

Related Finance Charges vs Similar Finance Charges: How Broadly Will the New Definition of Interest Be Interpreted?

By Johan Kotze, Tax Executive

The definition of 'interest' under section 24J of the Income Tax Act No. 58 of 1962 refers to 'interest or **related** finance charges'. The Supreme Court of Appeal has interpreted the word 'related' widely, including guarantee fees, facility fees, and even legal fees for drafting financing documents.

Under the Taxation Laws Amendment Act No. 15 of 2016 (promulgated on 19 January 2017), the word 'related' is now to be substituted by the word 'similar', so that the definition of interest will read 'interest or **similar** finance charges'. The draft Explanatory Memorandum states that this is to clarify 'the policy position that this applies to finance charges of the same kind or nature.' This change is more than likely to narrow the courts' previous interpretations.

So, what is now meant by the word: 'similar'? Words such as 'similar' and 'related' are rather imprecise and would depend on the context in which they are used. 'Similar finance charges' and 'related finance charges' would in practice not be materially distinguishable, and whether the meaning of 'related finance charges', as ascribed to it in case law, will now be curbed, is debatable.

In the case of *Genn* (20 SATC 113), Schreiner JA held that no distinction, in principle, could be drawn between the interest paid to the actual lenders of the moneys borrowed and the raising fees paid to the company which arranged the loans. Does this mean that raising fees is interest, or that it falls within the ambit of interest? If so, then raising fees are not affected by the amendment.

More recently, in case of *South African Custodial Services (SACS)* (74 SATC 61), Plasket AJA has given the term 'related finance charges' an extremely wide interpretation, including not only the cost to bid for a tender, but also the cost to raise the loans, and held that 'because of their close connection to the obtaining of the loans and the furtherance of SACS's project, they qualify as 'related finance charges' for purposes of the section'.

In *South African Custodial Services (SACS)* (74 SATC 61), to make sure that the expenses in issue had in fact been incurred in the relevant tax year, the matter was referred to SARS. The order issued stated that 'the assessment is referred back to the Commissioner for him to determine the amount that is deductible from the appellant's income in terms of s 11(bA) of the Income Tax Act 58 of 1962.' Upon being referred back, SARS did not accept that a 'further costs' category of R64 million was to be included in 'related finance charges' and the matter proceeded to Tax Court (ITC 1870, 76 SATC 97) to clarify Plasket's judgment in the Supreme Court of Appeal. 'Further costs' in this case comprised inter alia of bid expenses, developer fees, legal fees, insurance, start-up costs, specialist advocate costs and lenders technical advisors' costs. SACS submitted that these items had the character of 'related finance charges'.

SACS contended that once the matter had been referred back, the Commissioner was not at large to disallow the deduction of R64 million as his role was limited to the timing issue of whether the expenses had been incurred in the relevant year as per the principle enunciated in *Caltex Oil (SA) Ltd v SIR* (37 SATC 1). If any doubt existed as to the ambit of Plasket's reference to 'further costs' or the phrases 'to bid for the tender', 'to raise the loans' or 'their close connection to the obtaining of the loans and the furtherance of SACS's project', it was clarified by Victor J in the Tax Court when she agreed with the taxpayer.

It is submitted that the term '*related finance charges*', wherever used in the Income Tax Act, should be afforded the same meaning. The only question is how a court will interpret '**similar** finance charges' and whether it will still be as widely interpreted as in SACS's case. It is also not clear whether this amendment will be applicable to existing instruments at the time of the amendment or only to instruments issued, acquired or transferred on or after the date of promulgation - probably the latter.

For more information on the above, please contact:

Johan Kotze

Executive in the Tax Department

Shepstone & Wylie Attorneys

jkotze@wylie.co.za

+27 11 290 2540