

Be cautious when claiming tax allowances for future contractual expenditure

Many taxpayers have made use of Section 24C of the Income Tax Act which allows for the holding over of income received in the present year that is due to be used on expenses in the following year (until that year). As long as the income relates to the same contract that gives rise to the obligation to incur the future expenses, this allowance can be claimed.



[123rf.com](https://www.123rf.com)

The section applies if the income of a taxpayer in any year of assessment includes an amount received by him in terms of any contract, and the South African Revenue Service (Sars) is satisfied that the amount will be used to finance future expenditure which will be incurred by the taxpayer in the performance of his obligations under that contract. In these circumstances, the taxpayer is entitled to deduct an allowance in the determination of his taxable income for the relevant year of assessment and the amount of the allowance claimed in any year of assessment is deemed to be income in the following year of assessment (when it is effectively cancelled out by the expenses incurred).

Case studies

"Although originally aimed at the construction industry, section 24C may find application in a number of instances, and a number of South African companies have made use of this allowance. One such company has applied it to the income derived applying its loyalty programme which allows customers to redeem their points for free or reduced purchases later. Another has applied it to the income earned from restaurant patrons and the expenses for restaurant upkeep required by their franchise agreement. Other possible applications could include products that are sold subject to a warranty agreement," says Liesl Kruger, tax specialist at Caveat Legal.

These two companies have found themselves at odds with Sars over the applicability of the section to their business operations, and have fought through the court system right to our highest courts. The issue in dispute in both cases revolved around the requirement that the income claimed as an allowance should arise from the same contract that obliged the future expenditure.

The Constitutional Court has found that it is a requirement of section 24C that the contract in terms of which the income that is to finance future expenditure is received or accrued must be the same contract under which the expenditure is incurred. But the sameness requirement does not connote that there must, for example, in the case of a written contract, be one piece of paper stipulating for the earning of income and the imposition of future expenditure. The court held that two or more contracts may be so inextricably linked that they may satisfy this requirement.

Time will tell which of these applications will hold muster. "For now, caution should be exercised in cases where the future expenditure is required from a contract that is different to or not inextricably linked to the contract in terms of which the relevant income is received or accrued," says Kruger

For more, visit: <https://www.bizcommunity.com>