

Pre-production interest deductions proposed deletion

By Johan Kotze

There is considerable confusion around the proposed amendments of the Income Tax Act. One of the many far-reaching amendments proposed in the draft Taxation Laws Amendment Bill, 2011, is the deletion of section 11(bA) of this Act.

At first commentators speculated that the deletion proposed in the Bill is probably an error. However, the Clause by Clause Explanation to the Draft Explanatory Memorandum on the Draft Taxation Laws Amendment Bill suggests that paragraph (bA) is obsolete in light of the business start-up deduction rules contained in section 11A.

Expenditure incurred in respect of an asset, prior to an asset being brought into use for purposes of a taxpayer's trade, is generally not deductible. Section 11(bA) does make special provision for interest and related finance charges incurred in respect of assets not brought into use for the purposes of a taxpayer's trade yet. It also provides that the interest and related finance charges incurred prior to the asset being brought into use will be allowed as a deduction in the year of assessment during which the asset is brought into use.

The term 'trade' used in section 11(bA) has a wide meaning and even includes the letting of property. The assets to which this allowance refers also includes all assets used by a taxpayer in the course of his business.

Reference in section 11(bA) to 'related finance charges' has given rise to some disputes with SARS, but could this actually have been the reason why the section is proposed to be deleted?

Some may argue that section 11A, which provides for deductions in respect of expenditure and losses incurred prior to commencement of trade, would now cover this position. Section 11A refers to expenditure incurred prior to the commencement of and in preparation for carrying on the trade. It is hard to imagine how interest incurred on a liability in respect of an asset which is still to be brought into use for purposes of trade, is preparatory in nature.

Section 11A is further limited to a situation prior to the commencement of trade, whereas section 11(bA) refers to a situation when an asset will be brought into use for purpose of trade, which may be at the commencement or post commencement of trade.

Section 11A also ring-fences the expenses to the income from that specific trade.

Let's hope the proposed deletion of section 11(bA) would be forego, as it does cover an area which section 11A does not reach, but then again it seems some paranoia has crept into the legislature!

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