CHARTERED ACCOUNTANTS
PHYSICAL 1st FLOOR, 67 FLORIDA ROAD, DURBAN, KWAZULU NATAL, SOUTH AFRICA
POSTAL PO BOX 48619, QUALBERT 4078
TEL + 27 31 303 6130 FAX + 27 31 303 4399
EMAIL global@sjcasa.co.za WEB www.sjcasa.co.za

MoneyTalk

SARS taking aim at corporate interest-free loans

THE SOUTH African Revenue Services (SARS) is on the interest free loan offensive, and corporate business could face millions in tax if their loan contracts are not properly structured.

There is definitely a shift in SARS' view of intra-company loans and a recent court case is an indication that SARS has been quick to implement its draft interpretation note issued in the fourth quarter of 2008.

This interpretation note sets out how SARS intends to implement new tax principles that were confirmed in the well-documented court case of SARS vs. Brummeria Renaissance 2007.

In that court case it was confirmed that the right to use loan capital free of interest had a monetary value, and although the value of this right could not necessarily be realized in physical money, it should nevertheless be included in the gross income of the tax payer in the year of assessment in which it was accrued.

SARS will apply these "Brummeria Principles" in all cases where the right to use an interest free loan is granted in exchange for (or as a *quid pro quo* for) goods supplied, services rendered, or any other benefit given.

This receipt or accrual in a form other than money will have to be valued and included in the taxpayer's gross income for the year of assessment in which it was received or accrued.

The method of deciding the value of the loan should be done objectively, taking into account the facts and circumstances of the loan and the intention of the lender and borrower.

Complicating matters further is that SARS points out that applying the average weighted prime overdraft rate applicable for the relevant year (as was done in Brummeria) does not necessarily mean that this will always be the most appropriate method of valuing a right to use an interest-free loan.

Furthermore, if the shareholder of group-company that grants the loan does not necessarily intend there to be an exchange of goods, services, or any other benefit, then the Brummeria principles do not apply. For example, if a holding company were to provide an interest-free loan to a subsidiary to invest as capital expenditure, it would not attract tax. However if, in exchange for the interest-free loan, the holding company required either goods or services in return without a charge or fee, then this would be deemed to be taxable.

Companies found to be contravening these tax principles could face substantial tax bills, as the taxable portion of the deemed interest to be recouped will be assessed at the interest rate applicable at the time the interest free loan was granted.

Through careful tax planning and by being risk aware, companies can ensure that they do not fall foul of these principles.

Copied from a Moneyweb publication by Madelaine Schubert.

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