The tax implications of 'fruitless and wasteful expenditure'

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One of the proposals in the Budget Review 2018 (Budget) to preserve a sustainable tax base is to disallow fruitless and wasteful expenditure by government entities.

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The Budget candidly notes that poorly governed and administered public entities are a burden to the fiscus due to the substantial costs of operational inefficiencies and financial mismanagement. Media reports over the last few years have echoed this, and, increasingly, notes that public entities, in particular, are plagued by fruitless and wasteful expenditure.

As it stands, the Income Tax Act 58 of 1962 (ITA) does not use the term "fruitless and wasteful expenditure" in any of its provisions, nor does it contain a tailored fiscal mechanism to penalise public entities for that specific mischief. The Public Finance Management Act 1 of 1999 (PFMA), in contrast, defines fruitless and wasteful expenditure as "expenditure which was made in vain and would have been avoided had reasonable care been exercised". Yet it appears that the applicable sanctions imposed by the PFMA are not wholly effective in addressing this rampant disorder.

As part of its stated efforts to undo the ill effects of corruption on tax morality and in order to repair domestic confidence in public entities, the Budget proposes to disallow income tax deductions available to public entities (listed in Schedules 2 and 3 of the PFMA), in instances where losses and expenditure are classified as fruitless and wasteful. Whether terminology similar to that of the PFMA will be introduced to the ITA, which specific types of expenditure will be targeted and what test(s) will be employed to determine whether the expenditure is fruitless and wasteful, remains to be seen.

It is possible that proposed amendments to the ITA to give effect to this proposal will be circulated for comment in the 2018 draft tax amendment bills. However, given the scope for political sensitivities it is also possible that a thorough consultation process involving the relevant Ministries and public entities will first be undertaken. We submit that if the latter route is followed, National Treasury would be well served by keeping the public informed on progress and not allow this opportunity to become obscured by political wrangling.

In any event, this is an encouraging proposal, which will hopefully be realised soon in the form of a clear and practical fiscal remedy to address a very prevalent and harmful ill hampering the proper functioning of many public entities.

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