CHAPTER 6

SHIPBUILDERS AND OWNERS OF SHIPS

6.1 The nature and meaning of a "ship"

Certain South African taxpayers are allowed to deduct the cost of a ship in a manner prescribed by the Income Tax Act, in the determination of their taxable income. Although "ship" in ordinary language may mean some large sea-going vessel, the question arises whether the cost of a large yacht (capable of going to sea) say, on the Vaaldam would qualify for a deduction. In order to arrive at an answer it would be necessary to examine the following -

- the definition of "ship" in dictionaries;
- the definition of "ship" and "South African ship" as used in the Merchants Shipping Act; and
- the judicial interpretation of "ship" under -
  - South African law; and
  - English law.

There is no definition of "ship" in the Income Tax Act. The Shorter Oxford English Dictionary defines a "ship" as a "large sea-going vessel (opposed to boat)", and it defines "boat" as a "small open vessel usually propelled by oars though sometimes by sail". Websters Third New International Dictionary defines a "ship" as "any large-sea going boat" and the Imperial Dictionary as "a vessel of some size adapted to navigation; the general term for vessels of whatever kind, excepting boats" and a "boat" as "a small open vessel or water craft usually moved by oars or rowing".

The general rule is that the interpretation of an expression under one Statute is of no great assistance in construing the same expression in another Statute. [R v Lombard, 1948 (2) SA 31]. The definition in the Merchant Shipping Act, No 57 of 1951, may therefore serve as some guidance as to the interpretation of similar expressions under the Income Tax Act. In section 2 of the Merchant Shipping Act "ship" is defined as "any kind of vessel used in navigation not propelled by oars". The expression "boat" is not defined in that Act, but "fishing boat" is defined as meaning "any ship engaged in sea-fishing for financial gain or reward, but does not include any sealing boat or whaling boat". "Sealing boat" is defined as meaning "any ship exclusively employed in seal catching", and "whaling boat" is defined as meaning "any ship engaged exclusively in whale catching ..."

From the above a "ship" appears to be a sea-going vessel of some size which is not a small open boat propelled by oars. The South African courts have to date, not been required to interpret the expression "ship" under tax law.

The Income Tax Act defines a "South African ship" in section 14(2) as meaning "a ship which is owned by a person referred to in section 9(1)(c), if such ship is a South African ship as defined in section 2 of the Merchant Shipping Act 1951 ...." The meaning given to the expression "South African ship" in the Merchant Shipping Act is "a ship registered in the Republic in terms of this Act or deemed to be so registered."

A "South African ship" under tax law is therefore restricted to those ships which are -

. "any kind of (vessels) used in navigation not propelled by oars" (definition of "ship" in the Merchants Shipping Act); and

. registered or deemed to be registered under the Merchants Shipping Act.

A crucial question is what type of vessels are required to be registered under the Merchant Shipping Act. Section 10 of that Act provides: "Every person who at the coming into operation of this section is building, or after such coming into operation intends to build, a vessel which when completed will be required to be registered or licensed in terms of this Act, shall within sixty days of such coming into operation or before beginning to build the vessel, as the case may be, furnish to the proper officer at the port where the vessel will be registered or licensed or to the Director-General such written particulars of the vessel as may be prescribed". The person on whose account any vessel is built is, in terms of the same section, deemed to have built that vessel.

Section 11 of the Merchant Shipping Act provides for the qualification for owning a ship registered under that Act: "No ship shall be registered in the Republic unless the whole of the ship is owned by the Government of the Republic or by persons to each of whom one or other of the following descriptions applies:

a) South African citizens;
b) citizens of a treaty country (other than the Republic); and
c) corporate bodies established under and subject to the law in force in any treaty country and having their principal place of business in any treaty country".

That section further provides that no person other than the Government of the Republic or a person as above, shall acquire, except by such transmission as is referred to in section 43 of that Act, any interest in a ship registered in the Republic. (Section 43 of that Act governs the transmission of property in a ship to an unqualified person).

Section 13 of the Merchants Shipping Act provides:

"(1) Whenever the whole of a ship of twenty-five or more gross tons is owned -

a) by the Government of the Republic; or

b) by persons all of whom in terms of section eleven are qualified to own a South African ship, and -

i) a majority of the owners either in number of extent of ownership are persons resident in the Republic or corporate bodies having their principal place of business within the Republic; or

ii) the ship is, as to her management and use, principally controlled in the Republic,

the said Government or the other owners, as the case may be, shall, unless she is already registered in the Republic or elsewhere apply to the proper officer at one of the ports of registry appointed in terms of paragraph (c) of section four for the ship to be registered in terms of this Act.

(2) The application for registry mentioned in sub-section (1) shall be made -

a) in the case of a ship already owned at the coming into operation of this section by persons who in terms of section eleven are qualified to own a South African ship, within one month of such coming into operation; and

b) in the case of a ship acquired after the coming into operation of this section by persons so qualified, within one month of the date on which she is so acquired.

(3) The Minister may in his discretion exempt the owners of certain classes of ships of less than one hundred gross tons, to be determined by him, or the owners of ships which are not self-propelled and which are used exclusively in a port, from the provisions of this section".

Certain ships are deemed to be registered in terms of section 14 of the Merchant Shipping Act: "All ships registered at a port in the Republic at the coming into operation of this section in accordance with the provisions of any law repealed by section one shall be deemed to be registered in terms of this Act and the provisions of section thirteen shall not apply in respect of such ships".

6.2 The nature and meaning of a "ship" under English law

In order to describe the nature of a ship it remains to enquire what is meant by "any kind of vessel used in navigation not propelled by oars" (definition of "ship" in the Merchants Shipping Act). There appears to be no South African judicial interpretation of this definition. The judicial interpretation of "ship" under English law may therefore be of guidance to South African taxpayers as regards the nature of a "ship". In deciding whether a vessel is a "ship" the English courts have regarded the expression "used in navigation" to be important. The plaintiffs in The Gas Float Whitton, No 2 [(1896) P42] claimed to be entitled to a salvage award because of services rendered to a gas float adrift in the tidal waters of the Humber. Lord Esher MR stated the facts on page 45: "The lower part (of the float) bore the resemblance of a ship or boat; that part called by the county court judge the hull had two ends, shaped like the bows of a vessel; it was 50ft long and 20ft broad;

it had no mast, sternpost, forepost, or rudder; its interior was wholly occupied by a cylinder into which gas was pumped so as to fill it, and so that the gas went to a light elevated on a pyramid of pieces of wood 50ft high. The float could not, by reason of its structure, be used for any purpose of its being navigated. It could not be navigated. It could not carry any man or any goods from place to place. It could not hold any man in it except that he could by means of a man-hole and ladder ascend to the light at the top to clean or arrange it. The float was fixed by an anchor or anchors and otherwise at a particular spot in the River Humber, so as to remain always fixed at that spot".

It had broken away, and a claim arose for salvage services. In his judgement Lord Esher MR held on page 58: "It seems impossible to say that within the ordinary English meaning among merchants or sailors or persons dealing with maritime affairs this thing could be called a ship, a vessel, or a boat. But now we have to deal with the argument that the general law maritime acknowledged in the High Court of Admiralty included, and includes, subjects or objects as the subjects or objects of salvage which are beyond ship, apparel, and cargo, including flotsam, jetsam, and lagan, and wreck of ship or cargo. It was argued that everything found floating on the water, although it itself could not possibly be a navigable thing, might be the subject or object of salvage".

On page 60 Lord Esher MR quotes with approval a passage form Nicholson v Chapman [(1793) 2 Hy Bl 254]: "They are not vehicles intended for the navigation of the sea, or the arms of the sea; they are not recognised as instruments of commerce or navigation by any Act of Congress. They are piles of lumber, and nothing more, fastened together and placed upon the water until suitable vehicles are ready to receive them and transport them to their destined port ..."

In the classification of a vessel as a "ship" Lord Esher MR appeared to consider it important whether the vessel could fairly be said to navigate the seas. The case went to the House of Lords [(1897) AC 337] where Lord Herschell said on page 343: "It was not constructed for the purpose of being navigated or of conveying cargo or passengers".

In Merchant's Marine Insurance Co Ltd v North of England Protecting & Indemnity Association [(1926) 25 Lloyd LR 446] the issue came up whether a pontoon crane was a ship or vessel. Roche J held that it was not and said at page 447: "With regard to the decisions that have been cited to me, and the definitions derived from dictionaries which have been put before me very fully by Mr Jowitt, I say that the adaption for navigation or to navigation is an ever-recurring element in the definitions in the dictionaries. It is indeed part of the definition adopted by Mr Jowitt himself, which was that a vessel was an articial structure made and used for the conveyance by water of persons or property".

The dominant test applied by Roche J in deciding whether a vessel qualifies as a ship was whether the vessel was intended to be used for navigation. The Court of Appeal adopted the same approach but did not lay down any principle or any definition. That court held that a floating crane was not something which could be regarded as being built in order to be used in navigation.

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In a Scottish case of Watson v RCA Victor Co Incorporated [(1934) 50 Lloyd, LR 77] the issue was whether a seaplane was a "ship or vessel" for the purposes of salvage. It was held (page 78): "On consideration of the question presented here for decision I am satisfied that the answer to it must be in the negative. It is common knowledge that a seaplane is in reality only a species of aircraft, and that although its construction permits of its floating on the sea, or even being navigated a short distance, its primary function - as illustrated in this case by the flight of the seaplane from New York to an island off the east coast of Greenland - is navigation in the air. Its construction for the purpose of floating or moving on the water, I understand, mainly designed for purposes of safety should it be compelled through stress of weather or mechanical defect or for other reason to descend from the air while flying above water.

In short, in popular language, no one would, I think, describe a seaplane as a ship, or vessel, or boat. But further it is, I think, plain that a seaplane does not satisfy the definitions or descriptions of a ship or a vessel given in either the Merchant Shipping Acts or in the decided cases".

The court then quoted the definitions of "ship" and "vessel" in the Merchant Shipping Act. The judgement continued: "The essential element in these definitions is that ships or vessels must be structures 'used in navigation'. Plainly it cannot be predicated of a seaplane - which as pointed out is a species of aircraft - that it is 'used in navigation' in the sense in which a vessel or a ship is so used".

The issue in Polpen Shipping Co Ltd v Commercial Union Assurance Co Ltd [(1942) 1 KB 162] was whether a flying-boat is a "ship or vessel" for the purpose of an insurance claim. Atkinson J stated the facts on page 162: "The object of this action is to claim indemnity in respect of an accident in which a certain ship was involved. The plaintiffs are the owners of a ship called the Polpero, and in 1939 they held a policy covering them in respect of ordinary marine perils of the sea as from December 30, 1938, to December 30, 1939. The policy with the defendants covered them for a certain part of any loss that might be sustained in respect of claims under the policy. On January 14 1939, the ship ran into a flying-boat which we have called the X. The X was a flying-boat and not a seaplane. The difference between the two is this. A seaplane rests upon the water by means of floats on either side and the body of the seaplane is clear of the water, but a flying-boat, which is heavier and bigger, cannot be supported by floats and, therefore, the body of it rests upon the water and is supported in that way. That is why it is called a boat, because the body is constructed differently so as to maintain or bear the weight of the plane".

The court considered the definition of "ship" and "vessel" together with their judicial interpretation. Atkinson J concluded, at page 165, that "it is impossible to hold that the words 'ship' or 'vessel' include this flying-boat. I do not want to attempt a definition, but I think a ship or vessel does involve two ideas. If I had to define them, I should say a vessel was any hollow structure intended to be used in navigation, that is, intended to do its real work upon the seas or other waters, and which is capable of free and ordered movement from one place to another. Its ability to navigate is not merely incidential to the work for which it is really intended. A seaplane's real wor. is to fly. That is its real work and what it is built for, and its ability to float and navigate short distances is merely incidental to its real work, and to my mind that is where the real difference lies. A ship or vessel must be something which is intended to do its real work upon the waters, and it has got to be capable of free and ordered movement. I put the word 'free' to recognise the point in that case before Roche J, where the pontoon crane could be navigated to a small extent and with difficulty, but I do not think that that is navigation within the meaning of this definition. At any rate, there has to be free and ordered movement from one place to another on the waters, and, if you have not those three things, I do not think you are dealing with a ship or vessel." [The reference to Roche J in his judgement in Merchant's Marine Insurance Co Ltd v North of England Protecting & Indemintv Association (supra)].

The appellants in The Mayor of Southport v Morris [(1893) 1 QB 359] were the owners of an artificial lake, half a mile long by 180 yards wide, situated on the foreshore in the borough of Southport. The lake which had been excavated from the sand to a depth of three feet, was surrounded by a concrete wall, and was not open to the sea except at high spring tides. The lake was used for boating purposes, and the appellants had placed on it for hire a certain vessel, or launch, of about three tons which was propelled by electricity from accumulators charged by a dynamo from a charging station. The launch had not been registered as a British ship under the Merchants Shipping Act. For the purposes of certificates issued in respect of ships by the Board of Trade, the court had to decide whether the vessel was a "ship".

Lord Coleridge CJ, referring to the definition of "ship" in the Merchant Shipping Act, 1876, said at 361 that " ... the term 'ship' is defined to include 'every description of vessel used in navigation not propelled by oars'. We are therefore reduced to the question whether this launch was a vessel used in navigation. I think that, having regard to the size of the sheet of water on which it was used, it was not. Navigation is a term which, in common parlance would never be used in connection with a sheet of water half a mile long".

In Ex Parte Ferguson and Hutchinson [(1870) 6 QB 280] a steamship came into contact with a "coble". There was a loss of life to those on board the fishing vessel. The issue which the court had to resolve was whether the fishing coble was a "ship". Blackburn J said at 291: "But the point which remains is this: It is said on behalf of the master and mate that the fishing coble cannot be a 'ship'. She is twenty-four feet long; she is not entirely decked over; she has two masts and a rudder which are removable, and she may be propelled by four oars. She goes out well to sea; and though the oars are used to get her out of harbour, they are merely auxiliary to the use of sails. It is said on behalf of the Board of Trade that that is a 'ship'. The chief argument against that proposition is by referring to the interpretation clause (s 2 of 17 and 18 Vict C 104) which says, "'ship' shall include every description of vessel used in navigation not propelled by oars". And the argument against the proposition is one which I have heard very frequently, viz, where an Act says certain words shall include a certain thing, that the words must apply exclusively to that which they are to include. That is not so; the definition given of a 'ship' is in order that 'ship' may have a more extensive meaning. Whether a ship is propelled by oars or not, it is still a ship, unless the words 'not propelled by oars' exclude all vessels which are ever propelled by oars. Most small vessels rig out something to propel them, and it would be monstrous to say that they are not ships. What, then, is the meaning of the word 'ship' in this Act? It is this, that every vessel that substantially goes to sea is a 'ship'. I do not mean to say that a little boat going out for a mile or two to sea would be a ship; but where it is its business really and substantially to go to sea, if it is not propelled by oars, it shall be considered a ship for the purpose of this Act. Whenever the vessel does go to sea, whether it be decked or not decked, or whether it goes to sea for the purpose of fishing or anything else, it would be a ship. I take it that this was what the justices thought. The facts stated are, that this vessel, though of small size (of only ten tons burthen, and only twenty-four feet long), yet goes out twenty or thirty miles to sea - does go there almost entirely with sails, does stay out many hours, as the affidavits state, and I think it is probable that it goes out for days and nights. This makes it impossible to say that it is not a sea-going vessel, and consequently a 'ship', coming within the Act without the aid of the interpretation clause".

<u>Nature and meaning of "ship' - conclusion</u>

It appears that a vessel would qualify as a "ship" if such vessel is -

- a sea-going vessel and not a small open boat propelled by oars (within the ordinary meaning of the word);
- wholly owned by qualifying persons under section 11 of the Merchants Shipping Act and registered under that Act (in terms of the definition of "South African ship" under that Act);

- a ship of twenty five or more gross tons (in terms of the definition of "South African ship" under the Merchant Shipping Act); and
- a hollow structure intended to be used in navigation, that is, intended to do its real work upon the seas or other waters, and which is capable of free and ordered movement from one place to another (in terms of English law).

6.4 Ship and its appurtenances

The question arises as to what should be included in the expression "ship" for the purposes of cost. The issue could be important in view of capital allowances in respect of machinery or plant. Consider a whaling boat, for instance. Certain of these boats are fitted out with the necessary machinery or plant to produce oil and other products. Should the process of producing oil, for instance, qualify as a process of manufacture, the cost of the plant or machinery would qualify for the allowances available to industrialists. It would under these circumstances be important whether plant or machinery is part of the ship. This issue has not yet been decided by the South African courts. It is interesting to consider how the English courts resolved this issue.

It was held in Gale v Laurie and Others (5 B & C 156) that whatever is on board a ship for the object of her voyage or adventure on which she is engaged, belonging to the owner, constitutes a part of the ship and her appurtenances. In that case, a ship "Dundee" collided with another ship, the "Princess Charlotte" which was sunk. The "Dundee" was sailing outward on a voyage to the Greenland fishery, having on board the necessary stores and implements for the taking of whales and other fish, and procuring oil and blubber obtained from them. The case was decided under an insurance claim instituted against the owners of the "Dundee". Abbott CJ said at 164: "The ship in question was in the prosecution of a voyage in which no freight could be carried. The fishing stores were not carried on board the ship as merchandise, but for the accomplishment of the object of the voyage; and we think, that whatever is on board a ship for the object of the voyage and the adventure on which she is engaged, belonging to the owners, constitutes a part of the ship and her appurtenances within the meaning of this Act, whether the object be warfare, the conveyance of passengers, or goods, or the fishery.

This construction furnishes a plain and general rule; whereas if it should be held that nothing is to be considered as part of the ship that is not necessary for her navigation or motion on the water, a door would be opened to many nice questions, and much discussion and cavil". (The Act referred to in that case was the Marchant Shipping Act, 1954).

The case of <u>Coltman v Chamberlain</u> [(1890) 25 QB 328] concerned the mortgage of a ship. The court had to decide whether certain articles were to pass to the mortgagee under the mortgage. Charles J referred to <u>Salmon & Woods, Ex Parte Gould</u> (2 Mor Bkcy Cas 137) and said at 333: "These certain fishing boats had been mortgaged, and upon the bankruptcy of the mortgagor the mortgagees laid claim to the nets and fishing gear which had been used on board the boats; there was, however, nothing to identify any particular nets as having been appropriated, or as specially belonging to any particular boat, and upon that ground alone the Court though that the fishing gear did not come within the word 'ship' in s2 of the Merchant Shipping Act 1854, nor within the word 'appurtenances' in the form of mortgage then used. Section 72 of that Act uses the word 'ship' only and Wills J says in his judgement: 'It has been argued that 'ship' is equivalent to 'ship and its appurtenances', and to a certain extent that is doubtless so. It would include spare sails, duplicate anchors - anything, in fact, which it would not be prudent to send a ship to sea without'. We have here a judicial interpretation of the meaning of the word 'ship' as used in the Merchant Shipping Act, 1854, and taking that definition, I am of the opinion that those articles, which practically consisted of machinery for working the fishing gear - articles necessary for sailing - passed to the mortgagee under the mortgage of the ship. So far as those articles are concerned there is no necessity to place a meaning on the word 'appurtenances'".

The above decision was in respect of an insurance claim under English law at the time. It is not certain whether our courts will follow the principle established in that case, should the issue arise.

6.5 Movable property

A ship, even if it has a gross tonnage of 400 000 is movable property (Port Alfred Landing and Shipping Co v Bonnievale 3 EDC 146). Movable property consists of objects which are capable of being moved from one place to another irrespective of its mass. (Carlis v Oldfield, 4 HC 385).

6.6 Machinery or plant

Ships are specifically included in the expression "machinery and plant" under English tax law. (Section 31 of the Capital Allowances Act, 1968). The question is whether a ship can be regarded as machinery or plant for the purposes of South African tax law. Unlike the position under English tax law, a ship is not under South African tax law specifically regarded as machinery or plant. The South African courts have to date not been required to resolve the issue. The question therefore remains open, and one will have to refer to the judicial interpretation of the expression "machinery or plant" for guidance. (See "machinery or plant" C21.7 <u>infra</u>).

6.7 <u>Capital allowances</u>

Any person who is ordinarily resident in the Republic or in the case of a company is a domestic company, as owner or charterer of any ship, is entitled to the following allowances in terms of section 14 of the Act with effect from the year of assessment ending 30 June 1953 -

- a 'straight-line' annual allowance of 10% on the cost of any ship used by a taxpayer for the purposes of his trade, in lieu of wear and tear allowances in terms of section 11(e) of the Act;
- a special initial allowance equal to 40 per cent of the cost of ships; and
- a reserve for expenditure on future repairs.

6.8 <u>Annual allowance</u>

Section 14(1)(a) provides that in respect of any ships used for the purposes of trade during a year of assessment by any person referred to in section 9(1)(c), an allowance is to be granted equal to 10 per cent of the adjustable cost (<u>infra</u>) to him of such ship, provided that -

- this allowance may not be granted in the tax year during which a ship is first used for trade purposes if a special initial allowance (<u>infra</u>) under section 14(1)(b) has been granted in respect of that ship; and

- the aggregate of all wear and tear allowances under this or any previous Income Tax Act; allowances under section 14(1)(a); and the special initial allowance provided for in section 14(1)(b); shall not exceed the cost or adjustable cost (infra) of the ship.

The annual allowance is made on the "straight-line" basis and not on the "reducing value" basis. It appears from the wording of the subsection that the allowance will not be subject to reduction even if the ship is used for only a portion of the year of assessment.

Example:

A company purchased a ship for an amount of R2 million in March 1982. The ship was registered in South Africa and brought into use in November 1983. The Commissioner is satisfied as regards all the requirements of section 14(1)(b).

Solution:

			R
Cost of ship			2 000 000
Less section 14(1)(b) allowance -			
Year of asessment ending 28 February 1984			800 000
			1 200 000
Section 14(1)(a) allowance of 10% of cost:			
Year of assessment ending			
28 February	1983	Nil	
	1984	Nil	
	1985	200 000	
	1986	200 000	
	1987	200 000	
	1988	200 000	
	1989	200 000	
	1990	200 0001	1 200 000
Tax value at 28 February 1990			Nil

Note: No allowance is available in 1983 as the ship was not used, nor in 1984 because that was the first year in which the ship was in use and in respect of which a special initial allowance has been granted.

6.9 Special initial allowance

Any person referred to in section 9(1)(c) of the Act who during any year of assessment concludes a contract for the acquisition of a ship (whether built or still to be built), may claim an allowance equal to 40 per cent of the adjustable cost (infra) or adjusted estimated cost of the ship (if at the time at which the allowance is granted, the cost price of the ship has not yet been determined) subject, however, to the following:

- The ship must be new, or in the case of a ship which is not new, it must be proved to the satisfaction of the Director-General: Transport that the ship has at all times since its construction been maintained in the highest class applicable to a ship of its type.
- The Commissioner must be satisfied that the ship is or will be a South African ship (supra).
- The Commissioner must be satisifed that the ship is or will be used for the purposes of the paid person's trade either as -
  - prospecting for minerals (including natural oil); or
  - for mining operations; or
  - as a foreign-going ship which means -
    - a ship plying between a port in one country and a port in another country; or
    - a ship of not less than two hundred gross register tons plying between ports in the same country; or

- a ship of not less than two hundred gross register tons exclusively employed in sea fishing or seal catching; or
- a whaling boat other than shore-based whaling boat of less than two hundred gross register tons.

- The Commissioner must be satisfied that not less than 40 per cent of the cost price or of the estimated cost price of the ship will be paid within two years or, if the Commissioner agrees, three years after the end of the year of assessment in which the contract for the acquisition of the ship is concluded.
- If the person fails to satisfy the Commissioner in terms of the latter, the allowance in respect of any year of assessment is not to exceed 40 per cent of the portion, if any, of the adjustable cost price (infra) or adjustable estimated cost price of the ship paid during that year of assessment.
- The special initial allowance is not available in respect of any ship in respect of which such an allowance has been granted to any other person;
- Paragraphs (iii) of the proviso to section 14(b) provides for the inclusion of portion of the special initial allowance previously made in the income of the taxpayer during a year of assessment in which -
  - the Commissioner is no longer satisfied that the ship will be registered in South Africa or will be used by the taxpayer for the purposes of his trade as set out above; or
  - if the ship is taken off the South African register or is no longer used for the purposes of the taxpayer's trade as set out above; or
  - if the taxpayer ceases to be a person referred to in section 9(1)(c). The amount to be included is calculated in the following manner:

- Determine the amount, if any, to be included in income as a recoupment in terms of section 8(4). Deduct the amount so determined from the amount of the special initial allowance originally granted in terms of section 14(1)(b). It is assumed that the phrase "so much of the amount of the said allowance as is not in terms of section 8(4) required to be included in the taxpayer's income" in proviso (iii) to section 14(1)(b) requires that as much as possible of any recoupment in respect of a ship must first be related to the initial allowance. (aa)
- Determine the aggregate of the annual allowance under section 14(1)(a) and the scrapping allowance under section 11(o) which would have been allowed as a deduction if section 14(1)(b) had not been enacted. Deduct from the amount so determined the total actually allowed as deductions under sections 14(1)(a) and 11(o). (bb)
- The amount arrived at in (aa) above less the amount determined in (bb) above represents the portion of the special initial allowance to be included in income in terms of section 14(1)(b)(iii).

6.10 Allowance in respect of future repairs

Section 14(c) of the Act provides for an allowance in respect of ship repairs to be undertaken within a period of five years. The allowance is in the form of a reserve and is additional to the normal annual expenditure in keeping the ship in running repair. The purpose of the allowance is to cover the cost of heavy repairs in overhauling and refitting which are normally done approximately once in every five years.

The allowance is at the discretion of the Commissioner and will be made on the same principle as a doubtful debt allowance. In other words the allowance for the previous year will be added back and replaced by a new allowance determined in accordance with subsequent estimates of the cost of heavy repairs. In practice the estimated cost is spread over a period and an allowance is not granted in any one year to cover the total estimated cost of the heavy repairs.

The Commissioner in practice is conservative as regards the amount of the allowance because ordinary running repairs are allowed each year. He also considers, as a general guide that the cost of a major refit should not exceed 10 per cent of the cost of the ship. On this basis the reserve should be accumulated at the rate of 2 per cent of the cost of the ship per annum.

6.11 Adjustable cost

The expression "adjustable cost" is defined in section 14(2) of the Act as meaning the cost to the taxpayer of such ship or, if the ship was acquired by the taxpayer to replace a ship and there was an amount recouped or recovered on the previous ship which was not taxed as a recoupment (see below) the cost of the ship so acquired less so much of the amount recovered or recouped and which was not taxed as does not exceed the cost.

6.12 Recoupment of allowance

Section 8(4)(b) of the Act provides that recoupments resulting from the loss, sale or disposal of a ship by a person referred to in section 9(1)(c) will not be included in such person's income if the person -

- concludes a contract for the acquisition of a ship to replace the previous one within a year or such longer period as the Commissioner may allow, after the end of that year of assessment subect to the conditions that for a period of seven years -
  - such ship will b use d by such person for the purposes of his tr e; and
  - such ship will be a ship in relation to which the provisions of section 14(1)(a) or (b) of the Act will apply;
- in respect of a ship of more than two hundred gross register tons, deposits with the Public Debt Commissioners an amount equal to the amount to be excluded from such persons income, less such amount, if any as has in the meantime been paid in respect of the cost of the further ship. (The amount must be deposited within three months after the end of the year of assessment during which there was a recovery or recoupment).

Should an amount which has been recovered or recouped be excluded from a taxpayer's income (where it is taken into account in the determination of the adjustable cost price of a further ship) and the further ship is, within seven years, sold or withdrawn from South African registration (except as a consequence of the loss of the ship), the amount which was taken into account in respect of the cost price of the further ship must be included in the taxpayer's taxable income [section 8(4)(d) read with section 8(4)(b)(ii)].

Should the taxpayer receive or become entitled to an amount, as a result of loss, sale or disposal of a ship, which exceeds the adjustable cost price of such ship, so much of the excess as is greater than the amount which was taken into account in respect of the cost price of a further ship in terms of section 8(4)(b)(bb) [unless such amount has already been taxed under section 8(4)(d) (see preceding paragraph supra] shall be regarded as having been recovered or recouped and must be included in the taxpayer's income.

6.13 Scrapping allowance

A scrapping allowance is available to taxpayers in respect of ships which have been scrapped. The allowance equals the excess of the original cost to the taxpayer of the ship over the aggregate allowances which have been granted under sections 14(1)(a) and (b), and any amount or the value of any advantage accruing on the disposal of the ship. The cost for the purposes of the scrapping allowance shall be deemed to be the actual cost less an amount [not being an amount which has been included in the income of the taxpayer in terms of section 8(4)(d)] by which the cost or estimated cost price of such ship has, in the calculation of the allowance under section 14, been reduced in terms of the definition of "adjustable cost" or "adjustable cost price".

The foregoing provisions relating to ships can best be illustrated by means of examples.

Example 1

A domestic company purchases ship A on 1 March 1974 for R5 000 000. The ship is lost on 1 July 1978 and an amount of R2 500 000 is received from an insurance company. In November 1978 the company purchases a further ship B to replace ship A for an amount of R11 500 000. Ship B is sold in August 1981 for R5 000 000 and no replacement is purchased. The year end of the company is 28 February.

Solution

	R	R
Ship A - cost price 1 March 1974		5 000 000
Less: Initial allowance in 1975 -		
40% of R5 000 000		2 000 000
		3 000 000
Less: Annual allowances -		
10% of R5 000 000		
1975	Nil	
1976	500 000	
1977	500 000	
1978	500 000	
1979 - The ship was lost on 1 July 1978. The annual allowance is not proportionately reduced	500 000	2 000 000
Tax value on date of loss		1 000 000
Proceeds of insurance		2 500 000
Amount recouped in terms of section 8(4)(a)		1 500 000
Ship B - cost price November 1978		11 500 000
Less: untaxed recoupment (section 8(4)(b))		1 500 000
		10 000 000
Less: Initial allowance in 1979 -		
40% of 10 000 000		4 000 000
Carried forward		6 000 000

	R	R
Brought forward		6 000 000
<u>Less</u>: Annual allowances		
10% of 10 000 000		
1979 (initial allowance made)	Nil	
1980	1 000 000	
1981	1 000 000	
1982 10% of 11 500 000 - ship B sold August 1981 (The "adjustable cost" becomes R11 500 000. The amount recouped in respect of Ship A must be included in income and not be taken into account in the determination of "adjustable cost").	1 150 000	
		3 150 000
Tax value of ship B on date of sale		2 850 000
Amount to be included in income in 1982:		
<u>Ship A</u> Ship B was not used for purposes of trade for a period of seven years. The untaxed recoupment becomes taxable		1 500 000
<u>Ship B</u> The adjustable cost price is the actual cost price because section 8(4)(a) has been applied in respect of ship A	11 500 000	
Initial allowance actually granted	(4 000 000)	
Annual allowances actually granted	(3 150 000)	
	4 350 000	
Proceeds of sale	5 000 000	
Surplus regarded as recoupment		650 000
Carried forward		2 150 000

			R	R
Brought forward				2 150 000
Portion of special initial allowance to be included in income in respect of ship B				
Initial allowance actually granted			4 000 000	
Less: actual recoupment (as above)			(650 000)	
			3 350 000	
Less: Amount of annual allowance which would have been allowed had section 14(1)(b) not been enacted:		R		
	1979	1 000 000		
	1980	1 000 000		
	1981	1 000 000		
	1982 (10% of 11 500 000 The "adjustable cost" excludes the recoupment which must be included in income)	1 150 000		
		4 150 000		
Less: annual allowances actually granted (as above)		3 150 000		
			1 000 000	
				2 350 000
Amount to be included in income in 1982				4 500 000

Example 2

The same facts as in example one except that instead of ship B being sold in August 1981, it is lost and an insurance claim realises R5 000 000. The company purchases a replacement ship C for R5 000 000.

Solution

Amount to be included in income in 1982:

Ship A	recoupment (as in example 1 above) (The amount is not taxed as the ship B was lost)	1 500 000
		R
Ship B	Insurance proceeds	5 000 000
	Less tax value (see example 1 above)	2 850 000
	Recoupment which is not taxed as a further Ship C was purchased	2 150 000

Portion of special initial allowance to be included in income in respect of ship B.	
Initial allowance actually granted	4 000 000
Less: recoupment to be taken into account in respect of the cost of ship C	2 150 000
	1 850 000
Less: Annual allowances which would have been allowed had section 14(1)(b) not been enacted (See example 1 above)	1 000 000
Amount to be included in income in 1982	850 000

Example 3

The same facts as in example 1 except that instead of ship B being sold in August 1981, it is scrapped and sold for R2 500 000

Solution

		R
Amount to be included in income in 1982		
Ship A recoupment (same as in example 1 above)		1 500 000
	R	
Ship B Tax value (see example 1 above)	2 850 000	
Add untaxed recoupment in respect of ship A	1 500 000	
	4 350 000	
Less proceeds	2 500 000	
Scrapping allowance		(1 850 000)
		(350 000)

Portion of special initial allowance to be included in income in respect of ship B.

Initial allowance actually granted		4 000 000	
Less allowances which would have been allowed had section 14(1)(b) not been enacted:			
	R		
Annual allowance (see example 1 above)	4 150 000		
scrapping allowance (notional):	4 850 000		
R			
Cost of ship B 11 500 000			
Less annual allowances as above 4 150 000			
7 350 000			
Proceeds 2 500 000			
	9 000 000	4 000 000	(350 000)

	R	R	R
Brought forward	9 000 000	4 000 000	350 000
Less actual -			
annual (see example 1)	(3 150 000)		
scrapping	(1 850 000)		
		4 000 000	
			Nil
Excess of scrapping allowance over recoupment in 1982			350 000

The recoupment in 1982 in respect of ship A is taxed under section 8(4)(d). The adjustable cost price of ship B must therefore be increased to its full cost [see proviso (v) to section 11(o)].

Example 4

A domestic company purchases a ship B in 1972 at a cost price of R8 000 000. An amount of R3 200 000 was recouped on a previous ship A. Ship B is sold in 1982 for an amount of R6 000 000 and a further ship is purchased at an estimated cost price of R8 000 000.

Solution

	R
Ship B cost in 1972	8 000 000
Less untaxed recoupment in respect of ship A	3 200 000
Adjustable cost of ship B	4 800 000
Less: Special initial allowance - 1972	
40% of 4 800 000	1 920 000
	2 880 000
Less annual allowances	
1973 - 1982 10% of R2 880 000 for 10 years	2 880 000
Tax value in 1982	Nil

			R
Amount to be included in income in 1982:			
Ship A	The ship was used for more than seven years. There is no occurrence or circumstance which would cause the recoupment to be taxable		Nil
		R	
Ship B	Tax value on date of sale	Nil	
	Proceeds of sale	6 000 000	
	The taxable portion is limited to the adjustable cost of ship B ie R4 800 000. The recoupment escapes tax as a replacement ship C is purchased.		Nil

Portion of special initial allowance to be included in income in respect of ship B [section 14(1)(b)(iii)]. There is no occurrence or circumstance which affects the Commissioner's discretion		Nil

Recoupment to be taxed in terms of section 8(4)(dA):

	R	
Ship B cost in 1972	8 000 000	
<u>Less</u> untaxed recoupment in respect of ship A which was not included in income under section 8(4)(b)(bb)	3 200 000	
	4 800 000	
Proceeds of sale	6 000 000	
Surplus deemed to have been recovered or recouped in terms of section 8(4)(dA)	1 200 000	
Amount to be included in income in 1982		1 200 000

6.14 Subsidiary companies

Sections 14(1A), (1B) and (1C) which were added to the Act in 1974 provides for the situation where a company and its subsidiary are involved in shipping operations. The expression "subsidiary company" is defined in section 14(2)(b) as a company "which is managed and controlled in the republic if the sole beneficial shareholder in that company is a South African company (in this section referred to as a parent company) which is managed and controlled in the Republic".

"South African company" is defined in section 1 of the Act as meaning "any association, corporation, company or body corporate referred to in paragraph (a) of the definition of 'company' in this section or any association referred to in paragraph (d) of that definition, but does not include any company whose registered office is in a country which formerly formed part of the Republic nor any company formed, established or incorporated under the law of such country after it obtained its independence from the Republic". (The paragraphs in the definition of "company" referred to includes ordinary companies, associations, which are beneficial to the public and unit portfolios but excludes associations referred to in section 10(1)(e) and unit portfolios in property shares).

From the wording of the definition of "South African ship" it appears that a ship owned by the subsidiary company may in certain circumstances qualify as a "South African ship" regardless of its place of registration. The assessed loss of such a subsidiary carrying on business as the owner of such ship may be deducted by the parent company if the assessed loss is attributable to shipping operations. Any such allowance to the parent company must be added back to its income in a subsequent year [section 14(1A)].

Should a subsidiary buy from its parent company a "South African ship" and use it for specified purposes, the subsidiary's annual allowance will be equal to the allowance which the parent company could have claimed had it continued to use the ship [section 14(1B)(a)]. The subsidiary may not, however, claim the annual allowance in a year in which the parent company had been granted a special initial or an annual allowance [section 14(1B)(b)]. For the purpose of the calculation of the subsidiary's annual allowance, any scrapping allowance or any recoupment on the ship, the cost of the ship to the subsidiary is deemed to be equal to the "adjustable cost" to the parent company [section 14(1B)(c)]. The initial and annual allowances granted to the parent company are deemed to have been granted to the subsidiary company [section 14(1B)(d)]. The subsidiary is treated as the taxpayer referred to in section 14(1)(b)(iii); that is if the Commissioner is no longer satisfied about matters on which he is required to be satisfied [section 14(1B)(d)]. The parent company is placed in a corresponding situation by [section 14(1B)(e)]. If the ship ceases to be a South African ship or ceases to be used in the required manner, the Commissioner may direct that the resulting amount to be included in the subsidiary's income under section 14(1)(b)(iii) be included instead in the parent company's income [section 14(1B)(f)]. The provisions of section 14(1B) do not apply to a ship acquired by the subsidiary from its parent company to replace another ship.

The parent company will be granted the initial allowance on a ship acquired under a contract concluded after 1 January 1974 if it satisfies the Commissioner -

- the ship will be sold to a subsidiary company for a consideration not exceeding its cost to it;
- the subsidiary company will qualify for an allowance in respect of the ships under section 14(1)(b); and
- not less than forty per cent of the cost price will be paid by the parent company within two years or if the Commissioner agrees, three years after the end of the year of assessment during which the contract was concluded [section 14(1C)].

In the year in which the subsidiary itself qualifies for the initial allowance on the ship, the allowance previously granted to the parent company will be included in the parent company's income. The allowance is also included in the parent company's income if the Commissioner ceases to be satisfied about its compliance with the conditions laid down [section 14 (1C)].

CHAPTER 7

OWNERS OF AIRCRAFT

7.1 Brief history of flight

The standard of living enjoyed by man has always been influenced by the speed and comfort with which he is able to transport himself or his material needs from one point to another. The latest technological development in the transportation of man and materials in the earths atmosphere is that of air transport. It is interesting to note that the invention and development of flight vehicles coincided historically with the development of photographic processes. Historic photographs of this technological breakthrough in the form of men with their flying machines are therefore available.

The inventors of the balloon were Joseph and Etienne Montgolfier, sons of a paper manufacturer of Annonay in South Eastern France. On 12 September 1783 Joseph Montgolfier appeared by invitation before the Academy of Sciences. He described his experiments with balloons which his brother and he carried out at Annonay. He was invited to repeat the experiment before Louis XVI and his court at Versailles. An aerostat (balloon) was built and at approximately 13h00 on 19 September, 1783 it was released from the Great Court at Versailles carrying a sheep, a rooster and a duck. The reason why those animals were passengers was to ascertain whether or not high altitude travel had any adverse effects on living creatures!

One Jean-Francois Pilâtre de Rozier and Francois Laurent, Marquis d'Arlandes volunteered to be the first humans to take to the air. On 21 November 1783 they took off in free flight from Jardine de la Muette in the Bois de Boulogne. After reaching an altitide of approximately 3 000 feet and an estimated distance of ten miles they landed safely near Gentilly. Thus was completed man's first aerial voyage.

Aeronautical historians accept that the Wright brothers, Wilbur and Orville, of Dayton, Ohio, were the actual inventors of the world's first practical powered airplane. The first controlled man-carrying mechanical flight in the history of man was achieved at 10h35 on 17 December, 1903, by Orville Wright. He made a successful takeoff, flew twelve seconds, and landed without damage.

7.2 Nature of an aircraft

The expression "aircraft" is not defined in the Income Tax Act, neither have our courts been required to express an opinion as to its interpretation. Funk and Wagnalls New Practical Standard Dictionary defines aircraft as: "Any form of craft designed for the navigation of the air; airplanes, dirigibles, balloons, helicopters, kites, gliders, etc." The Encyclopedia Britannica considers aircraft "to be vehicles operating primarily in the earth's atmosphere but at appreciable distances above the ground". The Shorter Oxford English Dictionary defines "aircraft" as "flying machines collectively".

The general rule is that the interpretation of an expression under one statute is of no great assistance in construing the same expression in another statute [R v Lombard, 1948 (2) SA 31]. The definition of the expression "aircraft" in the Aviation Act of 1962, may be of some guidance as to the interpretation of similar expressions in the Income Tax Act. "Aircraft" is defined in section 1 of the Aviation Act as meaning "any machine free flight from Jardine de la Muette in the Bois de Boulogne. After reaching an altitide of approximately 3 000 feet and an estimated distance of ten miles they landed safely near Gentilly. Thus was completed man's first aerial voyage.

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All aircraft are classified into two general categories -

. lighter-than-air; or
. heavier-than-air

Lighter-than-air craft rise and float because they displace a volume of air the weight of which is equal to or greater than the total weight of the craft. Examples are balloons and airships.

Heavier-than-air craft derive their flight capability (lift) from the dynamic reaction of air flowing around suitably shaped surfaces (wings and airfoils). Examples are gliders and sailplanes, conventional aircraft, short takeoff and landing airplanes, and vertical takeoff and landing airplanes (helicopters).

7.3 Capital allowance

Section 14 bis of the Act provides for capital allowances in respect of aircraft acquired on or after 1 April 1965. No wear and tear allowances are granted in respect of aircraft purchased on or after that date. The capital allowances consist of an annual allowance and an initial allowance. Both these allowances are calculated with reference to the adjustable cost to the taxpayer of the aircraft concerned.

7.4 Annual allowance

This allowance is available to any person in respect of any aircraft acquired on or after 1 April 1965, and used by such person for the purposes of his trade during the year of assessment. The allowances are calculated at 25 per cent of the adjustable cost of the aircraft. The amount of the allowance is not reduced if the aircraft is used for only a portion of the year [section 14 bis (1)(a)].

The allowance is not available in any year in which the initial allowance (see below) is granted [section 14 bis (1)(a)(i)]. The aggregate of the annual and initial allowances in respect of any aircraft is limited to the adjustable cost (see below) of the aircraft. If, however, an untaxed recoupment was deducted from the actual cost in arriving at the adjustable cost and such recoupment was taxed in terms of section 8(4)(i) of the Act, such aggregate is limited to the actual cost [section 14 bis (1)(a)(ii)].

7.5 Initial allowance

The initial allowance is restricted to persons who are ordinarily resident in the Republic or in the case of a company, is registered, managed and controlled in the Republic, and who carries on the business as the owner or charterer of any aircraft. The allowance is available to a person if he concludes a contract for the acquisition of a new aircraft or of an aircraft which is not new if the Commissioner for Transport is satisfied that it has at all times since its construction been maintained in the highest class applicable to an aircraft of its type, provided the following are complied with:

- The person must satisfy the Commissioner that the aircraft is or will be registered in the Republic and that such registration will be the aircraft's first registration in the Republic.

- The person must further satisfy the Commissioner that the aircraft is or will be used by him in his business of transporting by air and for reward persons, livestock, goods or mail.
- The person must further satisfy the Commissioner that at least 40 per cent of the cost price or estimated cost price of the aircraft will be paid by him within two years, or three years if the Commissioner agrees, after the end of the year of assessment during which the contract of purchase was concluded [section 14 bis (1)(b)].

The amount of the initial allowance is equal to 40 per cent of the adjustable cost (see below) or the adjustable estimated cost price. Should the person not satisfy the Commissioner as regards the payment of at least 40 per cent of the cost as set out above, the allowance, if claimed should equal 40 per cent of the portion of the adjustable cost paid by the person during the year of assessment.

It should be noted that the initial allowance is not dependent upon the aircraft being brought into use. A delay may occur between the date of the contract of purchase and the date on which the aircraft is brought into use. The person must, however, satisfy the Commissioner that the aircraft will be used by him in his business of transporting by air and for reward persons, livestock, goods or mail.

Should the person fail to pay at least 40 per cent of the cost price or estimated cost price within the period as stipulated above and he was granted a full initial allowance, such allowance must be added on to his income at the end of the period. In its stead may be claimed an initial allowance equal to 40 per cent of that portion of the cost actually paid. Where this latter allowance is less than 25% the Commissioner will in practice substitute the allowance with the annual allowance. The initial allowance, under these circumstances, could be claimed in a subsequent year as long as both the initial and annual allowances are not granted in the same year of assessment [section 14 bis (1)(b)(ii)].

If the Commissioner is no longer satisfied as regards the requirements for the granting of the initial allowance, there must be added to the person's income so much of the initial allowance -

- as is not required to be included in his income under section 8(4); and
- is not required to be deducted from the cost or the estimated cost of a further aircraft.

From this amount is deducted the amounts which the person would have been allowed by way of annual allowances and by way of scrapping allowance as if section 14 bis (1)(b) had not been enacted [section 14 bis (1)(b)(iii)].

7.6 Adjustable cost

The expression "adjustable cost" or "adjustable cost price" are defined to mean "the cost to the taxpayer of such aircraft or, if such aircraft was acquired by the taxpayer to replace an aircraft and the aircraft so acquired is an aircraft in relation to which the Commissioner is satisfied in regard to the matters in regard to which he is required to be satified in terms of paragraph (g) of sub-section (4) of section eight, the cost to the taxpayer of the aircraft so acquired, less so much of any amount referred to in paragraph (a) of that sub-section which has been recovered or recouped in respect of the aircraft so replaced as does not exceed such cost, and 'adjustable estimated cost price' shall be construed accordingly" [section 14 bis (2)(a)].

Example

A domestic company carries on the busi[illegible]s of transporting passengers by air for reward. On 1 February 1980 an aircraft B is purchased to replace a previous aircraft A, for a cash price of R1 000 000. An amount of R200 000 is recouped in respect of aircraft A. Aircraft B is brought into use on 28 February 1980 and is sold on 31 March 1983 for an amount of R180 000. Aircraft C is purchased as a replacement of aircraft B.

Solution

		R
Aircraft B cost		1 000 000
Less: Untaxed recoupment, aircraft A		200 000
Adjustable cost of aircraft B		800 000
Less: initial allowance - 40% of R800 000		
- in 1980 tax year		320 000
		480 000
Less: annual allowance - 25% of		
800 000	R	
1980	NIL	
1981	200 000	
1982	200 000	
1983	80 000	
		480 000
Tax value 28 February 1983		NIL

Amount to be included in income in 1982:

Aircraft B

The aircraft is sold for R180 000. The amount is not added to income as a further aircraft C is purchased as a replacement. The R180 000 must be deducted from the cost of aircraft C.

Section 8(4)(i) There is no amount to be added to income in respect of aircraft A as aircraft B was used for a period of three years as required by section 8(4)(i).

Section 14*bis*(1)(b)(iii)

		R
Initial allowance of aircraft B		320 000
Less portion required to be included in income under section 8(4)		NIL
Portion not required to be included under section 8(4)		320 000
Less portion thereof required to be set off against cost of aircraft C under section 14*bis*(2)(a). This is the recoupment on aircraft B. It is assumed that the recoupment of section 14 *bis* allowances must in the first place be regarded as having accrued in respect of the initial allowance		180 000
Portion not required to be included in income under section 8(4) and not required to be set off against cost of aircraft C		140 000
Deduct the difference between notional annual allowances and actual annual allowances:		
Notional 1980 - 1983	800 000	
Actual - see above	480 000	320 000
Amount to be included in income		NIL

Example 2

The same facts as example 1 except that aircraft B is brought into use on 28 February 1980 and one of the following occurs during the 1981 tax year:

a) The company is liquidated.

b) Aircraft B ceases to be registered in the Republic.

c) The company ceases to be a domestic company as required by section 14 *bis* (1)(b).

Solution

			R
Aircraft B, cost			1 000 000
Less untaxed recoupment on aircraft A			200 000
Adjustable cost of aircraft B			800 000
Initial allowance in 1980 tax year – 40% of 800 000			320 000
Tax value at 28 February 1980			480 000
1981 tax year			
Section 8(4)(i)	The aircraft is not used for three years. The untaxed recoupment in respect of aircraft A must be added to income		200 000
		R	
Section 14 *bis* (1)(b)(iii)			
Initial allowance, aircraft B		320 000	
Deduct difference between notional annual allowances and actual annual allowances:			
Notional – 1980– 25% of			
Carried forward		320 000	200 000

			R	R
Brought forward			320 000	200 000
National - 1980 - 25%		R		
	of R800 000	200 000		
	1981- 25% of			
	R1 000 000	250 000		
		450 000		
Actual 1981 - 25% of				
	1 000 000	250 000		
			200 000	
Amount to be added to income				120 000
Total amount to be added to income in 1981 tax year				320 000
In effect only R70 000 is added to income in 1981:				
As above				320 000
Less annual allowance				250 000
				70 000

Example 3

The same facts as example 1 except aircraft B is brought into use on 1 March 1980 and sold on 1 July 1980 for R720 000. Aircraft C is purchased as a replacement.

Solution

Aircraft B cost	1 000 000
Less untaxed recoupment in respect of aircraft A	200 000
Adjustable cost of aircraft B	800 000
1980 tax year	
Initial allowance - 40% of R800 000	320 000
Tax value at 28 February 1980	480 000

(The initial allowance may be claimed even though the aircraft is only brought into use during the next tax year).

<u>1981 tax year</u>

		R	R
Section 8(4)(i)	Aircraft B has not been used for three years. The untaxed recoupment in respect of aircraft A must be added to income		R200 000

Section 8(4) Actual recoupment:

	R
Adjustable cost of aircraft B becomes actual cost because section 8(4)(i) has been applied	1 000 000
<u>Less</u> - 1980 initial allowance	(320 000)
1981 annual allowance - 25% of R1 000 000	(250 000
	430 000
Selling price of aircraft B	720 000
Actual recoupment	290 000

The actual recoupment is to be set off against the cost price of aircraft C and is not added to income.

Section 14 <u>bis</u> (1)(b)(iii)

	R	R
Initial allowance, aircraft B	320 000	
<u>Less</u> portion thereof actually recouped and set off against cost of aircraft C	290 000	
	30 000	
Deduct the difference between the notional annual allowances and the actual annual allowances:		
Brought fcward	30 000	200 000

	R	R	R
Brought forward		30 000	200 000
Notional -			
1980 (not used)	NIL		
1981 - 25% of R1 000 000	250 000		
	250 000		
Actual - 1981	250 000		
		NIL	
			30 000
Amount to be included in income in 1981 tax year			230 000
In effect R20 000 is deducted from income in 1981:			
As above			230 000
Annual allowance			250 000
			20 000

It should be noted that as in the previous example the adjustable cost of aircraft B increases to its original cost in 1981.

Example 4

The same facts as example 1 except that aircraft B is brought into use on 28 February 1980 and is scrapped in the 1982 tax year. The scrap realised R200 000.

Solution

Aircraft B cost	1 000 000
Less untaxed recoupment in respect of aircraft A	200 000
Adjustable cost of aircraft B	800 000
1980 tax year: initial allowance -	
40% of R800 000	320 000
	480 000
1981 tax year: Annual allowance - 25% of	
R800 000	200 000
	280 000

			R
<u>1982 tax year:</u>			
<u>Section 8(4)(i)</u>			
The aircraft B is not used for three years.			
The untaxed recoupment in respect of aircraft			
A must therefore be included in income			200 000
<u>Section 11(o)</u> - Scrapping allowance			
		R	
Cost of aircraft B		1 000 000	
<u>Less</u> actual allowance	R		
1980 - initial	320 000		
1981 - actual	200 000		
1982 - annual	250 000		
		770 000	
		230 000	
Proceeds of sale of scrap		200 000	
Scrapping allowance to be deducted from income			30 000
			170 000
Section 14 <u>bis</u> (1)(b)(iii)			
Scrapping allowance which would have been allowed if section 14 <u>bis</u> (1)(b) had not been enacted:			
Aircraft B cost		1 000 000	
Notional annual allowances -			
1980	200 000		
1981	200 000		
1982	250 000		
		650 000	
		350 000	
Proceeds of sale of scrap		200 000	
Notional scrapping allowance		150 000	
Initial allowance		320 000	
Deduct the difference between the notional annual and scrapping allowances and the actual annual and scrapping allowances:			
Carried forward		320 000	170 000

	R	R	R
Brought forward		320 000	170 000
Notional allowances –			
1980 – annual	200 000		
1981 – annual	200 000		
1982 – annual	250 000		
1982 – scrapping	150 000		
	800 000		
Actual allowances	480 000		
1980 – annual	NIL		
1981 – annual	200 000		
1982 – annual	250 000		
1982 – scrapping	30 000		
		320 000	
Initial allowance to be taxed			NIL
Amount to be included in income in the 1982 tax year			170 000
In effect R80 000 is deducted from income in the 1982 tax year:			
As above			170 000
Annual allowance			250 000
			80 000

Example 5

Same facts as example 1 except that aircraft B is brought into use on 28 February 1980 and is scrapped with no residual value in the 1981 tax year.

Solution

Aircraft B, cost	1 000 000
Less untaxed recoupment in respect of aircraft A	200 000
Adjustable cost of aircraft B	800 000
1980 tax year – Initial allowance – 40% of R800 000	320 000
Tax value at 28 February 1980	480 000

	R	R	R
Brought forward		320 000	170 000
Notional allowances -			
1980 - annual	200 000		
1981 - annual	200 000		
1982 - annual	250 000		
1982 - scrapping	150 000		
	800 000		
Actual allowances	480 000		
1980 - annual	NIL		
1981 - annual	200 000		
1982 - annual	250 000		
1982 - scrapping	30 000		
		320 000	
Initial allowance to be taxed			NIL
Amount to be included in income in the 19[illegible] tax year			170 000
In effect R80 000 is deducted from income in the 1982 tax year:			
As above			170 000
Annual allowance			250 000
			80 000

Example 5

Same facts as example 1 except that aircraft B is brought into use on 28 February 1980 and is scrapped with no residual value in the 1981 tax year.

Solution

Aircraft B, cost	1 000 000
Less untaxed recoupment in respect of aircraft A	200 000
Adjustable cost of aircraft B	800 000
1980 tax year - Initial allowance - 40% of R800 000	320 000
Tax value at 28 February 1980	480 000

		R	R
1981 tax year			
Section 14 *bis* (1)(b)(iii)			
Notional scrapping allowance had section 14 *bis* (1)(b) not been enacted:			
Adjustable cost			800 000
Less notional annual allowance -			
1980		200 000	
1981		200 000	400 000
Notional scrapping allowance			400 000
Initial allowance			320 000
Less notional allowances			
1980 - annual		200 000	
1981 - annual		200 000	
- scrapping		400 000	
		800 000	
Less actual allowances	R		
1980 - annual	NIL		
1981 - annual	200 000		
- scrapping	280 000	480 000	
			320 000
Initial allowances to be taxed			NIL
Scrapping allowance to be deducted from 1981 tax year's income			480 000

7.7 Recoupment

Recoupments of the capital allowances resulting from the loss, sale or disposal of aircraft are in certain circumstances not subject to taxation in the hands of the taxpayer. The tax consequences of these recoupments are governed by sections 8(4)(g), (h), (i) and (j) of the Act.

Section 8(4)(g) provides that where the capital allowances are recouped as a result of the loss, sale or disposal of an aircraft, to the extent that it does not exceed the cost of a further aircraft, be set off against such cost and will not be included in the taxpayer's income if the taxpayer shows -

- that he will within a year (or such longer period as the Commissioner may allow) after the end of the tax year during which the recoupment occurs, conclude a contract for the acquisition by him of a further aircraft to replace the aforesaid aircraft; and
- that such further aircraft will be used by him for purposes of his trade for at least three years.

A taxpayer is required by section 8(4)(h), in order to qualify for the concession under secton 8(4)(g), to, within three months after the end of the tax year during which the recoupment occurs, deposit with the Public Debt Commissioners an amount equal to the amount to be set off against the cost of the further aircraft. This amount is the amount which is excluded from income under section 8(4)(g) and may be reduced by any amount paid by the taxpayer in respect of the cost price of the further aircraft. In practice the deposit is repaid to the taxpayer as and when the balance of the cost price of the further aircraft is paid.

Should it transpire that the taxpayer has not complied with the requirements of section 8(4)(g) (supra) due to any occurrence [other than the loss by the taxpayer of the further aircraft referred to in section 8(4)(g)] or due to any other circumstances arising, the amount excluded from income under section 8(4)(g) must be included in the taxpayer's income in the tax year during which such occurrence takes place or such circumstance arises.

Should an aircraft be replaced by a further aircraft and a recoupment of the first mentioned aircraft is set off against the cost of the further aircraft under section 8(4)(g), the recoupment (or portion thereof) is subject to tax in terms of section 8(4)(j) if -

- the further aircraft is lost, sold or disposed of; and
- an amount accrues to the taxpayer as a result of such loss, sale or disposal which exceeds the adjusted cost of the further aircraft.

The amount taxed is equal to the excess of the amount over the adjusted cost of the further aircraft, but is limited to the recoupment.

Example

A taxpayer whose year of assessment ends on 28 February acquires an aircraft B on 1 February 1982 at a cost price of R270 000. He is allowed to set off against the purchase price a recoupment of a previous aircraft A amounting to R150 000. The aircraft is lost in May 1983 as a result of an accident and the taxpayer receives R135 000 from an insurance company.

Solution

	R	R
Aircraft B - cost		270 000
Less recoupment aircraft A		150 000
Adjusted cost of aircraft B		120 000
Deduct section 14 *bis* allowances;		
1982 - 40% x R120 000	48 000	
1983 - 25% x 120 000	30 000	
1984 - 25% x 120 000	30 000	108 000
Tax value at date of loss		12 000
Insurance claim		135 000
Surplus		123 000

The amount to be included in income in the 1984 tax year would be -	R
Insurance claim	135 000
Less adjusted cost of aircraft B	120 000
	15 000

An amount of R108 000 (R123 000 - R15 000) has therefore been recouped in respect of capital allowances granted on aircraft B. Whether this amount is subject to inclusion in the income of the taxpayer would depend on whether a further aircraft is purchased as a replacement. The amount of R15 000 is in effect a portion of the recoupment of aircraft A and must be included in income in the 1983 tax year irrespective of whether a further aircraft is purchased.

7.8 Scrapping allowance

A scrapping allowance is available to taxpayers in respect of aircraft which have been scrapped. The allowance equals the excess of the original cost to the taxpayer of the aircraft over the aggregate allowances which have been granted under sections 14 bis (1)(a) and (b), and any amount or value or any advantage accruing on the disposal of the aircraft. The cost for the purposes of the scrapping allowance shall be deemed to be the actual cost less any amount [not being an amount which has been included in the income of the taxpayer in terms of section 8(4)(i)] by which the cost or estimated cost price of such aircraft has, in the calculation of the allowance under section 14 bis, been reduced in terms of the definition of "adjustable cost" or "adjustable cost price".

CHAPTER 8

EXPORTERS CARRYING ON A BENEFICIATION PROCESS

What the Minister said in his 1975 Budget Speech:

"The Economic Advisory Council recently transmitted to the Government a number of recommendations designed to provide special additional incentives for the local beneficiation of minerals. South Africa is exceptionally rich in mineral resources, and greater local beneficiation of these minerals can undoubtedly make an important contribution to our future economic development and balance of payments. The Government has accepted the recommendations, which will initially be implemented for five years with the possibility of extension thereafter.

The various incentives will be granted selectively on the recommendation, in each individual case, of an inter-departmental committee. The tax incentives proposed are -

(a) an investment allowance up to a maximum of 20% of the cost of machinery and 15% of the cost of buildings in a beneficiation plant not connected with a mining company. This will be additional to the general investment allowance granted to all manfacturers;

(b) a similar investment allowance in respect of the beneficiation plant of a mining company where the company undertakes advanced beneficiation. This will be additional to the 100% write-off of capital expenditure already granted to such mining companies.

Furthermore, these allowances will be granted over and above any tax concessions which may be accorded under the decentralisation scheme.

The allowances will apply to new machinery taken into use, and to buildings the erection of which is commenced, on or after 27 March 1975. The loss of revenue may eventually be considerable, but for 1975/76 it will probably be small".

The beneficiation allowance was first introduced into the Act in 1975 by the insertion of section 15A. It provides for an allowance to be granted to industrialists who produce for export raw materials derived from base minerals and apply advanced beneficiation processes for the purposes of producing such raw materials. The allowance is calculated as a percentage of the cost of the following assets which have been brought into use by a taxpayer wholly or mainly for the purposes of his export trade:

- New or unused machinery or plant which is -
  - used by the taxpayer directly in a beneficiation process; and
  - is so brought into use before 30 June 1985.
- Buildings erected by the taxpayer if -
  - the erection of such building was commenced before 30 June 1985;
  - such building is so brought into use by the taxpayer not later than 30 June 1986; and
  - such building is wholly or mainly used by the taxpayer for the purpose of carrying on therein any beneficiation process.
- Improvements (other than repairs) effected by the taxpayer to a building, if -

- such improvements were commenced before 30 June 1985;
- such improvements are completed not later than 30 June 1986; and
- such building is wholly or mainly used by the taxpayer for the purpose of carrying on therein any beneficiation process..

8.1 The nature of the beneficiation allowance

The beneficiation allowance is granted in respect of the cost of certain capital assets which are used by the taxpayer directly in a beneficiation process. The term "beneficiation process" is given two meanings in section 15A:

"(a) any process whereby any base mineral is refined or otherwise processed to yield any intermediate product the value of which is substantially higher than the value of the base mineral from which such product is derived; or

(b) any process whereby an intermediate product yielded by a process referred to in paragraph (a) is further refined or processed without such product ceasing to be an intermediate product, or is further refined or processed in order to yield some other intermediate product".

These two definitions are qualified not to "include any process which the Minister of Finance is satisfied is either a simple purification process in consequence of which the base mineral or intermediate product in question remains unchanged except for the removal of impurities or a physical process resulting merely in a change of shape".

The expression "base mineral" is defined as meaning any base mineral as defined in the Mining Rights Act, 1967, which reads:

"'Base mineral' means any substance, whether in solid, liquid or gaseous form, occurring naturally in or on the earth, which has been formed by or subjected to a geological process, but does not include -

(a) precious metals;

(b) precious stones;

(c) natural oil

(d) water, not being water taken from a borehole, well, excavation or natural saltpan for the extraction therefrom of a substance in solution therein and of commercial value; or

(e) soil, not being soil taken from the earth for the extraction therefrom of a substance of commercial value contained therein or for the manufacture therefrom of a product of commercial value".

A further qualification to a "base mineral" under section 15A is the requirement that the base mineral must have been mined in South Africa.

The judicial interpretation of the expression "base mineral" is the same as the judical interpretation of the word "mineral". This appears to be so because all other classes of minerals (precious metals, precious stones and natural oil) are specifically defined in the Mining Rights Act, 1967. Section 15A of the Income Tax Act requires "base minerals" to be interpreted as it would be interpreted under the Mining Rights Act, 1967. The expression appears therefore not be interpreted in a narrow sense of the ordinary or popular use of the expression, but in a very wide sense. The expression "base mineral" would include sand, stone, gravel and clay. [Belleville - Inry Edms Bpk v Continental China and Others, 1976 (3) SA 583(C): Falcon Investments Ltd v CD of Birnam (Suburban) (Pty) Ltd and Others 1973 (4) SA 384(A)]. Rumpff JA in the latter case said at 405: "It is difficult to envisage why the local authority would have wanted to confine 'minerals' to its narrow meaning and to exclude the humbler and more commonplace mineral substances like clay, stone, etc. After all, an economically exploitable deposit of the latter can often be most valuable and its exploitation can serve the public interest too ......"

The definition of "base mineral" above is comparable to the definition of "mineral" in the Mines and Works Act of 1956: "'Mineral' means any substance, whether in solid, liquid or gaseous form, occurring naturally in or on the earth and having been formed by or subjected to a geological process, but does not include water and soil unless they are taken from the earth for the production, or extraction, therefrom of a product of commercial value".

The beneficiation process is the process whereby any base mineral is refined or processed to yield an intermediate product, the value of which is substantially higher than the value of the original base metal. "Intermediate product" in terms of section 15A "means any substance or material which the Minister of Finance is satisfied is produced by the taxpayer concerned in order to be used by any person as a raw material".

The case of Zaaiplaats Tin Mining Co Ltd v Union Government (1944 TPD 42) did not concern a beneficiation process. The facts of the case, however, illustrate a typical beneficiation process. The taxpayer carried on tin mining operations. The activities of mining were as follows:

(a) The mining of crude tin bearing ore (termed "ore at grass").

(b) Processing such ore at grass resulting in its reduction to tin ore concentrates, or cassiterite.

(c) Subjecting the tin ore concentrates to a different set of operations than those involved in the production of tin ore concentrates from tin ore at grass, resulting in the reduction of tin ore concentrates into metallic tin, cast into ingots.

At this point it should be noted that in terms of section 15A(3), the beneficiation allowance is not available in respect of assets used in the course of mining operations, "unless the Minister, having regard to the circumstances of the case, is satisfied that the beneficiation process in question is additional to the processes normally carried on in the course of any of the said operations or that it is introduced as part of a scheme for the creation of extensive extra capacity to be used wholly or mainly for export".

To continue with the above illustration, let us assume for purposes of illustration that the activities of the taxpayer cease after (b) above and that the Minister is satisfied that the process in (b) above is "additional to the processes normally carried on ...." Process (b) would then qualify as a beneficiation process in terms of the definition. The intermediate product would be the tin ore concentrates, which would have a value substantially higher than the value of the base mineral which is crude tin bearing ore.

In the <u>Zaaiplaats Tin Mining case</u> (<u>supra</u>) the taxpayer did not carry on the process under (c) above until war conditions in 1941 forced it to do so. Until then, however, it carried on mining operations consisting of the activities in (a) and (b) above. Assuming then that the Minister has consented to the process in (c) above, this process would qualify as a beneficiation process under the alternative definition of that process as above. The intermediate product (tin ore concentrates) produced as a result of process (b) above, has been further processed resulting in yet another intermediate product in the form of metallic tin, cast into ingots. The metallic tin is a raw materal in the subsequent process of manufacturing tin articles.

The beneficiation allowance is granted in respect of the assets listed above only where the taxpayer brings them into use wholly or mainly for the purposes of his export trade. "Export trade" is defined in section 15A and "means such trade or branch of any trade as the Commissioner is satisfied is carried on by the taxpayer wholly or mainly in order to produce any intermediate product for export".

8.2 <u>Beneficiation process v process of manufacture</u>

The beneficiation allowance is an extremely generous allowance for it is granted in addition to all the other allowances available to taxpayers under the Act. It is therefore possible for a taxpayer to, for example, claim allowances on qualifying machinery or plant to the extent of 150% of the cost thereof.

<u>Example</u>

A taxpayer qualifies for both the beneficiation allowance and the machinery initial and investment allowances. Machinery costing R100 000 is installed in his factory which produces an intermediate product for the purposes of his export trade.

Solution

The aggregate capital allowances available to the taxpayer under the Act would be:

S11(e):	Wear and tear Allowance	75%	75 000
S12(1):	Machinery initial allowance	25%	25 000
S12(2):	Machinery investment allowance	30%	30 000
S15A :	Beneficiation allowance	20%	20 000
			R150 000

The amount of the beneficiation allowance

The amount of the beneficiation allowance is determined under section 15A(2). This section provides that the Minister of Finance, having regard to the circumstances of the case, may allow an amount in the form of a beneficiation allowance, to be deducted by a taxpayer from his income. The Minister having regard to the circumstances of the case may make the following maximum allowances:

- 20% of the cost to the taxpayer of qualifying machinery or plant.
- 15% of the cost to the taxpayer of buildings or improvements.

The "cost price" is an amount as established to the satisfaction of the Commissioner. [Section 15A(2)(c)].

8.4 Recoupment of the beneficiation allowance

The recoupment or recovery of the beneficiation allowance as a result of the disposal of the relevant assets is not subject to tax. The application of the general recoupment section 8(4)(a) is specifically excluded in respect of section 15A.

8.5 Scrapping allowance

A scrapping allowance in respect of machinery or plant used in a beneficiation process may be claimed. The scrapping allowance is, however, not available on buildings or improvements thereto used by the taxpayer for the purpose of carrying on therein any beneficiation process. The scrapping allowance in respect of buildings is only available to manufacturers, hotelkeepers and co-operatives (section 11(o)).

8.6 Machinery or plant

Unlike the wear and tear allowance, the beneficiation allowance is not restricted so as to exclude from machinery or plant such items which are structures or works of a permanent nature (C21.5 infra).