

Draft Interpretation note on home office expenses

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Following the COVID-19 pandemic and the various government restrictions imposed as a result thereof, many employees in South Africa now find themselves remotely working. Employees under these circumstances have had to accommodate this by setting up home offices and bearing certain other expenses in order to facilitate a proper working environment from home. Following the surge in employees working from home, SARS seeks to provide clarity and guidance on the deductibility of home office expenses incurred by employees with draft Interpretation Note 28 (IN28).

Relevant legislation

The general deduction of expenses in respect of a home office is determined by sections 11, in particular paragraphs (a), (d) and (e), read with section 23(b) and 23(m) of the Income Tax Act, 58 of 1962 (the Act). In order for a home office expense to be deductible, the requirements of section 11 of the Act must be met and the prohibitions under section 23(b) and 23(m) must not apply.

Section 11 of the Act provides for the deduction of expenses actually incurred in the production of income and include expenditure on repairs and maintenance on property occupied for the purposes of trade or on home office equipment, where the wear-and-tear of said equipment would meet the requirements of section 11. Section 11 of the Act is regarded as a positive test as it discusses all elements that must be met for the deduction to be allowed in contrast to sections 23(b) and 23(m) of the Act which serve as negative tests, since they deal with deductions not allowed.

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Section 23(m) of the Act sets out a list of items which do not qualify as a deduction for taxable income. Particularly in respect of the deduction of home office expenses, section 23(m) states that no deduction shall be provided on expenditure where the taxpayer's trade constitutes any employment or the holding of office unless the taxpayer's income is mainly commission based. The section further limits the deduction of expenses of repairs, maintenance, rental and expenses in relation to a dwelling house or domestic premises under section 11(a) and (d), and wear-and-tear allowances under section 11(e) of the Act.

A further restriction of deductions is provided for by **section 23(b) of the Act** which states that the deduction may only be allowed where such expense or repair is in connection with any premises occupied for the purposes or trade, where the part so occupied is specifically equipped for the purposes of trade. The part must be regularly and exclusively used for the purposes of trade where said part must not be used for any other purposes but the person's trade.

Section 23(b) imposes further restrictions depending on whether or not the income that the employee receives constitutes mainly commission. Where an employee receives commission that accounts for more than 50% of its total income, the employee's duties must not be performed mainly in an office provided by its employer. On the other hand, where an employee does not earn the majority of its income from commission, their duties must be performed mainly in the part occupied for the purposes of the employee's trade. Section 23(b) excludes employees who do not earn commission but spend the majority of their time performing their duties at their client's premises.

In order for an employee to substantiate that their duties were mainly performed in such part, the employer cannot issue a letter to this effect as it is not within the employer's personal knowledge to confirm whether or not an employee performed their duties in the home office. IN28 goes on further to state it is not simply the *intention* of the employee to work in such part or whether the employer *requires* the employee to perform duties mainly at home but whether the employee *actually* worked in such part.

Permitted expenditure

IN28 expands on the permitted expenditure allowed by section 23(b) of the Act which allows for the rent of, cost of repairs of, or expenses in connection with, any premises occupied for purposes of trade.

Repairs

In order for a repair to constitute as a deduction, said repair must be connected to the home office in some relation.

Expenses in connection with the premises

Expenses in connection with premises that would qualify for a deduction include items such as interest on the mortgage bond; rates and taxes, and any other municipal service charges such as sewerage and refuse; levies; electricity; and cleaning costs.

Expenses such as insurance costs, phone costs (including the monthly charges), stationery, furniture, and computer and communication equipment are not incurred in connection with premises and fall outside of the scope of what is permitted by section 23(b). Further, fibre optic cabling (fibre), the initial costs of installing fibre and its monthly subscription are prohibited from being deducted by section 23(m) of the Act. The law applicable to fibre also applies to telecommunication expenses.

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Equipment may, however, qualify for a wear-and-tear allowance under section 11(e) and would thus be excluded from the section 23(m) prohibition.

Apportionment

In order to determine the deduction that may be claimed for a home office, both the apportionment ratio and the expenditure that is subject to apportionment must be determined. SARS regards the apportionment based on the floor area of the premises to be an accepted method of calculating the proportion of expenditure attributed to the home office. The employee must further be able to substantiate the exact floor area claimed to be attributed to the home office.

Capital gains tax consequences on the disposal of a primary residence used partially for purposes of trade

Ordinarily, where there is a disposal of a primary residence, the first R2 million of a capital gain or capital loss on the disposal would usually be disregarded for capital gains tax purposes.

However, where the primary residence has been partially used for the purposes of their trade and makes use of a part as a home office then the primary residence exclusion of R2 million must be apportioned for the non-residential use and the R2 million-proceeds rule for disregarding any capital gain, does not apply to the part of the premises used for purposes of trade.

In summary, the deduction of expenses relating to a home office are governed by the provisions of sections 11, 23(b) and (m) of the Act and are limited to rental, repairs and expenses incurred in relation to a dwelling house or domestic premises under section 11(a) and (d), and wear-and-tear allowances under section 11(e) for items such as office equipment used by the taxpayer for the purpose of their trade.

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