

THE CONFLICT BETWEEN CERTAIN CAPITAL ALLOWANCES IN THE INCOME TAX ACT AND THE SPECIAL ECONOMIC ZONES POLICY OBJECTIVES

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SUMMARY

Through various incentives, special economic zones (SEZs) aim to promote industrial capacity development, create jobs and stimulate the South African economy. However, in practice, misalignment of tax legislation requirements with current practices may undermine the success of the SEZ programme. If property developers are unable to claim capital allowances for expenditure incurred on property developments within an SEZ, this acts as a disincentive to investment, which conflicts with the overarching rationale for the SEZ initiative. This study seeks to determine the extent to which current practices prevent property developers from claiming capital allowances for developments in SEZs, and to propose appropriate

remedies. The study presents a doctrinal analysis of the requirements of the SEZ Act and relevant provisions of the Income Tax Act in the context of current practices in SEZ development. The analysis demonstrates that, where the ownership of land designated for SEZ development is retained by government, property developer lessees may be unable to claim capital allowances in respect of expenditure incurred on property developments. This study therefore motivates for the removal of the ownership requirement from building allowance provisions of the Income Tax Act. This would align tax legislation with current practice and the policy objectives of the SEZ programme, as well as address the current inconsistency in the requirements of building allowances.

1 INTRODUCTION

Special economic zones (SEZs) are

“geographically designated areas of a country set aside for specifically targeted economic activities, which are then supported through special arrangements (which may include laws) and support systems to promote industrial development.”¹

Globally, SEZs share four characteristics: location in geographically delimited areas; the presence of multiple companies; a zone management facility or administration; and a government land policy.²

One key objective of SEZs is to increase foreign direct investment.³ Yet despite their proliferation across southern Africa in recent years, there is a lack of clear evidence that SEZs make a meaningful contribution to industrial output or employment. SEZs have been positioned as oases of efficient administration and infrastructure in the region, while the greater challenge of improving the investment proposition at the national level has not been adequately addressed.⁴

This notwithstanding, the South African government has through its budgetary allocation signalled its continued commitment to promoting economic and industrial development through SEZs.⁵ The SEZ programme is one application of government policy to foster economic growth, create

¹ Department of Trade and Industry “Policy on the Development of Special Economic Zones in South Africa: 2012” (23 January 2012) in GG 34968 of 2012-01-23 https://www.gov.za/sites/default/files/gcis_document/201409/34968gen45.pdf (accessed 2021-05-10) 9.

² World Bank Group “Special Economic Zones” (2017) <https://openknowledge.worldbank.org/handle/10986/29054> (accessed 2021-08-11) 9.

³ Siggers “A Critical Analysis of the Fiscal Incentives Offered to Particular South African Special Economic Zones” (2015) <https://open.uct.ac.za/handle/11427/16869> (accessed 2021-08-10) 13.

⁴ Makgetla “Learning From Experience: Special Economic Zones in Southern Africa” (2021) <https://www.wider.unu.edu/publication/learning-experience-special-economic-zones-southern-africa> (accessed 2021-08-10) 19.

⁵ Haasbroek “Evaluating the Design of Special Economic Zones as a Tax Incentive in South Africa” (2019) <https://repository.nwu.ac.za/handle/10394/33003> (accessed 2021-08-10) 11.

jobs, reduce poverty and address underdevelopment.⁶ Yet even in South Africa, which contains the largest and best-resourced SEZs in the region, SEZs have not delivered on their promise of economic growth or job creation.⁷

The SEZ proposition is a blend of political, economic and fiscal considerations.⁸ Most SEZ propositions incorporate some form of tax incentives. Such incentives are particularly significant for export-oriented undertakings and for investors in developing countries.⁹ Tax incentives are the primary means of promoting SEZ investment in South Africa.¹⁰ These incentives have the potential to significantly reduce the tax burden of investors. Income tax incentives are contained within sections 12R and 12S of the Income Tax Act 58 of 1962 (Income Tax Act). Together with Value-Added Tax (VAT) and customs duty exemptions, they offer the greatest benefit to export companies located in an SEZ. This is in line with the government's intention to pursue foreign direct investment and increase export capacity.¹¹

2 RESEARCH PURPOSE AND OBJECTIVES

The objective of this study is to consider whether the provisions of the Special Economic Zones Act 16 of 2014 (SEZ Act) and the common practices in the establishment of SEZs conflict with the criteria of the capital allowance provisions of the Income Tax Act, and whether, in so doing, in certain instances they prevent a property developer lessee from claiming capital allowances in respect of capital expenditure incurred. Where the study finds such potentially unintended consequences that may frustrate the policy objectives of the SEZ Act, the study recommends appropriate amendments that seek to remedy these outcomes.

3 LITERATURE REVIEW

3.1 SEZs in South Africa

SEZs were introduced with effect from 2016 as the successor to the Industrial Development Zone (IDZ). The objective of the SEZ regime is to

“(i) promote industrial agglomeration, (ii) build the required industrial infrastructure, (iii) promote coordinated planning among key government

⁶ Department of Trade and Industry “South African Special Economic and Industrial Development Zones” (2018) http://www.thedtic.gov.za/wp-content/uploads/SEZ_brochure.pdf (accessed 2021-02-04) 4.

⁷ Makgetla <https://www.wider.unu.edu/publication/learning-experience-special-economic-zones-southern-africa> 6 15.

⁸ Sagers <https://open.uct.ac.za/handle/11427/16869> 10.

⁹ World Bank Group <https://openknowledge.worldbank.org/handle/10986/29054> 18.

¹⁰ Haasbroek <https://repository.nwu.ac.za/handle/10394/33003> 8.

¹¹ Sagers <https://open.uct.ac.za/handle/11427/16869> 7.

agencies and the private sector, and (iv) guide the deployment of other necessary development tools".¹²

As part of this new dispensation, the four pre-existing IDZs – those at Coega, East London, Richards Bay and Saldanha Bay – were granted SEZ status, and a further six SEZs have subsequently been created.¹³ The Coega SEZ in the Eastern Cape is the largest in the southern hemisphere.¹⁴ Coega accounts for more than half of all private investment in SEZs in South Africa, while the East London IDZ and Dube TradePort in KwaZulu-Natal account for a further 30 per cent of investment.¹⁵

The SEZ structure begins with a licensee, which is the entity that applies for SEZ status for a specified area. The licensee must be established as a national or provincial government business enterprise, a municipal entity, or a company in the case of a public-private partnership. Among other things, the applicant must indicate the extent to which it owns or controls the area to be considered for designation as an SEZ.¹⁶

Once an area has been designated as an SEZ, the licensee must establish an operator to manage the SEZ and must transfer ownership or control of the land within the SEZ to the operator. Only an operator is entitled to develop, operate and manage an SEZ. The operator must provide infrastructure and facilities, adequate security, make recommendations for the granting of applications of businesses to locate within the SEZ, and establish rules and regulations for businesses operating within the SEZ.¹⁷

3 2 SEZ practices

There is strong (although not conclusive) evidence that normal practice is for the operator to grant leases over land within the SEZ, while government remains the owner of that land¹⁸ and the lessee is responsible for development of the property. This is particularly evident in the Dube TradePort Corporation's recent communication of investment opportunities, where the Corporation as operator company positions itself as the master

¹² Department of Trade and Industry http://www.thedtic.gov.za/wp-content/uploads/SEZ_brochure.pdf 4.

¹³ *Ibid.*; SARS "Simplified Overview of Special Economic Zones Tax and Customs Incentives" (2019) http://www.thedtic.gov.za/wp-content/uploads/SEZ_Tax.pdf (accessed 2021-02-01) 1.

¹⁴ Haasbroek <https://repository.nwu.ac.za/handle/10394/33003> 27.

¹⁵ Makgetla <https://www.wider.unu.edu/publication/learning-experience-special-economic-zones-southern-africa> 6.

¹⁶ Chapter 6 (ss 31–38) of Special Economic Zones Act 16 of 2014.

¹⁷ *Ibid.*

¹⁸ See, for example, the frequent references to leasing in the promotional material of Coega Development Corporation "One Stop Investor Services" (2021) <http://www.coega.co.za/Content2.aspx?objID=91> (accessed 2021-02-02). See also examples of Dube TradePort and Richards Bay practices referred to in Trade & Investment KwaZulu-Natal "KwaZulu-Natal Investment Opportunities 2018/19" (2018) [https://www.rbidz.co.za/images/download/KWAZULU_NATAL_INVESTMENT_OPPORTUNITIES_\(INVESTMENT_BOOKLET\)_2018.pdf](https://www.rbidz.co.za/images/download/KWAZULU_NATAL_INVESTMENT_OPPORTUNITIES_(INVESTMENT_BOOKLET)_2018.pdf) (accessed 2021-02-02).

developer and seeks “prospective developers, investors and tenants” in terms of 49-year leases.¹⁹

The business model outlined above suggests that in many instances the successful development of specific sites within SEZs depends on the incurral of costs by a third-party developer that is not the owner of the land and that will in turn sublease the development to a tenant. The model thus envisaged by this study is the following:

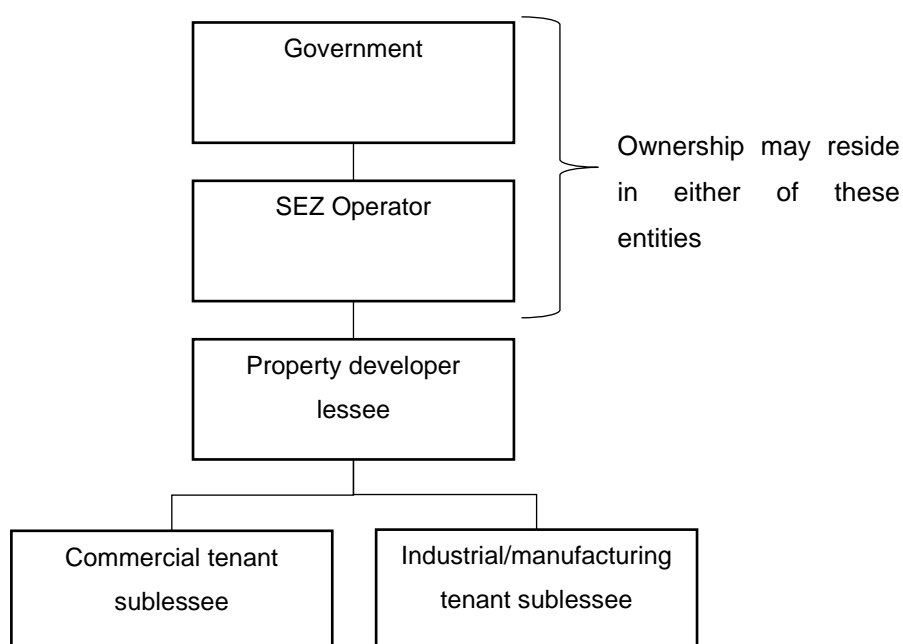


Figure 1: SEZ structure

3.3 SEZ income tax incentives

Whereas IDZs offered only VAT and customs incentives, SEZs offer significant income tax incentives. The primary income tax incentives are:

- a preferential corporate tax rate of 15 per cent, available until the later of 1 January 2031 or 10 years after the approval by the Minister of Finance of that SEZ for the preferential tax rate²⁰ (although not explicitly stated, it may be surmised that the 15 per cent tax rate was selected in order to

¹⁹ Dube TradePort Corporation “Opportunities | Developments | Dube City | Dube TradePort” (2021) <https://web.archive.org/web/20181202072940/http://city.dubetradeport.co.za/Pages/Developments/Opportunities> (accessed 2023-07-21).

²⁰ S 12R of the Income Tax Act.

equalise the return on investment after corporate tax and dividends tax – as it then was at 15 per cent of after-tax distributed profit – for foreign investors, with the standard corporate rate of 28 per cent – reduced to 27 per cent with effect from years of assessment commencing on or after 1 April 2022; however, no adjustment was made to reflect the subsequent increase in the dividends tax rate);²¹

- a building allowance of 10 per cent per annum on new and unused buildings or improvements to buildings (other than residential accommodation) owned by a “qualifying company”²² (this was probably intended to align with the 10-year time frame of section 12R);²³
- an additional incentive allowance of 75 per cent of the cost of any new and unused manufacturing asset used by a greenfield or brownfield industrial policy project approved by the Minister of Trade and Industry, increased to 100 per cent if that project is granted preferred status;²⁴ and
- the waiver of the age criteria for employment incentives.²⁵

To be a “qualifying company”, the taxpayer must *inter alia* be a tax resident in South Africa and operate from a fixed place of business within an economic zone from which it derives at least 90 per cent of its income. There is no specific requirement that a qualifying company be engaged in a process of manufacture. However, it may not be engaged in certain manufacturing processes, such as those relating to alcohol, tobacco and weapons.²⁶

Irrespective of whether it is a “qualifying company”, a taxpayer may qualify for section 11(g), 13 or 13*quin* (read with section 12N) capital allowances in respect of costs incurred in the construction, acquisition or improvement of industrial or commercial property if it meets the requirements of one of those sections. It is the availability of these capital allowances that is the focus of this study.

4 RESEARCH DESIGN

The study presents a critical analysis of the current legislation. It is therefore primarily an undertaking of legal interpretive, doctrinal tax research, or establishing *de lege lata*.²⁷ To the extent that it identifies possible

²¹ Saggars <https://open.uct.ac.za/handle/11427/16869> 30.

²² S 12S of the Income Tax Act.

²³ Saggars <https://open.uct.ac.za/handle/11427/16869> 31.

²⁴ S 12I of the Income Tax Act.

²⁵ S 6(a)(ii) of Employment Tax Incentive Act 26 of 2013.

²⁶ S 12R of the Income Tax Act.

²⁷ *De lege lata* means “of the existing law”, whereas *de lege ferenda* means “of the law (that is) to be proposed” (Fellmoth and Horwitz “Guide to Latin in International Law” (2009) <https://www-oxfordreference-com.ezproxy.uct.ac.za/view/10.1093/acref/9780195369380.001.0001/acref-9780195369380> (accessed 2021-05-10)). See Hutchinson and Duncan “Defining and Describing What We Do: Doctrinal Legal Research” 2012 17 *Deakin Law Rev* <https://heinonline.org/HOL/Page?handle=hein.journals/deakin17&id=91&div=8&collection=journals> (accessed 2018-06-13) 83–119.

contradictions arising from the application of the current legislation and proposes remedies to these challenges, it engages in reform-oriented research or *de lege ferenda*.²⁸

This study was conducted through an analysis of the relevant legislation, as well as of contextual documents that provide insight into the history and practices surrounding SEZs. The relevant provisions of the Income Tax Act pertaining to capital allowances are explored in order to establish the main obstacles to their application in the context of SEZ property developments. These obstacles are shown to be the requirement of ownership and the prohibition of subleasing within those provisions. Whether a lessee may under certain circumstances be considered an owner for income tax purposes is then investigated. The study then presents recommendations to remedy the identified problem, analyses their income tax consequences, and draws conclusions.

5 CAPITAL ALLOWANCE PROVISIONS FOR SEZs

5.1 Analysis of the relevant sections of the Income Tax Act

An analysis of specific provisions in the Income Tax Act is performed in order to determine which provisions could be applicable to the erection of developments by the property developer lessee on leased land situated in SEZs. Although there are also incentives related to VAT, among others, this article focuses on the relevant provisions of the Income Tax Act.

5.1.1 Section 12S

The first capital allowance to consider is contained in section 12S of the Income Tax Act and applies exclusively to SEZs. Section 12S(2) of the Income Tax Act reads as follows:

“A qualifying company may deduct from the income of that qualifying company an allowance equal to ten per cent of the cost to the qualifying company of any new and unused building *owned by the qualifying company*, or any new and unused improvement to any building *owned by the qualifying company*, if that building or improvement is wholly or mainly used by the qualifying company during the year of assessment for purposes of producing income within a special economic zone, as defined in section 12R(1), in the course of the taxpayer’s trade, other than the provision of residential accommodation.”
(emphasis added)

Section 12S(2) thus allows for a 10 per cent allowance on the cost of a new and unused building, or of a new and unused improvement to any building, that is owned by the qualifying company in an SEZ. It is clear that the

²⁸ Hutchinson “The Doctrinal Method: Incorporating Interdisciplinary Methods in Reforming the Law” 2015 8 *Erasmus Law Rev* <http://www.elevenjournals.com/doi/10.5553/ELR.000055> (accessed 2018-06-14) 130–138.

building must be owned by the qualifying company. Leasehold improvements would not fall within this provision except by virtue of the application of section 12N of the Income Tax Act.²⁹

An operator may thus potentially qualify for the accelerated building allowance of 10 per cent per annum.³⁰ It is however difficult to see whether any taxpayers other than the SEZ operator were envisaged by this provision. It is clear that a property developer or trader that is not the owner of the building will be unable to claim a section 12S allowance in respect of costs incurred on the erection of the building in an SEZ. Furthermore, a property developer would be excluded from the definition of a “qualifying company” by virtue of the gazetted exclusion of real estate activities.³¹ Section 12S would therefore appear to have limited application and does not address the potential problem identified in this study.

5 1 2 Section 11(g)

Where a lessee incurs costs in respect of improvements erected on land not owned by the lessee, section 11(g) of the Income Tax Act may provide the lessee with an annual allowance. This section allows a deduction for expenditure actually incurred by a taxpayer, in pursuance of an obligation to effect improvements on land or to buildings, incurred under an agreement whereby the right of use or occupation of the land or buildings is granted by any other person (the lessor), where the land or buildings are used or occupied for the production of income (by the lessee). Section 11(g) neither specifically mentions nor disallows subleasing by the lessee. It does, however, specifically require that the lessor be subject to tax on the amount on which the deduction is based.

If ownership of the land of an SEZ is retained by the government of the Republic of South Africa in the national, provincial or local sphere, section 11(g) will not find application as the amount incurred to erect improvements to this land will not be subject to tax in the hands of government institutions. Section 11(g) therefore only addresses the problem identified in the study where ownership is transferred to a tax-paying SEZ operator.

5 1 3 Section 12N

As a consequence of the requirements of section 11(g) and to ensure, *inter alia*, that the leasing of land from the government remains attractive from a tax perspective, section 12N was introduced into the Income Tax Act in

²⁹ Saggars <https://open.uct.ac.za/handle/11427/16869> 31.

³⁰ Department of Trade and Industry http://www.thedtic.gov.za/wp-content/uploads/SEZ_brochure.pdf 23.

³¹ National Treasury “Notice in Terms of Section 12R of the Income Tax Act, 1962, Regarding Activities to Which Section 12R Does Not Apply” in GG 39930 of 2016-04-15 www.gpwonline.co.za (accessed 2022-01-27).

2010.³² This section finds application where a lessee undertakes improvements on leased property in terms of a public private partnership or where the property is owned by the government in the national, provincial or local sphere or by certain government-owned exempt entities.

Earlier versions of section 12N also included the obligation-to-improve requirement of section 11(g), but this was subsequently removed in amendments to the section. The section does not cross-refer to section 11(g), and therefore it must act as an alternative to the section rather than as a route to a section 11(g) allowance.

Section 12N(1) of the Income Tax Act reads as follows:

“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; or
 - (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);
 - (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.*” (emphasis added)

This section therefore permits an allowance on improvements to be calculated as if the lessee owned the property with one of the conditions being that the taxpayer must use the property to produce income. In such a case, the expenditure incurred by the lessee to complete improvements is deemed to be the cost for the purposes of the various capital allowances mentioned.

The restrictions imposed by subsection (3) of section 12N however cannot be ignored. This subsection states:

“This section does not apply if the taxpayer–

- (a) is a person carrying on any banking, financial services or insurance business; or

³² National Treasury “Explanatory Memorandum on the Taxation Laws Amendment Bill, 2010” (2010) <https://www.sars.gov.za/wp-content/uploads/Legal/ExplMemo/LAPD-LPrep-EM-2010-01-Explanatory-Memorandum-Taxation-Laws-Amendment-Bill-2010.pdf> (accessed 2021-05-10) 45.

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- (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." (emphasis added)

Applied to the context of a property developer lessee in an SEZ, in a scenario where the taxpayer subleases the property to a third party that is unlikely to be a member of the same group of companies, section 12N seems not to be available to the lessee owing to the restriction of section 12N(3)(b).

The Explanatory Memorandum on the Taxation Laws Amendments Bill, 2010 does not explicitly address why subletting is outside the scope of section 12N. However, it might be a legacy of the historic rationale for not granting a deduction to lessees, as captured in this introduction:

"The general denial of the improvement allowance in respect of leased land or buildings of an exempt lessor was enacted in the early 1980's to prevent tax avoidance. At that time, a number of lease financing schemes existed so that financiers could obtain artificial write-offs for improvements on leased property as if these financiers had directly owned and operated the underlying property. These schemes were particularly prevalent in the case of exempt parties seeking finance because these entities lacked a tax base from which a depreciation allowance could be utilised. The purpose of the lease finance schemes was to shift the depreciation allowance to financiers that had a tax base upon which the allowance could be utilised."³³

The above, in the authors' opinion, refers to schemes designed to take advantage of section 11(g). The extension of such denial to prohibit the deduction of commercial building allowances in the context of section 12N is, it is submitted, unnecessarily wide. Although the legislature's intention to combat tax avoidance through the artificial shifting of depreciation allowances from exempt entities to taxpayers is acknowledged, it is submitted that the restriction is unnecessarily wide. This may discourage participation by property developers that will use the property for purposes of their own trade.

In the "Taxation Laws Amendments Bills, 2010: Final Response Document from National Treasury and SARS", the Standing Committee on Finance noted that section 12N should put the lessee in the same position

³³ National Treasury <https://www.sars.gov.za/wp-content/uploads/Legal/ExpIMemo/LAPD-LPrep-EM-2010-01-Explanatory-Memorandum-Taxation-Laws-Amendment-Bill-2010.pdf> 46.

as the owner, but not in a better position.³⁴ This effectively means that if an owner would not have qualified for an allowance, a lessee should also not qualify for an allowance through section 12N. However, by denying an allowance to a lessee that develops and sublets the property on land owned by government, the property developer lessee is placed in a worse position than if it had been the owner of that land, without tax avoidance being present. Furthermore, section 12N facilitates certain allowances for improvements made to land or buildings not owned by the taxpayer but over which the taxpayer holds a right of use or occupation.

The concept of “right of use or occupation” is not defined in the Income Tax Act. In South African law, the Latin term *commodus usus* refers to the use and enjoyment of property and includes various factors, since the term “use” includes both the right to use the property and the right to gather and enjoy the civil and natural fruits of the property.³⁵ It is submitted that a developer that subleases a property applies that property in its trade in the production of income. South African tax principles allow for expenditure incurred in the production of income to be deducted against income.

It is commonly acknowledged that the maxims of taxation – namely, equality, certainty, convenience and economy – serve as indicators of a good tax policy.³⁶ Of particular relevance in the current context is the concept of neutrality (encompassed by the maxim on equality). Neutrality means that tax outcomes should not cause economic distortions.³⁷ Although neutrality can be achieved by way of the recommendations in this study, the study acknowledges that in certain instances there may be a trade-off within the maxims, and also between the maxims and economic policy.³⁸ This study does not propose a comprehensive analysis of the incentives related to SEZs against each of the maxims of taxation.

The remaining potentially relevant provisions of the Income Tax Act applicable to buildings are sections 13 (buildings used in the process of manufacture) and 13*quin* (commercial buildings).

³⁴ Standing Committee on Finance “Taxation Laws Amendments Bills, 2010: Final Response Document from National Treasury and SARS” (8 November 2010) <https://www.sars.gov.za/wp-content/uploads/Legal/RespDocs/LAPD-LPrep-Resp-2010-01-Response-Documents-Taxation-Laws-Amendment-Bills-2010.pdf> (accessed 2021-05-10) 13.

³⁵ Hutchison, Van Heerden, Visser, Van der Merwe *Wille's Principles of South African Law* 8ed (1191) 548 549.

³⁶ Alley and Bentley “A Remodelling of Adam Smith's Tax Design Principles” 2005 20 *Aust Tax Forum* <https://heinonline.org/HOL/Page?handle=hein.journals/austraxrum20&id=577&collection=journals&index=#> (accessed 2018-04-20) 579–624.

³⁷ Besley, Blundell, Gammie and Poterba “Dimensions of Tax by Design: The Mirrlees Review” (2010) https://www.researchgate.net/profile/Richard_Blundell/publication/50876719_Dimensions_of_Tax_Design_The_Mirrlees_Review/links/00b4953a94b4a8b25d000000/Dimensions-of-Tax-Design-The-Mirrlees-Review.pdf (accessed 2018-04-17) 2.

³⁸ Davis Tax Committee “Report on the Efficiency of South Africa's Corporate Income Tax System” (2018) <https://www.taxcom.org.za/docs/20180411%20Final%20DTC%20CIT%20Report%20-%20to%20Minister.pdf> (accessed 2018-06-01) 70; American Institute of CPAs (AICPA) “Tax Policy Concept Statement 1 Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals” (2017) <https://www.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/tax-policy-concept-statement-no-1-global.pdf> (accessed 2018-04-20) 14.

5 1 4 Section 13

Section 13(1) of the Income Tax Act allows a taxpayer to deduct an allowance on the cost of a building erected where:

“such building was wholly or mainly used by the taxpayer during the year of assessment for the purpose of carrying on therein in the course of its trade ... any process of manufacture, ..., or such building was let by the taxpayer and was wholly or mainly used by the tenant or subtenant for the purposes of carrying on therein any process as aforesaid in the course of trade.”

The taxpayer claiming the allowance can either be the owner or the lessee of the building, ownership not being a requirement in order to receive this allowance. The taxpayer that incurred the expenditure for the improvements, which can be either the lessor or the lessee, can receive the allowance in respect of costs incurred by that person.

The effect of section 13 is that a property developer lessee (or indeed a sublessee tenant) incurring costs in respect of property development or improvement within an SEZ may claim an allowance in respect of such costs, notwithstanding that government continues to own the land on which that property is located, as long as the building houses a process of manufacture. This entitlement to allowances arises as a result of the direct application of section 13 and is not dependent on the application of section 12N, and therefore circumvents the prohibition on subleasing contained in section 12N(3). In fact, since ownership is not a requirement in section 13, the reference to section 13 within section 12N for the purposes of deemed ownership seems somewhat anomalous.

However, section 13 applies only where the sublessee tenant is engaged in a process of manufacture within that building. It therefore does not address the problem with respect to other forms of commercial activity.

5 1 5 Section 13quin

Section 13quin of the Income Tax Act, on the other hand, grants to the taxpayer:

“an allowance equal to five per cent of the cost to the taxpayer of any new and unused building owned by the taxpayer, or any new and unused improvement to any building owned by the taxpayer, if that building or improvement is wholly or mainly used by the taxpayer during the year of assessment for purposes of producing income in the course of the taxpayer’s trade, other than the provision of residential accommodation.”

Section 13quin therefore requires the taxpayer to be the owner of the commercial building and does not permit the claiming of such capital allowance by a lessee. Section 13quin therefore does not extend to a lessee except through the application of section 12N. In the context of SEZs, the property developer lessee is then prohibited from claiming such deduction by the prohibition on subleasing contained in section 12N(3).

5 1 6 Section 11(e)

For the sake of completeness, it may be added that section 11(e) of the Income Tax Act finds no application in this context, since it does not apply to structures and works of a permanent nature.³⁹

5 2 Conclusion: availability of capital allowances

From the preceding analysis, it may be concluded that section 11(g) allowances will only be available to a property developer lessee where ownership of the land developed resides in the SEZ operator. Where ownership is retained by government, section 11(g) allowances are unavailable. Section 13quin is only available where the lessee is also the occupier for the purposes of trading (that is, the development is not subleased) in terms of section 12N. In addition, a capital allowance in terms of section 13 is available to the property developer lessee where the tenant is engaged in a process of manufacture.

In all other situations, the obstacle to a property developer lessee claiming a section 13quin allowance is that section 13quin requires the taxpayer to be the owner of the building, while section 12N requires that the lessee not be engaged in subleasing the building. This obstacle may be overcome if the building might be considered “owned” by the lessee in the context of a long-term lease for purposes of the Income Tax Act. This is considered in the next section.

6 OWNERSHIP VERSUS LEASE

6 1 Ownership

Sections 12S and 13quin of the Income Tax Act require that a building or improvement be “owned” by the taxpayer for the building allowance to apply.⁴⁰ “Owned” and/or “ownership” is not defined in the Income Tax Act and must therefore take on the meaning under common law.

A person or entity owns fixed property if it is registered in the Deeds Office under the entity’s name,⁴¹ which effectively gives the owner almost unfettered real rights to do as it pleases, subject to the law, servitudes and the like. The South African Revenue Service (SARS) considers ownership in its “Interpretation Note 107: Deduction in Respect of Commercial Buildings”:

³⁹ SARS “Interpretation Note 107: Deduction in Respect of Commercial Buildings” (2018) <https://www.sars.gov.za/wp-content/uploads/Legal/Notes/LAPD-IntR-IN-2018-10-IN107-Deduction-in-respect-of-commercial-buildings.pdf> (accessed 2021-02-01) par 2.

⁴⁰ Ownership is also required in sections 13quat and 13sex of the Income Tax Act (although not directly relevant to the context of SEZs).

⁴¹ SARS <https://www.sars.gov.za/wp-content/uploads/Legal/Notes/LAPD-IntR-IN-2018-10-IN107-Deduction-in-respect-of-commercial-buildings.pdf>, par 4.1.6.

“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. A taxpayer wanting to claim an allowance under section 13quin must therefore be the owner of the land on which the building is erected, or the improvements are effected. This requirement is relevant in the context of section 13quin as it deals with buildings of a permanent nature and such buildings will be permanently attached to the land.”⁴²

6.2 Long-term leases

With respect to long-term leases, Snymans Inc Attorneys state the following:

“Fundamentally, a long-term lease is a contract between the lessor and the lessee that entitles the lessee to a limited real right over the property in question for an agreed period of time ranging from 10 years to 99 years. The lessor agrees to allow the lessee use and enjoyment of the property, and the lessee agrees to compensate the lessor through a rental fee.”⁴³

A lease longer than 10 years is accepted as a long-term lease. This creates a limited real right and is registrable in the Deeds Office.”⁴⁴

A lease may be akin to ownership, especially where the “purchase” of a property entails the acquisition of a 99-year lease of the property and the cancellation of the preceding lease, no matter the remaining duration of the previous leaseholder’s occupation.⁴⁵ However, leasehold grants a limited real right and is not freehold ownership under South African law. The deeds register records the property leased under the name of the owner with an endorsement noting the 99-year lease against that property in the name of the lessee.

Although not dealing with long leases as such, the Supreme Court of Appeal had the following to say in *CSARS v Wyner*:⁴⁶

“[39] I therefore do not agree with the reasoning and findings of the court *a quo* that the *mix of private rights and public forbearance gave the respondent a sui generis claim to the property which was close to ownership*, that the respondent was to all intents and purposes entitled to treat the site as her own and that she should notionally be put in the same category as someone who by force of circumstance is forced to sell her home. In my view this reasoning and the findings ignored the juristic nature of the relevant transaction.” (emphasis added)

These sentiments accord with the concepts raised by Muller, Brits, Pienaar and Boggenpoel:

⁴² SARS <https://www.sars.gov.za/wp-content/uploads/Legal/Notes/LAPD-IntR-IN-2018-10-IN107-Deduction-in-respect-of-commercial-buildings.pdf>, par 4.1.6.

⁴³ Snymans Inc Attorneys “What Is a ‘Long Term Lease?’” 2015 2 *Rental Management* <https://www.snymans.com/advice/what-is-a-long-term-lease/> (accessed 2021-05-21).

⁴⁴ S 1(2) of Formalities in Respect of Leases of Land Act 18 of 1969.

⁴⁵ Anecdotally, these transactions have been accepted by the banks as a legitimate and secure transaction, providing adequate security for property-financing loans.

⁴⁶ [2003] 4 All SA 541 (SCA); 66 SATC 1.

“As a point of departure, we should briefly distinguish between ownership, as the only real right with regard to one’s own property (*ius in re propria*), and rights with regard to things which belong to another person (*iura in re aliena*). For present purposes, it suffices to say that of all real rights the right of ownership in its unrestricted form confers the most comprehensive control over a thing. A right with regard to a thing which belongs to another person, on the other hand, is a limited real right in the sense that it is a real right ‘less than ownership’ in a thing owned by a person other than the holder of such a right.”⁴⁷ (emphasis added)

6.3 Implications of ownership versus lease in an SEZ

It is clear that in South African law, ownership grants a real right to the owner over the property in question. In contrast, leases grant limited real rights to the lessee. Even though a lease may diminish the rights of an owner, the rights granted under ownership and lease are fundamentally different.

Thus, it is submitted that, irrespective of the length of the lease or the conditions for renewal or extension, ownership as envisaged in the Income Tax Act does not include leased property. This is confirmed by the provisions of sections 12N, where in certain cases improvements carried out on leased property are deemed to be owned by the lessee.

A lease, therefore, irrespective of its duration or the availability of unlimited extensions, grants limited real rights, and even if akin to ownership, cannot be regarded as ownership. Leasehold grants a limited real right. This is true, even if it is a 99-year lease that is renewable in perpetuity. A lease, therefore, regardless of its terms, can never be considered to grant the lessee the status of “owner” for the purposes of applying the capital allowance provisions of the Income Tax Act. To the extent that the ownership of land, and therefore improvements, in SEZs remains with either government or the SEZ operator, the property developer lessee cannot own the improvements under South African law.

7 RECOMMENDATIONS

Underlying the obstacles to SEZ property developers claiming capital allowances in various circumstances is the asymmetry between the application criteria of sections 13 and 13*quin* of the Income Tax Act. This asymmetry would appear to fail the test of equity or neutrality in terms of the commonly accepted principles of a good tax system.⁴⁸ Indeed, Interpretation Note 107 observes, in relation to the introduction of section 13*quin* of the Income Tax Act, that there was “no policy rationale for excluding commercial

⁴⁷ Muller, Brits, Pienaar and Boggenpoel *Silberberg and Schoeman’s The Law of Property* 6ed (2019) 53.

⁴⁸ Pistone, Roeleveld, Hattingh, Nogueira and West *Fundamentals of Taxation: An Introduction to Tax Policy, Tax Law and Tax Administration* (2019) par 2.1.2.

buildings that were not used within the specified trades from an allowance".⁴⁹ It is submitted that the inclusion of the ownership requirement in section 13quin, which is absent from section 13, is equally without policy rationale. This study therefore recommends that the term "owned" be removed from section 13quin and that the application of the section be aligned with that of section 13.

While the immediate issue identified in this study might also be resolved either through the removal of the prohibition against subleasing contained in section 12N(3), or the inclusion of leases of ten or more years' duration within the definition of "owned" as used in section 12S of the Income Act, it is submitted that the more far-reaching amendment of section 13quin would be most appropriate in establishing equity (or neutrality) in the building allowance provisions. Although not specifically considered by this study, it is recommended that similar consideration be given to amending other building allowance sections such as those in sections 13quat, 13ter and 13sex of the Income Tax Act, which also include ownership requirements.

The implications of this recommendation in different circumstances may be illustrated as follows.

7 1 Lease between tax-exempt lessor and tax-paying lessee and sublessee

In the case of a lease between a tax-exempt lessor and a tax-paying lessee and sublessee, the lessee may deduct the rentals paid or incurred if the property leased is used for trade purposes (section 11(a) read with section 23(g) of the Income Tax Act). Rental costs therefore do not form part of the base cost of the right of use of the property.

In terms of existing legislation, a lessee is not entitled to any capital allowances in respect of improvements effected. Section 11(g) is not applicable, as the lessor did not include the amount in gross income (since it is a tax-exempt entity).

Section 12N is not applicable because it prohibits subletting. Section 13quin is also not applicable as the lessee is not the owner of the building.

An "asset" is defined in paragraph 1 of the Eighth Schedule to the Income Tax Act as including a "right or interest of whatever nature to or in such property". While the rights granted under ownership and lease are fundamentally different, it is submitted that this element of the definition of "asset" includes the rights granted to a lessee under a lease agreement.

SARS has clarified that a part-disposal includes the granting of a lease over immovable property. In its *Comprehensive Guide to Capital Gains Tax*, after a quote from *Vairetti v Zardo NO*,⁵⁰ the following is noted:

⁴⁹ SARS <https://www.sars.gov.za/wp-content/uploads/Legal/Notes/LAPD-IntR-IN-2018-10-IN107-Deduction-in-respect-of-commercial-buildings.pdf> par 2.

⁵⁰ [2010] ZAWCHC 146 par 17 *et seq.*

“Therefore, for example, the granting of a lease over property by the owner creates a contractual right in favour of the lessee. *That right is an asset for CGT purposes.* The creation of this right has given rise to a disposal of part of the full right in the property that the owner previously enjoyed. In other words, there has been a part-disposal. As can be seen, the ‘creation’ has given rise to both an acquisition and a disposal.”⁵¹ (emphasis added)

Although the lease of property may be considered to be an alienation by the owner of a right to use the property for the duration of the lease, paragraph 33(3)(b) of the Eighth Schedule of the Income Tax Act excludes such a transaction from the ambit of a part-disposal as envisaged in that paragraph, where no proceeds are received or accrued. In addition, improvements effected by a lessee to immovable property owned by a lessor will not trigger a part-disposal for the lessee (see paragraph 33(3)(c) of the Eighth Schedule).

Any disposal of the *bare dominium* in the improvements⁵² is thus deferred until the end or the expiry of the lease agreement. Because no deduction is available, the expenditure by the lessee constitutes the base cost of the *bare dominium* in the improvement,⁵³ which is disposed of for no consideration at the conclusion of the lease, when it passes to the lessor. The Income Tax Act and the Draft Interpretation Note on sections 12N and 12NA do not consider the impact of such disposal.

In terms of the amendment proposed in this article, the lessee would qualify for a section 13quin allowance. This would reduce the base cost of the *bare dominium* to nil over the course of the lease, which would lead to the elimination of any capital loss for the lessee at the end of the lease. The lessor, which is a tax-exempt entity, and the sublessee, which incurs no cost in respect of the improvements, are unaffected by the proposed amendment.

The net effect to the fiscus is a loss in tax revenue equal to the difference between the capital loss and the revenue deduction of the lessee.

This may be illustrated as follows:

Assume Entity A (tax-exempt entity) leases a piece of land to Entity B for R25 000 per annum. According to the 20-year lease agreement, Entity B is obligated to effect leasehold improvements (the erection of a building on the piece of land) to the value of R3 million within one year of entering into the lease agreement. Entity B then subleases the building to Entity C for R200 000 per annum. Entity C uses the building for the distribution of goods (thus, not for a process of manufacture). At the conclusion of the lease, Entity C vacates the building, and Entity A sells the property for R10 million.

⁵¹ SARS “Comprehensive Guide to Capital Gains Tax” (2020) <https://www.sars.gov.za/wp-content/uploads/Ops/Guides/LAPD-CGT-G01-Comprehensive-Guide-to-Capital-Gains-Tax.pdf> (accessed 2022-01-26) 88.

⁵² That is, ownership of improvements without the right of use of them.

⁵³ SARS <https://www.sars.gov.za/wp-content/uploads/Ops/Guides/LAPD-CGT-G01-Comprehensive-Guide-to-Capital-Gains-Tax.pdf>, 342

Table 1: Tax-exempt lessor and tax-paying lessee and sublessee

Entity A	Current legislation	Proposed legislation
Lease income, improvements, end of lease, sale of property	No effect as a tax-exempt entity	No effect as a tax-exempt entity

Entity B	Current legislation	Proposed legislation
Annual gross income on sublease to Entity C	R200 000	R200 000
Annual deduction of lease payments to Entity A – s 11(a)	(R25 000)	(R25 000)
Annual deductions for improvements – s 13quin	(–)	(R150 000) (R3m x 1/20)
Capital gain or (loss) on disposal of <i>bare dominium</i>	Proceeds – Base cost (R3 000 000) Capital loss (R3 000 000)	Proceeds – Base cost (–) Capital gain/loss –
Net benefit to taxpayer / cost to fiscus		R600 000⁵⁴

Entity C	Current legislation	Proposed legislation
Annual deduction of annual lease payments to Entity B	(R200 000)	(R200 000)
Annual deductions for improvements	(–)	(–)

7.2 Lease between tax-paying lessor and lessee with obligatory improvements

In the case of a lease (whether long-term or short-term) between a tax-paying lessor and a tax-paying lessee, the rental received by or accrued to the lessor is gross income and therefore not proceeds for capital gains tax (CGT) purposes. The lessor may deduct, per section 11(a) of the Income Tax Act, expenditure relating to the lease, since rental of property is included in the definition of “trade” in section 1(1) of the Income Tax Act.

In terms of existing legislation, the lessee is entitled to an annual section 11(g) allowance, because the lessee is obligated to effect improvements and

⁵⁴ R150 000 x 20 years – R3m x 80% capital loss (assuming a corporate taxpayer).

the lessor is a tax-paying entity. The amount stipulated in the lease agreement, less any allowances utilised under section 11(g), will be the base cost of the improvements. However, since section 11(g)(vii) grants an allowance of any amount not yet deducted in terms of section 11(g) where a lease is terminated before the full allowance has been utilised, there will be no base cost. Therefore, there is no capital gain or loss arising for the lessee on disposal of the *bare dominium* at the end of the lease.

Obligatory improvements effected to land or property will not constitute a disposal of an asset by the lessor for CGT purposes, but rather will result in the acquisition of an asset. The base cost of the improvements under paragraph 20(1)(h)(ii)(cc) of the Eighth Schedule of the Income Tax Act is the amount included in the lessor's gross income in terms of paragraph (h) of the definition of "gross" income in section 1(1), less any allowance granted under section 11(h). Thus, the lessor gains the improvements at the end of the lease period having been taxed on a portion thereof at the beginning of the lease period.

In terms of the proposed amendment, the lessee would be entitled to either a section 13quin or section 11(g) allowance and would presumably elect the lesser write-off period. The net effect to the fiscus is therefore only a possibly reduced write-off period for the cost of the improvements.

This may be illustrated as follows:

Assume Entity A (a taxable entity) leases a piece of land to Entity B for R25 000 per annum. According to the 25-year lease agreement, Entity B is obligated to effect leasehold improvements (the erection of a building on the piece of land) to the value of R3 million within one year of entering into the lease agreement. The improvements are completed within one year of entering into the lease agreement. Entity B uses the building for the distribution of goods (thus, not for a process of manufacture). No allowance under section 11(h) was granted to Entity A. At the conclusion of the lease, Entity B vacates the building, and Entity A sells the property for R10 million.

Table 2: Tax-paying lessor and lessee with obligatory improvements

Entity A	Current legislation		Proposed legislation
Annual gross income on lease to Entity B	R25 000		R25 000
Gross income inclusion for leasehold improvements – paragraph (h)	R3 000 000		R3 000 000
Capital gain on disposal of property	Proceeds R10 000 000 Base cost		Proceeds R10 000 000 Base cost

	(R3 000 000) Capital gain R7 000 000		(R3 000 000) Capital gain R7 000 000
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Entity B	Current legislation	Proposed legislation
Annual deduction of lease payments to Entity A – s 11(a)	(R25 000)	(R25 000)
Annual deductions for improvements – s 11(g) or s 13quin	(R125 000) (R3m x 1/24)	(R125 000) or (R150 000)
Capital gain or (loss) on disposal of <i>bare dominium</i>	Proceeds – Base cost (–) Capital gain/loss –	Proceeds – Base cost (–) Capital gain/loss –
Net benefit to taxpayer / cost to fiscus		– ⁵⁵

7 3 Lease between tax-paying lessor and lessee without obligation to make improvements

In the case of a lease between a tax-paying lessor and a tax-paying lessee where there is no obligation to make improvements, voluntary improvements, or amounts in excess of obligatory improvements, result in neither gross income nor a base cost to the lessor. In terms of current legislation, the lessee is not entitled to any allowance under section 11(g). The expenditure thus constitutes the base cost in the *bare dominium* in the improvement, which is disposed of at the conclusion of the lease, when it passes to the lessor. To the extent that the lessee is not compensated for such improvements, the expenditure will result in a capital loss at the end of the lease period.

The anomalous exception to this outcome is where voluntary expenditure relates to an improvement used mainly in a process of manufacture. In such an instance, the lessee may claim an allowance for such expenditure in terms of section 13 (which does not contain an ownership requirement) and need not look to section 11(g). To the extent that the lessee claims capital allowances under section 13, this will reduce any capital loss at the end of the lease period.

⁵⁵ The availability of a section 13quin deduction accelerates the taxpayer's capital allowances but does not increase the total amount over the duration of the lease.

Because the lessor neither incurs any cost, nor includes any amounts in its gross income in respect of the improvement, that improvement has a base cost of nil for the lessor.

In terms of the amendment proposed by this article, the lessee would be entitled to a section 13quin allowance for the cost of any voluntary improvements. This would reduce the base cost of the *bare dominium* to nil over time and eliminate any capital loss for the lessee at the end of the lease (assuming it were for a period exceeding 20 years, being the section 13quin write-off period). The lessor would be unaffected by the amendment.

Once again, the net effect to the fiscus is a loss in tax revenue arising from the difference between the capital loss and the revenue deduction of the lessee.

This may be illustrated as follows:

Assume Entity A (a taxable entity) leases a piece of land to Entity B for R25 000 per annum. Entity B is entitled but not obligated to effect leasehold improvements in terms of the lease agreement. Entity B in fact erects a building at a cost of R3 million within one year of entering into the lease agreement. Entity B uses the building for the distribution of goods (thus, not for a process of manufacture). At the conclusion of the lease, Entity B vacates the building, and Entity A sells the property for R10 million.

Table 3: Tax-paying lessor and lessee with no obligatory improvements

Entity A	Current legislation	Proposed legislation
Annual Gross income on lease to Entity B	R25 000	R25 000
Gross income inclusion for leasehold improvements – paragraph (h)	–	–
Capital gain on disposal of property	Proceeds R10 000 000 Base cost (–) Capital gain R10 000 000	Proceeds R10 000 000 Base cost (–) Capital gain R10 000 000

Entity B	Current legislation	Proposed legislation
Annual deduction of lease payments to Entity A – s 11(a)	(R25 000)	(R25 000)
Annual	(–)	(R150 000)

deductions for improvements – s 13quin		
Capital gain or (loss) on disposal of <i>bare dominium</i>	Proceeds – Base cost (R3 000 000) Capital loss (R3 000 000)	Proceeds – Base cost (–) Capital gain/loss –
Net benefit to taxpayer / cost to fiscus		R600 000⁵⁶

8 FURTHER CONSIDERATIONS

8.1 Sale of a long-term lease

Where, for whatever reason, land may not be sold, but is leased on a long-term lease and the lease is then transferred to another lessee (not as a sublease but as an outright sale of the lease), the normal CGT rules would apply. As a consequence of the amendment proposed by this article, the person incurring the expense of an improvement to the leased property may claim allowances, but on selling the lease, would have a receipt or accrual partly in compensation for the value of the improvement disposed of, and partly for the right to the lease disposed of. It is submitted that in this case the same consequences as for the sale of land and buildings would apply. There would be a recoupment in respect of the improvement, but not for the lease itself. The buyer would have a base cost, being partly the right to the lease and partly the improvement acquired. It is further submitted that since the lease and improvement are inextricably linked, there is no part-disposal as envisaged in paragraph 33 of the Eighth Schedule of the Income Tax Act.

8.2 Possible reduction in inclusion of leasehold improvement obligation clauses

As may be evident from comparing the outcomes above, a possible consequence of the proposed amendment is the rendering obsolete of section 11(g) of the Income Tax Act, since it would no longer be a prerequisite to the lessee obtaining a capital allowance in respect of improvements effected. Section 11(g) would only be advantageous to a lessee where a lease period is less than 20 years, being the period over which section 13quin building allowances may be claimed.

Clauses obligating a lessee to effect improvements may be omitted from lease agreements, *inter alia* to avoid an inclusion in the lessor's gross income in terms of paragraph (h). The extent to which such clauses might

⁵⁶ R150 000 x 20 years – R3m x 80% capital loss (assuming a corporate taxpayer).

continue to be incorporated in lease agreements in order to provide the lessor with an enforceable right to have improvements effected is unclear.

9 CONCLUSION

The objectives of the SEZ regime, which follows the directives of government, are to encourage investment and proliferate economic development, both within and outside these zones. This study has demonstrated that, where the ownership of land in an SEZ is not transferred to a property developer, the property developer will only be able to claim capital allowances, in terms of the direct application of section 13 of the Income Tax Act, in respect of expenditure incurred when the sublessee tenant is engaged in a process of manufacture. In contrast, in all other circumstances, the property developer will not be able to claim capital allowances in respect of similar expenditure incurred in developing commercial property in terms of section 13*quin* of the Income Tax Act, since that section requires the taxpayer to be the owner of the property. The possible application of section 12N of the Income Tax Act (intended to promote development of land owned by government) is in this instance frustrated by the prohibition within that section against subleasing by the property developer lessee.

In South Africa, buildings and improvements that adhere to the land are owned by the landowner. Leasing, regardless of the length of the lease, does not confer ownership rights. The rights granted under ownership and lease are fundamentally different. This difference is confirmed by the provisions of section 12N of the Act. Land leased by a property developer as well as any development on that land cannot therefore be considered “owned” by the property developer for the purposes of the Income Tax Act.

As an emerging market, it seems that the unavailability of capital allowances where the property developer lessee is not the owner of the commercial building, but did erect it, could detract from stimulating economic growth and development in South Africa, and restrict development within SEZs to that of industrial buildings. This may significantly undermine the policy objectives of the SEZ Act.

This study therefore concludes that it is an anomaly that no allowance is currently available for leased commercial buildings in SEZs, which is at odds with the principle of neutrality and a potential barrier to the success of the SEZ initiative in South Africa. This finding highlights the greater anomaly of a failure of equity or neutrality between available building allowances, for which there is no clear policy rationale.

It is submitted that removing the “ownership” requirement from section 13*quin* would create equity between the income-tax treatment of improvements made to leased commercial property and the treatment of improvements made to manufacturing property. This would more closely align with the sentiment expressed in the 2010 “Final Response Document”

on the Taxation Laws Amendment Bill⁵⁷ upon the introduction of section 12N. There, National Treasury and SARS indicated that the lessee should be put in the same place as the owner, but not in a better place. Such equity would however come at a cost to the fiscus in the form of the substitution of deductible expenditure for a capital loss for the lessee in some instances.

It is further submitted that the tax incentives for SEZ investment provided for in sections 12S and 12R, and from which commercial property developers are excluded, are sufficient to preserve the policy objectives of SEZs in the absence of an ownership requirement in section 13quin.

⁵⁷ Standing Committee on Finance <https://www.sars.gov.za/wp-content/uploads/Legal/RespDocs/LAPD-LPrep-Resp-2010-01-Response-Document-Taxation-Laws-Amendment-Bills-2010.pdf> 13.