

## **JOHANNESBURG INNER CITY**

### **URBAN RENEWAL TAX INCENTIVE GUIDE**

*Prepared by the City of Joburg*

#### **1. Introduction**

In the recent past, global big cities with extensive investment in infrastructure, have been adversely affected economically by considerable urban decay, dereliction of buildings and impoverishment partly caused by increased urban migration. Johannesburg, particularly its core Inner City, and other main South African cities have also experienced similar negative economic factors. To reverse this economic decline and to maximize efficient utilization of the existing infrastructure, the South African government has followed international trends and intervened through the introduction of economic and fiscal incentives.

In 2003, the Minister of Finance announced the promulgation of the Urban Renewal Tax Incentive in respect of 16 South African designated urban areas, to promote private investment in property to rejuvenate the inner cities' economies. The incentive comes in a form of an accelerated depreciation allowance to promote private sector investment in construction, extensions, additions and improvement or refurbishment of buildings in the specified urban development zones (UDZs).

The Revenue Laws Amendment Act, effected by the insertion of section 13quat of the Income Tax act no. 58 of 1962, and designating the UDZ status to Joburg's Inner City and Cape Town was promulgated on October 14, 2004. Other large South African cities were accorded the UDZ status later in 2004 and mid-2005. The UDZ legislation has since been amended further and promulgated on February 1, 2006 to allow part or sectional title building ownerships as well as purchased buildings or parts thereof to qualify for the incentive.

This guide highlights the main features of the Urban Renewal Tax Incentive as promulgated and amended by the Urban Renewal Tax Incentive legislation (section 13quat of the Income Tax Act No. 58 of 1962).

Please refer to the [www.treasury.gov.za](http://www.treasury.gov.za) and [www.sars.gov.za](http://www.sars.gov.za) websites for more detailed information regarding the incentive.

#### **2. The Urban Development Zone approved for Johannesburg**

#### **3. Johannesburg Inner City UDZ Boundaries**

- South boundary – M2 highway
- West boundaries – Park Drive, Krause Street & Clarendon Place
- East boundaries – De la Rey Street, 1<sup>st</sup> Street, Albemarle Street & First Street
- North boundaries – First & Hoofd Streets, Louis Botha Avenue & Pricilla Street

#### **4. Johannesburg Inner City UDZ Areas**

- Johannesburg CBD, Newtown, Braamfontein, Hillbrow & Joubert Park
- Bertrams, Fairview, Jeppestown, Jeppestown South, Elcedes & Spes Bona
- Berea, Yeoville, Pageview, Vrededorp, Bellevue, Bellevue East & Randview
- Troyeville, Highlands, Lorentzville, Judith's Paarl, New & North Doornfontein
- Marshalltown, City & Suburban, Salisbury Claims, Ferreirasdorp & Droste Park
- Fordsburg, Burgersdorp, City West, Westgate, Selby Ext. 19 & Crown North Ext
- Village Main, Wemmer, Reynolds View, Wolhuter, Benrose, Benrose Ext, Denver Exts 2 & 6.

Please refer to UDZ map on [www.joburg.org.za](http://www.joburg.org.za)

#### **5. UDZ Tax Incentive Applicability:**

This incentive comes in the form of an accelerated depreciation deducted from the UDZ eligible taxpayer's taxable income, thus reducing the taxpayer's payable tax.

The deduction is applicable in respect of:

- erection, extension or improvement of or addition to an entire building;
- erection, extension, improvement or addition of part of a building representing a floor area of at least 1 000 m<sup>2</sup>; or
- the purchase of such a building or part of a building directly from a developer on or after 8 November 2005, subject to the requirements that:
  - The developer has erected, extended, added to or improved the building or part of the building representing a floor area of at least 1 000 m<sup>2</sup>.
  - The developer has not claimed any UDZ allowance in respect of the building or that part of the building.
  - In the case of the improvement of a building or part of a building, the developer has incurred expenditure in respect of these improvements equal to at least 20 per cent of the purchase price paid by the first purchaser in respect of the building or part of the building.

#### **6. Features of the UDZ Renewal Tax Incentive**

The incentive differentiates between new building construction and refurbishment of existing buildings:

- The improvement of an existing building or part of a building***  
In respect of the improvement of an existing building the deductible amounts are equivalent to 5 year straight-line depreciation or:
  - 20% of the cost of improvement of the building in the year of assessment during which the building is brought into use by the taxpayer solely for the purposes of trade; and
  - An amount equal to 20% of the cost in each of the four succeeding years of assessment, provided that the person does not cease to use the building or that part of the building solely for the purposes of trade.

***The erection or extension of or addition to a building***

In respect of the erection of a new building or part of a building or the extension of or addition to an existing building, the deductions are computed as follows:

- 20% of the cost of either the erection or extension of or addition to the building in the year of assessment during which the building is brought into use by the taxpayer solely for the purposes of trade; and
- 5% of the cost in each of the 16 subsequent years of assessment provided that the person does not cease to use the building or that part of the building solely for purposes of trade.

**7. UDZ Tax Incentive Eligibility**

- Any individual or legal entity – company, close corporation, trust and partner in a partnership – that *owns or purchases* property within the UDZ and invests in new building construction and/or refurbishment of existing buildings or parts thereof *solely for trade purposes including rental of residential property* is eligible for the tax incentive.
- First purchasers – investors who procure newly constructed or refurbished buildings or parts thereof for trade purposes from *bona fide* developers, or registered Johannesburg Inner City UDZ building owners.

**8. UDZ Tax Incentive Eligible Costs**

The incentive covers all construction costs related to the erection, extension, addition or improvement of UDZ situated buildings including:

- Land excavations and demolitions of existing buildings or parts thereof.
- Costs incurred in relation to permanent structures or works directly adjoining building construction or refurbishment sites for the purposes of providing:
  - Building access, sidewalks, parking and landscaping
  - Electricity, water, sewerage, drainage and waste disposal
  - Building security including fences, cameras and surveillance equipment
- In respect of purchased building or part of a building from a Developer, the amounts that will be deemed to constitute eligible costs amount to the following: –
  - 55 per cent of the purchase price of the building or part thereof, in the case of a new building erected, extended or added to by the developer; and
  - 30 per cent of the purchase price of the building or part of the building, in the case of a building improved by the developer,

**9. UDZ Tax Incentive Conditions**

The Johannesburg Inner City UDZ Tax Incentive is applicable under the following conditions:

- ☒ All investors must be registered South African Revenue Service (SARS) taxpayers;
- ☒ All building constructions and refurbishments must fall within the designated Inner City UDZ;
- ☒ Buildings must be owned by the investor and used solely for trade purposes – commercial and industrial purposes including rental of residential property;
- ☒ Building construction and/or refurbishment contracts must have been formally signed by all parties *on or after 14<sup>th</sup> October 2004* to qualify for the incentive;
- ☒ A minimum requirement of 1000 m<sup>2</sup> floor space for the refurbishment parts of existing buildings. This requirement does not apply to the refurbishment of entire buildings;
- ☒ Developers who construct or refurbish buildings within the UDZ with the intention of on-selling do not qualify for the tax incentive. On-selling of buildings or parts thereof leads to forfeiture of the right to claim the incentive;
- ☒ First purchasers can claim UDZ tax incentive based on a percentage of the purchase price which is deemed to be attributable to developer's construction or refurbishment costs;
- ☒ Investors who live in newly constructed or refurbished building while leasing other parts of the building can only claim the UDZ tax incentive for portions of the building that are *used for trade purposes* including rental of residential property;
- ☒ The City of Joburg has issued:
  - *Occupancy Certificates* for each building in terms of section 14 (1) of the National Building Regulations and Buildings Standards Act No. 103 of 1997.
  - *Registration Certificate*-ascertaining that building constructions or refurbishments against which UDZ tax incentives are being claimed, are located within the Johannesburg Inner City UDZ.
  - *Location Certificates* – Confirming that the construction or refurbishment process has been completed.

#### **10. Benefits of UDZ Tax Incentive on Investor Income Tax**

Deductibility of costs incurred by investors in the construction or refurbishment of UDZ buildings against the investor's entire income:

- ☒ Deduction related to one building can be offset against any other investor income, regardless of whether the income relates to the building or the line of business to which the building relates.
- ☒ Any excess losses that cannot be fully offset within a year are carried forward indefinitely. These excess losses can be offset in later years until fully absorbed.

#### **11. Property Sale Conditions**

Investor entitlement to the tax incentive is strictly limited to UDZ property ownership and the utilization thereof for trade purposes:

- ☒ Developers who construct or refurbish buildings within the UDZ with the intention of on-selling do not qualify for the tax incentive.
- ☒ On-selling of buildings or parts thereof on a sectional title basis, necessarily includes transference of the right to claim the incentive to first purchasers.
- ☒ First purchasers qualify for the tax incentive based on a percentage of the purchase price which is deemed to be attributable to developer's construction or refurbishment costs.
- ☒ The incentive ceases on re-selling of property or parts thereof by first purchasers.
- ☒ Property sales may trigger ordinary revenue to the extent that any gain on the sale represents a recoupment of the prior write-off with the excess gain being capital.

#### **14. OBLIGATIONS OF A DEVELOPER FOR PURPOSES OF THE UDZ TAX INCENTIVE**

To facilitate access to the UDZ tax incentive to taxpayers that purchase buildings or parts of buildings located in an urban development zone directly from developers, the developers have to provide those taxpayers with certificates (UDZ 3 available on the SARS website [www.sars.gov.za](http://www.sars.gov.za)), which confirm that –

- the erection, extension or improvement of or addition to the building or part thereof was commenced by the developer on or after the date of publication in the *Gazette* of the particulars of the demarcated area in which the building is located, in terms of a contract formally and finally signed by all parties thereto on or after that date;
- the erection, extension or improvement of or addition to the building by the developer covers either the entire building or a part of the building representing a floor area of at least 1 000 m<sup>2</sup>;
- the developer has not claimed any UDZ allowance in respect of the building or that part of the building;
- a certificate of occupancy has been issued by the relevant municipality in respect of the building or that part of the building; and
- where the developer has improved the building or part of the building, that developer has incurred expenditure in respect of those improvements which is equal to at least 20 per cent of the purchase price paid by the person in respect of the building or that part of the building.

In addition to the obligation of a developer to provide a purchaser of a building or part of a building within an urban development zone with a UDZ 3 form, any developer who erects, extends, adds to or improves a building within an urban development zone of which the estimated cost thereof is likely to exceed R5million, further, has to comply with the reporting requirements to:

- inform the Commissioner within 30 days after the commencement of that erection, addition or improvement, of the estimated costs thereof in respect

of the building or part(s) of the building which the developer intends to sell and the estimated selling price of the building or those parts; and

- inform the Commissioner within 30 days after the sale of the building or any parts of the building have been concluded, of the actual costs incurred in respect of that building or part(s) of that building and the actual selling price of that building or part(s) thereof.

#### **15. Johannesburg Inner City UDZ Tax Incentive Process**

Property owners and purchasers must obtain the following documents from the City of Johannesburg to qualify for the Johannesburg Inner City UDZ tax incentive:

- Registration Certificates* for all UDZ buildings to confirm that building erections or refurbishments against which UDZ tax incentive is being claimed, are located within the Johannesburg Inner City UDZ, and facilitate tracking of property ownership and entitlement to the UDZ tax incentive; (*This is an optional municipal requirement*)
- Occupancy Certificates* for all building constructions or refurbishments within the UDZ in terms of section 14 (1) of the National Building Regulations and Buildings Standards Act No. 103 of 1997;
- Location Certificates* – which confirm that the building erection, extension, addition or refurbishment process has been completed and the taxpayers are ready to claim the incentive.
- SARS Application Forms:
  - UDZ 1: To be completed only by the UDZ owners of buildings or parts of buildings, who erect, extend, add or improve their buildings or parts thereof;
  - UDZ 2: To be completed in respect of erected, extended or improved buildings or parts thereof purchased from developers;
  - *UDZ 3*: issued by bona fide to first purchasers of buildings or parts of buildings located in the UDZ for purposes of the urban development zone tax incentive to facilitate their access to the UDZ tax incentive;
  - *UDZ 4*: To be completed by developers to comply with the UDZ legislation in respect of buildings whose costs are likely to exceed R5 million.

Please click on the Application Process button on this website [www.joburg.org.za/udz](http://www.joburg.org.za/udz) for more details.

## EXAMPLES

### Example 1

- An investor purchases a property in the UDZ for R8 million and refurbishes it for R100 million.
- The investor can deduct 20% of the R100 million refurbishment costs over 5 years (R20 million annually) once the building is in use.
- The R8 million property acquisition costs do not qualify for the incentive.

### Example 2

- An investor purchases a vacant land for R5 million and constructs a new commercial building for R100 million.
- The investor can deduct 20% (R20 million) of the construction costs in the 1<sup>st</sup> year and 5% (R5 million) for the next 16 years once the building is in use.
- The R5 million land acquisition costs do not qualify for the incentive.

### Example 3

- An investor who generates R500 000 income as a doctor, purchases a townhouse within the UDZ and refurbishes it for R50 000.
- He generates R36 000 annual rental income from the townhouse, R34 000 of which is spent on ongoing expenses associated with the townhouse rental – resulting in a net annual profit of R2 000.
- The R50 000 UDZ townhouse refurbishment tax write-off is deductible against his entire income of R502 000 – R500 000 income as a doctor plus the R2 000 townhouse rental profit.
- The townhouse acquisition costs do not qualify for the incentive.

### Example 4

- Company X which is involved in a number of trades, including an IT business, erects a R600 million building for its IT trade.
- Thus qualifying for the 17-year UDZ new construction tax initiative – 20% (R120 million) write-off (capital allowance) in the 1<sup>st</sup> year and 5% for the next 16 years.
- The company does not generate income from the building in the 1<sup>st</sup> year but generates a net income of R35 million from its overall IT business plus another R50 million from its other businesses in the same year.
- The R120 million UDZ tax write-off can be offset against the company's overall R85 million income regardless of whether the income relates to the company's IT business for which the building was related.

- The company can also utilize the R120 million capital allowance in the current year to eliminate all of its R85 million income.
- The remaining R35 million capital allowance can be used as an offset against income arising in later years.

Example 5

- An investor constructs a R100 million commercial building in the UDZ for retail business and decides to write-off 30% of the building over 3 years.
- Thus receiving a R30 million deduction – R20 million in the 1<sup>st</sup> year and R5 million in the following 2 years.
- He then sells the building for R108 million.
- The net result is that the investor gains R38 million on the sale – R30 million recoupment of the prior write-off as ordinary revenue plus R8 million of capital gain.