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South African Revenue Service
Private Bag X923
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BY E-MAIL: policycomments@sars.gov.za

Dear SARS

COMMENTS ON THE PROPOSED WITHDRAWAL OF PRACTICE NOTE 31 OF 1994

We herewith present the comments of the South African Institute of Chartered Accountants (SAICA) on the SARS Notice of its proposed withdrawal of Practice Notes 31 and 37, with effect from years of assessments commencing 1 March 2023.

We set out below our overarching and specific comments in this regard.

1. On 17 November 2022 SARS noted its intention to withdraw Practice Note (PN) 31 of 1994 "Interest paid on Moneys Borrowed" and Practice Note (PN) 37 of 1995 "Deduction of Fees Paid to Accountants, Bookkeepers and Tax Consultants for the completion of Income Tax Returns".

2. Practice Note 31 "Interest paid on monies borrowed" was issued on 3 October 1994 and confirmed SARS' practice of allowing interest incurred in financing the production of interest income as a deduction but limiting the deduction to the amount of that income. Any excess interest incurred was forfeited.

3. We believe that this was done in fairness by SARS in matching income and expenses for tax rather than being just legally technical, which we supported.

4. The reason provided for the withdrawal is the increasing abuse of the concession in PN31 where taxpayers have relied on the PN as a means to structure transactions or undertake transactions in order to obtain a deduction of interest or expenditure incurred, which would not otherwise have been allowed as a deduction under the Income Tax Act. Transactions are structured to maximise the deduction of interest or other expenditure incurred using PN 31 whilst there is no corresponding inclusion in gross income for the recipient. This is achieved where the transactions are concluded with either exempt or non-resident taxpayers.

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5. Notwithstanding the increasing abuse noted by SARS in its withdrawal notice, many taxpayers have over the years made use of PN 31 in the manner originally envisaged by SARS.

6. For example, if a taxpayer borrows an amount at say 10% interest from a person who is taxed on this interest as income, and on-lends the amount borrowed at say 8%, if PN 31 is withdrawn there will be no mechanism for such taxpayer to obtain a tax deduction for the interest incurred. This is manifestly unfair as the interest income would have been fully subject to tax in the hands of all recipients of interest income. To deny a deduction to the taxpayer in these circumstances would create an unfair distortion.

7. The above example is merely one illustration of a business situation faced by many group companies. To simply remove PN31 without allowing a deduction in these circumstances would detrimentally affect the cost of doing business in SA for many groups of companies in this position, who rely on PN31 for what is simply equitable treatment.

8. As recommended by the SARS Notice, we made representations to National Treasury for legislative amendments as part of the Budget 2023 Annexure C process.

9. Our submission in this regard called for a legislative amendment providing for the insertion of a separate section in the Act codifying the principles laid down in Practice Note 31 (i.e. the deduction of interest and other expenditure incurred in the production of such interest income). This new provision would also include targeted anti-avoidance measures to address the abuse noted by SARS.

10. While the withdrawal of the Practice Note is understood, it is worth noting that a large number of investments and financing arrangements were entered into on the assumption that the Practice Note would continue to apply.

11. Should PN 31 be withdrawn prior to the enactment of a legislative provision allowing for the aforementioned deduction of interest expense, certain investment vehicles making use of it will immediately experience significant financial difficulties due to the increased tax burden arising from the disallowance of the interest deduction.

12. It must be appreciated that this sudden tax burden was not accounted for at the time these financial transactions were formulated and entered into.

13. A lot of these investment arrangements may need to be unwound as they may no longer be financially viable.

14. Furthermore, SARS has effectively given the business community only four months from the issuance of the notice of intent to withdraw, to March 2023.

15. This is an insufficient amount of time to allow industry to adapt to the proposed withdrawal and make alternative arrangements to the structures already in place.

16. Submission: The withdrawal of Practice Note 31 should be suspended until National Treasury has enacted a provision allowing for the deduction of interest expenditure incurred in the production interest income derived otherwise than in the carrying on of a trade, with the interest expense so claimable being limited to the related interest produced by such interest expense and any excess being forfeited.

Conclusion

17. We once again thank SARS for the ongoing opportunity to provide constructive comments in this regard. SAICA continues to believe that a collaborative approach is best suited in seeking solutions to complex challenges and should you wish to clarify any of the above matters please do not hesitate to contact us.

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Yours sincerely

Lesedi Seforo
Project Director: Tax Advocacy

The South African Institute of Chartered Accountants