



Tax & Legal Flash



Tax Considerations of a Reduction in the Repo Rate

The South African Reserve Bank announced on 14 April 2020, a cut in the repo rate by 100 basis points (i.e. 1%) effective, 15 April 2020. This was the second interest rate cut in less than a month, following a 1% interest rate cut in mid-March this year and the third interest rate cut for the calendar year (the first interest rate cut being in January 2020). The latest reductions were part of the necessary measures taken to counter the negative economic impact that the COVID-19 pandemic is having on an ailing South African economy. What is the tax impact of an interest rate cut?

Impact for taxpayers

There are various provisions contained in the Income Tax Act 58 of 1962 (“the Income Tax Act”) that rely on or make reference to the repo rate in the determination of the taxable income of a taxpayer.

Most notably, the reduction in the repo rate could have a significant impact on the calculation of the interest limitations provided for in sections 23M and 23N of the Income Tax Act. These sections seek to add back otherwise deductible interest expenditure where the amount exceeds the limitation calculated.

Tax treatment of interest deductions and other financial payments are a focus area for the South African Revenue Service (“SARS”) as evidenced by the recent budget proposals. In this regard, taxpayers should be mindful of repo rate movements when

preparing various tax calculations (including but not limited to thin capitalisation impact, section 23M and 23N calculations).

Due to the fact that the repo rate is one of the key variables in determining the interest limitation, we recommend that forecasted calculations are performed to determine the impact thereof on taxable income and consequently the estimated taxable income, especially due to the potential impact that this could have on provisional tax calculations and hence cash flow. Any underestimation of provisional tax could result in potential penalties and interest being levied by SARS.

KPMG Tax and Legal has a strong team that has extensive experience in performing these forecasted calculations that can thereafter be used for the final tax return submission.

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Regards

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