

BINDING PRIVATE RULING: BPR 177

DATE: 31 July 2014

ACT : INCOME TAX ACT NO. 58 OF 1962 (the Act)
SECTION : SECTIONS 1(1) DEFINITION OF “GROSS INCOME”, 11(g) AND 11(h)
SUBJECT : IMPROVEMENTS ON LAND BY SUB-LESSEE UNDER A SUB-LEASE

1. Summary

This ruling deals with the income tax consequences for the lessor, lessee and sub-lessee of land, arising from an obligation on the sub-lessee to effect improvements on the land under a sub-lease while no such express obligation for improvements to be effected is placed on the lessee by the main lease.

2. Relevant tax laws

This is a binding private ruling issued in accordance with section 78(1) and published in accordance with section 87(2) of the Tax Administration Act No. 28 of 2011.

In this ruling references to sections are to sections of the Act applicable as at 6 June 2014 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of the provisions of –

- section 1(1), definition of “gross income” paragraph (h);
- section 11(g); and
- section 11(h).

3. Parties to the proposed transaction

The Applicant: A company incorporated in and a resident of South Africa that owns land on which improvements will be effected in terms of a lease agreement

The Lessee: A company incorporated in and a resident of South Africa that leases the land from the Applicant and sublets it to a Sub-lessee

The Sub-lessee: A company incorporated in and a resident of South Africa that has entered into a sub-lease agreement with the Lessee in terms of which it is obliged to effect improvements on the land

4. Description of the proposed transaction

The Applicant, the Lessee and the Sub-lessee are independent persons that are neither controlled by the same shareholders nor hold any interest in each other.

The Applicant will conclude a 99-year renewable notarial lease agreement (the main lease) with the Lessee in respect of the land. The main lease will provide amongst others that the Lessee is not under any obligation to effect any improvements on the land, but that the Lessee or its Sub-lessee) may do so at its own cost.

The main lease specifies the type of improvements to be effected and the time periods in which such improvements must be completed, if effected

The Lessee will pay a monthly rental to the Applicant based on the developmental cost of any improvements effected on the land.

At the time of the conclusion of the main lease, the Lessee will conclude a further 99-year renewable notarial lease agreement (the sub-lease) contemporaneous with the main lease term with the Sub-lessee of the land. The same terms as the main lease will apply except with regard to the obligation to make improvements and the sub-lease rental.

The sub-lease will provide that the Sub-lessee will be obliged to effect improvements on the land.

The rental for the sub-lease will be based on the developmental cost of the improvements effected on the land which increases by an additional amount after an agreed period of time.

5. Conditions and assumptions

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

6. Ruling

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

- The Applicant must include in its gross income, the fair and reasonable value of all improvements effected by the Sub-lessee as contemplated in paragraph (h)(ii) of the definition of "gross income" in section 1(1).
- Having regard to the circumstances of this transaction and in particular the duration of the lease and sub-lease agreements, the Applicant will be entitled to an allowance under section 11(h), determined by using the present value of the actual development cost arising from the performance of the Sub-lessee's obligations under the sub-lease, discounted at the rate of 6 per cent over the 99-year period of that lease.
- The Sub-lessee will be entitled to an allowance under section 11(g) over a 25 year period in respect of any expenditure actually incurred in effecting the improvements, provided the improvements are occupied or used by it in the production of its income.
- In the event that the proposed sub-lease is terminated before the expiry of the full 25 year period during which the section 11(g) allowance may be claimed, the unredeemed balance of this allowance as at the termination date may be deducted by the Sub-lessee from its income under section 11(g)(vii).

7. Period for which this ruling is valid

This binding private ruling is valid for a period of 5 years from 6 June 2014.

Issued by:

**Legal and Policy Division: Advance Tax Rulings
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