



# Tax & Legal - News Alert

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## Deduction of expenses incurred in the production of interest

### New legislation addresses expenditure incurred by companies that are not trading

As a general rule, the deduction of expenditure requires that the amount is incurred in the production of income and in the course of carrying on a trade. This test is problematic where a taxpayer incurs expenditure in the production of income but does not carry on a trade. Relief has historically been offered to such taxpayers through Practice Note 31 (PN 31). The South Africa Revenue Service (SARS) intends to withdraw PN 31. The Draft Taxation Laws Amendment Bill, 2023 (the DTLAB) proposes legislative intervention to address the inequitable position that would result from the withdrawal of PN 31.

PN 31 allows for a deduction of expenditure incurred by a taxpayer who does not carry on a trade up, to amount of any interest income earned by the taxpayer. In November 2022, SARS announced its intention to withdraw PN 31 ([see Tax Alert dated November 2022 titled Withdrawal of Practice Note 31](#)). The withdrawal of PN 31 would result in the position where e.g. an investment holding company, which raises interest-bearing funding for purposes of on lending the funding, would be taxed on any interest received but would not be able to claim a deduction in relation to the interest incurred.

The DTLAB released on 31 July 2023 proposes the introduction of a new section 11G which allows for the deduction of expenditure in circumstances where the taxpayer is not trading. The provisions of section 11G are however narrower than PN 31. The deduction will only be available to companies and can only be claimed against interest income accruing in respect of a loan advanced to another company that forms part of the same group of companies<sup>[1]</sup>. The deduction is limited to the amount of interest income accruing from the loan advanced to the group company.

Section 11G will come into operation on 1 January 2024 and will apply in respect of years of assessment ending on or after that date. It remains to be seen whether SARS will align the timing of the withdrawal of PN 31 with the effective date of section 11G.

It was noted that the wording of the proposed section 11G differs from the requirements listed in the Explanatory Memorandum (EM) which accompanied the DTLAB. The EM requires that the group company who obtains the funding from the taxpayer (also within the same group), use the funding for "purposes of its trade to produce income". To the extent the intention of the EM is carried through and contained in the final wording of section 11G, this could result in tax leakage in tiered funding structures.

KPMG will be making submissions to National Treasury by 31 August 2023. In the interim, it may be prudent for taxpayers with tiered holding structures to identify entities and related arrangements which may be impacted by the proposed legislative changes and assess whether it is possible to restructure the related funding arrangements.

KPMG has a highly skilled team of professionals who would be able to assist taxpayers in this regard.

**For more information and assistance, please contact:**



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[1] As defined in section 1(1) of the Income Tax Act.

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