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BY EMAIL: [policycomments@sars.gov.za](mailto:policycomments@sars.gov.za)

**RE: DRAFT INTERPRETATION NOTE RELATING TO COMMERCIAL, RESIDENTIAL AND HOTEL BUILDING ALLOWANCES**

This submission is in response to the SARS draft interpretation notes dealing with building allowances, especially in relation to commercial buildings. We are comfortable with the draft interpretation notes in the main.

#### Definition of building

While the interpretation notes provide a significant amount of clarity in terms of what items can be included as part of a building, questions still remain in relation to many attached fixtures / structures:

- *Environmental / energy initiatives:* There is a growing level of investment in renewable energy and other environmental friendly initiatives. Query at what point are these items viewed as stand-alone fixtures / structures or an integral part of the building. These items can include solar panels, grey water systems, and water reservoirs affixed to the building. Does this analysis change if the item at issue is possibly depreciable under another tax section (e.g. under section 11(e) and section 12B)?
- *Outside sidewalks, walls, pools and other concrete structures:* It appears that the main dividing line is whether the concrete structure is within the four walls of the building versus outside. We must assume that outside sidewalks, walls, etc... are not part of the building even if attached. Query whether this

outcome makes sense given that the level of wear and tear is the same. For instance, an indoor pool appears depreciable; whereas, an outdoor pool is not (even though an outdoor pool is more likely to wear down faster than an indoor pool due to the outdoor exposure to the elements).

- *Mixed structures:* With the rise of malls and multi-purpose buildings, sometimes mixed use can occur in the same building. For instance, it is increasingly common for a hotel to be attached to a mall. In these instances, at what point does the hotel begin and the mall end? Sometimes, a single building will have residential apartments on top and retail shops on bottom, what then?
- *Specific non-industrial buildings:* For instance, healthcare and medical facilities pose unique questions. These commercial facilities include special built-in lights and electrical facilities as well as counters and storage facilities.

#### Transactional Costs

The draft interpretation notes focus on the physical / structural cost of buildings without regard to associated acquisition costs. These costs include legal costs, transfer duty and other transactional costs associated with any property acquisition. These items should be viewed as part of “cost” to the extent potentially non-deductible under section 11(a). These cost items should presumably match the expenses included as part of “base cost” under paragraph 20 of the 8<sup>th</sup> Schedule.

A related issue is the VAT. While refundable VAT should not be deductible. It should be made clear that VAT is part of “cost” if the VAT is non-refundable. Non-refundable VAT will arise in the case of transport as well as acquisitions by banks and other financial institutions (who cannot obtain input credits in respect of the VAT exempt portion of the business).

#### Land and Building Cost Allocation

If a taxpayer acquires a whole property that includes the full building and land, no rules exist in terms of allocation between building and land this is in contrast to the required 55 / 30 per cent allocation when a portion of a building is acquired.

Query whether municipal land valuations are relevant for this purpose. In valuing property, another question comes in terms of zoning. Does the preferred / non-preferred zoning impact the building or the land?

#### New and Unused

The draft interpretation notes need to add further clarity in terms of the concept of “new and unused”. It seems that the term “unused” is solely a physical concept. Presumably, mere ownership or leasing by itself is not “use” but only meaningful physical occupation of the building. Therefore, a building remains new and unused if a developer sells the building to a commercial landlord (such as a REIT) without the developer actually occupying building. Issues such as ownership and renting should be irrelevant until actually physical use and occupation arise (regardless of whether this use occurs by the owner or a lessee of the building).

Another issue relates to the definition “new”. Is a building “new” as long as the building remains idle? For instance, what happens if a developer constructs a building and the building sits idle for two years before sale? Can one say the purchaser has a “new” building? The real question is how long does “new” last.

#### Consistency of coverage between draft interpretation notes

The draft interpretation notes for commercial buildings, hotels and residential units largely cover the same topics with certain unnecessary deviations. In particular, we would request consistency in terms of the following considerations.

- All three draft interpretation notes should cover the corporate reorganisation rules of sections 41 through 47 – not just the draft interpretation note dealing with commercial buildings. The draft interpretation notes for hotels and residential units should cover the same.

- All three draft interpretation notes should deal with REITs – not just the draft interpretation note dealing with commercial building. The draft interpretation notes for hotels and residential units should cover the same.

We understand that the corporate rules follow the principles of Binding Private Ruling 202. One issue, however, not covered in terms of corporate reorganisations involving buildings is whether the transferor or transferee claims the allowance when corporate reorganisations occur mid-year. For instance, assume Company A and B form part of the same group of companies, and Company A transfers a commercial building to Company B as part of a section 45 reorganisation. Further assume that both companies have financial year-ends that fall on 31 December and that the transfer occurs on 31 March. Under these conditions, is it Company A or Company B who can claim the entire year of the commercial building allowance of section 13quin?

We thank you for the opportunity to comment on the above draft interpretation notes. Please feel free to contact us should any further engagement be desired.

Yours sincerely

**Keith Engel**  
**Chief Executive**