



*SOUTH AFRICAN REVENUE SERVICE*

**INTERPRETATION NOTE NO. 13 (Issue 2)**

**DATE: 30 March 2005**

**ISSUE NO. : 2**  
**ACT : INCOME TAX ACT, 1962 (the Act)**  
**SECTION : SECTION 23(m)**  
**SUBJECT : DEDUCTIONS: LIMITATION OF DEDUCTIONS FOR EMPLOYEES AND OFFICE HOLDERS**

1. **What's new**

The purpose of this update of the Interpretation Note is to -

- expand on the meaning of certain terminology used in the context of the relevant legislation, such as “employment”, “remuneration” and “normally”; and
- include comments on subsequent legislative changes.

2. **Introduction**

It was proposed in the 2002 Budget Review that the taxation of employment income be simplified by limiting the number of deductions against income from employment.

To give effect to this proposal, section 23(m) was introduced into the Act by the Taxation Laws Amendment Act, No 30 of 2002.

3. **The law**

Section 23(m) of the Act reads as follows:

*“23. No deductions shall in any case be made in respect of the following matters, namely –*  
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 (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 sections 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); and*

*(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—*

*(aa) to the extent that it covers that person against the loss of income as a result of illness, injury, disability or unemployment; and*

*(bb) in respect of which all amounts payable in terms of that policy constitutes or will constitute income as defined.”*

4. **Application of the law**

The wording of section 23(m) is analysed and interpreted below.

<b>Wording</b>	<b>Interpretation</b>
<b>No deductions shall in any case be made in respect of the following matters, namely – ...</b>	Section 23 of the Act contains a number of prohibitions on deductions. Paragraph (m) of section 23 is one of them.
<b>subject to paragraph (k)</b>	Paragraph (k) of section 23 prohibits certain deductions for labour brokers without an exemption certificate, personal service companies and personal service trusts. The application of paragraph (m) is subject to the application of paragraph (k), which means that a personal service company, a personal service trust or a labour broker that falls under the restrictions imposed by paragraph (k) will remain restricted under that paragraph despite the provisions of section 23(m).
<b>any expenditure, loss or allowance, contemplated in section 11</b>	Prior to the introduction of section 23(m) an employee or holder of an office could under certain (in practice very limited) circumstances have been entitled to claim a deduction under section 11 of the Act. With effect from 1 March 2002 this is, with a few exceptions, no

	<p>longer possible. <b>[See examples (a) and (b) of Annexure A]</b></p> <p>The prohibition on the deduction of expenditure, losses and allowances only applies to expenditure, losses and allowances that would otherwise have been deductible under section 11 of the Act. Expenditure, losses and allowances that are deductible or capable of being set-off under other sections of the Act are still permitted. For example, subsistence and travelling expenses under section 8(1)(b) or (c) of the Act, or the expenditure listed under section 8(1)(d) of the Act in respect of holders of a public office, or the medical deductions under section 18 of the Act remain available. <b>[See example (b) of Annexure A]</b></p>
<p><b>which relates to any employment of, or office held by, any person</b></p>	<p>The prohibition on deductions applies to expenditure, loss or allowances which relate to the employment of any person or to an office held by any person.</p> <p>The term “employment”, in this context, should be afforded its narrower meaning of an employer-employee (master-servant) relationship. An independent contractor is therefore not affected by the prohibition on deductions. <b>[See example (b) of Annexure A]</b></p> <p>The holding of an office generally flows from an appointment (such as the President of South Africa, a Minister in the Cabinet, and a Judge) whereas the holding of employment flows from a contract and is something in the nature of a post.</p>
<p><b>(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)</b></p>	<p>An agent or representative whose remuneration is normally derived mainly in the form of commission based on sales or turnover that are attributable to that agent or representative is excluded from the provisions of section 23(m). The term “remuneration” in this context is <b>not</b> necessarily as defined in</p>

	<p>the Fourth Schedule, i.e. it is a general reference to a reward or pay received in return for services rendered or work done. The term “mainly” is interpreted to mean more than 50% of the taxpayer’s gross remuneration. This means that the total income of the taxpayer (including 100% of all allowances) must be compared to his or her commission income. Where the commission is more than 50% of the gross remuneration, the agent or representative who is in this position may continue to be granted permissible deductions under section 11 of the Act. <b>[See examples (c), (d), (e) and (f) of Annexure A]</b></p> <p>Where an agent or representative did not derive more than 50% commission income for the year of assessment, but it can nevertheless be shown that his or her income normally consists of more than 50% commission, the limitation of section 23(m) will not be applicable. The test for “normally” is a subjective test and each case must be evaluated on its own merits, with due regard to the taxpayer’s previous and future years of assessment.</p> <p>For purposes of section 23(m) the terms “agent”, “representative” and “commission” should be interpreted as follows:</p> <p><b>“agent”</b> - a person authorised or delegated to transact business for another.</p> <p><b>“representative”</b> – one who represents another or others.</p> <p><b>“commission”</b> - a percentage of sales or turnover of the person on behalf of whom the agent or representative is acting.</p>
<p><b>in respect of which he or she</b></p>	<p>The prohibition on deductions applies to natural persons only.</p>
<p><b>derives any remuneration, as defined in paragraph 1 of the Fourth Schedule,</b></p>	<p>The prohibition applies to expenditure, losses and allowances that relate to “remuneration” as defined in the Fourth Schedule to the Act. Expenditure, losses and allowances that relate to income other than “remuneration”</p>

	<p>may therefore still be considered for deduction. An employee or office holder in receipt of two or more streams of income may thus be in a situation where the deduction of expenditure, losses or allowances relating to a “remuneration” stream of income is prohibited, while expenditure, losses or allowances relating to another trade remain deductible.</p> <p><b>[See example (b) of Annexure A]</b></p>
<p><b>other than—</b></p> <p><b>(i) any contributions to a pension or retirement annuity fund as may be deducted from the income of that person in terms of sections 11 (k) or (n);</b></p> <p><b>(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 ); and</b></p> <p><b>(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—</b></p> <p><b>(aa) to the extent that it covers that person against the loss of income as a result of illness, injury, disability or unemployment; and</b></p> <p><b>(bb) in respect of which all amounts payable in terms of that policy constitutes or will constitute income as defined.</b></p>	<p>These expenses and allowances are still deductible.</p> <p>The exclusion in relation to insurance policy premiums is limited to premiums paid in respect of the loss of income following illness, injury, disability or unemployment. This means that only that portion of the premiums on an insurance policy that relate to benefits or coverage in respect of loss of income can be permitted as a deduction.</p> <p>The exclusion is also subject to the taxable status of the loss-of-income benefit. The benefit must be “income” as defined in section 1 of the Act.</p>

5. **Effective date**

Section 23(m) is effective from 1 March 2002. The substitution of section 23(m)(iii)(aa) is effective from the commencement of years of assessment ending on or after 1 January 2004.

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## EXAMPLES

(a) An employee received pensionable salary of R130 000. The employee contributed R9 750 to an approved pension fund and incurred -

- entertainment expenses of R1 000;
- cell phone airtime expenditure of R1 500; and
- text book costs of R750 that are required for and relate directly to her profession.

The restrictions of section 23(m) apply to the remuneration of R130 000. In terms of these restrictions the entertainment, cell phone and textbook expenditure are not permissible deductions. Section 23(m) continues, however, to permit a wear and tear allowance under section 11(e) in respect of the text book expenditure. The pension fund contribution remains deductible.

(b) Ms X received salary of R100 000 and fees of R198 000 from a professional practice in which she trade as an independent contractor. She incurred expenses of R88 000 in relation to the professional practice. In relation to the salary income she incurred -

- medical expenses of R3 000;
- entertainment expenses of R1 000;
- cell phone airtime expenditure of R1 500; and
- bad debt of R8 333 for salary due but not paid by the liquidated employer.

The expenses relating to the professional practice are deductible for tax purposes as they relate to income other than "remuneration". The restrictions of section 23(m) apply to the salary of R100 000. In terms of these restrictions the entertainment and cell phone costs are not permissible deductions, and the bad debt of R8 333 may be considered for purposes of section 11(i) or (j) as it relates to remuneration. The medical expenses can be considered for deduction under section 18 of the Act.

(c) An employee received pensionable salary of R40 000 and commission income of R130 000 on sales. The employee contributed R3 000 to an approved pension fund and incurred commission-related business expenses of R70 000. Since more than 50% of the employee's remuneration consists of commission, the restrictions of section 23(m) do not apply. The R70 000 commission expenses may therefore be considered for deduction against the commission income of R130 000 in terms of section 11. The pension fund contribution is unaffected by the introduction of section 23(m) and remains deductible.

(d) An employee received pensionable salary of R60 000 and commission of R60 000 on sales. The employee contributed R4 500 to a pension fund and incurred commission-related business expenditure of R10 000, consisting of telephone and stationery costs. Since not more than 50% of the employee's remuneration consists of commission, the restrictions of section 23(m) apply. The commission-related business expenditure of R10 000 can therefore not be considered under section 11 for deduction. The pension fund contribution remains deductible.

(e) For the period 1 March 2002 to 31 August 2002 an employee received salary of R300 000 from **employer A**, in respect of which cell phone airtime expenses of R3 000 were incurred. For the period 1 September 2002 to 28 February 2003 the employee received commission income of R250 000 on sales from **employer B** (which is not connected to employer A) and incurred commission-related business expenses consisting of telephone and stationery of R30 000.

For purposes of section 23(m), each contractual arrangement arising from unconnected sources has to be considered on its own. This means that section 23(m) prohibits the deduction of the expenses incurred in relation to remuneration received from **employer A**, but that section 23(m) does not prohibit the deduction of expenses incurred in relation to remuneration received from **employer B**.



- (f) An employee receives a pensionable salary of R80 000 per annum, commission income of R100 000 and is in receipt of a travel allowance of R40 000 for the year. The employee contributes R4 000 towards a retirement annuity. He was involved in a legal dispute with his employer and incurred legal costs of R5 000. In addition he incurred commission related expenses of R35 000. Since the employee's commission income is less than 50% of his total income i.e. salary and total allowances (R80 000 + R40 000), the restrictions of section 23(m) will apply. The commission related expenditure of R35 000 will therefore not be considered under section 11 for a deduction. The retirement annuity of R4 000 will remain deductible. Where it is proved that the employee incurred business mileage and travel related expenses, he may be able to deduct the travel allowance. The legal costs of R5 000 may be considered for a deduction under section 11(c) of the Act.

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