

General Note 26 - 14 January 2002

GENERAL SUBJECT: SECTION 11(a) OF THE INCOME TAX ACT

SPECIFIC ASPECT: DEDUCTIBILITY OF ADMINISTRATION COSTS

STATUS: OPINION

BACKGROUND: Section 11(a) of the Income Tax Act (the Act) provides for the deduction of expenditure actually incurred in the production of income while carrying on a trade. It has been argued that administration costs incurred by an annuitant in the production of annuity income are deductible under section 11(a) of the Act.

OPINION: The costs associated with annuity products can broadly be placed in two categories, namely initial investment costs and subsequent additional costs over the lifetime of the annuity.

It should be clear from the requirements of RF1/96 that the initial costs associated with providing a so-called living annuity or equity-linked annuity are debited against the capital invested. The long-term insurer owns the capital used to purchase the annuity. It follows that the costs are incurred by the insurer and not by the annuitant. It cannot, therefore, be argued that the annuitant incurred these costs in the production of the annuity income, and no deduction of these expenses is therefore available under section 11(a) of the Act.

Subsequent costs over the lifetime of the annuity are also debited to the underlying capital. The insurer, as mentioned before, owns the capital. The costs are therefore an expense incurred by the insurer and it cannot be argued that the annuitant incurred these costs in the production of the annuity income. No deduction of these expenses is therefore available under section 11(a) of the Act.

ISSUED BY THE SOUTH AFRICAN REVENUE SERVICE

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