20 MAY 2021

TAX & EXCHANGE CONTROL **ALERT**

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Potential tax deductions available for employees making use of home offices during the pandemic

Section 23(m) provides that employees (other than commission-based earners) may only deduct amounts pertaining to very specific expenses.

For many employees in South Africa, remote working as a result of the COVID-19 pandemic has become the new normal and as a consequence, more people are establishing and making use of home offices in order to accommodate the demands of their employment. To this end, some of the operational costs associated with places of employment (which are normally paid for by employers) are now being borne by employees.

To the extent that these employees do not get relief by way of reimbursements from their employers for the actual expenditure incurred by them (within the scope of their employment), certain tax deductions may be claimed by employees (in specified circumstances) in order to alleviate the financial burden that they are now faced with.

The legal principles

Generally, the deductibility of expenses relating to a home office must be determined with reference to section 11 of the Income Tax Act 58 of 1962 (ITA), read with sections 23(b) and 23(m).

Section 11 (and more particularly paragraphs (a), (d) and (e) thereof) delineates which types of expenses may be claimed (and the requirements to be met in respect thereof), while section 23(m) specifically prohibits certain deductions. As such, when an employee considers claiming home office expenses as a tax deduction, they will have to satisfy themselves that the expenditure in question qualifies in terms of section 11, and is further not specifically prohibited in terms of section 23(m).

Section 23(m) provides that employees (other than commission-based earners) may only deduct amounts pertaining to very specific expenses, which include pro-rated deductions based on rent, interest on mortgage bonds, repairs to the premises, rates and taxes, cleaning, wear and tear, and all other expenses relating to the house. In Interpretation Note 28 (IN 28), issued by the South African Revenue Service (SARS), the types of expenditure that may be claimed by employees have been set out as follows –

- rent of the premises;
- interest on a bond;
- the cost of repairs to the premises; and
- other expenses in connection with the premises – including wear and tear in terms of section 11(e) of the Income Tax Act.

Once the relevant deductions have been ascertained, the employee will have to consider the provisions of section 23(b), which deals with the prohibition of deductions of private and domestic expenditure except in specified circumstances. In order for an employee to be allowed to claim domestic or private expenses relating to their home offices, the following requirements must be met:

(1) The employee must have a dedicated workspace that is specifically equipped for the purpose of employment and is used regularly and exclusively by the employee for work purposes.

Potential tax deductions available for employees making use of home offices during the pandemic...*continued*

Whether a home office is used regularly and exclusively for work purposes will have to be determined on a case by case basis.

- Whether these criteria have been met is a question of fact rather than a question of law and it will be necessary for an employee to be able to prove that the designated workspace exists. To this end, it is worth noting that a kitchen counter or office space, that is only occasionally used by the employee for work purposes, will not satisfy this requirement.
- While it is necessary to have a separate space in the employee's home that is allocated for purposes of performing their employment functions, an employee need not necessarily set aside an entire room for use as a home office. In so far as a portion of a room has been equipped and set aside for the exclusive use by the employee for work purposes, it is likely that this requirement will be met.
- Whether a home office is used regularly and exclusively for work purposes will have to be determined on a case by case basis. However, it should be borne in mind that a home office that is merely maintained and only occasionally used by the employee will not suffice. In addition, SARS has adopted the view that the use of a home office for any purpose other than the fulfilment of the employee's employment functions will result in this requirement being unfulfilled.

(2) Either the employee's income must consist mainly of commission or other variable payments which are based on the employee's work performance, or the employee must perform their duties mainly from the dedicated workspace in their home.

- To the extent that an employee's income consists of more than 50% commission (or other variable payments) this requirement will be readily met. However, if the employee is a salaried employee, this requirement will only be met if more than 50% of the employee's duties are performed for their employer from their home office.
- On this basis, an employee must have worked from home for more than 50% of the relevant tax year in order to qualify for a deduction of their home office expenses. Where employees work from home for only a couple of days per week, it will be necessary for them to keep records of the number of days that they worked from home and the number of days that were spent at the office. If the number of days working from home does not exceed the number of days that the employee works from the office, then the deduction will not be allowed.

(3) The employee must be allowed to perform their services from home. It is not necessary for an employer to expressly instruct an employee to work from home in order to meet this requirement as it is a factual inquiry as to whether the employee did in fact discharge their duty to the employer mainly in their home office.

Potential tax deductions available for employees making use of home offices during the pandemic...*continued*

In the Budget Speech that was delivered on 24 February 2021, National Treasury announced that the large-scale migration to remote working over the course of the pandemic has prompted it to review the current travel and home office allowances regime, with the view of investigating the efficacy, equity in application and simplicity of use thereof.

(4) The employee has to have actual expenses that have been incurred, which expenses related to their employment.

To the extent that an employee meets each of the requirements set out in section 23(b), those home office expenses dealt with in section 23(m) and IN 28 may be claimed as a deduction on a pro-rata basis in the employee's ITR12 when submitting their tax return for the relevant year of assessment. The amounts that qualify for the deduction must be calculated as a percentage of the square metres of the home office over the total square metres of the employee's entire house. It is important to note, however, that some expenses are not subject to the pro-rata formula (e.g. wear and tear on office equipment (the calculation for wear and tear is specifically stipulated in section 11(e) of the ITA)).

Employees who own their homes and intend on claiming the tax deduction in respect of their home offices should be aware of the negative capital gains consequences associated with such claim. In particular, it should be borne in mind that the primary residence exclusion of R2 million that they may be entitled to when they sell their home will not apply to any capital gain that arises in respect of the home office portion of their home. As such, the primary residence exclusion will have to be apportioned, which apportionment must take into account the length of time that the home office was used as a portion of the entire period of ownership, as well as the size of the home office compared to the size of the entire property. This should be taken into consideration when claiming the home office deduction, as it may create a higher capital gain in the employee's hands later on sale of the property.

Comment

In the Budget Speech that was delivered on 24 February 2021, National Treasury announced that the large-scale migration to remote working over the course of the pandemic has prompted it to review the current travel and home office allowances regime, with the view of investigating the efficacy, equity in application and simplicity of use thereof. It was stated that consultations in this respect will commence during 2021/2022. A review of the use and application of the relevant provisions in the context of home offices may be highly beneficial to many employees as the requirements for claiming the deductions are arduous and the burden of proof on the employee to demonstrate that they are entitled to the deductions is extensive.

In addition to the review to be undertaken by National Treasury, SARS has updated and amended IN 28, a draft of which was published for public comment on 17 May 2021. Amongst others, this updated IN 28 addresses the previously ambiguous issue of the deductibility of expenses pertaining to fibre optic cables and other telecommunication devices. On the basis that (in SARS' view) the initial costs of installing fibre networks are not expenses that are incurred in connection with a premises, and because the initial costs and monthly subscriptions are prohibited from being deducted in terms of section 23(m), the view adopted by SARS is that the fibre and telecommunication expenses incurred by employees will not be deductible expenses.

The closing date for public comment on the draft IN 28 is 14 June 2021, and all comments may be sent to policycomments@sars.gov.za.

Louise Kotze

Milnerton Estates revisited: Accruals and suspensive conditions

The matter concerned some of the general principles relating to the accrual of amounts, and more specifically, the deemed accrual of amounts in terms of section 24 of the Income Tax Act.

We had previously reported on the Supreme Court of Appeal's (SCA) judgment in the case of *Milnerton Estates Ltd v Commissioner for South African Revenue Service* 81 SATC 193 (20 November 2018) in our Tax Alert of 23 November 2018, as well as on the judgment in the *court a quo* in our Tax Alert of 14 July 2017.

The matter concerned some of the general principles relating to the accrual of amounts, and more specifically, the deemed accrual of amounts in terms of section 24 of the Income Tax Act 58 of 1962 (Act).

The taxpayer had concluded sale agreements for the sale of 25 immovable properties during its 2013 year of assessment. The sale agreements provided that the purchaser would only make payment of the purchase consideration to the taxpayer *"against registration of transfer"* of the immovable properties. Transfer was given to the purchaser only in the 2014 year of assessment.

The taxpayer accordingly did not account for the accrual of the purchase consideration in its 2013 year of assessment and intended to only account for it in the 2014 year of assessment.

However, the taxpayer was subsequently assessed by the South African Revenue Service (SARS) on the basis that the consideration accrued during the 2013 year of assessment.

SARS's position was that, on the basic principles, the accrual was not postponed by the requirement that the taxpayer first had to give transfer to the purchaser. In the alternative SARS argued that, in terms of section 24 of the Act, the purchase consideration is in any event deemed to have accrued in the year that the agreement was entered into into in terms of section 24 of the Act.

On general principles, an amount can be said to accrue to a taxpayer where the taxpayer has become unconditionally and un-contingently *"entitled"* to that amount (see *Lategan v CIR* 2 SATC 16; *Ochberg v CIR* 6 SATC 1; *CIR v People's Stores* (Walvis Bay) (Pty) Ltd 52 SATC 9).

Milnerton Estates revisited: Accruals and suspensive conditions*...continued*

The mere deferral of payment to a subsequent tax year does not prevent an accrual in a current tax year where the taxpayer has actually become entitled to the amount in the current tax year.

This would include amounts to which a taxpayer has a legal entitlement or claim, but which have not been actually received.

For purposes of the definition of "*gross income*" in section 1 of the Act, it also does not matter whether the amount is payable yet or not.

The proviso to the definition specifically provides that if a taxpayer has become entitled to an amount in a particular tax year, but such amount is only payable in a subsequent tax year, such amount is deemed to have accrued to the taxpayer in the year that the taxpayer has become entitled to the amount and not the year in which the amount becomes payable.

The mere deferral of payment to a subsequent tax year does not prevent an accrual in a current tax year where the taxpayer has actually become entitled to the amount in the current tax year.

In this regard it must be appreciated that it is still required for the taxpayer to have become unconditionally and un-contingently entitled to the amount. An accrual can still be suspended by way of an appropriate suspensive condition.

The Tax Court did consider the particular matter on the general principles, and provisionally concluded that the purchase consideration (in respect of all properties, save one) did accrue to the taxpayer during the 2013 year of assessment on the basis that the taxpayer had in fact become entitled to payment in that year. The relevant suspensive conditions were met, and other statutory permissions were obtained, during that year.

However, both the Tax Court and the SCA ultimately decided the matter based on the application of the deeming provision in section 24 of the Act.

Section 24(1) of the Act provides –

> *"... if any taxpayer has entered into any agreement with any other person in respect of any property the effect of which is that ... in the case of immovable property, transfer shall be passed from the taxpayer to that other person, upon or after the receipt by the taxpayer of the whole or a certain portion of the amount payable to the taxpayer under the agreement, the whole of that amount shall for the purposes of this Act be deemed to have accrued to the taxpayer on the day on which the agreement was entered into."*

This section effectively provides for a deemed accrual in certain circumstances during a particular tax year despite there not having necessarily been an actual accrual in that tax year as per the application of the general principles.

The circumstances in which section 24(1) of the Act applies is where transfer to the purchaser is subject to receipt by the seller of the whole or a certain portion of the purchase price.

The accrual of the full purchase price will then be deemed to have occurred during the tax year that the agreement was entered into, and not only when transfer is passed.

Milnerton Estates revisited: Accruals and suspensive conditions*...continued*

What is of particular interest here is the argument advanced by the taxpayer in respect of the application of section 24 of the Act to agreements subject to suspensive conditions.

Effectively, section 24(1) removes any argument that there is no accrual to the seller during the tax year that the agreement is concluded on the basis that the obligation to give transfer is delayed until receipt of payment in a subsequent tax year. Stated differently, the seller cannot rely on saying that it is not yet entitled to the purchase price at the time of conclusion of the agreement because it has not yet given transfer and is not obliged to do so until payment is received.

However, section 24(1) of the Act is not limited to cases where payment is required to be made before transfer.

It includes cases where payment is to be made upon transfer – and as such, cases where payment is to be made *"against transfer"*.

The court in this case found that payment was to be concurrent with transfer of ownership by registration. In the SCA's words, the agreements provided for the seller to effectively *"pass ownership to the purchaser upon or after receipt of the whole of the purchase price in terms of section 24(1)"*.

The agreements had all become unconditional in the same tax year that they were concluded, so there could be no question as to the non-application of section 24(1) on the basis that the agreements were still subject to suspensive conditions by the end of that tax year.

However, what is of particular interest here is the argument advanced by the taxpayer in respect of the application of section 24 of the Act to agreements subject to suspensive conditions. The concern was essentially that, so long as an agreement made provision for the passing of ownership on or after receipt of payment, then the accrual will be deemed to occur on the date that the agreement is entered into, irrespective of whether the agreement is subject to suspensive conditions.

Essentially the taxpayer argued that to uphold the application of section 24 in the current circumstances, would *"bring all sales of immovable property subject to suspensive conditions within the ambit of section 24(1)"* and that *"sellers of immovable property might be liable to pay income tax on amounts the recovery of which was uncertain and in circumstances where, if the worst happened and the transaction failed for any reason, they might not be able to recover the tax they had paid."*

However, the SCA referred to the case of *Corondimas v Badat* 1946 AD 548 for an answer.

The principle upheld in that decision was effectively that *"when a contract of sale is subject to a true suspensive condition 'there exists no contract of sale unless and until the condition is fulfilled'"*.

More specifically, the SCA stated that, *"If subject to a true suspensive condition then, until the condition is fulfilled, on a proper interpretation of the section there may well be no binding agreement that ownership be passed upon or after receipt of the amount payable to the taxpayer."*

The court therefore at the very least proposed some answer to the potentially hazardous consequences of the deeming provision in section 24(1) of the Act.

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