

A Critical Analysis of the Application of Section 37C(1) of the Income Tax Act

C Thiart

CA(SA) MAcc(Taxation)

School of Accountancy, Faculty of Economic and Management Sciences, Stellenbosch

University, Stellenbosch, South Africa

<https://orcid.org/0000-0002-5559-6150>

E Du Plessis

BCom (Law) (cum laude) LLB MCom (Taxation)

School of Accountancy, Faculty of Economic and Management Sciences, Stellenbosch

University, Stellenbosch, South Africa

<https://orcid.org/0009-0003-2009-5211>

SUMMARY

Section 37C(1) of the Income Tax Act 58 of 1962 was introduced as a tax incentive to encourage private landowners to incur conservation and maintenance expenditure for the public good. Section 37C(1) of the Income Tax Act deems conservation and maintenance expenditure incurred under a biodiversity management agreement concluded in terms of section 44 of the National Environmental Management: Biodiversity Act 10 of 2004 to be incurred in the production of income and for the purposes of trade. Consequently, section 37C(1) of the Income Tax Act serves as a deeming provision that allows taxpayers to apply section 11(a) of the Income Tax Act. Section 37C(1) of the Income Tax Act does not specify the types of maintenance and conservation expenditure that would qualify for a deduction. In contrast, section 11(a) of the Income Tax Act does not permit the deduction of any expenditure of a capital nature. The Explanatory Memorandum to section 37C(1) of the Income Tax Act further specifies that expenditure of a capital nature will not qualify for a deduction.

Given that section 37C of the Income Tax Act was introduced as a tax incentive – to encourage taxpayers to incur conservation and maintenance expenditure for the preservation of nature and the environment for the public good – its introduction raises the question whether the legislature intended for expenditure beyond that normally permitted in terms of section 11(a) of the Income Tax Act to be deductible. Section 37C(1) of the Income Tax Act further allows the deduction of conservation and maintenance expenditure against taxable income earned on land, including land in the proximity of the land that is subject to a biodiversity management agreement,

suggesting that taxable income not directly related to the conservation and maintenance activities may be reduced by such expenditure.

The objective of this article is to provide a critical analysis of the application of section 37C(1) of the Income Tax Act in an attempt to provide clarity as to when and how the section will apply. In analysing the application of section 37C(1) of the Income Tax Act, the first step is to establish the meaning of the words “conserve” or “maintain” to determine whether capital expenditure incurred in terms of a biodiversity agreement would potentially qualify for a deduction in terms of section 37C(1) read with section 11(a) of the Income Tax Act. Furthermore, the article evaluates whether the intended objective of section 37C(1) is impeded by the exclusion of capital expenditure.

The second step is to establish the appropriate meaning and interpretation of “immediate proximity” to determine when expenditure incurred for the conservation or maintenance of land is deductible from taxable income that is not necessarily related to conservation or maintenance activities.

The article concludes by exploring the use of biodiversity tax incentives in Australia and Canada to determine whether the principles applied in these jurisdictions: 1) allow for the expenditure of a capital nature to be deducted; and 2) could potentially be suitable to adjust the current format of section 37C of the Income Tax Act to assist in reaching the intended objective of being a tax incentive; or 3) could be used to formulate alternative biodiversity tax incentives to encourage biodiversity conservation in South Africa.

KEYWORDS: section 37C of the Income Tax Act, conservation and maintenance expenditure, biodiversity management agreement, conserve or maintain, immediate proximity

1 INTRODUCTION

South Africa ranks as the third most biologically diverse country in the world and is home to over 95 000 known plant and animal species.¹ However, agriculture, industrial development, climate change and urban expansion pose a significant threat to the country's biodiversity.² Since the early 2000s, there has been increasing recognition of the importance of biodiversity conservation for the public benefit.³ Section 24(1)(b)(ii) of the Constitution⁴ provides: “Everyone has the right to have the environment protected, for the benefit of present and future generations through reasonable legislative and other measures that promote conservation.” One of the acts promulgated by Parliament to give effect to section 24(1)(b)(ii) of the Constitution is the National Environmental Management: Biodiversity Act⁵ (NEMBA). Parliament enacted NEMBA with the aim of preserving biological diversity. It allows the Minister of Environmental Affairs to enter into bilateral biodiversity

¹ Department of Environmental Affairs *Biodiversity Finance Initiative (BIOFIN) South Africa: Biodiversity Finance Plan* (2017).

² United Nations Environment Programme (UNEP) *Convention on Biological Diversity* 1760 UNTS 79; 31 ILM 818 (1992). Adopted: 05/06/1992; EIF: 29/12/1993 <https://www.cbd.int/countries/profile/?country=za> (accessed 2023-12-03).

³ Paterson “Tax Incentives – Invaluable Tools for Biodiversity Conservation in South Africa” 2005 122(1) *South African Law Journal* 182 184.

⁴ Constitution of the Republic of South Africa, 1996.

⁵ 10 of 2004.

management agreements with private landowners to conserve and maintain specific areas of land for the public good.⁶

Before the enactment of the Revenue Laws Amendment Act⁷ (RLAA of 2008), minimal tax relief was provided to private landowners involved in biodiversity conservation and management.⁸ Prior to the RLAA of 2008, expenditure incurred by private landowners that did not constitute a donation in terms of section 18A of the Income Tax Act⁹ would not have been deductible unless it met the requirements of the general deduction formula contained in section 11(a) of the Income Tax Act.

Section 37C(1) of the Income Tax Act was introduced by the RLAA of 2008 to allow the government to enter into bilateral agreements with private landowners as an incentive for them to conserve or maintain land for the public good.¹⁰ According to the Explanatory Memorandum on the Revenue Laws Amendment Bill¹¹ (Explanatory Memorandum), the intended purpose of section 37C(1) is to create a mechanism for deducting environmental conservation and maintenance expenditure, thereby encouraging taxpayers to preserve nature and the environment for the public good.¹² Section 37C(1) reads verbatim as follows:

“Expenditure actually incurred by a taxpayer to conserve or maintain land is deemed to be expenditure incurred in the production of income and for purposes of a trade carried on by that taxpayer if,—

- (a) the conservation or maintenance is carried out in terms of a biodiversity agreement that has a duration of at least five years entered into by the taxpayer in terms of section 44 of the National Environment Management: Biodiversity Act, 2004; and
- (b) land utilised by the taxpayer for the production of income and for purpose of a trade consists of, includes or is in the immediate proximity of the land that is the subject of the agreement contemplated in paragraph (a).”

In the Preamble to section 37C(1) of the Income Tax Act, expenditure actually incurred to conserve or maintain land is deemed to be incurred in the production of income and for the purposes of a trade. Consequently, section 37C(1) serves as a deeming provision that allows taxpayers to consider applying section 11(a) of the Income Tax Act. However, section 37C(1) does not specify the types of maintenance and conservation expenditure that would qualify for a deduction. In contrast, section 11(a) of the Income Tax Act does not permit the deduction of any expenditure of a capital nature. Given that section 37C of the Income Tax Act was introduced

⁶ S 44 of NEMBA.

⁷ 60 of 2008.

⁸ Van Wyk “Tax Incentives for Biodiversity Conservation in the Western Cape” 2010 18(1) *Meditari Accountancy Research* 58 65.

⁹ 58 of 1962.

¹⁰ Stiglingh, Koekemoer, Van Heerden, Wilcocks, De Swardt and Van der Zwan *Silke: South African Income Tax 2023* (2023) 467.

¹¹ National Treasury *Explanatory Memorandum on the Revenue Laws Amendment Bill*, 2008 <https://www.sars.gov.za/wp-content/uploads/Legal/ExplMemo/LAPD-LPrep-EM-2008-01-Explanatory-Memorandum-Revenue-Laws-Amendment-Bill-2008.pdf> (accessed 2023-12-03).

¹² National Treasury *Explanatory Memorandum* (2008) 88.

as a tax incentive – to encourage taxpayers to incur conservation and maintenance expenditure for the preservation of nature and the environment for the public good – its introduction raises the question whether the legislature intended for expenditure beyond that normally permitted in terms of section 11(a) of the Income Tax Act to be deductible. Therefore, it is essential to define and clarify the meaning of the phrase “to conserve or maintain land” to determine whether it includes expenditure of a capital nature. If it is determined that “to conserve or maintain land” does not include capital expenditure, it prompts questions about the rationale for the introduction of section 37C(1) to provide a tax incentive, as such an interpretation would not provide for a different tax treatment of maintenance and conservation expenditure from that already provided for in section 11(a) of the Income Tax Act.

Furthermore, section 37C(1) deems expenditure incurred for the conservation and maintenance of land under a biodiversity management agreement, and signed in terms of a biodiversity management plan, to be incurred in the production of income and for the purposes of trade. However, section 37C(1) allows the deduction of this expenditure against “taxable income earned on the land or in the proximity of the land”, suggesting that taxable income not directly related to the conservation and maintenance activities may be reduced by such expenditure. It is, therefore, essential to define and clarify the interpretation of the phrase “in the immediate proximity”.

2 PROBLEM STATEMENT AND RESEARCH OBJECTIVE

The objective of this article is to provide a critical analysis of the application of section 37C(1) of the Income Tax Act, and to provide clarity as to when and how the section is applicable. Uncertainty regarding the section’s application exists owing to ambiguous words and phrases used in the section. The ambiguous wording of the section creates uncertainty about when taxpayers are eligible for a deduction for conservation or maintenance expenditure incurred in terms of a biodiversity management agreement concluded in terms of section 44 of the NEMBA, as well as the nature of expenditure that would be deductible.

The first step in this article is to determine how capital expenditure incurred for the conservation and maintenance of land is treated in terms of section 37C(1) of the Income Tax Act. The terms “conservation” and “maintenance” are defined in neither the Income Tax Act nor the Interpretation Act.¹³ The analysis therefore commences by clarifying the meaning and interpretation of these words so as to determine whether capital expenditure would include expenditure incurred for the conservation or maintenance of land. This is an important analysis since section 37C(1) was introduced as a tax incentive, which raises the question of whether the legislature intended expenditure beyond that normally allowed in terms of

¹³ 33 of 1957.

section 11(a) of the Income Tax Act to be deductible. After determining the meaning of “conservation or maintenance”, the article evaluates whether the intended objective of section 37C(1) of the Income Tax Act is impeded owing to such interpretation. This analysis examines the broader purpose of tax incentives, as well as the specific objectives of section 37C(1) as outlined in the Explanatory Memorandum, along with the circumstances that led to the section’s enactment.

Section 37C(1) allows conservation and maintenance expenditure to be deducted against taxable income earned on the land (or on land in proximity to the land) that is subject to a biodiversity management agreement. It therefore appears that taxable income not directly related to conservation and maintenance activities could potentially be reduced by conservation and maintenance expenditure. A further objective of the article is to establish the appropriate meaning and interpretation of “immediate proximity” to enable taxpayers to determine whether expenditure incurred for the conservation or maintenance of land is deductible from taxable income that is not necessarily related to conservation or maintenance activities.

The article concludes by exploring tax incentives used in Australia and Canada to assess whether the principles applied in these jurisdictions offer insights into the application of section 37C(1) of the Income Tax Act and whether they can be applied to the South African tax landscape.

3 CAPITAL EXPENDITURE INCURRED FOR THE CONSERVATION AND MAINTENANCE OF LAND IN TERMS OF SECTION 37C(1) OF THE INCOME TAX ACT

3.1 Ordinary meaning of “conserve or maintain land”

The terms “conserve” and “maintain” are defined in neither the Income Tax Act nor the Interpretation Act. As established by the court in *Mincer Motors v Commissioner of Customs and Excise*,¹⁴ words with no definitions in the relevant Act or the Interpretation Act should be given their ordinary dictionary meaning unless a contrary intention appears.

The *Oxford English Dictionary* (2022) assigns the following ordinary meaning to “conserve”:

“Conserve (Verb): to prevent (something of natural or environmental importance) from being damaged or destroyed; to preserve by conservation.”

Since the definition of “conserve” provided by the *Oxford English Dictionary* (2022) references “conservation”, it is crucial also to consider the definition of the word “conservation” in order to comprehend fully the meaning of “conserve”.

¹⁴ 1958 (1) SA 652 (T) par 653.

The *Oxford English Dictionary* (2022) assigns the following ordinary meaning to “conservation”:

“Conservation (Noun): the preservation, protection, or restoration of the natural environment and or wildlife; the practice of seeking to prevent the wasteful use of a resource in order to ensure its continuing availability.”

Section 37C(1) of the Income Tax Act further deems expenditure incurred to “maintain” land to be incurred in the production of income and for the purposes of a trade. The *Oxford English Dictionary* (2022) provides the following definition of “maintain”:

“Maintain (Verb): to keep up, preserve, cause to continue in being (a state of things, a condition, an activity, etc.); to keep vigorous, effective or unimpaired; to guard against loss or deterioration.”

Based on the ordinary meanings of conserve, conservation and maintain, it is concluded that the meanings of these words encompass a broad spectrum of activities and expenditures aimed at protecting the environment. This conclusion is consistent with the discussions below, which consider the definitions of “conservation” and “conserve” within the context of environmental law as well as relevant jurisprudence, which offers insights into distinguishing between expenditure of a capital or revenue nature.

3 2 The meaning of “conserve or maintain land” in the context of environmental law

The objective of section 37C(1) of the Income Tax Act is to incentivise taxpayers to incur expenditure for the conservation and maintenance of the environment, and further requires the conclusion of a biodiversity management agreement under section 44 of NEMBA.¹⁵ There is, therefore, a significant interaction between section 37C(1) of the Income Tax Act and environmental law. Academic literature has sought to define conservation within the environmental-law framework. Saunders defines conservation as encompassing any behaviour aimed at the protection, improvement and wise use of the planet’s natural resources.¹⁶ It has been held that conservation entails the management of people’s use of the environment to retain the advantage thereof for future generations.¹⁷

The Department of Forestry, Fisheries and the Environment recently published the White Paper on Conservation and Sustainable Use of South Africa’s Biodiversity (White Paper of 2023).¹⁸ The White Paper of 2023 defines conservation as:

¹⁵ National Treasury *Explanatory Memorandum* (2008) 88.

¹⁶ Saunders “The Emerging Field of Conservation Psychology” 2003 10(2) *Human Ecology Review* 137 138.

¹⁷ Hugo, Viljoen and Meeuwis *The Ecology of Natural Resource Management: The Quest for Sustainable Living. A Text for South African Students* (1997) 53.

¹⁸ Department of Forestry, Fisheries and the Environment (DFFE) *White Paper on Conservation and Sustainable Use of South Africa’s Biodiversity* (2023) 5.

“protection, management, care, sustainable use, maintenance, rehabilitation, restoration, and recovery of ecological and evolutionary processes, biological diversity and its components, for their intrinsic and instrumental value, to improve the well-being of people and nature”.

Although the White Paper of 2023 has not yet been enacted, it was approved by the Cabinet for implementation on 29 March 2023 and has persuasive power, since it is expected that the government will use it to amend existing laws or introduce new legislation regarding the conservation of the environment.¹⁹ The Western Cape recently enacted the Western Cape Biodiversity Act²⁰ to give effect to section 24 of the Constitution. In section 1 of the Western Cape Biodiversity Act, conservation is defined as follows:

“in relation to biodiversity and nature, [conservation] means the protection, care, management, rehabilitation and maintenance of ecosystems, habitats and indigenous species and populations, including the genetic variability within ecosystems and species, to safeguard the natural conditions for their long-term persistence and the ecosystem services that they may provide, and ‘conserve’ has a corresponding meaning.”

Based on the definition of conservation as outlined in the Western Cape Biodiversity Act, the White Paper of 2023, and academic literature that has sought to define conservation, it is concluded that the definition of conservation encompasses a broad range of activities and related expenditure. It is important to determine whether the activities and expenditure included in the definition of “conserve” and “conservation” are of a capital or revenue nature. Such a classification is necessary since it will determine the subsequent tax treatment of the expenditure. The guidance offered by the South African judiciary in relation to distinguishing between expenditure of a capital or revenue nature is considered below.

3 3 Guidance obtained from legal precedent

Distinguishing between capital and revenue expenditure can often be challenging, as the Income Tax Act does not specify what constitutes a capital or revenue expense.²¹ However, the South African judiciary has provided guidelines for determining when expenditure should be considered to be of either a capital or revenue nature. In *BP South Africa (Pty) Ltd v The Commissioner for the South African Revenue Services*,²² the Supreme Court of Appeal held that where no new asset is created for the enduring benefit of the taxpayer, the expenditure is likely to be of a revenue nature. The Appellate Division (now the Supreme Court of Appeal) held in *Heron Investments (Pty) Ltd v Secretary for Inland Revenue*²³ that an addition or alteration to an existing asset constitutes an improvement of the asset rather than a mere repair. By applying the principles of *BP South Africa (Pty) Ltd*²⁴

¹⁹ DFFE *White Paper of 2023* 6.

²⁰ 6 of 2021.

²¹ Stiglingh *et al Silke: South African Income Tax* 131.

²² 2006 (5) SA 559 (SCA) 15.

²³ 1971 (4) SA 201 (A) 208A.

²⁴ *Supra*.

and *Heron Investments (Pty) Ltd*²⁵ to the definition of conservation, as proposed by Saunders,²⁶ it can be argued that conservation expenditure incurred for the improvement of the environment is likely to be of a capital nature, since it will result in an enduring benefit. Similarly, applying the principles from *BP South Africa (Pty) Ltd*²⁷ to the definition of conservation as advocated by Hugo, Viljoen and Meeuwis²⁸ further indicates that expenditure incurred for the conservation of the environment will provide an enduring benefit and is therefore likely to qualify as expenditure of a capital nature. It is contended that if one aligns legal precedent (in which courts have provided guidance on distinguishing between expenditure of a capital and revenue nature) with the definitions of “conservation”, the expenditure incurred by taxpayers to conserve the environment could include capital expenditure. This becomes particularly evident if such conservation expenditure results in an improvement to the environment or biodiversity.

3 4 Biodiversity management agreements

The application of section 37C(1) of the Income Tax Act is contingent upon taxpayers entering into a biodiversity management agreement concluded in terms of section 44 of NEMBA. In terms of that section, the Minister has the authority to enter into a biodiversity management agreement with a person for the implementation of an approved biodiversity management plan under section 43 of NEMBA. A biodiversity management agreement concluded under section 44 may outline expenditure that the party responsible for implementing a biodiversity management plan, or any related aspect thereof, may potentially incur. For example, a biodiversity management agreement focussing on the implementation of a biodiversity management plan for black rhinoceros (*Diceros bicornis*) lists expenditure related to infrastructure construction, transportation and the purchase of vehicles to contribute to the recovery and persistence of the global black rhino population in South Africa.²⁹ Applying the principles set out in *BP South*³⁰ and *Heron Investments (Pty) Ltd*³¹ to the expenditure listed in the biodiversity management agreement for black rhinoceros – expenditure incurred for infrastructure construction, transportation and the purchase of vehicles – would typically be considered expenditure of a capital nature, as the expenditure enables the taxpayer to obtain a new asset as well as an enduring benefit.

Derived from the literature considered under headings 0, 0, and 0, it is submitted that the words “conserve” and “maintain” should be interpreted broadly, allowing for the inclusion of various activities and expenditures,

²⁵ *Supra*.

²⁶ Saunders 2003 *Human Ecology Review* 137 138.

²⁷ *Supra*

²⁸ Hugo *et al* *The Ecology of Natural Resource Management* 53.

²⁹ The biodiversity management agreement in question is not in the public domain but was shared with the authors by the African Wildlife Foundation. See also GN 49 in GG 36096 of 2013-01-25.

³⁰ *Supra*.

³¹ *Supra*.

some of which will be classified as expenditure of a capital nature. While the literature discussed above offers useful insights into the interpretation of conservation and maintenance, it is vital to bear in mind that none of these interpretations has been examined with a specific focus on section 37C(1) of the Income Tax Act. It is, therefore, necessary to consider the circumstances that led to the enactment of the section, as well as of the Explanatory Memorandum.

3.5 Does the meaning assigned to “conserve” or “maintain” include capital expenditure for the purposes of section 37C(1) of the Income Tax Act?

The introduction of section 37C(1) of the Income Tax Act as a tax incentive raises the question whether the legislature intended expenditure beyond that normally allowed in terms of section 11(a) of the Income Tax Act to be deductible. Despite the absence of any explicit provision in section 37C(1) of the Income Tax Act regarding the treatment of expenditure of a capital nature, the Explanatory Memorandum explicitly disallows the deduction of capital expenditure.³²

It was for many years uncertain when a court could consider extrinsic evidence such as an explanatory memorandum in determining the meaning and interpretation of a section in legislation, and the significance that should be attached thereto. The current approach to statutory interpretation was first articulated by the landmark Supreme Court of Appeal decision of *Natal Joint Municipal Pension Fund v Endumeni Municipality*.³³ In this judgment, Wallis JA held that the starting point for statutory interpretation is the language of the provision itself, read in its context and having regard to the purpose and the background of the provision.³⁴ Therefore, the appropriate statutory interpretation method is to consider, from the outset, the words used in their context and in light of all relevant factors.³⁵ In the recent case of *Mobile Telephone Networks (Pty) Limited v The Commissioner for the South African Revenue Services*,³⁶ the presiding judge held that an explanatory memorandum accompanying a Bill before it is enacted as a statute is the most appropriate source for determining the intended purpose of a section.

As a result of the approach to statutory interpretation laid down in *Natal Joint Municipal Pension Fund*,³⁷ a court tasked with determining the meaning and interpretation of section 37C(1) of the Income Tax Act will consider the Explanatory Memorandum from the outset. Since expenditure of a capital nature is explicitly disallowed in terms of the Explanatory Memorandum, taxpayers who incur conservation or maintenance expenditure of a capital

³² National Treasury *Explanatory Memorandum* 89.

³³ 2012 (4) SA 593 (SCA).

³⁴ *Natal Joint Municipal Pension Fund v Endumeni Municipality* *supra* 18.

³⁵ Seligson “Judicial Forays in Statutory Construction” 2021 12(2) *Business Tax and Company Law Quarterly* 8 16.

³⁶ 2021 JOL 49403 (GP) 32.

³⁷ *Supra*.

nature will not qualify for a deduction in terms of section 37C(1) read with section 11(a) of the Income Tax Act, irrespective of whether such expenditure has been incurred in terms of a biodiversity management agreement. This conclusion is supported by the inclusion of the word “potentially” in the Explanatory Memorandum, indicating that even if the expenditure is incurred in terms of a biodiversity management agreement, it may not necessarily qualify for a deduction in terms of section 37C(1) read with section 11(a) of the Income Tax Act.³⁸

4 THE IMPACT OF EXCLUDING CAPITAL EXPENDITURE ON THE INTENDED APPLICATION OF SECTION 37C(1) OF THE ACT

Section 37C(1) of the Income Tax Act was introduced as a tax incentive to encourage taxpayers to incur expenditure for the conservation or maintenance of the environment.³⁹ Owing to the conclusion that expenditure of a capital nature will not be deductible in terms of section 37C(1) of the Income Tax Act, it is necessary to inquire whether such a conclusion impedes the intended purpose of the section.

According to the World Conservation Monitoring Centre of the United Nations Environment Programme (UNEP), South Africa is considered one of the world's 17 megadiverse countries.⁴⁰ These countries are home to more than two-thirds of the world's biodiversity.⁴¹ The Constitution places an obligation on the government to safeguard the environment and promote conservation through reasonable legislative measures.⁴² South Africa is also a signatory to two international conventions, namely the Convention on Biological Diversity,⁴³ and the Convention on Wetlands of International Importance Especially as Waterfowl Habitat⁴⁴ (Ramsar Convention). Both conventions emphasise the value of using incentives to promote biodiversity conservation.⁴⁵ To fulfil its obligations in terms of the above-mentioned conventions and the Constitution, the government has enacted various statutes to establish a framework for protecting and conserving the environment. One of the measures implemented to meet its obligations is the enactment of NEMBA, which provides a framework for managing and conserving biodiversity.⁴⁶

³⁸ National Treasury *Explanatory Memorandum* (2008) 89.

³⁹ National Treasury *Explanatory Memorandum* (2008) 88.

⁴⁰ Republic of South Africa *White Paper* 9.

⁴¹ Republic of South Africa *White Paper* 14.

⁴² S 24(1)(b)(ii) of the Constitution.

⁴³ UNEP *Convention on Biological Diversity* 1760 UNTS 79; 31 ILM 818 (1992). Adopted: 05/06/1992; EIF 29/12/1993.

⁴⁴ UNESCO *The Convention on Wetlands of International Importance Especially as Waterfowl Habitat* 996 UNTS 245, 11 ILM 963 (1972). Adopted: 02/02/1971; EIF 21/12/1975 <https://en.unesco.org/about-us/legal-affairs/convention-wetlands-international-importance-especially-waterfowl-habitat> (accessed 2023-12-03).

⁴⁵ Paterson 2005 *South African Law Journal* 184.

⁴⁶ S 2(a)(i) of NEMBA.

The purpose of tax incentives is to provide a more favourable tax treatment for certain activities and expenditure than is normally allowed.⁴⁷ Tax incentives therefore deviate from the general rules provided for in a tax system and are often used to encourage taxpayers to change their behaviour positively towards the environment.⁴⁸ The Income Tax Act contains several provisions that allow for a deduction of expenditure incurred, even if the expenditure does not meet the requirements of the general deduction formula as outlined in section 11(a) of the Income Tax Act. Some notable environmental tax incentives can be found in section 37B and section 37D of the Income Tax Act.

Section 37C(1) of the Income Tax Act was introduced by the RLAA of 2008 as a tax incentive to provide tax relief to private landowners involved in biodiversity conservation and management for the public good.⁴⁹ The section's intended purpose is to create a mechanism for deducting environmental conservation and maintenance expenditure, so as to encourage taxpayers to incur expenditure to conserve the environment for the public good.⁵⁰ Given the significance of the Explanatory Memorandum in the interpretation of provisions, it is submitted that the South African Revenue Service (SARS) and the courts will exclude capital expenditure from the definition of expenditure incurred to "conserve" or "maintain" for purposes of section 37C(1). Section 37C(1) therefore does not allow for any expenditure to be deducted that is not already permitted in terms of section 11(a) of the Income Tax Act. Therefore, section 37C(1) is unlikely to achieve its intended purpose of incentivising taxpayers to conserve the environment since it does not deviate from the standard tax rules by offering more favourable treatment to taxpayers who incur capital conservation and maintenance expenditure. This conclusion is consistent with the findings of the Fiscal Benefits Project, which has indicated that there has been only one unsuccessful attempt to use the benefits of the section.⁵¹

5 THE MEANING OF "IMMEDIATE PROXIMITY" AS USED IN SECTION 37C(1) OF THE INCOME TAX ACT

From the opening provision of section 37C(1) of the Income Tax Act, it appears that the section deems expenditure incurred in the conservation and maintenance of land (in line with a biodiversity management agreement signed under a biodiversity management plan) to be expenditure incurred in the production of income and for the purposes of trade. However, section 37C(1) allows this expenditure to be deducted against taxable income earned on land, including land "in the immediate proximity of the land", that

⁴⁷ Klemm "Causes, Benefits, and Risks of Business Tax Incentives" 2010 17(3) *International Tax and Public Finance* 3.

⁴⁸ Arendse "Go Green for Tax Benefits: Tax" 2007 7(11) *Without Prejudice* 41 41.

⁴⁹ Stiglingh *et al Silke: South African Income Tax* 456.

⁵⁰ National Treasury *Explanatory Memorandum (2008)* 88.

⁵¹ The findings of the Fiscal Benefits Project were shared with the authors in conversation with Candice Stevens, Founder and CEO of the Sustainable Finance Coalition. She is a biodiversity finance expert and niche tax specialist.

is the subject of a contemplated agreement. This implies that taxable income not directly related to conservation and maintenance activities may be reduced by such expenditure. It is, therefore, essential to define and clarify how the phrase “in the immediate proximity” should be interpreted.

5 1 Ordinary meaning of “immediate proximity”

“Immediate proximity” is defined in neither the Income Tax Act nor the Interpretation Act. Therefore, it is uncertain when land would be considered to be in the immediate proximity of land in relation to which a NEMBA section-24 biodiversity management agreement has been concluded. Owing to the absence of a definition in those Acts for “immediate proximity”, its ordinary dictionary meaning should be applied unless a contrary intention appears.⁵²

The *Oxford English Dictionary* assigns the following ordinary meaning to “immediate”:

“Immediate (Adjective): having no person, thing, or space intervening, in place, order, or succession; standing or coming nearest or next; proximate, nearest, next; close, nearby. In reference to place often used loosely of a distance which is treated as of no account.”

The term “proximity” is defined as follows by the *Oxford English Dictionary*:

“Proximity (Noun): the fact, condition, or position of being near or close by in space; nearness. Now the dominant sense.”

The ordinary dictionary meanings of “immediate” and “proximity” imply that two objects will be considered to be in “immediate proximity” in relation to each other if it can be confirmed that no other thing or object is positioned closer or nearer to the object in question. Applying the dictionary definition of “immediate proximity” to land used by the taxpayer for the production of income and for the purposes of a trade, it is evident that to be regarded as being in ‘immediate proximity’, the income-producing land must be the nearest or closest to the land that is subject to a biodiversity management agreement concluded under section 44 of NEMBA. Therefore, there should be no land that could be considered nearer or closer to the land in respect of which the biodiversity management agreement was concluded.

5 2 Guidance obtained from the Explanatory Memorandum

According to the Explanatory Memorandum, land would be considered to be in the “immediate proximity” of land subject to a biodiversity management agreement if it is adjacent or across the road from such land.⁵³ The guidance offered by the Explanatory Memorandum is consistent with the ordinary

⁵² French and Stretch *Income Tax in South Africa* (2023) 2.6 <https://www.mylexisnexis.co.za/Index.aspx> (accessed 2023-12-03).

⁵³ National Treasury *Explanatory Memorandum* (2008) 89.

meanings discussed earlier. Consequently, for land to qualify as being in “immediate proximity” to land that is subject to a biodiversity management agreement, for the purposes of section 37C(1) of the Income Tax Act, there should be no intervening land between the two parcels of land in question.

Section 37C(1) of the Income Tax Act was introduced as a tax incentive to encourage taxpayers to incur expenditure for the conservation and maintenance of land.⁵⁴ Applying the guidelines from the Explanatory Memorandum, expenditure incurred to conserve or maintain land would be deductible from taxable income earned on land adjacent or across the road from land that is subject to a biodiversity management agreement concluded in terms of section 44 of NEMBA. Allowing expenditure incurred for the conservation and maintenance of land to be deductible against taxable income earned on a different portion of land deviates from established tax principles, as set forth in section 11(a) of the Income Tax Act. Section 11(a) specifies that expenditure actually incurred in the production of income can be deducted from the taxable income derived by a person from carrying on any trade.

As discussed under heading 0, tax incentives deviate from the standard tax rules by offering more favourable treatment to taxpayers to incentivise certain positive behavioural changes. Therefore, providing clarity to taxpayers on determining when conservation and maintenance expenditure can be deducted from taxable income earned on land in the “immediate proximity” of land that is subject to a biodiversity management agreement may incentivise taxpayers to incur such expenditure.

6 INSIGHTS FROM THE USE OF BIODIVERSITY TAX INCENTIVES IN AUSTRALIA AND CANADA

The objective of this part of the article is to gain insights from other jurisdictions – Australia and Canada – regarding the use of biodiversity tax incentives. This exploration aims to determine whether the principles applied in these jurisdictions: 1) allow for expenditure of a capital nature to be deducted; 2) are potentially suitable for adapting the current format of section 37C of the Income Tax Act to achieve its intended objective as a tax incentive; and 3) could be used to formulate alternative biodiversity tax incentives to encourage biodiversity conservation in South Africa. Australia and Canada have been selected as comparable jurisdictions since they provide tax relief to taxpayers who enter biodiversity conservation covenants.⁵⁵ Furthermore, Australia has been identified owing to the frequent reliance of South African courts on Australian jurisprudence and the similarity of tax provisions in the two countries.⁵⁶

⁵⁴ *Ibid.*

⁵⁵ Smith, Smillie, Fitzsimons, Lindsay, Wells, Marles, Hutchinson, O'Hara, Perrigo and Atkinson “Reforms Required to the Australian Tax System to Improve Biodiversity Conservation on Private Land” 2016 33 *Environmental and Planning Journal* 443 448.

⁵⁶ Moosa “A Comparison Between the Modalities of Interpreting Tax Legislation Applied in South Africa and Australia” 2018 25(1) *Revenue Law Journal* 1 2.

6 1 Biodiversity tax incentives in Australia

Australia's Income Tax Assessment Act⁵⁷ (Australian Act) provides a general deduction for expenditure incurred in producing assessable income or in carrying on a business, provided that such expenditure is not of a capital nature. As in South Africa, Australia's general deduction formula focuses primarily on business and income-producing expenditure, thereby excluding conservation activities and related expenditure unless it is directly associated with the commercial use of such land.⁵⁸ Therefore, taxpayers who incur expenditure for the conservation of the environment without generating assessable income will not qualify for a deduction in terms of section 8-1 of the Australian Act.

The first tax incentive under review is section 31-5 of the Australian Act, which provides an incentive to landowners to enter into conservation covenants for the environmental benefit of Australia.⁵⁹ The Australian Act stipulates that taxpayers who enter into a conservation covenant with an authorised entity may be eligible for a tax deduction, provided that the covenant is approved by the Minister for the Environment and satisfies the requirements set out in section 31-5.⁶⁰ The requirements for a conservation covenant are set out in section 31-5(2) of the Australian Act, which reads verbatim as follows:

"These conditions must be satisfied:

- (a) the covenant must be perpetual;
- (b) you must not receive any money, property or other material benefit for entering into the covenant;
- (c) the market value of the land must decrease as a result of your entering into the covenant;
- (d) one or both of these must apply:
 - (i) the change in the market value of the land as a result of entering into the covenant must be more than \$5,000;
 - (ii) you must have entered into a contract to acquire the land not more than 12 months before you entered into the covenant;
- (e) the covenant must have been entered into with:
 - (i) a fund, authority or institution that meets the requirements of section 31-10; or
 - (ii) the Commonwealth, a State, a Territory or a local governing body; or
 - (iii) an authority of the Commonwealth, a State or Territory."

A taxpayer who enters a conservation covenant that complies with the above requirements qualifies for a deduction in terms of section 31-5(3) of the Australian Act. In terms of section 31-5(3) of the Australian Act, the amount deductible against the taxpayer's taxable income is the difference between the market value of the land prior to entering into the conservation covenant

⁵⁷ S 8-1 of Act 38 of 1007.

⁵⁸ Guglyuvatyy "Failing to See the Wood for the Trees: A Critical Analysis of Australia's Tax Provisions for Land and Forest Conservation" 2018 33(3) *Australian Tax Forum* 551 559.

⁵⁹ Woellner, Barkoczy, Murphy, Evans and Pinto *Australian Taxation Law* (2019) 1135.

⁶⁰ *Ibid.*

and the market value of the land directly thereafter.⁶¹ However, where a landowner receives any form of consideration for entering into a conservation covenant, such landowner is not eligible for a deduction in terms of section 31-5(3) of the Australian Act. This is because section 31-5(2)(b) of the Australian Act determines that a landowner should not have received any form of money, property or material benefit for entering into a conservation covenant. It is submitted that the requirements for a conservation covenant and the subsequent tax treatment thereof, as specified in section 31-5(3) of the Australian Act, bear a close resemblance to the requirements of section 37D of the Income Tax Act. Section 31-5(3) of the Australian Act requires the covenant to be perpetual, in alignment with section 37D(1)(a) of the Income Tax Act, which mandates that the agreement should have a duration of at least 99 years. Section 31-5(3) of the Australian Act and section 37D of the Income Act both use the market value of the land as a guideline for determining the available deduction, in contrast to section 37C(1) of the Income Tax Act, which considers the actual conservation and maintenance expenditure incurred.

The second tax incentive under review is subdivision 40-G of the Australian Act, which regulates the treatment of capital expenditure incurred for landcare operations. Section 40-635 of the Australian Act lists the types of activity that would be considered to constitute "landcare operations". Landcare operations include activities such as the eradication and extermination of animal pests, erecting fences to separate different land classes, the construction of a levee or similar improvement on the land, or any structural improvement, alteration or addition that is reasonably incidental to the construction of a levee or drainage.⁶² The deduction for landcare operations is applicable under very limited circumstances, as the Australian Act requires the taxpayer to carry on a primary production business or use rural land for business purposes.⁶³ According to Smith, the deduction for landcare operations fails adequately to recognise the capital expenditure incurred by landowners who permanently conserve the environment for the public good without carrying on a primary production business or a business for a taxable supply.⁶⁴ These landowners do not receive any income for contributing to the conservation of the environment. Smith proposes expanding the deduction eligibility for landcare operations to include landowners with conservation covenants.⁶⁵ This would enable landowners who are not primary producers to claim a deduction for capital expenditure incurred in relation to landcare operations. Furthermore, it is suggested that landowners with conservation covenants should be permitted to deduct the capital expenditure incurred for landcare operations, regardless of their source of income or whether they are carrying on a business for a taxable purpose.⁶⁶ In addition, Guglyuvatyy⁶⁷ recommends broadening the scope of landcare operations to include "conservation of

⁶¹ Smith *et al* 2016 *Environmental and Planning Journal* 446.

⁶² S 40-635 of Act 38 of 1007.

⁶³ *Ibid.*

⁶⁴ Smith *et al* 2016 *Environmental and Planning Journal* 448.

⁶⁵ *Ibid.*

⁶⁶ *Ibid.*

⁶⁷ Guglyuvatyy 2018 *Australian Tax Forum* 561.

environmentally sensitive land". Such an extension would enable landowners who do not use rural land for carrying on a business for a taxable purpose or primary production purpose still to qualify for a deduction for capital expenditure incurred on landcare operations, even if their land is solely dedicated towards conservation activities.

While the requirements for the deductibility of landcare operations expenditure are not similar to the requirements of section 37C(1) of the Income Tax Act, the criticism raised in relation to the deductibility of landcare operations expenditure offers valuable insights into the operation of conservation incentives in South Africa. The concern identified by Smith,⁶⁸ that the deduction for landcare operations does not adequately recognise capital expenditure incurred by landowners for the public benefit, is equally applicable to South Africa. The recommendation of Guglyuvatyy⁶⁹ that the definition of landcare operations allowing for the deduction of capital expenditure should be extended to include the conservation of sensitive land can be used to support the proposal that section 37C(1) of the Income Tax Act should similarly allow for a deduction of capital expenditure incurred for the conservation or maintenance of land.

6.2 Biodiversity tax incentives in Canada

Similar to section 11(a) of the Income Tax Act and section 8-1 of the Australian Act, section 18(1) of Canada's Income Tax Act⁷⁰ (Canadian Act) allows for a deduction of expenditure incurred by taxpayers for the purpose of generating or producing income, provided that such expenditure is not of a capital nature. Therefore, expenditure incurred in relation to conservation activities will not qualify for a deduction in terms of section 18(1) of the Canadian Act if the purpose of such expenditure is not to produce income.⁷¹

The Minister of Environment and Climate Change of Canada established Canada's Ecological Gifts Program (EGP) to incentivise taxpayers to incur expenditure for the conservation of the environment and to address the shortcomings of section 18(1) of the Canadian Act.⁷² Through the EGP and the Canadian Act, taxpayers can receive a tax benefit for the donation of an ecological gift to a qualified conservation charity, federal, provincial, territorial or municipal government.⁷³ For landowners to be eligible for a deduction or tax credit in terms of the EGP and the Canadian Act, the gift must be ecologically sensitive land or an interest or right in such land, such as a conservation easement, covenant, or servitude, to a qualified recipient certified by the Minister of Environment and Climate Change. In contrast to the Australian Act, which disqualifies landowners from claiming a tax deduction under section 31-5 of the Australian Act if they receive any consideration for entering into a conservation covenant, the Canadian Act

⁶⁸ Smith *et al* 2016 *Environmental and Planning Journal* 448.

⁶⁹ Guglyuvatyy 2018 *Australian Tax Forum* 561.

⁷⁰ RSC of 1985, c 1 (5th Supp).

⁷¹ Guglyuvatyy 2018 *Australian Tax Forum* 559.

⁷² Guglyuvatyy 2018 *Australian Tax Forum* 558.

⁷³ *Ibid.*

permits the practice of split-receipting. The principle of split-receipting applies where a landowner makes an ecological gift and receives some form of consideration in return.⁷⁴ In instances where split-receipting applies, the value of the deduction or tax credit will be reduced by any advantage received by the taxpayer.⁷⁵

Derived from the above literature, it is the author's opinion that the tax regime of Canada more effectively acknowledges the public benefits resulting from private landowners' participation in conservation of the environment. This recognition can be attributed to the principle of split-receipting, which enables taxpayers to qualify for a deduction despite receiving some form of consideration. However, it is submitted that owing to the differences between the requirements and tax treatment of conservation covenants in Canada, on the one hand, and biodiversity management agreements concluded in South Africa on the other, limited guidance can be obtained for the application and interpretation of section 37C(1) of the Income Tax Act.

7 CONCLUSION

The objective of the article was to analyse critically the application of section 37C(1) of the Income Tax Act by clarifying identified ambiguities related to undefined words and phrases in the section. It is submitted that the current wording of the section cannot have the intended consequence of incentivising taxpayers to incur expenditure for the conservation or maintenance of land, as the section does not allow for any expenditure to be deducted beyond what is already permitted in terms of section 11(a) of the Income Tax Act. It is recommended that the section be amended to enable taxpayers to deduct capital expenditure incurred in relation to the implementation of a biodiversity management plan concluded in terms of section 44 of NEMBA. Since section 44 of NEMBA already enables the Minister to enter into a biodiversity management agreement with a person regarding the implementation of a biodiversity management plan, there are already sufficient measures to ensure that the expenditure that taxpayers incur will contribute to the conservation or maintenance of the land.

The article ultimately concludes that owing to the ambiguous wording used in the section, the section does not allow for any expenditure to be deducted beyond what is already permitted in terms of section 11(a) of the Income Tax Act, therefore limiting the intended application of the section and the achievement of its purpose.

⁷⁴ Guglyuvatyy 2018 *Australian Tax Forum* 565.

⁷⁵ *Ibid.*