November 2022

Withdrawal of Practice Note 31

The South African Revenue Service (SARS) has announced that it plans to withdraw Practice Note 31 for years of assessment commencing on or after 1 March 2023. The proposed withdrawal of the long-standing Practice Note will have far-reaching consequences for taxpayers such as investment holding companies incurring interest expenditure.

The deduction of interest is provided for in section 24J of the Income Tax Act No. 58 of 1962 (**the Income Tax Act**). A crucial element for deductibility is that the income against which the deduction is sought, must be income derived from the carrying on of a trade. Whilst the term 'trade' is widely defined in the Income Tax Act, case law has confirmed that the mere holding of investments does not constitute a trade. Thus, by way of common example, investment holding companies that merely hold shares in subsidiaries and act as a conduit for loan funding would ordinarily not be regarded as carrying on a trade. These companies (and other persons who act in a passive capacity and have no trade) would therefore not qualify for a deduction in respect of any interest incurred on loans advanced to them. Interest accrued on loans advanced by these taxpayers would however remain taxable.

Practice Note 31, issued on 3 October 1994, provides much needed relief from this inequitable position. Notwithstanding the fact that a taxpayer may not be carrying on a trade, Practice Note 31 allowed a deduction of "expenditure incurred in the production of the interest to the extent that it does not exceed such income".

SARS intends to withdraw the Practice Note as a result of the abuse of the concession.

The withdrawal of Practice Note 31 without the contemporaneous introduction of legislation or a binding general ruling to allow for the deduction of interest where interest is earned by a taxpayer who is not carrying on a trade, would have a significant impact on these taxpayers.

SARS has invited comment on the proposed withdrawal by 15 December 2022. In addition, National Treasury is currently accepting proposals for legislative amendments as part of the annual Annexure C process which closes on 30 November 2022.

KPMG will be making submissions both to SARS and National Treasury. In the interim, it may be prudent for taxpayers to review their investment holding structures to identify any entities that are reliant on Practice Note 31 and assess whether it is possible to restructure the funding. KPMG has a highly skilled team of professionals who would be able to assist taxpayers in this regard.

Lesley Bosman
Associate Director
Corporate Tax
M: +27827195523
Lesley.Bosman@kpmg.co.za

Carl Nel
Director
Tax Management Services
M: +27827195611
Carl.Nel@kpmg.co.za

kpmg.com/socialmedia

kpmg.com/app