

BINDING PRIVATE RULING: 107

DATE: 13 October 2011

ACT : INCOME TAX ACT, NO. 58 OF 1962 (the Act)
SECTION : SECTION 8(5) AND PARAGRAPHS 20(1)(a) AND 20(1)(h)(ii)(aa) OF THE EIGHTH SCHEDULE TO THE ACT
SUBJECT : RECOUPMENT OF LEASE PREMIUM AND RENTAL AMOUNTS PREVIOUSLY ALLOWED AS DEDUCTIONS IN RESPECT OF A LEASED PROPERTY

1. Summary

This ruling deals with the income tax and capital gains tax consequences for a lessee of a property when such lessee acquires the leased property.

2. Relevant tax laws

This is a binding private ruling issued in accordance with section 76Q of the Act.

In this ruling legislative references to sections and paragraphs are to sections of the Act and paragraphs of the Eighth Schedule to the Act applicable as at 8 April 2011 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

This ruling has been requested under the provisions of –

- section 8(5); and
- paragraphs 20(1)(a) and 20(1)(h)(ii)(aa) of the Eighth Schedule.

3. Parties to the proposed transaction

The Applicant:	A company that is a resident of South Africa
Holdco:	The holding company of the Applicant, a resident of a foreign country
The Lessor:	A property owner that is a resident in South Africa

4. Description of the proposed transaction

The Applicant entered into a lease agreement with the Lessor (an unrelated third party), whereby it leases a property for purposes of conducting its business operations. In terms of the lease agreement, which will terminate shortly, an upfront lease premium was also paid.

At the same time that this lease agreement was entered into Holdco entered into an option agreement with the Lessor in terms of which the property being leased by the Applicant could be purchased on termination of the lease agreement for an amount significantly less than the market value.

The option agreement made provision for Holdco to assign all of its rights and obligations under the option agreement to any of its subsidiary companies.

Holdco assigned the rights and obligations under the option agreement to the Applicant for no consideration.

The Applicant prefers, from a commercial perspective, to own a property and building rather than to pay rent and as the new “grantee”, is in the position to exercise the option and purchase the property it currently leases on termination of the lease agreement.

The Applicant will, in this instance, exercise the option and acquire the property for an amount significantly less than market value.

The Applicant accepts that the consideration payable to purchase the property on exercising the option will not constitute a fair market value for the property and that the lease premium and rental payments made by the Applicant in respect of the property and to be paid in the future until the lease is terminated, will have contributed and will contribute in future to the reduced purchase price.

5. Conditions and assumptions

This ruling is not subject to any condition or assumption.

6. Ruling

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

- Section 8(5) will apply to the lease premium and rental payments that were allowed as deductions in respect of the property. The Applicant must include in its income these amounts (that is, the lease premium and rental payments mentioned in section 8(5)) previously allowed as deductions (limited to the fair market value of the property) in determining the Applicant's taxable income.

- The base cost of the property to be acquired will include the purchase price and the amounts recouped under the provisions of section 8(5), as contemplated in paragraphs 20(1)(a) and 20(1)(h)(ii)(aa) of the Eighth Schedule, respectively.

7. Period for which this ruling is valid

This binding private ruling is valid for a period of five (5) years as from April 2011.

Issued by:

**Legal and Policy Division: Advance Tax Rulings
SOUTH AFRICAN REVENUE SERVICE**