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August 2021

Home Office Expenses: To Claim or Not to Claim?

"We would simply ask taxpayers to consider carefully the longer-term implication of defining an area in their primary residence as a home office for tax purposes"
(Edward Kieswetter - SARS Commissioner)



"All employers should allow their employees to work from home unless it is absolutely necessary for them to perform work on-site" was among the government's directives issued on 28 June, when South Africa was placed under an adjusted Alert Level 4 lockdown in response to the third wave of Covid-19 infections in the country.

While working from home has certainly become a more familiar feature of the employment landscape and is predicted to remain so long after all lockdown restrictions are lifted, it has been some time since employees were actually compelled to work from home wherever possible.

This, along with the opening of the 2021 tax season on 1 July, refocused attention on the issue of home office expenses and how these should be treated for an optimal tax outcome for employees and employers.

Just days later after the lockdown commenced, SARS announced that it had published an update on its website in relation to home office expenses to provide “additional clarity for individual taxpayers who may be considering submitting claims for home office expenses in their income tax returns that can now be filed for the 2021 tax year” from 1 March 2020 to 28 February 2021.

What has changed?

SARS notes that expenses in maintaining a home office have been a controversial issue since the 1968 judgment *KBI v Van der Walt*. The legislative provision relating to home office expenditure that a taxpayer may claim, section 23(b) of the Income Tax Act, has therefore been periodically amended since 1990.

However, since March 2020, things have changes drastically due to Covid-19, and more employees have been compelled to spend more time than ever before working from home. It is in any case likely to be a permanent feature of the employment landscape in the future. Employees have been accommodating this shift by setting up home offices and bearing certain expenses to create and maintain a proper working environment at home.

Despite the substantial change in the employment landscape, SARS emphasized in their media statement that “there have been no changes to the legislation in relation to a ‘home office’... the legal requirements remain the same as before the Covid-19 pandemic.”

However, in May, SARS also issued a 17-page draft Interpretation Note 28 (IN28) on what taxpayers who are “in employment or holding an office” can deduct for home office expenses, providing various examples of when expenses will not be permitted. These include, for example, working at a dining room table instead of in a dedicated room; or also using the home office space for purposes other than working.

Media comments have suggested that the draft interpretations are narrow, excluding most employees from claiming a tax deduction; do not adequately address tax implications arising from the increase in home office use due to Covid-19; and do not align with National Treasury’s intention, expressed in the February Budget Review, to investigate current travel and home office allowances for “efficacy, equity in application, simplicity of use, certainty for taxpayers and compatibility with environmental objectives”.

While the Draft Interpretation is under discussion, SARS says that the legal requirements set out in the Income Tax Act remain the same as before the Covid-19 pandemic.

6 questions to determine if you are eligible to claim home office expenses

SARS’ “Home Offices Expenses Questionnaire” [here](#) says that answering ‘Yes’ to all 6 questions below confirms eligibility to claim home office expenses.

1. Did you receive remuneration for duties performed mainly (more than 50%) in part of your private premises occupied for purposes of that remuneration?
2. Do you have a dedicated room in your premises?
3. Is this room specifically equipped for the purpose of that remuneration?
4. Is this room regularly used for purposes of performing the duties in relation to that remuneration?
5. Is this room exclusively used for purposes of performing the duties in relation to that remuneration?
6. Did you incur home office expenditure relating to your domestic premises?

Just please read the “Pitfalls” section below before making any decisions!

What can and cannot be claimed?

For a home office expense to be deductible, the requirements of the Income Tax Act must be met and its prohibitions must not apply.

Typically, home office expenditure includes rental of the premises; cost of repairs to the

premises; and expenses in connection with the premises.

This means that taxpayers may deduct rental or bond interest on the home and home repairs; municipal rates, electricity and water; wear and tear on office equipment considering differing depreciation rates on computer equipment and office furniture.

In terms of the rental or bond, as well as the municipal rates and utilities, an apportionment of the costs must be made when claiming. This is typically calculated on a pro-rated basis of floor space i.e. square metre basis of the home office in relation to the total area of the home.

Employees may also incur numerous costs in running a home office such as telephones and cell phones, Internet connectivity, equipment repairs, stationery, and cleaning.

Beware the pitfalls

- 1. The specific wording, narrow interpretations and possible changes to home office expenses could place taxpayers at risk.** For example, to claim home office expenses, the home office must be a room “dedicated” to work where duties are performed “mainly” or “more than 50% of the time”, and it must also be “specifically equipped” and “regularly” and “exclusively” used for work. Wording such as this, along with possible changes and the narrow interpretations suggested in the most recent draft Interpretation Note (IN28) should prompt employers and employees to take professional advice before deciding to claim a tax deduction in respect of home office expenses.
- 2. The burden of proof lies with you as taxpayer.** Employees should be provided with written confirmation regarding the specific timeframe they are required to work from home. In addition, employees should keep a running spreadsheet of hours and days worked at home covering the entire tax year, or consider other solutions such as keyboard tracking software, stealth monitoring or mobile time clocking solutions.
- 3. Home office expenses must be linked to employment use and must be verifiable.** Be sure to retain invoices and statements of all home office expenses. Where expenses are not specified as deductible in the Income Tax Act, opting for reimbursement by your employer may be a more efficient solution.
- 4. The possible impact on capital gains tax.** SARS warns that where the home office is on taxpayer-owned property, formally defining part of a primary residence as a home office will ‘most likely have an adverse impact on a future capital gains determination’. This is because the home office area will, on a pro-rated basis, be excluded from the primary residence exclusion of R2 million on disposal of the residence. Careful consideration should therefore be given before a claim for home office expenses is made and **it is essential to get professional advice on this aspect.**
- 5. Increased risk of being audited.** SARS warns that while all claims for home office expenses may be subject to further verification or audit, there is a high likelihood that a taxpayer who claims home office expenses for the first time will be selected for verification or audit.

Cost vs Benefit Analysis

Given all the potential pitfalls, it is important for employers and employees to consider whether the cost, risk and administration involved in claiming home office expenses are worth the benefit received in terms of the total tax deduction.

Other options should also be explored to ensure the optimal tax outcome for employers and employees. For example, should the employer provide the employee with an allowance per month to cover home office expenses, such an allowance will be taxed as part of their remuneration. Where the employer reimburses such expenses, however, it would not be taxable in the employee’s hands. Similarly, if the employer reimburses expenses for the purchase of home office equipment, such equipment is then the property of the employer and would also not be taxable in the employee’s hands. Employers should consider a reimbursement policy to clarify the treatment and maximum reimbursement amounts and are strongly advised to obtain advice from their accountant when making these decisions.

SARS itself notes that taxpayers may find that working from home resulted in savings on expenses they would otherwise have incurred, like transport, wear and tear on vehicles and so forth. These savings, together with the loss of part of the capital gains

exclusion, may outweigh the benefit of a claim for home office expenses.

“We understand that many employers, and employees alike, are grappling with establishing a new normal,” says SARS Commissioner Edward Kieswetter. “We would simply ask taxpayers to consider carefully the longer-term implication of defining an area in their primary residence as a home office for tax purposes. **It may be more prudent to wait and establish a more sustainable rhythm before making the decision**” (Emphasis supplied).

6 Tips on Surviving the Failure of a Big Client

“Generosity is a virtue, but unlimited generosity is a fast route to bankruptcy” (Bret Stephens)

Healthy cash flow is what keeps a company afloat. The ability to pay suppliers and staff, without risking the future of the business, entirely independently of expected new payments, is vital for any enterprise to keep going.



In this era of regular redundancies and corporate collapses, managing your cash flow is the most important aspect of managing your business. Key clients and customers getting into difficulties and potentially failing puts serious strain on your own company's ability to stay afloat. The six tips below should help you stay solvent even if your biggest clients bow out.

1. Secure the debt upfront

Firstly, to talk “prevention rather than cure” for a moment, seek advice on taking some form of security for your debt (a cession of the client’s debtors perhaps) upfront. As we shall see below, being a “secured creditor” gives you a much better chance of at least partial recovery in the event of liquidation than being a “concurrent creditor”.

2. Request upfront payments as standard

Still talking prevention, requesting payment up front can often feel like a rude or difficult thing to do. You may fear offending clients by implying they will not pay, or you don't want to scare new business away by asking them to trust you to deliver. At the end of the day upfront payment is about trust; and asking for someone to pay you before you deliver may feel wrong. It does, however, have many advantages.

Apart from ensuring you will not be taken for a ride by fraudulent clients, asking for payment up front also protects against failure of those clients. The worst situation you can find yourself in is one in which you have done work, and now owe your own suppliers, only for the payment not to come through. Asking for money up front means this will never happen and questions around scaring off clients are generally unfounded. Of course, your own suppliers may already be asking you for upfront payment, especially in the current environment.

If a client has decided to work with you, they have likely done their research and are already trusting you to deliver within certain time frames and deadlines that they themselves need to meet. Generally there is also an understanding that costs will be incurred by you to meet their requirements. Asking for upfront payment is therefore a relatively small pain point in this transaction and upfront payments are therefore common in trade businesses, or creative enterprises

where payments may need to be made in order to start a job.

If you still feel uncomfortable asking for the money up front, at least ask for a deposit and progress payments. Be prepared to pause work on projects if payments are late before you incur additional expenses.

Particularly if it is your standard policy, you need not feel you are discriminating against any one client. In the long run your cash flow will be healthier for it.

3. Win new clients

The first, and most important, thing to do to protect your company from going under when a client fails, is to have as many clients as possible. Diversifying your client base means you are not as dependent on that one client who may be struggling. It sounds like obvious advice, but there are business owners who, once that one big client is secured, sit back on their haunches and live the easy life servicing that goose that lays the golden eggs.

It is important then to never stop marketing, or hustling for new business, and this is particularly important when that one big client goes under. One person's misfortune is another's gain, and your client's failure is going to have a ripple effect through their industry. Somewhere, one of their competitors may find some space to grow. By marketing yourself and your products/services you may find your business in the perfect position to pick up that work when they start expanding.

So while it's important to focus on the clients you have now, it's also important to start planning as early as possible for a future without one or more of them. If you landed one big client, the chances are you can land another.

4. It's time to become strict

No matter how long you have been dealing with a client, the second you suspect they may be struggling financially it's time to alter the terms of your arrangement. Protecting your business needs to be your number one priority. If you had the client on a 90 day payment plan, move that to 30. Stop paying for things on their behalf and secure payments wherever possible up front. Suspend projects until payments are received. If your product or service is key to their operations they will find a way to pay in advance, and if it's not, well your payments would have been first on the chopping block anyway. There is absolutely no sense continuing work and spending good money chasing bad.

5. Negotiate early and be willing to sacrifice

As soon as a client indicates that they are in financial distress it's time to look at your books and decide just how much of what they owe you is essential and how much you could reasonably lose. Then negotiate as below, because when a company goes into liquidation there are three types of creditors and which kind you are will determine just how likely you are to get all or a portion of your money back during the winding-up process.

Preferent creditors include employees of the company, who are owed wages, and of course the tax authorities.

Secured creditors are those that have liens/security on the debtor's property (such as the bank that loaned the company money to buy a factory taking a cession of debtors).

Unsecured ("concurrent") creditors include those that provided the company goods or services, such as suppliers and contractors, without taking any security. Unsecured creditors will be the last to get paid in any bankruptcy process and are therefore most likely to lose everything. Getting at least some of that back before the process begins is therefore the best you can hope for.

Once you become aware of a client's financial difficulties, making them an attractive offer may help get something into your accounts. A good offer would be to ask for a 30% payment now with an offer to extend payment on the rest to a later date. An alternative would be to ask for 50% payment now in return for wiping out the remainder of the debt. The earlier in the process you do this, the more likely you are to get something back and don't be afraid to be pushy. Keep lines of communication open and send frequent reminders. Most people feel bad about letting down their vendors and making sure you are front of mind will also encourage them to pay you out first.

A client's financial difficulties could also result in their going into business rescue. This will mean that no payments may be demanded by creditors until (if) they trade out of business rescue back into health. So being aware of how your customers are doing is essential. This also applies to your suppliers as the failure of a key supplier may be a real problem for your business.

6. Do a Cost-Benefit analysis

When your client has actually gone into business rescue or liquidation it's time for you to decide whether you are going to pursue your claim. This can be an expensive and time consuming process and the amount of debt involved will need to be measured against the costs and time chasing it.

In a practical sense, you need to look at the value of the client company, how many assets they have and what chance there is that there may actually be any money to recover. Then look at how much time and money you can spend chasing that money. Again beware of spending good money chasing after bad.

To be in line for some payment in a liquidation, you will need to submit your claims with proof at the first meeting of creditors which will be scheduled by the liquidator, which sounds like an easy decision to make. You must be careful, however, because if there are not enough assets in the company to satisfy the cost of liquidation, anybody who proves a claim at a meeting of the creditors may be called upon to contribute to the costs of liquidation. Check first with the liquidator and find out if there is a danger of a contribution being levied on concurrent creditors.

Only go as far along in the process as you are willing to, based on costs, efforts and the money you reasonably expect to recover. There is little sense spending good money to chase bad. Often your time will be better spent looking for a new client.

Alternative Funding for Your Small Business

***“When looking for funding, don't just look for cash. Look for the right people”
(American fashion entrepreneur, Jodie Fox)***

According to South African Reserve Bank data, the low level of small business financing appears to be emanating from the demand side as “the vast majority of SMEs indicate that they do not borrow from financial institutions, particularly banks”.



Statistics SA's *Annual Financial Statistics (AFS)* recorded that “Industries in the South African formal business sector, and included in the AFS survey, generated R10,5 trillion in total turnover in the 2019 financial year. ... A breakdown of turnover by business size

shows that small businesses were responsible for generating R2,3 trillion (or 22%) of the R10,5 trillion.”

There are however alternative funding options for small businesses in general, rather than the conventional method of going to the banks.

Agency funding options

These are available to small businesses with the objective of meeting certain quotas, including gender, race, regional and industrial transformation.

Examples of agency funding programmes include:

- National Empowerment Fund (NEF) services business loans from R250 000 to R75 million across a variety of industry sectors.
- Small Enterprise Finance Agency (SEFA) has a programme called the Township and Rural *Entrepreneurship* Programme (*TREP*), among others, where it finances SMMEs in townships, rural areas and farms with R350 000. R300 000 is for equipment and R50 000 working capital in a form of a grant.
- Department of Trade and Industry's (DTI) mandate is economic enlargement and Black Economic Empowerment.
- Isivande Women's Fund is a BEE and gender equality programme that provides funding from R30 000 to R2 million.
- The Small Enterprise Development Agency (SEDA)

Bootstrapping finance

Bootstrapping, also known as financial bootstrapping, describes a position in which an entrepreneur starts a company with little capital, relying on own funds rather than outside investments to build the business. Bootstrap financing techniques are often favoured by smaller businesses.

Crowd funding

Various crowd funding platforms are available online in South Africa, with the general touch points being a funding goal project description, audio visual presentation, rewards structures for backers, “jump starters” profiles and project deadlines.

The size of the crowdfunding market in South Africa is yet to be determined, even though regulators are said to still be trying to get a full understanding of the increasingly popular trend.

Although crowd funding is not specifically regulated in South Africa, certain activities may fall under various financial services regulatory provisions and legislation.

Crowd funding is also popular with crypto-assets managers, deriving from their common nature of surviving in a digital habitat.

Crowd funding classes are:

- **Debt-based crowd funding, which is** basically a loan where the investors provide funding to the recipient, which is then repaid over time with interest.
- **Equity-based crowd funding**, whereby the investors provide funding to a start-up company by subscribing for shares and these funders sign-up to only to receive dividends when the project becomes profitable.
- **Rewards-based crowd funding** has characteristics of bartering as **investors** generally make an “investment” into a business with an undertaking that allows for them to receive goods or services in return for the funding once the business has been launched successfully.

Make space for a partner

Getting a business partner comes with both advantages and disadvantages and should not be embarked on without professional advice.

Audit Your Employee Taxes, Before SARS Does

***“One of our strategic objectives is to make it easy for taxpayers to comply with their tax obligations, and hard and costly for those who willfully do not comply”
(Edward Kieswetter, SARS Commissioner)***



Earlier this year, SARS and the NPA (National Prosecuting Authority of South Africa) announced that they are joining up to deal with tax non-compliance, initially focussing on employers.

Employers under intensified scrutiny

While this enhanced collaboration covers a number of aspects, the immediate focus will be non-compliance by employers, who deduct employee taxes and levies, never turn those taxes over to SARS, and do not file their returns when required, as well as “other general corrupt activities”.

To enable the collaboration, the Criminal Investigations Division within SARS will allocate dedicated capacity and work closely with the NPA in its Specialised Tax Units (STUs). Solid cases ready for prosecution will be prepared in a coordinated manner across the country. The SARS regional leaders in criminal investigations and the NPA regional directors of the STUs will enrol these cases on a specific date for each region.

Why audit your employees’ tax?

The Tax Administration Act holds an employer liable for an amount of tax withheld and not paid to SARS, or which should have been withheld but was not withheld. The employer could also be held criminally liable for failure to withhold and pay PAYE.

SARS’ Criminal Investigations Division has already handed over 30 non-compliant employers to the NPA in their new joint venture and are working to identify and prioritise more cases.

They are further enabled by recent changes to the tax laws that effectively lowered the threshold for criminally prosecuting taxpayers through removing the requirement to prove that the taxpayer’s conduct was “wilful and without just cause” for selected offences. While previously a mistake made by a taxpayer was only a crime when it was done “wilfully and without just cause”, taxpayers can now in certain cases be convicted of an imprisonable criminal offence even if non-compliance was due to negligence or ignorance. Offences include, among others, failure to submit a return when required to do so; failure to retain all relevant substantiating records; failure to provide any information requested by SARS; or failure to disclose any material information to SARS.

This, along with SARS’ and the NPA’s intensified focus on employers, as well as SARS’ increased abilities to draw taxpayer information from third parties, make an employee tax audit a necessity.

It also protects employees. Employees’ tax is not a separate form of tax, but rather an amount that the employer is obliged to withhold in respect of the employee’s liability for normal tax. On assessment annually, the employee’s tax withheld is set off against the employee’s liability for normal tax. The correct calculations and deductions will certainly help protect employees from unexpected surprises on assessment, and will also ensure that the employer’s processes are not the cause of disputes or delays when, for example, an employee needs to claim UIF.

How to audit your employees’ tax

- An employee tax audit is a deliberate process undertaken to review payroll taxes and records, with the intention of ensuring accuracy to protect your employees as well as to comply with regulations. It is also an important part of a payroll audit.

- Verify the employee information on your payroll: Do you have the required information for each employee in respect of identifying and calculating the applicable taxes, rebates and more? For example, the employment relationship affects the classification of an employee, which in turn determines the tax rate that must be applied.
- Verify and review the remuneration for each employee: Remuneration, whether in cash or otherwise, includes any wage, salary, overtime, bonus, voluntary award, leave encashment, fee, stipend, commission, gratuity, pension, emolument, annuity, allowance, lump sum benefit payment, director's remuneration, etc. Can the remuneration be structured more tax efficiently for the employee?
- Verify that the correct taxes and levies are deducted:
 - Pay As You Earn (PAYE) must be withheld from the remuneration paid to employees, subject to thresholds and rebates.
 - Unemployment Insurance Fund (UIF) contributions, for which the monthly threshold recently (1 March) increased from a maximum of R14,872 pm (R178,464 pa) to R17,712 pm (R212,544 pa).
 - Skills Development Levy (SDL) is payable by employers with a payroll of more than R500,000 pa.
 - Employment Tax Incentive (ETI) rebates incentivise employers to employ young workers - if your company has taken advantage of the ETI rebate, these tax deductions should be verified in respect of each qualifying employee.
- Verify that the correct amounts are deducted: Both over deductions and under deductions as well as any corrections to submitted returns will certainly flag your employee tax account at SARS for audit.
 - Make sure the correct tax rate is used to withhold the correct PAYE taxes from each employee's wages, verifying that all tax thresholds, rebates, directives, tax credits, deductions, benefits, exemptions, contributions and allowances have been considered and correctly applied where appropriate.
 - UIF is calculated at a rate of 2% of remuneration (1% employee and 1% employer contribution).
 - SDL is calculated at a rate of 1% of total remuneration paid to employees, excluding certain payments such as reimbursements or severance benefits.
 - The ETI allows "eligible employers" of "qualifying employees", subject to specific criteria, to claim a rebate with a maximum value of R1,000 per month for employees earning up to R4,500 per month, with the rebate tapering to zero at the maximum monthly remuneration of R6,500. The ETI was recently extended to February 2029 and should be considered with the assistance and advice of your accountant. Employers will be able to claim the incentive for a 24 qualifying month period for all employees who qualify.
- Verify that the deducted amounts are correctly declared and remitted: The employees' taxes and levies deducted from an employee's remuneration must be declared on the Monthly Employer Declaration (EMP201) return and paid to SARS within seven days after the month end, or the previous working day if the seventh day is on a weekend or holiday. Late filing is subject to newly-introduced penalties, and late payments are subject to an immediate penalty of 10% and interest at the prescribed rate will be charged monthly on the outstanding amount.
- Employment Taxes Validation - IRP5 Certificates: An employer must furnish employees from whom employees' tax was deducted with an IRP5 certificate, within the prescribed tax period. From the 2020 year of assessment, SARS is performing tax calculations on the IRP5/IT3(a) certificates. Where the incorrect amount of tax was deducted from the employee, a letter will be issued to the

employer.

- Verify compliant employee record keeping: Employers must keep a number of specified records for each employee for a period of five (5) years and make them available for scrutiny by the Commissioner.
- Schedule regular employees' tax audits: Ideally, employers should conduct a payroll and employees' tax audit on a routine basis and certainly any time there are changes in the tax regime, the labour laws, in the business or in its internal processes.
- Professional processes: Much of a business' employee tax risk can be mitigated by putting professional processes in place. Invest in SARS-compliant automated payroll software with training for the relevant staff members and regular legal updates; or outsource your payroll and its taxes to professionals such as your accountant or even a payroll specialist.

Your Tax Deadlines for August 2021

- 7 August - Monthly Pay-As-You-Earn (PAYE) submissions and payments
- 25 August - Value-Added Tax (VAT) manual submissions and payments
- 30 August - Corporate Income Tax (CIT) Provisional Tax Payments, where applicable
- 30 August - Excise Duty Payments
- 30 August - Personal Income Tax (PIT) Provisional Tax Payments



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