled to any deduction of input tax.

The court in *SIR v Eaton Hall (Pty) Ltd* considered the meaning of "cost to the taxpayer of the building" and held that –[53]

> "[f]irstly… from the context … 'cost of any building' means the cost of erecting that building. Secondly, in the absence of any definition in the Act of such cost one must look at its ordinary meaning. The *Oxford English Dictionary* defines 'cost' as meaning: 'That which must be given or surrendered in order to acquire, produce, accomplish, or maintain something; the price paid for a thing.' Hence 'the cost to the taxpayer of the building' ordinarily means 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*. … the use of the preposition 'of' instead of a phrase with a wider connotation, like 'in respect of' … indicates that the connection between them must be direct and close; in other words, the expression comprehends the cost of erecting the building and nothing more. … 'the cost of building or improving' something is not as well delineated as 'the cost of any building or improvements'. The former might well cover certain expenses incurred incidentally in building or improving a structure, whereas under the latter the cost is delimited by the very physical nature of the building or improvements."

(Emphasis added.)

The principles expressed in the *Eaton Hall* case apply to a residential unit which is either a building or self-contained apartment as discussed in **4.1.1**. If the taxpayer purchased a building which constitutes a residential unit, the cost of the residential unit is the cost to the taxpayer to purchase it, that is, the purchase price paid to the seller. However, if a taxpayer acquires part of a building which constitutes a residential unit without erecting or constructing it, there is a deemed cost for the part or the improvement acquired – see **4.6**.

The cost of a residential unit for purposes of section 13*sex* does not, for example, include –

- the cost of the land on which the residential unit is erected (the purchase price of land and buildings will require an apportionment);
- the costs related to the preparation of the land for the erection of the residential unit;[54]
- costs incurred to obtain a rezoning in order to permit a higher building height which are incurred in connection with the erection of the building but are not part of the cost of the building;[55] or
- interest incurred on any financial instrument used to fund the acquisition, erection or improvement of the residential unit.[56]

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52 Section 23C(1).

53 1975 (4) SA 953 (A), 37 SATC 343 at 347 to 348.

54 In ITC 1137 (1969) 32 SATC 1 (C) the levelling of the site and excavations for the foundation were held not to form part of the erection phase.

55 1975 (4) SA 953 (A), 37 SATC 343 at 347 to 348.

56 1975 (4) SA 953 (A), 37 SATC 343 at 347 to 348.

Costs directly and closely connected with the erection of the building such as architect and civil engineering fees are included in the cost of the building.[57]

The cost of an improvement to a residential unit which qualifies for a deduction must be determined by applying the same principles.

As noted above, the cost of the residential unit does not include the land upon which the residential unit stands. A reasonable apportionment must therefore be done between the cost of the residential unit and the cost of the land if there is a single cost for land and the residential unit. The relative value of the land and the residential unit is generally an appropriate method for apportioning a single cost between the land and the residential unit. 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 residential unit erected on it. Municipal valuations can also potentially be used but there may be reasons why in a particular case they are inappropriate, for example, a municipal valuation may not provide the necessary distinction between the land and the residential unit or it may be outdated.

Example 7 – Calculation of the allowance

Facts:

On 15 February 2016 Company A bought vacant land for R5 million. It built a block of flats consisting of 20 residential units for use by its employees at a cost of R10 million. Company A also built a parking area alongside the building at a cost of R700 000 and erected a security fence at a cost of R400 000. The residential units were all let by year end, 31 December 2016.

Company A owns 10 residential units in South Africa which are let to various tenants.

Result:

Company A qualifies for the 5% allowance under section 13*sex*(1). The cost of the land, the parking area and the fence do not qualify for the allowance as those costs are not part of the cost of the residential unit. The allowance is not apportioned.

10 000 000 × 5% = R500 000 per annum

The block of flats does not qualify as a low-cost residential unit because its cost exceeds R300 000.

[57] 1975 (4) SA 953 (A), 37 SATC 343 at 348.

4.3 Deeming provision

A special deeming rule[58] deems a taxpayer to have been allowed a deduction under section 13*sex* on a residential unit or an improvement to a residential unit in a previous financial year if the taxpayer qualifies for a deduction under section 13*sex* in a current year of assessment and if during that previous financial year –

- the taxpayer used the residential unit or improvement to the residential unit for the purposes of the taxpayer's trade;
- the receipts and accruals from that trade were not included in income during that previous year; and
- had the receipts and accruals been included in income, the taxpayer would have been entitled to a deduction under section 13*sex*.

The amount of the deduction which is deemed to have been allowed for the purposes of section 13*sex* is the amount which would have been allowed under section 13*sex* in previous years in which the residential unit or improvement to the residential unit was used by the taxpayer, if the receipts and accruals of that trade had been included in the taxpayer's income.

The total deductions, including these deemed deductions, available in respect of a residential unit, or an improvement to a residential unit, are limited to cost (see **4.5**).

The recoupment provisions under section 8(4)(*a*) do not apply to the deemed allowance under section 13*sex*(4).

Example 8 – Deeming provision

Facts:

Company A used a residential unit that it purchased new and unused from a developer for purposes of trade. During years 1 to 5 Company A's income was exempt from tax. Subsequently, Company A's income was taxable. Assume Company A met the requirements of section 13*sex* and qualified for a deduction under section 13*sex*(1) from year 6 onwards.

Result:

For purposes of calculating the allowance to which Company A is entitled from year 6 onwards, the 5% allowance is deemed to have been allowed for years 1 to 5 when Company A's income was exempt from tax. Company A may therefore claim the 5% allowance in years 6 to 20. No deduction is available from year 21 onwards because the total cost limitation was reached in year 20 (see **4.5**).

4.4 Disposal of the residential unit

Once a taxpayer disposes of a residential unit or an improvement to a residential unit in a year of assessment, no allowance under section 13*sex* can be claimed by that taxpayer in respect of that residential unit or improvement to a residential unit in a subsequent year of assessment.[59] This prohibition reinforces the ownership requirement (see **4.1.6**) as once a taxpayer has disposed of the building that taxpayer can no longer claim the section *13sex* allowance on it. It also, for example**,**

[58] Section 13*sex*(4).
[59] Section 13*sex*(5).

prevents a taxpayer from claiming the allowance on a residential unit for a number of years, disposing of it, reacquiring that residential unit at a later stage and, after reacquiring it, again claiming an allowance under section 13*sex* on it.

4.5 Limitations

No deduction is allowable under section 13*sex* for the cost of a residential unit or improvement to a residential unit if any of the cost has qualified or will qualify for deduction from the taxpayer's income as a deduction of expenditure or an allowance for expenditure under any other section of the Act.[60] Depending on the facts, an example of another deduction or allowance a taxpayer may qualify for in respect of a residential unit or improvement to a residential unit is an allowance for the erection or improvement of buildings in urban development zones.[61]

The aggregate of all deductions which may be allowed or deemed to have been allowed under section 13*sex* or any other section in respect of the cost of the residential unit or the improvement to the residential unit may not exceed that cost.[62] The limitation includes, for example, those allowances deemed to have been allowed for those years of assessment when the accruals and receipts of the taxpayer were not included in its income (see **4.3**).

4.6 Part acquisition

To the extent a taxpayer acquires a residential unit, or improvement to a residential unit, representing only a part of a building without erecting or constructing that unit or improvement, the cost of acquiring that part or improvement for the purposes of section 13*sex is* deemed to be –

- 55% of the acquisition price, for a unit being acquired;[63] and
- 30% of the acquisition price, for an improvement being acquired.[64]

The reference to a residential unit representing only a part of a building would apply, for example, to the acquisition of a flat forming part of a block of flats under sectional title.[65]

The acquisition price is the actual cost to the taxpayer to acquire the residential unit or the improvement to a residential unit, representing part of a building. The "deemed cost" under section 13*sex*(8) will be regarded as cost for the purposes of the allowance.

The purpose of the limitation on cost to 55% of the acquisition price of such a unit is to ensure that the allowance is not calculated on the cost of the land which would be included in the acquisition price of the unit. In the absence of section 13*sex*(8) which deems the cost of part of the building, or the cost of the improvement, to be equal to the amount calculated as indicated above, the acquisition price would have needed to be adjusted to exclude a portion in respect of land (see **4.2**).

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60 Section 13*sex*(6).
61 Section 13*quat*.
62 Section 13*sex*(7).
63 Section 13*sex*(8)(*a*).
64 Section 13*sex*(8)(*b*).
65 Depending on the facts, a unit in a sectional title scheme can relate to part of a building or a whole building.

Example 9 – Acquisition of a residential unit which is part of a building

Facts:

Company A acquired 6 new and unused apartments in a building at a purchase price of R320 000 each. The building, which is located in South Africa, has 30 apartments which are all used for purposes of residential accommodation.

Company A has let the 6 apartments at a rental of R3 200 per month.

Result:

Company A will qualify for the allowance of 5% under section 13*sex*(1) equal to 5% of the cost of the residential unit. Under section 13*sex*(8)(*a*) the cost of a residential unit representing part of a building is deemed to be equal to 55% of the acquisition price.

Cost of the 6 residential units = 55% × (R320 000 × 6) = R1 056 000

Allowance under section 13*sex*(1): R 1 056 000 × 5% = R52 800 per annum

An additional allowance under section 13*sex*(2) may be claimed as the apartments qualify as low cost residential units: R 1 056 000 × 5% = R52 800 per annum

Example 10 – Acquisition of an improvement to a residential unit which is part of a building

Facts:

Company A acquired a new and unused one-bedroom apartment in a block of flats two years ago at a cost of R500 000 and let it to a tenant at a monthly rental of R7 500.

The bedroom was exceptionally large so during the current year of assessment, after the tenant failed to extend the lease, Company A contracted a builder to convert the bedroom into two bedrooms with permanent walls, doors, built-in cupboards and windows at a total cost of R100 000. On completion the two-bedroom flat was let at a monthly rental of R11 000.

Company A has 10 other apartments located in South Africa which are also let as residential accommodation.

Result:

Company A will qualify for the allowance of 5% under section 13*sex*(1) equal to 5% of the cost of the apartment. Under section 13*sex*(8)(*a*) the cost of a residential unit representing part of a building is deemed to be equal to 55% of the acquisition price.

Cost of the residential unit = 55% × R500 000 = R275 000

Allowance under section 13*sex*(1): R275 000 × 5% = R13 750 per annum

In relation to the improvement, the allowance will be based on the actual cost of R100 000 because it resulted from construction performed by the builder on behalf of Company C and therefore section 13*sex*(8) is inapplicable.

Cost of the improvement to the residential unit R100 000

Allowance under section 13*sex*(1): R100 000 × 5% = R5 000 per annum

The apartment does not meet the definition of "low cost residential unit" and therefore the additional allowance under section 13*sex*(2) is unavailable for the residential unit or the improvement to the residential unit.

5. Section 13*sex* allowance and intra-group transactions

Section 45 of the Act potentially provides for corporate roll-over relief for the transfer of assets between companies forming part of the same group of companies. In order to qualify for the roll-over relief, the transaction must meet the requirements of the definition of "intra-group transaction" in section 45(1) and the other requirements of section 45.

Briefly, if rollover relief applies and the transferor company disposes of a capital asset (for example, a residential unit owned by the transferor company) which the transferee company acquires as a capital asset, the transferor company is, amongst other aspects, deemed to have disposed of that capital asset at base cost.

In addition, section 45(3) applies to capital assets which constitute an "allowance asset" as defined in section 41(1). A residential unit in respect of which a deduction was allowable under section 13*sex* is an allowance asset. Section 45(3) provides, amongst others, that if a transferor company transfers an allowance asset and the transferee company acquires it as an allowance asset then –

- no allowance allowed to the transferor company for that asset will be recovered, recouped or included in the transferor company's income in the year of the transfer; and
- the transferor company and the transferee company are 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.

The effect of the last bullet point is that the transferee company is treated as having met the "new and unused" requirement in section 13*sex.* In addition, if the transferee company continues to meet the requirements of section 13*sex* (for example, continued to use the asset solely for the purposes of trade and has 5 residential units in the Republic)*,* future allowances claimable by the transferee company in respect of costs incurred by the transferor company will be limited to the remaining deduction under section *13sex* on the transferred allowance asset to which the transferor company would have been entitled had it retained ownership and continued to use the asset as required under section 13*sex*.

If the transferor company meets the requirements for claiming the allowance in a particular year of assessment before transfer occurred, the transferor company and not the transferee company will claim the full allowance for that year of assessment even if the transferee company also met the requirements. The transferee company cannot claim the allowance for the same period, since the two companies are deemed to be one and the same person for purposes of determining the allowance.

This principle applies irrespective of whether the transferee has the same or a different year of assessment.

The total of the deductions allowed or deemed to have been allowed under section 13*sex* and any other section for the transferor company and the transferee company on the asset transferred under section 45 may not exceed cost as initially determined under section *13sex for* the transferor company. Costs incurred on improvements effected by the transferee company subsequent to the transfer may qualify for an allowance if the requirements of section13*sex* are met.

The amount of any deduction claimed by the transferor company is potentially subject to recoupment in the transferee company even though it did not actually claim the deductions before the intra-group transaction. In addition, the amount of any deduction claimed by the transferee company is potentially subject to recoupment in the transferee company.

Section 42 (asset-for-share transactions), section 44 (amalgamation transactions) and section 47 (liquidation, deregistration and winding-up transactions) have similar provisions in relation to allowance assets.

6. Allowance under section 13*ter*

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

Section 13*ter* 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 can qualify for an allowance under section 13*sex* provided all the requirements of the section are met.

Example 11 – Residential units purchased under section 13*ter*

Facts:

Company A erected 5 residential units in South Africa. Construction commenced before 21 October 2008 and all of the units qualified for the section 13*ter* allowances.

Company A sold one of these units in November 2008 and acquired ownership of a new residential unit located in South Africa in the same month.

Result:

Company A continues to apply the 2% annual allowance under section 13*ter* on the remaining 4 units purchased before 21 October 2008. The section 13*ter* recoupment provision will apply to the initial allowance claimed on the unit sold. In addition, depending on the detailed facts relating to the disposal, a section 8(4)(*a*) recoupment may apply to the initial allowance to the extent it was not recouped under section 13*ter* and the annual building allowance.

Assuming the detailed requirements of section 13*sex* are met, the residential unit acquired in November 2008 will qualify for the section 13*sex* allowance at 5% as the 4 residential units qualifying for the 13*ter* allowance meet the definition of “residential unit” in section 1(1) and Company A therefore owns 5 residential units in South Africa.

7. General recoupment provision

Under section 8(4)(*a*) there must be included in a taxpayer's income (subject to certain exceptions) 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.

Section 8(4)(*a*) will apply upon the disposal of the building if it is disposed of for an amount in excess of its tax value.[66] In summary, the amount of the recoupment will be equal to the amount for which the building is disposed of (limited to the cost of the building) less its tax value. In limited circumstances the recognition of the recoupment may be deferred.[67]

The recoupment provision under section 8(4)(*a*) does not apply to the deduction which is deemed to have been allowed under section 13*sex*(4).[68]

8. Conclusion

Section 13*sex* provides for an allowance on any new and unused residential unit or new and unused improvements effected to existing residential units that are used by the taxpayer solely for purposes of a trade. The unit or improvement must be owned by the taxpayer and it must have been acquired, or the erection commenced, on or after 21 October 2008. In addition, the unit must be situated in South Africa and the taxpayer must own at least 5 units in South Africa that are used by the taxpayer for the purposes of trade.

The allowance available under section 13*sex* is equal to 5% per year of the cost of the residential unit or improvement to the residential unit. Cost is the lesser of actual cost or cost in an arm's length transaction. To the extent a taxpayer acquires a residential unit or improvement to a residential unit, which represents part of a building, without erecting or constructing it, the cost of that unit or improvement will be a percentage of the acquisition price as specified in the Act. Once a taxpayer has disposed of a building, that taxpayer is not entitled to a deduction under section 13*sex* during any subsequent year of assessment.

An additional allowance of 5% is available if the residential unit qualifies as a low-cost residential unit.

The section makes provision for an allowance on a building and part of a building owned by the taxpayer. A residential unit is defined as a building or a self-contained apartment mainly used for residential accommodation, unless it is used in carrying on a trade as a hotel keeper.

Section 13*sex* is subject to section 36, which means that section 36 takes precedence for the deduction of expenditure incurred in a mining operation for the provision of residential accommodation for employees and the furniture for such accommodation.

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66 Tax value means the amount remaining after reducing the cost of the building by the cumulative deductions under section 13*sex* and other sections on that asset.

67 See section 8(4)(*e*).

68 Section 8(4A). See **4.3** for the treatment of the deeming provision under section 13*sex*(4).

A residential unit which qualified for an allowance under section 13*ter* before 21 October 2008 and continues to meet the requirements of that section will still qualify for an allowance under that section. Section 13*sex* potentially applies to all acquisitions and erections of residential units and improvements to residential units after 21 October 2008.

The total deduction available under section 13*sex* and other sections on a residential unit or improvement to a residential unit is limited to cost. This includes deductions which, although not allowed under section 13*sex* in previous years of assessment, are specifically deemed to have been allowed for purposes of section 13*sex*.

If a transferor company transfers an allowance asset in an intra-group transaction that meets the requirements of section 45 and the relief applies, the transferor company and the transferee company are deemed to be one and the same person with regards to calculating the amount of any deduction to which the transferee company is entitled and the amount of the recoupment if, for example, the transferee company disposes of the residential unit. Similar provisions are contained in sections 42, 44 and 47.

The deductions claimed under section 13*sex* are subject to potential recoupment under section 8(4)(*a).* The deductions deemed to have been claimed under section 13*sex*(4) are not subject to recoupment under section 8(4)(*a*).

The allowance may not be claimed if the cost of the residential unit or improvement to the residential unit, or any part thereof, qualifies or will qualify for a deduction or allowance under any other section of the Act.

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Annexure – The law

Section 1

"low-cost residential unit" means—

(*a*) an apartment qualifying as a residential unit in a building located within the Republic, where—

(i) the cost of the apartment does not exceed R350 000; and

(ii) the owner of the apartment does not charge a monthly rental in respect of that apartment that exceeds one per cent of the cost; or

(*b*) a building qualifying as a residential unit located within the Republic, where—

(i) the cost of the building does not exceed R300 000; and

(ii) the owner of the building does not charge a monthly rental in respect of that building that exceeds one per cent of the cost contemplated in subparagraph (i) plus a proportionate share of the cost of the land and the bulk infrastructure:

Provided that for the purposes of paragraphs (*a*)(ii) and (*b*)(ii), the cost is deemed to be increased by 10 per cent in each year succeeding the year in which the apartment or building is first brought into use;

"residential 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;

Section 13*sex*

13*sex*. Deduction in respect of certain residential units.—(1) Subject to section 36, there must be allowed to be deducted from the income of a taxpayer an allowance equal to five per cent of the cost to the taxpayer of any new and unused residential unit (or of any new and unused improvement to a residential unit) owned by the taxpayer if—

(*a*) that unit or improvement is used by the taxpayer solely for the purposes of a trade carried on by the taxpayer;

(*b*) that unit is situated within the Republic; and

(*c*) the taxpayer owns at least five residential units within the Republic, which are used by the taxpayer for the purposes of a trade carried on by the taxpayer:

Provided that if a taxpayer completes an improvement as contemplated in section 12N, the expenditure incurred by the taxpayer to complete the improvement shall be deemed to be the cost to the taxpayer of any new and unused residential unit (or of any new and unused improvement to a residential unit), for the purposes of this section.

(2) There shall be allowed to be deducted from the income of the taxpayer an additional allowance of five per cent of the cost of a low-cost residential unit of a taxpayer for a year of assessment if deductions are allowable to that taxpayer in respect of that unit in terms of subsection (1) during that year of assessment.

(3) For the purposes of this section, the cost to the taxpayer of a residential unit (or an improvement thereto) shall be deemed to be the lesser of the actual cost to the taxpayer or the cost which a person would, if that person had acquired or improved the residential unit under a cash transaction concluded at arm's length on the date on which the transaction for the acquisition of the new and unused residential unit (or of the new and unused improvement to the residential unit) was in fact concluded, have incurred in respect of the direct cost of the acquisition or erection of the residential unit or improvement.

(4) Where any residential unit (or an improvement to the residential unit) in respect of which any deduction is claimed in terms of this section was during any year of assessment used by the taxpayer for the purpose of any trade carried on by that taxpayer, the receipt and accruals of which were not included in the income of that taxpayer during that year, any deduction which could have been allowed in terms of this section during that year or any subsequent year in which that residential unit (or an improvement to the residential unit) was used by the taxpayer shall for the purposes of this section be deemed to have been allowed during that previous year or those years as if the receipts and accruals of that trade had been included in the income of that taxpayer.

(5) No deduction shall be allowed under this section in respect of the cost of any residential unit (or an improvement to a residential unit) that has been disposed of by the taxpayer during any previous year of assessment.

(6) No deduction shall be allowed under this section in respect of the cost of a residential unit (or an improvement to a residential unit) if any of the cost has qualified or will qualify for deduction from the taxpayer's income as a deduction of expenditure or an allowance in respect of expenditure under any other section of this Act.

(7) The deductions which may be allowed or deemed to have been allowed in terms of this section and any other provision of this Act in respect of the cost of any residential unit (or any improvement to a residential unit) shall not in the aggregate exceed the amount of such cost.

(8) For the purposes of this section, to the extent that the taxpayer acquires a residential unit (or improvement to a residential unit) representing only a part of a building without erecting or constructing that unit or improvement—

(*a*) 55 per cent of the acquisition price, in the case of the unit being acquired; and

(*b*) 30 per cent of the acquisition price, in the case of the improvement being acquired,

is deemed to be the cost incurred by that taxpayer in respect of that unit or improvement, as the case may be.