

INTERPRETATION NOTE: NO. 28 (Issue 2)

DATE: 15 March 2011

ACT : INCOME TAX ACT NO. 58 OF 1962 (the Act)
SECTION : SECTIONS 11(a), 11(d), 23(b) AND 23(m)
**SUBJECT : DEDUCTIONS OF HOME OFFICE EXPENSES INCURRED BY PERSONS
IN EMPLOYMENT OR PERSONS HOLDING AN OFFICE**

Preamble

References to sections are to sections of the Act, unless otherwise stated.

1. Purpose

This Note provides clarity on the deductibility of home office expenses incurred by persons in employment or persons holding an office.

This update incorporates the changes made, in terms of section 37(1)(c) of the Revenue Laws Amendment Act No. 60 of 2008, to section 23(m).

2. Background

Expenses in maintaining a home office have been a controversial issue since the judgment handed down in *KBI v Van der Walt*.¹ The legislation relating to home office expenditure that a taxpayer may claim has been periodically amended since 1990. The most recent amendment to have an effect on the deduction of home office expenditure was the amendment to section 23(m).

Section 23(m) prohibits, subject to specific exceptions, the deduction of certain expenditure, losses and allowances that relate to employment or the holding of an office. For a detailed discussion on the operation of section 23(m), see Interpretation Note No. 13 (Issue 3) dated 15 March 2011: "Deductions: Limitation of Deductions for Employees and Office Holders".

The effect of this section on the deductibility of home office expenditure is the topic of this Note.

3. The law

For ease of reference, the relevant sections of the Act are quoted in **Annexure C**.

¹ 48 SATC 104, 1986 (4) SA 303 (T).

4. Application of the law on the deductibility of home office expenses

4.1 What constitutes home office expenditure?

Typically, home office expenditure will be the type of expense referred to in section 23(*b*), namely –

- rent of the premises;
- interest on bond;
- cost of repairs to the premises; and
- other expenses in connection with the premises.

In addition to these expenses, other typical home office expenditure may include –

- phones;
- stationery;
- rates and taxes;
- cleaning;
- office equipment; and
- wear-and-tear.

4.2 The general rule

The deductibility of expenses relating to a home office is determined by reference to section 11, in particular paragraphs (*a*), (*d*) and (*e*), read together with sections 23(*b*) and 23(*m*). This means that for a home office expense to be deductible the requirements of sections 11, 23(*b*) and 23(*m*) must **all** be met.

4.3 Requirements of section 11

It is not difficult to show that a home office expense meets the requirements of section 11, provided the expense is not of a capital nature. Expenditure such as maintenance, rates and taxes and wear-and-tear on office equipment would usually satisfy the requirements of section 11. Section 11, in so far as it relates to home office expenses, draws no distinction between taxpayers in employment, taxpayers that are holding an office or other taxpayers.

4.4 Requirements of section 23(*m*)

Section 23(*m*) is applicable if the taxpayer is in receipt of remuneration derived from employment or the holding of an office, unless the remuneration is derived mainly from commission based on sales or turnover (for more details see Interpretation Note No. 13). Deductions available to the taxpayer are limited under section 23(*m*) to the deductions listed in this section. As far as home office expenses are concerned, the taxpayer will only be able to claim rental, repairs and expenses incurred in relation to a dwelling house or domestic premises under sections 11(*a*) and (*d*) and wear-and-tear allowances under section 11(*e*).

4.5 Requirements of section 23(b)

An expense must still meet the requirements of section 23(b) even though it meets the requirements of section 11 and is allowed under section 23(m). The requirements of section 23(b) are as follows:

- The part of the home in respect of which a claim is submitted must be occupied for purposes of a “trade”, as defined in section 1.
- The part that is so occupied must be specifically equipped for purposes of the trade.

The Collins English Dictionary² defines “specific” to mean “relating to a specified or particular thing” and “equip” to mean “to furnish with”. The Concise Oxford English Dictionary³ defines “specific” as “relating uniquely to a particular subject” and “equip” to mean “supply with the items needed for a particular purpose”. It is clear from these definitions that, in order for a part of a private home to be considered “specifically equipped” for the purposes of trade, that part must be fitted with the instruments, tools and equipment required to conduct that trade.

For example, taxpayers who meet clients at their homes would not be permitted a deduction under this head if they meet their clients in their dining or sitting rooms. A separate office would need to be equipped and maintained. An office that requires specialised equipment, such as a mechanic’s tools, an architect’s drawing board or a doctor’s examination room equipment, must be equipped with these items.

- The part must be regularly and exclusively used for purposes of the trade.

The Concise Oxford Dictionary⁴ defines “regularly” to mean “done or happening frequently” and “exclusively” to mean “excluding or not admitting other things; excluding all but what is specified”.

It is not possible to define what would be acceptable to SARS as regular usage for the purposes of trade, as each case will have to be judged on its own merits. However, a home office that is maintained and is only used occasionally, for example, once on a weekend due to the taxpayer maintaining separate business premises, is not used frequently enough to constitute “regular” use. As regards the requirement of exclusivity, it is considered that this provision contemplates that the part used for trade may not be used for any other purpose other than the taxpayer’s trade. A deduction is not permitted where it is evident that the taxpayer conducts any activities of a private nature in the part used for trade, such as permitting children to use the room as a play room.

- If the trade is employment or the holding of an office –
 - the income derived from this trade must be mainly (that is, must exceed 50% of total income from employment or office) commission or other variable payments which are based on the taxpayer’s work

² Collins English Dictionary. 3rd ed. Glasgow: Harper Collins, 1991. Print.

³ Concise Oxford English Dictionary. Edited by Catherine Soanes, Angus Stevenson. 11th ed. rev. New York: Oxford University Press, 2006.

⁴ Above.

performance, and the taxpayer's duties were not performed mainly in an office provided by his or her employer; or

- the taxpayer's duties must be performed mainly (more than 50%) in that part of the private premises occupied for purposes of trade.

Employees who do not earn commission but who spend the majority of their time on the road visiting clients perform their duties mainly at their clients' premises and as a result they do not qualify for a deduction under section 23(b).

5. Conclusion

Annexure A contains two examples setting out how sections 23(b) and 23(m) interact. In the event that section 23(m) applies, and the requirements of section 23(b) are met, it effectively means that deductible home office expenses 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 his or her trade (employment).

A decision chart, which will assist taxpayers in identifying when home office expenses may be deducted, is attached in **Annexure B**.

Legal and Policy Division
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Annexure A – Examples

Example 1 – Determination of home office deduction by an employee with income derived mainly from commission

Facts:

X is an employee who is in receipt of commission income of R50 000, a salary of R20 000 and a travel allowance of R3 000 a year. X is obliged in terms of his employment contract to work from home since his employer does not provide him with an office at work. He maintains a home office which he has specifically set up for the purposes of his employment duties. The home office is used regularly and exclusively for the purposes of work. His duties are performed mainly in the home office. The total area (square metres [m²]) of the home study is 20 m² in relation to the total area of his house which is 200 m². The percentage area of the home office in relation to the total area of the house is 10% (20/200). He had purchased a computer for R12 000, an office desk for R2 000 and an office chair for R800 for the home office. The interest on his household bond amounts to R25 000 a year. The rates and taxes for the year amount to R2 500. X contributes R5 000 a year to a pension fund and had also incurred commission-related business expenses of R9 000 consisting of cell phone expenses and stationery costs.

Result:

Since more than 50% of X's total income consists of commission, the restrictions imposed by section 23(m) will not apply. Furthermore, he maintains a home office which is regularly and exclusively used for the purposes of earning income. The home office has been specifically equipped for the purposes of his trade and is mainly used by him to perform his duties. X can therefore claim a deduction for the following:

- Pension fund contributions of R5 000, subject to the limits imposed by section 11(k).
- Cell phone expenses and stationery expenses of R9 000.
- Wear-and-tear allowance under section 11(e) for the computer, office desk and office chair.
- Travel deduction.
- Interest on bond of R2 500*.
- Rates and taxes of R250*.

* 10% of the total area of the house relates to the home office. Therefore 10% of the interest on bond and rates and taxes will be allowed as a deduction.

Example 2 – Determination of a home office deduction by employee with income not derived mainly from commission

Facts:

Y is an employee, who is in receipt of a salary of R50 000, commission of R20 000 and a travel allowance of R3 000 a year. Y is obliged in terms of her employment contract to work from home since her employer does not provide her with an office at work. She maintains a home office which she has specifically set up for the purposes of her employment duties. The home office is used regularly and exclusively for the purposes of work. Her duties are performed mainly in the home office. The total area (square metres) of the home study is 20 m² in relation to the total area of her house which is 200 m². The percentage area of the home office in relation to the total area of the house is 10% (20/200). She had purchased a computer for R12 000 and incurred computer repair costs of R2 000, an office desk for R2 000 and an office chair for R800 for the home office. The interest on her household bond amounts to R25 000 a year. The rates and taxes for the year are R2 500. The renovation costs amount to R5 000. Y contributes R5 000 a year to a pension fund and has also incurred commission-related business expenses of R9 000 consisting of cell phone expenses and stationery costs.

Result:

Since more than 50% of Y's total income consists of a salary, the restrictions imposed by section 23(m) will apply. Although she meets the requirements of section 23(b), that is, she maintains a home office which is regularly and exclusively used for the purposes of earning income, the home office has been specifically equipped and is mainly used for the purposes of her trade. Y will be limited under section 23(m) to the following deductions:

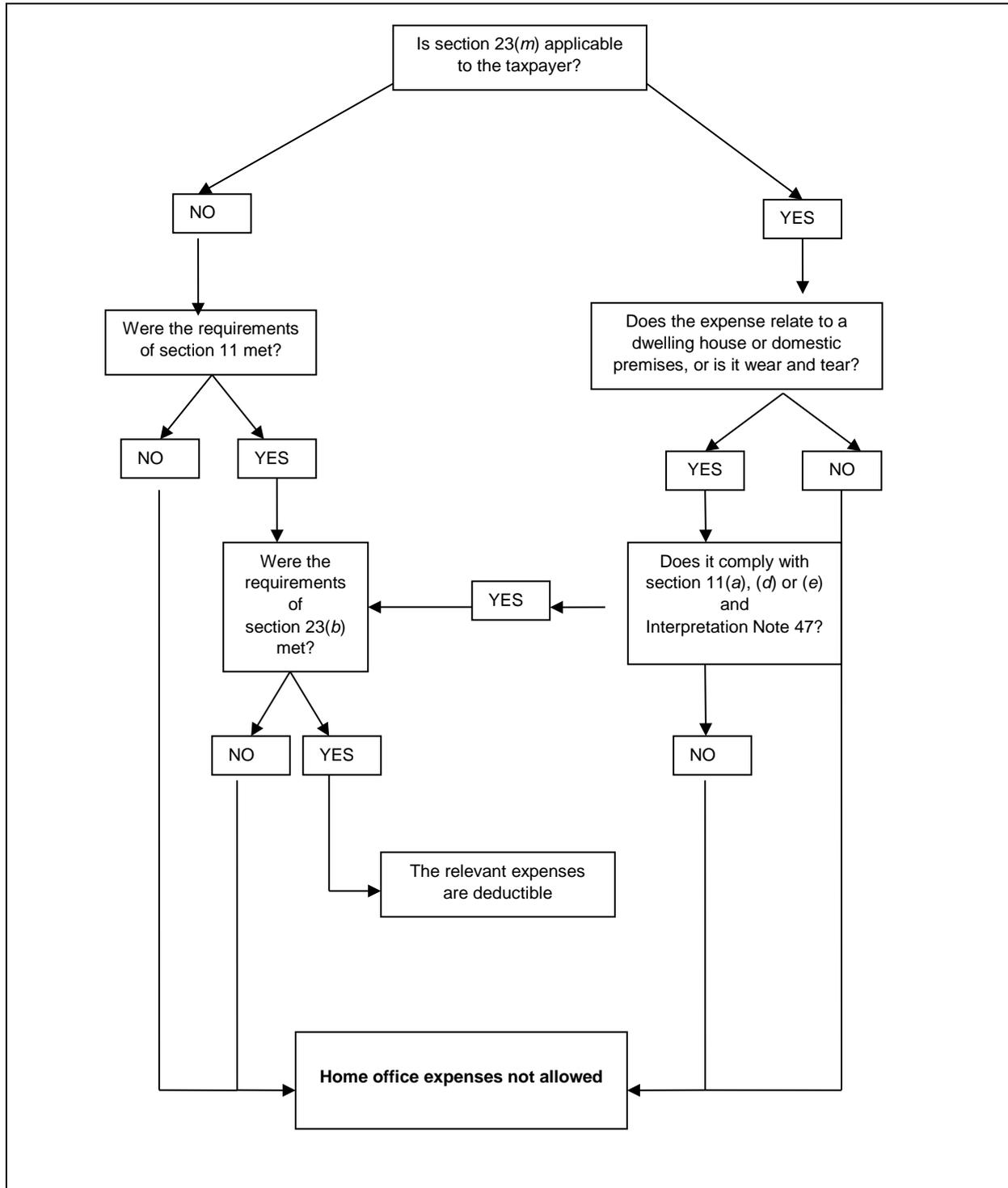
- Pension fund contributions of R5 000, subject to the limits imposed by section 11(k).
- Wear-and-tear allowance under section 11(e) for the computer, office desk and office chair.
- Travel deduction.
- Interest on bonds of R2 500*.
- Rates and taxes of R250*.
- Renovation costs of R500*.

* 10% of the total area of the house relates to the home office. Therefore, 10% of the interest on bond, rates and taxes and renovation costs will be allowed as a deduction.

The following expenses will be disallowed under section 23(m):

- Cell phone expenses and stationery costs of R9 000.
- Repair costs of computer of R2 000.

Annexure B – Decision chart: Home office expenses



Annexure C – The law

Sections 11(a) and 11(d)

11. General deductions allowed in determination of taxable income.—For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived—

- (a) expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital nature;
- (b) – (c)
- (d) expenditure actually incurred during the year of assessment on repairs of property occupied for the purpose of trade or in respect of which income is receivable, including any expenditure so incurred on the treatment against attack by beetles of any timber forming part of such property and sums expended for the repair of machinery, implements, utensils and other articles employed by the taxpayer for the purposes of his trade;

Sections 23(b) and 23(m)

23. Deductions not allowed in determination of taxable income.—No deductions shall in any case be made in respect of the following matters, namely—

- (a)
- (b) domestic or private expenses, including the rent of or cost of repairs of or expenses in connection with any premises not occupied for the purposes of trade or of any dwelling-house or domestic premises except in respect of such part as may be occupied for the purposes of trade: Provided that—
 - (a) such part shall not be deemed to have been occupied for the purposes of trade, unless such part is specifically equipped for purposes of the taxpayer's trade and regularly and exclusively used for such purposes; and
 - (b) no deduction shall in any event be granted where the taxpayer's trade constitutes any employment or office unless—
 - (i) his income from such employment or office is derived mainly from commission or other variable payments which are based on the taxpayer's work performance and his duties are mainly performed otherwise than in an office which is provided to him by his employer; or
 - (ii) his duties are mainly performed in such part;
- (c) – (l)
- (m) subject to paragraph (k), any expenditure, loss or allowance, contemplated in section 11, which relates to any employment of, or office held by, any person (other than an agent or representative whose remuneration is normally derived mainly in the form of commissions based on his or her sales or the turnover attributable to him or her) in respect of which he or she derives any remuneration, as defined in paragraph 1 of the Fourth Schedule, other than—
 - (i) any contributions to a pension or retirement annuity fund as may be deducted from the income of that person in terms of section 11(k) or (n);
 - (ii) any allowance or expense which may be deducted from the income of that person in terms of section 11(c), (e), (i) or (j);
 - (iiA) any deduction which is allowable under section 11(nA) or (nB);
 - (iii) any deduction which is allowable under section 11(a) in respect of any premium paid by that person in terms of an insurance policy, to the extent that—
 - (aa) it covers that person against the loss of income as a result of illness, injury, disability or unemployment; and

- (*bb*) the amounts payable in terms of that policy as contemplated in item (*aa*) constitutes or will constitute income as defined; and
- (iv) any deduction which is allowable under section 11(*a*) or (*d*) in respect of any rent of, cost of repairs of or expenses in connection with any dwelling house or domestic premises, to the extent that the deduction is not prohibited under paragraph (*b*);