



SOUTH AFRICAN REVENUE SERVICE

**INTERPRETATION NOTE NO. 45**

DATE: 30 June 2008

**ACT : INCOME TAX ACT, NO. 58 OF 1962 (the Act)**  
**SECTION : SECTIONS 11(a) AND (e), 22(8), 23(b) AND (g), 24D AND PARAGRAPHS 20 AND 53 OF THE EIGHTH SCHEDULE**  
**SUBJECT : DEDUCTION OF SECURITY EXPENDITURE**

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**1. Purpose**

The purpose of this Note is to provide guidance as to whether security expenditure incurred by a taxpayer is deductible for income tax purposes under the existing provisions of the Act.

## 2. Background

Taxpayers incur a variety of expenditure for the purpose of preventing and combating crime in South Africa. Such security expenditure usually falls into one of the following categories:

- Expenditure of a domestic or private nature.
- Donations.
- Business-related expenditure.

This Note examines each of these categories of expenditure.

## 3. The law

**Note:** Legislative references in this Note to sections and Schedules are to sections and Schedules of the Act. Any word or expression in this Note bears the meaning ascribed to it in the Act, unless the context indicates otherwise.

The following provisions of the Act are relevant to this Note:

- Section 11(a) – general deduction formula
- Section 11(e) – wear and tear allowance
- Section 18A – deductible donations
- Section 22 – trading stock
- Section 23(b) – prohibition on the deduction of domestic or private expenses
- Section 23(g) – prohibition on deduction of non-trade expenditure
- Section 24D – security expenditure
- Paragraphs 20 and 53 of the Eighth Schedule – the base cost of assets and the disregarding of capital gains and capital losses in respect of personal-use assets respectively for capital gains tax purposes
- Part II of the Ninth Schedule – public benefit activities for purposes of section 18A

## 4. Application of the law

### 4.1 Expenditure of a domestic or private nature

Section 23(b) prohibits the deduction of domestic or private expenditure.

In *CIR v Hickson* 1960 (1) SA 746 (A), 23 SATC 243, Beyers JA said the following at 249:

“Domestic and private expenses’ are, I should say, without attempting an exhaustive definition, expenses pertaining to the household, and to the taxpayer’s private life as opposed to his life as a trader.”

Thus the cost of securing an individual’s private residence does not qualify as a deduction. Examples include defensive walls, burglar alarms, electric fences, razor wire, guard dogs, insurance, 24-hour monitoring and armed-response services.

### *Capital gains tax*

Some security expenditure may qualify as part of the base cost of immovable property held for domestic or private purposes, such as a primary residence or holiday home. Paragraph 20(1)(e) of the Eighth Schedule includes in the base cost of an asset –

“the expenditure actually incurred in effecting an improvement to or enhancement of the value of that asset, if that improvement or enhancement is still reflected in the state or nature of that asset at the time of its disposal;”.

Examples of such improvement or enhancement expenditure include the cost of installing an electric fence or the cost of a burglar alarm system which is integrated into the fabric of a building. To qualify for inclusion in the base cost of an asset, the relevant improvement must still be on hand at the time of disposal of the property.

Owners of sectional title units have an undivided share in the common property. Sometimes they are required to pay a special levy for the purpose of effecting improvements to the common property, such as the installation of a security fence. Expenditure of this nature will normally be of a capital nature as it provides an enduring benefit. Since it enhances the owner's right of use it forms part of the base cost of the sectional title unit. The same principle applies to owners of share block units who enjoy a right of use of the common property.

Movable assets, used by individuals mainly for non-trade purposes, such as firearms or private vehicle tracking or alarm systems are personal-use assets as contemplated in paragraph 53(2) of the Eighth Schedule, and capital gains and capital losses on the disposal of such assets must be disregarded.

Expenditure in respect of maintaining, repairing, protecting or insuring an asset qualifies to be included in the base cost of an asset if it is incurred wholly and exclusively for business purposes (paragraph 20(1)(g) of the Eighth Schedule).

## **4.2 Donations**

As a general rule donations are not deductible for income tax purposes.

Despite section 23(b), which prohibits the deduction of domestic or private expenditure, section 18A(1) provides for the deduction of any *bona fide* donations to –

- a public benefit organisation (PBO) approved by the Commissioner under section 30(3);
- an entity which has been approved by the Commissioner as being exempt under section 10(1)(cA)(i);
- any public benefit organisation approved by the Commissioner under section 30 which provides funds or assets to any PBO, institution, board or body contemplated in section 18A(1)(a); or
- the government, any provincial administration or municipality as contemplated in section 10(1)(a) or (b),

to be used for the purpose of any activity contemplated in Part II of the Ninth Schedule.

The protection of the safety of the general public is listed in paragraph 1(k) of Part II of the Ninth Schedule.

The deduction in respect of all qualifying *bona fide* donations is limited to 10% of the taxpayer's taxable income (excluding any retirement fund lump sum benefit) as determined before allowing any deduction of donations under section 18A or medical expenses under section 18. The donation must be supported by an official receipt issued under section 18A by the PBO, institution, board or body or the government, provincial administration or municipality concerned.

For further information in this regard refer to paragraph 13 of the *Tax Exemption Guide for Public Benefit Organisations in South Africa*, available on the SARS website [www.sars.gov.za](http://www.sars.gov.za).

### **4.3 Business-related expenditure**

#### **4.3.1 Own business expenditure of a revenue nature**

For an expense to be deductible under section 11(a), it must be –

- actually incurred,
- during the year of assessment,
- in the production of income, and
- not of a capital nature.

Conversely, section 23(g) prohibits the deduction of any moneys against income derived from trade to the extent such moneys were not laid out or expended for the purposes of trade.

Expenditure incurred in securing business premises will generally be incurred in the production of income as it is closely connected with the business operations.

Recurring costs which do not create an enduring benefit are likely to be of a revenue nature and will be deductible under section 11(a). Examples include the monthly service fees in respect of a satellite tracking system for motor vehicles, monthly payments to an armed-response company, salary costs of security personnel and the cost of food and veterinary bills for a guard dog.

Capital expenditure is not deductible under section 11(a). Characteristically it is incurred "once and for all" and creates an enduring benefit. For the tests applied in distinguishing capital and revenue expenditure, see Chapter 2 of the *SARS Comprehensive Guide to Capital Gains Tax*, available on the SARS website. Examples of capital expenditure include the cost of installing an alarm system, an electric fence and in acquiring a guard dog.

While capital expenditure is not deductible under section 11(a), it may qualify for a deduction, albeit over a period, elsewhere under the Act, for example, under section 11(e) (wear and tear allowance – see **4.3.5**) or section 24D (security expenditure – see **4.3.6**).

#### **4.3.2 Contributions to anti-crime initiatives**

Contributions to crime-prevention initiatives may take the form of –

- donations which are not deductible;
- donations which are deductible under section 18A (see **4.2**); or
- advertising or sponsorship expenditure deductible under section 11(a).

The common law meaning of a donation was summed up by Trollip JA in *Ovenstone v SIR* 1980 (2) SA 721 (A), 42 SATC 55 when he stated the following at 73:

“In a donation the donor disposes of the property gratuitously out of liberality or generosity, the donee being thereby enriched and the donor correspondingly impoverished, so much so that, if the donee gives any consideration at all therefor, it is not a donation . . .”

Sponsorship on the other hand, generally involves the support or promotion of an activity such as a sporting event in return for advertising of the sponsor’s products or services.

From an income tax perspective, the question has been raised as to whether contributions to anti-crime initiatives are deductible under section 11(a) read with section 23(g). The contributions may take the form of cash, goods and products or services rendered free of charge. In order for the contributions to qualify as a deduction under section 11(a) they must be incurred in the production of income in the carrying on of a trade, such as advertising a contributor’s business.

The treatment of the contributions will be as follows:

**(a) Cash contributions**

The deduction will be limited to so much of the contributions as the taxpayer can prove produced commercial value for the business through exposure of its name or products.

**(b) Contributions of trading stock**

The cost of trading stock generally qualifies for deduction under section 11(a) and is deductible in the year of assessment in which the trading stock was purchased.

However, section 22(8) provides for a deemed inclusion in a taxpayer’s income when trading stock has been disposed of otherwise than in the ordinary course of trade for a consideration which is not market-related. The deemed inclusion applies, for example, when trading stock is –

- donated (section 22(8)(b)(i));
- disposed of other than in the ordinary course of trade for less than its market value (section 22(8)(b)(ii)); or
- applied for any other purpose other than the disposal thereof in the ordinary course of trade (section 22(8)(b)(iv)).

In these circumstances the taxpayer is deemed to have recovered or recouped an amount equal to the market value of the trading stock (section 22(8)(B)). If, however, a donation of trading stock qualifies for a deduction under section 18A, the inclusion in income is equal to the value of the trading stock

that was taken into account during the year of assessment in question (that is, the cost price less any write down for loss in value) (section 22(8)(C)).

A taxpayer who can prove that the contribution of trading stock produced commercial value for the business through exposure of the taxpayer's name or services will be allowed a deemed deduction under paragraph (a) of the proviso to section 22(8). This could apply, for example, to the contribution of a car by a motor vehicle manufacturer as part of an anti-crime campaign.

**(c) Provision of services**

The deduction will be limited to so much of the actual cost of providing the services as the taxpayer can prove produced commercial value for the business through exposure of its name or services in any anti-crime campaign.

Examples of such services include free airtime supplied by cell phone operators, daily newspapers carrying safety and security messages including theme-related pamphlets, and operating a data centre where the public can blow the whistle on criminals.

**4.3.3 Dual-purpose expenditure**

The Act is not concerned with the method employed in advertising and promoting a taxpayer's business or products. In this regard the courts have looked at the dominant purpose of the expenditure. If a contribution is made with a dual purpose, an apportionment under section 23(g) may be made between the expenditure incurred for business purposes and that which relates to philanthropy. Any method of apportionment must be logical, fair and reasonable and take into account the facts and circumstances of the particular case.

At the time the case of *CIR v Pick 'n Pay Wholesalers (Pty) Ltd* 1987 (3) SA 453 (A), 49 SATC 132 was heard, section 23(g) required deductible expenditure to be wholly or exclusively laid out for the purpose of trade. The court had to consider whether the taxpayer's purpose was solely the promotion of its business or whether it was of a dual nature, including philanthropy.

The company made a series of donations to the Urban Foundation, an organisation concerned with the upgrading of housing and the provision of community facilities, as a means of "indirect advertising" to secure valuable publicity. The announcement of the donations had a positive effect on its turnover. The majority of the Appellate Division of the Supreme Court found that, on the probabilities, the taxpayer failed to show that in making the donation it did not have a philanthropic purpose as well as a business purpose. As a result the company's claim for a deduction was disallowed. However, based on the current wording of section 23(g) it is possible that the company may have been able to apportion the expenditure and claim the business-related part as a deduction.

In ITC 696 (1950) 17 SATC 86 (C) the taxpayer incurred expenditure in respect of the purchase of footballs which it presented to school football clubs. The footballs were inscribed with words connecting them with articles in which the taxpayer traded. The court held that the expenditure was incurred for advertising purposes and thus qualified as a deduction.

#### 4.3.4 Costs incurred in providing security to employees

##### (a) Employer

Employers sometimes incur security costs in relation to their employees such as the following:

- The cost of an armed-response service at an employee's home.
- The provision of bodyguards for employees.
- The supply of a guard to protect an employee's home or family while the employee is away on business or on leave.
- The installation of a security system at an employee's home.

From the employer's perspective these costs are simply a cost of employment or a form of insurance and should qualify for deduction under section 11(a), unless they are of a capital nature, in which case the expenditure may qualify for deduction under section 11(e) (for example, when the employer retains ownership of the asset supplied to the employee).

##### (b) Employee

**Note:** References under this heading to paragraphs are to paragraphs in the Seventh Schedule.

Security costs incurred by an employer in relation to employees may give rise to a taxable benefit in the hands of the employees under the Seventh Schedule with attendant employees' tax implications. A taxable benefit will arise, for instance, when –

- an asset is acquired by an employee from the employer or any associated institution in relation to the employer or from any person by arrangement with the employer (for example, the employer arranges to have a security system installed at an employee's home and ownership of the system passes to the employee) (paragraph 2(a));
- an employee is granted the right to use any asset for private or domestic purposes (for example, the employer installs a security system at the employee's home but retains ownership of it) (paragraph 2(b));
- any service has at the expense of the employer been rendered to the employee (whether by the employer or by some other person), and that service has been utilized by the employee for his or her private or domestic purposes (for example, the employer pays the monthly cost of an armed-response service) (paragraph 2(e)); or
- an interest-free or low-interest loan has been granted to an employee (for example, to enable the employee to erect a wall or electric fence around the employee's residence) (paragraph 2(f)).

#### 4.3.5 Wear and tear allowance

The cost or value of certain capital assets may qualify for a deduction by way of an allowance under section 11(e). In such cases the expense will usually be allowed over a number of years of assessment.

For the purposes of section 11(e), individual items costing less than R5 000 which do not form part of a set may be written off in full in the year of assessment in which the expenditure is incurred (see 2006/7 Budget Tax Proposals in terms of which the threshold of R5 000 was increased from R2 000 with effect from 1 March 2006).

Removable security systems may be written off over five years of assessment (Practice Note: No. 39 dated 10 May 1995; Draft Interpretation Note on section 11(e) issued on 1 April 2008).

Security expenditure comprising a structure or work of a permanent nature will not qualify for the wear and tear allowance under section 11(e) (paragraph (ii) of the proviso to section 11(e)). Examples of such structures include walls or electric fences around the perimeter of business premises. See, for example, ITC 773 (1953) 19 SATC 308 (C) in which the cost of erecting a partition in leased premises to protect trading stock was held to be a structure of a permanent nature, and ITC 225 (1931) 6 SATC 158 (U) in which the court held that the cost of erecting fencing was a work of a permanent nature.

Farmers are entitled to claim the cost of fencing under paragraph 12(1)(e) of the First Schedule, but the deduction is limited under paragraph 12(3) to taxable income derived from farming operations, with any excess being carried forward to the succeeding year of assessment.

#### 4.3.6 Security expenditure under section 24D

Section 24D provides a deduction in respect of certain security expenditure actually incurred by a taxpayer in a year of assessment which is not otherwise allowable as a deduction under the Act. The deduction applies to a “**National Key Point**” (NKP) as defined in section 1 of the National Key Points Act, No. 102 of 1980, or “**place**” or “**area**” which, although not declared as an NKP, has been evaluated and approved by the Minister of Defence or any person or committee appointed by the Minister as such a place or area in respect of which measures for the efficient security thereof ought to be taken by the taxpayer.

No deduction will be granted unless confirmation has been received by the Commissioner for SARS from the Minister of Defence or any person or committee appointed by the Minister to the effect that the expenditure incurred was deemed necessary or expedient (section 24D(2)(b)).

Section 24D is restrictive in its application and will therefore only be of relevance to a limited number of taxpayers.



**5. Conclusion**

In deciding whether security expenditure qualifies for a deduction the facts and circumstances of each case must be taken into account.

**Legal and Policy Division  
SOUTH AFRICAN REVENUE SERVICE**

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