



The good investment called property

A conversation about investment property

YOUR KEY TO THE TAX COMMUNITY

Welcome

On the lunch plate today

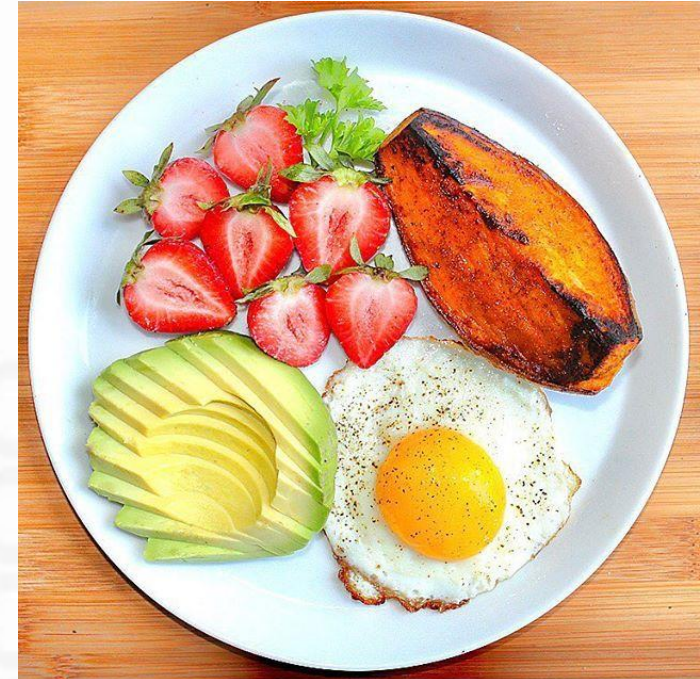
1. **Tax focus points** touching on investment property

- a) Fair value adjustments?
- b) VAT
- c) Possible capital allowances
- d) Recoupment and CGT when sold
- e) Rental income

2. **Accounting focus points** touching on investment property

- a) What is investment property? (including examples)
- b) Interesting classification challenges in practice
- c) Recognition and initial measurement of investment property
- d) Subsequent measurement models for investment property
- e) Example contrasting the two subsequent measurement models
- f) Deferred tax implications relating to investment property

3. Conclusionary remarks



Tax focus points touching on investment property

Various provisions to consider

- ✓ No FV adjustments (i.e., must be reversed from a tax perspective)
- ✓ VAT: Exempt residential accommodation vs taxable commercial accommodation
- ✓ Possible capital allowances
 - ☐ Section 13(1) on manufacturing buildings
 - ☐ Section 13quin on commercial buildings
 - ☐ Section 13sex on residential units
- ✓ Recoupment and Capital gains tax when sold
 - ☐ Deferrals?
- ✓ Rental income: Include in gross income earlier of receipt / accrual
 - ☐ Allowable deductions against rental income

Accounting for investment property

What is investment property? The theory...

- Investment property is:
 - property
 - land;
 - a building;
 - part of a building; or
 - both
 - held by
 - the owner, or
 - the lessee under a finance lease
 - for the purpose of
 - earning rental income;
 - capital appreciation; or
 - both
 - instead of for
 - use in the production or supply of goods or services or for administrative purposes; or
 - sale in the ordinary course of business.



Accounting for investment property

Examples

Examples of investment property:

land held for long-term capital appreciation.

land held for a currently undetermined future use.

building leased out under an operating lease.

vacant building held to be leased out under an operating lease.

property that is being constructed or developed for future use as investment property.



Accounting for investment property

Examples (continued)

The following examples are NOT investment property:	So, what is it?
property held for use in the production or supply of goods or services, or, for administrative purposes.	property, plant and equipment.
property held for sale in the ordinary course of business, or, in the process of construction of development for such sale.	Inventories/WIP.
property being constructed, or developed, on behalf of third parties.	construction contracts.
owner-occupied property , including property held for future use as owner-occupied property, property held for future development and subsequent use as owner-occupied property, property occupied by employees, and owner-occupied property awaiting disposal.	property, plant and equipment.
property leased to another entity under a finance lease (<i>significant risks and rewards associated with owning the property transferred to the lessee in substance</i>).	derecognised, and replaced by financial asset (debtor).

Accounting for investment property

Classification issue 1: Property interest held by lessee under an operating lease

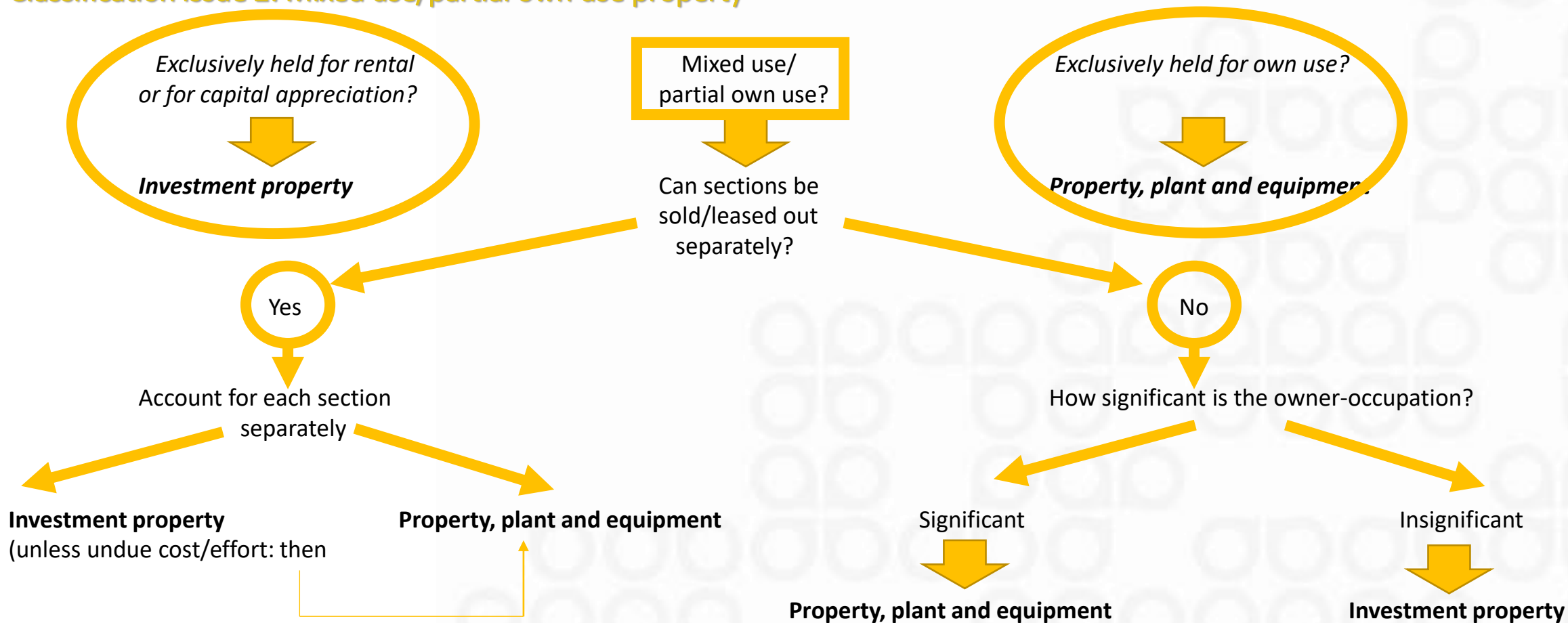
A property interest that is held by a **lessee** under an **operating lease** may be classified and accounted for as investment property, provided that:

- the rest of the definition of investment property is met;
- the operating lease is accounted for as if it were a finance lease; and
- the lessee uses the fair value model set out in this Standard for the asset recognised.

An entity may make the foregoing classification on a property-by-property basis.

Accounting for investment property

Classification issue 2: Mixed use/partial own use property



Accounting for investment property

Classification issue 3: Ancillary services

- If the entity provides ancillary services to the occupants of a property held by the entity, the appropriateness of classification as investment property is determined by the **significance** of the services provided.
- If those services are a relatively *insignificant* component of the arrangement as a whole (for instance, the building owner supplies security and maintenance services to the lessees), then the entity may treat the property as investment property.
- Where the services provided are *more significant* (such as in the case of an owner-managed hotel), the property should be classified as owner-occupied.

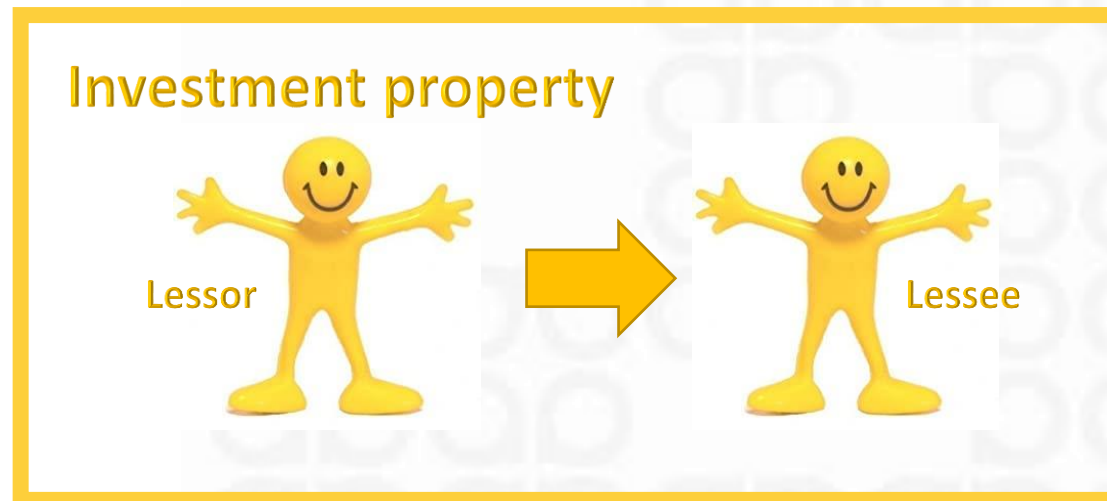


Accounting for investment property

Classification issue 4: Intercompany rentals

- Property rented to a parent, subsidiary, or fellow subsidiary is not investment property in consolidated financial statements that include both the lessor and the lessee, because the property is owner-occupied from the perspective of the group.
- However, such property could qualify as investment property in the separate financial statements of the lessor, if the definition of investment property is otherwise met.

Property, plant and equipment



Accounting for investment property

Recognition and initial measurement of investment property

- Investment property should be **recognised** as an asset when:
 - it is probable that the future economic benefits that are associated with the property will flow to the entity, and
 - the cost of the property can be reliably measured.
- Investment property is **initially measured** at cost, including transaction costs.
 - Such cost should not include start-up costs, abnormal waste, or initial operating losses incurred before the investment property achieves the planned level of occupancy.
 - Cost is equal to the fair value of consideration to acquire the investment property.

Accounting for investment property

Subsequent measurement of investment property

For the **subsequent measurement** of an investment property, an entity can choose between:

- a fair value model, and
- a cost model.

One method must be adopted for all of an entity's investment property (*consistency*).

Change between the two measurement models is permitted only if this results in a more appropriate presentation.

The IFRS for SMEs notes that this is highly unlikely for a change from a fair value model to a cost model.



Accounting for investment property

Notes on the 'fair value' subsequent measurement model

What is fair value?

- The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Where are gains or losses arising from changes in the fair value of investment property recognised?

- Included in net profit or loss for the period in which it arises.

What must be included in fair value?

- The actual market state and circumstances as of the balance sheet date.

The best evidence of fair value?

- Normally given by current prices on an active market for similar property in the same location and condition and subject to similar lease and other contracts.
- In the absence of such information, the entity may consider current prices for properties of a different nature or subject to different conditions, recent prices on less active markets with adjustments to reflect changes in economic conditions, and discounted cash flow projections based on reliable estimates of future cash flows.

Accounting for investment property

Example of the accounting recognition and measurement of investment property

Ignore VAT.

On 1 January 2022, company ABC (Pty) Ltd acquired an office building for cash. They immediately decided not to occupy the building themselves, but to lease it to a tenant in its entirety, in terms of an operating lease.

The cost price information relating to the acquisition transaction, is as follows:

- Land R1 million (transaction costs: R20 000)
- Building R9 million (transaction costs: R80 000)

The fair values of land and buildings as at 31 December 2022, were:

- Land R1,5 million
- Building R11 million

It is the policy of ABC (Pty) Ltd to depreciate all items of property, plant and equipment over their useful lives. The building had a useful life (with no residual value) of 20 years at acquisition date. Land is not depreciated.

Accounting for investment property

Example of the accounting recognition and measurement of investment property

Required

Provide all the journal entries to account for the transaction in the accounting records of ABC (Pty) Ltd for the year ended 31 December 2022, in terms of the requirements of the IFRS for SMEs Accounting Standard, if it is assumed that:

- (a) ABC (Pty) Ltd subsequently measures investment property using the **cost model**; and
- (b) ABC (Pty) Ltd subsequently measures investment property using the **fair value model**.

Provide recognition, as well as initial and subsequent measurement, as far as available information permits.

Ignore journal entries relating to deferred tax.

Accounting for investment property

Example of the accounting recognition and measurement of investment property

Suggested solution (a) – cost model

1 January 2022 – acquisition date

Dr Land (R1m + R20k)

R1 020 000

Dr Buildings (R9m + R80k)

R9 080 000

Cr Bank

R10 100 000

(acquisition of office building).

31 December 2022 – year-end

Dr Depreciation – land (P/L)

N/A

Dr Depreciation – building (P/L) (R9,08m/20 years)

R454 000

Cr Accumulated depreciation – buildings

R454 000

(account for depreciation of building over 20 years useful life).

Accounting for investment property

Example of the accounting recognition and measurement of investment property

Suggested solution (b) – fair value model

1 January 2022 – acquisition date

Dr Land (R1m + R20k)

R1 020 000

Dr Buildings (R9m + R80k)

R9 080 000

Cr Bank

R10 100 000

(acquisition of office building).

31 December 2022 – year-end

Dr Land (R1,5m – R1,02m)

R480 000

Dr Building (R11m – R9,08m)

R1 920 000

Cr Fair value gain – investment property (P/L)

R2 400 000

(account for fair value adjustments on land and buildings).

Accounting for investment property

Deferred tax relating to investment property

If the 'cost' subsequent measurement model is used

Compare accounting depreciation (and/or impairment) relating to investment property to tax allowances granted, if applicable.

If the 'fair value' subsequent measurement model is used

No depreciation of investment property.

Compare fair value adjustments relating to investment property to tax allowances granted, if applicable.

Consider whether fair value adjustment exceeds base cost of asset, for purposes of CGT.

- Only for accounting, not applicable to tax.



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