Prohibition of wear and tear allowance on structures of a permanent nature

by

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ABSTRACT

The capital allowance mentioned in section 11(e) of Income Tax Act 58 of 1962 ("the Act") refers to machinery, plant, implements, utensils and articles, the value of which may have diminished by reason of wear and tear or depreciation. The machinery, plant, and articles in question, often accede to other assets of a permanent nature such as immovable buildings. This is a problem in South Africa because the wear and tear allowance is lost when machinery, plant or articles lose their identities upon being absorbed into assets of a permanent nature such as a building. Buildings and other structures of a permanent nature do not qualify for the wear and tear allowance in terms of section 11(e) of the Act. This article investigates the uncertainties with regard to interpreting what constitutes "buildings, or other structures or works of a permanent nature" for the purposes of the prohibition of wear and tear allowances contained in section 11(e)(ii) of the Act.

KEY WORDS

Accession; Accessory article; Buildings or other structures or works of a permanent nature; Integral part of/part of the fabric of the building; Machinery in Australia; New approach/intention approach; Plant in Australia; Principal article; Subject matter; Traditional approach; Unit of property in Australia
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1. INTRODUCTION

At issue in this paper is the definition of “buildings or other structures or works of a permanent nature” which section 11(e)(ii) disqualifies from allowance for depreciation. Secondly, this paper examines whether or not legislative intervention is required in order to provide clarity and narrow the depreciation allowance prohibition in subsection (ii) to very specific circumstances. This paper, argue that section 11(e) should not disqualify depreciation allowances on machinery, plant, implements, utensils and articles that diminish in value, even if these items, from a property law perspective, might be said to have acceded to structures of a permanent nature.

2. PROHIBITION OF DEPRECIATION ALLOWANCE FOR STRUCTURES OF A PERMANENT NATURE AS PER SECTION 11(E)

The relevant part of section 11(e) reads (emphasis added):

“For the purposes of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deduction from the income of such person so derived-

(e) save as provided in paragraph 12 (2) of the First Schedule, such sum as the Commissioner may think just and reasonable as representing the amount by which the value of any machinery, plant, implements, utensils and articles (other than machinery, plant, implements, utensils and articles in respect of which a deduction may be granted under section 12B, 12C or 12E) owned by the taxpayer or acquired by the taxpayer as purchaser in terms of an agreement contemplated in paragraph (a) of the definition of “instalment credit agreement” in section 1 of the Value-Added Tax Act, 1991 (Act No. 89 of 1991), and used by the taxpayer for the purpose of his or her trade has been diminished by reason of wear and tear or depreciation during the year of assessment: Provided that—

…;

(ii) in no case shall any allowance be made for depreciation of buildings or other structures or works of a permanent nature;
(iiA) where any machinery, implement, utensil or article qualifying for an allowance under this paragraph is mounted on or affixed to any concrete or other foundation or supporting structure and the Commissioner is satisfied -

(aa) that the foundation or supporting structure is designed for such machinery, implement, utensil or article and constructed in such a manner that it is or should be regarded as being integrated with the machinery, implement, utensil or article; (bb) that the useful life of the foundation or supporting structure is or will be limited to the useful life of the machinery, implement, utensil or article mounted thereon or affixed thereto,

the said foundation or supporting structure shall for the purposes of this paragraph not be deemed to be a structure or work of a permanent nature but shall for the purposes of this Act be deemed to be part of the machinery, implement, utensil or article mounted thereon or affixed thereto”.

3. SOUTH AFRICAN TAX ALLOWANCE FOR DEPRECIATION OF ASSETS ATTACHED TO STRUCTURES OF A PERMANENT NATURE

The Act does not provide a definition for “buildings or other structures or works of a permanent nature”. In ITC 11623, Judge Levinson interprets this phrase as follows:

“We find a clue to legislature’s intention by its use of the word “buildings”. The words that follow are eiusdem generic. In its ordinary meaning “buildings” connote a structure which has been constructed on a plot of land. It is regarded as immovable having acceded to the land. It was contemplated that this type of permanent structure would not qualify for depreciation allowances”.

Authors agree that the ordinary dictionary meaning should be used to define buildings (Davis, Olivier & Urguhart, 2011: 11(e) – 5; Emslie, Davis, Hutton & Olivier; Huxham & Haupt). The Oxford Advanced Learner’s Dictionary (2005) defines a building as a structure such as a house or school that has a roof and walls, while, MacMillan English Dictionary for Advanced Learners (2006) defines a building as a structure made of a strong material such as stone or wood that has a roof and walls,
for example a house. Judge Levinson’s statement raises a number of factors that need to be present for a structure to be declared of a permanent nature, in particular that it should be “regarded as immovable having acceded to the land”. Numerous common law and property law cases have been decided on the basis of the factors that Levinson refers to (Olivier and others v Haarhof & Co., 1906, TS 497; Potchefstroom Dairies & Industries Co. Ltd, 1915, AD 454; Unimark Distributors (Pty) Ltd v Erf 94 Silvertondale (Pty) Ltd, 1998, JOL 4003 (T); Theatre Investments (Pty) Ltd and Another v Butcher Brothers Ltd, 1978, 4 All SA 260 (A); Melcorp SA (Pty) Ltd v Joint Municipal Pension Fund (Tvl), 1980, SA 498 (W)). It is thus important to examine these common law and property law cases in order to interpret what is meant by a permanent nature. This will assist in determining instances where the prohibition stated in subsection 11(e)(ii) applies.

Tax law, as developed through tax cases and legislation, involves the concept of accession in that, where an article (called an accessory) accedes to another article (called the principal), the accessory would be said to have lost its identity and the owner of the principal article becomes the owner of both as the accessory ceases to “exist” so to speak (Income Tax Act No. 58, 1962: s11(e) proviso(ii); Olivier and others v Haarhof & Co., 1906, TS 497; Macdonald Ltd v Radin, N.O., and The Potchefstroom Dairies and Industries Co. Ltd, 1915, AD 454; ITC No. 866, 1958, 22 SATC 397). In this discussion, the word “article” will be used with the necessary indication as to whether it is an “accessory article” or “principal article”, where an accessory will represent “machinery, plant or article[s]”. The discussion will aim to determine whether or not the accessory article has been integrated into “buildings or structures or works of a permanent nature”, referred to as the “principal article”.

For tax purposes, the allowances that may have been available to the accessory article may not necessarily be available to the principal article as these allowances would be different. For example, if the accessory is furniture, the fact that it might have acceded to a building (a principal article in this case) would mean that no allowance may be available for wear and tear on the furniture as, by law, there would be no furniture to speak of (ITC No. 866, 1958, 22 SATC 397), which refers to hot water, gas and plumbing installations). Therefore, it is necessary to identify the type of asset in order to determine the allowances that may be available. It should also be acknowledged that the consequences of accession are not limited to taxation issues,
but also apply to other areas such as property valuation for municipality rates; sale in execution; and rural development (Olivier and others v Haarhof & Co., 1906, TS 497; Potchefstroom Dairies & Industries Co. Ltd, 1915, AD 454; ITC No. 866, 1958, 22 SATC 397).

Accession from movable to immovable assets is determined using the following factors:

a) the nature and function of the thing being attached;

b) the manner of attachment; and

c) the intention of the person annexing the thing (Olivier and others v Haarhof & Co., 1906, TS 497; Macdonald Ltd v Radin, N.O., and The Potchefstroom Dairies & Industries Co. Ltd, 1915 AD 454; CIR v Le Sueur, 1960, (2) SA 709 (A), 23 SATC 261; ITC No. 866, 1958, 22 SATC 397; Chevron SA (Pty) Ltd v Awaiz at 110 Drakensburg cc & Another, 2008, JOL 21162(t)).

The “traditional approach” to accession, often favoured as the correct approach, considers the first two factors and, where the first two factors are equivocal, the third factor is then considered (Unimark Distributors (Pty) Ltd v Erf 94 Silvertondale (Pty) Ltd, 1998. JOL 4003 (T); Macdonald Ltd v Radin, N.O., and The Potchefstroom Dairies & Industries Co. Ltd, 1915, AD 454). It must be noted that each case is decided on its own particular facts (SIR v Charkay Properties (Pty) Ltd, 1976, (4) SA 872 (A), 38 SATC 159), as a fence wall made up of stones around a farm is certainly a work of a permanent nature, while a pile of stones on a farm may not be a work of a permanent nature. However, in some cases and in some academic material, it has been argued that the third factor is the main factor and the first two factors exist merely to give substance or weight to the intention (Unimark Distributors (Pty) Ltd v Erf 94 Silvertondale (Pty) Ltd, 1998, JOL 4003 (T); Theatre Investments (Pty) Ltd and Another v Butcher Brothers Ltd, 1978, SA 260 (A); Melcorp SA (Pty) Ltd v Joint Municipal Pension Fund (Transvaal), 1980, 1 SA 498 (W)). In ITC 11623, Judge Levinson supports the contention that intention is the main factor in determining the permanency of an attached accessory article.
Nevertheless, it is not altogether clear whether tax law adopts the same conception of accession as it has evolved in property law. A number of cases followed the so-called “new approach”, though, some of these cases were not dealing with tax matters (SIR v Charkay Properties (Pty) Ltd, 1976, (4) SA 872 (A), 38 SATC 159; ITC 866, 22 SATC 397; Theatre Investments (Pty) Ltd and Another v Butcher Brothers Ltd, 1978, 4 SA 260 (A); Melcorp SA (Pty) Ltd v Joint Municipal Pension Fund (Transvaal), 1980 1 SA 498 (W)). In CIR v Le Sueur, 1960, (2) SA 709 (A), 23 SATC 261 Ramsbottom JA rejected the “intention” approach by the special court judge in preference of his test that he called “part of the fabric of the building”. Therefore, there appears to be three possible tests: the “traditional approach”, the “new approach”, and the “part of the fabric of the building” approach. SARS’ practice also does not seem to provide taxpayers with certainty. This is particularly so if one refers to some of the items listed in Income SARS Tax Practice note No. 19 – 30 April 1993, such as lift installations, weighbridges (movable parts), solar energy units, public address systems, air conditioners (window type, movable parts only), and in SARS Income Tax – Practice Note: No. 39 – 10 May 1995, such as hot-water systems.

The difficulty with these practice notes is that they do not provide principled and definitive guidance that accord with case law. For example, hot-water system installations have been held to be part of the building (Income Tax Appeal No. 2547 as quoted in ITC 866, 22 STAC 397 at 398), yet they are one of the items subject to allowance, per the Practice note, without regard to the intention of the taxpayer as an annexor. It is also perplexing that items on the Practice notes, such as air conditioners are qualified (in that only “movable parts” or “window type” are included in the practice note). This is perplexing because, per case law, an item loses its nature to buildings or other structures or works of a permanent nature as an item or as part of an installation. This is the case in the “traditional approach”, or as “part of the fabric of the building” approach (ITC 866, 22 STC 397).

There is no indication in case law, either on property ownership cases or existing income tax cases, that a dissection of an article into its constituent “movable” and “static” parts is what the statutes intended. In Australia, a smaller “unit” is defined based on function in cases such as Monier Colourtile Pty Ltd v. FC of T 69 ATC
Lift installations have been held to be movable in a property ownership case based on the so called “new approach” that emphasises the intention factor without referring to certain parts thereof that are movable (Melcorp SA (Pty) Ltd v Joint Municipal Pension Fund (Transvaal), 1980, 1 SA 498 (W)). One must also note that SARS practice notes are not legally binding but are merely the opinions of SARS (ITC 1675, 62 SATC 219). The difficulty that is experienced when deciding which allowances are applicable illuminates the need for clear, standardised classifications of assets for purposes of section 11(e)(ii) of the Act. In ITC 866, 22 SATC 379 the Commissioner allowed boilers, sterilisers, autoclaves and heaters but at 400, the court held that the installations as a whole could no longer be removed from the building, even the removable radiators, based on the fact that they were part of the nursing home and were intended to remain there by the annexor. SARS Income Tax –Practice Note: No. 19 – 30 April 1993 lists items such as lift installations, weighbridges (movable parts), solar energy units, public address systems, air conditioners (window type, movable parts only) and SARS Income Tax –Practice Note: No. 39 – 10 May 1995 lists item such as hot water systems.

3.1. Nature and function of accessory and principal

3.1.1. Accessory article

The nature and the function of the thing that is annexed are determined objectively (Unimark Distributors (Pty) Ltd v Erf 94 Silvertondale (Pty) Ltd, 1998, JOL 4003 (T)). The nature of an article(accessory) may determine whether it is possible for it to be attached to immovable assets in such a way as to preserve or restore its separate identity (CIR v Le Sueur,1960, (2) SA 709 (A), 23 SATC 261). In Caltex (Africa) Ltd and Others v Director of Valuations,1961, 1 SA 551 (C), it was said that pipe sections forming a complex of pipes distributing petroleum-related products were removable. Therefore, the nature of the pipes could not have precluded them from retaining or preserving their character as pipes. However, it is insufficient to examine only the nature of the article (accessory), without regard also for the nature of the article(principal) to which the article is attached.
3.1.2. Principal article

The principal article to which the accessory is attached has to be a physical object for one to determine whether the accessory could be an integral part thereof. An accessory would not be integral to something intangible such as a process that is tied together by the fact that it produces a particular product. In *Caltex (Africa) Ltd and Others v Director of Valuations*, 1961, 1 SA 551 (C), Judge Herbstein said:

“The article in issue could well be an integral part of something which in some sense could be said to be a unit or entity, without the article itself becoming immovable. If the unit or entity is something physical and immovable, like a house, then an article which is in a physical sense an integral part thereof, like a door or window, would naturally also be immovable. But where a complex of things is said to be a unit or entity in a mere functional sense, e.g. with regard to an activity such as production or construction, or the like, then nothing is gained in an enquiry of the instant kind by labelling an article as an “integral part” of the unit”.

In the specific case, the unity or entity (principal) was a complex that did not cause accessories to be structurally integrated into it in such a way as to lose their identity. This is distinguished from a house, for example, where doors, windows or roof tiles would accede to the house structurally, despite the fact that these articles (accessories) are easily removable.

3.2. Manner of attachment

The manner of attachment of the accessory to the principal will often determine the extent to which a separate identity has been retained or restored without injury to the accessory or principal (*CIR v Le Sueur*, 1960, (2) SA 709 (A), 23 SATC 261). This is the second factor for inquiry, at which the inquiry will end per the so-called traditional approach, unless the answer is equivocal(*ITC 1313, 42 SATC 197*).
3.3. Intention of the annexor

In *Macdonald Ltd v Radin and The Potchefstroom Dairies and Industries Co Ltd* 1925 *AD* 456, the following dictum is often quoted to illuminate the relevance of two objective factors including the manner of annexation:

“The importance of the first two factors is self-evident from the very nature of the inquiry. But the importance of the intention is for practical purposes greater still; for in many instances it is the determining element. Yet it is sometimes settled by the mere nature of annexation. The article may be actually incorporated in the realty, or attachment may be so secured that separation would involve substantial injury either to the immovable or its accessory. In such cases the intention as to permanency would be beyond dispute”

From the dictum in *Macdonald Ltd v Radin and The Potchefstroom Dairies and Industries Co Ltd*, it is clear that the intention may be inferred from direct evidence obtained from both the nature and the manner of annexation of an article. Therefore, it is argued that nothing will be gained from the subjective intention of the owner (*Unimark Distributors (Pty) Ltd v Erf 94 Silverthondale (Pty) Ltd*, 1998, JOL 4003 (T)). In *Salisbury Municipality v Nestlé’s Products (Rhodesia) Ltd [1963] 1 All SA 163 (SR)*, a quotation from Winsen in the case of *Standard-Vacuum Refining Company of SA (Pty) Ltd v Durban City Council, 1961 (2) SA 669 (AD)*, pointed out that “intention” is the most important of the three elements but, in order to ascertain intention, regard must be given to the physical features (that is, the nature of the movable object and the method and degree of its attachment to the immovable object. If the nature of the article is such that it is readily capable of acceding to the immovable article or is so securely attached that separation would cause injury to the article or to the immovable article, then it must be inferred that the article was attached with the intention of permanency and for that reason became immovable.

However, if the physical features produce equivocal results, the intention of the annexor – the “subjective element” – may be decisive. From this statement, it is submitted that “physical” factors or “objective factors” are examined to determine the intention by way of inference. This appears to suggest that intention is always inferred, except where inference from physical elements could not be drawn. In such instances, the intention as professed by the annexor becomes decisive. The intention
has to be judged at the time of annexation (Unimark Distributors (Pty) Ltd v Erf 94 Silvertondale (Pty) Ltd, 1998, JOL 4003 (T); Salisbury Municipality v Nestlé’s Products (Rhodesia) Ltd, 1963, 1 SA 163 (SR) at 168; Standard-Vacuum Refining Co. of S.A. (Pty.) Ltd. v. Durban City Council, 1961, (2) S.A. 669 (A.D.)).

However, the so-called “new approach” takes into account all evidence – direct and inferential – with regard to intention and, on the balance of all probabilities, determines whether the person who annexed the accessory intended the annexation to be permanent (Unimark Distributors (Pty) Ltd v Erf 94 Silvertondale (Pty) Ltd, 1998, JOL 4003 (T)). In the appellate division case of Theatre Investments (Pty) Ltd and Another v Butcher Brothers Ltd [1978] All SA 260 (A), it was argued:

“...the seats in question were clearly designed and manufactured specifically for the Playhouse theatre and that they could not without adaptation be used in another Theatre. This he stated tended to indicate that the person who annexed the seats to the floor of the building intended that they should remain there permanently. The learned Judge also placed reliance upon the terms of the lease which he said conveyed to him that the parties thereto had contemplated that upon the termination of the lease the lessor would have returned to it a theatre building in good state of repair and able to be leased as such. This fact, so he said, afforded an important guide as to the intention of the lessee when it installed the seats and taking this fact in conjunction with the “physical features of the seats” he concluded that the annexor of the seats intended that they should remain part of the theatre buildings permanently.”

In this Appellate Division case, Winsen, posits that the seats could be removed without causing inconsiderate damage to the fabric of the building, but, due to the fact that the seats were purpose-built for the theatre and expected to be there for 50 years, it could be inferred that the annexor expected that they were to remain there permanently. The judge also noted that the terms of the lease strengthen the inference that the intention of the annexor was for the seats to remain there permanently. All the other judges of the Appellate Division seated on this case concurred. The judgement of this case considered all three factors and weighed them in the light of the evidence. This case appears to assume intention to be part and parcel of decision-making.
It should be noted, however, that the annexor’s *ipse dixit* or professed intention has to be weighed against how society, or a reasonable member of society, would view the situation – the so-called “publicity principle”, or the impression created with others (Unimark Distributors (Pty) Ltd v Erf 94 Silvertondale (Pty) Ltd, 1998, JOL 4003 (T)). An unreasonable intention professed by the annexor cannot be accepted. For example, selling a suburban house and thereafter removing the imported oak doors and windows – as the annexor always intended, but never told the buyer – would be unreasonable in the eyes of the public.

It should be kept in mind that the three factors discussed for determining whether an accessory attached to the principal has lost its identity and has therefore acceded thereto, are mainly used in the context of property ownership and municipal valuation cases. It remains unclear, however, which approach is being followed by judges in tax cases and whether the same factors are used in tax cases as in property ownership cases.

In *CIR v Le Sueur 1960* (2) SA 709 (A), 23 SATC 261, Ramsbothom distinguished his approach from that used in cases where accession of movable to immovable property is determined for purposes of resolving property ownership disputes. As such, Ramsbothom appears to suggest that different factors need to be used for tax purposes. Ramsbothom then went on to suggest that determining whether an article is part of the building or not, is dependent on “whether it has become part of the fabric of the building”.

However, in the same case of *CIR v Le Sueur 1960*, 2 SA 709 (A), 23 SATC 261, Bothast states that an application of a “similar test” to that used in *Macdonald v Radin*, which was a property ownership dispute case, would not lead to results inconsistent with the intention of the legislature. Therefore, there is disagreement with regard to whether or not the same factors used in property ownership cases can be used for the purposes of tax cases.

Nevertheless, some income tax cases have used the factors used in the “traditional approach”, where the nature of the accessory article and the manner of attachment are examined to determine whether the accessory article has in fact formed part of
the building or other structure or work of a permanent nature, while intention is only considered where the first two factors produce a results that is equivocal (ITC 1313, 42 SATC 197; SIR v Charkay Properties (Pty) Ltd, 1976, (4) SA 872 (A)). However, there are no Appellate Division Court judgements on tax cases that I know of, where the so-called “new approach” was applied (ITC 866, 22 SATC 397; ITC 11623 were decided based on the intention approach).

The question as to whether or not the same factors can be used both in the context of tax cases as well as in the context of property ownership cases or municipality property valuation cases is significant. This is because case decisions, in the context of property ownership, would become precedents in the context of tax cases assuming the facts are similar. The implication of this would be profound in that, should courts follow the so-called “new approach” in the context of tax cases, the subjective factor of intention would become more important resulting in uncertainty on the part of the taxpayer. In ITC 11623, decided on 6 June 2007, Judge Levinson emphasised that intention is the most important factor. The judge also pointed to subsection 11(e)(iiA) as an indication that the legislature intended that items of machinery and plant, based on the facts of that case, retain their movable features.

4. AUSTRALIAN TAX ALLOWANCE FOR DEPRECIATION OF ASSETS ATTACHED TO STRUCTURES OF A PERMANENT NATURE

In Australia, the deduction of expenditure on articles, plant and machinery is dealt with either under Division 40 – depreciable assets, or Division 43 - capital works, the equivalent of which would be assets of a permanent nature in South Africa (Division 40 and 43 are part of the Income Tax Assessment Act 1997 of Australia). Even in Australia, the question as to whether an article or machinery is depreciable in its own right or has been incorporated into the premises or capital works is still a contentious issue as is borne out in the number of court cases and Australian Tax Office Rulings dealing with the issue. However, there is a number of differences between the South African approach and the Australian approach to this problem.
4.1. Legal ownership of an asset

As in South Africa, legal ownership of an asset as a result of accession does not determine whether the article or machinery would or would not be subject to wear and tear allowance. Articles and machinery are defined specifically for the purposes of tax allowances, despite the fact that they may have acceded to structures of a permanent nature such as land or building for legal ownership purposes (Australian Taxation Office, 2004, Taxation Ruling, Income tax: plant in residential rental properties, TR 2004/16; Pearce v. FC of R, 1989, 89 ATC 4064).

4.2. Plant as depreciable asset

In Australia, plant in its ordinary meaning depends on the function it performs as it relates specifically to the taxpayer’s type of business (Macquarie Worsted Pty Ltd v. FC of T, 1974, 74 ATC 4121). The role played by function in determining whether an asset is plant despite the fact that it may have acceded to a structure of a permanent nature is illustrated by the passage from Wangaratta Wollen Mills Ltd v. FC of T, 1969, 119 CLR 1 at 10 where McTierman said:

“The complex ventilation system including the cavity wall does more than merely clear the atmosphere. Its structure is an active tool in preventing spoiling of material, and in enabling the operatives to carry out their tasks. It would be completely unnecessary in almost every other industry and quite useless to any buyer except a dyer”

While in Imperial Chemical Industries of Australia and New Zealand Ltd v. FC of T, 1970, 120 CLR 396 at 398, Kitto stated:

“The truth is that the ceilings with which we are concerned do nothing for the appellant’s business that they would not do for the business of any other occupier”

From the Australian point of view, plant would therefore be eligible for depreciation allowance even if it acceded to structures of a permanent nature. The South African position is different in this regard in that subsection 11(e)(ii) prohibits the depreciation allowance where plant may be said to have acceded to a structure of a permanent
nature, unless the allowance could be obtained under other sections (Section 12C allows depreciation of plant used in the process of manufacture).

4.3. Machinery as depreciable asset

A second difference is that, in Australia, machinery would be part of plant, hence depreciable under Division 40, whether or not it acceded to buildings for legal ownership purposes (Carpentaria Transport Pty Ltd v. FC of T 90). If one takes this further, one would assume that in almost all cases, machinery would be considered part of division 40 – depreciable assets, as the question of whether they have acceded to capital works or not would not disturb its classification as machinery for the purposes of taxation deduction. The definition of machinery then becomes very important. In Auckland City Corporation v. Auckland Gas Co Ltd, 1919, NZLR 561 as quoted by Australian Tax Office, it was stated:

“The word ‘machinery’ has no definite legal meaning and ... the general rule is, in dealing with matters relating to the general public, that statutes are presumed to use words in their popular sense…”

It was further stated on page 586 that machinery in a popular sense:

“means primarily a number of machines, taken collectively, and a machine in its popular sense is a piece of mechanism which, by means of its interrelated parts, serves to utilise or apply power, but does not include anything that is merely a reservoir or conduit, although connected with something which is without doubt a machine.”

The Oxford Advanced Learner’s Dictionary (2005) defines machinery as:

“1 machines as a group, especially large ones... 2 the parts of a machine that makes it work…”

And machine as:

“...a piece of equipment with moving parts that is designed to do a particular job. The power used to work a machine may be electricity, steam, gas, etc. or human power...”
For Australian tax cases, machinery does not include ducting; piping and wiring despite the fact that it may be connected to a machine or machinery (Australian Taxation Office, 2004, Taxation Ruling, Income tax: plant in residential rental properties, TR 2004/16). For South African tax case purposes, there appears to be no justification for prohibiting machinery from the depreciation allowances mentioned in section 11(e) simply because it acceded to a structure of a permanent nature. This is because machinery, in most cases, has a limited effective life as compared to buildings.

4.4. How articles accede to capital works

A third difference is the elements for determining whether articles other than machinery are part of any capital works, which are as follows:

1. Whether the item appears visually to retain a separate identity;
2. The degree of permanence with which it has been attached;
3. The incompleteness of the structure without it; and
4. The extent to which it was intended to be permanent or whether it was likely to be replaced within a relatively short period (Australian Taxation Office, 2004, Taxation Ruling, Income tax: plant in residential rental properties, TR 2004/16).

Essentially, these elements apply to “articles” only as opposed to machines or machinery or plant. As such, the definition of articles becomes important. As in South Africa, articles are defined in various ways for Australian tax purposes. Australia appears to apply the test of being an “integral part” or “fabric” of a building or structure in determining whether an item has retained its separate identity. South African Courts have also used this approach in one instance in CIR v Le Sueur 23 SATC 261.

4.5. The unit of property

A fourth difference is the fact that, in Australia, a functional “unit of property” is examined on its own as opposed to looking at an installation as one physical asset,
as is the case in South Africa (ITC 866, 1958, 22 SATC 379; Ready Mixed Concrete (Vic) Pty. Ltd v FC of T, 1969, 69 ATC4038). Here, the definition of a “unit of property” becomes very important. In Australia, the identification of a “unit of property” of a depreciable asset is a legislative (Per Income Tax Assessment Act of 1936 and currently Income Tax Assessment Act 1997) requirement despite the fact that the unit of property is not defined legislatively. The four characteristics to determine a “unit of property” in Australian tax cases are: separate function and identification, functional completeness, independent functionality of attached items, and definable, identifiable functions (Monier Colourtile Pty Ltd v. FC of T, 1984, 84 ATC 4846; FC of T v. Tully Co-operative Sugar Milling Assoc. Ltd., 1983, 83 ATC 4495).

In Ready Mixed Concrete (Vic) Pty. Ltd. V FC of T 69 ATC 4038; (1969) 1 ATR 123, a concrete mixer mounted on a truck and the truck were held to be separate units of property as each had a separate and independent function: the mixer to mix concrete in a condition ready for pouring and the truck to be used for delivery. This was despite the manner in which they were attached.

With regard to functional completeness, it was stated in FC of T v. Tully Co-operative Sugar Milling Assoc. Ltd. 83 ATC 4495; (1983) 14 ATR 495, that judgement as to whether there is one whole unit is dependent on the intended function of what is being examined. In this case, it was held that a whole pumping station including valves, and motors, among others, was a unit of property that could be eligible for depreciation.

In South Africa, a machine that formed part of an installation which in turn formed part of the fabric of a building was held not to be eligible for wear and tear per section 11(e) of the Act (In South Africa, a hot water system, and steriliser system that uses a boiler was held to be part of a building even though this system had a machine in the form of a boiler. See ITC 866, 1958, 22 SATC 379). Furthermore, Section 11 (e) does not refer to the function of the asset, but to the type of assets as a reference point for determining whether the asset falls within the section.
However, it is encouraging that the current SARS Interpretation note: No. 47 dated 28 July 2009, which replaces previous SARS practice notes 15, 19 and 39, lists the proposed write-off periods in years for items such as air conditioners (window type, room unit) and also air-conditioning assets (excluding pipes, ducting and vents, but including air handling units, cooling towers and condensing sets). There is no explanation as to why some of these air-conditioning installation parts are now regarded as “depreciable assets” in terms of section 11(e) of the Act given proviso (ii). We may conclude that it is a recognition that “machines” are depreciable even though they may have acceded to a building for property ownership purposes, or that it is an attempt to identify something similar to what Australian legislation refers to as a “unit of property” with distinct and independent functions of its own, and is hence depreciable.

5. PROPOSED LEGISLATIVE INTERVENTION

Legislative intervention is necessary, firstly, to amend the proviso (ii) to section 11 (e) to the Act to apply in limited circumstances and, secondly, to introduce new criteria for allowing depreciation for assets which have a limited effective useful life despite having acceded to structures of a permanent nature. Based on comparisons of South African and Australian tax treatment of allowances for depreciation of assets that may be said to have acceded to structures of a permanent nature, I propose the following areas are where legislative intervention is required: defining the features of a “depreciable asset” for section 11(e) purposes; machinery; plant; articles and the fact that if the asset meets the legislative specified factors, it is depreciable despite having acceded to structures of a permanent nature.

5.1. Features of depreciable assets

Items such as air-conditioning installations, hot water installations and weighbridges that are clearly subject to wear and tear by nature and have limited life given technology and other factors, are said to be an integral part of buildings or similar permanent structures. However, these should ideally be part of the wear and tear allowances per section 11(e), but are not (Income Tax –Practice Note: No. 19 – 30 April 1993 replaced by Interpretation Note No 47 - 28 June 2009 has items like air-
conditioning assets, hot water systems and weighbridges as subject to wear and tear. Even though this is favourable to taxpayers, it may be outside the powers of SARS as the practice note is not law. The Interpretation note 47, itself, limits this scope to the determination of value and amount not the asset type). In *ITC 866*, 1958, 22 SATC 379 the subject matter was installations for heating and sterilisation, with components such as boilers, sterilisers, heaters, radiators and pipes which were all held to be of a permanent nature, since these components had to be considered as an integral part of an installation. However, in *Caltex (Africa) Ltd and Others v Director of Valuations* (1961) 1 All SA 551 (C), Herbstein referred to a “complex” of things that only form a unit in a functional sense and accordingly held that pipes were separate articles even though they were part of a complex in a functional sense. In the context of tax, there is a broader conception of how articles acquire permanency by virtue of being components of installations even though they have distinct functions and are capable of operating in a different system.

Permanency has been taken to refer not to “eternity” or “everlasting” or “indefinitely” (ITC No. 1313 (1980, 42 SATC 197 (R); ITC No 271, 1933, 7 SATC 170 (U); SIR v Charkay Properties (Pty) Ltd, 1976, (4) SA 872 (A)). As such, the mere fact that an article will be subject to wear and tear given its nature is not sufficient to conclude that the article is depreciable. Repairs deductions are instead granted where the requirements thereof are satisfied (Section 11(d) of Income Tax Act 58 of 1962). Therefore, articles with a shorter working life than the buildings to which they are affixed, would not necessarily be subject to a wear and tear allowance.

However, where the asset has an independent, identifiable function as distinct from the other asset to which it is attached, it should be depreciated separately according its expected useful life. Machinery or machines as defined using an ordinary dictionary definition should be depreciable under section 11(e) of the Act whether or not they have acceded to a structure of a permanent nature from a property law perspective. Similarly, plant should also be depreciable under section 11(e) of the Act whether or not it has acceded to a structure of a permanent nature other than those allowed under specific industry allowances as noted. Whether articles are depreciable or not should be determined by using the “traditional method”.

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6. CONCLUSION

Given the differing objectives of the taxing statutes as compared to property ownership and municipal rate valuation, the proviso (ii) to section 11(e) of the Income Tax Act No. 58 of 1962 should be amended to only be applicable in the case of articles other than machinery and plant. The process of determining whether an article is of a permanent nature should also be clarified statutory so as to be limited only to “traditional” methods of accession due to the fact that the “new approach” relies mainly on the subjective annexor’s intention. The subject matter of the allowance sections such as 11 (e), should be legislatively redefined to be the smallest functional unit along the lines of the Australian “unit of property”. Machinery and plant should also be clarified legislatively for tax to be a separate functional unit or asset, even if it forms part of an installation or apparatus that is said to have acceded to a building for property ownership purposes, or other structures or works of a permanent nature.
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