



2018 Proposed Tax Amendments

Fruitless and Wasteful Expenditure

August 2018



Fruitless and wasteful expenditure to be denied deduction in your tax computation?

The Public Finance Management Act No.1 of 1999 (“PFMA”), prohibits all public entities from incurring fruitless and wasteful expenditure. Fruitless and wasteful expenditure is defined in the PFMA as any expenditure that was made in vain and would have been avoided had reasonable care been exercised.

The PFMA requires a public entity to take effective and appropriate disciplinary steps against any employee of the public entity who makes or permits fruitless and wasteful expenditure. Effective and appropriate steps include any actions by the public entity to recover such fruitless and wasteful expenditure from the offending employee including criminal prosecution.

Section 11(a) of the Act makes provision for the deduction of expenditure actually incurred in the production of income, provided such expenditure is not of capital nature. Section 23 of the Act read with section 11(a) however makes provision for a limitation of deduction of certain types of expenditure, including expenditure that constitutes a corrupt activity as defined in the Prevention and Combating of Corrupt Activities Act No.12 of 2004 or expenditure that constitutes a fine or penalty imposed as a result of an unlawful activity.

Fruitless and wasteful expenditure incurred in the production of income and may qualify for deduction in terms of section 11(a) read with section 23 of the Act.



Proposed Amendments

Government through its continuing efforts to ensure proper governance of public entities has prioritised measures aimed at curbing of fruitless and wasteful expenditure. In order to encourage further accountability, it is proposed that any expenditure determined and reported by a Public Entity as fruitless and wasteful expenditure in terms of the PFMA should not be allowed as a deduction in the determination of that Public Entity’s taxable income.

It is also proposed that as a measure to ensure tax neutrality in the legislation, that any amount of fruitless and wasteful expenditure that was not allowed as a deduction and was recovered by the public entity be deemed to be exempt from income tax during the year of assessment in which it is received or accrued.

The effective date of the proposed change is 1 April 2019 and will apply in respect of years of assessment commencing on or after that date.

Practical Challenges of the Proposed Amendment



Fruitless and wasteful expenditure discovered a year(s) after being included as a deduction

Fruitless and wasteful expenditure in certain circumstances are only detected after the fact and well after the year of assessment, and in some instances it may even be detected in subsequent years of assessment. The practical challenge in respect of the proposed amendment is applicable to instances where fruitless and wasteful expenditure is only discovered a year or years after it was incurred and included in tax deductions where it qualified for section 11(a). Clarity will need to be sought on whether the public entities will be required to reopen prior period’s tax returns to correct the fruitless and wasteful expenditure claimed or they will be allowed to add the expenditure as non-deductible in the year it is discovered and reported by the public entity.

Financially challenged public entities

Certain public entities incur interest on late payments to creditors due to financial and cash flow constraints. This interest is classified as fruitless and wasteful expenditure in terms of the PFMA. Clarity will need to be sought on what measures will be put in place to not further burden these public entities in terms of the financial and cash flow constraints already experienced.



Conclusion

We applaud the efforts that Government is making to ensure proper governance of public entities and specifically the measures implemented that aimed at curbing of Fruitless and wasteful expenditure.

Although these efforts encourage further accountability, it is our opinion that the proposed amendment whereby any expenditure determined and reported by a Public Entity as fruitless and wasteful expenditure in terms of the PFMA should not be allowed as a deduction in the determination of that Public Entity's taxable income will not alone resolve the governance issues in the public sector.

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