

UDZ Tax Incentive

"Revenue Laws Amendment Act", 2003 Promulgated on 17 December 2003 Extract (English: Pages 2, 62, 64, 66 & 68)

GENERAL EXPLANATORY NOTE:

- [] Words in bold type in square brackets indicate omissions from existing enactments.
_____ Words underlined with a solid line indicate insertions in existing enactments.

Insertion of section 13quat in Act 58 of 1962

33. The following section is hereby inserted in the Income Tax Act, 1962, after section 13ter:

“Deductions in respect of erection or improvement of buildings in urban development zones

13quat. (1) For the purposes of this section—

‘certificate of occupancy’ means a certificate contemplated in section 14(1) of the National Building Regulations and Building Standards Act, 1977 (Act No. 103 of 1977);

‘cost’ means the costs (other than borrowing or finance costs) actually incurred in erecting or extending, adding to or improving a building and includes any costs incurred—

- (a) in demolishing any existing building or part thereof;
(b) in excavating the land for purposes of that erection, extension, addition or improvement; and
(c) in respect of structures or works directly adjoining the building so erected, extended, added to or improved, for purposes of providing—
- (i) water, power or parking with respect to that building;
 - (ii) drainage or security for that building;
 - (iii) means of waste disposal for that building; or
 - (iv) access to that building, including the frontage thereof;

‘urban development zone’ means an area demarcated by a municipality in terms of subsection (6), the particulars of which were published in the *Gazette* in terms of subsection (8);

(2) There shall be allowed to be deducted from the income of the taxpayer an allowance determined in terms of subsection (3), in respect of the cost of the erection, extension, addition or improvement of any commercial or residential building within an urban development zone to be used solely for purposes of that taxpayer’s trade—

- (a) which was commenced by the taxpayer on or after the date of publication of the notice contemplated in subsection (8) in respect of that urban development zone, in terms of a contract formally and finally signed by all parties thereto on or after that date; and
(b) in respect of which a certificate of occupancy has been granted.

(3) The amount of the allowance contemplated in subsection (2)—

- (a) in the case of the erection of any new building or the extension of or addition to any building (other than a building in respect of which paragraph (b) applies), is equal to—
- (i) 20 per cent of the cost to the taxpayer of the erection or extension of or addition to that building, which is deductible in the year of assessment during which that building is brought into use by that taxpayer solely for the purposes of that taxpayer’s trade; and
 - (ii) five per cent of that cost in each of the 16 succeeding years of assessment; or

(b) in the case of the improvement of any existing building or part of a building (including any extension or addition which is incidental to that improvement) where the existing structural or exterior framework thereof is preserved, is equal to—

- (i) 20 percent of the cost to the taxpayer of the improvement, extension or addition which is deductible in the year of assessment during which the part of the building so improved, extended or added is brought into use by the taxpayer solely for the purposes of that taxpayer's trade; and
- (ii) 20 per cent of that cost in each of the four succeeding years of assessment.

(4) No deduction shall be allowed under this section, unless the taxpayer has together with the tax return for the year of assessment in which the deduction is claimed under subsection (3)(a)(i) or (b)(i), provided to the Commissioner—

- (a) a certificate from the municipality confirming that the building is located within an urban development zone within that municipality;
- (b) the total amount of the costs to the taxpayer of the erection, extension, addition or improvement and the extent that those costs relate to any portion of the building in respect of which a certificate of occupancy has been granted; and
- (c) particulars as to whether the costs were incurred in respect of the erection of a building as contemplated in subsection (3)(a) or the extension, addition or improvement of a building as contemplated in subsection (3)(b).

(5) No deduction shall be allowed under this section in respect of any building—

- (a) where that taxpayer ceased to use that building solely for purposes of that taxpayer's trade during any previous year of assessment; or
- (b) which has been disposed of by the taxpayer during any previous year of assessment.

(6) For the purposes of this section, one area may be demarcated by a municipality where—

- (a) that area is a developed urban location with the municipality of Buffalo City, Cape Town, Ekurhuleni, Emalaheni, Emfuleni, eThekweni, Johannesburg, Mafikeng, Mangaung, Matjhabeng, Mbombela, Msunduzi, Nelson Mandela, Polokwane, Sol Plaatje or Tshwane;
- (b) that area is demarcated through formal resolution by the relevant municipal council no later than 30 June 2004 or such later date as the Minister may approve on good cause shown;
- (c) that area is prioritised in that municipality's integrated development plan adopted and undertaken in terms of Chapter 5 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) as a priority area for further investments to promote business and industrial activity as well as dense residential settlements to support such activity;
- (d) that area proportionately contributes or previously contributed a significant portion of the total revenue collections for all areas located within the current boundaries of that municipality, as measured—
 - (i) in the form of property rates; or
 - (ii) assessed property values used to determine those rates, and where the contribution from that area is undergoing a sustained decline;
- (e) significant fiscal measures have been implemented by that municipality to support the regeneration of that area, including—
 - (i) the appropriation of significant funds for developing the area in the annual budget of the municipality;
 - (ii) special tariffs for categories of residential, commercial or industrial users; or
 - (iii) partnership arrangements with the business community for the promotion of urban development within that area; and
- (f) that municipality commits to the objective of processing all planning approval applications for that area within 90 days of submission and to report those applications that are processed in a longer period, together with reasons for the delay, to the National Treasury on a quarterly basis within 30 days of the end of each quarter.

- (7) (a) Subject to paragraph (d), the area demarcated in terms of subsection (6) may not exceed—
- (i) where that municipality has a population of not more than 500 000 persons, a total area of 150 hectares; or
 - (ii) where that municipality has a population of more than 500 000 persons, 150 hectares plus 20 hectares for each additional 100 000 persons included in that population.
- (b) Where that municipality has a population of 2 million persons or more, the municipal council may demarcate two areas in lieu of the one area demarcated in terms of subsection (6) provided that—
- (i) the two areas do not in total exceed the one area contemplated in paragraph (a)(ii); and
 - (ii) each area otherwise satisfies the requirements of subsection (6).
- (c) For purposes of this subsection, the population of a municipality shall be the population figures as determined by Statistics South Africa in the Census for 2001 and the total population of that municipality must be rounded to the nearest multiple of 100 000.
- (d) The area demarcated in terms of subsection (6) may exceed the limits contemplated in paragraph (a) where—
- (i) the municipality proves to the Minister that the excess area is integrally related to the area within the limitation contemplated in paragraph (a);
 - (ii) the municipality can prove to the Minister that sound economic reasons exist for demarcating a larger area;
 - (iii) the municipality has not demarcated two areas as contemplated in subparagraph (b); and
 - (iv) the Minister is satisfied that the demarcation of the excess area would fall within Government's affordability constraints.
- (8) The Minister must publish by notice in the *Gazette* particulars of an area demarcated by a municipality after that municipality has proved to the Minister that the area so demarcated complies with the provisions of subsection (6).
- (9) Every municipality must provide an annual report to the Commissioner and the Minister for each urban development zone located within that municipality within such time as is prescribed by the Minister, listing—
- (a) each taxpayer to which a certificate contemplated in subsection 4(a) has been issued;
 - (b) the location of each building for which that certificate was issued;
 - (c) the costs incurred by the taxpayer in respect of each building;
 - (d) the total jobs created as a result of this section;
 - (e) the additional property rates collected as a result of this section; and
 - (f) the total applications for a certificate contemplated in subsection 4(a).
- (10) Where—
- (a) a municipality does not provide an annual report as contemplated in subsection (9) or a quarterly report as contemplated in subsection 6(f) or the Commissioner reports to the Minister that the municipality has issued a certificate contemplated in subsection (4)(a) in respect of a building that is located outside an urban development zone; and
 - (b) corrective steps are not taken by that municipality within a period specified by the Minister, the Minister may withdraw the notice contemplated in subsection (8) for that municipality in respect of contracts formally and finally signed by all parties thereto on or after the date of withdrawal.
- (11) The Commissioner must on an annual basis submit a report to the Minister containing information relating to—
- (a) the number of taxpayers which have during the relevant year claimed an allowance in terms of this section;
 - (b) the total amount of the deductions by taxpayers allowed in that year in terms of this section; and
 - (c) the total amount of the costs to those taxpayers which are or will be allowable as a deduction in terms of this section.

“Explanatory Memorandum on the Revenue Laws Amendment Bill, 2003”, SARS & National Treasury, Extract (Pages 54 – 59)

Income Tax Act 58 of 1962

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CLAUSE 33

Income Tax: Insertion of section 13quat of the Income Tax Act, 1962

Under current law, the tax depreciation of buildings is generally low, either being nil, 2% or 5%. No provision exists for the accelerated tax depreciation of buildings. Like many countries, South Africa has a number of urban areas that are impoverished and suffering from extensive urban decay. In order to address these concerns and maintain existing infrastructure that was developed at great cost, governments internationally have utilised tax measures to support efforts aimed at regenerating these urban areas. These narrowly targeted capital allowances seek to attract private sector businesses to areas where interest would otherwise be lacking. The proposed legislation therefore introduces a tax incentive as a response, coming in the form of an accelerated depreciation allowance for investments in the inner cities. The core objectives of the incentive are to promote urban renewal and development by promoting investment by the private sector in the construction and improvement of buildings.

The Bill contains accelerated depreciation deductions for the construction and improvement of buildings within demarcated urban development zones. Significant time has been spent with municipalities in developing the criteria for determining the location and size of the zones.

Subsection (2)

General:

The proposed section 13quat provides taxpayers investing in under utilized designated urban areas with a special depreciation allowance. The allowance will cover the erection, extension, addition or improvement (the last three will be referred to as “refurbishment”) of any commercial or residential building in a demarcated area. The allowance is deductible in the year the erected building or the refurbished part of the building is brought into use by the taxpayer for purposes of trade. This tax expenditure will benefit owners, users or lessors of such buildings. The detailed set of criteria required to be met to qualify for this incentive are described below.

Demarcated Areas

The urban development allowance will apply to demarcated areas only. Accordingly, only buildings that are erected or refurbished within these areas will qualify for the incentive. Several criteria (set out in subsection 6) have been taken into account in demarcating qualifying zones (demarcated areas) within the selected metropolitan and urban areas. This approach is adopted in order to ensure that the impact of the incentive is maximised in these parts of the cities and towns that are most in need of development. International experience suggests that successful urban renewal occurs only if efforts are concentrated at specific locations.

Commencement of erection or refurbishment

As with any legislation, the proposed amendment contains an effective date. Under this effective date, the contract in terms of which the erection or refurbishment is carried out must have been signed by all parties involved on or after the date the details of the relevant demarcated area are published in the *Gazette*. This will encourage municipalities to demarcate their areas as quickly as possible. No relief is available for projects occurring before the effective date because these projects would have been performed in any event, thereby leading to a dead-weight loss.

Certificate of Occupancy

A Certificate of Occupancy must support the erection or refurbishment of any commercial or residential building. The purpose of the certificate is to differentiate between substantial changes and minor changes (i.e. repairs). Minor changes have been excluded from the incentive because these changes will have no meaningful impact on urban renewal.

Subsection (3)

Amount of allowance

The allowance covers all the costs of the erection or refurbishment of any commercial or residential building. These costs include the costs that a taxpayer has incurred in demolishing or destroying any existing building (or any part thereof) and costs that have been incurred with respect to permanent fixtures directly adjoining the site. These latter costs involve provision for amenities like water, power, sewage, access or parking for the building, drainage, security for the building (including fences, cameras and surveillance equipment), means of waste disposal, sidewalks and landscaping (including earthworks, greenery and irrigation). The amount of the allowance is dependant on whether the taxpayer erects a new building or refurbishes an existing commercial or residential building.

Depreciation on erection of new buildings

Taxpayers erecting a new commercial or residential building within a demarcated area will be allowed a 17-year write-off period. Specifically, they will be allowed a 20 percent write-off in the first year and an annual 5 percent write-off for the following 16 years.

Example

Facts: The taxpayer constructs a new commercial building for consumer retail purposes. The new construction costs R100 million.

Result: Under current law, the taxpayer receives a 0 percent deduction. Under proposed law, the taxpayer can deduct 20 percent of cost in the first year (i.e., R20 million). Thereafter, the taxpayer can deduct 5 percent of the cost for the next 16 years (i.e., R5 million per annum for the next 16 years). The estimated tax savings for companies in this circumstance is R6 million in the first year (R20 million x 30 percent) and R1,5 million in each year thereafter (R5 million x 30 percent).

Depreciation on refurbishment of existing building

Taxpayers refurbishing existing buildings will receive a 20 percent straight-line depreciation allowance over a 5-year period. The purpose of this enhanced incentive is to maintain structures considered worthy of retention and to maximise the use of all the sunken capital in existing buildings, which were developed at great cost. In order to qualify as a refurbishment, taxpayers must preserve a substantial part of the building's existing structural or exterior framework must be preserved. In addition, any extension or addition to an existing building must be of an incidental nature to the improvement.

Example

Facts: The taxpayer refurbishes an old commercial building for consumer retail purposes. The refurbishment costs R100 million.

Result: Under current law, the taxpayer receives a 0 percent deduction. Under proposed law, the taxpayer can deduct 20 percent of the cost over 5 years (i.e., R20 million over 5 years). The estimated tax savings over 5 years is R6 million per year for companies in this circumstance (R20 million x 30 percent).

Subsection (4)

Reporting Requirement

This subsection creates a reporting obligation in order for taxpayers to obtain deductions under section 13*quat*. Under this rule, a taxpayer must provide certain additional information when filing an income tax return. Failure to submit this prescribed information for the year means the deduction will not be available for that year. The reason for this subsection is to ensure that Government's revenue costs allocated to urban renewal are carefully monitored to review the affordability thereof. This subsection also provides a means of monitoring the success of the project through transparent tax expenditure reporting and budgeting.

A taxpayer must attach a certificate from the local authority confirming that the building is situated within a demarcated area of that local authority. In addition, a taxpayer must state the total amount of costs incurred by him for the erection or refurbishment of the building, and the extent to which those costs relate to any part of a building in respect of which a certificate of occupancy has been granted. Lastly, details as to whether the costs were incurred in the erection or the refurbishment of a building must be provided.

Subsection (5)

Limitation of allowance

As with all depreciation allowances, a taxpayer receives the deduction only while using the building for the purposes of trade or still owning it. If a taxpayer ceases to use the building solely for the purpose of trade or disposes of it, the deduction in respect of that building ceases.

Subsection (6)

Geographic Targeting - Designation of Inner City Districts

Subsection (6) stipulates that the Municipal Councils for each of the 16 municipal areas identified are responsible for the designation of one inner city district within their municipal boundaries. Each designation will specifically constitute an inner city district which traditionally formed the social and economic heart of a municipality and which has the potential with financial incentives to act as a catalyst for the rejuvenation of a wider area suffering from economic decline. While tax incentives can be useful, urban renewal cannot be achieved by tax incentives alone. Tax incentives should merely act as a complementary intervention to best facilitate the achievement of development objectives. Hence, several criteria have been included in demarcating qualifying zones that seek to ensure that the proposed tax incentive complements other existing urban renewal efforts.

The criteria for selecting a single inner city district are as follows:

a) *Formal resolution by municipal council*

The municipal council must demarcate the area by formal resolution by 30 June 2004 or such later date as the Minister may approve.

b) *Municipality's Integrated Development Plan*

The demarcated area must be consistent with that municipality's integrated development plan. This plan often encompasses a short-term delivery strategy of approximately 3 to 5 years. The purpose of the integrated development plan is to bring about the rejuvenation of the area through a series of actions, which aim to:

- o Support existing residential functions through refurbishment of existing properties, sensitively designed new developments, and the provision of adequate amenity or recreation space;
- o Support the development of a broad based social mix in the area;
- o Provide opportunities for employment to locate to the area;
- o Impose linkages within the area and outside; and
- o Bring vacant, derelict and unused buildings or sites back into productive use.

c) *Declining contribution to total revenue*

This factor requires that the demarcated area currently contribute, or have previously contributed, the largest portion of the total revenue (i.e. rates and taxes) for the municipal area. Further, the level of contribution must evidence a declining trend. In other words, the demarcated area must currently be, or previously been, a focal point, but now demonstrates a high degree of urban decay relative to other parts of the city.

d) *Additional Financial Measures*

Each municipality must provide additional financial measures to support and enhance regeneration within its area. These additional financial measures can take any number of forms, such as reduced property rates and local user charges.

e) *Commitment to speedy processing of planning approval applications*

Each municipality must commit to the objective of processing all planning approval applications in the demarcated area within 90 days of submission and to providing National Treasury with regular reports of cases where this period is exceeded.

Subsection (7)

Demarcated areas

A hectare limitation is set for the surface area a municipality may demarcate based on its population. This limitation is designed to ensure that the incentive is properly targeted and to ensure that the incentive is within affordability constraints. The area is limited to 150 hectares for the first 500 000 or less persons in a municipality and an additional 20 hectares for each additional 100 000 persons. A municipality with a population of 2 million persons or more may divide its allowable area between two demarcated areas. The population of a municipality must be rounded to the nearest 100 000 in order to determine the allowable area. The legislation contains some flexibility so that municipalities can motivate for higher hectare limitations if required. The municipality must prove to the Minister that the extended area is part of a bigger integrated area and sound economic reasons exist for the extension. The Minister must also be satisfied that the extended area will be within Government affordability constraints.

Subsection (8)

Publication in Government Gazette

The demarcated area may be published by notice in the Government Gazette only after the Minister of Finance is satisfied that the selected area satisfies the requirements as set out in subsection 6 above.

Subsections (9)

Requirements for reporting by municipality

Subsection (9) lists the required information each municipality must provide in the annual report which it must furnish to the Commissioner and the Minister for each of its urban development zones. This requirement ensures proper monitoring of this initiative.

Subsection (10)

Failure to report

Subsection (10) provides that where the municipality does not provide the required reports and does not take corrective steps within the period specified by the Minister, the Minister may withdraw the notice in terms of subsection (8) for that municipality.

Subsection (11)

Commissioner's Report

SARS must annually provide information about the urban renewal project to the Minister of Finance so that the Minister can fully report to Parliament regarding:

- a) the number of taxpayers that claimed the allowance in that particular year;
- b) the total amount allowed as a deduction to taxpayers in that particular year; and
- c) the total amount of deductions allowable by taxpayers in that particular year.

This requirement ensures proper monitoring of this initiative and annual accountability to Parliament.