
Depreciation allowances for tax purposes in periods of less than a year

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SUMMARY

In tax legislation, a depreciation allowance is applied in three provisions and results in a reduction of taxable amounts. A depreciation allowance is calculated for the period an employer owned a vehicle prior to granting the right of use to an employee (paragraph 7(1) of the Seventh Schedule to the Income Tax Act and section 10(13) of the Value-Added Tax Act) or the period an asset was leased prior to acquisition by the lessee (section 8(5)(bB) of the Income Tax Act). Both periods could consist of or include a period of less than a year. The uncertainty of interest in this article is whether a depreciation allowance should be disregarded or not when a period of less than a year is concerned. The tax implications, wording, and context of the three tax provisions were considered with due regard for the limited current guidance offered by the SARS. The findings of this article suggest that a taxpayer following current guidance in the application of all three tax provisions would not be correct. In line with current guidance relating to paragraph 7(1) of the Seventh Schedule to the Income Tax Act, the depreciation allowance contemplated in section 10(13) of the Value-Added Tax Act should disregard a period of less than a year. Contrary to current guidance, the different context of the depreciation allowance contemplated in section 8(5)(bB) of the Income Tax Act is argued as affording the opportunity to apply the depreciation allowance when a period of less than a year is concerned. A depreciation allowance applied for a period of less than a year would result in a lower recoupment for inclusion in taxable income for normal tax purposes and, as a result, argued as beneficial to taxpayers.

1 Introduction

For tax purposes, reference is made to a “depreciation allowance” in only three provisions of the Income Tax Act 58 of 1962 (hereinafter ITA) and the Value-Added Tax Act 89 of 1991 (hereinafter VAT Act). The three references are made in the calculation of a fringe benefit in respect of the right of use of a vehicle for normal tax purposes,¹ in the calculation of a fringe benefit in respect of the right of use of a vehicle for VAT purposes,² and the calculation of fair market value in respect of the acquisition of a

1 Proviso (a) to Para 7(1) of the Seventh Schedule to the ITA.

2 S 10(13) of the VAT Act read with Government Notice (GN) 2835 in *Government Gazette* (GG) 13651 of 1991.

leased movable asset at the end of a lease.³ The term “depreciation allowance” contemplated in this article refers to these three specific references in tax legislation.⁴

The period for which depreciation allowances are calculated is based on the period a vehicle was previously owned by an employer prior to granting the right of use to an employee or the period a movable asset was leased prior to acquisition at the end of a lease. From a practical perspective, both these periods could be for less than a year as either the total period could be less than a year or the total period might not be full years only. The taxpayer tasked with the calculation of a depreciation allowance would have to consider whether a depreciation allowance should be deducted when a period of less than a year is concerned. The South African Revenue Service (SARS) currently only provides guidance in respect of the depreciation allowance relating to the right of use of a vehicle for normal tax purposes and that a depreciation allowance should be disregarded for periods of less than one year.⁵ Uncertainty arises on whether the current guidance for normal tax purposes extends to the application of section 10(13) of the VAT Act and the depreciation allowance for purposes of section 8(5)(bB) of the ITA. As a depreciation allowance could be beneficial to taxpayers in terms of a reduction of the taxable amount, guidance on this uncertainty is warranted. As section 8(5) relates to leases, an attempt to clarify the uncertainty could make a particular contribution. The importance of being diligent when accounting for finance leases has been highlighted as the income tax and VAT consequences are often overlooked as the principles of financial accounting tend to dominate practices.⁶ When deciding whether to finance an asset under an instalment sale, operating lease, or financial lease, the income tax and VAT consequences require due consideration.⁷ The depreciation allowance for purposes of section 8(5)(bB) of the ITA could potentially have income tax consequences in respect of which this article attempts to provide related guidance.

As the wording applied in the three depreciation allowance provisions does not agree in all respects, further investigation into the language (or wording) of these provisions is warranted. In instances of uncertainty regarding phrases in tax statutes, research could be pursued in order to

3 S 8(5)(bB)(i) of the ITA. The calculation of fair market value is also applied in S 18A(3)(c)(ii) of the ITA.

4 The term “depreciation allowance” is therefore not the term applied as a synonym for wear-and-tear allowances or capital allowances for normal tax purposes. See SARS *Interpretation Note 47: Wear-and-Tear or Depreciation Allowance (Issue 5)* (2021), where depreciation allowances are applied as a synonym for capital allowances.

5 SARS *Interpretation Note 72: Right of Use of Motor Vehicle* (2013) 7.

6 Latief, Mohamed and Kamdar “Income tax and VAT consequences of finance leases” 2019 *Tax Professional* 18-19.

7 Feinstein “Financial leases - income tax and VAT consequences” 1998 *SAICA Integritax* 551.

suggest an amendment to the acts to eliminate any ambiguity or uncertainty.⁸ In terms of the modern purposive approach to the interpretation of documents, the context and the language should be considered with neither dominating the other.⁹ When dealing with a tax statute, context does not involve conjecture as to the intention of the legislature, but rather a reasoned assessment of the broad purpose underlying its enactment is required.¹⁰ An interpretation of a tax statute favourable to the fiscus is further not necessary merely because the purpose of the statute is to raise revenue.¹¹ However, anti-avoidance provisions in tax statutes may be entitled to more generous consideration than provisions that define what is taxable.¹² Persons involved in the interpretation of a statutory provision should not engage in a complex process or introduce into the provision that which is not intended by the legislature.¹³ The depreciation allowance provisions broadly have the same objective as a reduction of an amount for tax purposes; however, the wording and the context of the three provisions do not agree with reference to the person tasked with the calculation of the depreciation allowances and the underlying assets. Due consideration should accordingly be given to the language (or wording) of tax provisions, as well as the context of the tax provisions.

This article considers whether depreciation allowances should, for tax purposes, be disregarded or not when a period of less than a year is concerned. Firstly, an overview of the tax implications and the context of the three depreciation allowance provisions is provided to highlight similarities and differences. Regarding the context of provisions, the person tasked with the calculation of the depreciation allowance, as well as the nature of the underlying asset that forms the basis of the depreciation allowance, were considered. Secondly, it is considered whether depreciation allowances for purposes of section 10(13) of the VAT Act should be taken into account when a period of less than a year is concerned with reference to the wording and the context of the provision. Thirdly, it is considered whether depreciation allowances for purposes of section 8(5)(bB) of the ITA should be taken into account when a period of less than a year is concerned with reference to the wording and the context of the provision. Lastly, the article concludes with a summary of findings and recommendations.

8 Barnard, Bornman and Horn “Withholding tax on interest: Who has the withholding obligation?” 2019 *JEF* 4.

9 *Natal Municipal Joint Pension Fund v Endumeni* (2012) 4 SA 593 (SCA) 16.

10 Wallis “Interpretation before and after *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 4 SA 593 (SCA)” 2019 *PER* 17.

11 As above.

12 As above.

13 *Peresoft Software and Support (Pty) Ltd v Minister of Science and Innovation* (11372/19) [2020] ZAGPPHC 430 (12 February 2020).

2 The tax implications and the context of depreciation allowances

For normal tax purposes, an employee could be liable for normal tax in respect of the right of use of a vehicle granted by an employer as such use constitutes a fringe benefit.¹⁴ The determined value of the fringe benefit is based on the retail market value of the vehicle on the date of acquisition by the employer, or the date the employer first obtained the right of use of the vehicle, or the date the employer manufactured the vehicle.¹⁵ In the calculation of the determined value, a depreciation allowance is deducted and calculated according to the reducing balance method at the rate of fifteen per cent for each completed period of twelve months from the date on which the employer first obtained the vehicle, or the right of use thereof, to the date on which the employee was first granted the right of use of the vehicle.¹⁶ The depreciation allowance accordingly reduces the determined value of the vehicle and hence the value of the fringe benefit in recognition that the employee could have been granted the use of a second-hand vehicle.¹⁷ Although taxation of fringe benefits could be argued as an anti-avoidance provision (to ensure that benefits that substituted taxable salaries are also taxable), the depreciation allowance results in an employee not being taxed on the use of a new vehicle if a second-hand vehicle was used. The depreciation allowance accordingly benefits the employee as a taxpayer as it would result in lower normal tax. The determined value would, however, not be adjusted with the depreciation allowance if the period is less than twelve months (for example, only three months).¹⁸ Based on existing guidance relating to paragraph 7(1) of the Seventh Schedule to the ITA, it is evident that depreciation allowances should be disregarded for periods of less than one year. An employer would be tasked with the calculation of the depreciation allowance¹⁹ and vehicles are the underlying assets of the depreciation allowances in respect of the right of use of a vehicle for normal tax purposes.

For VAT purposes, an employer could be liable for output tax in respect of the right of use of a vehicle granted to an employee.²⁰ The determined value of the fringe benefit is based on the original cost to the employer on acquisition or the retail market value when the employer first obtained the right of use of the vehicle.²¹ In the calculation of the

14 S 1(1) gross income definition in Para (i) read with Para 2 of the Seventh Schedule to the ITA.

15 Para 7(1) of the Seventh Schedule to the ITA.

16 Proviso (a) to Para 7(1) of the Seventh Schedule to the ITA.

17 Fisher, Hoffman and Sithole "Fringe benefits: 198. Company car transferred to employee" 1995 *Integritax* October.

18 SARS *Interpretation Note 72: Right of Use of Motor Vehicle* (2013) 7.

19 As part of the obligation to withhold employee tax in terms of Para 2 of the Fourth Schedule to the ITA.

20 S 18(3) of the VAT Act.

21 S 10(13) of the VAT Act read with GN 2835 in GG 13651 of 1991.

determined value, a depreciation allowance is deducted and calculated according to the reducing balance method at the rate of fifteen per cent for each completed period of twelve months from the date on which the vendor (employer) first obtained such vehicle (or the right of use of the vehicle) to the date on which the said employee was first granted the right of use thereof.²² The depreciation allowance benefits the employer as it results in lower output tax being payable by the employer. Based on existing guidance issued by the SARS relating to section 10(13) of the VAT Act, it is not evident whether the depreciation allowance should be disregarded or not for periods of less than one year.²³ An employer that is a VAT vendor would be tasked with the calculation of the depreciation allowance²⁴ and vehicles are the underlying assets of the depreciation allowances in respect of the right of use of a vehicle for VAT purposes.

For normal tax purposes, if upon the termination of a lease a lessee of a movable asset is permitted to apply the leased asset for own benefit without the payment of any consideration or the payment of a nominal consideration, the fair market value of the movable asset is included in the lessee's taxable income.²⁵ The fair market value of the movable asset is based on the cost to the former lessor or the cash value in the case of a finance lease concluded by the former lessor.²⁶ In the calculation of the fair market value a depreciation allowance is deducted which for the first year is calculated at the rate of twenty per cent of the cost or cash value of the asset and for each succeeding year is calculated at the rate of twenty per cent on the balance of the said cost or cash value remaining after the deduction therefrom of the allowance(s) calculated for the year(s) preceding such succeeding year.²⁷ Depreciation allowances are accordingly calculated at the rate of twenty per cent per annum on the diminishing balance method.²⁸ If the lease is renewed at a nominal (or low) rental, the person liable for the rental would be deemed to have acquired the movable asset at no consideration and is consequently taxed on the calculated fair market value.²⁹ Nominal (or low) rental is less than ten per cent per annum of the fair market value of the asset.³⁰ For normal tax purposes, the acquisition of leased movable assets at the end

22 As above.

23 SARS *VAT 404 Guide for Vendors* (2019); SARS *Interpretation Note 82: Input Tax on Motor Cars* (2015). Neither of these sources indicates whether the depreciation allowances should be applied for VAT purposes if the period concerned is less than one year.

24 As part of the obligation to levy output tax in terms of S 7 of the VAT Act read with S 18(3) of the VAT Act.

25 National Treasury *Explanatory Memorandum on the Income Tax Bill 1984* (1984) 23.

26 S 8(5)(bA) of the ITA.

27 S 8(5)(bA) of the ITA.

28 National Treasury *Explanatory Memorandum on the Income Tax Bill 1983* (1983) 8-9.

29 Huxham and Haupt *Notes on South African Income Tax* (2021) 208.

30 S 8(5)(bB)(iii) of the ITA.

of a lease could accordingly result in a recoupment for the person acquiring the leased asset.³¹ The one disadvantage of a financial lease is the fact that there is invariably a recoupment at the termination of the lease, unless it can be shown that the asset at the end of the agreement has no market value.³² The recoupment would be in instances of actual acquisition where the purchase price is reduced by previous lease payments and in instances of deemed acquisition when the asset is still being leased at a nominal (or low) rental. In the case of actual acquisition, the practice is to allow wear-and-tear allowances on the value that is taxable³³ on the condition that a taxpayer applies the asset in the production of income in the carrying on of a trade.³⁴ Taxpayers carrying on a trade would have the immediate tax consequences of being taxed on a recoupment and allowed a deduction over the period the asset is used for trade purposes³⁵ – resulting in a timing difference in the taxable recoupment and allowance of deductions. Taxpayers not carrying on a trade after acquiring the leased asset would only have immediate tax consequences, without being afforded further deductions in respect of the leased asset acquired. The importance of the depreciation allowance is therefore emphasised as it could reduce the taxable value of a recoupment that could have immediate tax consequences for taxpayers at the end of the lease when the leased asset is acquired.

From an administrative perspective, the former lessor is required to calculate the fair market value of the movable asset and is obligated to inform the lessee (or current owner) of the fair market value by no later than fourteen days after the end of three months following the termination of the relevant lease.³⁶ The Commissioner is empowered to either increase or reduce the value in instances where the actual fair market value of the asset is shown to differ from the fair market value calculated by the former lessor.³⁷ However, in practice the Commissioner has indicated that the fair market value calculated by the former lessor will not increase.³⁸ The former lessor would accordingly be tasked with the calculation of the depreciation allowance and movable assets, machinery, or plant constitute the underlying assets of the depreciation allowance in respect of the acquisition of a leased movable asset at the end of a lease for normal tax purposes.

In conclusion, the tax implication of each of the three references to depreciation allowances in tax legislation is that of a reduction in a

31 S 8(5) of the ITA.

32 Feinstein 1998 *SAICA Integrity* 551.

33 Huxham and Haupt *Notes on South African Income Tax* (2021) 209.

34 Latief, Mohamed and Kamdar 2019 *Tax Professional* 18.

35 Unless the leased asset acquired is a small item (with a value of less than R7 000) in respect of which a deduction in terms of S 11(e) will be allowed in full in the year the asset is brought into use. See SARS *Binding General Ruling (Income Tax) No. 7* (2020) 9.

36 S 8(5)(bC) of the ITA.

37 National Treasury *Explanatory Memorandum on the Income Tax Bill 1985* (1983) 8-9.

38 Huxham and Haupt *Notes on South African Income Tax* (2021) 209.

taxable amount. A taxpayer could therefore benefit from the deduction of a depreciation allowance, in which case the question of whether to apply the depreciation allowance for periods of less than a year would be relevant. In the sections that follow it is considered, based on the wording and the context of provisions, whether depreciation allowances for purposes of section 10(13) of the VAT Act and for purposes of section 8(5)(bB) of the ITA should be disregarded or not for periods of less than one year.

3 Depreciation allowance for purposes of section 10(13) of the VAT Act

The wording applied in respect of the depreciation allowance for VAT purposes and normal tax purposes relating to the right of use of a vehicle both refer to “each completed period of 12 months”.³⁹ In the ITA, there are other references to “each completed period of one year”⁴⁰ relating to capital allowances in which case guidance indicates that capital allowances for a period of less than one year should not be disregarded nor be apportioned.⁴¹ However, no other reference in tax legislation to “each completed period of 12 months” is made. The similar wording applied in the ITA and for VAT purposes is submitted as an indication of the fact that these provisions are similar in nature. Both the provisions for normal tax and VAT purposes are aimed at the fringe benefit in respect of the right of use of a vehicle granted by an employer. Guidance has been issued that “each completed period of 12 months” for normal tax purposes should be disregarded for periods of less than one year.⁴² The context of the normal tax and VAT purposes in respect of depreciation allowances are also submitted as similar in nature as the employer in question is tasked with the calculation and vehicles are the underlying assets of the depreciation allowances. Based on the distinct wording applied in these provisions (“each completed period of 12 months”) and the similar context submitted in this article, it is submitted that the depreciation allowance for purposes of section 10(13) of the VAT Act should be disregarded for a period of less than a year.

39 Proviso (a) to Para 7(1) of the Seventh Schedule to the ITA and GN 2835 in GG 13651 of 1991.

40 S 13ter(7)(a) of the ITA and Para 12(6) of the First Schedule to the ITA.

41 SARS *Guide to Building Allowances* (2014) 18. For purposes of this article it is submitted that the context of the building capital allowances and the depreciation allowances for purposes of S 10(13) of the VAT Act differs – as a result of the wording and context that differ the guidance in respect of building allowances would not apply in respect of depreciation allowances contemplated in S 10(13) of the VAT Act.

42 SARS *Interpretation Note 72: Right of Use of Motor Vehicle* (2013) 7.

4 Depreciation allowance for purposes of section 8(5)(bB) of the ITA

The depreciation allowance for normal tax purposes relating to the acquisition of a leased movable asset at the end of a lease is submitted as distinct from other depreciation allowance provisions based on five evident differences resulting from a comparison. Firstly, the wording applied in respect of the depreciation allowance for normal tax purposes relating to the acquisition of a leased movable asset (“each succeeding year”) differs from the wording applied in other depreciation allowance provisions (“each completed period of 12 months”). Secondly, the rate applied in respect of the depreciation allowance for normal tax purposes relating to the acquisition of a leased movable asset (“twenty per cent”) differs from the rate applied in other depreciation allowance provisions (“fifteen per cent”). Thirdly, the person tasked with the calculation of the depreciation allowance relating to the acquisition of leased assets (the lessor) differs from the person tasked with the calculation of other depreciation allowance provisions (the employer). Fourthly, the depreciation allowance relating to the acquisition of leased assets is broader in application and not limited to fringe benefits in the context of an employer-employee relationship whereas other depreciation allowance provisions are limited to fringe benefits with an employer-employee relationship as a precondition. Fifthly, the underlying assets are leased movable assets and are not limited to vehicles as in other depreciation allowance provisions. These differences suggest that the context of the depreciation allowance for normal tax purposes relating to the acquisition of a leased movable asset differs from other depreciation allowance provisions. Accordingly, the guidance and conclusions in respect of other depreciation allowances should not be applied directly to the depreciation allowance for purposes of section 8(5)(bB) of the ITA. Consideration is therefore given to other provisions in tax legislation that apply similar wording as section 8(5)(bB) of the ITA and relate to similar underlying assets.

The assets that form the subject of section 8(5)(bB) of the ITA are corporeal movable assets or any machinery or plant.⁴³ Other provisions in the ITA relating to capital allowances in respect of movable assets, including machinery or plant, refer to “each succeeding year”,⁴⁴ in which case capital allowances are not disregarded nor apportioned if an asset is used for less than one year⁴⁵ – an allowance can therefore be claimed in full even if the underlying asset is used for less than one year during the year of assessment. Contrarily, capital allowances in the ITA that do not refer to “each succeeding year”⁴⁶ would require an apportionment if the

43 S 8(5)(bB) of the ITA.

44 SS 12C(1), 12E(3)(a), 13ter(2), and 37B(2)(a) of the ITA.

45 Stiglingh, Koekemoer, Van Heerden, Wilcocks and Van der Zwan *Silke: South African Income Tax* (2021) 387-388.

46 With S 11(e) of the ITA as an example.

asset is used for less than one year.⁴⁷ The rate applied in respect of the depreciation allowance for normal tax purposes relating to the acquisition of a leased movable asset (“twenty per cent”) is also similar to the rate applied in other capital allowance provisions relating to movable assets that include machinery and plant.⁴⁸ The similar assets contemplated in section 8(5)(bB) of the ITA and other capital allowance provisions are submitted as indicative of being in a similar context. This argument is further advanced since the former lessor, who is the former owner of the leased asset, would have been entitled to capital allowances until such time as the lessee acquired the asset at the end of the lease. The lessor could therefore previously have claimed capital allowances in respect of the leased asset and is also tasked with the calculation of the depreciation allowance when the lessee acquires the asset.

Based on the similar wording (“each succeeding year”), the context applied in other provisions in the ITA, and guidance that such other provisions should not be disregarded nor apportioned for periods of less than one year, it is submitted that the depreciation allowance for purposes of section 8(5)(bB) of the ITA should not be disregarded nor apportioned for a period of less than a year.

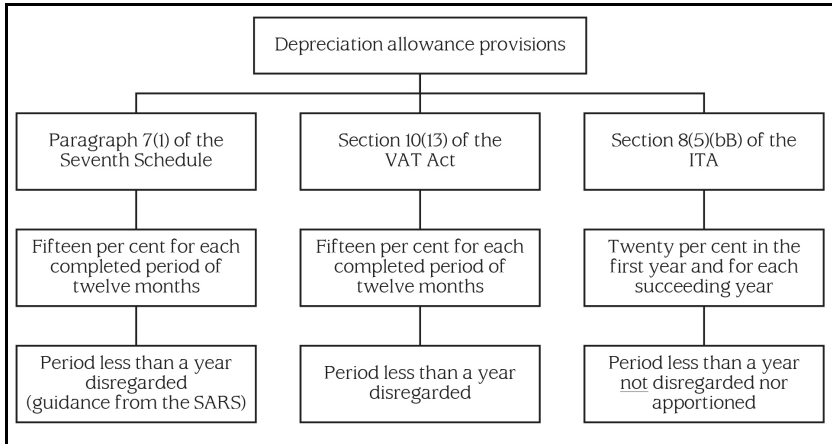
5 Conclusion

Depreciation allowances for tax purposes are applied as a reduction of amounts that could result in lower normal tax and lower output tax (VAT) being payable. The uncertainty that served as a focus for this article is whether depreciation allowances for tax purposes should be disregarded or not when a period of less than a year is concerned.

The figure that follows illustrates the similarity and differences in the wording of the three depreciation allowances considered and summarises the findings of this article.

⁴⁷ SARS *Binding General Ruling (Income Tax) No. 7 (2020) 9*.

⁴⁸ Refer to SS 12B(2)(iii), 12C(1), and 12E(3)(a) of ITA.



A taxpayer that followed existing guidance issued by the SARS to disregard periods of less than a year in the calculation of a depreciation allowance⁴⁹ in all instances would therefore not be correct based on the findings of this article. The different context of the depreciation allowance contemplated in section 8(5)(bB) of the ITA is argued as affording the opportunity to apply the depreciation allowance for a period of less than a year.⁵⁰ If a taxpayer is able to apply the depreciation allowance for a period of less than a year it could be beneficial as a lower recoupment would stand for inclusion in taxable income for normal tax purposes. The findings further contribute to providing guidance on normal tax consequences of leases, which are often overlooked⁵¹ and required in deciding between different types of leases.⁵² If the intention of the legislature is not to afford the depreciation allowance contemplated in section 8(5)(bB) of the ITA for a period of less than a year, an amendment to the act – in line with the wording applied in other depreciation allowance provisions⁵³ – is submitted as warranted. In light of the increasing use of leases and the potential tax avoidance relating to cross-border leases,⁵⁴ the intention could well be not to afford the depreciation allowance in section 8(5)(bB) of the ITA for periods of less

49 SARS *Interpretation Note 72: Right of Use of Motor Vehicle* (2013) 7.

50 S 3(4)(b) of the ITA stipulates that any decision of the Commissioner relating to S 8(5)(b) and S 8(5)(bA) of the ITA is subject to objection and appeal in accordance with Chapter 9 of the Tax Administration Act. A taxpayer accordingly has a means of disputing the fair market value determined with reference to the depreciation allowance contemplated in S 8(5)(bB).

51 Latief, Mohamed and Kamdar 2019 *Tax Professional* 18.

52 Feinstein 1998 *SAICA Integritax* 551.

53 Para 7(1) of the Seventh Schedule and S 10(13) of the VAT Act.

54 Oguttu "Curbing income tax avoidance that results from cross-border leasing: A comparative overview with specific reference to South Africa" 2014 *SA Mercantile Law Journal* 338-386.

than a year, in which case and based on the findings of this article, an amendment or further guidance would be required.