

**DRAFT INTERPRETATION NOTE**

DATE:

**ACT : INCOME TAX ACT 58 OF 1962**  
**SECTIONS : SECTIONS 12N AND 12NA**  
**SUBJECT : DEDUCTIONS IN RESPECT OF IMPROVEMENTS TO LAND OR BUILDINGS NOT OWNED BY A TAXPAYER**

**CONTENTS**

	<b>PAGE</b>
<i>Preamble</i> .....	2
1. Purpose .....	2
2. Background .....	2
3. The law .....	3
4. Application of the law .....	3
4.1 Meaning of Public Private Partnership .....	3
4.2 Meaning of improvement .....	5
5. Application of section 12N .....	6
5.1 Requirements of section 12N .....	6
5.1.1 Right of use or occupation of land or a building .....	8
5.1.2 Effect an improvement to the land or building under one of the specified methods ...	8
5.1.3 Incurs expenditure to effect the improvement .....	10
5.1.4 Uses or occupies the land or building for a specified purpose .....	10
5.2 Exclusions from section 12N .....	11
5.3 The extent of the allowance facilitated by section 12N .....	11
6. Application of section 12NA .....	12
6.1 Requirements of section 12NA .....	12
6.2 Right of use or occupation .....	12
6.4 Exclusions from section 12NA .....	12
6.5 The extent of the allowance under section 12NA .....	13
7. Comparison of section 12N and 12NA .....	14
8. Conclusion .....	15

### **Preamble**

In this Note unless the context indicates otherwise –

- “**lease agreement**” means an agreement under which the right of use or occupation of land or a building is granted;
- “**PPP**” means a “Public Private Partnership” as defined in section 1(1) (see 4.1);
- “**section**” means a section of the Act;
- “**state**” means the government of the Republic in the national, provincial or local sphere;
- “**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.

All interpretation notes referred to in this Note are available on the SARS website at [www.sars.gov.za](http://www.sars.gov.za). Unless indicated otherwise, the latest issues of these documents should be consulted.

## **1. Purpose**

This Note provides guidance on the interpretation and application of –

- section 12N, which facilitates allowances under specified sections of the Act for improvements made to land or buildings not owned by a taxpayer but over which the taxpayer holds a right of use or occupation. The improvement must be effected under a PPP, a lease agreement with the state or certain other tax-exempt statutory bodies and the state or that body owns the land or building, or under the Independent Power Producer Procurement Programme.
- section 12NA, which deals with deductions for improvements effected under a PPP by a person to land or to a building over which the state holds the right of use or occupation.

Other sections in the Act, which potentially provide an allowance on improvements to land or buildings not owned by the taxpayer, include section 11(g) and section 13*bis*. These sections are not dealt with in this Note. See Interpretation Note 110 “Leasehold Improvements” and Interpretation Note 105 “Deductions in respect of Buildings used by Hotelkeepers”.

## **2. Background**

The Act provides for a variety of depreciation allowances for the creation or acquisition of qualifying movable or immovable assets. In order to qualify for these allowances, the taxpayer must generally be the owner of the assets. 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.

Often lease agreements of immovable property require the lessee to effect improvements on land or to buildings as part of the obligations under the agreement. The problem with such an arrangement is that the land belongs to the lessor and the improvements become the property of the lessor when effected. The lessor is not entitled to use the improvements until the lease expires and as the lessee is not the

owner, many allowances are not applicable. In order to address these issues the Act contains specific provisions relating to leasehold improvements.<sup>1</sup>

In relation to the lessee, section 11(g) provides for a deduction of expenditure actually incurred by a lessee in pursuance of an obligation to effect improvements on land or to buildings under an agreement under which the right of use or occupation of the land or buildings is granted by the lessor.<sup>2</sup>

The allowance under section 11(g) does not, however, apply if the value of the improvements effected by the lessee does not constitute income of the lessor.<sup>3</sup> A taxpayer effecting leasehold improvements to land owned by the state would not be able to secure a deduction under section 11(g), since the state is exempt from tax under section 10(1)(a). In order to encourage private sector participation in government projects it was therefore necessary to introduce specific legislation to enable taxpayers to secure deductions for leasehold improvements effected to state-owned land or buildings.

Section 12N does not provide for a deduction, however it was introduced to facilitate allowances available under other sections on improvements not owned by a taxpayer.<sup>4</sup> With effect from 4 July 2013, section 12N was amended to facilitate allowances on expenditure incurred under an obligation or voluntarily by a lessee to effect improvements on leased land or buildings.<sup>5</sup>

With effect from 1 January 2013, section 12NA was introduced to provide for a deduction when a person is under an obligation under a PPP to effect an improvement to land or a building over which the state holds the right of use or occupation.

### 3. The law

Sections 12N and 12NA are quoted in the **Annexure**.

### 4. Application of the law

Central to section 12N and 12NA are the concepts of a Public Private Partnership and improvements to land or buildings. These concepts will be considered below (see **4.1** and **4.2**) before section 12N and 12NA are considered in detail.

#### 4.1 Meaning of Public Private Partnership

A “PPP” is defined in section 1(1) as follows:

“ **Public Private Partnership**’ means a Public Private Partnership as defined in—

- (a) Regulation 16 of the Treasury Regulations issued in terms of section 76 of the Public Finance Management Act; or

---

<sup>1</sup> See paragraph (h) of the definition of “gross income” in section 1(1) as well as section 11(g) and section 11(h).

<sup>2</sup> See Interpretation Note 110 “Leasehold Improvements” for more detail.

<sup>3</sup> Section 11(g)(vi).

<sup>4</sup> Section 12N was inserted by section 29(1) of the Taxation Laws Amendment Act 7 of 2010 with effect from the date of promulgation of that Act, 2 November 2010, and applies to a right of use or occupation granted on or after that date.

<sup>5</sup> See section 40 of the Taxation Laws Amendment Act 31 of 2013 which amended section 12N(1)(b) by deleting the words “incurs an obligation to effect”.

- (b) the Municipal Public-Private Partnership Regulations made in terms of section 168 of the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003);”

Treasury Regulation 16<sup>6</sup> defines a “PPP” as –

“a commercial transaction between an institution<sup>7</sup> and a private party<sup>8</sup> in terms of which the private party—

- (a) performs an institutional function on behalf of the institution; and/or
- (b) acquires the use of state property for its own commercial purposes; and
- (c) assumes substantial financial, technical and operational risks in connection with the performance of the institutional function and/or use of state property; and
- (d) receives a benefit for performing the institutional function or from utilising the state property, either by way of:
  - (i) consideration to be paid by the institution which derives from a revenue fund or, where the institution is a national government business enterprise or a provincial government business enterprise, from the revenues of such institution; or
  - (ii) charges or fees to be collected by the private party from users or customers of a service provided to them; or
  - (iii) a combination of such consideration and such charges or fees”.

The activities carried on under PPPs can be divided into two categories, namely –

- an “institutional function” that involves the performance by a private party of a public or state function; and
- the “use of state property” that involves the use of state property by a private party for own commercial purposes.

The first category includes a service, task, assignment or other function that an institution is entitled or required to perform in the “public interest”; or any part or component of any service, task, assignment or other function performed or to be performed in support of such a service, task, assignment or other function.<sup>9</sup> The second category involves the use of state property in a variety of forms, for example, under a lease or concession. State property covers all movable and immovable property belonging to the state including intellectual property rights.<sup>10</sup>

---

<sup>6</sup> GNR 225 GG 27388 of 15 March 2005.

<sup>7</sup> Per Regulation 16, GNR 225 GG 27388 of 15 March 2005, “institution” means a department, a constitutional institution, a public entity listed, or required to be listed in Schedules 3A, 3B, 3C and 3D to the Act (Public Finance Management Act, 1 of 1999), or any subsidiary of any such public entity.

<sup>8</sup> Certain parties are specifically excluded from being a private party, for example, another institution or municipal entity under control of a municipality – see Regulation 16, GNR 225 GG 27388 of 15 March 2005, for full definition.

<sup>9</sup> Definition of “institutional function” in Regulation 16, GNR 225 GG 27388 of 15 March 2005.

<sup>10</sup> Definition of “state property” in Regulation 16, GNR 225 GG 27388 of 15 March 2005.

The Municipal Public-Private Partnership Regulations<sup>11</sup> define a “public-private partnership” as follows:

“**[P]ublic-private partnership**’ means a commercial transaction between a municipality and a private party in terms of which the private party—<sup>12</sup>

- (a) performs a municipal function for or on behalf of a municipality, or acquires the management or use of municipal property for its own commercial purposes, or both performs a municipal function for or on behalf of a municipality and acquires the management or use of municipal property for its own commercial purposes; and
- (b) assumes substantial financial, technical and operational risks in connection with—
  - (i) the performance of the municipal function;
  - (ii) the management or use of the municipal property; or
  - (iii) both; and
- (c) receives a benefit from performing the municipal function or from utilising the municipal property or from both, by way of—
  - (i) consideration to be paid or given by the municipality or a municipal entity under the sole or shared control of the municipality;
  - (ii) charges or fees to be collected by the private party from users or customers of a service provided to them; or
  - (iii) a combination of the benefits referred to in subparagraphs (i) and (ii);”

Not every transaction between an institution or municipality and a private party constitutes a PPP for purposes of sections 12N and 12NA. The following will, for example, not meet the definition of a PPP:

- A simple outsourcing of functions when substantial financial, technical and operational risk is retained by the state department.
- A donation by a private party for a public good.
- The commercialisation of a public function by the creation of a state-owned enterprise.

## 4.2 Meaning of improvement

The word “improvement” is not defined in the Act. It is described in the *New Oxford Thesaurus of English*<sup>13</sup> 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”.

---

<sup>11</sup> GNR 309 GG 27431 of 1 April 2005.

<sup>12</sup> The definition of municipal function, municipal property and private property is similar to the equivalent term in the definition of PPP under Rule 16 referred to above – see GNR 309 GG 27431 of 1 April 2005 for the full definitions.

<sup>13</sup> Patrick Hanks (2000) Oxford University Press Inc.

For the purposes of section 13, however, “improvements” is defined as follows:<sup>14</sup>

“**[I]mprovements**, in relation to any improvements commenced on or after the first day of April, 1971, means any extension, addition or improvements (other than repairs) to a building which is or are effected for the purpose of increasing or improving the industrial capacity of the building;”

In the context of this Note, an example of a typical arrangement encountered would be the construction of improvements such as toll roads, hospitals and prisons on land belonging to the state (section 12N) or over which the state has a right of use or occupation (section 12NA).

## 5. Application of section 12N

### 5.1 Requirements of section 12N

In order for section 12N to apply, a taxpayer must –

- hold a right of use or occupation of land or a building;<sup>15</sup>
- effect an improvement on the land or to the building under –<sup>16</sup>
  - a PPP;<sup>17</sup>
  - a lease agreement for land or buildings owned by the government of the Republic in the national, provincial or local sphere<sup>18</sup> or any entity of which the receipts and accruals are exempt from tax under section 10(1)(cA) or (t);<sup>19</sup> or
  - the Independent Power Producer Procurement Programme administered by the Department of Energy;<sup>20</sup>
- incur expenditure to effect the improvements;<sup>21</sup> and
- use or occupy the land or building for the production of income or derive income from the land or building.<sup>22</sup>

A taxpayer meeting the above requirements is deemed to be the owner of the completed improvements for purposes of the following sections and will be entitled to claim an allowance on the cost of the improvements if the requirements of these sections are met:

- Deductions in respect of scientific or technological research and development (section 11D)
- Deduction in respect of certain machinery, plant, implements, utensils and articles used in farming or production of renewable energy (section 12B)

---

<sup>14</sup> See section 13(9).

<sup>15</sup> Section 12N(1)(a).

<sup>16</sup> Section 12N(1)(b).

<sup>17</sup> Section 12N(1)(b)(i).

<sup>18</sup> Section 12N(1)(b)(ii)(aa).

<sup>19</sup> Section 12N(1)(b)(ii)(bb).

<sup>20</sup> Section 12N(1)(b)(iii). Applicable to obligations incurred on or after 1 January 2013.

<sup>21</sup> Section 12N(1)(c).

<sup>22</sup> Section 12N(1)(e).

- Deduction in respect of assets used by manufacturers or hotelkeepers and in respect of aircraft and ships, and in respect of assets used for storage and packing of agricultural products (section 12C)
- Deduction in respect of certain pipelines, transmission lines and railway lines (section 12D)
- Deduction in respect of airport and port assets (section 12F)
- Additional investment and training allowances in respect of industrial policy projects (section 12I)
- Deduction in respect of buildings in special economic zones (section 12S)
- Deductions in respect of buildings used in a process of manufacture (section 13)
- Deductions in respect of residential buildings (section 13*ter*)
- Deductions in respect of erection or improvement of buildings in urban development zones (section 13*quat*)
- Deduction in respect of commercial buildings (section 13*quin*)
- Deduction in respect of certain residential units (section 13*sex*)
- Calculation of redemption allowance and unredeemed balance of capital expenditure in connection with mining operations (section 36)

If, after treating the taxpayer as the owner of the improvement, the taxpayer meets the requirements of a section specified above, the allowance available, for example the percentage and the period over which the allowance can be claimed, is determined under the specified section.

In addition, the taxpayer effecting the improvements is deemed to be the owner of the improvements for the purposes of the Eighth Schedule to the Act.<sup>23</sup>

Under section 12N(2) if the right of use or occupation is terminated, the taxpayer is deemed to have disposed of the improvements to the owner of the land or building on the later of the date when –<sup>24</sup>

- the right of use or occupation terminated; or
- the use or occupation ended.

For example, assume that a lessee effects improvements to state land in the form of a building under a 15-year lease. At the end of year 14 the lessee ceases to operate the business and vacates the premises. Under these circumstances the lessee is deemed to dispose of the improvements on the later of the date when the right of use or occupation terminated (end of year 15) or the date when the use or occupation ended (end of year 14).

---

<sup>23</sup> Section 12N(1).

<sup>24</sup> Section 12N(2)(a).

Should the lessee, on termination of the right of use or occupation, continue to use or occupy the land or building or renew such right, the renewed right is deemed to be the same as the right previously held.<sup>25</sup> This means there will only be a deemed disposal of the improvement under section 12N(2) on the later of the termination of the renewed right of use or occupation and the termination of the use or occupation.

The purpose of the deemed disposal rule is to terminate the deemed ownership of the improvements. Section 12N(2) does not specify a deemed consideration for the deemed disposal of the improvements. Depending on the facts and circumstances of the particular case, the taxpayer will need to consider whether there is a recoupment or scrapping allowance and possibly a capital gain or loss on disposal.

The tax consequences of any consideration received from the lessor as compensation for the improvements, whether upfront or upon termination, must be considered and taken into account as well as the potential impact on the allowances available under the sections mentioned above. It is beyond the scope of this Note, but, for example, government grants are often exempt for the taxpayer receiving the grant, however, there is an impact on the amount of the allowance available under the relevant allowance sections.<sup>26</sup>

### **5.1.1 Right of use or occupation of land or a building**

The taxpayer must hold a right of use or occupation. The right of use or occupation entitles the taxpayer to use or occupy another's property but not to become the owner of such property.

### **5.1.2 Effect an improvement to the land or building under one of the specified methods**

The improvement to the land or building must be effected in terms of –<sup>27</sup>

- a PPP;
- a lease agreement for land or buildings owned by –
  - the government of the Republic in the national, provincial or local sphere;<sup>28</sup> or
  - any entity of which the receipts and accruals are exempt from tax under section 10(1)(cA) or (f);<sup>29</sup> or
- the Independent Power Producer Procurement Programme administered by the Department of Energy.

Before 4 July 2013 this requirement was met only if the taxpayer incurred an obligation to effect the improvement in terms of the above-mentioned partnerships, agreements or Programme. On or after 4 July 2013, section 12N was amended to include improvements effected in terms of an obligation or voluntarily in terms of the above-mentioned partnerships, agreements or Programme.

---

<sup>25</sup> Section 12N(2)(b).

<sup>26</sup> Refer to section 12P.

<sup>27</sup> Section 12N(1)(b).

<sup>28</sup> Section 12N(1)(b)(ii)(aa).

<sup>29</sup> Section 12N(1)(b)(ii)(bb).



Although ITC 1188<sup>30</sup> dealt with the requirements of section 11(g), the same principles can be applied for establishing whether there is an obligation to effect improvements under section 12N.<sup>31</sup> Margo J explained the obligation as follows:<sup>32</sup>

“The absence of a right to claim specific performance or damages is therefore by itself not necessarily fatal to the appellant’s case, but the appellant has to establish that there was a legally enforceable obligation incurred by it to erect the building, and this it has failed to do. Indeed, the evidence is that it was specifically agreed that there was to be no enforceable obligation to build. The fact that the right of occupation could have been terminated if the building was not erected did not create a legally enforceable obligation to erect the building; nor was the power of the town council or of the central body to cancel the appellant’s right of occupation upon failure to erect the building agreed upon as an enforcement procedure in respect of any such obligation.”

An agreement that permits a person to make improvements is not tantamount to an obligation.<sup>33</sup> The obligation may be expressed or implied. A legal obligation may exist even if the agreement does not specify the detailed nature of the improvements to be effected.

The national sphere of government consists of the national state departments determined by the national executive authority.<sup>34</sup> The nine provinces<sup>35</sup> each have their own provincial governments and departments determined by the provinces’ executive authority. The local sphere of government consists of municipalities.

Section 10(1)(cA)(i)<sup>36</sup> refers to any institution, board or body (other than a company as defined in the Companies Act 71 of 2008, any co-operative, close corporation, trust or water services provider), established by or under any law and which, in the furtherance of its sole or principal object –

- conducts scientific, technical or industrial research;
- provides necessary or useful commodities, amenities or services to the state or members of the general public; or
- carries on activities (including the rendering of financial assistance by way of loans or otherwise) designed to promote commerce, industry or agriculture or any branch thereof.

Section 10(1)(cA)(ii) refers to any association, corporation or company contemplated in paragraph (a) of the definition of “company” in section 1(1), all the shares of which are held by any institution, board or body, if the operations of such association, corporation or company are ancillary or complementary to the object of such institution, board or body.

---

<sup>30</sup> (1972) 35 SATC 1850(T).

<sup>31</sup> Particularly relevant before 4 July 2013 when section 12N only included improvements effected under an obligation.

<sup>32</sup> At 155.

<sup>33</sup> See ITC 964 (1961) 24 SATC 709 (O).

<sup>34</sup> A list of all departments is available on the South African Government Online website at [www.gov.za](http://www.gov.za).

<sup>35</sup> Limpopo, Mpumalanga, Gauteng, North West, Free State, KwaZulu-Natal, Northern Cape, Eastern Cape and Western Cape.

<sup>36</sup> See requirements for qualification in section 10(1)(cA).

The entities referred to in section 10(1)(t) include, amongst others –<sup>37</sup>

- the Council for Scientific and Industrial Research;
- the South African Inventions Development Corporation;
- the South African National Roads Agency Limited;
- the Armaments Corporation of South Africa Limited; and
- the Development Bank of Southern Africa.

The Independent Power Producer Procurement Programme (IPPPP) has been designed to contribute towards the renewable energy industry in South Africa and towards socio-economic and environmentally sustainable growth. Technologies that potentially qualify under the programme include onshore wind, concentrated solar thermal, solar photovoltaic, biomass solid, biogas, landfill gas and small hydro.<sup>38</sup>

### 5.1.3 Incurs expenditure to effect the improvement

The taxpayer must have incurred expenditure in effecting the improvement. In *C: SARS v Labat Africa Ltd*<sup>39</sup> the Supreme Court of Appeal said that the term ‘expenditure’ is not defined in the Act and, being an ordinary English word, unless the context indicates otherwise, it must be given its ordinary meaning. The court went on to say the ordinary meaning refers to the action of spending funds, disbursement or consumption, and hence the amount of money spent.

The word “incurred” does not merely mean “paid”, but also means ‘the undertaking of an obligation to pay or the actual incurring of a liability’.<sup>40</sup> As long as there is an unconditional liability to pay, the amount is incurred. Actual payment is therefore not essential for the deduction of an expenditure provided the taxpayer has an unconditional liability to pay the amount.

### 5.1.4 Uses or occupies the land or building for a specified purpose

Under section 12N the taxpayer must use or occupy the land or building for the production of income or income must be derived from the land or building.

“Income” is defined in section 1(1) and means –

“the amount remaining of the gross income of any person for any year or period of assessment after deducting therefrom any amounts exempt from normal tax under Part I of Chapter II”.

Therefore, for example, if the relevant taxpayer earns exempt income this requirement would not be met.

---

<sup>37</sup> See the complete list of institutions in section 10(1)(t).

<sup>38</sup> Department of Energy, renewable energy website [www.ipp-renewables.co.za/](http://www.ipp-renewables.co.za/) [Accessed 13 January 2021]. Different programmes are run under the IPPPP, for example, the Coal baseload IPP Procurement programme and Renewable IPP Procurement programme.

<sup>39</sup> 2013 (2) SA 33 (SCA), 74 SATC 1.

<sup>40</sup> *Ackermans v C:SARS* 2011 (1) SA 1 (SCA), 73 SATC 1.

## 5.2 Exclusions from section 12N

Section 12N does not apply if the taxpayer –

- carries on any banking, financial services or insurance business;<sup>41</sup> or
- enters an agreement under which the right of use or occupation is granted to any other person,<sup>42</sup> that is, any sub-letting is prohibited, subject to the exception indicated below.

The taxpayer may grant the right of use to another person only if –

- the land and building is occupied by that other person and that other person is a company which is a member of the same “group of companies” as defined in section 1(1) as the taxpayer;<sup>43</sup>
- the cost of maintaining the land or building and of carrying out repairs in consequence of normal wear-and-tear is carried by the taxpayer;<sup>44</sup> and
- except for any claim that the taxpayer may have against the other person by reason of the other person’s failure to take proper care of the land or building, the risk of destruction or loss of or other disadvantage to the land or building is not assumed by that other person.<sup>45</sup>

## 5.3 The extent of the allowance facilitated by section 12N

As noted in 5.1, a taxpayer falling within section 12N is deemed to be the owner of the improvement and potentially qualifies for a capital allowance on the cost of the improvements made to the land or buildings under one of the specified allowance provisions. The amount of the allowance and the period over which it may be claimable is determined under the specified allowance provision.

### **Example 1 – Taxpayer enters into a lease with a sphere of government under a PPP (section 12N)**

*Facts:*

Company A enters into a lease agreement under a PPP with its local municipality, the terms of which are that Company A will lease a building from the municipality, effect improvements to the amount of R100 000 and use the building for its business activities. The building is located in an urban development zone.

*Result:*

Although Company A is neither the owner of the land on which the building has been erected nor the owner of the building, section 12N deems Company A to be the owner of the improvements. This deemed ownership enables Company A to potentially claim an allowance of 20% a year on the cost of improving the building under section 13*quat*.

<sup>41</sup> Section 12N(3)(a).

<sup>42</sup> Section 12N(3)(b).

<sup>43</sup> Section 12N(3)(b)(i).

<sup>44</sup> Section 12N(3)(b)(ii).

<sup>45</sup> Section 12N(3)(b)(iii).

**Example 2 – Taxpayer enters into a lease with a sphere of government and sublets to a company that is not part of the same group of companies (section 12N)**

*Facts:*

Company A enters into a lease agreement under a PPP with its local municipality, the terms of which are that Company A will lease a building from the municipality, effect improvements to the building in the amount of R100 000 and use the building for its business activities. Company A intends sub-letting the building, which could qualify for a section 13quin allowance, to Company B. Company B is not part of the same group of companies as Company A.

*Result:*

Company A intends sub-letting the building to Company B, which is not part of the same group of companies as Company A. In these circumstances section 12N(3)(b) provides that section 12N does not apply and Company A will not be entitled to an allowance under section 13quin, since ownership is one of the requirements for deduction.

## **6. Application of section 12NA**

### **6.1 Requirements of section 12NA**

Under section 12NA a person is entitled to a deduction from income for expenditure actually incurred by that person in effecting an improvement to land or a building if –

- the person is obliged to effect that improvement under a PPP; and
- the government of the Republic in the national, provincial or local sphere holds the right of use or occupation of that land or building.<sup>46</sup>

### **6.2 Right of use or occupation**

Section 12NA requires that the state must hold the right of use or occupation over the land or building. The taxpayer is not required to have any interest in the land or building, whether as a lessor or lessee.

### **6.3 Obligation to effect improvement**

Section 12NA will apply only if the expenditure is actually incurred under an obligation on a taxpayer to effect the improvement in terms of a PPP.<sup>47</sup> See 5.1.2 for commentary on what constitutes an obligation to effect an improvement.

### **6.4 Exclusions from section 12NA**

The allowance under section 12NA cannot be claimed if the taxpayer carries on any banking, financial services or insurance business.<sup>48</sup> This exclusion is intended to counter what in essence are financing arrangements with a sphere of government.

---

<sup>46</sup> Section 12NA(1).

<sup>47</sup> Section 12NA(1).

<sup>48</sup> Section 12NA(4).

## 6.5 The extent of the allowance under section 12NA

The amount deductible in any year of assessment is determined on a straight-line basis by dividing the expenditure actually incurred in effecting an improvement by the lesser of the number of years over which the taxpayer will derive income under the PPP agreement or 25 years.<sup>49</sup>

The aggregate allowable deduction is limited to the actual expenditure incurred.

### **Example 3 – Taxpayer enters into a PPP with a sphere of government and does not hold a right of use or occupation (section 12NA)**

#### *Facts:*

On 1 January Year 1 Company A entered into a 20 year PPP with its local municipality under which Company A will finance, design, construct, operate and maintain a new serviced head office building for the local municipality on land owned by the government. Company A will have access to the new building exclusively for purposes of providing the services but will not hold any right of use or occupation over the land or building. Company A erected the building at a total cost of R6 million, completing the erection on 31 December Year 2.

*Company A's year of assessment ends on 31 December.*

#### *Result:*

Under section 12NA(2) Company A is entitled to claim the cost of the improvements over the number of years for which income will be derived under the PPP or 25 years, whichever is the lesser. The claim in Year 1, 2, 3 and 4 is calculated below, the same principles apply in later years. The aggregate allowable deduction is limited to R6 million.

#### Year 1

No allowance – the improvement is still under construction and the taxpayer has not derived any income.

#### Year 2

No allowance – the improvement was completed on the last day of the year of assessment but the taxpayer has not derived any income.

#### Year 3

R6 million / 18\* = R333 333

\* The contract was 20 years but during the first two years the building was under construction and it is only in Year 3 – Year 20 that the taxpayer will derive income.

#### Year 4

R6 million / 18 = R333 333

---

<sup>49</sup> Section 12NA(2).

Before 1 January 2016, if an amount that was exempt from tax under section 10(1)(z) was received by or accrued to the taxpayer from the relevant government body (that is, a grant) for the purpose of effecting an improvement to land or a building or to defray the cost of any improvements under the relevant PPP, the expenditure deducted under section 12NA had to be reduced by an amount equal to the exempt amount.<sup>50</sup>

On or after 1 January 2016 the aggregate amount that may be claimed as a deduction is limited to the cost of the improvements less the amount of the grant under section 12P(4).

**Example 4 – Taxpayer enters into a PPP with a sphere of government, does not hold a right of use or occupation and government makes a capital contribution (section 12NA)**

*Facts:*

On 1 January 2020 Company A entered into a PPP with its local municipality under which Company A will finance, design, construct, operate and maintain a new serviced head office building for the local municipality on land owned by the government. Company A will have access to the new building exclusively for purposes of providing the services but will not hold any right of use or occupation over the land or building. The municipality made a capital contribution of R2 billion to be used by Company A towards the cost of the improvements to the land. In addition, the municipality will pay a monthly fee, which will fund monthly operating costs, over 25 years amounting to R18 billion.

*Result:*

Under section 12NA(2) Company A is entitled to claim the cost of the improvements over the period of the agreement or 25 years, whichever is the lesser.

The capital contribution from the Municipality of R2 billion for the purpose of effecting improvements is exempt from normal tax in Company A under section 12P(2A). Under section 12P(4) the aggregate capital allowances to which Company A will be entitled under section 12NA(2) are limited to the cost of the improvements less the exempt grant of R2 billion. The monthly payments will be taxable in the hands of Company A.

## 7. Comparison of section 12N and 12NA

Section 12NA is similar to section 12N in that it also deals with improvements to land or a building not owned by the taxpayer. Section 12NA, however, differs in four main respects from section 12N, namely –

- section 12NA applies to PPP's only, while section 12N also applies to other arrangements such as a lease of state-owned land (see **5.1**);
- section 12NA applies when the property is used or occupied by any of the three spheres of government, while section 12N requires that the taxpayer must hold the right of use or occupation of land or a building (see **5.1.1**),

---

<sup>50</sup> Section 12NA(3).

- section 12NA requires the taxpayer to incur the expenditure in terms of an obligation in the PPP to effect the improvements, while on or after 4 July 2013 section 12N includes voluntary and obligatory improvements effected under the specified arrangements; and
- section 12NA is a self-contained deduction provision, while section 12N merely facilitates a deduction under other specified provisions.

## 8. Conclusion

Under section 11(g) a lessee is entitled to write off obligatory improvements over the period of the lease or 25 years, whichever is the lesser. Section 11(g) does not, however, apply when the lessor is a tax-exempt person and thus excludes, for example, lessees that effect improvements to state-owned property.

Section 12N was introduced to enable a lessee to claim capital allowances on leasehold improvements effected to land or buildings for which the taxpayer has a right of use or occupation and effects the improvements under a PPP, a lease agreement with the state or certain other tax-exempt statutory bodies if the state or entity owns the property, or under the Independent Power Producer Procurement Programme. It deems the lessee to be the owner of the improvements for the purposes of specified allowance provisions and the Eighth Schedule. Banks, financial service providers and insurers are excluded from section 12N. The improvement is deemed to be disposed of on the later of when the right of use or occupation is terminated or the use or occupation terminates. Depending on the facts, taxpayers may need to consider a potential recoupment or scrapping allowance, and capital gain or loss consequences. Sub-letting is impermissible except in specified circumstances between members of the same group of companies.

Section 12NA applies when government holds a right of use or occupation for land or buildings and a person effects obligatory improvements to that land or those buildings under a PPP. The amount deductible in any year of assessment is determined on a straight-line basis by dividing the expenditure actually incurred in effecting an improvement by the lesser of the number of years over which the taxpayer will derive income under the PPP agreement or 25 years.

A grant received or accrued for the purposes of effecting the improvements may be exempt from normal tax if it meets the requirements of section 10(1)(zl) (before 1 January 2016). Before 1 January 2016 the person must reduce the cost of the improvements for the purpose of determining the amount that may be claimed as a deduction under section 12NA(3). On or after 1 January 2016 the aggregate amount that may be claimed as a deduction is limited to the cost of the improvements less the amount of the grant under section 12P(4). Banks, financial service providers and insurers are excluded from section 12NA.

**Annexure – The law****12N. Deductions in respect of improvements not owned by taxpayer.—**(1) If a taxpayer—

- (a) holds a right of use or occupation of land or a building;
- (b) effects an improvement on the land or to the building in terms of—
  - (i) a Public Private Partnership;
  - (ii) an agreement in terms of which the right of use or occupation is granted, if the land or building is owned by—
    - (aa) the government of the Republic in the national, provincial or local sphere; or
    - (bb) any entity of which the receipts and accruals are exempt from tax in terms of section 10(1)(cA) or (t); or
  - (iii) the Independent Power Producer Procurement Programme administered by the Department of Energy;
- (c) incurs expenditure to effect the improvement contemplated in paragraph (b); and
- (d) ...
- (e) uses or occupies the land or building for the production of income or derives income from the land or building,

the taxpayer must, for the purposes of any deduction contemplated in section 11D, 12B, 12C, 12D, 12F, 12I, 12S, 13, 13*ter*, 13*quat*, 13*quin*, 13*sex* or 36, and for the purposes of the Eighth Schedule, be deemed to be the owner of the improvement so completed.

(2) (a) When the right of use or occupation terminates, the taxpayer must be deemed to have disposed of the improvement to the owner of the land or building on the later of the date when—

- (i) the right of use or occupation terminated; or
  - (ii) the use or occupation ended.
- (b) If the right of use or occupation terminates and the taxpayer—
- (i) continues to use or occupy the land or building; or
  - (ii) renews the right of use or occupation,

the renewed right of use or occupation must be deemed to be the same right of use or occupation as the right of use or occupation previously held by the taxpayer.

(3) This section does not apply if the taxpayer—

- (a) is a person carrying on any banking, financial services or insurance business; or
- (b) enters into an agreement whereby the right of use or occupation of the land or building is granted to any other person, unless—
  - (i) the land or building is occupied by that other person and that other person is a company that is a member of the same group of companies as that taxpayer in terms of such an agreement;
  - (ii) the cost of maintaining the land or building and of carrying out repairs thereto required in consequence of normal wear and tear is borne by the taxpayer; and
  - (iii) subject to any claim that the taxpayer may have against the other person by reason of the other person's failure to take proper care of the land or building, the risk of destruction or loss of or other disadvantage to the land or building is not assumed by that other person.



**12NA. Deductions in respect of improvements on property in respect of which government holds a right of use or occupation.**—(1) There shall be allowed to be deducted from the income of a person, expenditure actually incurred by that person to effect an improvement to land or to a building in terms of an obligation to effect those improvements to that land or to that building in terms of a Public Private Partnership if the government of the Republic in the national, provincial or local sphere holds the right of use or occupation of that land or building.

(2) The amount allowed to be deducted in terms of this section in respect of any year of assessment shall be equal to the amount of expenditure contemplated in subsection (1) that has not been allowed to be deducted in terms of this section, divided by the number of years (including that year of assessment) for which the taxpayer will derive income in respect of the Public Private Partnership in terms of the agreement or 25 years, whichever is the lesser.

(3) Where any amount as contemplated in section (10) (1) (z) is received by or accrues to a person from the government of the Republic in the national, provincial or local sphere for the purpose of effecting an improvement to land or a building or in respect of the defraying of the cost of any improvements in terms of the Public Private Partnership contemplated in subsection (1), the expenditure to be deducted in terms of this section shall be reduced in an amount equal to an amount that is exempt in terms of that section.

(4) This section shall not apply if the person effecting an improvement to land or to a building is a person carrying on any banking, financial services or insurance business.