INTERPRETATION NOTE: NO. 60

DATE: 10 January 2011

ACT : INCOME TAX ACT NO. 58 OF 1962 (the Act)
SECTION : SECTIONS 11(*o*), 20B AND 24M
SUBJECT : LOSS ON DISPOSAL OF DEPRECIABLE ASSETS

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Preamble

In this Note –

- **"Eighth Schedule"** means the Eighth Schedule to the Act;
- **"First Schedule"** means the First Schedule to the Act;
- **"section"** refers to a section of the Act unless otherwise indicated;
- **"tax value"** means the amount remaining after reducing the cost or value of a depreciable asset by the cumulative capital allowances on that asset; and
- unless the context otherwise indicates, any word or expression in this Note bears the meaning ascribed to it in the Act.

1. Purpose

This Note gives guidance on the interpretation and application of section 11(*o*), which grants a deduction for a loss on disposal of a qualifying depreciable asset as a result of alienation, loss or destruction.

2. Background

Section 11(*o*) previously provided for a deduction for assets used by the taxpayer for the purposes of trade which were scrapped during the year of assessment. The erstwhile "scrapping allowance" applied to assets which qualified for a deduction under sections 11(*e*), 12D, 12F, 13(1*)* or (4), 13(8), 13*bis*(1), 13*ter*, 24G, and 27(2)(*b*).

Section 11(*o*) was substituted by section 27(1)(*f*) of the Revenue Laws Amendment Act No. 45 of 2003. The completely revised provision came into operation on 22 December 2003 and applies to any disposal on or after that date. The amendment brought about material changes to the section. Among others, the use of the word "scrapped" was removed and replaced by the words "alienation, loss or destruction"

Under the amended form of section 11(*o*) a taxpayer can elect to claim a revenue loss on the alienation, loss or destruction of a qualifying depreciable asset, if certain requirements are met.

3. The law

Section 11(*o*)

11. General deductions allowed in determination of taxable income.—For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived—

(*o*) at the election of the taxpayer, an amount by which the cost to that taxpayer of any depreciable asset—

(i) which qualified for an allowance or deduction in terms of section 11(*e*), 11B, 11D, 12B, 12C, 12DA, 12E, 14, 14*bis* or 37B(2)(*a*); and

(ii) the expected useful life of which for tax purposes did not exceed ten years as determined on the date of original acquisition,

exceeds the sum of the amount received or accrued from the alienation, loss or destruction of that asset and the amount of any allowance or deduction allowed in respect of that asset in that year or any previous year of assessment or which was deemed to have been allowed in terms of section 12B(4B), 12C(4A), 12DA(4) or 37B(4) or taken into account in terms of section 11(*e*)(ix), as the case may be: Provided that for the purposes of this paragraph—

(*aa*) the cost of any plant, machinery, implements, utensils or articles shall be deemed to be the actual cost plus the amount by which the value of such plant, machinery, implements, utensils or articles has been increased in terms of paragraph (v) of the proviso to paragraph (*e*) less the amount by which such value has been reduced in terms of paragraph (iv) of that proviso;

(*bb*) the actual cost of any plant, machinery, implement, utensil or article acquired by the taxpayer on or after 15 March 1984 shall be deemed to be the cost of that plant, machinery, implement, utensil or article as determined under paragraph (vii) of the proviso to paragraph (*e*);

(*cc*) the cost of any aircraft in respect of which any allowance has been made to the taxpayer under section 14*bis* shall be deemed to be the actual cost less any amount (not being an amount which has been included in the income of the taxpayer for any year of assessment in terms of section 8(4)(i)) by which the cost or estimated cost price of such aircraft has in the calculation of such allowance been reduced in terms of section 14*bis*(2)(*a*);

(*dd*) the cost of any ship in respect of which any allowance has been made to the taxpayer under the provisions of section 14 shall be deemed to be the actual cost less any amount (not being an amount which has been included in the income of the taxpayer for any year of assessment in terms of section 8(4)(*d*)) by which the cost or estimated cost price of such ship has in the calculation of such allowance been reduced in terms of the definition of “adjustable cost” or “adjustable cost price” in section 14(2):

Provided further that no election may be made in terms of this paragraph by the taxpayer if the amount received or accrued from the alienation, loss or destruction of the asset was received or accrued from a person that is a connected person in relation to the taxpayer;

4. Interpretation and application

4.1 Requirements

4.1.1 Election of the taxpayer

Under section 11(*o*) a taxpayer must elect to claim the allowance (that is, as a revenue loss). The section is silent on how the election must be made, but it is accepted that a taxpayer will have made an election under section 11(*o*) if the allowance is claimed in the return of income reflecting the disposal.

Should the taxpayer not make the election, a capital loss will result under the Eighth Schedule. Paragraph 11 of the Eighth Schedule defines the term “disposal” in wide terms. It includes amongst others the sale, donation, scrapping, loss or destruction of an asset.

A company may decide not to make an election under section 11(*o*), for example, because it does not expect to trade during the succeeding year of assessment. Under section 20(1) the company would forfeit any assessed loss created by the section 11(*o*) allowance because of the failure to trade,[1] while any capital loss would not be similarly forfeited.

No election may be made to claim a deduction under section 11(*o*) if the amount received or accrued from the alienation, loss and destruction of the asset was received or accrued from a connected person in relation to the taxpayer [second proviso to section 11(*o*)].

4.1.2 The trade requirement

Cessation of trade

The deduction under section 11(*o*) forms part of the determination of a taxpayer's taxable income from carrying on any trade (opening words of section 11). The allowance will thus not be available to a taxpayer that has ceased to carry on trade.

Apportionment between business and private usage

The section 11(*o*) allowance must be apportioned under section 23(*g*) when an asset has been used for both business and private purposes.[2] The allowance is determined with reference to the original cost and total wear-and-tear allowances ignoring any private element. Once the section 11(*o*) allowance has been established, it is apportioned in order to disallow the portion relating to private use.

Example 1 – Apportionment of section 11(*o*) allowance between business and private usage

Facts:

D, a sole trader, acquired a passenger vehicle at the beginning of year 1 at a cost of R500 000. The vehicle has an expected useful life for income tax purposes of five years. D claims a wear-and-tear allowance under section 11(*e*) on the straight-line basis. At the end of year 3 D sells the vehicle for R150 000. D's log book reflected the following odometer readings for the vehicle each year:

	Opening	Closing	Distance for year	Business	Private
Year 1	0	30 000	30 000	24 000	6 000
Year 2	30 000	55 000	25 000	15 000	10 000
Year 3	55 000	90 000	35 000	15 000	20 000
				54 000	36 000

[1] Interpretation Note No. 33 (Issue 2) "Assessed Losses: Companies: The 'Trade' and 'Income from Trade' Requirements" (30 June 2010).
[2] ITC 322 (1935) 8 SATC 243 (U).

Result:

The tax value of the vehicle immediately before it was sold was as follows:

	R
Cost	500 000
Less: Section 11(*e*) allowances R500 000/5 x 3	(300 000)
Tax value	200 000
Consideration received	(150 000)
Section 11(*o*) allowance before adjustment for private use	50 000
Less: Private use 36 000/90 000 x R50 000	(20 000)
Section 11(*o*) allowance	30 000

Note: The following portions of the section 11(*e*) wear-and-tear allowances would have been disallowed in each year of assessment under section 23(*g*):

		R
Year 1	R100 000 x 6 000/30 000	20 000
Year 2	R100 000 x 10 000/25 000	40 000
Year 3	R100 000 x 20 000/35 000	57 143
Total amount disallowed		117 143
Total amounts allowed R300 000 – R117 143		182 857
Total wear-and-tear		300 000

The section 11(*o*) allowance is determined with reference to the original cost and total wear-and-tear allowances ignoring any private element. Once the section 11(*o*) allowance has been established it is apportioned to disallow the portion relating to private use. In this example there is an overall economic loss of R350 000 comprising the cost of the vehicle of R500 000 less the proceeds of R150 000. This amount is accounted for as follows:

	R
Section 11(*e*) allowances allowed	182 857
Section 11(*o*) allowance allowed	30 000
Capital loss (see below)	137 143
Total amount claimed for income tax and CGT purposes	350 000

The capital loss is determined as follows:

		R
Cost of acquiring asset (paragraph 20(1)(*a*) of Eighth Schedule)		500 000
Less: Amounts allowed against income (paragraph 20(3)(*a*) of Eighth Schedule)		(212 857)
– Allowed under section 11(*e*)	(182 857)	
– Allowed under section 11(*o*)	(30 000)	
Base cost		287 143
Proceeds (paragraph 35 of Eighth Schedule)		(150 000)
Capital loss		137 143

In this example the vehicle was used mainly for the purposes of trade and it is therefore not a personal-use asset referred to in paragraph 53(2) of the Eighth Schedule. Had it been a personal-use asset the capital loss would have been disregarded under paragraph 53(1) of the Eighth Schedule.

Assets previously used for private purposes that are introduced into the taxpayer's trade

A portion of the section 11(*o*) allowance must be disregarded when an asset that was previously used for private purposes is introduced into the business. This adjustment can be made by determining the value of the asset at the time it is introduced into the business.

Example 2 – Asset previously used for private purposes later used for carrying on trade

Facts:

E purchased a pick-up truck at the beginning of year 1 at a cost of R100 000 and used it for private purposes until the end of year 2 after which the pick-up truck was used exclusively in E's delivery business. The market value of the pick-up truck at that point was R60 000. The expected remaining useful life of the vehicle at the beginning of year 3 for tax purposes was three years. At the end of year 4 E sold the vehicle for R5 000.

Result:

For the purposes of section 11(*e*), the following wear-and-tear allowances were claimed:

Year 3 R60 000/3 = R20 000

Year 4 R60 000/3 = R20 000
The deduction under section 11(*o*) is determined as follows:

	R
Original cost of pick-up truck	100 000
Less: Loss in value due to private usage [section 23(*b*)]	(40 000)
Remaining cost for tax purposes	60 000
Less: Wear-and-tear allowances R60 000/3 x 2	(40 000)
Tax value	20 000
Less: Selling price	(5 000)
Section 11(*o*) allowance	15 000

4.1.3 Qualifying asset

The allowance applies to a "depreciable asset". The latter term is defined in section 1 as follows:

"depreciable asset" means an asset as defined in paragraph 1 of the Eighth Schedule (other than any trading stock and any debt), in respect of which a deduction or allowance determined wholly or partly with reference to the cost or value of that asset is allowable in terms of this Act for purposes other than the determination of any capital gain or capital loss;

The term "asset" is defined in paragraph 1 of the Eighth Schedule as follows:

"asset" includes—

(*a*) property of whatever nature, whether movable or immovable, corporeal or incorporeal, excluding any currency, but including any coin made mainly from gold or platinum; and

(*b*) a right or interest of whatever nature to or in such property;

The depreciable asset must qualify for an allowance under one of the sections set out in the table below:

Table 1 – Qualifying assets

Qualifying asset	Applicable section
• Machinery, plant, implements, utensils and articles that qualified for the wear-and-tear allowance	• 11(*e*)
• Buildings, machinery, plant, implements, utensils or articles, including improvements thereto, that were used for research and development that qualified for the allowance (applies to assets acquired before 2 November 2006)	• 11B
• Buildings (or part thereof), machinery, plant, implements, utensils or articles, including improvements thereto, that were used for scientific or technological research and development that qualified for the allowance (applies on or after 2 November 2006)	• 11D
• Machinery, implements, utensils and articles, including improvements thereto, that were used in farming or production or renewable energy that qualified for the 50/30/20 allowance	• 12B
• Machinery, plant, implements, utensils, articles, aircraft or ships, including improvements thereto, that qualified for a deduction	• 12C
• Rolling stock that qualified for the allowance	• 12DA
• The following assets of a small business corporation that qualified for the allowance: ➢ Plant or machinery used in a process of manufacture or similar process ➢ Machinery, plant, implements, utensils, articles, aircraft or ships	• 12E
• Ships that qualified for the allowance (applies before 1 April 1995)	• 14
• Aircraft that qualified for the allowance (applies before 1 April 1995)	• 14bis
• New and unused environmental treatment and recycling asset that qualified for a deduction	• 37B(2)(*a*)

The section 11(*o*) allowance does not apply to a depreciable asset which qualifies for an allowance or deduction under a section other than those listed in the above table.

The section will not, for example, apply to buildings which qualify for a deduction under section 11(*g*), intellectual property assets which qualify for a deduction under section 11(*g*A), (*g*B) or (*g*C) and airport and port assets qualifying for a deduction under section 12F.

4.1.4 Expected useful life

In order to qualify for the section 11(*o*) deduction, the expected useful life of the asset *for tax purposes* must not exceed ten years as determined on the date of original acquisition. The expression "for tax purposes" means that the expected useful life of the asset must be determined in accordance with the relevant deduction provision. For example, an aircraft qualifying for a 20% per year write-off under section 12C may in reality have an expected useful life of 20 years, but for tax purposes its expected useful life will be five years.

For assets qualifying for the wear-and-tear allowance under section 11(*e*) see Annexure A of Interpretation Note No. 47 (Issue 2)[3] for a schedule of write-off periods acceptable to SARS. Non-qualifying assets in the annexure and their write-off periods include –

- certain air-conditioning components such as air handling units (20 years) and cooling towers (15 years);
- artefacts (25 years);
- escalators (20 years);
- fishing vessels (12 years);
- stand-by generators (12 years);
- lift installations (12 years);
- valuable paintings (25 years);
- pleasure craft (12 years);
- portable safes (25 years); and
- water distillation and purification plant (25 years).

A capital loss will have to be sought for these assets under the Eighth Schedule. If a taxpayer has obtained approval from SARS to write off any of these assets over a period not exceeding 10 years, the asset in question will be regarded as having an expected useful life of less than 10 years. An asset that is let for a period of 10 years or more must be written off over the lease period as opposed to any shorter period which may appear in the annexure, and will accordingly not qualify under section 11(*o*).

The period of ten years is determined on the date of original acquisition of the asset [section 11(*o*)(ii)] and not the date on which it was brought into use.

[3] "Wear and Tear or Depreciation Allowance", (11 November 2009).

4.1.5 "Alienation, loss or destruction"

The words **"**alienation, loss or destruction**"** are not defined in the Act. Under the rules of the interpretation of statutes **t**hey must therefore be read in their ordinary and popular sense.

Alienation

The word "alienation" is defined in the *New Shorter Oxford English Dictionary*[4] as –

> "1. the action of transferring ownership of anything".

The issue arises as to whether the scrapping of an asset comprises the alienation of an asset. The consigning of an asset to a scrap heap situated on the land of another person (for example, a municipal scrap heap) would comprise an alienation, since the taxpayer would be parting with ownership of the asset. Similarly the donation of an asset also involves a transfer of ownership and would fall within the ambit of section 11(*o*). In the case of computer software, the taxpayer would have to ensure that it parts with ownership of the software by deleting it from its computer systems and physically disposing of the CDs or DVDs on which the software is stored.

The withdrawal of an asset from production (for example, for the purpose of mothballing the asset) would not qualify because the taxpayer retains ownership of the asset. In order to qualify for the allowance the asset must be alienated from its owner.

Loss

The meaning of the word "loss" was considered by Watermeyer CJ in *Joffe & Co (Pty) Ltd v CIR*, in which he stated that –[5]

> "in relation to trading operations the word is sometimes used to signify a deprivation suffered by the loser, usually an involuntary deprivation, whereas expenditure usually means a voluntary payment of money".

In *COT v Rendle* the court formulated the difference between expenditure and loss as follows:[6]

> "For the purposes of this case, expenditure incurred for the purpose of trade may be grouped broadly under two heads. First, money voluntarily and designedly spent by the taxpayer for the purpose of his trade; and second, money which is what I might call involuntarily spent because of some mischance or misfortune which has overtaken the taxpayer. For the sake of convenience, I will refer to the first type of expenditure as 'designed expenditure', and to the second as 'fortuitous expenditure'."

The word "loss", in contrast to "expenditure", was described in the English case of *Allen (HM Inspector of Taxes) v Farquharson Brothers and Co* as follows:[7]

> "A loss is something different. That is not a thing which he expends or disburses. That is a thing which, so to speak, comes upon him *ab extra*."

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[4] Lesley Brown, 4 ed (1993) Oxford University Press Inc., New York, United States of America in vol 2.
[5] 1946 AD 157, 13 SATC 354 at 360.
[6] 1965 (1) SA 59 (SRAD), 26 SATC 326 at 329.
[7] 17 TC 59 at 64.

The *New Shorter Oxford English Dictionary*[8] defines the word "loss" as follows:

> "1. Perdition, ruin, destruction, the state of fact of being destroyed or ruined."

The term "loss" includes the theft of an asset.

Destruction

The same dictionary defines "destruction" as follows:

> "1. the action of destroying, demolition, devastation, slaughter.
>
> 2. the fact or condition of being destroyed; ruin.
>
> 3. a means of destroying; a cause of ruin."

4.2 Limitation of losses under section 20B

Section 24M(1)

> **24M. Incurral and accrual of amounts in respect of assets acquired or disposed of for unquantified amount.—(**1) If a person during any year of assessment disposes of an asset for consideration which consists of or includes an amount which cannot be quantified in that year of assessment, so much of that consideration as—
>
> (*a*) cannot be quantified in that year must for purposes of this Act be deemed not to have accrued to that person in that year; and
>
> (*b*) becomes quantifiable during any subsequent year of assessment must for purposes of this Act be deemed to have been accrued to that person from that disposal in that subsequent year.

Section 20B

> **20B. Limitation of losses from disposal of certain assets.—(**1) Any deduction which is allowable during any year of assessment under section 11(*o*) in respect of the disposal by a person during that year of any asset the full consideration of which will not accrue to that person during that year, must be disregarded in that year.
>
> (2) So much of any amount disregarded in terms of subsection (1), which has not otherwise been allowed as a deduction, may be deducted from the income of that person in any subsequent year of assessment to the extent that any consideration which is received by or accrued to that person in that subsequent year from that disposal is included in the income of that person.
>
> (3) If during any year of assessment a person contemplated in subsection (1) proves that no further consideration will accrue to him or her in that year and any subsequent year as contemplated in subsection (2), so much of the amount which was disregarded in terms of subsection (1) as has not been allowed as a deduction in any year, must be allowed as a deduction from the income of that person in that year of assessment.

Section 24M(1) applies when an asset is disposed of for an unquantifiable consideration. The consideration is deemed to accrue when it becomes quantifiable. This can give rise to a larger section 11(*o*) allowance in the year of disposal than would be the case if the entire consideration had been received or accrued up front. Section 20B addresses this situation.

[8] Above.

A deduction under section 11(*o*) must be disregarded if the full consideration for the disposal of the asset has not accrued to the taxpayer during the current year of assessment [section 20B(1)]. The loss disregarded under section 20B(1) will be allowed in future years of assessment to the extent that any future income from the disposal of the asset is included in the taxpayer's income. This will not apply to the extent that the amount has otherwise been allowed as a deduction. Any remaining portion of a disregarded loss will be allowed in full in the year of assessment in which a taxpayer proves that no further consideration will accrue [section 20B(3)].[9]

Example 3 – Depreciable asset with a suspended section 11(*o*) allowance

Facts:

At the beginning of year 1 B acquired an asset for R57 000 (including value-added tax of R7 000) which was used in the production of B's income in carrying on a trade. B claimed the value-added tax of R7 000 as an input tax deduction under section 16(3) of the Value-Added Tax Act No. 89 of 1991. The asset has an expected useful life for income tax purposes of six years. B used the asset for three years before selling it to C for 5% of the income generated by the asset over the next three years. B received R10 000 in year 4, R5 000 in year 5 and R6 000 in year 6.

Result:

Under section 23C(1) the cost of the asset for the purposes of section 11(*o*) excludes the value-added tax claimed as an input tax deduction.

Since the consideration due to B consists of unquantified amounts, the section 11(*o*) loss of R25 000 is suspended in the first year of assessment under section 20B(1). Under section 24M the amounts receivable on disposal of the asset are deemed to accrue once they become quantifiable.

Year 3	R
Cost of asset	50 000
Less: Wear-and-tear allowances under section 11(*e*) R50 000/6 x 3	(25 000)
Tax value at time of sale	25 000
Less: Amount received or accrued	(Nil)
Section 11(*o*) allowance (suspended)	25 000

The suspended loss will be reduced by subsequent recoupments under sections 20B(2) and 24M(3) as follows:

Year	Year 4	Year 5	Year 6
	R	R	R
Receipts	(10 000)	(5 000)	(6 000)
Suspended loss b/f	25 000	15 000	10 000
Suspended loss c/f	15 000	10 000	4 000

[9] See the *Comprehensive Guide to Capital Gains Tax* (Issue 3) dated 6 May 2010 for a discussion of section 20B.

Notes:

At the end of years 3, 4 and 5 the section 11(*o*) allowance of R25 000, R15 000 and R10 000 respectively must be disregarded because the full consideration had not accrued to B at the end of each of those years of assessment. Under section 20B(2) the suspended loss must be deducted from any consideration included in B's income during the years in question.

B will be entitled to claim a section 11(*o*) allowance of R4 000 at the end of year 6 under section 20B(3). At that stage no further amounts will accrue under the agreement of sale.

See the *Comprehensive Guide to Capital Gains Tax* (Issue 3)[10] for a discussion on the application of section 24M.

4.3 Calculation of the allowance

Under section 23C(1), any value-added tax payable on acquisition or delivery of an asset must be excluded from the cost for purposes of calculating an allowance if the taxpayer is a registered vendor that is entitled to a deduction of input tax under section 16(3) of the Value-Added Tax Act, No. 89 of 1991.

The allowance under section 11(*o*) is equal to the amount by which the cost to the taxpayer of the asset exceeds the sum of –

- the amount received or accrued from the alienation, loss or destruction of the asset; and
- the amount of the allowances or deductions in respect of the asset allowed in the current or any previous year of assessment.

The second bullet point includes amounts deemed to have been allowed under sections 12B(4B), 12C(4A), 12DA(4) or 37B(4) or taken into account under section 11(*e*)(ix). These provisions deem a taxpayer to have claimed allowances during a previous year of assessment if the asset was used during that year in carrying on the taxpayer's trade, the receipts and accruals from which were not included in the taxpayer's income. This could apply, for example, if the taxpayer was previously not a resident and did not derive income from a source within South Africa.

Reformulated in more conventional terms, the section 11(*o*) allowance is equal to the amount by which the consideration received or accrued on disposal of the asset is less than its tax value. Tax value for this purpose means the actual cost of the asset (as opposed to the value of the asset) less the qualifying capital allowances.

Although section 11(*o*) refers to –

> "the amount received or accrued from the alienation, loss or destruction of that asset",

the section does not require that some consideration be received or accrued. The section will therefore, also apply if the amount received or accrued is nil. For example, it could apply to the theft of an uninsured asset.

[10] In Chapter 10.

Cost deemed to be actual cost subject to certain adjustments [paragraph (aa) of the first proviso to section 11(o)]

The cost of any plant, machinery, implements, utensils or articles is deemed to be the actual cost as determined under paragraph (*bb*) of the first proviso to section 11(*o*) (see below). The actual cost must be increased by the cost of moving such assets from one location to another [other than amounts allowed under section 11(*a*)]. The actual cost must be reduced by any amount referred to in paragraph (iv) of the proviso to section 11(*e*). This proviso relates to the predecessor to section 8(4)(*e*), which enabled a taxpayer whose plant and machinery had been damaged or destroyed to disregard a recoupment on those assets, the *quid pro quo* for that concession being that the cost of the replacement plant and machinery for wear-and-tear purposes had to be reduced.

Cost determined under a cash transaction [paragraph (bb) of the first proviso to section 11(o)]

The actual cost of machinery, implements, utensils or articles acquired by the taxpayer on or after 15 March 1984 is deemed to be the cost which, in the opinion of the Commissioner, a person would, if he had acquired such assets under a cash transaction concluded at arm's length on the date on which the transaction for the acquisition of such assets was in fact concluded, have incurred in respect of the direct cost of the acquisition of such assets, including the direct cost of the installation or erection thereof. This provision ensures that interest and finance charges are excluded from the actual cost of an asset.

Aircraft qualifying for the section 14bis allowance (paragraph (cc) of the proviso)

The cost of an aircraft which qualified for an allowance under section 14*bis* is deemed to be the actual cost. The actual cost must be reduced by any recoupment referred to in the definition of "adjustable cost" under section 14*bis*(2)(*a*). Section 8(4)(*g*) provided for the disregarding of a recoupment on the disposal of an aircraft provided that it was replaced within a certain period. The *quid pro quo* for disregarding the recoupment was that the "adjustable cost" of the aircraft for the purposes of section 14*bis* had to be reduced.

Ships qualifying for the section 14 allowance (paragraph (dd) of the proviso)

The cost of a ship which qualified for an allowance under section 14 is deemed to be the actual cost. The actual cost must be reduced by any recoupment referred to in the definition of "adjustable cost" or "adjustable cost price" under section 14(2). Section 8(4)(*b*), before its deletion by section 5(1)(*b*) of the Taxation Laws Amendment Act No. 3 of 2008, provided for the disregarding of a recoupment on the disposal of a ship provided that it was replaced within a certain period. The *quid pro quo* for disregarding the recoupment was that the "adjustable cost" or "adjustable cost price" of the ship for the purposes of section 14 had to be reduced.

Asset acquired from connected person

If a buyer and seller of a depreciable asset are connected persons in relation to each other, the buyer must reduce the cost of the asset by the allowances claimed by the seller [section 23J(2)(*a*)(i)]. Such allowances will not include section 11(*o*) because the seller is not permitted a deduction under that section [second proviso to section 11(*o*)].

Assets acquired for no consideration

A taxpayer may acquire an asset for no consideration, for example by donation or inheritance. In practice a wear-and-tear allowance will be granted on such an asset based on the value of the asset when it is introduced into the business. However, on disposal such an asset will not qualify for the section 11(*o*) allowance should the proceeds be less than the tax value of the asset, since the asset does not have a cost.

Consideration in excess of tax value

Should the proceeds on disposal of the asset exceed its tax value the excess must be –

- included in the taxpayer's income as a recoupment under section 8(4)(*a*) to the extent that the proceeds do not exceed the cost of the asset; and
- as a capital gain to the extent that it exceeds the cost of the asset.

Example 4 – Alienation, loss or destruction allowance

Facts:

At the beginning of year 1 the taxpayer purchased a machine at a cost of R10 000 and brought it into use on the same date. At the beginning of year 2 the taxpayer incurred an amount of R2 100 to move the machine to another location. The useful life of the machine for income tax purposes is five years and it is depreciated on a straight-line basis. At the end of year 3 the machine was sold for R3 000. The taxpayer claimed a wear-and-tear allowance during years 1, 2 and 3 under section 11(*e*). Determine the amount of the section 11(*o*) allowance assuming that the taxpayer makes the required election.

Result:

	R
Cost of machine	10 000
Moving costs	2 100
Total cost	12 100
Less: Section 11(*e*) wear-and-tear allowance:	
*O*n machine (R10 000 x 20% x 3)	(6 000)
On moving costs (R2 100 x 25% x 2)	(1 050)
Tax value	5 050
Selling price	(3 000)
Section 11(*o*) allowance	2 050

Note: Under Interpretation Note No. 47 the moving costs are written off over the remaining useful life of the asset.

Example 5 – Loss of asset as a result of theft

Facts:

A taxpayer acquired a motor vehicle at a cost of R500 000 at the beginning of year 1. The vehicle had an expected useful life for tax purposes of five years. At the end of year 3 the vehicle was stolen and never recovered. The taxpayer received an insurance payout of R150 000 at the end of year 3. Determine the deduction under section 11(*o*).

Result:

	R
Original cost	500 000
Less: Wear-and-tear allowances R500 000 x 20% x 3	(300 000)
Tax value	200 000
Insurance payout	(150 000)
Section 11(*o*) allowance	50 000

Example 6 – Recoupments

Facts:

At the beginning of year 1 X purchased a motor vehicle at a cost of R30 000. X used the vehicle for business purposes for three years of assessment during which a wear-and-tear allowance of 20% per year was granted on the straight-line basis. Thus the total allowances claimed after three years amounted to R30 000 x 20% x 3 = R18 000. At the end of year 3, X disposed of the vehicle for R25 000.

Result:

	R
Original cost of the vehicle	30 000
Less: Wear-and-tear allowance [section 11(*e*)]	(18 000)
Tax value	12 000
Selling price	(25 000)
Recoupment [section 8(4)(*a*)]	(13 000)

4.4 Asset disposed of by donation

A depreciable asset that is donated is alienated by the donor and consequently falls within the expression “alienation, loss or destruction”. In determining whether a deduction under section 11(*o*) is admissible, sections 8(4)(*k*) and 23(*g*) need to be considered. The outcome will have consequences for the determination of a capital gain or loss under the Eighth Schedule.

Under section 8(4)(*k*) an asset that is donated is for the purposes of section 8(4)(*a*) deemed to be disposed of for an amount received or accrued equal to its market value on the date of donation. This provision only applies if the market value of the asset exceeds its tax value, thereby resulting in a recoupment for the purposes of section 8(4)(*a*). Should the market value of the asset be less than or equal to its tax

value, section 8(4)(*k*) will not apply and the section 11(*o*) allowance must be calculated without taking into account any deemed consideration.

If the asset has been donated out of pure liberality without any expectation of a *quid pro quo* the loss under section 11(*o*) will not have been incurred for the purposes of trade. The section 11(*o*) allowance will accordingly be disallowed under section 23(*g*).

Under paragraph 38 of the Eighth Schedule a taxpayer that donates an asset is deemed to have disposed of it for an amount received or accrued equal to its market value on the date of disposal. In the case of a depreciable asset that is not subject to recoupment under section 8(4)(*a*), the market value of the asset will comprise the proceeds on disposal of the asset under paragraph 35. In determining the base cost of the asset, any expenditure referred to in paragraph 20(1)(*a*) to (*g*) must be reduced under paragraph 20(3)(*a*) to the extent that it has been allowed under the relevant capital allowance provisions [for example, section 11(*e*) or 12C].

Example 7 – Donation of depreciable asset

Facts:

A taxpayer acquired a vehicle at the beginning of year 1 at a cost of R500 000 for the purposes of trade. The asset had an expected useful life under section 11(*e*) of five years. At the end of year 4 the taxpayer donated the vehicle to an approved public benefit organisation when the market value of the vehicle was R80 000. The donation fell under the 10% threshold referred to in section 18A(1).

Result:

The tax value of the asset at the time of donation was as follows:

	R
Cost of vehicle	500 000
Less: Wear-and-tear allowances [section 11(*e*)] R500 000 x 20% x 4	(400 000)
Tax value	100 000

Under section 23(*g*) the amount of R100 000 will not be allowed as a deduction under section 11(*o*), since it was not incurred for the purposes of trade.

Under section 18A(3)(*b*) the amount of the donation for the purposes of section 18A will be limited to the lower of R100 000 (cost less allowances allowed) and R80 000 (fair market value of the asset).

For the purposes of the Eighth Schedule, the proceeds on disposal of the asset will be R80 000 under paragraph 38. The expenditure on the asset under paragraph 20 will be reduced as follows under paragraph 20(3)(*a*):

	R
Cost of asset [paragraph 20(1)(*a*)]	500 000
Less: Amounts allowed against income [paragraph 20(3)(*a*)]	
Wear-and-tear allowances	(400 000)
Section 18A deduction	(80 000)
Base cost	20 000

Proceeds (paragraph 38 read with paragraph 35)	80 000
Less: Base cost (as above)	(20 000)
Capital gain	60 000

4.5 Death of a taxpayer

When a taxpayer dies there is no deemed recoupment of capital allowances under section 8(4)(*k*). However, section 23(*g*) and paragraph 40 of the Eighth Schedule need to be considered.

The alienation of an asset as a result of the death of a taxpayer does not arise as a result of carrying on trade. Accordingly any loss under section 11(*o*) arising on death will be disallowed under section 23(*g*).

For the purposes of the Eighth Schedule a taxpayer's assets are deemed to be disposed of at market value on date of death under paragraph 40, subject to some exceptions such as assets bequeathed to a surviving spouse. In determining the base cost of the asset in the hands of the deceased person, any expenditure referred to in paragraph 20(1)(*a*) to (*g*) must be reduced by any capital allowances [paragraph 20(3)(*a*)].

Example 8 – Death of taxpayer

Facts:

A taxpayer acquired a vehicle at the beginning of year 1 at a cost of R500 000 for the purposes of trade. The asset had an expected useful life for tax purposes of five years. At the end of year 4 the taxpayer passed away when the market value of the vehicle was R80 000.

Result:

The tax value of the asset at the time of death was as follows:

	R
Cost of vehicle	500 000
Less: Wear-and-tear allowances [section 11(*e*)] R500 000 x 20% x 4	(400 000)
Tax value	100 000

Under section 23(*g*) the amount of R100 000 will not be allowed as a deduction under section 11(*o*), since it was not incurred for the purposes of trade.

For the purposes of the Eighth Schedule, the proceeds on disposal of the asset will be R80 000 under paragraph 40. The expenditure on the asset under paragraph 20 will be reduced as follows under paragraph 20(3)(*a*):

	R
Cost of asset [paragraph 20(1)(*a*)]	500 000
Less: Amounts allowed against income [paragraph 20(3)(*a*)]	
Wear-and-tear allowances	(400 000)
Base cost	100 000

	R
Proceeds (paragraph 40)	80 000
Less: Base cost (as above)	(100 000)
Capital loss	(20 000)

4.6 Interaction between section 11(*o*) and the Eighth Schedule

A taxpayer that makes an election under section 11(*o*) will be prevented from claiming the section 11(*o*) loss under the Eighth Schedule by paragraph 20(3)(*a*) of that Schedule. Similarly, any recoupment included in a taxpayer's income under section 8(4)(*a*) is excluded from the proceeds for CGT purposes by paragraph 35(3)(*a*) of the Eighth Schedule.

Example 9 – Interaction with Eighth Schedule – Taxpayer making an election under section 11(*o*)

Facts:

A taxpayer acquired an asset at a cost of R100. The asset has an expected useful life for the purposes of section 11(*e*) of five years. At the beginning of year 3 the taxpayer sold the asset for an amount received or accrued of R40 and made an election under section 11(*o*). Determine the section 11(*o*) allowance and any capital gain or loss on disposal of the asset.

Result:

	R
Cost of asset	100
Less: Wear-and-tear allowances	(40)
Tax value	60
Less: Consideration received	(40)
Loss – section 11(*o*)	20

Determination of capital gain or loss

Base cost (paragraph 20 of Eighth schedule)

Cost of asset (paragraph 20(1)(*a*) of Eighth Schedule)		100
Less: Amounts allowed against income (paragraph 20(3)(*a*) of Eighth Schedule):		(60)
Wear-and-tear allowances	(40)	
Section 11(*o*) allowance	(20)	
Base cost		40

Capital gain or loss

Proceeds on disposal of asset	40
Less: Base cost (as above)	(40)
Capital gain or loss	Nil

Paragraph 20(3)(*a*) of the Eighth Schedule thus prevents a double deduction.

Example 10 – Interaction with Eighth Schedule – Taxpayer not making an election under section 11(*o*)

Facts:

The facts are the same as in Example 9, except that the taxpayer does not make an election under section 11(*o*).

Result:

Since no election has been made there is no deduction under section 11(*o*). A capital loss will accordingly arise, calculated as follows:

The base cost of the asset is equal to its acquisition cost of R100 less the wear-and-tear allowances allowed under section 11(*e*) of R40, that is, R60.

	R
Proceeds	40
Less: Base cost (R100 – R40)	(60)
Capital loss	(20)

As a result of the section 11(*o*) allowance not being allowed the taxpayer becomes entitled to a capital loss.

4.7 Limitation imposed on the lessor under section 23A

Section 23A(2) limits the section 11(*o*) allowance to rental income derived from "affected assets". For more on section 23A, see Interpretation Note No. 53 "Limitation of Allowances Granted to Lessors of Affected Assets" dated 12 February 2010.

4.8 Prohibition of the allowance for certain assets falling under the First Schedule

An allowance under section 11(*o*) is prohibited by paragraph 12(2) of the First Schedule for machinery, implements, utensils or articles for which a deduction under paragraph 12(1) or (1A) of that Schedule is allowable.

5. Conclusion

A taxpayer may elect to claim a deduction under section 11(*o*) for the alienation, loss or destruction of a qualifying depreciable asset. If no election is made, a capital loss must be determined under the Eighth Schedule.

Legal and Policy Division
SOUTH AFRICAN REVENUE SERVICE