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## Guide to the Urban Development Zone Tax Incentive for

### The Msunduzi Municipality

Compiled by the Corporate Asset Management Business Unit

#### Background to the UDZs and the Tax Incentive

At the end of 2003, a tax incentive in respect of the erection, extension, addition or improvement of buildings demarcated within Urban Development Zones (UDZs) in selected cities of South Africa, including Pietermaritzburg, was signed into law.

The Income Tax Act (No. 58 of 1962) now permits owner/developers to write off costs of refurbishment and/or new development in demarcated UDZ areas. The Income Tax Act has been amended through the promulgation of section 33 (7) of the Revenues Law Amendment Act (45 of 2003) and inserts section 13 *quat*, i.e. "Deductions in respect of erection or improvement of buildings in urban development zones".

The UDZ tax incentive is directed at the stimulation of the regeneration of declining urban areas, in targeted inner city areas across South Africa, and the encouragement of economic development.

#### Promulgation of the UDZ

With the demarcation of the UDZ by the Minister of Finance in the Government Gazette No. 27656, on 6 June 2005, owners of land and buildings in such demarcated UDZ area may apply for the tax incentive. The incentive applies to any refurbishment or new building projects within the UDZ.

#### The UDZ approved for Pietermaritzburg

The Pietermaritzburg UDZ covers a portion of an area known as the Inner City, comprising about 170 hectares. This demarcated area within the Inner City has been promulgated as the only UDZ for Pietermaritzburg.

#### The Pietermaritzburg Inner City UDZ

The proposed UDZ of 170 hectares in extent and has been structured in such a way as to include those blighted areas which most need attention, as well as those which will have the biggest impact on attracting investment to the inner city.

A full map and description of the Inner City UDZ is attached on Page 2. It is important for the taxpayer to ensure that the property to be developed or refurbished is within the Inner City UDZ.

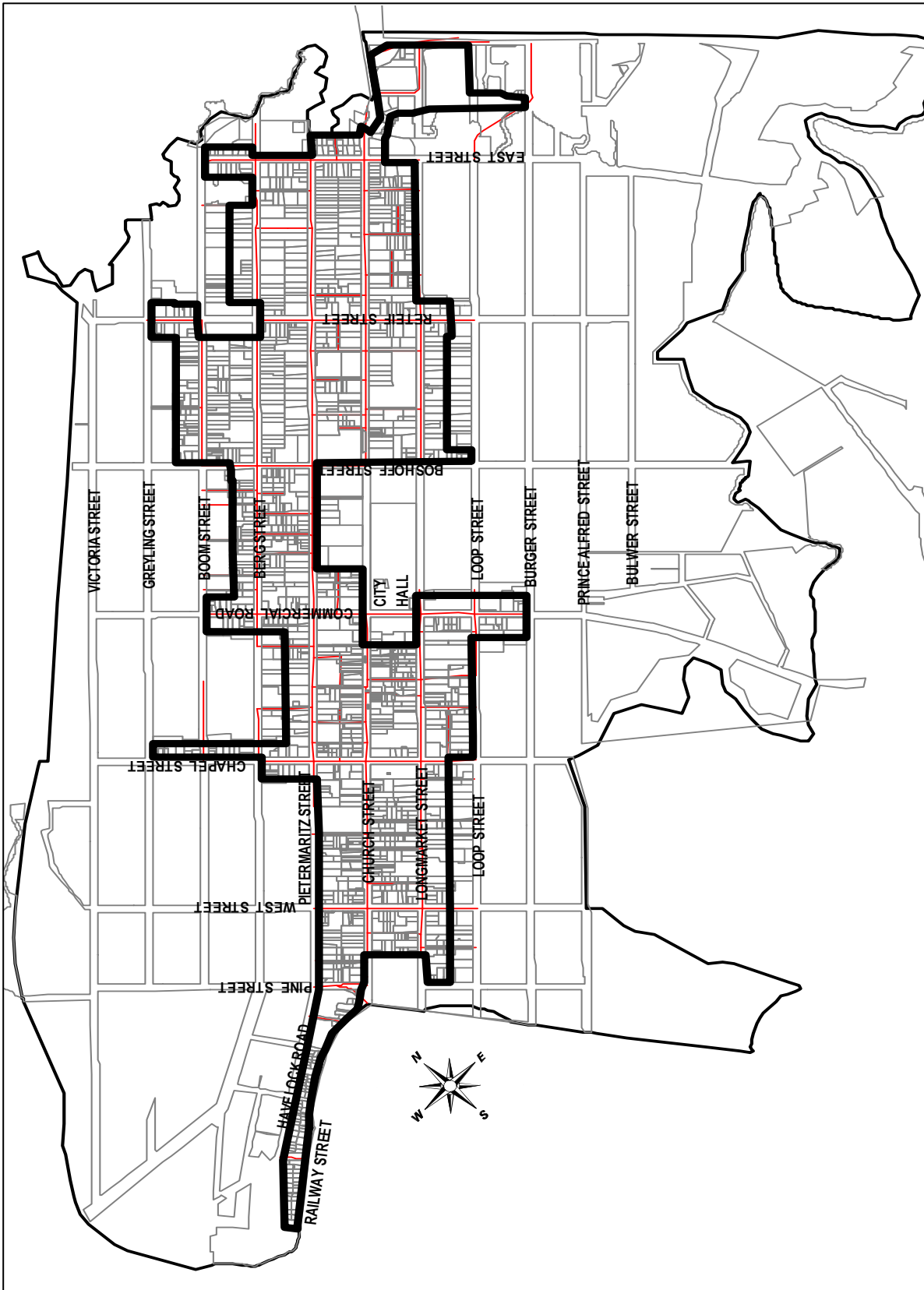
#### Who is eligible for the UDZ tax incentive?

Any taxpayer-owner, user, and lessor of a building within the UDZ can qualify for the incentive. If you own a property for investment purposes in an individual capacity, the tax allowance may be offset against your personal taxable income, so long as you do not use the premises for personal purposes.

#### How does the UDZ tax incentive work?

Deductions shall be allowed from the taxpayer's income in respect of the cost of the erection, extension, addition, or improvement, if the building is used for that taxpayer's trade and if:

- Building and/or improvement operations were commenced by the taxpayer, and/or the contract for construction was formally signed, on or after the date of promulgation of the UDZ
- An occupancy certificate, in terms of the National Building Regulations, was issued by the municipality, on completion of the construction work



## URBAN DEVELOPMENT ZONE (UDZ)

### **How much depreciation does the UDZ tax incentive allow for in terms of refurbishments?**

In the case of the refurbishment of an existing building within the UDZ, an accelerated straight-line depreciation allowance of 20% per year of the cost of improvements, over 5 years is permitted. The refurbishment must preserve a substantial part of the structure or exterior framework and any extensions or additions must be of incidental nature to improvement (see elsewhere in this document for examples).

### **How much depreciation does the UDZ tax incentive allow for in terms of new developments?**

In the case of a new building, a write-off period over 17 years is permitted with an initial 20% in the first year and an annual 5% for the next 16 years (see elsewhere in this document for examples).

### **What general operations and procedures are involved?**

No tax deduction will be allowed, unless the taxpayer has together with the tax return, submitted to SARS:

- A UDZ location certificate stating that the building is within an approved UDZ must be obtained from the council
- The nature/particulars and costs relating to any portion of the building for which an occupancy certificate has been granted

As soon as the taxpayer wishes to take advantage of the UDZ tax incentive, he must apply to the council for a UDZ Registration Certificate.

Once all planning and building plan approvals have been obtained, and the building work has been completed, the taxpayer must request a UDZ location certificate, and must supply the council with the following information:

- The anticipated costs incurred in the construction
- The number of jobs expected to be created post-construction in terms of the construction

Thereafter, the taxpayer must submit the Certificate of Location and the Certificate of Occupancy received from the council, with the relevant SARS form, as part of the tax return to SARS (see separate process diagram for details).

### **What do I do when the building is really old and the refurbishments I plan do not require approvals from Council?**

If the taxpayer still holds the original Certificate of Occupancy (which can be difficult when there have been a number of owners, or the building was built many decades ago), he may submit this certificate to SARS with the Certificate of Location. If however, the Certificate of Occupancy can not be found, the taxpayer must make submission for building plans approval (generally providing as-built drawings, engineering certificates, and/or whatever that may be required), and a Certificate of Occupancy will be issued after inspections have been carried out.

### **What is the effective date of the UDZ tax incentive?**

A taxpayer can only claim the incentive for building refurbishments and/or developments commenced, or where the construction contract was signed, ON or AFTER the date of demarcation of the UDZ area in the Government Gazette. There is NO relief for projects before this date. The costs are deductible in the year that the erected, or refurbished, building is brought into use by taxpayer.

### **What kinds of buildings are eligible for the UDZ tax incentive?**

Any commercial, industrial or residential building is eligible for the UDZ tax incentive.

**What costs does the UDZ tax incentive cover?**

- Construction costs
- Demolition of existing building (or part thereof)
- Permanent fixtures adjoining the site
- Water, power, sewage, drainage, waste disposal
- Access or parking
- Security (fence, cameras, surveillance equipment)
- Sidewalks
- Landscaping as part of the development

**What does the taxpayer have to do when submitting the income tax return?**

The taxpayer must supply the UDZ Location and Tax certificate plus a statement of total costs relating to the building (or part) where the council has granted the Occupancy Certificate plus any details of the costs of erection or refurbishment.

**Is the UDZ tax incentive limited in any way?**

If taxpayer stops using the building, or sells it, the deduction ceases. A taxpayer cannot claim any deduction if prior to the erection, extension, addition or improvement of the building, the taxpayer:

- Ceased to use that building solely for the purposes of his/her trade during any previous year of assessment; or
- Disposed of such building during a previous year of assessment

Simple examples of applying the UDZ incentive

<b>Example One</b>			
<b>I own a company that owns four office blocks in the CBD. I want to renovate two of the buildings for R2 million and I want to claim this UDZ incentive. Where do I go from here? And what does it mean from a tax point of view, for example, what is the tax benefit to my company?</b>			
Make sure you follow the processes to, first, register for the tax incentive with the council and then next follow the other guidelines in this document.			
In terms of tax, once the building is bought into use, the following scenario would apply in Year 1:			
Item	Without UDZ Incentive	With UDZ Incentive	Notes
Income	R480,000	R480,000	Your company's annual income, say, all rental from all offices let and assuming 10 units per block at R1000 rental per month for purposes of this example
Less UDZ Depreciation Allowance	-	R400,000	You could claim the accelerated straight-line depreciation, i.e. 20% of the cost of work, i.e. 20% of R2 million
Thus total taxable income	R480,000	R80,000	Income less UDZ allowance
Company tax	R144,000	R24,200	Company tax at 30% of total taxable income.
<b>Thus tax saving in Year 1 is R119,800.</b>			

### Example Two

I own four blocks of flats in the City in my individual capacity. I want to renovate two of the buildings for R2 million and I want to claim this UDZ incentive. Where do I go from here? And what does it mean from a tax point of view, for example, what is the tax benefit to me?

Make sure you follow the processes to, first, register for the tax incentive with the council and then next follow the other guidelines in this document.

In terms of tax, once the building is bought into use, the following scenario would apply in Year 1:

Item	Without UDZ Incentive	With UDZ Incentive	Notes
<b>Income</b>	R780,000	R780,000	Your annual income from, say, all rental from all flats and assuming 10 units per block at R1000 per month plus also any other income, say, your annual salary of R300,000 from your employer, for purposes of this example (i.e. R480,000 + R300,000)
<b>Less UDZ Depreciation Allowance</b>	-	R400,000	You could claim the accelerated straight-line depreciation, i.e. 20% of the cost of work, i.e. 20% of R2 million
<b>Thus total taxable income</b>	R780,000	R380,000	Income less UDZ allowance
<b>Personal tax</b>	R390,070	R230,070	Personal tax rate applied to total taxable income, i.e. R78,070 + (40% of R380,000) = R230,070 . Please note the figures are for purposes of this example and may not accurately reflect your own situation (please consult your SARS office or the website for tax rates)

**Thus tax saving in Year 1 is R160,000.**

The same depreciation allowance then also applies to Year 2, 3, 4 and 5 and is offset against your relevant annual total income.

### Example Three

I own, and live in a house in the inner city. I want to refurbish the main house for R1 million and build a granny cottage for R200,000 so that I can rent that out to augment my income. I want to claim this UDZ incentive. Where do I go from here? And what does it mean from a tax point of view, for example, what is the tax benefit to me?

Make sure you follow the processes to, first, register for the tax incentive with the council and then next follow the other guidelines in this document.

You will not be eligible for any renovations on the main house that you occupy, only the granny flat. In terms of tax, once the building is bought into use, the following scenario would apply in Year 1:

Item	Without UDZ Incentive	With UDZ Incentive (Year 1)	With UDZ Incentive (Year 2)*	Notes
<b>Income</b>	R324,000	R324,000	R324,000	Your annual income from rental of the granny flat at, say, R2,000 per month, plus also any other income, say, your annual salary of R300,000 from your employer, for purposes of this example (i.e. R24,000 + R300,000)
<b>Less UDZ Depreciation Allowance</b>	-	R40,000	R10,000	You cannot apply for the costs of refurbishing the main house as you live in it, so only the costs of the granny flat can be claimed in terms of the incentive. You could claim the depreciation related to new building work, i.e. 20% of the costs in the first year, and then 5% of the costs for each of the next 16 years, thus R40,000 in Year 1 and R10,000 in each of the 16 years thereafter.
<b>Thus total taxable income</b>	R324,000	R284,000	R314,000	Income less UDZ allowance
<b>Personal tax</b>	R207,670	R191,670	R203,670	Personal tax rate applied to total taxable income, i.e. R78,070 + (40% of R284,000) = R191,670 in Year 1, and R203,670 in Year 2. Please note the figures are for purposes of this example and may not accurately reflect your own situation (please consult your SARS office or the website for tax rates)

**Thus tax saving in Year 1 is R16,000 (see next page for further details), and for Year 2 it is R4,000. The depreciation allowance applies to each of the 16 years after Year 1 and is offset against your relevant annual total income. Thus in this example, the total tax savings will be R80,000\* over 17 years.**

\* Assumes zero inflation

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**Disclaimer:** Please note that this brochure is a summary and should not be used to finalise business decisions. Refer to the original legislation (available from us on request) or the SARS for such purpose.



## The Msunduzi Municipality UDZ Process

(A total of 90 days is allowed for Planning and