

RELAXATION OF TAX LAW ON INTEREST by Jonathan Hore

Ever since the enactment of Income Tax Amendment Act 38 of 2018 in December 2018, interest deductions for companies were capped through a rather technical formula which refers to 30% of what is known as Tax EBITDA. Any excess interest determined by such formula would technically be added back to profits and increase the tax costs of companies. Following the said amendment, there was a lot of debate and anxiety in business about the possibility of the law slowing down business growth through discouraging borrowing. Technically, the law precluded, effective 1 July 2019, the tax deduction of 100% of interest expenses for companies, including productive interest such as for expansion and acquisition of property. The only two groups of taxpayers who were not affected by this law were banks and insurance companies.

MORE EXEMPTIONS

The anxiety mentioned above is partially over, at least for some companies, following the enactment of a relaxed law on 28 August 2018 which increased the persons exempted from the interest limitation. Whilst the new law is to commence on a date to be announced by the Minister of Finance and Economic Development through the government gazette, its enactment brings relief by expanding the interest limitation exemptions list to include variable rate loan stock companies (VRLSCs) and small, micro and medium businesses (SMMEs). The interest expense for such businesses will not increase their tax costs as it will not be limited. VRLSCs are companies specifically set-up to build massive properties such as Airport Junction, Riverwalk and Game City and by nature, incur excessive interest.

SMMEs are defined in the new law as companies which do not own 20% shares or more in another company or have another company owning at least 20% of their shares. In other words, SMMEs are companies which do not belong to a group of companies and their interest expenses will also not be limited. However, those companies which belong to groups will have the interest limited. There will not be any interest limitation for those which do not breach the 20% shareholding, i.e. for shareholding which is below 20%.

EFFECTS OF AMENDMENT

The amendment to the law allays fears that there was going to be a slowdown in property development or as some of the affected companies had hinted, that they could possibly only embark on expansions outside the country, which could stifle economic growth. Further, exempting VRLSCs, most of which are registered on the BSE means that they remain as profitable as they were before the introduction of the December 2018 law, preserving their share value. If the law had been maintained as it was, their shareholding, technically called linked units could crumble due to excessive tax costs, which could potentially affect their trading on the bourse. This could also negatively affect further property developments as such companies would fail to attract investors.

On the other hand, it is well known that SMMEs play a pivotal role in any economy as they are known to be the largest employer, employing more people than large enterprises. The amendment of the law recognises the critical role that the SMMEs play in employment and wealth creation. If the law was not amended to exclude SMMEs from the interest limitation, that would have compounded their operational challenges, which also include access to finance.

CONSEQUENCES

Since SMMEs are no longer affected by the law and any group company will still be required to limit interest deductions, it is likely that corporates could reconsider their group arrangements, if the tax bills bite. Some may have to sell off their shareholding to qualify as SMMEs so that their tax bills remain in check. The new amendment, whilst welcome, may mean that within the same group, some group entities will have their interest expenses limited whilst some will not, depending on the shareholding structure. This calls for careful consideration of the impact of the laws on the group companies for businesses belonging to groups.

It is also possible that some who still feel that their businesses require significant financing such as mines and other property developers other than VRLSCs may still lobby for their inclusion under the exempt entities. This would also bring about positive growth prospects for them.

Without doubt, the new law generally increases tax costs for heavily borrowed companies which are not included under the exemptions list. This will effectively result in more tax bills and reduced dividends to shareholders. Those listed on the BSE may find their shares losing value as tax costs spike. It is also undeniable that the taxman will pocket more taxes as a result of the limitation of the interest deductions.

Disclaimer: This article is of a general nature and is not meant to address the particular matters of any person. Tax advice is recommended if decisions are to be made.