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TAX & EXCHANGE CONTROL ALERT

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COVID-19: Some practical tax issues

Businesses and individuals may well ask themselves what practical, day-to-day tax consequences the COVID-19 pandemic now holds for them.

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COVID-19: Some practical tax issues

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Businesses and individuals may well ask themselves what practical, day-to-day tax consequences the COVID-19 pandemic now holds for them.

For example, a company operating a financial services business may be obliged to incur expenditure which it would not incur in the ordinary course, such as sanitizers, gloves, masks and temperature measuring equipment for screening employees and customers. A taxpayer is entitled to deduct expenditure provided certain requirements are met. Notably, to be deductible, the expenditure must be "actually incurred in the production of income" as contemplated in section 11(a) of the Income Tax Act, 58 of 1962 (Act).

In the seminal case of *Port Elizabeth Electric Tramway Co Ltd v CIR* 1936 CPD 241 the court held as follows:

"The purpose of the act entailing expenditure must be looked to. If it is performed for the purpose of earning income, then the expenditure attendant upon it is deductible...The other question is, what attendant expenses can be deducted? How closely must they be linked to the business operation? Here, in my opinion, all expenses attached to the performance of a business operation bona fide performed for the purpose of earning income are deductible whether such expenses are necessary for its performance or attached to it by chance or are bona fide incurred for the more efficient performance of such operation provided they are so closely connected with it that they may be regarded as part of the cost of performing it."

Now, strictly speaking, the costs of the items listed in the example above do not *per se* lead to the generation of income for the financial services company. However, there is an argument that the costs should be deductible because they are incurred *bona fide* and the costs are necessary to perform the business operations. In other words, if the company did not incur the costs of protecting staff and customers they would not be able to continue operations effectively, or at all.

Consider also the following scenario. A building contractor is obliged to send his workers home for an extended period of time. The contractor accordingly is unable to deliver the building on time. The customer sues the contractor for breach of contract. The court awards damages to the customer. Will the contractor be able to deduct the amount of the damages for tax purposes?

Our courts have held on a number of occasions that, generally, damages payable which arise from commercial inefficiency, negligence and willful breach of contract are not deductible in the hands of the taxpayer who is liable to pay the damages: see *Kangra Group (Pty) Ltd v C:SARS* [2018] 4 All SA 383 (WCC). On the other hand, if a taxpayer becomes liable to pay damages through no fault of its own, the damages could be deductible in its hands. In the *Kangra* case, the Court provided the example where a coal supplier faces a damages claim from the buyer arising out of non-delivery due to a breakdown in the railway system resulting in the load not reaching the port on time. There is a potential argument that, if a taxpayer does

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The payment of damages may give rise to value-added tax (VAT). Accordingly, from the perspective of the taxpayer paying the damages, the amount should be stated as being exclusive of VAT.

not deliver goods or services on time as a result of an innocent act or omission resulting from COVID-19, the taxpayer should be able to deduct the amount of the damages paid for income tax purposes.

The payment of damages may give rise to value-added tax (VAT). Accordingly, from the perspective of the taxpayer paying the damages, the amount should be stated as being exclusive of VAT. In the case where a taxpayer receives compensation under a loss-of-profits insurance policy, the compensation will generally be subject to income tax in the hands of the taxpayer in accordance with ITC 594 (1945) 14 SATC 249. The compensation may be subject to VAT in terms of section 8(8) of the Value-Added Tax Act, No 89 of 1991. Please see in this regard our previous [Tax Alert](#) discussing VAT on out of court settlements and payments of damages.

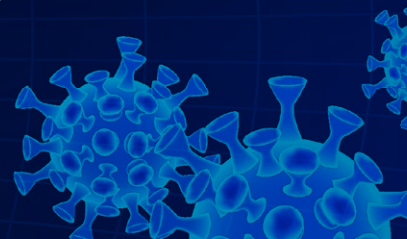
Consider also the position where employees are obliged to work from home.

If, for instance, the company provides a 3G data card to an employee who does not have sufficient data available at home to perform her functions properly during the lockdown period, the company may be able to deduct the expense so long as the 3G data card is utilised for business purposes. The same would potentially apply where the employee purchased the data herself and was then reimbursed by the company. In such case, the employee would potentially not pay income tax on the reimbursement of the data purchases that was used for business purposes.

The employee may incur additional expenses because she has to work from home. Generally, in accordance with section 23(b) of the Act, domestic and private expenses are not deductible by

CDH'S COVID-19 RESOURCE HUB

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COVID-19: Some practical tax issues *...continued*

The problem that many employees may face is that they may not have a dedicated workspace for the period that they are working from home.

an employee. However, an employee may deduct expenses in respect of the part of her house which is used for work purposes, subject to certain provisos. First, that part of her house must be specifically equipped for work purposes. Second, that part of the house must be used regularly and exclusively for work purposes. Third, the employee must not be paid a fixed salary, or the employee must perform her duties mainly in that part of the house.

The problem that many employees may face is that they may not have a dedicated workspace for the period that they are working from home. For example, if an employee sets up a workspace on the kitchen table, that part of the house will not be used exclusively for work purposes, and the employee will not be able to deduct any expenses.

If employers are obliged to retrench employees, the employers should ensure that any severance benefits are structured correctly so that employees get the full benefit of reduced taxes provided for in the Act that may apply in those cases.

It is apparent from the examples above that COVID-19 has given rise to several unforeseen tax consequences. Taxpayers should consult their tax advisers when incurring expenses, claiming under insurance policies, and dealing with employees.

Ben Strauss

WEBINAR INVITATION

DATE: Tuesday, 2 June 2020 TIME: 13h00 - 14h00

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