

**DRAFT INTERPRETATION NOTE**

DATE:

ACT : INCOME TAX ACT 58 OF 1962**SECTION : SECTION 13sex****SUBJECT : DEDUCTION IN RESPECT OF CERTAIN RESIDENTIAL UNITS****CONTENTS**

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Preamble

In this Note unless the context indicates otherwise –

- “**section**” means a section of the Act;
- “**the Act**” means the Income Tax Act 58 of 1962; and
- any other word or expression bears the meaning ascribed to it in the Act.

1. Purpose

This Note provides guidance on the interpretation and application of section 13sex which provides for an allowance on any new and unused residential unit or improvements to a residential unit used for the purpose of trade and an additional allowance on that residential unit if it qualifies as a low-cost residential unit.

2. Background

Before 21 October 2008 various provisions in the Act allowed for deductions relating to residential buildings, for example, sections 11(t) and 13ter and paragraph 12(5) of the First Schedule. Section 13sex¹ replaced these provisions and brought in one simplified and comprehensive provision for low-cost housing from 21 October 2008.

Section 13sex is subject to section 36,² which means that section 36 takes precedence for the deduction of expenditure incurred in a mining operation for the acquisition, erection, construction, improvement or laying out of housing for residential occupation by the mining operation’s employees and the furniture for such housing.

3. The law

The relevant sections of the Act are quoted in the **Annexure**.

4. Application of the law**4.1 Requirements of section 13sex**

A taxpayer may deduct an allowance of 5% of the cost to the taxpayer of any new and unused residential unit, or any new or unused improvement to a residential unit, if the following requirements are met –³

- the unit or improvement was acquired, or the erection commenced, on or after 21 October 2008;
- the unit or improvement is owned by the taxpayer;
- the unit or improvement is used by the taxpayer during the year of assessment solely for the purposes of the taxpayer’s trade;
- the unit is situated in the Republic; and

¹ Introduced by section 31(1) of Act 60 of 2008 and deemed to have come into operation on 21 October 2008.

² The section deals with the calculation of redemption allowance and unredeemed balance of capital expenditure in connection with mining operations.

³ Section 13sex(1).

- the taxpayer owns at least 5 units in the Republic that are used by the taxpayer for the purposes of trade.

An additional allowance of 5% of the cost of a residential unit is allowable if that residential unit constitutes a low-cost residential unit and the taxpayer qualifies for a deduction in respect of that unit under section 13sex(1)⁴ (refer above).

The deduction of expenditure incurred in a mining operation for the acquisition, erection, construction, improvement or laying out of housing for residential occupation by the mining operation's employees and the furniture for such housing is governed by section 36. The allowance and additional allowance under section 13sex are therefore not available if the expenditure on the residential unit constitutes capital development expenditure as defined under section 36(11).

Under section 25BB(4) a company that is a REIT or a controlled company on the last day of the year of assessment may not claim a deduction, amongst others, under section 13sex.

4.1.1 Meaning of “residential unit”

Residential Unit

A residential unit is defined in section 1(1) and means a building or a self-contained apartment mainly used for residential accommodation and excludes a building or apartment used by a person in carrying on a trade as an hotel keeper.

Building

The word “building” is not defined in the Act but has been considered in a number of court cases from which several general principles have emerged.

Normally a building is a substantial structure, more or less of a permanent nature, consisting of walls, a roof and the necessary appurtenances (accessories).⁵

The word “permanent” is defined in the Merriam-Webster Learner's Dictionary⁶ as –

“lasting or continuing for a very long time or forever : not temporary or changing”

It is also defined as –⁷

“1. Lasting or remaining without essential change:

2. Not expected to change in status, condition, or place”.

⁴ Section 13sex(2).

⁵ *CIR v Le Sueur* 1960 (2) SA 708 (A), 23 SATC 261 at 273.

⁶ www.learnersdictionary.com/definition/permanent [Accessed 10 January 2018].

⁷ www.thefreedictionary.com/permanent [Accessed 10 January 2018].

It is evident therefore that the word “permanent” does not necessarily mean everlasting. In determining if a building is “of a permanent nature” the following aspects must be considered; the nature of the building, the degree and manner of annexation and the intention of the person annexing it to a particular place.⁸

A building can sometimes be a movable or temporary structure and accordingly not be of a permanent nature. The relevant section must be considered in determining whether it applies to a building of a permanent nature, buildings that are movable or of a temporary nature, or both. If one considers the purpose of section 13sex (see 2) and the purpose of proviso (ii) of section 11(e),⁹ section 13sex applies to buildings of a permanent nature only.

The facts of a particular case must always be considered in deciding whether a building is of a permanent nature, however, generally speaking, when assessed in terms of the factors mentioned above, buildings such as portable bungalows, rondavels, huts, sheds and prefabricated structures used on construction sites, will not be regarded as buildings of a permanent nature. In ITC 370¹⁰ it was held that the wood and iron buildings, originally constructed of old material, that were used by a taxpayer to carry on business as a general dealer were buildings of a permanent nature since it was attached to the soil and used for permanent purposes of the business.

The determination of whether accessories, attachments or improvements to a building are part of the building depends on whether the attachment to the building is of a permanent nature and, if so, if the accessory or attachment is structurally integrated or otherwise permanently physically integrated into the building in such a manner that it has lost its own separate identity and character.¹¹ The assessment of these criteria is dependent upon the facts of each case. Factors to be considered in assessing if the attachment is permanent are, for example, the intention with which the accessory or attachment is attached, the nature of the accessory or attachment and the degree and manner in which it has been attached to the building.¹²

⁸ These are the aspects which are considered in assessing whether a moveable asset accedes to immovable property (land) and, if it does, the owner of the immovable property becomes the owner of the previously moveable asset (assuming it was not already owned by such owner). See WA Joubert “Accession” 27 (Second Edition Volume) *LAWSA* [online] (My LexisNexis: 31 January 2014) in paragraph 184; *Pettersen & Others v Sorvaag* 1955 (3) SA 624 (A); *Macdonald Ltd v Radin NO & the Potchefstroom Dairies & Industries Co. Ltd* 1915 AD 454 and *Newcastle Collieries Co Ltd v Borough of Newcastle* 1916 AD 561 at 564. The issue of ownership through accession is not always the same issue as whether a building is of a permanent nature, however, there is a close overlap. Accordingly, it is submitted that in assessing whether a building is of a permanent nature, or whether a moveable asset has been permanently fixed to a building, the same elements are relevant.

⁹ Proviso (ii) denies a deduction under section 11(e) for buildings or other structure or works of a permanent nature.

¹⁰ (1936) 9 SATC 313 (U).

¹¹ *SIR v Charkay Properties (Pty) Ltd* 1976 (4) SA 872 (A), 38 SATC 159; *CIR v Le Sueur* 1960 (2) SA 708 (A), 23 SATC 261 (A) at 275.

¹² *Konstanz Properties (Pty) Ltd v WM Spilhaus and Co (WP) Ltd* 1996 (3) SA 273 (A).

In *CIR v Le Sueur*¹³ the court considered whether the laying batteries used in poultry farming constituted part of the building. Ramsbottom JA held that –¹⁴

“... the laying batteries are valuable property... and it is therefore not at all unlikely that the purpose of the buildings is at least partly to protect the laying batteries, which according to the stated case are liable to rust, against the ravages of the weather. If then it can be said, as I think it can reasonably be said on the facts, that the buildings provide shelter not only for the poultry but also for the laying batteries, the latter clearly cannot be said to have lost their separate identity and to have become integral parts of the buildings in which they are housed.

In my view therefore the laying batteries ... do not for the purposes of para. 17(1)(f) of the Third Schedule to the Income Tax Act, form part and parcel of the buildings in which they are housed...”

In *SIR v Charkay Properties (Pty) Ltd*¹⁵ the court considered whether the demountable partitions that were used in fourteen upper floors of a building that contained no internal walls and were let as offices were articles for purposes of the depreciation allowance under section 11(e) or constituted part of the building. Trollip JA held that –¹⁶

“...[t]he nature of respondent’s demountable partitions and the way in which they were mounted and used in respondent’s building during the relevant years of assessment have been fully described above. According to that description they were only lightly, albeit rigidly, attached to the floors and ceilings; they could easily and inexpensively be detached and removed without causing any injury to themselves or the floors or ceilings; they could then be either stored or similarly mounted and attached in some other position to suit the tenants; indeed, their normal use and function was not for them to remain unmoved but to be shifted around; hence their mounting and attachment in a particular position could not be regarded, ..., as being permanent; moreover, for the same reasons, it can be said that, while in position, they did not lose their identity or character as movable inner walls. Consequently, I do not think that they were structurally integrated or otherwise physically incorporated into the building permanently in such a way that they lost their own, separate identity and character, or, in the words used by Ramsbottom JA, that they were built into the fabric of respondent’s building.

... True, the ordinary doors of a building or roof tiles are a part of it, although the doors are only attached by their hinges and the roof tiles by their own weight and both can easily be removed. None the less they are regarded as part of the building because they are structurally integrated or physically incorporated into it permanently; for although they are easily removable, the purpose and intention with which they are built into the building’s fabric (and intention here is of importance) is that they should remain in those positions permanently. On the other hand, the demountable partitions are not only easily removable, but, according to their normal use, they are meant to be and are in fact moved about or removed from time to time.”

External paving, fencing and landscaping do not form part of a building for purposes of section 13sex. In addition, a building does not include the land upon which the structure stands.¹⁷

¹³ 1960 (2) SA 708 (A), 23 SATC 261 (A).

¹⁴ *CIR v Le Sueur* 1960 (2) SA 708 (A), 23 SATC 261 (A) at 275.

¹⁵ 1976 (4) SA 872 (A), 38 SATC 159 (A).

¹⁶ *SIR v Charkay Properties (Pty) Ltd* 1976 (4) SA 872 (A), 38 SATC 159 (A) at 169.

¹⁷ ITC 1619 (1996) 59 SATC 309 (C) at 314.

Self-contained apartment

The definition of residential unit also refers to “self-contained apartment”. This term is not defined in the Act. The method of attributing meaning to the words used in legislation involves, as a point of departure, examining the language of the provision at issue, the language and design of the statute as a whole and its statutory purpose.¹⁸ Following this principle one has to have regard to the ordinary grammatical meaning.

The word “self-contained” is described in the online Oxford Dictionary,¹⁹ as –
“(of a thing) complete, or having all that is needed, in itself”.

The word “apartment”²⁰ is described as –

“[a] suite of rooms forming one residence; a flat” or “[a] set of private rooms in a very large house”.

The facts of a specific case are critical, however, a flat which constitutes a section in a sectional title scheme under the Sectional Title Act 95 of 1986 will often constitute a self-contained apartment.²¹

Mainly used

As noted above, the building or self-contained apartment must be used mainly for residential accommodation. The determination of whether a building or self-contained apartment is mainly used for residential accommodation is a question of fact.

In *Glen Anil Development Corporation Ltd v SIR Botha JA* stated the following:²²

“Section 103(2) uses the words ‘solely or mainly for the purpose . . .’ In the *Oxford English Dictionary* ‘mainly’ is defined to mean ‘for the most part; in the main; as the chief thing, chiefly, principally’. The word ‘hoofsaaklik’ is used in the Afrikaans text. . . the onus was on the appellant to show that the transactions in question were not entered into solely or mainly for the purpose of utilizing the assessed loss or balance of assessed loss . . . That onus would be discharged if the appellant satisfied the court that the avoidance . . . was not a more important consideration in the mind of Dr Rubenstein (acting on the advice of his auditors) than the avoidance of estate duty and undistributed profits tax.”

In *SBI v Lourens Erasmus (Edms) Bpk*²³ Botha JA held that, in the context of an exemption for the previously applicable undistributed profits tax, the word “mainly” prescribed a purely quantitative standard of more than 50%.

In context of section 13sex “mainly” is also interpreted to mean “more than 50%”. Therefore, the building or self-contained apartment will potentially qualify as a residential unit if it is used more than 50% during the year of assessment for residential accommodation.

¹⁸ See *Chetty t/a Nationwide Electrical v Hart & another* 2015 (6) SA 424 (SCA).

¹⁹ The online Oxford Dictionary at <https://en.oxforddictionaries.com/definition/self-contained> [Accessed 10 January 2018].

²⁰ The online Oxford Dictionary at <https://en.oxforddictionaries.com/definition/apartment> [Accessed 10 January 2018].

²¹ Depending on the facts, a section in a sectional title scheme can relate to part of a building or a whole building.

²² 1975 (4) SA 715(A), 37 SATC 319 at 325.

²³ 1966 (4) SA 434(A), 28 SATC 233 at 245.

A building or apartment could be used for a dual purpose, for example, residential accommodation and offices. In practice, if more than 50% of a building, measured by floor space or volume, is used during the year of assessment for residential accommodation the “mainly” requirement will be met. Depending on the facts of a particular case, it is possible that there may be circumstances in which an alternative method is more appropriate than floor space or volume.

Example 1 – Residential unit - mainly used for residential accommodation*Facts:*

Company C built an office block which it occupies for purposes of providing advisory services to clients. The total floor space of the office block is 1 000 square metres.

The office block includes a small apartment of 45 square metres in which the building’s caretaker lives.

Result:

The apartment is used for residential accommodation which means the office block is used 4,55% (45/1000) for residential accommodation. Accordingly, the office block will not qualify as a residential unit because it is not mainly, that is, more than 50%, used for residential accommodation.

Example 2 – Residential unit - mainly used for residential accommodation*Facts:*

Company A built a building which contained six floors. The bottom two floors contain office premises and retail space and the top four floors contain residential apartments. Each of the six floors is the same size. Construction was completed during the current year of assessment.

During the year of assessment Company A rented out office premises and retail space equal to one floor. The other office premises and retail space were available for rental but Company A had not been successful in finding suitable tenants. Similarly, all the residential apartments were available for rental, but Company A only managed to rent out apartments which combined represented space of one floor during the year of assessment.

Result:

The four floors of residential apartments represent the part of the building which is considered to be “used for residential accommodation”. The fact that apartments making up three floors in space were not successfully rented out during the current year of assessment does not change the fact that all the apartments were available to rent for residential accommodation purposes, that Company A was actively trying to rent them and that the apartments are therefore considered to be used for residential accommodation. It would depend on all the facts, however, if the apartments were not successfully rented out for an extended period of time or the intended use changed, this assessment may change.

The two floors of office premises and retail space are not used for residential accommodation.

This means the building was used 66,66% (4 floors / 6 floors) for residential accommodation. The building is, accordingly, “mainly”, that is, more than 50%, used for residential accommodation and qualifies as a residential unit under section 13sex.

Example 3 – Residential unit - mainly used for residential accommodation

Facts:

Company C purchased a flat which constituted a unit in a sectional title scheme under the Sectional Title Act 95 of 1986. The flat had two bedrooms, a lounge, a kitchen and a bathroom.

The flat was located near the company’s head office and was used to accommodate employees participating in the long term secondment program as part of the company’s skills development program.

Result:

The flat is a self-contained apartment which is solely used for residential accommodation. Accordingly, the flat qualifies as a residential unit because it is mainly, that is, more than 50%, used for residential accommodation.

Residential accommodation

The word “residential”²⁴ is described as –

“[d]esigned for people to live in”.

The word “accommodation”²⁵ is described as –

“[a] room, group of rooms, or building in which someone may live or stay”.

The provision of residential accommodation therefore refers to the provision of a place for someone to live in such as a house, flat, hostel or hotel room.²⁶

A residential unit would have sleeping, catering and ablution facilities.²⁷

Exclusions from residential unit

A building or self-contained apartment that is used by a person in carrying on a trade as an hotel keeper is excluded from the definition of “residential unit”. A hotel keeper is defined in section 1(1) and means any person carrying on the business of hotel keeper or boarding or lodging house keeper where meals and sleeping accommodation are supplied to others for money or its equivalent.

²⁴ The online Oxford Dictionary at <https://en.oxforddictionaries.com/definition/residential> [Accessed 10 January 2018].

²⁵ The online Oxford Dictionary at <https://en.oxforddictionaries.com/definition/accommodation> [Accessed 10 January 2018].

²⁶ See the definitions of “accommodation” and “residence” in www.merriam-webster.com/dictionary/accommodation; www.macmillandictionary.com/dictionary/british/accommodation and www.macmillandictionary.com/dictionary/british/residence. [Accessed 10 January 2018].

²⁷ D Clegg and R Stretch *Income Tax in South Africa* [online] (My LexisNexis: August 2017) in paragraph 11.5.19.

4.1.2 Meaning of “low-cost residential unit”

Low-cost residential unit is defined in section 1(1) as—

- (a) an apartment qualifying as a residential unit in a building located within the Republic, where—
 - (i) the cost of the apartment does not exceed R350 000; and
 - (ii) the owner of the apartment does not charge a monthly rental in respect of that apartment that exceeds one per cent of the cost; or
- (b) a building qualifying as a residential unit located within the Republic, where—
 - (i) the cost of the building does not exceed R300 000; and
 - (ii) the owner of the building does not charge a monthly rental in respect of that building that exceeds one per cent of the cost contemplated in subparagraph (i) plus a proportionate share of the cost of the land and the bulk infrastructure:

Provided that for the purposes of paragraphs (a) (ii) and (b) (ii), the cost is deemed to be increased by 10 per cent in each year succeeding the year in which the apartment or building is first brought into use.

The definition distinguishes between a building and an apartment, both of which must qualify as a residential unit (**4.1.1**).

One of the requirements included in the definition of “low-cost residential unit” is that the monthly rental charged by the owner may not exceed 1% of the cost of the apartment or, in the case of a building, 1% of the cost of the building plus a proportionate share of the cost of the land and the bulk infrastructure. Cost for the purpose of calculating the maximum monthly rental that may be charged in order to meet that part of the definition is deemed to be increased by 10% in each year succeeding the year in which the building or apartment is first brought into use.

Example 4 – Low-cost residential units: individual apartments

Facts:

Company A acquired 6 residential apartments in buildings located in different parts of South Africa in 2016. The cost of Apartment 1, 2 and 3 was R375 000 per apartment and the cost of Apartment 4, 5 and 6 was R340 000 per apartment. The apartments were rented to various tenants at a rent of R3 500 in 2016 and R3 800 in 2017.

Result:

The apartments each constitute a residential unit because each apartment is a self-contained apartment which is mainly used for residential accommodation and Company A is not a hotel keeper.

Apartment 1, 2 and 3 do not qualify as low-cost residential units because their cost of R375 000 exceeds the maximum amount of R350 000.

The cost of Apartment 4, 5 and 6 (R340 000 per apartment) does not exceed the maximum amount of R350 000. In addition, the monthly rental of R3 500 in 2016 and R3 800 in 2017 is less than the maximum monthly rental (see note 1 below) permitted under the definition of “low-cost residential unit”. Accordingly, Apartment 4, 5 and 6 qualify as low-cost residential units.

Note 1:

For purposes of determining the maximum monthly rental which may be charged for Apartment 4, 5 and 6, the cost of the apartments are deemed to be increased by 10% in each year succeeding the year in which the apartments are first brought into use. Therefore, the maximum monthly rental for Apartment 4, 5 and 6 in:

2016 is R3 400 (1% of R340 000)

2017 is R3 740 [1% of R374 000 (R340 000 plus 10%)]

2018 is R4 114 [1% of R411 400 (R374 000 plus 10%)]

Example 5 – Low-cost residential units: building comprising residential apartments

Facts:

Company A constructed a building of residential apartments on land owned in South Africa in 2016. The residential apartment building had 10 apartments at a cost of R350 000 each. The total cost of the building was R5 000 000 [cost of apartments (10 x R350 000) + cost of other areas forming part of the building, for example, the reception area, stairways etc. (R1 500 000)]. The cost of the land and bulk services was R2 000 000.

The apartments were rented to various tenants at a rental charge of R3 500 in 2016 and R3 800 in 2017.

Result:

Company A owns the entire building and therefore the building as a whole, and not the individual apartments, must be assessed against the definition of a “residential unit”. The building constitutes a residential unit in 2016 and 2017 because it was used 100% for residential purposes, which means the building was mainly used for residential accommodation, and Company A is not a hotel keeper.

The building will not constitute a low-cost residential unit because its cost of R5 000 000 exceeds the maximum cost of R300 000. It does not matter that the cost of the individual apartments does not exceed the maximum cost for a self-contained apartment of R350 000 because the building, not the apartments, is the residential unit.

4.1.3 Meaning of “improvement to a residential unit”

The allowance under section 13sex can also be claimed on any new and unused improvement to a residential unit if the other requirements of the section are met.

The word “improvement” is not defined in the Act and must be given its ordinary grammatical meaning. It is described in the New Oxford Thesaurus of English,²⁸ as –

“[d]evelopment, upgrade, change for the better, refinement, enhancement, furtherance, advancement, forwarding; boost, augmentation, raising; correction, rectification, rectifying, upgrading, amelioration, rally, recovery, upswing, breakthrough”.

²⁸ P Hanks, first published (2000) Oxford University Press Inc, New York.

The Appellate Division in *African Detinning Works (Pty) Ltd v SIR*²⁹ held that in order to constitute an improvement to a building the “extension, addition or improvements” must be physically attached to, connected or integrated with the building. In this case some years after a factory building was built, concrete aprons were added around the building. The aprons were held not to form part of the building as they were separate structures and not physically attached to the building. Accordingly, the aprons did not qualify as an improvement to the building. In *SIR v Charkay Properties (Pty) Ltd*³⁰ the majority held that, at the very least, for an article to form part of a building it must have been structurally integrated or otherwise physically incorporated into the building.

An improvement must be distinguished from repairs.³¹

In ITC 617³² various court cases were reviewed from which the following principles emerged relating to repairs and improvements:

- Repair is restoration by renewal or replacement of subsidiary parts of the whole. Renewal as distinguished from repair is reconstruction of the entirety, meaning by the entirety not necessarily the whole but substantially the whole subject matter under discussion.
- For repairs effected by renewal it is not necessary that the materials used should be identical with the materials replaced.
- The test for distinguishing repairs from improvement is – has a new asset been created resulting in an increase in the income-earning capacity or does the work undertaken merely represent the cost of restoring the asset to a state in which it will continue to earn income as before?

4.1.4 The residential unit or improvement to a residential unit must have been acquired, or the erection must have commenced, on or after 21 October 2008

Section 13sex was inserted by the Revenue Laws Amendment Act 60 of 2008. The section was deemed to have come into effect on 21 October 2008 and applies only to residential units or improvements to residential units, acquired, or the erection of which commenced, on or after 21 October 2008.

Whether a residential unit or an improvement to a residential unit was acquired, or whether the erection thereof commenced, on or after 21 October 2018 must be determined on a case-by-case basis.

Section 13sex does not require that the taxpayer must personally have constructed the residential unit or the improvement to a residential unit in order to claim the allowance. Accordingly, the residential unit or the improvement to a residential unit may, for example, be acquired by the taxpayer from a third party, such as a property developer, provided that it was acquired on or after 21 October 2008 and that the other requirements, for example, that it is new and unused, are met.

²⁹ 1982 (1) SA 797 (A) 44 SATC 1. Although this case dealt with a specific definition in section 13(9), the principles are relevant to section 13sex because that definition referred to any extension, addition or improvement to a building and section 13sex refers to an improvement to a residential unit.

³⁰ 1976 (4) SA 872 (A), 38 SATC 159.

³¹ See Interpretation Note 74 “Deduction and Recoupment of Expenditure on Repairs” on the SARS website for a discussion of the meaning of repairs and improvements.

³² (1946) 14 SATC 474 (U).

The courts have held that the date when erection of a building or improvements commences is the date when the laying of the foundation begins. The clearing and levelling of the site and the conducting of excavations in preparation for the laying of the foundation have been held not to form part of the erection phase.³³

4.1.5 The residential unit or improvement to a residential unit must be “new and unused”

In order to qualify for the allowance the residential unit or improvement to the residential unit, as appropriate, must be new and unused. Whether a residential unit or an improvement to a residential unit is new and used is a factual enquiry based on the facts of each case. If the allowance is claimed only on an improvement, only the improvement needs to be new and unused.

“New” means that the residential unit or improvement to the residential unit must have been recently erected or effected. The residential unit or improvement to the residential unit must therefore be newly built. If a taxpayer erected a residential unit which had been immediately mothballed³⁴ for some years, it would be unused but not new.

Unused means the residential unit or improvement to the residential unit must not have been previously used for any purpose by any person. The residential unit or improvement to the residential unit will therefore not qualify for the allowance if it has been previously used for any purpose.

The assessment regarding whether a residential unit or improvement to a residential unit is new and unused is made when the taxpayer becomes the owner of the residential unit or improvement to the residential unit. For example, if a taxpayer acquires a new and unused residential unit during a year of assessment, the residential unit will be considered to have met the “new and unused” requirement for that taxpayer for purposes of section 13sex in the year of acquisition and in subsequent years of assessment.

See **4.1.6** for detail on situations in which an improvement on land or to buildings by a lessee is deemed to be owned by the lessee and to be the cost of a new and unused residential unit or improvement contemplated in section 13sex.

If a residential unit is purchased, the purchaser will not be entitled to a deduction under section 13sex if the residential unit is not new and unused from the purchaser’s perspective. Whether or not the residential unit is still new and unused depends on how long the previous owner held it and whether or not it was used. Even if the residential unit does not meet the requirement of being “new and unused”, improvements effected by the purchaser to the residential unit could be “new and unused” and, subject to meeting all the requirements of the section, qualify for the allowance.

³³ ITC 1137 (1969) 32 SATC 1 (C).

³⁴ That is, kept aside for possible future use.

Example 6 – New and used building*Facts:*

Company D purchased a residential apartment building from Company C on 1 September year 1.

Company C completed construction of the residential apartment building on 30 June year 1 and at the time of the sale to Company D 75% of the apartments had been leased to tenants for various lease periods and monthly rentals.

Result:

Company D will not qualify for an allowance under section 13sex because although the building is still new, it was used by Company C and various tenants before Company D acquired it.

4.1.6 Owned by the taxpayer

Ownership is not defined in the Act, however, general common law principles apply. Under the common law principle of *superficies solo cedit* (owner by accession), buildings or other structures affixed or attached to land become the property of the owner of the land. The taxpayer wanting to claim the allowance under section 13sex therefore has to be the owner of the land on which the residential unit is erected or the improvements effected. This is relevant in the context of section 13sex as it deals with buildings of a permanent nature and such buildings will be permanently attached to the land (see 4.1.1).

The acquisition of land, or a building and the land on which it is situated, occurs by means of a deed of transfer from one person to another and is effected by the process of registration in the Deeds Office.³⁵ A residential unit purchased by the taxpayer, but not yet transferred into its name is not owned by the taxpayer. Parties entering into an unconditional contract to transfer ownership does not mean the purchaser is the owner as the registration process with the necessary authority is required for transfer of ownership to occur. Acquisition of ownership through transfer is required and not the acquisition of mere possession.

Land and buildings may be co-owned, that is jointly owned by two or more persons. A building that is co-owned by a taxpayer qualifies as a building owned by the taxpayer³⁶ and the taxpayer would therefore be able to claim the section 13sex allowance on the proportional share of the cost of the building actually incurred by that taxpayer.

A taxpayer may also own a building or self-contained apartment under sectional title.³⁷ A unit in a sectional title scheme gives its owner or holder, sole ownership of the relevant section of the scheme and joint ownership of an undivided share in the

³⁵ Section 16 of the Deeds Registries Act 47 of 1937 provides that “Save as otherwise provided in this Act or in any other law the ownership of land may be conveyed from one person to another only by means of a deed of transfer executed or attested by the registrar”.

³⁶ D Davis *et al Juta’s Tax Library* [online] (Jutastat e-publications: 30 November 2015) in Commentary on Income Tax - section 13quin. The principle of joint ownership is equally applicable to section 13sex.

³⁷ See Binding Private Ruling 169 dated 9 May 2014 “Commercial Building Allowance”. The principle of ownership under section title is equally applicable to section 13sex.

common property. Although a unit is deemed to be land under the Sectional Title Act,³⁸ it is submitted that to the extent a unit relates to a building or part of a building, the deeming to be land is ignored for purposes of section 13sex.

A residential unit that the taxpayer does not own but to which the taxpayer has the right of use or occupation does not qualify for the allowance. For example, a leased building or a building to which the taxpayer has the right of use through shares in a share block scheme or timeshare. Accordingly, a lessee that erects improvements on land or to a building owned by the lessor will not qualify for a deduction under section 13sex but may, depending on the facts, qualify for a deduction or a partial deduction under section 11(g).

A lessee who undertakes obligatory improvements on a leased property as envisaged under section 12N³⁹ and incurs expenditure doing so, is deemed to be the owner of such improvements for purposes of, amongst others, section 13sex, provided the requirements of section 12N are met.⁴⁰ Section 12N permits the allowance on the improvements to be calculated as if the lessee owns the underlying property directly, provided the lessee uses or occupies the property for the production of income or derives income from it. The expenditure incurred by the lessee to complete the improvements is deemed to be the cost to the lessee of any new and unused residential unit or of any new and unused improvements to a residential unit for the purposes of section 13sex.⁴¹

The taxpayer does not have to erect the residential unit to claim the allowance. The residential unit may be acquired by the taxpayer from a third party, such as a property developer, provided the residential unit is new and unused when the taxpayer becomes the owner of the building (see 4.1.5).⁴²

4.1.7 Used solely for the purposes of a trade

Section 13sex(1)(a) requires that the residential unit or improvement to a residential unit must be used by the taxpayer solely for the purposes of a trade carried on by the taxpayer. Solely means the residential unit or improvement to the residential unit must be used only for the trade and for nothing else. The allowance is therefore not available for a residential unit should that residential unit be partly used for the purposes of trade and partly for other non-trade purposes, for example, the owner also resides in the residential unit. No apportionment will take place. The allowance may be available for other residential units owned by the taxpayer if all of the requirements of section 13sex are met for those units.

Trade is defined in section 1(1) and includes every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and

³⁸ Section 3(4) of the Sectional Titles Act 95 of 1986.

³⁹ In terms of a Public Private Partnership, on leased property owned by the government in the national, provincial or local sphere of government or certain government owned exempt entities or an obligation under the Independent Power Producer Procurement Programme administered by the Department of Energy - see section 12N(1).

⁴⁰ See section 12N for consequences when the right of use or occupation terminates and section 12N(3) for specific exclusions from the section.

⁴¹ Section 13sex(1).

⁴² D Davis *et al Juta's Tax Library* [online] (Jutastat e-publications: 30 November 2015) in Commentary on Income Tax – section 13quin. This is also applicable to section 13sex which uses the same wording in this regard.

the use of or the grant of permission to use, as defined, any patent, design, trade mark, copyright or any other similar property.

In ITC 770⁴³ it was held that this definition should be widely construed and is obviously intended to embrace every profitable activity.

The test to be applied to determine whether a trade is being carried on is an objective test and if objective factors indicate that the taxpayer is trading, the trade requirement is satisfied.

If the taxpayer did not derive any income in a particular year of assessment, it does not automatically mean that the taxpayer did not trade in that year of assessment. In ITC 777⁴⁴ the court held that a company that had unsuccessfully attempted to let its property did carry on a trade. If no income is earned, it can practically raise more questions regarding whether there is an intention to trade or to earn income and more evidence may be required.

4.1.8 Residential unit concerned and five residential units in total situated in the Republic

The residential unit or improvement to a residential unit must be situated in the Republic in order to qualify for the allowance. In addition, the taxpayer is required to own at least five⁴⁵ residential units in the Republic which are used for the purposes of a trade carried on by the taxpayer. The residential units can be in different places within the Republic.

If a taxpayer acquires one residential unit per year for five years, the allowance on all five will commence when the fifth unit is available for occupation. When the number of residential units owned by the taxpayer falls below five, for example, if during the year of assessment a taxpayer that owned 5 residential units used for purposes of trade, sold one of the residential units or no longer used it for purposes of trade, the remaining 4 residential units will no longer qualify for the allowance from the subsequent year of assessment.

In order for the allowance to be claimed on an improvement to a residential unit, the minimum threshold of owning five residential units must also be met.

4.2 The determination of cost and calculation of the allowance

The allowance is calculated at a rate of 5% a year on the cost of the residential unit⁴⁶ or the improvement to the residential unit with an additional 5% if that residential unit qualifies as a low-cost residential unit.⁴⁷ The allowance is not apportioned if the residential unit or improvement to a residential unit is brought into use for part of the year.

⁴³ (1953) 19 SATC 216 (T). See also *Burgess v CIR* 1993 (4) SA 161 (A), 55 SATC 185.

⁴⁴ (1953) 19 SATC 320 (T).

⁴⁵ Section 13sex replaced section 13ter for acquisitions and erections commenced on or after 21 October 2008. Section 13ter made provision for an allowance on the erection of residential units under a "housing project" with a minimum threshold of five residential units. This requirement carried over to section 13sex.

⁴⁶ Section 13sex(1).

⁴⁷ Section 13sex(2).

The allowance is granted for the first time in the year the residential unit is brought into use for the purposes of trade provided all the requirements of the section have been met (see 4.1).

The cost is the lesser of the actual cost to the taxpayer or the arm's length direct cost under a cash transaction for the erection or acquisition of the residential unit or the improvement to it, as appropriate, on the date on which the transaction for the acquisition or improvement was concluded.⁴⁸

The court in *SIR v Eaton Hall (Pty) Ltd* considered the meaning of "cost to the taxpayer of the building" and held that it –⁴⁹

"... from the context ... 'cost of any building' means the cost of erecting that building ... ordinarily means the price or consideration given or paid by him for the erection of the building. It does not, therefore, include expenses, incurred by the taxpayer *in connection with* the erection of the building *unless*, of course, they are *part of the price* or consideration paid *for the erection*. ... the use of the preposition 'of' instead of a phrase with a wider connotation, like 'in respect of' ... indicates that the connection between them must be direct and close; in other words, the expression comprehends the cost of erecting the building and nothing more. ... 'the cost of building or improving' something is not as well delineated as 'the cost of any building or improvements'. The former might well cover certain expenses incurred incidentally in building or improving a structure, whereas under the latter the cost is delimited by the very physical nature of the building or improvements." (Our emphasis.)

The principles expressed in the *Easton Hall* case are applicable to a residential unit which is either a building or self-contained apartment as discussed in 4.1.1. If the taxpayer purchased a building which constitutes a residential unit then the cost of the residential unit is the cost to the taxpayer to purchase it, that is, the purchase price paid to the seller. However, if a taxpayer acquires part of a building which constitutes a residential unit, without erecting or constructing it, there is a deemed cost figure for the part or the improvement acquired – see 4.6.

The cost of a residential unit for purposes of section 13sex does not, for example, include –

- the cost of the land on which the residential unit is erected, therefore, for example, in the case of a purchase of land and buildings, an apportionment would be required;
- the costs related to the preparation of the land for the erection of the residential unit;⁵⁰
- costs incurred to obtain a rezoning in order to permit a higher building height which are incurred in connection with the erection of the building but are not part of the cost of the building;⁵¹ or
- interest incurred on any financial instrument used to fund the acquisition, erection or improvement of the residential unit.⁵²

⁴⁸ Section 13sex(3).

⁴⁹ 1975 (4) SA (A), 37 SATC 343 at 347 to 348.

⁵⁰ ITC 1137 (1969) 32 SATC 1 (C) - levelling of the site and excavations for the foundation were held not to form part of the erection phase.

⁵¹ 1975 (4) SA (A), 37 SATC 343 at 347 to 348.

⁵² 1975 (4) SA (A), 37 SATC 343 at 347 to 348.

Costs that are directly and closely connected with the erection of the building such as architect and civil engineering fees are included in the cost of the building.⁵³

The cost of an improvement to a residential unit which qualifies for a deduction must be determined applying the same principles.

Example 7 – Calculation of the allowance

Facts:

On 15 February 2016 Company A bought vacant land for R5 million. It built a block of flats consisting of 20 residential units for use by its employees at a cost of R10 million. Company A also built a parking area alongside the building at a cost of R700 000 and erected a security fence at a cost of R400 000. The residential units were all rented out by year end, 31 December 2016.

Company A owns 10 residential units in South Africa which are rented out to various tenants.

Result:

Company A qualifies for the 5% allowance under section 13sex(1). The cost of the land, the parking area and the fence do not qualify for the allowance as those costs are not part of the cost of the residential unit. The allowance is not apportioned.

$$10\,000\,000 \times 5\% = R500\,000 \text{ per annum}$$

The block of flats does not qualify as a low-cost residential unit because its cost exceeds R300 000.

4.3 Deeming provision

A special deeming rule⁵⁴ deems a taxpayer to have been allowed a deduction under section 13sex on a residential unit or an improvement to a residential unit in a previous financial year if the taxpayer qualifies for a deduction under section 13sex in a current year of assessment and if during that previous financial year –

- the taxpayer used the residential unit or improvement to the residential unit for the purposes of the taxpayer's trade;
- the receipts and accruals from that trade were not included in income during that previous year; and
- had the receipts and accruals been included in income the taxpayer would have been entitled to a deduction under section 13sex.

The amount of the deduction which is deemed to have been allowed for the purposes of section 13sex is the amount which would have been allowed under section 13sex in previous years in which the residential unit or improvement to the residential unit was used by the taxpayer, if the receipts and accruals of that trade had been included in the taxpayer's income.

⁵³ 1975 (4) SA (A), 37 SATC 343 at 348.

⁵⁴ Section 13sex(4).

The total deductions, including these deemed deductions, available in respect of a residential unit, or an improvement to a residential unit, are limited to cost (see **4.5**).

The recoupment provisions under section 8(4)(a) do not apply to the deemed allowance under section 13sex(4).

Example 8 – Deeming provision

Facts:

Company A used a residential unit, that was purchased new and unused from a developer, for purposes of trade. During year 1 – 5 Company A's income was exempt from tax. Thereafter, Company A's income was taxable. Company A qualified for a deduction under section 13sex(1) from year 6 onwards.

Result:

For purposes of calculating the allowance to which Company A is entitled to from year 6 onwards, the 5% allowance is deemed to have been allowed for years 1 – 5 when Company A's income was exempt from tax. Company A may therefore claim the 5% allowance in years 6 – 20. No deduction is available from year 21 because the total cost limitation was reached in year 20 (see **4.5**).

4.4 Disposal of the residential unit

Once a residential unit or an improvement to a residential unit is disposed of in a year of assessment, no allowance under section 13sex can be claimed for the residential unit or improvement to a residential unit in a subsequent year of assessment.⁵⁵

4.5 Limitations

No deduction is allowable under section 13sex for the cost of a residential unit or improvement to a residential unit if any of the cost has qualified or will qualify for deduction from the taxpayer's income as a deduction of expenditure or an allowance for expenditure under any other section of the Act,⁵⁶ for example, an allowance for the erection or improvement of buildings in urban development zones.⁵⁷

The aggregate of all deductions which may be allowed or deemed to have been allowed under section 13sex or any other section in respect of the cost of the residential unit or the improvement to the residential unit may not exceed that cost.⁵⁸ The limitation includes, for example, those allowances deemed to have been allowed for those years of assessments when the accruals and receipts of the taxpayer were not included in its income (see **4.3**).

⁵⁵ Section 13sex(5).

⁵⁶ Section 13sex(6).

⁵⁷ Section 13quat.

⁵⁸ Section 13sex(7).

4.6 Part acquisition

To the extent a taxpayer acquires a residential unit, or improvement to a residential unit, representing only a part of a building without erecting or constructing that unit or improvement, the cost of acquiring that part or improvement for the purposes of section 13sex is deemed to be –

- 55% of the acquisition price, for a unit being acquired;⁵⁹ and
- 30% of the acquisition price, for an improvement being acquired.⁶⁰

The reference to a residential unit representing only a part of a building would apply, for example, to the acquisition of a flat forming part of a block of flats under sectional title.⁶¹

The acquisition price is the actual cost to the taxpayer to acquire the residential unit or the improvement to a residential unit, representing part of a building. The “deemed cost” under section 13sex(8) will be regarded as cost for the purposes of the allowance.

The purpose of the limitation on cost to 55% of the acquisition price of such a unit is to ensure that the allowance is not calculated on the cost of the land which would be included in the acquisition price of the unit. In the absence of section 13sex(8) which deems the cost of part of the building, or the cost the improvement, to be equal to the amount calculated as indicated above, if the acquisition price included land it would need to be adjusted to exclude a portion in respect of the land.

Example 9 – Acquisition of a residential unit which is part of a building

Facts:

Company A acquires 6 new and unused apartments in a building at a purchase price of R320 000 each. The building, which is located in South Africa, has 30 apartments which are all used for purposes of residential accommodation.

Company A has rented the 6 apartments out at a rental of R3 200 per month.

Result:

Company A will qualify for the allowance of 5% under section 13sex(1) equal to 5% of the cost of the residential unit. Under section 13sex(8)(a) cost of a residential unit representing part of a building is deemed to be equal to 55% of the acquisition price.

Cost of the 6 residential units = $55\% \times (R320\,000 \times 6) = R1\,056\,000$

Allowance under section 13sex(1): $R\,1\,056\,000 \times 5\% = R52\,800$ per annum

An additional allowance under section 13sex(2) may be claimed as the apartments qualify as low cost residential units: $R\,1\,056\,000 \times 5\% = R52\,800$ per annum

⁵⁹ Section 13sex(8)(a).

⁶⁰ Section 13sex(8)(b).

⁶¹ Depending on the facts, a unit in a sectional title scheme can relate to part of a building or a whole building.

Example 10 – Acquisition of an improvement to a residential unit which is part of a building

Facts:

Company A acquired a new and unused one-bedroom apartment in a block of flats two years ago at a cost of R500 000 and rented it to a tenant at a monthly rental of R7 500.

The bedroom was exceptionally large so during the current year, when the tenant did not extend their lease, Company A contracted a builder to convert the bedroom into two bedrooms with permanent walls, doors, built-in cupboards and windows at a total cost of R100 000. On completion the two-bedroom flat was rented out at a monthly rental of R11 000.

Company A has 10 other apartments located in South Africa which are also rented out for the purposes of residential accommodation.

Result:

Company A will qualify for the allowance of 5% under section 13sex(1) equal to 5% of the cost of the apartment. Under section 13sex(8)(a) the cost of a residential unit representing part of a building is deemed to be equal to 55% of the acquisition price.

Cost of the residential unit = 55% × R500 000 = R275 000

Allowance under section 13sex(1): R275 000 × 5% = R13 750 per annum

In relation to the improvement, the allowance will be based on the actual cost of R100 000 because it resulted from construction performed by the builder on behalf of Company C and therefore section 13sex(8) is not applicable.

Cost of the improvement to the residential unit R100 000

Allowance under section 13sex(1): R100 000 × 5% = R5 000 per annum

The apartment does not meet the definition of a low cost residential unit and therefore the additional allowance under section 13sex(2) is not available for the residential unit or the improvement to the residential unit.

5. Section 13sex allowance and intra-group transactions

Section 45 of the Act provides for corporate rollover relief for the transfer of assets between companies forming part of the same group of companies. In order to qualify for the rollover relief the transaction must meet the requirements of the definition of an “intra-group transaction” in section 41(1) and the other requirements of section 45.

Briefly, if rollover relief applies and the transferor company disposes of a capital asset (for example, a residential unit owned by the transferor company) which the transferee company acquires as a capital asset, the transferor company is, amongst other aspects, deemed to have disposed of that capital asset at base cost.

In addition, section 45(3) applies to capital assets which constitute an “allowance asset” as defined in section 45(1). A residential unit in respect of which a deduction was allowable under section 13sex is an allowance asset. Section 45(3) provides, amongst others, that if a transferor company transfers an allowance asset and the transferee company acquires it as an allowance asset then –

- no allowance allowed to the transferor company for that asset will be recovered, recouped or included in income of the transferor company in the year of the transfer; and
- the transferor company and the transferee company are deemed to be one and the same person for purposes of determining the amount of any allowance to which the transferee company may be entitled and which may be recovered, recouped or included in the transferee company’s income in respect of that asset.

The effect of the last bullet point, in context of a residential unit for which the transferor company qualified for a deduction under section 13sex being transferred, is that the transferee company will be seen to have met the “new and unused” requirement in section 13sex and “cost” will be cost as initially determined for the transferor company. This means that provided the transferee company continues to meet the other requirements of section 13sex (for example, continued to use it solely for the purposes of trade and has 5 residential units in the Republic), it will be entitled to the remaining deduction under section 13sex on the transferred allowance asset to which the transferor company would have been entitled had it retained ownership and continued to use the asset in a qualifying manner. The total of the deductions allowed or deemed to have been allowed under section 13sex and any other section for the transferor company and the transferee company may not exceed cost as initially determined under section 13sex for the transferor company.

The amount of any deduction claimed by the transferor company and the amount of any deduction claimed by the transferee company may, depending on the facts, be recouped by the transferee company even though it did not actually claim the deductions before the intra-group transaction occurred.

Section 42 (asset-for-share transactions), section 44 (amalgamation transactions) and section 47 (liquidation, deregistration and winding-up transactions) have similar provisions in relation to allowance assets.

6. Allowance under section 13ter allowance

A residential building annual allowance and initial allowance were available under section 13ter to a taxpayer that erected residential units on or after 1 April 1982 and before 21 October 2008 under a housing project.

Section 13ter was not repealed and continues to be applicable to those units erected between the above-mentioned dates. Any residential unit acquired, or the erection of which commenced, on or after 21 October 2008 can qualify for an allowance under the section 13sex provided all the requirements of the section are met.

Example 11 – Residential units purchased under section 13ter*Facts:*

Company A erected 5 residential units in South Africa. Construction commenced before 21 October 2008 and all of the units qualified for the section 13ter allowances.

Company A sold one of these units in November 2008 and acquired ownership of a new residential unit located in South Africa in the same month.

Result:

Company A continues to apply the 2% annual allowance under section 13ter on the remaining 4 units purchased before 21 October 2008. The section 13ter recoupment provision will apply to the initial allowance claimed on the unit sold. In addition, depending on the detailed facts relating to the disposal, a section 8(4)(a) recoupment may apply to the initial allowance to the extent it was not recouped under section 13ter and the annual building allowance.

Assuming the detailed requirements of section 13sex are met, the residential unit acquired in November 2008 will qualify for the section 13sex allowance at 5% as the 4 residential units qualifying for the 13ter allowance meet the definition of “residential unit” in section 1(1) and Company A therefore owns 5 residential units in South Africa.

7. General recoupment provision

Under section 8(4)(a) there must be included in a taxpayer’s income (subject to certain exceptions) all amounts allowed to be deducted or set off in the current or any previous year of assessment that have been recovered or recouped during the current year of assessment.

Section 8(4)(a) will apply upon the disposal of the building if it is disposed of for an amount in excess of its tax value.⁶² In summary, the amount of the recoupment will be equal to the amount the building is disposed of (limited to the cost of the building) less its tax value. In limited circumstances the recognition of the recoupment may be deferred.⁶³

8. Conclusion

Section 13sex provides for an allowance on any new and unused residential unit or new and unused improvements effected to existing residential units that are used by the taxpayer solely for purposes of a trade. The unit or improvement must be owned by the taxpayer and it must have been acquired, or the erection commenced, on or after 21 October 2008. In addition, the unit must be situated in South Africa and the taxpayer must own at least 5 units in the Republic that are used by the taxpayer for the purposes of trade.

The allowance available under section 13sex is equal to 5% per year of the cost of the residential unit or improvement to the residential unit. Cost is the lesser of actual cost or cost in an arm’s length transaction. Once a building has been disposed of the

⁶² Tax value means the amount remaining after reducing the cost of the building by the cumulative deductions under section 13sex and other sections on that asset.

⁶³ See section 8(4)(e).

taxpayer is not entitled to a deduction under section 13sex. An additional allowance of 5% is available if the residential unit qualifies as a low-cost residential unit.

The section makes provision for an allowance on a building and part of a building owned by the taxpayer. A residential unit is defined as a building or a self-contained apartment mainly used for residential accommodation, unless it is used in carrying on a trade as a hotel keeper.

Section 13sex is subject to section 36, which means that section 36 takes precedence for the deduction of expenditure incurred in a mining operation for the provision of residential accommodation for employees and the furniture for such accommodation.

A residential unit which qualified for an allowance under section 13ter before 21 October 2008 and continues to meet the requirements of that section will still qualify for an allowance under that section. Section 13sex potentially applies to all acquisitions and erections of residential units and improvements to residential units after 21 October 2008.

The total deduction available under section 13sex and other sections on a residential unit or improvement to a residential unit is limited to cost. This includes deductions which, although not allowed under section 13sex in previous years of assessment, are specifically deemed to have been allowed for purposes of section 13sex.

If a transferor company transfers an allowance asset in an intra-group transaction that meets the requirement of section 45 and the relief applies, the transferor company and the transferee company are deemed to be one and the same persons with regards to calculating the amount of any deduction to which the transferee company is entitled and the amount of the recoupment if, for example, the transferee company disposes of the residential unit. Similar provisions are contained in sections 42, 44 and 47.

The deductions claimed under section 13sex are subject to potential recoupment under section 8(4)(a). The deductions deemed to have been claimed under section 13sex(4) are not subject to recoupment under section 8(4)(a).

The allowance may not be claimed if the cost of the residential unit or improvement to the residential, or any part thereof, qualifies or will qualify for a deduction or allowance under any other section of the Act.

Annexure – The law

Section 1

“low-cost residential unit” means—

- (a) an apartment qualifying as a residential unit in a building located within the Republic, where—
 - (i) the cost of the apartment does not exceed R350 000; and
 - (ii) the owner of the apartment does not charge a monthly rental in respect of that apartment that exceeds one per cent of the cost; or
- (b) a building qualifying as a residential unit located within the Republic, where—
 - (i) the cost of the building does not exceed R300 000; and
 - (ii) the owner of the building does not charge a monthly rental in respect of that building that exceeds one per cent of the cost contemplated in subparagraph (i) plus a proportionate share of the cost of the land and the bulk infrastructure:

Provided that for the purposes of paragraphs (a)(ii) and (b)(ii), the cost is deemed to be increased by 10 per cent in each year succeeding the year in which the apartment or building is first brought into use;

“residential unit” means a building or self-contained apartment mainly used for residential accommodation, unless the building or apartment is used by a person in carrying on a trade as an hotel keeper;

13sex. Deduction in respect of certain residential units.—(1) Subject to section 36, there must be allowed to be deducted from the income of a taxpayer an allowance equal to five per cent of the cost to the taxpayer of any new and unused residential unit (or of any new and unused improvement to a residential unit) owned by the taxpayer if—

- (a) that unit or improvement is used by the taxpayer solely for the purposes of a trade carried on by the taxpayer;
- (b) that unit is situated within the Republic; and
- (c) the taxpayer owns at least five residential units within the Republic, which are used by the taxpayer for the purposes of a trade carried on by the taxpayer:

Provided that if a taxpayer completes an improvement as contemplated in section 12N, the expenditure incurred by the taxpayer to complete the improvement shall be deemed to be the cost to the taxpayer of any new and unused residential unit (or of any new and unused improvement to a residential unit), for the purposes of this section.

(2) There shall be allowed to be deducted from the income of the taxpayer an additional allowance of five per cent of the cost of a low-cost residential unit of a taxpayer for a year of assessment if deductions are allowable to that taxpayer in respect of that unit in terms of subsection (1) during that year of assessment.

(3) For the purposes of this section, the cost to the taxpayer of a residential unit (or an improvement thereto) shall be deemed to be the lesser of the actual cost to the taxpayer or the cost which a person would, if that person had acquired or improved the residential unit under a cash transaction concluded at arm's length on the date on which the transaction for the acquisition of the new and unused residential unit (or of the new and unused improvement to the residential unit) was in fact concluded, have incurred in respect of the direct cost of the acquisition or erection of the residential unit or improvement.

(4) Where any residential unit (or an improvement to the residential unit) in respect of which any deduction is claimed in terms of this section was during any year of assessment used by the taxpayer for the purpose of any trade carried on by that taxpayer, the receipt and accruals of which were not included in the income of that taxpayer during that year, any deduction which could have been allowed in terms of this section during that year or any subsequent year in which that residential unit (or an improvement to the residential unit) was used by the taxpayer shall for the purposes of this section be deemed to have been allowed during that previous year or those years as if the receipts and accruals of that trade had been included in the income of that taxpayer.

(5) No deduction shall be allowed under this section in respect of the cost of any residential unit (or an improvement to a residential unit) that has been disposed of by the taxpayer during any previous year of assessment.

(6) No deduction shall be allowed under this section in respect of the cost of a residential unit (or an improvement to a residential unit) if any of the cost has qualified or will qualify for deduction from the taxpayer's income as a deduction of expenditure or an allowance in respect of expenditure under any other section of this Act.

(7) The deductions which may be allowed or deemed to have been allowed in terms of this section and any other provision of this Act in respect of the cost of any residential unit (or any improvement to a residential unit) shall not in the aggregate exceed the amount of such cost.

(8) For the purposes of this section, to the extent that the taxpayer acquires a residential unit (or improvement to a residential unit) representing only a part of a building without erecting or constructing that unit or improvement—

(a) 55 per cent of the acquisition price, in the case of the unit being acquired; and

(b) 30 per cent of the acquisition price, in the case of the improvement being acquired,

is deemed to be the cost incurred by that taxpayer in respect of that unit or improvement, as the case may be.