Tax considerations for investments in business premises

Background

Mostly, the cost incurred in construction or acquisition of a building is deducted from the revenues earned (as a depreciation charge). However, depreciation is not an allowable deduction in our tax laws. So the depreciation charge is added back in determining the profits that you should be paying taxes on. The tax laws instead provide for capital allowances and deductions at certain rates for different types of capital expenditure for different sectors.

Unfortunately, with respect to buildings only few sectors are allowed to claim deductions.

Tax simplified

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Issues analysed in this publication

1. Summary of incentives in our tax laws
2. Some tax considerations for investments in business premises
3. Review of current structures

Tax incentives do not favour all sectors for investment in buildings

In an ideal tax policy making process, the key value drivers for each industry are evaluated and the appropriate incentives provided. Unfortunately, for buildings/premises regardless of taxpayers incurring huge costs to build or acquire them are not always considered a key value driver for all sectors.

Our tax laws only allow capital deductions on buildings to very limited sectors, mainly manufacture, real estate, education and hospitality, subject to meeting the set requirements. This has left many investors in very unfavourable tax positions for the rest of the sectors.

For example, if a transport company and decides to build a 100 million office block, the 100 million capital cost will be expensed as depreciation in determining the operating profits of the transport business. However, for purposes of computing the profits of the company that should be taxed, this capital cost (depreciation) will not be allowable. So how can this transport company and its owners plan better around this investment in an office to ensure they get some capital allowances and deduction?

Is all lost if you have already built or acquired the premises?

There are still opportunities available to restructure premises built or acquired for own use. The options available will depend on some of the following:

- The legal vehicle owning the premises
- Financial obligations on the premises (asset)
- The tax positions of the entities involved in the premises
- Transaction levies and taxes involved e.g. VAT, capital gains tax and stamp duty.

Possible tax optimal structure

The premises can be owned by a separate entity owned by the same shareholders/directors. This entity can let the premise as a commercial building to the business. The entity owning and letting the property will be allowed to claim capital allowances for the cost of developing the property for the purposes of determining its taxable profits, if any. This way most of the rental income, if not all will be reduced by the capital allowances. On the other hand, the business letting the premises will expense the rental charges against its profits. Cumulatively, the group will significantly save more of the total taxes paid.

What you should do – review or evaluate the best investment structure

It is important to evaluate how you have structured your investments in property to manage the total tax liability for your businesses.

However, there are landmines in most restructuring and it is advisable that you engage an expert to advise you and assist you with the process. For example the VAT implication and how to manage it.

Each case will depend on the peculiarities of each business. It is advisable to have a detailed expert evaluation of your tax planning options.

Let’s talk

For discussions on tax considerations on investments in property, please contact Johnson Mutuku on:

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