

BINDING PRIVATE RULING: BPR 078

DATE: 15 February 2010

ACT : INCOME TAX ACT, NO. 58 OF 1962 (the Act)
SECTION : SECTION 1, DEFINITION OF “GROSS INCOME” AND SECTION 11(g) and (h)
SUBJECT : INCOME TAX CONSEQUENCES OF LEASEHOLD IMPROVEMENTS FOR BOTH THE LESSOR AND THE LESSEE

1. Summary

This ruling deals with the income tax consequences for both the lessor and the lessee in respect of leasehold improvements to be effected by the lessee in pursuance of an obligation under a lease agreement.

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 are to sections of the Act applicable as at 30 September 2009 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 1, paragraph (h) of the definition of “gross income”;
- section 11(g); and
- section 11(h).

3. Parties to the proposed transaction

The Applicant:	A subsidiary company that will acquire a piece of land from a fellow subsidiary company
The Co-Applicant:	A company that will lease and develop the piece of land to be acquired by the Applicant
The Sub-Lessee:	A company that will lease the improvements to be effected by the Co-Applicant

4. Description of the proposed transaction

The proposed transaction concerns the development of the piece of land to be acquired by the Applicant for the purpose of establishing a commercial building thereon. A summary of the proposed transaction is set out in the steps below:

- A farm, which is owned by a fellow subsidiary company of the Applicant, will be subdivided.
- A subdivided portion (piece of land) will, while it is still subject to a Notarial Deed of Lease/Perpetual Lease, be sold to the Applicant. The amount payable for the piece of land will be minimal due to the fact that the farm is burdened with the Perpetual Lease in favour of the Holding company of the Applicant and the *bare dominium* which is held by the fellow subsidiary company will therefore hold minimal value.
- The Perpetual Lease is to be cancelled for market value in respect of the said piece of land to facilitate the conclusion of a new lease (main lease) to be entered into between the Applicant and the Co-Applicant.
- The Applicant will lease that piece of land to the Co-Applicant (the Applicant and the Co-Applicant are not connected persons) for a 99 year period and the main lease may be renewed for another 99 year period. The rental payable by the Co-Applicant in the event of a renewal shall be as stipulated in the main lease agreement.
- The Co-Applicant will be obliged to effect improvements on that piece of land, for the agreed purpose as specified in the main lease agreement, at its own cost.
- The Co-Applicant will conclude a sub-lease agreement with the Sub-Lessee in terms of which the Sub-Lessee will operate and lease the improvements for a minimum period of 12 years subsequent to the completion of the improvements. The Sub-Lessee will be granted renewal options for two successive periods of 10 years each.

5. Conditions and assumptions

This ruling is made subject to the conditions and assumptions that:

- The proposed transaction, in its entirety, will not be a part of or be connected with any other transaction, operation or scheme. It is, however, specifically noted that the proposed transaction has to be entered into in its present form, because the Applicant's holding company considers the land, which it is intended to subdivide, inalienable for religious reasons.

- The aggregate development costs to be written off by the Co-Applicant under section 11(g) will not exceed the fair and reasonable value of the improvements.

6. Ruling

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

- The Applicant will be obliged, under paragraph (h) of the definition of “gross income” in section 1, to include in its gross income the fair and reasonable value of all improvements effected by the Co-Applicant in terms of the main lease.
- Having regard to the circumstances of this transaction and in particular the duration of the lease, the lessor will be entitled to an allowance under section 11(h), in respect of amounts included under paragraph (h) of the definition of “gross income” in section 1, determined by using the present value of the development cost discounted at 6% over a 99 year period.
- The Co-Applicant will be entitled to an allowance under section 11(g) over a 25 year term in respect of any expenditure actually incurred, provided such improvements are used or occupied for the production of income or income is derived therefrom.

7. Period for which this ruling is valid

This binding private ruling is valid for a period of five (5) years as from 6 November 2009.

Issued by:

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