



SOUTH AFRICAN REVENUE SERVICE

INTERPRETATION NOTE NO. 14 (Issue 2)

DATE: 8 January 2008

ACT : INCOME TAX ACT, 1962 (the Act)
SECTION : SECTIONS 8(1)(a) and 8(1)(c)
SUBJECT : ALLOWANCES, ADVANCES AND REIMBURSEMENTS

1. Purpose

This update of the Interpretation Note incorporates the changes made in terms of section 49(1)(c) of the Revenue Laws Amendment Act, No. 31 of 2005 to paragraph (bA) of the definition of “remuneration” in paragraph 1 of the Fourth Schedule to the Act and other relevant legislative changes.

2. Background

It was proposed in the 2002 Budget Review to simplify the taxation system of employment income. One of the ways in which this proposal was effected, was the introduction in terms of the Taxation Laws Amendment Act, No 30 of 2002 and the Revenue Laws Amendment Act, No 74 of 2002 of structural and other changes to sections 8(1)(a) and 8(1)(c) of the Act by –

- consolidating the various sections dealing with allowances into one section; and
- simplifying the structure of the Act in this regard.

3. The concepts of allowances, advances and reimbursements

It is necessary to distinguish between an allowance, an advance and a reimbursement for purposes of sections 8(1)(a) and 8(1)(c) of the Act, as follows:

3.1 Allowance

An **allowance** is an amount of money granted by an employer to an employee in circumstances where the employer is certain that the employee will incur business-related expenditure on behalf of the employer, but where the employee is not obliged to prove or account for the business expenditure to the employer. The amount of the allowance is based on the expected business-related expenditure.

3.2 Advance

An **advance** is an amount of money that is granted by an employer to an employee in circumstances where the employer is certain that the employee will incur business-related expenses on behalf of the employer, and where the employee is obliged to prove or account for the business-related expenditure to the employer. The amount of the advance is based on the business-related expenditure. Where the actual expenses incurred are less than the advance granted, the employer recovers the difference from the employee, and *vice versa*.

3.3 Reimbursement

A **reimbursement** of business expenditure occurs when an employee incurred business-related expenses on behalf of an employer out of his or her own pocket (i.e. without having had the benefit of an allowance or an advance) and is subsequently reimbursed for this expenditure by the employer after having proved and accounted for the expenditure to the employer.

4. The law

Prior to the amendment of section 8(1) of the Act, allowances, advances and reimbursements were dealt with under a number of different sections of the Act. To consolidate the previous provisions dealing with allowances, advances and reimbursements, the following amendments were introduced:

4.1 Allowances and advances in general

Section 8(1)(a) was amended by section 12(1)(a) of the Taxation Laws Amendment Act, No. 30 of 2002 –

- to bring within its ambit **all** allowances and advances paid by a “principal” to an employee or holder of an office; and
- to provide that the allowances and advances so paid will be included in taxable income to the extent that they are not expended –
 - for travelling on business; or
 - for accommodation, meals and incidental costs while such office holder or employee is obliged to spend a night away from his usual place of residence as a result of business or official purposes; or
 - by reason of the duties attendant upon public office.

4.2 Reimbursements

Section 8(1)(a) was further amended by section 12(1)(a) of the Taxation Laws Amendment Act, No. 30 of 2002 to exclude reimbursements or advances from taxable income provided –

- the reimbursement or advance was or must be expended by the recipient on instruction of the “principal” in the furtherance of the “principal’s” business; **and**
- the recipient is required to produce proof to the “principal” that the amounts were wholly and actually expended for this purpose; **and**

- where this expenditure was incurred to acquire any asset, the ownership in that asset must vest in the “principal”.

4.3 The term “principal”

For purposes of section 8(1)(a) the term “**principal**” was introduced by section 12(1)(a) of the Taxation Laws Amendment Act, No. 30 of 2002 to refer to –

- the employer of the recipient of an allowance; or
- the authority, company, body or other organisation in relation to which any office is held; or
- any associated institution as defined in the Seventh Schedule to the Act in relation to that employer, authority, company, body or organisation.

4.4 Subsistence allowances

Section 8(1)(c) was amended by section 12(1)(c) of the Taxation Laws Amendment Act, No. 30 of 2002 to provide that accommodation, meals and incidental costs will be **deemed** to have been actually expended (but limited to the amount of the allowance or advance granted to meet these expenses) –

- if the employee use supporting documentation for the actual expenditure incurred by him/her to complete his or her tax return (the employee must keep all supporting documentation for a period of five years from the date upon which his/her income tax return was received by SARS and must be able to produce such documentation upon request by SARS); **or**
- if the employee did not submit proof, by an amount determined by the Commissioner for the relevant year of assessment by way of notice in the *Gazette* in respect of meals and other incidental costs, or incidental costs only, for each day or part of a day in the period during which he or she is absent from his or her usual place of residence. This deeming provision does not apply to the extent that –
 - the employer has borne the expenses (otherwise than by way of the allowance or advance) in respect of which the allowance was paid or granted for that day or part of that day; **or**
 - the employee has proven to the Commissioner that the amount of the actual expenditure in respect of meals or incidental costs for that day or part of that day.

4.5 Entertainment allowances

Paragraph (c) of the definition of “gross income” in section 1 of the Act was amended by section 9(a) of the Taxation Laws Amendment Act, No. 30 of 2002 to delete the provision dealing with entertainment allowance and advances.

4.6 Holders of a public office

Section 8(1)(d) was amended by section 12(1)(d) of the Taxation Laws Amendment Act, No. 30 of 2002 to equalise the treatment of entertainment allowances and deductions between a holder of a public office and an employee. In terms of this

amendment the amount of R2 500 previously allowed to a holder of a public office for hospitality expenses was removed.

4.7 Employees' tax

The definition of "remuneration" in the Fourth Schedule to the Act was amended by section 32(1)(a) of the Taxation Laws Amendment Act No. 30 of 2002 to include all the allowances that are deemed to be taxable income in terms of section 8(1)(a)(i), with the **exception** of –

- allowances granted to the holders of any public office of which 50% is already included in the definition of "remuneration";
- travelling allowances of which 60% is already included in the definition of "remuneration"; and
- an allowance or advance granted to the person in respect of accommodation, meals or other incidental costs while that person is obliged to spend at least one night away from his or her usual place of residence in the Republic provided that where –
 - such an allowance or advance was paid or granted to a person during any month in respect of a night away from his or her usual place of residence, and
 - that person has not by the last day of the following month either spent the night away from his or her usual place of residence or refunded that allowance or advance to his or her employer,

that allowance or advance is deemed not to have been paid or granted to that person during the first-mentioned month in respect of accommodation, meals or other incidental costs, but is deemed to be an amount which has become payable to that person in that following month in respect of service rendered by that person.

4.8 The Gazetted subsistence amounts

4.8.1 The amounts deemed to have been expended on meals and/or incidental costs are determined by the Commissioner by way of notice in the *Gazette*. A copy of the latest notice is available on the SARS website, www.sars.gov.za.

4.8.2 The amount deemed to have been expended on incidental costs are only applicable to allowances paid **solely** to cover beverages (including alcoholic beverages), private telephone calls, gratuities and room service.

4.8.3 The amounts deemed to have been expended on meals and incidental costs while away on business within the Republic, are only applicable to allowances paid solely in respect of meals and incidental costs. Where an allowance is paid that covers meals but not incidental costs, the amount deemed to have been expended must be reduced by the deemed amount applicable to incidental costs.

5. Application of the law

5.1 Section 8(1)(a)(i) of the Act **includes** in taxable income **all** allowances and advances, after deducting the following expenses from allowances or advances paid to cover these expenses:

- Expenditure incurred on travelling for business (i.e. the normal travel allowance provisions).
- Expenditure incurred on accommodation, meals and/or incidental costs while away on business under certain circumstances.
- Certain expenditure incurred by a holder of a public office **[see example 1]**.

5.2 Section 8(1)(a)(ii) of the Act **excludes** from taxable income reimbursements or advances for expenditure incurred or to be incurred on the instruction of the “principal” if the recipient submits proof and accounts for the expenditure to the principal. In addition to these conditions, a reimbursement or advance for the purchase of an asset can only be excluded from taxable income if ownership of the asset vests in the “principal”.

5.3 The deeming provisions under which a recipient of a subsistence allowance or advance may claim certain deemed expenditure without having to submit proof, are limited to allowances or advances in respect of **meals and/or incidental costs only**, and do not include any reference to an allowance or advance in respect of accommodation **[see example 2]**. This, effectively, means that an allowance or advance paid in respect of **accommodation** will be included in taxable income unless –

- the recipient can prove accommodation expenditure; or
- the recipient was reimbursed or received an advance for expenditure incurred or to be incurred on the instruction of the “principal”, if the recipient submitted proof and accounted for the expenditure to the “principal” as contemplated under the reimbursement or advance rules mentioned in paragraph **3.2** above.

5.4 In relation to allowances or advances in respect of accommodation, meals or incidental expenditure, no deemed expenditure in excess of the amount paid to meet the expenditure is permitted **[see example 3]**. Furthermore, such an allowance or advance paid or granted to an employee during any month and the employee had not spent, for business purposes, at least one night away from his or her usual place of residence by the end of the month following the month in which the allowance or advance was paid or granted, any amount of such allowance or advance not refunded to the employer will be subject to employees’ tax. This ensures that subsistence allowances or advances are not used as a form of salary structuring by employers resulting in employees receiving a tax-free allowance which is not provided for by legislation **[see example 4]**.

5.5 In relation to allowances in respect of meals and incidental costs, or incidental costs only, the amount deemed by the Commissioner to have been actually expended by the recipient must, where the allowance paid does not exceed the deemed expense, be reduced by that portion of the expenditure borne by the employer, or where the allowance paid exceeds the deemed expense, be proportionally reduced. The effect of this is that the employee will not be able to claim the full deemed subsistence amounts where the employer has paid for a portion of the subsistence expenses for which the allowance or advance was granted **[see examples 5 & 6]**.

5.6 In relation to allowances in respect of meals and incidental costs, or incidental costs only, the amount deemed by the Commissioner to have been actually expended by the recipient is not applicable where any amount of actual expenditure was proved to the Commissioner. The effect of this is that the employee will not be able to also claim the deemed amounts where he or she proved the actual expenditure to SARS **[see examples 7 & 8]**.

6. General observations

6.1 The nature of allowances, advances, and reimbursements

The nature of allowances, advances and reimbursements are frequently misunderstood, as are the reasons for granting such disbursements. In this regard the following must be noted:

6.1.1 Any allowance, advance or reimbursement is a reflection of business expenditure or anticipated business expense of the **employer**. A payment to an employee under the guise of an allowance but actually for services rendered or to be rendered is subject to tax under the normal provisions of "gross income" and is not treated under the provisions of section 8(1)(a) as an allowance. The label of a payment does not necessarily correctly reflect the true nature of the payment.

6.1.2 The judgment in ITC 1523 (54 SATC 194) confirmed that when the word "allowance" is used in an employee-employer relationship it means a grant of something additional to ordinary wages.

6.1.3 A typical misconception is that the quantum of an allowance or advance does not have to reflect the anticipated business expense. This misconception is sometimes caused by the incorrect understanding that an allowance can, without reference to the actual expenditure anticipated, be based on the amounts deemed to be available by the Act. The misconception means that employees are sometimes in receipt of allowances that are much greater than the true anticipated business expense. This position can be regarded by SARS to mean that –

- the excessive portion of the allowance is normal remuneration for services rendered,
- this portion is not covered by section 8(1)(a) but by the definition of "gross income" in section 1 of the Act, and

- the excessive portion is subject to the normal PAYE rules.

Employers will be liable for the under-deduction of PAYE in these circumstances, as well as the concomitant interest and penalties. Employers should base the quantum of an allowance on the anticipated business expenditure of a particular trip, and not on the deemed amounts available under the Act.

6.1.4 The deeming provisions (i.e. the ability to claim actual expenses or to claim the Gazetted amounts) under section 8(1)(c) in relation to a subsistence allowance are not available to employees who are seconded to other work places of the employer or employees who are normally required to stay away from their usual places of residence for extended periods of time. This aspect was confirmed in ITC 1668 (61 SATC 444).

6.2 Other exemptions of allowances

The exemption provisions under section 10 of the Act as they apply to allowances or advances remain applicable. In this regard, the so-called uniform allowances and relocation cost allowances are unaffected and remain exempt from income tax, provided they meet the conditions specified in the particular exemption sections.

6.3 Accommodation

Where the service provider for accommodation does not have a separate tariff for breakfast, it is the practice of SARS to regard the breakfast as part of the cost of accommodation.

7. Effective dates

- 7.1 The amendments to section 8(1)(a) and (c) of the Act which relate to the inclusion of allowances and advances into the employee's taxable income and remuneration for the purposes of employees' tax are effective from 1 March 2002.
- 7.2 The amendment to paragraph (bA)(ii) of the definition of "remuneration" as defined in the Fourth Schedule to the Act is effective from 1 February 2006.
- 7.3 The amounts deemed to have been actually expended by the recipient of an allowance or advance to defray meals and/or incidental costs are effective from the date(s) stipulated in the *Gazette*.

Legal and Policy Division
SOUTH AFRICAN REVENUE SERVICE

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ANNEXURE A

EXAMPLES

(Based on the amounts determined in the Gazette dated 28 February 2007)

Example number	Facts	Answer
1	<p>In addition to basic salary, an employee received allowances in respect of cell phone costs, entertainment, travelling and a home office during the year of assessment, and was reimbursed for meals during a business trip away from his office.</p>	<p>The allowances received in respect of cell phone costs, entertainment and home office remain included in the taxable income of the employee.</p> <p>The allowance received in respect of travelling is excluded from taxable income to the extent that the employee is permitted to claim travelling expenditure or deemed expenditure, and the reimbursed costs for meals are excluded from taxable income to the extent that the requirements relating to reimbursements were met.</p>
2	<p>An employee receives an advance of R5 000 for accommodation and an allowance of R1 000 for meals and incidental costs to conduct business-related activities in the furtherance of the employer's trade. The employee is away on business for 5 nights. On his return, the employee is not able to prove any expenditure on accommodation or meals to the employer. The employer does not recover the advance.</p>	<p>The advance of R5 000 remains included in the taxable income of the employee</p> <p>The allowance of R1 000 will be reduced by the amount per day determined by the Commissioner, and the balance remains included in the taxable income of the employee</p>
3	<p>An employee receives an advance of R5 000 for accommodation and an allowance of R1 000 for meals and incidental costs to conduct business-related activities in the furtherance of the employer's trade. The employee is away on business for 5 nights. On his return, the employee accounts for and proves to the employer that expenditure of R7 000 was incurred on accommodation. The employee is unable to prove any of the cost of meals and incidental costs</p>	<p>The exclusion from taxable income in relation to the advance for accommodation is limited to R5 000. The additional R2 000 cannot be utilised to reduce the taxable income of the employee.</p> <p>The allowance of R1 000 for the cost of meals and incidental costs will be reduced by the amount per day determined by the Commissioner, and the balance remains included in the taxable income of the employee.</p>
4	<p>An employee receives an advance of R5 000 for accommodation and an allowance of R1 000 for meals and incidental costs in May 2007 to conduct business-related activities in the furtherance of the employer's trade. By the end of June 2007, the employee has not yet been away on business and he only refunded R1 000 to the employer.</p>	<p>The R5 000 advance not refunded by the employee to the employer will be deemed to be remuneration received by the employee in June 2007 for services rendered (i.e. R5 000 is subjected to employees' tax in June 2007).</p>

Example number	Facts	Answer
5	<p>An employee is on a business trip in South Africa for his employer. The employer pays for accommodation costs as well as for lunch in respect of each of the days away on business. The employer also pays an allowance of R250 per day to enable the employee to pay for meals and to meet incidental costs. The employee is away for 5 days, and received R1 250 as an allowance to cover the cost of meals and incidental costs. The employer paid R520 in total for the employee's lunches. The employee did not keep any evidence of expenditure on other meals and incidental costs.</p>	<p>The total amount deemed to have been actually expended on meals and incidental costs are R1 040 (R208 x 5). This amount must, however, be reduced by the proportion borne by the employer (R520). The ratio in this case is 50% (R520:R1 040), which means that the amount deemed to have been actually expended must be reduced to R520 (R208 x 50% x 5). The allowance of R1 040 may therefore be reduced by R520. The difference of R520 is included in the employee's taxable income.</p>
6	<p>An employer arranges to pay directly by credit card for accommodation and meals in respect of a business trip to be undertaken by his employee for 10 days. In addition to this, the employee receives R2 080 (R208 per day) for any subsistence expenses she may incur.</p>	<p>As the employer has borne the expenses in respect of meals, the employee will not be entitled to the deemed subsistence amount of R208 per day or part of a day to have been expended by her. Instead, the deemed amount of R63.50 per day or part of a day in respect of incidentals may be offset against the allowance and the balance of R1 445 [(R208 less R63.50) x 10 days] must be taxed, or she must have proof available of how the full amount of the subsistence allowance (R2 080) was expended.</p>
7	<p>An employee is required by her employer to spend 4 days away from her usual place of residence, for a business trip within South Africa. The employer pays the employee an allowance of R300 per day to compensate her for meals and incidental costs during the 4 days. This means that the employee received an allowance of R1 200 in total. The employee kept proof of her expenditure on accommodation, meals and incidental costs. Her total actual costs amount to R1 500.</p>	<p>The employee may claim actual expenses of R1 500 but limited to R1 200 (amount of allowance) on assessment. She will not be allowed to claim the deemed amount of R208 per day or part of a day for the same days in respect of meals and incidentals in addition to this actual expenditure claim.</p>
8	<p>An employee is on a business trip inside South Africa for her employer. The employer pays for accommodation costs. The employer also pays an allowance of R220 per day to enable the employee to purchase meals and to meet related incidental costs. The employee is away for 5 days and received an allowance of R1 100. The employee kept vouchers of her expenditure on meals and incidental costs. The vouchers show that she spent R900 on meals and incidental costs.</p>	<p>On assessment, an amount of R900 can be offset against the allowance if the vouchers are available as proof. The employee would not also be able to claim R208 or R63.50 per day. This means that the employee is taxable on the difference, i.e. R200.</p>