

# **THE INTERACTION BETWEEN THE INTEREST DEDUCTIBILITY RULES CONTAINED IN THE INCOME TAX ACT 58 OF 1962**

by

**SHIRLEEN RITCHIE**

**(Student number: u04353986)**

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Supervisor:      Doctor Benjamin Kujinga

**Executive Summary:**

This dissertation considers the conceptual interaction between section 23M and section 31 of the Income Tax Act, 1962. Both sections limit tax deductible interest expenditure paid to non-resident related persons based on specific requirements.

The dissertation establishes the ambit of each section by relying on an interpretive guide, which takes into account three aspects of interpretation. These three aspects are: the ordinary grammatical meaning of the words comprising each section; the contextual understanding of each section; and the purpose of each section.

The dissertation determines that there is an overlap in the ambit of section 23M and section 31 in respect of the taxpayer to which each section applies, interest as determined for purposes of the common law and the purpose of each section, being to prevent tax base erosion through excessive interest rate deductions.

Despite the presence of an overlap, a taxpayer falling within the ambit of both sections is always limited to a deduction equal to the smaller answer yielded by section 23M or section 31. However, in respect of the carry-forward in section 23M(4) there is uncertainty as to the calculation of the carry-forward.

The dissertation recommends an amendment to section 23M(4) to clarify the calculation of the carry-forward amount. In the absence of a carry-forward, the dissertation determines that a possible interpretational solution may be to calculate the carry-forward with reference to actual interest expenditure and to subject any deduction in respect of an amount carried forward to section 31 in the year of assessment during which a deduction is claimed.

## TABLE OF CONTENTS:

<b>LIST OF APPENDICES .....</b>	<b>5</b>
<b>LIST OF DEFINITIONS .....</b>	<b>6</b>
<b>CHAPTER ONE: INTRODUCTION .....</b>	<b>7</b>
I. OVERVIEW .....	7
II. PROBLEM STATEMENT .....	9
III. RESEARCH OBJECTIVE .....	10
IV. RESEARCH METHODOLOGY .....	10
V. CHAPTER OUTLAY .....	10
VI. LIMITATIONS OF THIS STUDY .....	11
VII. CONCLUSION.....	12
<b>CHAPTER TWO: THE DEVELOPMENT OF BEPS AND THE SOUTH AFRICAN RESPONSE.....</b>	<b>13</b>
I. INTRODUCTION .....	13
II. INTERNATIONAL RESPONSE TO BASE EROSION AND PROFIT SHIFTING.....	13
III. THE SOUTH AFRICAN RESPONSE TO BASE EROSION AND PROFIT SHIFTING.....	15
IV. CONCLUSION.....	18
<b>CHAPTER THREE: INTERPRETING FISCAL LEGISLATION .....</b>	<b>19</b>
I. INTRODUCTION .....	19
II. INTERPRETATION OF STATUTES .....	19
III. INTERPRETATION OF FISCAL STATUTES.....	21
IV. INTERPRETATION OF SPECIFIC ANTI-AVOIDANCE PROVISIONS .....	23
V. CONCLUSION.....	25
<b>CHAPTER FOUR: THE AMBIT OF SECTION 23M AND SECTION 31 .....</b>	<b>27</b>
I. INTRODUCTION .....	27
II. THE AMBIT OF SECTION 23M .....	27
a) <i>Ordinary grammatical meaning of words</i> .....	28
b) <i>Contextual indicators</i> .....	32
c) <i>The mischief targeted by section 23M</i> .....	34
III. THE AMBIT OF SECTION 31 .....	35
a) <i>Ordinary grammatical meaning of words</i> .....	35
b) <i>Contextual indicators</i> .....	39
c) <i>The mischief targeted by section 31</i> .....	40
IV. INTERRELATIONSHIP BETWEEN SECTION 23M AND SECTION 31 .....	41

a)	<i>The taxpayer</i> .....	42
b)	<i>The related party test</i> .....	43
c)	<i>The definition of interest</i> .....	43
d)	<i>The disallowance</i> .....	44
e)	<i>The purpose</i> .....	45
V.	MATHEMATICAL REPRESENTATION OF THE APPLICATION OF SECTION 23M AND SECTION 31 .....	46
a)	<i>Scenario 1:</i> .....	47
b)	<i>Scenario 2:</i> .....	48
VI.	CONCLUSION.....	49
<b>CHAPTER FIVE: COMMON LAW PRESUMPTIONS AS PART OF STATUTORY INTERPRETATION.....</b>		<b>52</b>
I.	INTRODUCTION .....	52
II.	PRESUMPTIONS PERTAINING TO FISCAL STATUTES.....	54
a)	<i>The legislator is presumed not to have intended an unfair, unjust or unreasonable result</i> .....	54
b)	<i>Contra fiscum</i> .....	55
c)	<i>Presumption that legislation does not intend to change the existing law more than is necessary</i> .....	56
d)	<i>Generalia Specialibus non derogant</i> .....	57
e)	<i>Presumption that legislation is consistent with international law</i> .....	59
III.	CONCLUSION.....	61
<b>CHAPTER SIX: LIMITATIONS ON TAX DEDUCTIBLE INTEREST EXPENDITURE IN THE UNITED KINGDOM.....</b>		<b>64</b>
I.	INTRODUCTION .....	64
II.	RELEVANT LEGISLATION .....	64
a)	<i>Thin capitalisation</i> .....	64
b)	<i>Debt limitation rules</i> .....	65
III.	CONCLUSION .....	68
<b>CHAPTER SEVEN: CONCLUSIONS AND RECOMMENDATIONS.....</b>		<b>70</b>
I.	SUMMARY OF FINDINGS .....	70
II.	CONCLUSIONS .....	72
III.	SUMMARY OF CONTRIBUTIONS .....	74
IV.	RECOMMENDATION .....	74
<b>BIBLIOGRAPHY .....</b>		<b>76</b>

## LIST OF APPENDICES

- Appendix "A": South Africa Treaty Withholding Rates Table, effective as at 1 January 2014 and based on information up to 1 July 2015, published by the IBFD.
- Appendix "B": Complete wording of section 23M.
- Appendix "C": Complete wording of section 31.
- Appendix "D": Calculations showing application of section 23M and section 31 based on assumptions to illustrate the limitations on tax deductible interest expenditure.
- Appendix "E": The comprehensive definition of "connected persons" as contemplated in section 1 of the Act.
- Appendix "F": Part 4 of TIOPA.
- Appendix "G": Part 7 of TIOPA.

## LIST OF DEFINITIONS

<b>"the Act"</b>	: means the Income Tax Act 58 of 1962;
<b>"Action Plan"</b>	: means the Action Plan contemplated in the OECD Action Plan on Base Erosion and Profit Shifting published by the OECD;
<b>"BEPS"</b>	: means Base Erosion and Profit Shifting;
<b>"draft Interpretation Note"</b>	: means the draft Interpretation Note setting out the guidelines in respect of section 31 issued by the SARS for comment on 3 April 2013;
<b>"DTC"</b>	: means the Davis Tax Committee;
<b>"HMRC"</b>	: means Her Majesty's Revenue and Customs Authority, being the revenue authority of the United Kingdom;
<b>"ITC"</b>	: means Income Tax Case reported as a judgment issued by the Tax Court;
<b>"National Treasury"</b>	: means the Department of National Treasury;
<b>"NDP"</b>	: National Development Plan: Vision for 2030, issued by the South African National Planning Commission;
<b>"OECD"</b>	: Organisation for Economic Co-operation and Development;
<b>"Practice Note"</b>	: means Practice Note 2 issued by the SARS on 14 May 1996 setting out the transfer pricing and thin capitalisation guidelines, including addendum;
<b>"SARS"</b>	: South African Revenue Service or the Commissioner of the South African Revenue Service;
<b>"section"</b>	: means a section of the Act, unless otherwise specified expressly or by necessary implication;
<b>"SCOF "</b>	: means the Standing Committee on Finance, a parliamentary committee;
<b>"TIOPA"</b>	: means the United Kingdom Taxation (International and Other Provisions) Act, 2010;
<b>"UK"</b>	: means the United Kingdom; and
<b>"ZAR"</b>	: South African Rand being the legal currency of the Republic of South Africa.

## CHAPTER ONE: INTRODUCTION

### I. OVERVIEW

The famous 1776 discourse by Adam Smith entitled "An Inquiry into the Nature and Causes of the Wealth of Nations"<sup>1</sup> concludes that:

"All nations have endeavoured, to the best of their judgment to render their taxes as equal as they could contrive; as certain, as convenient to the contributor, both in the time and in the mode of payment, and in proportion to the revenue which they brought to the prince, as little burdensome to the people."

One of the founding principles of the Constitution of the Republic of South Africa, 1996, is the rule of law as set out in section 1(c). The rule of law assures that laws enacted and applied in the Republic will be clear and that the state will be bound by enacted laws.<sup>2</sup>

It is the right of every nation to impose taxation for the use and exploitation of its resources.<sup>3</sup> The system by which the taxes are imposed and deductions are allowed against income earned must however form a coherent whole in support of the revenue collection function.<sup>4</sup> One of the objectives of the South African Revenue Service ("SARS") is to collect revenue in a cost-efficient and effective manner.<sup>5</sup>

The ability of multinational enterprises to structure operations across multiple jurisdictions impedes the ability of local tax authorities to impose a meaningful effective tax burden on income economically attributable to resources located in their jurisdiction. This ability to shift profits and erode tax bases results in additional revenue pressure on governments that leads to increased taxation of individuals and local

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<sup>1</sup> Emslie, T and Davis, D. 2011. Income Tax: Cases and Materials. Third Edition (including a First and Second Supplement). Chapter 1: An Inquiry into the Nature and Causes of the Wealth of Nations, 1776, Book V Chapter II. Page 1.

<sup>2</sup> Currie, I and de Waal, J. 2009. The Bill of Rights Handbook. Fifth Edition. Juta & Co Ltd: Cape Town. Page 10.

<sup>3</sup> Organisation for the Economic Co-operation and Development. 2013. Action Plan on Base Erosion and Profit Shifting. <http://dx.doi.org/10.1787/97892642022719-en>. Page 9.

<sup>4</sup> Emslie, T and Davis, D. 2011. Income Tax: Cases and Materials. Third Edition (including a First and Second Supplement). Chapter 1: The Meade Committee Report. Page 3.

<sup>5</sup> South Africa. South African Revenue Services Act, 1997. Sections 2 and 3.

businesses. An increased tax burden on local business hampers the ability of such business to compete meaningfully against foreign multinational companies.<sup>6</sup>

Interest<sup>7</sup> is deductible for tax purposes in terms of section 24J of the Income Tax Act, 1962 ("the Act") against income derived from trade, provided that the interest is incurred in the production of income. Interest sourced<sup>8</sup> in South Africa is taxable in the hands of tax non-resident investors<sup>9</sup> in accordance with paragraph (ii) of the definition of "gross income". However, there is an exemption from normal tax in section 10(1)(h)<sup>10</sup> in favour of tax non-resident persons in respect of qualifying interest received or accrued to that person.

Furthermore, South Africa has a network of double taxation agreements<sup>11</sup> with other jurisdictions that allocates exclusive taxing rights in respect of interest to the country of residence of a tax non-resident investor. The exemption taken together with the

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<sup>6</sup> Organisation for the Economic Co-operation and Development. 2013. Action Plan on Base Erosion and Profit Shifting. <http://dx.doi.org/10.1787/97892642022719-en>. Page 8.

<sup>7</sup> South Africa. Income Tax Act, 1962. Section 24J(1): "Interest" is defined as the gross amount of interest or related finance charges, any discount or premium payable or receivable in terms of or in respect of a financial arrangement, any amount payable by a borrower to a lender in terms of any lending arrangement as represents compensation for any amount to which the lender would, but for such lending arrangement, have been entitled, and the absolute value of the difference between all amounts receivable and payable by a person in terms of a sale and leaseback arrangement as contemplated in section 23G throughout the full term of such arrangement to which such person is a party. This definition applies irrespective of whether the amount is calculated with regards to a fixed or variable rate of interest or payable or receivable as a lump sum or unequal instalments during the term of the financial arrangement. Furthermore, the ordinary meaning of interest is payment for the use of money in the presence of a debtor-creditor relationship.

<sup>8</sup> South Africa. Income Tax Act, 1962. Section 9(2): Interest is deemed to be sourced in South Africa to the extent that "interest...(i) is attributable to an amount incurred by a person that is a resident, unless the interest is attributable to a permanent establishment which is situated outside the Republic; or (ii) is received or accrues in respect of the utilisation or application in the Republic by any person of any funds or credit obtained in terms of any form of interest-bearing arrangement;"

<sup>9</sup> South Africa. Income Tax Act, 1962. Section 1: Gross income definition, paragraph (ii) provides that "in relation to any year or period of assessment, means in the case of any person other than a resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within South Africa."

<sup>10</sup> South Africa. Income Tax Act, 1962. Section 10(1)(h) provides that "There shall be exempt from normal tax any amount of interest which is received or accrues by or to any person that is not a resident, unless (i) that person is a natural person who was physically present in the Republic for a period exceeding 183 days in aggregate during the twelve-month period preceding the date on which the interest is received or accrues by or to that person; (ii) the debt from which the interest arises is effectively connected to a permanent establishment of that person in the Republic;"

<sup>11</sup> International Bureau of Fiscal Documentation. Publication of Treaty Rates for South Africa. 2014. Last updated 1 July 2015. <http://www.ibfd.org/>. A copy is attached as Appendix A.



allocation of taxing rights in double taxation agreements, effectively allows foreign investors to export capital<sup>12</sup> from South Africa in a South African tax neutral manner.

## II. PROBLEM STATEMENT

Sections 23M and 31 limit the deductibility of interest incurred in respect of loan funding advanced between related parties where one party is tax resident and the other tax non-resident.

The interaction between section 23M and section 31 of the Act was raised in submissions to the Department of National Treasury during public hearings on draft amendments to the Act in 2014. The thrust of the submissions was for National Treasury to clarify the interaction between section 23M and section 31.

The Department of National Treasury prepared a report to the parliamentary Standing Committee on Finance ("SCOF") pursuant to the submissions wherein it indicated that the submissions were noted, but that "[t]ransfer pricing always applies first by determining the correct pricing..."<sup>13</sup> (indicating that section 31 reprices interest before the limitation in section 23M applies).

The absence of express legislative regulation and case law creates uncertainty as to whether the interpretation of these sections results in interest being repriced in terms of section 31 and thereafter subjected to limitation in terms of section 23M; or whether interest must be subject to limitation in terms of section 23M and the limited amount be subject to repricing; or whether one of the sections applies to the exclusion of the other.

This problem statement gives rise to the following research questions:

- a) What is the ambit of the application of section 23M?
- b) What is the ambit of the application of section 31?

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<sup>12</sup> The exportation of capital from South Africa by non-residents as debt or equity or by any other means remains subject to regulation by the South African Reserve Bank in accordance with the South African Reserve Bank Act, 1989 and the regulations and circulars published thereunder.

<sup>13</sup> South Africa. Draft Taxation Laws Amendment Bill 2014 and Tax Administration Laws Amendment Bill 2014: Draft Response Document from National Treasury and SARS, as presented to the Standing Committee on Finance. Page 15.

- c) Is there is an overlap in respect of the application of section 23M and section 31?  
And
- d) Do the relevant common law rules and presumptions of statutory interpretation provide clarification in relation to the overlap?

### **III. RESEARCH OBJECTIVE**

The objective of the dissertation is to determine the interaction between the limitations on deductible interest calculated in accordance with section 23M, and the adjustments to interest made under transfer pricing rules in accordance with section 31.

### **IV. RESEARCH METHODOLOGY**

The research methodology used is the desktop method. This research methodology is selected as the data supporting the dissertation comprises primary and secondary sources of legal literature. Consideration is also given to the legislative framework in the United Kingdom.

The approach taken in support of this research will be exploratory in nature given the nascence of policies counteracting BEPS. Section 23M and section 31 have not been subjected to rigorous interpretation by South African courts and no indication is given in the legislation as to the application of these sections vis-à-vis each other.

### **V. CHAPTER OUTLAY**

The dissertation consists of seven chapters. Chapter 1 briefly addresses the background to the dissertation, including the purpose, problem statement, research questions, thesis statement, delineations and the significance. The chapter also sets out assumptions, limitations, data and research instruments.

Chapter 2 introduces the history of the BEPS initiative spearheaded by the Organisation for Economic Co-operation and Development ("OECD") and the response by South Africa.

Chapter 3 contains an exposition of the statutory interpretation rules relevant to interpreting conflicting statutory provisions. The findings in Chapter 3 will be used in Chapter 4 to analyse the ambit of section 23M and section 31.

Chapter 4 considers the ambit of section 23M and section 31, respectively. The consideration of the ambit of each section considers the plain meaning of the text as well as the intention of the legislature as evidenced in policy documents. The chapter draws conclusions as to the overlap in application of section 23M and section 31.

Chapter 5 considers the application of common law presumptions pertaining to statutory interpretation to provide further guidance as regards the interaction between section 23M and section 31. Three presumptions are considered, namely:

- a) the presumption that the legislature does not intend an unjust, unfair or unreasonable result;
- b) the presumption that the legislature does not intend to change existing law more than is necessary; and
- c) the presumption that domestic law should be interpreted in accordance with international law.

Chapter 6 considers the legislative framework in the United Kingdom as a comparable jurisdiction. This jurisdiction is selected on the premise of the interpretive similarities arising from the influence of English Law on South African procedural law and specifically the interpretation of taxing legislation.

Chapter 7 draws conclusions in response to the research questions posed, including a brief summary of the research findings. The chapter summarises the contributions as well as the limitations of the dissertation, while also suggesting relevant future research.

## **VI. LIMITATIONS OF THIS STUDY**

In responding to the research questions this dissertation only takes into account the limitation provisions in section 23M(2) and section 31(4) respectively. No analysis is done in respect of the exemptions<sup>14</sup> listed in respect of section 23M(6).

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<sup>14</sup> South Africa. Income Tax Act, 1962. Section 23M(6) provides exemptions in respect of interest incurred in respect of debt owed to a creditor as contemplated in section 23M(2) where the creditor funded that amount with funding granted by a lending institution that is not in a controlling relationship with that debtor, and the interest is determined with reference to the official rate of interest plus 100

The dissertation does not take into account changes to legislation proposed in the Budget Speech made during February 2015 to the extent that such legislative amendments have not been promulgated by Government Gazette by 31 July 2015. It is noted that draft legislation was released for comment prior to the finalisation of this dissertation, but that no material amendments were made to section 23M or section 31 so as to clarify the interaction between these sections.<sup>15</sup>

Any findings by the Davis Tax Committee in relation to the fourth action point in their BEPS report, or as regards the interaction between section 23M and section 31 will be incorporated to the extent that such findings are not available before 31 July 2015.

The interaction between either of section 23M or section 31 and the remaining provisions of the Act has also not been considered.

## VII. CONCLUSION

The purpose of this dissertation is to determine the nature of the interaction between section 23M and section 31. Prior to delving into the interpretation of these sections, it is important to contextualise the sections. Chapter 2 sets out a brief account of the work done by the OECD operation in relation to harmful tax practices, including development of Action Points relevant to the treatment of tax deductible interest. It also briefly examines the current work of the Davis Tax Commission in response to harmful tax practices.

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basis points. A second exemption is provided in respect of interest incurred by a debtor in respect of any linked unit that is held by a creditor as contemplated in subsection (2) where that creditor is a long-term insurer, pension fund or provident fund, subject to certain requirements.

<sup>15</sup> South Africa, Department of National Treasury. 2015. Draft Taxation Laws Amendment Bill, 2014. No specific page reference.

## CHAPTER TWO: THE DEVELOPMENT OF BEPS AND THE SOUTH AFRICAN RESPONSE

### I. INTRODUCTION

This chapter contextualises base erosion and profit shifting using tax deductible interest in the light of current international and South African initiatives. It highlights the tension between the necessity for South Africa to compete for foreign direct investment and the need to protect the South African tax base.

### II. INTERNATIONAL RESPONSE TO BASE EROSION AND PROFIT SHIFTING

Base erosion and profit shifting ("BEPS") constitutes a harmful tax practice<sup>16</sup> in accordance with the Harmful Tax Competition report<sup>17</sup> released by the Organisation for Economic Development and Co-operation ("OECD").

The OECD has developed an "Action Plan" in respect of harmful tax practices to address BEPS as part of its mandate.<sup>18</sup> The Action Plan comprises 15 Action Points that seek to harmonise international best practices, while recognising that each country retains a sovereign right to impose taxation on the utilisation of its resources.<sup>19</sup> Action Point 4 is aimed at a comprehensive strategy dealing with tax deductible interest and indicates that:

"The deductibility of interest expense can give rise to double non-taxation in both the inbound and outbound investment scenarios. From an inbound perspective, the concern regarding interest expense deduction is primarily with lending from a related entity that benefits from a low-tax regime, to create excessive interest deductions for the issuer without a corresponding interest income

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<sup>16</sup> Organisation for the Economic Co-operation and Development. 1998. Harmful Tax Competition: An Emerging Global Issue. <http://www.oecd.org/tax/transparency/44430243.pdf>. OECD Publishing. Page 19: Harmful tax practices constitute: i) a country is a tax haven and, as such, generally imposes no or only nominal tax on that income; ii) a country collects significant revenues from tax imposed on income at the individual or corporate level, but its tax system has preferential features that allow the relevant income to be subject to low or no taxation; iii) a country collects significant revenues from tax imposed on income at the individual or corporate level, but the effective tax rate that is generally applicable at that level in that country is lower than that levied in the second country

<sup>17</sup> Organisation for the Economic Co-operation and Development. 1998. Harmful Tax Competition: An Emerging Global Issue. <http://www.oecd.org/tax/transparency/44430243.pdf>. OECD Publishing. Page 19.

<sup>18</sup> Organisation for the Economic Co-operation and Development. 2014. The BEPS Project and Developing Countries: from Consultation to Participation. Page 11.

<sup>19</sup> Organisation for the Economic Co-operation and Development. 2014. The BEPS Project and Developing Countries: from Consultation to Participation. Page 9.

inclusion by the holder. The result is that the interest payments are deducted against the taxable profits of the operating companies while interest income is taxed favourably or not at all at the level of the recipient, and sometimes the group as a whole may have little or no external debt. From an outbound perspective, a company may use debt to finance the production of exempt or deferred income, thereby claiming a current deduction for interest expense while deferring or exempting the related income. Rules regarding the deductibility of interest expense therefore should take into account that the related interest income may not be fully taxed or that the underlying debt may be used to inappropriately reduce the earnings base of the issuer or finance deferred or exempt income."<sup>20</sup>

Action Point 4 seeks to redress base erosion resulting from the manipulation of tax deductible interest through recommending limitations on allowable deductions in domestic legislation. Action Point 4 specifically seeks to develop transfer pricing guidelines<sup>21</sup> in relation to financing transactions concluded between related parties.

Transfer pricing is considered to be the pricing of transactions concluded between related parties in relation to goods or services.<sup>22</sup> Thin capitalisation is a subcategory of transfer pricing relating to the advantages of investing by means of debt funding, which more often than not yields tax deductible interest in the hands of the investee company, as opposed to equity capital, which yields non-deductible dividends.

The use of the arm's length principle when assessing transfer pricing as contemplated in Action Point 9 of the OECD Action Plan has, to date, been almost uniformly adopted across all jurisdictions.<sup>23</sup> Action Point 9 suggests a formula based system for regulating transfer pricing as a possible alternative<sup>24</sup> to the arm's length transfer pricing principle.

The United Nations Manual on Transfer Pricing indicates that "[c]ountry tax administration often introduce rules that place a limit on the amount of interest that can

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<sup>20</sup> Organisation for the Economic Co-operation and Development. 2014. The BEPS Project and Developing Countries: from Consultation to Participation. Pages 16 to 17.

<sup>21</sup> Organisation for the Economic Co-operation and Development. 2014. The BEPS Project and Developing Countries: from Consultation to Participation. Page 31.

<sup>22</sup> United Nations. 2013. Practical Manual on Transfer Pricing for Developing Countries. ST/ESA/347. Page 2.

<sup>23</sup> United Nations. 2013. Practical Manual on Transfer Pricing for Developing Countries. ST/ESA/347. Page iii.

<sup>24</sup> Organisation for the Economic Co-operation and Development. 2014. The BEPS Project and Developing Countries: from Consultation to Participation. Pages 19 to 20.

be deducted in calculating the measure of a company's profit for tax purposes."<sup>25</sup> This manual deals specifically with issues relating to the application of limitations imposed on deductible interest in developing countries.

### **III. THE SOUTH AFRICAN RESPONSE TO BASE EROSION AND PROFIT SHIFTING**

Investors invest debt capital in addition to equity capital for commercial reasons, unrelated to tax. Debt ranks higher than equity in case of liquidation and provides a more certain return in a liquidation scenario.

The Act allows the deduction of interest incurred in the production of income from income derived from carrying on a trade.<sup>26</sup> Interest received or accrued from a source in South Africa is exempt from normal tax in the hands of tax non-resident corporate investors in terms of section 10(1)(h). International investors are, barring limitations imposed in terms of section 23M and section 31 among others, able to export interest from South Africa without much South African tax being incurred, which may result in aggressive tax planning.<sup>27</sup> Such planning was further encouraged by the lack of withholding tax on interest sourced in South Africa.

The tax deduction in the investment entity taken together with the normal tax exemption in the hands of the investor<sup>28</sup> could result in the erosion of the South African tax base. This would give rise to an instance of double non-taxation of interest sourced in South Africa. However, the Department of National Treasury allows the double non-taxation of interest sourced in South Africa in particular instances. This policy is evident in the exemption from normal tax of South African sourced interest paid to tax non-resident persons in terms of section 10(1)(h). The policy is also evident in the conclusion of agreements for the avoidance of double taxation wherein taxing rights in respect of South African sourced interest are waived in favour of the country of residence.

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<sup>25</sup> United Nations. 2013. Practical Manual on Transfer Pricing for Developing Countries. ST/ESA/347. Page 23.

<sup>26</sup> South Africa. Income Tax Act, 1962. Section 24J(2).

<sup>27</sup> South Africa, Department of National Treasury. 2013. Draft explanatory memorandum on the Taxation Laws Amendment Bill, 2013. Paragraph 2.6B.

<sup>28</sup> This reference is to tax non-resident investors and tax resident investors that are exempt from normal tax in accordance with the Income Tax Act, 1962.

Such tax arbitrage is not open to local investors<sup>29</sup> as tax resident investors are subject to normal tax in relation to interest received and are therefore not incentivised to partake in aggressive tax planning relating to interest.

The Department of National Treasury introduced section 31, and later section 23M, to limit base erosion resulting from excessive interest deductions in a cross-border related party context.

The Davis Tax Committee ("DTC"), appointed by the Minister of Finance on 17 July 2013, is actively reviewing BEPS in South Africa and Action Points 4 and 9 are implied deliverables due under the DTC terms of reference. The DTC, in its Interim Report on Addressing Base Erosion and Profit Shifting in South Africa, indicated that South African courts are bound by section 233 of the Constitution of the Republic of South Africa "to take into consideration two particular aspects of customary international law: firstly, the Vienna Convention on the Law of Treaties, 23 May 1969 and secondly, the Commentary on the OECD [Model Tax Convention]".<sup>30</sup>

In light of this constitutional obligation to interpret domestic legislation in accordance with customary international law, the DTC questioned the obligation on South Africa to follow the OECD Action Plan. In response to this question, the DTC recognised that the OECD Commentary on the Model Tax Convention is not currently legally binding in South Africa, but that South African tax courts tend to apply such commentary to interpretation of domestic legislation.<sup>31</sup> While acknowledging the importance of co-operation with the OECD and its member countries, the DTC warns that South Africa must adopt measures that are attuned to its unique circumstances to combat BEPS.<sup>32</sup>

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<sup>29</sup> Excluding persons who are exempt from normal tax in accordance with the Income Tax Act, 1962.

<sup>30</sup> South Africa. Constitution of the Republic of South Africa, 1996. Section 233: "[W]hen interpreting legislation, every court must prefer any reasonable interpretation of the legislation that is consistent with international law over any alternative interpretation that is inconsistent with international law".

<sup>31</sup> See *ITC 1503 53 SATC 342* (referred to by the DTC Interim Report. Paragraph 2.4 on page 18.). Paragraph 348.

<sup>32</sup> Davis Tax Committee Interim Report: Summary of Recommendations for South Africa: OECD September 2014 Deliverables. Available from: [http://www.taxcom.org.za/docs/New\\_Folder/9%20DTC%20Interim%20BEPS%20Report%20%20Summary%20of%20Recommendations%20on%20OECD%20Sept%202014%20deliverables.pdf](http://www.taxcom.org.za/docs/New_Folder/9%20DTC%20Interim%20BEPS%20Report%20%20Summary%20of%20Recommendations%20on%20OECD%20Sept%202014%20deliverables.pdf). Paragraph 2.4 on page 19.



In 2011, South Africa launched a National Development Plan ("NDP"). According to the DTC the NDP requires South Africa to develop "fiscal and economic policies that encourage foreign direct investment (FDI) to foster economic growth".<sup>33</sup> Some of the key objectives of the NDP are to grow the South African tax base and promote South Africa as a foreign investor destination. In the opinion of the DTC these economic goals should not be hampered unduly by measures to counter BEPS.<sup>34</sup>

The intention to attract foreign direct investment is reflected in Article 9 (the Interest Article) of most of the double taxation treaties in which South Africa foregoes much of its rights to tax interest sourced in South Africa.<sup>35</sup> This is meant to stimulate foreign direct investment. The rationale propounded for the waiver of taxing rights on interest sourced in South Africa is that South Africa seeks to attract foreign debt capital,<sup>36</sup> which is in line with the economic goals set in terms of the NDP.

At first glance, the limitations on tax deductible interest in domestic legislation as part of the BEPS strategy stands at odds with the double taxation treaty relief from domestic tax on interest sourced in South Africa. The DTC appears to recognise this tension when it states that: "[a] balance has to be struck"<sup>37</sup> between the need to develop a

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<sup>33</sup> Davis Tax Committee Interim Report: Addressing Base Erosion and Profit Shifting in South Africa. Available from: [http://www.taxcom.org.za/docs/New\\_Folder/1%20DTC%20BEPS%20Interim%20Report%20-%20The%20Introductory%20Report.pdf](http://www.taxcom.org.za/docs/New_Folder/1%20DTC%20BEPS%20Interim%20Report%20-%20The%20Introductory%20Report.pdf). Page 19.

<sup>34</sup> Davis Tax Committee Interim Report: Summary of Recommendations for South Africa: OECD September 2014 Deliverables. Available from: [http://www.taxcom.org.za/docs/New\\_Folder/9%20DTC%20Interim%20BEPS%20Report%20%20Summary%20of%20Recommendations%20on%20OECD%20Sept%202014%20deliverables.pdf](http://www.taxcom.org.za/docs/New_Folder/9%20DTC%20Interim%20BEPS%20Report%20%20Summary%20of%20Recommendations%20on%20OECD%20Sept%202014%20deliverables.pdf). Paragraph 2.3 on page 19.

<sup>35</sup> South Africa. Income Tax Act, 1962. Section 1: A resident is defined as any person (other than a natural person) that is "incorporated, established or formed in the Republic [of South Africa] or which has its place of effective management in the Republic [of South Africa]", subject to exclusions relating to provisions in double taxation agreements.

<sup>36</sup> South Africa, Department of National Treasury. 2014. Explanatory memorandum on the Taxation Laws Amendment Bill, 2014. Page 36.

<sup>37</sup> Davis Tax Committee Interim Report: Summary of Recommendations for South Africa: OECD September 2014 Deliverables. Available from: [http://www.taxcom.org.za/docs/New\\_Folder/9%20DTC%20Interim%20BEPS%20Report%20%20Summary%20of%20Recommendations%20on%20OECD%20Sept%202014%20deliverables.pdf](http://www.taxcom.org.za/docs/New_Folder/9%20DTC%20Interim%20BEPS%20Report%20%20Summary%20of%20Recommendations%20on%20OECD%20Sept%202014%20deliverables.pdf). Paragraph 2.5 on page 25.

competitive tax policy to attract foreign direct investment and counteracting BEPS through adherence to the principles of a good tax system.<sup>38</sup>

South Africa currently has comprehensive limitations relating to Action Points 4 and 9 of the BEPS initiative. The limitations comprise reclassification provisions catering for hybrid equity and debt instruments,<sup>39</sup> limitations on deductible interest on loan funding advanced by persons not subject to tax in South Africa,<sup>40</sup> limitations on tax deductible interest incurred in corporate reorganisation transactions,<sup>41</sup> transfer pricing (including thin capitalisation),<sup>42</sup> and interest withholding tax.<sup>43</sup>

#### IV. CONCLUSION

South Africa is not a member of the OECD, but does have observer status. The OECD commentary forms an essential part of the development of taxing legislation in South Africa. The universal adoption of the "arm's length" approach to limiting thin capitalisation and the suggestion of a formulaic alternative seem to suggest that the South African approach is overbroad.

In light of the emphasis on foreign direct investment by the DTC resulting from the NDP economic goals, it is imperative to recognise that any return on foreign direct investment is directly influenced by domestic tax legislation. The possible concurrent application of section 23M and section 31 gives rise to uncertainty thereby negating an essential pillar of a good tax system and the goals of the NDP.

Chapter 3 considers the common law interpretive framework that forms the backbone of the analysis of the ambit of section 23M and section 31, respectively, in Chapter 4.

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<sup>38</sup> Davis Tax Committee Interim Report: Summary of Recommendations for South Africa: OECD September 2014 Deliverables. Available from: [http://www.taxcom.org.za/docs/New\\_Folder/9%20DTC%20Interim%20BEPS%20Report%20Summary%20of%20Recommendations%20on%20OECD%20Sept%202014%20deliverables.pdf](http://www.taxcom.org.za/docs/New_Folder/9%20DTC%20Interim%20BEPS%20Report%20Summary%20of%20Recommendations%20on%20OECD%20Sept%202014%20deliverables.pdf). Paragraph 2.7 on page 30 and 31.

<sup>39</sup> South Africa. Income Tax Act, 1962. Sections 8E, 8EA, 8F and 8FA.

<sup>40</sup> South Africa. Income Tax Act, 1962. Section 23M.

<sup>41</sup> South Africa. Income Tax Act, 1962. Section 23N.

<sup>42</sup> South Africa. Income Tax Act, 1962. Section 31.

<sup>43</sup> South Africa. Income Tax Act, 1962. Section 50A to 50H, with effect from 1 March 2015.

## CHAPTER THREE: INTERPRETING FISCAL LEGISLATION

### I. INTRODUCTION

While Chapter 2 contextualised section 23M and section 31, Chapter 3 seeks to provide an overview of the statutory rules of interpretation of fiscal statutes as developed in the South African common law. The relevant rules of interpretation will then be used to determine a guide to establishing the ambit of section 23M and section 31, respectively.

In the *Glen Anil Development Corporation Ltd v SIR*<sup>44</sup> case the court expressly states that, for the most part, there is "little reason why the interpretation of fiscal legislation should be subjected to special treatment".

It is therefore necessary to consider the current state of the general framework of statutory interpretation in South Africa and thereafter, to consider the interpretation of fiscal statutes in greater detail.

### II. INTERPRETATION OF STATUTES

South African courts historically favoured a literalist mode of interpretation. The literal approach seeks to determine the primary meaning of legislation by considering the plain meaning of words.<sup>45</sup> Where courts encountered ambiguity or absurdity the courts relied on recognised internal and external aids.<sup>46</sup> It was therefore only in cases of ambiguity in the ambit of legislation or absurdity resulting from the literal interpretation that deviation from the literal meaning was condoned.<sup>47</sup>

As a development of the literal approach, South African courts relied on the intention of the Legislature.<sup>48</sup> Steyn<sup>49</sup> refers to the legislative intent approach as "die sowereine

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<sup>44</sup> 1975 (4) SA 715 (A). Page 334.

<sup>45</sup> Botha, C. 2007. Statutory Interpretation: An introduction for students. Fourth Edition. Page 47 at paragraph 5.2.1.

<sup>46</sup> Botha, C. 2007. Statutory Interpretation: An introduction for students. Fourth Edition. Page 47, *et seq.*

<sup>47</sup> *CIR v Delfos* 1933 AD 242. Paragraph 253. Stiglingh, M et al. Silke: South African Income Tax. Last updated 2015. Available from Lexis Nexis at: <http://www.mylexisnexis.co.za/Index.aspx>. (accessed on 29 May 2015). Chapter 25. Pages 2 and 3 at paragraph 25.1A. *Glen Anil Development Corporation Ltd v SIR* 1975 (4) SA 715 (A), 37 SATC 319 at 336.

<sup>48</sup> Botha, C. 2007. Statutory Interpretation: An introduction for students. Fourth Edition. Paragraph 320.

reël van alle interpretasie"<sup>50</sup> and argues that the intended meaning of a speaker outweighs the objective meaning of his words. This approach draws heavily on the South African Roman Dutch common law heritage and negates the strong influence of English Law<sup>51</sup> on the South African common law.

The advent of the Constitution of the Republic of South Africa as the supreme law, heralded a new era in statutory interpretation. Section 39(2) of the Constitution provides that:

"When interpreting any legislation, and when developing the common law or customary law, every court, tribunal or forum must promote the spirit, purport and objects of the constitution."

It has been stated that constitutional supremacy and section 39(2) of the Constitution supersedes the literal approach so that such an approach is no longer appropriate in a South African context.<sup>52</sup> Similarly, the intention of the Legislature as a proxy for the meaning of legislation does not accord with Constitutional supremacy and a teleological approach.<sup>53</sup>

The permeating nature of the spirit, purport and objects of the Bill of Rights in statutory interpretation leads to a teleological approach to interpretation. Teleological interpretation requires the interpreter to determine the "aim and purpose of legislation against the fundamental constitutional values."<sup>54</sup> The Constitution is a normative document and propagates a value-laden approach to statutory interpretation.<sup>55</sup>

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<sup>49</sup> Steyn, L. C (edited by SIE van Tonder). 1981. *Die Uitleg van Wette*. Fifth Edition. Page 2 at paragraph 2.

<sup>50</sup> Translated as: the sovereign rule of all interpretation.

<sup>51</sup> Du Plessis, L M. 2011. *Statute Law and Interpretation*. Law of South Africa. Paragraph 312.

<sup>52</sup> Botha, C. 2007. *Statutory Interpretation: An introduction for students*. Fourth Edition. Page 54, at paragraph (ii).

<sup>53</sup> Du Plessis, L M. 2011. *Statute Law and Interpretation*. Law of South Africa. Paragraph 327.

<sup>54</sup> Botha, C. 2007. *Statutory Interpretation: An introduction for students*. Fourth Edition. Page 59.

<sup>55</sup> Botha, C. 2007. *Statutory Interpretation: An introduction for students*. Fourth Edition. Page 59.

Some authors are of the opinion that judges in practise yield to a pragmatic approach that vacillates between formalistic literalism and free thinking purposivism in a "literalist-cum-intentionalist" approach:

"[W]hat all judicial approaches to statutory interpretation share is the belief that statutes are bearers of meaning and that statutory interpretation basically involves an exhumation of that meaning in accordance with prescribed rules and procedures."<sup>56</sup>

### III. INTERPRETATION OF FISCAL STATUTES

Taxing Acts have historically been interpreted in accordance with the strict literal approach.<sup>57</sup> One of the earliest cases to encapsulate this approach, and to provide an oft quoted example of this principle, is the case of *Cape Brandy Syndicate v IRC*<sup>58</sup>:

"It simply means that in a taxing Act one has to look at what is clearly said. There is no room for any intendment. There is no equity about tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used."

However, the development of the interpretation of fiscal statutes has kept abreast of the evolution of statutory interpretation as stated by Seligson AJ in *ITC 1584*<sup>59</sup> :

"It is a well-established rule of statutory construction that, where the usual, everyday, meaning of the words of an enactment is in conflict with the clear intention of the Legislature gleaned from the statute as a whole and other relevant circumstances, it is permissible to depart from such meaning to give effect to the real intention."

This extract indicates that the interpretation of fiscal legislation has progressed significantly from the strict application of the literal meaning of the words expounded by the court in the *Cape Brandy* case. *ITC 1584* applies a purposive approach by taking into account equity as one of the deciding factors when considering the ambit of an exemption provided for in section 10(1)(u).<sup>60</sup>

<sup>56</sup> Du Plessis, L M. 2011. Statute Law and Interpretation. Law of South Africa. Volume 25(1). Paragraph 320.

<sup>57</sup> *CIR v Delfos* 1933 AD 242. Paragraph 253.

<sup>58</sup> 1921 1 KB 64 at paragraph 71.

<sup>59</sup> 57 SATC 64 at paragraph 71.

<sup>60</sup> *ITC 1584* 57 SATC 63. Page 71: "A consistent, harmonious and equitable interpretation of both s 10(1)(u) and para (b) of the definition of 'gross income' in s 1 of the Act is achieved by treating them as including within their ambit maintenance payable not only by the former spouse himself, but by his

The purposive posture when interpreting taxing legislation is also detectable in the case of *CIR v Nemojim (Proprietary) Limited*<sup>61</sup> where it is stated:

"[T]his may in many instances be a relevant guiding principle in the interpretation of fiscal legislation, there is nevertheless a measure of satisfaction to be gained from a result which seems equitable, both from the point of view of the taxpayer and from the point of view of the fiscus."

This extract is reminiscent of the words of Adam Smith<sup>62</sup> stating that taxing legislation should be "in proportion to the revenue which they brought to the prince, as little burdensome to the people" and finds further support in the pillar of equity as a key principle of a good tax system as identified by the DTC.

This posture was again adopted by the court in the *Commissioner for the South African Revenue Service v Bosch and another*.<sup>63</sup>

"The words of the section provide the starting point and are considered in the light of their context, the apparent purpose of the provision and any relevant background material. There may be rare cases where words used in a statute or contract are only capable of bearing a single meaning, but outside of that situation it is pointless to speak of a statutory provision or a clause in a contract as having a plain meaning. One meaning may strike the reader as syntactically and grammatically more plausible than another, but, as soon as more than one possible meaning is available, the determination of the provision's proper meaning will depend as much on context, purpose and background as on dictionary definitions or what Schreiner JA referred to as 'excessive peering at the language to be interpreted without sufficient attention to the historical contextual scene.'"

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estate after his death. It is a well-established rule of statutory construction that, where the usual, everyday, meaning of the words of an enactment is in conflict with the clear intention of the legislature as gleaned from the statute as a whole and other relevant circumstances, it is permissible to depart from such meaning to give effect to the real intention. See *Venter v R* 1907 TS 910 at 91415; *Du Plessis v Joubert* 1968(1) SA 585(A) at 594 in fin – 595B; *Steyn Die Uitleg van Wette* 5ed at 68. I am mindful that a court should be cautious about departing from the literal meaning of a statutory provision by supplementing it and should only do so—'. . . where the contrary legislative intent is clear and indubitable.' (Per Corbett JA as he then was, in *Summit Industrial Corporation v Claimants against the Fund Comprising the Proceeds of the Sale of the MV Jade Transporter* 1987(2) SA 583(A) at 596J597B.) In my judgment this is such a case. For I am satisfied that to restrict the exemption to the case of a living spouse and to exclude therefrom maintenance paid in compliance with a divorce order by the estate of a subsequently deceased ex-spouse, would produce a glaring anomaly which the legislature could not have intended and one wholly in conflict with the real legislative intent."

<sup>61</sup> 1983 (4) SA 935 (A). Page 267.

<sup>62</sup> Emslie, T and Davis, D. 2011. *Income Tax: Cases and Materials*. Third Edition (including a First and Second Supplement). Chapter 1: An Inquiry into the Nature and Causes of the Wealth of Nations, 1776, Book V Chapter II. Page 1.

<sup>63</sup> [2015] JP: 32547 (SCA); 2015 (2) SA 174 (SCA). Page 184. See also *Commissioner for the South African Revenue Service v Airworld CC and Another* 2008 2 All SA 593 (SCA). *Standard General Insurance Co Ltd v Commissioner for Customs and Excise* 2005 (2) 168 (SCA). Paragraph 25. *De Beers Marine (Pty) Ltd v Commissioner, SARS* 2002 (5) SA 136 (SCA). Paragraph 7.

The Constitutional Court, however, relied on a teleological interpretation in the case of *First National Bank of SA Ltd t/a Wesbank v Commissioner for South African Revenue Service and Another; First National Bank of SA Ltd t/a Wesbank v Minister of Finance*<sup>64</sup> where it stated that "[t]here is a like obligation on the courts, when interpreting any legislation - including fiscal legislation - to promote those objectives" (reference is made here to the spirit, purport and object of the Bill of Rights).

The effect of constitutional supremacy on tax law is a continuously developing area of law<sup>65</sup> and the current position appears to be that:

"[i]n practice, the strict rule of interpretation will be used in circumstances where such interpretation is not in conflict with the overall as well as the specific intention or purpose of the legislature...the strict rule of interpretation does not and cannot always take account of justice, equity, harshness or unfairness and...has been replaced by the classical purposive approach...to incorporate the essential values underpinning the Constitution."<sup>66</sup>

The current approach to interpretation of fiscal legislation commences with the considering of the words of a particular provision. However, the interpretation of any specific provision must resonate with the contextual meaning of its content, the purpose with which it was inserted and the mischief it seeks to remedy. Overarching the entire enquiry must be a value-laden consideration of the meaning of a provision, which takes into account the principles of the Constitution.

#### IV. INTERPRETATION OF SPECIFIC ANTI-AVOIDANCE PROVISIONS

Section 23M and section 31 constitute specific anti-avoidance provisions<sup>67</sup> and it is apposite at this point to consider the interpretation of anti-avoidance provisions as a sub-set of fiscal legislation. In *Glen Anil Development Corporation Ltd*<sup>68</sup> the court

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<sup>64</sup> 2002 (4) SA 768 (CC). Paragraph 31.

<sup>65</sup> Goldswain, KG. 2012. The winds of change - an analysis and appraisal of selected constitutional issues affecting the rights of taxpayers. Published Doctoral Thesis, University of South Africa, Tshwane, Gauteng, South Africa. Page 40.

<sup>66</sup> Goldswain, KG. 2012. The winds of change - an analysis and appraisal of selected constitutional issues affecting the rights of taxpayers. Published Doctoral Thesis, University of South Africa, Tshwane, Gauteng, South Africa. Page 40.

<sup>67</sup> South Africa, Department of National Treasury. 2013. Explanatory Memorandum on the Income Tax Bill, 1995. Page 27. South Africa, Department of National Treasury. 2013. Explanatory memorandum on the Taxation Laws Amendment Bill, 2013. Page 37.

<sup>68</sup> *Glen Anil Development Corporation Ltd v SIR 1975 (4) SA 715 (A); 39 SATC 319*. Page 334.

stated, in relation to the now repealed section 103, which contained the general rules directed at defeating tax avoidance schemes, that:

"[the section] does not impose a tax nor does it relate to the tax imposed by the Act or to the liability therefore or to the incidence thereof, but rather to schemes designed for the avoidance of liability therefor. It should, in my view, therefore, not be construed as a taxing measure but rather in such a way that it will advance the remedy provided by the section and suppress the mischief against which the section is directed.

...

The section must, on the contrary, be so construed as to give effect to those words. The effect to be given to those words must depend upon the intention of the legislature as ascertained from a consideration of the context of s103 as a whole, and of such other circumstances as may be relevant, such as the history of the section."

The views expressed by the court in the *Glen Anil* case are repeated and confirmed in the case of *Commissioner for Inland Revenue v Ocean Manufacturing Ltd.*<sup>69</sup> The court in the latter case stated<sup>70</sup> that "[t]he Commissioner's powers should not be restricted unnecessarily by interpretation".

The validity of a court's ability to confer such wide berth on anti-avoidance provisions has been questioned. The court in the case of *Commissioner of Inland Revenue v MacNeillie's Estate*<sup>71</sup> stated:

"If we have here a rule allowing a special kind of latitude beyond that which is permissible in the interpretation of any other statute in which the intention is clear and manifest, but the language of the provision to be interpreted obscure, the grounds on which such a rule is to be justified in our law, are not apparent. Even without such a special rule, if it is to be so regarded, a Court would give effect to a manifest intention to tax a particular person in respect of particular property, unless the words to be construed, whether they appear in an assessment provision or elsewhere, are intractable. The court would in such a case, in interpreting such words, allow itself the latitude, within the limits distinguishing interpretation from legislation, which is necessary to give effect to such an intention. I am not aware of any authority in our law requiring or allowing an exceptional liberality larger than this in the construction of any provision of a taxing statute."

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<sup>69</sup> *Commissioner for Inland Revenue v Ocean Manufacturing Ltd* 1990 (3) SA 610 (A).

<sup>70</sup> *Commissioner for Inland Revenue v Ocean Manufacturing Ltd* 1990 (3) SA 610 (A). Page 162.

<sup>71</sup> 1961 4 All SA 27 (A); 1961 (3) SA 833 (A). Page 30.



It is noteworthy that the Court in the *Glen Anil* case did not refer to the earlier *MacNeillie's* decision. The more liberal interpretation by the court in the *Glen Anil* case may result from a more purposive approach to the interpretation of anti-avoidance provisions. The judgment in the earlier *MacNeillie's* case does however caution that courts do not have unfettered ability when interpreting legislation.

## V. CONCLUSION

The interpretation of legislation still commences with the interpretation of the words comprising a specific provision. These words are regarded as "bearers of meaning" that is uncovered in accordance with prescribed rules.<sup>72</sup>

Interpretation of fiscal legislation similarly commences with the considering of the words of a particular provision. However, it is no longer sufficient to uncover the grammatical meaning and the interpreter must consider the purpose of the provision. The interpretive process is permeated by the value-laden considerations of the Constitution.

It is further necessary to analyse of anti-avoidance provisions, such as section 23M and section 31, so as to give effect to the words<sup>73</sup> bearing in mind that courts interpret anti-avoidance provisions widely.<sup>74</sup> By the same token, it is important to restrain the interpretation of anti-avoidance provisions to avoid courts taking on the role of legislator.

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<sup>72</sup> Du Plessis, L. M. 2011. Statute Law and Interpretation. Law of South Africa. Volume 25(1). Paragraph 320.

<sup>73</sup> *ITC 1611 59 SATC 126*. Page 136 to 137, quoted in de Koker, AP et al. 2015. Silke on South African Income Tax: Chapter 25: Interpretation. Last updated March 2015. Available from Lexis Nexis: <http://www.mylexisnexis.co.za/Index.aspx>. (accessed on 29 May 2015). Page 19 to 20. *Glen Anil Development Corporation Ltd v SIR 1975 (4) SA 715 (A)*; 37 SATC 319. Page 334 to 335. *Commissioner for Inland Revenue v Ocean Manufacturing Ltd 1990 (3) SA 610 (A)*. Page 24.

<sup>74</sup> *Glen Anil Development Corporation Ltd v SIR 1975 (4) SA 715 (A)*. Page 334 to 335.

Taking cognisance of the prevailing approaches to statutory interpretation, the steps set out below will be followed in Chapter 4:

- a) Determine the ordinary grammatical meaning.<sup>75</sup> The ordinary grammatical meaning of words is determined by the following means -
  - i. the dictionary meaning of the words as currently understood;<sup>76</sup>
  - ii. definitions provided in the Act; and
  - iii. previous interpretations given by courts, if any are applicable.<sup>77</sup>
- b) Consider other relevant circumstances. Such "other circumstances as may be relevant"<sup>78</sup> comprise -
  - i. the history of each of the provisions;
  - ii. the position of each provision in the Act;
  - iii. the headings of each section;
  - iv. the information disseminated in the explanatory memoranda<sup>79</sup> pertaining to each section;
  - v. the mischief counteracted by each provision; and
  - vi. the BEPS initiative.

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<sup>75</sup> *Cape Brandy Syndicate v IRC* 1921 1 KB 64. Paragraph 71. *Glen Anil Development Corporation Ltd v SIR* 1975 (4) SA 715 (A). Paragraph 726.

<sup>76</sup> Du Plessis, L M. 2011. Statute Law and Interpretation. Law of South Africa. Volume 25(1) Page 347.

<sup>77</sup> *CIR v Est Crewe* 1943 AD 656. Pages 679 to 680.

<sup>78</sup> See also *CIR v Delfos* 1933 AD 242. Page 254: "...I do not understand this to mean that in no case in a taxing Act are we to give to a section a narrower or wider meaning than its apparent meaning, for in all cases of interpretation we must take the whole statute into consideration and so arrive at the true intention of the legislature."

<sup>79</sup> *Commissioner for the South African Revenue Service v Bosch and another* [2015] JP: 32547 (SCA); 2015 (2) SA 174 (SCA). Page 184 at paragraph 10.

## CHAPTER FOUR: THE AMBIT OF SECTION 23M AND SECTION 31

### I. INTRODUCTION

This chapter seeks to determine the ambit of section 23M and the ambit of section 31 in accordance with the prevailing climate of interpretation identified in Chapter 3.

This chapter contains an exposition of each section separately, determining firstly, the ordinary grammatical meaning of the words of the sections. Secondly, a contextual understanding is garnered and lastly, the determination of the purpose of each provision.

Section 23M will be considered at the outset, thereafter section 31.

### II. THE AMBIT OF SECTION 23M

Section 23M was inserted with effect from 1 January 2015 and applies to interest expenditure incurred on or after that date. Section 23M was inserted with the purpose of limiting "deductions for interest that is not subject to tax in the hands of the person to whom the interest accrues".<sup>80</sup> The Department of National Treasury considered this a necessary change as "excessive interest deductions pose a recurring risk if the creditor and debtor form part of the same economic unit."<sup>81</sup>

Section 23M(2) provides that:

"Where an amount of **interest** is incurred by a debtor during a year of assessment in respect of a debt owed to -

- (a) a creditor that is in a **controlling relationship** with that **debtor**; or
- (b) a creditor that is not in a controlling relationship with that debtor, if that creditor obtained the funding for the debt advanced to the debtor from a person that is in a controlling relationship with that debtor,

and the amount of interest so incurred is not during that year of assessment -

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<sup>80</sup> South Africa, Department of National Treasury. 2013. Draft explanatory memorandum on the Taxation Laws Amendment Bill, 2013. Paragraph 2.6.

<sup>81</sup> South Africa, Department of National Treasury. 2013. Draft explanatory memorandum on the Taxation Laws Amendment Bill, 2013. Paragraph 2.6.

(i) (aa) **subject to tax** in the hands of the person to which the interest accrues;

(bb) included in the net income of a controlled foreign company as contemplated in section 9D in the foreign tax year of the controlled foreign company commencing or ending within that year of assessment; and

(ii) disallowed under section 23N;

the amount of interest allowed to be deducted may not exceed the amount determined in accordance with subsection (3)."

(Own emphasis. A complete extract of section is attached as Appendix B.)

a) *Ordinary grammatical meaning of words*

The ambit of section 23M must be determined with regard to the meaning of a number of the words in the extract. The definition of "interest" is arguably the most important definition in this section. Section 23M provides that interest means interest as defined in section 24J.

"Interest" is defined in section 24J(1) as including:

- "(a) the gross amount of any interest or related finance charges, discount or premium payable or receivable in terms of or in respect of a financial instrument;
- (b) amount payable by a borrower to the lender in terms of any lending arrangement as represents compensation for any amount to which the lender would, but for such lending arrangement, have been entitled; and
- (c) absolute value of the difference between all amounts receivable and payable by a person in terms of a sale and leaseback arrangement as contemplated in section 23G throughout the full term of such arrangement, to which such person is a party,

irrespective of whether such amount is -

- (i) calculated with reference to a fixed rate of interest or a variable rate of interest; or
- (ii) payable or receivable as a lump or in unequal instalments during the term of the financial arrangement;..."

It should be noted that as regards item (a) in the definition of "interest" for the purposes of section 24J, the definition is circular. "Interest" is defined

as *interest*, which incorporates the common law definition of interest within the definition for purposes of section 24J. The common law understanding of interest requires the existence of a debtor-creditor relationship in terms of which an amount is payable for the use of money.<sup>82</sup> The Oxford Dictionary defines interest as "money paid regularly at a particular rate for the use of money lent, or for delaying the repayment of a debt."<sup>83</sup>

"Debtor" is defined as "a debtor who is a) person that is a resident; or b) any other person who is not a resident that has a permanent establishment in the Republic in respect of any debt claim that is effectively connected with that permanent establishment".

"Person" is in turn defined in section 1 as including "an insolvent estate; the estate of a deceased person; any trust; and any portfolio of a collective investment scheme, but does not include a foreign partnership."

A "permanent establishment" is defined as a "permanent establishment as defined from time to time in Article 5 of the Model Tax Convention on Income and Capital of the Organisation for Economic Co-operation and Development".<sup>84</sup> A permanent establishment is generally defined in Article 5(1) of the Model Tax Convention as "a fixed place of business through which the business of an enterprise is wholly or partly carried on."<sup>85</sup>

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<sup>82</sup> Taxation Principles of Interest and other Financing Transactions at page V5.

<sup>83</sup> Oxford Dictionary. Available online: <http://www.oxforddictionaries.com/definition/english/interest>. (Last accessed 8 November 2015).

<sup>84</sup> South Africa. Income Tax Act, 1962. Section 1: Definition of permanent establishment: This definition has a proviso in relation to "a qualifying investor in relation to a partnership, trust or foreign partnership has a permanent establishment in the Republic, any act of that partnership, trust or foreign partnership in respect of any financial instrument must not be ascribed to that qualifying investor." A financial instrument is a defined term in section 1 that includes "(a) a loan, advance, debt, bond, debenture, bill, share, promissory note, banker's acceptance, negotiable certificate of deposit, deposit with a financial institution, a participatory interest in a portfolio of a collective investment scheme, or a similar instrument; (b) any repurchase or resale agreement, forward purchase arrangement, futures contract, option contract or swap contract; (c) any other contractual right or obligation the value of which is determined directly or indirectly with reference to (i) a debt security or equity; (ii) any commodity as quoted on an exchange; (iii) a rate index or a specified index; (d) any interest-bearing arrangement; and (e) any financial arrangement based on or determined with reference to the time value of money or cash flow or the exchange or transfer of an asset;".

<sup>85</sup> Organisation for the Economic Co-operation and Development. Model Tax Convention with respect to taxes on Income and on Capital. <http://www.oecd.org/ctp/treaties/2014-model-tax-convention-articles.pdf>. (Last accessed 8 November 2015): Article 5(2) and 5(3) include a number of specific

Another important definition is that of "controlling relationship", which is defined as "a relationship where a person directly or indirectly holds at least 50 per cent of the equity shares in a company or at least 50 per cent of the voting rights in a company is exercisable by a person."

Section 23M furthermore only applies to the extent that interest received is not "subject to tax" in the hands of the person to whom it accrues. The phrase is not defined as a whole and the determination of "subject to tax" must be considered in light of the meaning of its constituent parts.

"Tax" is defined as "tax...imposed in terms of" the Act. Therefore, any tax imposed in terms of any provision of the Act results in a person being considered "subject to tax" for purposes of section 23M(2). There are two broad categories of creditors that would not be "subject to tax", namely: persons that are tax non-resident for purposes of the Act and persons who are exempt<sup>86</sup> in terms of the Act.

In terms of section 23M(3) the limitation amount is calculated as -

- a) the amount of interest received by or accrued to the debtor;
- b) plus a percentage of adjusted taxable income;
- c) reduced by so much of any interest incurred by the debtor in respect of debts (other than debts contemplated in section 23M(2)) as exceeds any amount not allowed to be deducted in terms of section 23N.

"Adjusted taxable income" is in turn calculated as taxable income<sup>87</sup> reduced by:

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examples of activities that constitute a permanent establishment, whereas article 5(4) excludes a number of activities. These activities are not relevant to this study and have not been reproduced.

<sup>86</sup> Examples of tax resident exempt persons are: Institutional investors such as pension funds and untaxed policy holder funds, as defined in section 1 and section 29A of the Income Tax Act, 1962.

<sup>87</sup> South Africa. Income Tax Act, 1962. Section 1: "the aggregate of (a) the amount remaining after deducting from the income of any person all the amounts allowed under Part I of Chapter II to be deducted from or set off against such income; and (b) all amounts to be included or deemed to be included in the taxable income of any person in terms of this Act."

- a) any amount of interest received or accrued;
- b) any amount included in the income of a person as contemplated in section 9D(2);
- c) any amount recovered or recouped in respect of an allowance contemplated in this Act in respect of a capital asset as defined in section 19; and

with the addition of -

- a) any amount of interest incurred;
- b) any amount allowed as a deduction in terms of this Act in respect of a capital asset as defined in section 19 for purposes other than the determination of any capital gain or loss; and
- c) any assessed loss or balance of assessed loss allowed to be set off against income in terms of section 20.

In summary, based on the ordinary grammatical meaning of the words comprising section 23M, it seeks to limit the amount of interest expenditure deductible in accordance with section 24J(2) incurred by a resident borrower where the interest is payable to or guaranteed by a lender or guarantor that holds directly or indirectly at least 50% of the equity shares or voting rights in the borrower, where the lender or guarantor is not subject to tax in the hands of the lender (regardless of the tax residency of the lender).

Section 23M(4) provides that "so much of any amount of interest as exceeds the amount determined in terms of section (3) may be carried forward to the immediately succeeding year of assessment and, subject to subsection (2), must be deemed to be an amount of interest incurred in that succeeding year of assessment." Section 23M(4) provides some relief to the disallowance under section 23M(2) and results in the disallowance becoming a temporary difference between the amount of interest actually incurred and the amount allowable as a deduction.

b) *Contextual indicators*

The structure of the Act as a whole contains a number of provisions limiting deductions available to taxpayers in section 23. Section 23M follows a series of specific limitation sections following immediately after section 23. Upon doing a tax computation in accordance with the scheme of the Act, a taxpayer would therefore calculate the amount of its deduction, subject to the limitations provided for in section 23 *et seq*, including section 23M. Section 23M is therefore taken into account at the deduction level for purposes of calculating taxable income.<sup>88</sup>

The heading of section 23M further reads: "Limitation of interest deduction in respect of debts owed to persons not subject to tax under this Chapter." The "chapter" under consideration here is Chapter II of the Act, which deals with "The Taxes". Chapter II directs the imposition of taxes, including but not limited to normal tax, withholding taxes on sale of immovable property<sup>89</sup>, withholding tax on interest<sup>90</sup>, donations tax<sup>91</sup> and dividend tax<sup>92</sup>, and essentially provides the manner in which the liability for various types of tax on income and increases in capital wealth<sup>93</sup> should be taxed.

"Persons not subject to tax in this Chapter" arguably includes any person that is exempt from normal tax in accordance with the listed exemptions provided in section 10 or any other provision exempting any person from normal tax. Persons that may fall within the ambit of this phrase comprise

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<sup>88</sup> South Africa. Income Tax Act, 1962. Section 1: Taxable income is defined as "the aggregate of (a) the amount remaining after deducting from income of any person all the amounts allowed under Part I of Chapter II to be deducted from or set off against such income; and (b) all amounts to be included or deemed to be included in the taxable income of any person in term of this Act".

<sup>89</sup> South Africa. Income Tax Act, 1962. Section 35A.

<sup>90</sup> South Africa. Income Tax Act, 1962. Section 50A.

<sup>91</sup> South Africa. Income Tax Act, 1962. Section 54.

<sup>92</sup> South Africa. Income Tax Act, 1962. Section 64D.

<sup>93</sup> South Africa. Income Tax Act, 1962. Section 26A read with the Eighth Schedule to the Income Tax Act, 1962.



institutional investors, for example pension funds<sup>94</sup> that are exempt in terms of section 10(1)(d).

Non-resident persons are subject to normal tax in accordance with paragraph (b) of the definition of "gross income" in respect of "the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within the Republic". There are listed source rules in section 9 of the Act in addition to certain common law source rules. As regards interest earned from a source within South Africa, such interest is sourced in South Africa to the extent that the interest as defined in section 24J:

"(a) is attributable to an amount incurred by a person that is a resident, unless the interest is attributable to a permanent establishment which is situated outside the Republic; or (b) is received or accrues in respect of the utilisation or application in the Republic by any person of any funds or credit obtained in terms of any form of interest-bearing arrangement."

However, section 10(1)(h) provides a complete exemption from normal tax in respect of interest earned by persons who are not resident in South Africa. Non-resident persons are also "persons not subject to tax in this Chapter".

The reference to "tax" imposed in this chapter includes any tax imposed in terms of the Act. The imposition of withholding tax on interest in accordance with section 50A with effect from 1 March 2015 results in non-resident investors becoming subject to tax in terms of Chapter II of the Act. It must however be noted that the reference to "this Chapter" has not been repeated within the body of the section.

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<sup>94</sup> South Africa. Income Tax Act, 1962. Section 1: Pension fund defined as including pension funds, pension preservation funds, provident funds, provident preservation funds or retirement annuity funds, or a beneficiary fund as defined in section 1 of the Pension Funds Act, 1956, benefit funds as defined in section 1 of the Medical Schemes Act, 1998, and mutual loan associations, fidelity or indemnity funds and trade unions. Most of these terms are defined terms in section 1 of the Income Tax Act, 1962, and therefore bear reference to very specific types of investors.

c) *The mischief targeted by section 23M*

Section 23M was first introduced in 2013 as part of a comprehensive strategy to deal with tax arbitrage between related parties relating to tax deductible interest. The reasons for including section 23M were included in the explanatory memorandum<sup>95</sup> in relation to the draft legislation during the course of 2013. The memorandum indicated:

"The current methods to limit excessive interest owed to exempt persons are largely incomplete. The 3:1 debt to equity rule had to be changed in favour of a more facts and circumstances approach so as to satisfy international transfer pricing standards. The 3:1 debt limit also allowed debt levels that are far too great with the prior rule arguably encouraging debt limits to the 3:1 level. As for cross-border interest withholding, the proposed change is frequently reduced to zero under most South African tax treaties."<sup>96</sup>

The 3:1 debt to equity ratio was a safe-harbour provision contemplated in Practice Note 2.<sup>97</sup> This is a reference to transfer pricing and the anomalies arising from the application of section 31 and the interpretive guidelines set out in Practice Note 2.

It should be noted that as part of interpreting taxing Acts explanatory memoranda were traditionally not a relevant guide to courts as regards the interpretation of statutory provisions.<sup>98</sup> However, recently the Supreme Court of Appeal allowed explanatory memorandum in respect of section 8A as an indication of purpose.<sup>99</sup> The court stated that:

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<sup>95</sup> South Africa, Department of National Treasury. 2013. Draft explanatory memorandum on the Taxation Laws Amendment Bill, 2013.

<sup>96</sup> South Africa, Department of National Treasury. 2013. Draft explanatory memorandum on the Taxation Laws Amendment Bill, 2013. Page 36 at clause 2.6.

<sup>97</sup> South African Revenue Service. Practice Note 2: *Income Tax: Determination Of Taxable Income Where Financial Assistance Has Been Granted By A Non-Resident Of The Republic To A Resident Of The Republic*. 14 May 1996 and Addendum issued on 17 May 2002. Paragraph 1.2. It should be noted that the withdrawal of Practice Note 2 is impending.

<sup>98</sup> de Koker, AP et al. 2015. *Silke on South African Income Tax: Chapter 25: Interpretation*. Last updated March 2015. Available from Lexis Nexis: <http://www.mylexisnexis.co.za/Index.aspx>. (accessed on 29 May 2015). Page 35 at paragraph 25.8.

<sup>99</sup> *Commissioner for the South African Revenue Service v Bosch and Another* [2015] JP: 32547 (SCA). Pages 12 to 14.

"as explained in the explanatory memorandum accompanying the amending legislation when it was placed before Parliament...That not only identifies the purpose of the amendment, but is also permissible guide to Parliament's understanding of the existing section."<sup>100</sup>

The Department of National Treasury therefore holds the view that the mischief of thin capitalisation was not adequately addressed by means of section 31 and therefore additional measures were required to counter the mischief of thin capitalisation and resultant base erosion.

### III. THE AMBIT OF SECTION 31

Section 31 was introduced with effect from 31 July 1995.<sup>101</sup> Section 31 sets out the relevant legislation concerning transfer pricing and thin capitalisation.

Section 31(2) provides:

"Where -

- (a) any transaction, operation, scheme, agreement or understanding constitutes an **affected transaction**; and
- (b) any term or condition of that transaction, operation, scheme, agreement or understanding

the taxable income or tax payable by any person contemplated in paragraph (b)(ii) that derives a **tax benefit** contemplated in that paragraph must be calculated as if that transaction, operation, scheme, agreement or understanding had been entered into on the terms and conditions that would have existed had those persons been independent persons dealing at **arm's length**."

(Own emphasis. A complete extract is attached as Appendix C)

- a) *Ordinary grammatical meaning of words*

An "affected transaction" is

<sup>100</sup> *Commissioner for the South African Revenue Service v Bosch and Another* [2015] JP: 32547 (SCA). Page 14.

<sup>101</sup> South African Revenue Service. Practice Note 2: *Income Tax: Determination Of Taxable Income Where Financial Assistance Has Been Granted By A Non-Resident Of The Republic To A Resident Of The Republic*. 14 May 1996 and Addendum issued on 17 May 2002. Paragraph 4.1.

"any transaction, operation, scheme, agreement or understanding where that transaction, operation, scheme, agreement or understanding has been directly or indirectly entered into or effected between or for the benefit of either or both"

a person that is a resident and a person<sup>102</sup> that is a non-resident; and

"any term or condition of that transaction, operation, scheme, agreement or understanding is different from any term or condition that would have existed had those persons been independent persons dealing at arm's length."

There is no definition for the phrase "arm's length", although the SARS issued Practice Note 2, which indicates that a 3:1 debt to equity ratio is indicative of an acceptable level of debt.<sup>103</sup> An "arm's length" amount is an amount of debt and rate of interest that the taxpayer would have been entitled to loan from an independent third party.

A draft interpretation note<sup>104</sup> that is meant to replace Practice Note 2 indicates that the determination of an "arm's length" amount should be applied using discretion and taking into account the following:

"In applying the arm's length basis, SARS requires taxpayers to consider the transaction from both the lender's perspective and the borrower's perspective. That is, from the lender's perspective, whether the amount borrowed could have been borrowed at arm's length (that is, what a lender would have been prepared to lend and therefore what a borrower could have borrowed) and from the borrower's perspective, whether the amount would have been borrowed at arm's length (that is, what a borrower acting in the best interests of its business would have borrowed). The arm's length amount of the debt is the lesser of the amount that could have been borrowed and the amount that would have been borrowed in a transaction between parties dealing at arm's length."

This test essentially seeks to determine the amount and rate at which a related entity would have been able to borrow a specific amount of cash

<sup>102</sup> Non-resident here includes a foreign based permanent establishment of a resident and a local permanent establishment of a non-resident.

<sup>103</sup> South African Revenue Service. Practice Note 2: *Income Tax: Determination Of Taxable Income Where Financial Assistance Has Been Granted By A Non-Resident Of The Republic To A Resident Of The Republic*. 14 May 1996 and Addendum issued on 17 May 2002. Paragraph 1.2

<sup>104</sup> South African Revenue Service. Draft Interpretation Note on Section 31. Determination of the Taxable Income of Certain Persons from International Transactions: Thin Capitalisation. South African Revenue Service. Issued on 3 April 2013. Page 7 at paragraph 5.2.

had it borrowed from an independent third party. The test, according to the note, seeks to determine whether the borrower would have had a business case to borrow an amount of money at a particular rate.

The presence of an "affected transaction" is not inherently indicative of an intention to minimise taxation through thin capitalisation.

Section 31(2) also requires one of the parties to derive a "tax benefit". "Tax benefit" is defined as "any avoidance, postponement or reduction of any tax liability." This definition is cast in wide and non-specific terms.

Section 31(4) provides that:

"For purposes of subsection (2), where any transaction, operation, scheme, agreement or undertaking has been directly or indirectly entered into or effected as contemplated in that subsection in respect of -

- (a) the granting of **financial assistance**; or
- (b) intellectual property as contemplated in the definition of "intellectual property" in section 231(1) or knowledge,

"connected person" means a connected person as defined in section 1: Provided that the expression "and no holder of shares holds the majority voting rights in the company" in paragraph d(v) of that definition must be disregarded."

(Own emphasis)

In order for a transaction to fall within this subsection it is necessary to determine the meaning of "financial assistance". "Financial assistance" is defined in section 31(1) as including "any debt or security or guarantee". These words are not defined in the Act and the ordinary grammatical meaning thereof must be determined. The Oxford Dictionary defines these phrases as follows:

"Debt" as "a sum of money that is owed or due."<sup>105</sup>

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<sup>105</sup> Oxford Dictionary. <http://www.oxforddictionaries.com/definition/english/debt>. (Last accessed 8 November 2015).

"Security" as "a thing deposited or pledged as a guarantee of the fulfilment of an undertaking or the repayment of a loan, to be forfeited in case of default."<sup>106</sup>

"Guarantee" as "an undertaking to answer for the payment or performance of another person's debt or obligation in the event of a default by the person primarily responsible for it."<sup>107</sup>

The "connected person" definition in section 1 refers to various types of taxpayer and the "connected persons" in relation to that taxpayer.<sup>108</sup> Based on the modified definition in accordance with section 31(4) a "connected person" in relation to companies<sup>109</sup> will include any person<sup>110</sup> holding equity shares or voting rights exceeding 20% in those companies.

Section 31(4) therefore broadens the "connected person" rule for purposes of an affected transaction comprising financial assistance, which results in a tax benefit, and where any term or condition of the affected transactions is different from a term or conditions that would have been included in that transaction had the parties been independent persons acting at arm's length.

Section 31 does not provide for any carry-forward of the amount that is not deductible. On the contrary, the amount is deemed to be a dividend that is

<sup>106</sup> Oxford Dictionary. <http://www.oxforddictionaries.com/definition/english/security>. (Last accessed 8 November 2015).

<sup>107</sup> Oxford Dictionary. <http://www.oxforddictionaries.com/definition/english/guarantee>. (Last accessed 8 November 2015).

<sup>108</sup> The full definition of a connected person is contained in Appendix D.

<sup>109</sup> South Africa. Income Tax Act, 1962. Section 1: Company is defined as "any association, corporation, or company incorporated or deemed to be incorporated by or under any law in force or previously in force in the Republic or in any part thereof, or any body corporate formed or established or deemed to be formed or established by or under any such law; any association, corporation or company incorporated under the law of any country other than the Republic or any body corporate formed or established under such law; any co-operative, any association formed in the Republic to serve a specified purpose, beneficial to the public or a section of the public, any portfolio comprised in any investment scheme...or a close corporation, but does not include a foreign partnership".

<sup>110</sup> South Africa. Income Tax Act, 1962. Section 1: Person is defined as including "an insolvent estate, the estate of a deceased person, any trust, and any portfolio of a collective investment scheme, but does not include a foreign partnership".

subject to dividends tax imposed in terms of section 64D or a donation depending on the circumstances.

b) *Contextual indicators*

Section 31(2) requires that the

"taxable income or tax payable by any person...that derives a tax benefit...must be calculated as if that transaction...had been entered into on the terms and conditions that would have existed had those persons been independent persons dealing at arm's length;"

Taxable income is defined<sup>111</sup> to mean the difference between the income of any taxpayer and the allowable deductions in respect of that taxpayer. Tax payable is the tax liability of the taxpayer in respect of a specific year of assessment.

The adjustment required in terms of section 31 appears to be an adjustment at the deduction level of calculating taxable income.

The heading to section 31 states that "Tax payable in respect of international transactions to be based on arm's length principle". It will be noted that the generic term "international transactions" is used in relation to this section.

The internal structure of section 31 sets out definitions in subsection 1, subsection 2 contains the general transfer pricing rule that stipulates the requirement that transaction terms must be concluded at arm's length as if between "connected persons". Subsection 3 sets out the treatment of an amount disallowed in terms of subsection 2. Subsection 4 is a more specific application of the general transfer pricing rule in subsection 2 as it deals specifically with thin capitalisation as a branch of transfer pricing. Subsections 5 and 6 provide for the specific application of transfer pricing in the presence of a headquarter company and a controlled foreign company. Subsection 7 deals specifically with shareholder loans advanced by a resident to a company forming part of the same group of companies.

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<sup>111</sup> South Africa. Income Tax Act, 1962. Section 1.

c) *The mischief targeted by section 31*

Section 31 was introduced in 1995 with a view to:

"address tax avoidance schemes involving the manipulation of prices for goods and services under cross border transactions between connected persons. In accordance with international precedent in many developed countries, it is the intention that such transfer pricing rules may also be applied to counter the abusive practice of thin capitalisation."<sup>112</sup>

A company, according to the explanatory memorandum introducing the change, may be capitalised using debt or equity financing, which gives rise to an effective tax avoidance device. The purpose of section 31 is to reclassify debt as equity to allow the SARS to disallow deductible interest expenditure on the premise that it is a return on equity and therefore constitutes non-deductible dividends.<sup>113</sup>

Section 31 is aimed at addressing "tax avoidance schemes involving the manipulation of prices for goods and services under cross border transactions between connected persons".<sup>114</sup> Provisions counteracting thin capitalisation<sup>115</sup> were inserted to combat tax avoidance schemes, "[b]ecause a company and its investors may be treated differently for tax purposes, depending on whether the return to the investor originates from debt or equity financing". The purpose of this provision is to enable SARS "to adjust the interest rate in terms of a loan which is not market related on the basis of the arm's length principle".

Section 31 was amended with effect from 1 October 2011 to align the transfer pricing provisions, including section 31, with more modern transfer

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<sup>112</sup> South Africa, Department of National Treasury. 1995. Explanatory memorandum on the Taxation Laws Amendment Bill, 1995. Page 27 at clause 23.

<sup>113</sup> South Africa, Department of National Treasury. 1995. Explanatory memorandum on the Taxation Laws Amendment Bill, 1995. Page 28.

<sup>114</sup> South Africa, Department of National Treasury. 1995. Explanatory memorandum on the Taxation Laws Amendment Bill, 1995. Page 27, at clause 23.

<sup>115</sup> Initially section 31(4) was provided for in section 31(3).



pricing and thin capitalisation rules.<sup>116</sup> Notably, thin capitalisation was merged into the transfer pricing rules so as to form "an extension of the transfer pricing rules".<sup>117</sup>

The purpose of this change is to "deny deductions of interest that would not have existed had the South African entity not been thinly capitalised with excessive debt."<sup>118</sup>

#### IV. INTERRELATIONSHIP BETWEEN SECTION 23M AND SECTION 31

The overlapping elements of section 23M and section 31 are considered in greater detail below. Table 1 below summarises the ambit of section 23M and section 31 pursuant to the steps identified in Chapter 2.

**Table 1:**

	<b>Section 23M(2)</b>	<b>Section 31</b>
<b>Taxpayer</b>	Debtor, any person that is a resident, including a local permanent establishment of a tax non-resident.	Any two related persons, where one person is resident and another is tax non-resident, including a local permanent establishment of a non-resident or a foreign permanent establishment of a resident.
<b>Relationship</b>	Controlling relationship. (>50% equity shares or voting rights).	Modified connected person in respect of financing transactions. (>20% equity shares or voting rights).
<b>Expenditure</b>	Interest on debt or guaranteed debt.	Interest on debt or guaranteed debt (as per the definition of financial assistance).
<b>Definition of</b>	Section 24J (including common	Not mentioned expressly in the

<sup>116</sup> South Africa, Department of National Treasury. 2010. Explanatory memorandum on the Taxation Laws Amendment Bill, 2010. Pages 74 to 75.

<sup>117</sup> South Africa, Department of National Treasury. 2010. Explanatory memorandum on the Taxation Laws Amendment Bill, 2010. Page 75 at paragraph II.

<sup>118</sup> South Africa, Department of National Treasury. 2010. Explanatory memorandum on the Taxation Laws Amendment Bill, 2010. Page 76 at paragraph B.

	Section 23M(2)	Section 31
<b>interest</b>	law).	section, but will fall within the ambit of a financial assistance. Interest here would be defined as common law interest.
<b>Limitation</b>	As per calculation applies to amount of interest deduction only.	Arm's length amount and rate.
<b>Tax computation</b>	Applies as an express limitation on the allowable deduction.	Adjusts taxable income or tax payable by adjusting the allowable deduction amount.
<b>Consequence</b>	Disallowance of amount, subject to carry-forward.	Excess amount deemed to be a dividend <i>in specie</i> or a donation. No carry-forward.
<b>Purpose</b>	Prevents erosion of the South African tax base through manipulation of interest deduction.	Prevents erosion of the South African tax base through manipulation of interest deduction.

These key aspects will now be considered in greater detail.

a) *The taxpayer*

The first aspect concerns the type of taxpayer to whom the sections apply. Section 23M(2) applies to "debtors", which are considered to be resident persons and local permanent establishments of tax non-resident persons. Section 23M therefore only adjusts the deduction allowed in the hands of resident taxpayers.

Section 31 applies in respect of the tax payable by a tax resident or a tax non-resident,<sup>119</sup> including payments by a South African permanent establishment, a foreign permanent establishment and a controlled foreign

<sup>119</sup> South Africa. Income Tax Act, 1962. Section 1: Tax non-resident persons are subject to the Act by virtue of the inclusion in paragraph (b) of the gross income definition of the total amount, in cash or otherwise, received by or accrued to or in favour of such persons from a source within South Africa.

company<sup>120</sup> of a resident. The overlapping areas are therefore tax resident persons and resident permanent establishments.

Section 31 appears to have a wider ambit than does section 23M. Resident taxpayers falling into both categories (i.e. companies having a single foreign based shareholder that holds at least 50% of the ordinary shares or voting rights in the resident company or local permanent establishments) will be subject to a more restrictive total regime than other taxpayers if it is assumed that both sections are to be applied.

b) *The related party test*

The second aspect concerns the relationship between the resident person and the tax non-resident counterparty. Section 23M applies to transactions in the presence of a "controlling relationship". A "controlling relationship" requires a direct or indirect interest of at least 50% voting rights or equity shares.

Section 31 has a broader test that includes any relationship in which a person holds a direct or indirect interest of at least 20% (in terms of the modified connected person test contemplated in section 31).

Where a non-resident shareholder has a direct or indirect interest exceeding 50% of the equity shares or voting rights in a subsidiary that is resident in South Africa the relationship will fall within both section 23M and section 31, assuming the non-resident shareholder is lending funds to the South African tax resident subsidiary.

c) *The definition of interest*

The third aspect relates to "interest". "Interest" is defined for purposes of section 23M with reference to the definition of "interest" as contemplated in

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<sup>120</sup> South Africa. Income Tax Act, 1962. Section 9D(1): A "controlled foreign company" is defined as "any foreign company where more than 50 per cent of the total participation rights in that foreign company are directly or indirectly held, or more than 50 per cent of the voting rights in that foreign company are directly or indirectly exercisable, by one or more persons that are residents other than persons that are headquarter companies;..." The definition is subject to an extensive proviso, which is not relevant to this study and therefore not reproduced here.

section 24J. The definition of interest in section 24J includes "interest", which incorporates the common law definition of "interest".

Section 31(2), read with section 31(4), applies to "financial assistance", which has a wide definition that includes the loan principal and interest. "Interest" is not defined for purposes of section 31 and the expanded definition in section 24J does not apply if no express reference is made thereto. Any compensation for the use of money paid by the subsidiary to the foreign shareholder in respect of debt advanced to it will constitute "interest" as defined in the common law.

Therefore in relation to this discreet aspect of section 23M and section 31 it appears that the sections apply to the same taxpayer, in respect of the same relationship and the same tax deductible amount. However, section 31 also applies to the loan principal.

d) *The disallowance*

Section 23M(2) limits the amount allowed to be deducted. Use of the word "allowed"<sup>121</sup> suggests that the amount that is subject to limitation for purposes of section 23M is the amount of interest to be deducted in accordance with the scheme of the Act as a whole.

Section 24J<sup>122</sup> deems interest expenditure to be incurred in accordance with a yield to maturity method calculated in terms of the provisions of that section. The provision seeks to smooth the deduction of the interest incurred in respect of an instrument over the existence of that instrument regardless of how the parties structured the payment of interest.

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<sup>121</sup> "Allowed" is defined as "declare or decide that an event or activity is legal or acceptable; take something into consideration when making plans or calculations; provide or set aside for a particular purpose;" Oxford Dictionary. <http://www.oxforddictionaries.com/definition/english/allow>. (last accessed 8 November 2015).

<sup>122</sup> South Africa. Income Tax Act, 1962. Section 24J(2) provides that "Where any person is the issuer in relation to an instrument during any year of assessment, such person shall **for purposes of this Act be deemed to have incurred an amount of interest** during such year of assessment, which is equal to...". (Own emphasis)

Express provision is made for the application of any limitation in accordance with section 23N prior to the application of section 23M.<sup>123</sup>

An argument exists to conclude that the interest subject to limitation in section 23M is therefore the amount of interest allowed to be deducted in terms of section 24J, regardless of the amount of interest actually contractually incurred by the taxpayer.

The word "allowed" may further support the argument put forward by SARS that interest is subject to section 31 first, being a provision which limits the ability of the taxpayer to deduct interest.

Section 31 does not make express mention of the amount of interest incurred or allowed. The basis of the measure for purposes of section 31 is the terms or conditions of an "affected transaction" as measured against terms or conditions that would have been agreed between independent persons dealing at arm's length. Arguably therefore the actual interest as set out in the terms of the financial assistance is subject to repricing.

There is no carry-forward in relation to the disallowed amount in terms of section 31, but is deemed to be a dividend *in specie* or a donation as the case may be. The deemed dividend may be subject to dividends tax imposed at a flat rate of 15%<sup>124</sup> and donations tax at a flat rate of 20%.<sup>125</sup>

e) *The purpose*

Section 23M is aimed at protecting the South African tax base against erosion in the context of related entities forming part of the same economic unit where the terms of debt funding can be manipulated to result in a deliberate and excessive mismatch of the taxation of interest.<sup>126</sup>

<sup>123</sup> South Africa. Income Tax Act, 1962. Section 23M(5).

<sup>124</sup> South Africa. Income Tax Act, 1962. Section 64E(1).

<sup>125</sup> South Africa. Income Tax Act, 1962. Section 64, read with section 54.

<sup>126</sup> South Africa, Department of National Treasury. 2012. Explanatory memorandum on the Taxation Laws Amendment Bill, 2012. Page 37 at paragraph 2.6 B.

Section 31 ensures "the arm's length allocation of taxable profits"<sup>127</sup> between related parties. The aim of section 31 therefore appears to be the prevention of potential base eroding effect of excess interest deductions by reclassifying debt as equity.

The difference between the mischief cured by section 23M and section 31 is subtle. Both sections prevent base erosion by limiting excessive deductions of interest. However, section 31(3) reclassifies the excessive portion of any interest as equity, whereas section 23M does not seek to reclassify the deduction.

This may allow for an argument that section 31 must be applied first to separate equity from interest and thereafter the limitation on deductible interest can be calculated.

## V. MATHEMATICAL REPRESENTATION OF THE APPLICATION OF SECTION 23M AND SECTION 31

To determine the importance of establishing the interrelationship between these sections, the following example can be considered, based on illustrative calculations included as Appendix E.

### *Illustrative Facts and Assumptions:*

Company A, a South African resident company, borrows ZAR 10 000 000 from its sole shareholder, Company B, a tax non-resident. The terms of the debt are that the loan is repayable in equal monthly instalments over a period of five years and is subject to an annual interest rate of 11%. The actual amount of interest expenditure in the first year of assessment is equal to ZAR 1 021 543.25.

Company A has taxable income of ZAR100 000 for the first year of assessment. Company A also receives interest income of ZAR10 000 per year.

A static repo rate of 6% is assumed and it is assumed that Company B does not qualify for a reduction in dividends tax rate. It is further assumed that the double taxation

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<sup>127</sup> South Africa, Department of National Treasury. 2012. Explanatory memorandum on the Taxation Laws Amendment Bill, 2012. Page 116 at paragraph 4.8 II.

agreement with the country of residence of Company B reduces the rate of withholding tax on interest to zero.

*Section 23M calculation:*

Section 23M limits the tax deductible interest expenditure in accordance with the following calculation:

$$A = \frac{C}{D}$$

- A: represents the percentage to be determined;
- B: represents the number 40;
- C: represents the average repo rate plus 400 basis points; and
- D: represents the number 10.

*Section 31 calculation:*

SARS regards the quantum as acceptable in both Scenario 1 and 2, but in Scenario 1 the interest rate is reduced to 9% and in Scenario 2 the interest rate is reduced to 3%.

These two scenarios will be discussed below.

a) *Scenario 1:*

If the calculation set out in section 23M(3) is applied to actual interest expenditure Company A is allowed to deduct a maximum amount of interest of ZAR 454 617.30.

If the arm's length limitation in section 31 is applied to actual interest expenditure Company A is allowed to deduct a maximum amount of ZAR 832 702.40.

Company A would therefore be allowed to deduct a maximum of ZAR 454 617.30 in respect of the first year of assessment.

If Company A is allowed to carry forward the amount of the difference between the limitation calculated in section 23M and the actual interest

expenditure, Company A can carry forward an amount of ZAR 566 925 95 (ZAR 1 021 543.25 - ZAR 454 617.30). However, if it is assumed that the interest expenditure is repriced in terms of section 31 first, Company A is entitled to carry forward a maximum amount of ZAR 378 082.10 (ZAR 832 702.40 - ZAR 454 617.30).

Company A will forego a cumulative tax shield of ZAR 158 739.27 (being 28% of the total disallowance) and incur ZAR 28 326.13 dividends tax (being 15% of the amount disallowed in terms of section 31).

If the calculation in section 23M is done taking into account "allowable" interest expenditure after applying section 31, the maximum deduction available to Company A is ZAR 343 080.96 and the amount of the carry-forward is ZAR 489 621.44 (ZAR 832 702.40 - ZAR 343 080.96).

The tax shield foregone by Company A increases to ZAR 189 969.44 (being 28% of the total disallowance).

b) *Scenario 2:*

If the calculation set out in section 23M(3) is applied to actual interest expenditure Company A is allowed to deduct a maximum amount of interest of ZAR 454 617.30.

If the arm's length limitation in section 31 is applied to actual interest expenditure Company A is allowed to deduct a maximum amount of ZAR 274 262.76.

Company A would therefore be allowed to deduct a maximum of ZAR 274 262.76 in respect of the first year of assessment.

If Company A is allowed to carry forward the amount of the difference between the limitation calculated in section 23M and the actual interest expenditure, Company A can carry forward an amount of ZAR 566 925 95 (ZAR 1 021 543.25 - ZAR 454 617.30). However, if it is assumed that the interest expenditure is repriced in terms of section 31 first, Company A is entitled to carry forward a maximum amount of ZAR 180 354.53 (ZAR 454 617.30 - ZAR 274 262.76).



Company A will forego a cumulative tax shield of ZAR 209 238.53 (being 28% of the total disallowance) and incur ZAR 112 092.07 dividends tax (being 15% of the disallowance in terms of section 31).

If the calculation in section 23M is done taking into account "allowable" interest expenditure after applying section 31, the maximum deduction available to Company A is ZAR 119 705.11 and the amount of the carry-forward is ZAR 154 557.66 (ZAR 274 262.76 - ZAR 119 705.11).

The tax shield foregone by Company A increases to ZAR 252 514.68 (being 28% of the total disallowance).

The maximum amount of the deduction is not influenced significantly by the order in which these sections are applied as the allowable deduction must always be equal to the amount of the smallest answer.

However, if section 31 applies first and the amount that a taxpayer is allowed to carry-forward for deduction in subsequent years of assessment is calculated with reference to the actual amount of interest incurred, the limitation imposed by section 31 is negated. However, if the carry-forward amount is calculated with regard to the maximum allowable amount in terms of section 31, the taxpayer foregoes a significant tax deduction.

## **VI. CONCLUSION**

This Chapter applied the guidelines established in Chapter 3 for purposes of determining the ambit of section 23M and section 31 respectively. Therefore, regard was given to the ordinary grammatical meaning of the words of each section, thereafter the contextual indicators were considered. The purpose of each section was analysed as the last step in the interpretive process.

Section 23M and section 31 constitute avoidance provisions and the interpretation thereof must be done in accordance with the expositions set out in the *Glen Anil*

*Development Corporation Ltd v CSARS* case<sup>128</sup>. However, it is important not to make the section "more effective than its language might suggest"<sup>129</sup>

The ambit of each of section 23M and section 31 is summarised in Table 1.<sup>130</sup> The key aspects of these two sections were compared to determine whether an overlap in the application of these sections is evident.

As regards the taxpayers to whom the two sections apply, section 31 appears to have a wider ambit than does section 23M. Taxpayers with a foreign based shareholder that holds at least 50% of the ordinary shares or voting rights in the resident company or local permanent establishment will be subject to a more restrictive total regime than other taxpayers if it is assumed that both sections are to be applied.

Use of the word "allowed" in section 23M is perhaps an indicator that the purpose of section 23M was to limit interest allowed to be deducted in accordance with the precepts of the Act as a whole, which would include interest repriced in terms of section 31.

The implications of such an argument are that the calculation of the limitation on the deductible amount of interest for purposes of section 23M uses interest that has been subjected to repricing in terms of section 31 first. As is noted from the calculations, the impact of calculating the limitation in terms of section 23M with regard to repriced interest results in a far more extensive limitation. It is contemplated that the carry-forward amount will therefore have to be calculated as the difference between the repriced interest and the interest limitation in terms of section 23M. This might result, as can be noted from the calculation, a negligible carry-forward if the repriced rate of interest is too restrictive. This may entirely negate the carry-forward in certain instances.

However, it can be argued that section 23M applies first as carry-forward might be preserved and subjected to section 31 in the year during which the taxpayer seeks to claim such carry-forward. This appears to be a more equitable result for resident

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<sup>128</sup> *Glen Anil Development Corporation Ltd v SIR* 1975 (4) SA 715 (A); 37 SATC 319. Page 334 to 335.

<sup>129</sup> Meyerowitz, D. 1995. Has the contra fiscum rule vanished? *Acta Juridica*. Vol. 79:79-88. Available from: HeinOnline: <http://heinonline.org>. Accessed on: 30 March 2015. Page 86.

<sup>130</sup> Table 1, refer to page 40.

taxpayers and accords with the purpose of the deeming rule contained in section 23M(4). Such an approach, it is argued, will comply with a teleological approach to interpretation and takes into account equity and fairness in the tax system.

Chapter 5 will consider the application of interpretive presumptions to the overlapping ambit of section 23M and section 31.

## CHAPTER FIVE: COMMON LAW PRESUMPTIONS AS PART OF STATUTORY INTERPRETATION

### I. INTRODUCTION

The application of the interpretive process in terms of Chapter 3 did not yield a more certain understanding of the interaction between section 23M and section 31. This chapter builds on the findings in Chapter 4 by applying common law presumptions available to courts as part of in the interpretive process.

However, before considering the application of common law presumptions pertaining to the interpretation of fiscal statutes, it is necessary to classify presumptions in the hierarchy of law.

Emslie *et al*<sup>131</sup> distinguish between presumptions of statutory interpretation and canons of construction and argue that presumptions arise out of the development of the common law and are binding principles. The premise for a distinction between presumptions and canons of construction is that the latter is merely an aid to interpretation to be followed at the whim of the interpreter.

Du Plessis<sup>132</sup> states that:

"in spite of their depreciation in a case law dominated by a literalist-cum-intentionalist order of primacy, they did acquire a special status. All the presumptions, even the most technical ones, are verbalisations of values vital to the sustenance of a just and effective legal order: equity reasonableness, equality, legality, legal certainty, public interest and so on."

Du Plessis further justifies reliance on presumptions in light of the values subsumed in the Constitution and the resultant teleological approach:

"...presumptions as interpretative guides, could still fulfil a number of useful functions. First, they can supplement, facilitate and mediate resort to constitutional values in statutory interpretation, in accordance with the requirements of section 39(2) of the Constitution. Secondly, they can advance foundational values consistent with - but not explicitly spelled out in - the Constitution. Thirdly, they

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<sup>131</sup> Emslie, T and Davis, D. 2011. *Income Tax: Cases and Materials*. Third Edition (including a First and Second Supplement). Page 15 at paragraph 1.

<sup>132</sup> Du Plessis, L M. 2011. *Statute Law and Interpretation*. Law of South Africa. Volume 25(1). Paragraph 333.

can advance foundational values embodied in the Constitution in but a fragmentary manner. Finally, they can guide constitutional interpretation itself and amplify certain of its procedures."

In light of the considerations set out above it is submitted that courts will be justified to consider the application of presumptions to resolve "difficulties inherent in language" in relation to fiscal legislation.<sup>133</sup>

Devenish states that:

"Interpretation of legislation therefore involves a synthetic process of inference not only from linguistic but also from legal and jurisprudential indicia. The process of interpretation should therefore be a holistic one in which the presumptions of interpretation, which embody normative principles of the common law, constitute an indispensable source of precipitation and applying the intention of the legislature."<sup>134</sup>

As part of the teleological approach introduced by the Constitution it is submitted that presumptions inform a value-laden interpretation and therefore are integral to the interpretive process.

This dissertation will consider the following presumptions only:

- a) The presumption that legislation does not intend to change the existing law more than is necessary.
- b) The legislator is presumed not to have intended an unfair, unjust or unreasonable result.
- c) Legislation is presumed to be consistent with international law.

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<sup>133</sup> Steyn, L. C (edited by SIE van Tonder). 1981. *Die Uitleg van Wette*. Fifth Edition. Page 69 at paragraph III. The author states that the legislature's intention "*blyk in 'n aansienlike mate ook uit sekere weerlegbare vermoedens*".

<sup>134</sup> Devenish, G E. 1992. *Interpretation of Statutes*. First Edition. Page 158 at paragraph 1.

## II. PRESUMPTIONS PERTAINING TO FISCAL STATUTES

- a) *The legislator is presumed not to have intended an unfair, unjust or unreasonable result*

"This presumption goes to the root of what most citizens believe a legal order should at any rate seek to achieve while it avoids, as far as is humanly possible, individual hardship."<sup>135</sup>

MT Steyn J<sup>136</sup> identified two principles of construction as being primary to the interpretative process:

"Two principles of construction are of prime importance whenever a statute has to be interpreted, and they are that

- (i) the main task is to ascertain the intention of the legislator, which is primarily to be sought in the language he chose to use (Steyn *Die Uitleg van Wette* 5 ed 1) and that
- (ii) unless the contrary be clearly evident from the terms of the measure itself, the legislator is presumed not to have intended an unfair, unjust or unreasonable result."

It is submitted that this rule was suppressed by the formalistic following of the literalist approach before the advent of the Constitution.<sup>137</sup> Its development may therefore be less pronounced, but certain of its manifestations have circumvented the literalist suppression.<sup>138</sup> The *contra fiscum* rule, as well as the presumption against the encroachment on existing rights, discussed below, has roots in this presumption.<sup>139</sup>

The *contra fiscum* rule only finds application where the court is satisfied that there is ambiguity or doubt as regards the interpretation of a statute or statutory provisions. This rule is discussed in greater detail below.

<sup>135</sup> Du Plessis, L M. 2011. Statute Law and Interpretation. Law of South Africa. Volume 25(1). Paragraph 334.

<sup>136</sup> 46 SATC 95. Page 101.

<sup>137</sup> Du Plessis, L M. 2011. Statute Law and Interpretation. Law of South Africa. Volume 25(1). Paragraph 334.

<sup>138</sup> Du Plessis, L M. 2011. Statute Law and Interpretation. Law of South Africa. Volume 25(1). Paragraph 334.

<sup>139</sup> Du Plessis, L M. 2011. Statute Law and Interpretation. Law of South Africa. Volume 25(1). Paragraph 334 (a(ii)).

b) *Contra fiscum*

The *contra fiscum* rule in the case of ambiguity in fiscal legislation, favours the interpretation that imposes the lesser burden on a taxpayer.<sup>140</sup> The apparent ambiguity must result from ambiguity in the intention of the legislature<sup>141</sup> (or the purpose of the provision) and not as a result of an inherent difficulty in the language of the statute itself.

The application of this rule to cases concerning tax avoidance is subject to the following comment by the tax court in the *Glen Anil* case:<sup>142</sup>

"Apart from the rule that in case of an ambiguity a fiscal provision should be construed *contra fiscum* (*Estate Reynolds and others v Commissioner for Inland Revenue 1937 AD 57 at 70*) which is but a specific application of the general rule that all legislation imposing a burden upon the subject should, in the case of an ambiguity, be construed in favour of the subject, there seems little reason why the interpretation of fiscal legislation should be subject to special treatment...

In any event I do not understand the rule to be that every fiscal statute, whether it relates to the tax imposed or not should be construed with due regard to any rules relating to the interpretation of fiscal legislation.

Section 103 of the Act is clearly directed at defeating tax avoidance schemes. It does not impose a tax, nor does it relate to the tax imposed by the Act or to the liability therefore or to the incidence thereof, but rather to schemes designed for the avoidance of liability therefor. It should, in my view, therefore, not be construed as a taxing measure but rather in such a way that it will advance the remedy provided by the section and suppress any mischief against which the section is directed."

According to an article by Meyerowitz this dictum affirms the *contra fiscum* rule, but also indicates an approach by the court to make an anti-avoidance provision "more effective than its language might suggest".<sup>143</sup>

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<sup>140</sup> *Shell's Annandale Farm (Pty) Ltd v Commissioner for Inland Revenue 62 SATC 97*. Page 108.

<sup>141</sup> Meyerowitz, D. 1995. Has the *contra fiscum* rule vanished? *Acta Juridica*. Vol. 79:79-88. Available from: HeinOnline: <http://heinonline.org>. Accessed on: 30 March 2015. Page 87.

<sup>142</sup> *Glen Anil Development Corporation Ltd v SIR 1975 (4) SA 715 (A)*. Page 334 to 335.

<sup>143</sup> Meyerowitz, D. 1995. Has the *contra fiscum* rule vanished? *Acta Juridica*. Vol. 79:79-88. Available from: HeinOnline: <http://heinonline.org>. Accessed on: 30 March 2015. Page 86.

In light of the *Glen Anil* case it appears that the *contra fiscum* rule does not apply to the interpretation of provisions aimed at the mischief of tax avoidance. Both section 23M and section 31 constitute anti-avoidance provisions on the premise that both sections aim to curb the manipulation of tax deductible interest in a related party context. In accordance with the provisions of the *Glen Anil* case, it is therefore unlikely that the *contra fiscum* rule will assist a taxpayer in this context.

In closing, Meyerowitz indicates the *contra fiscum* may only be necessary to underscore a conclusion drawn by a court without it.<sup>144</sup> This article doubts the necessity of the specific application of this presumption in the context of taxing legislation.

- c) *Presumption that legislation does not intend to change the existing law more than is necessary*

This presumption aims to limit the destabilisation of existing law<sup>145</sup> through the introduction of new law. It is specifically applied in cases where the common law is altered through the introduction of a statute, as well as the alteration of existing statutory law through the introduction of new statutes or statutory provisions. In the case of *Curtis v Johannesburg Municipality*<sup>146</sup> the court stated that: "In the absence of express provision to the contrary, statutes...if possible should be so interpreted as not to take away rights actually vested at the time of their promulgation."

In galvanising what is now considered the "new approach" to interpreting fiscal legislation, M T Steyn J states that "a statute must be so interpreted as to be as unoppressive as possible."<sup>147</sup>

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<sup>144</sup> Meyerowitz, D. 1995. Has the *contra fiscum* rule vanished? *Acta Juridica*. Vol. 79:79-88. Available from: HeinOnline: <http://heinonline.org>. Accessed on: 30 March 2015. Page 88.

<sup>145</sup> Du Plessis, L M. 2011. *Statute Law and Interpretation*. Law of South Africa. Paragraph 340.

<sup>146</sup> 1906 TS 308. Page 311.

<sup>147</sup> 46 SATC 95. Page 101.



However, this presumption requires as a first port of call that the interpreter should consider the consistent and coherent application of both legislative provisions.<sup>148</sup>

It is only if such reconciliation fails that the court will rely on the maxim *generalia specialibus non derogant*.<sup>149</sup> According to Emslie, this maxim:

"is merely an application of the wider principle that where any statutory provision which makes inroads on the rights of the individual whose rights are thereby diminished. The latter is a consequence of the presumption that the Legislature intends statutes to affect existing rights as little as possible."

d) *Generalia Specialibus non derogant*

*Generalia specialibus non derogant* implies that a provision of a more general import does not override a provision of specified import and that specific legislative provisions override general provisions contained within the same instrument.<sup>150</sup>

In the case of *Heiman, Maasdorp and Barker v Secretary for Inland Revenue*<sup>151</sup> the court stated that "[t]he language of the section would be decisive unless it is subject to the rule *generalia specialibus non derogant*." To resolve the query the court examined a provision of the Act as it then was as well as the common law right to legal privilege.

In considering whether a particular provision was special in nature, the court considered it appropriate to take into account the purpose of legal privilege as well as the purpose of the relevant statutory provision.<sup>152</sup> The court determined that:

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<sup>148</sup> Botha, C. 2007. *Statutory Interpretation: An introduction for students*. Fourth Edition. Page 45 at paragraph 4.6.2. Kellaway, E. A. 1995. *Principles of Legal Interpretation: Statutes, Contracts and Wills*. Page 367 at paragraph 30.

<sup>149</sup> Botha, C. 2007. *Statutory Interpretation: An introduction for students*. Fourth Edition. Pages 45 to 46 at paragraph 4.6.2. Du Plessis, L M. 2011. *Statute Law and Interpretation*. Law of South Africa. Paragraph 340.

<sup>150</sup> Du Plessis, L M. 2011. *Statute Law and Interpretation*. Law of South Africa. Paragraph 305.

<sup>151</sup> 1968 (4) SA 160 (W), 30 SATC 145. Page 148 to 149.

<sup>152</sup> 1968 (4) SA 160 (W), 30 SATC 145. Page 148.

"section 74(1) appl[ies] only in respect of matters relating to income tax and in that respect may be said to be special, it seems to me that it is **aimed at the community at large and in that way is more properly described as a general provision** enabling the S.I.R. to collect information in respect of any taxpayer".

(Own emphasis)

The court considered the application of the section as general based on the ambit thereof and quoted with approval, among others, the following passages from Steyn:

"Hierdie vermoede bring mee dat 'n wet, sover doenlik, so uitgelê moet word dat sy bepalings met die bestaande reg ooreenstem, of so min moontlik daarvan afwyk. Vir 'n verandering van die bestaande reg is 'n duidelike bepaling of wetsduiding nodig. Hierdie reel skyn te berus op 'n veronderstelde eerbied aan die kant van die wetgewer vir die historiese gewordene regsorde."<sup>153</sup>

and

"Ook die reël dat 'n latere algemene wet nie 'n vorige spesiale wet oor dieselfde onderwerp herroep of wysig nie, het herhaaldelik in ons regspraktyk erkenning gevind, en word toegepas nie alleen ten aansien van verskillende wette nie, maar ook wat betref verskillende bepalings in dieselfde wet."<sup>154</sup>

and

"On the preceding page (174) the learned author quotes with approval an opinion of Schomaker that a general law does not even abrogate a special local custom unless it expressly provides for it."<sup>155</sup>

Devenish agrees that this presumption may be used to resolve a conflict between provisions of the same statute, but cautions that the presumption is rebuttable if a contrary intention is clear from the wording of legislation.<sup>156</sup>

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<sup>153</sup> 1968 (4) SA 160 (W), 30 SATC 145. Page 149.

<sup>154</sup> 1968 (4) SA 160 (W), 30 SATC 145. Page 149.

<sup>155</sup> 1968 (4) SA 160 (W), 30 SATC 145. Page 149.

<sup>156</sup> Devenish, G E. 1992. Interpretation of Statutes. First Edition. Page 283 at paragraph 4.

In *ITC 1558*<sup>157</sup> the Court held that this maxim only applies where there is a conflict between provisions and that the maxim cannot be used to extend the application of a specific section by applying general legislation.

e) *Presumption that legislation is consistent with international law*

Section 233 of the Constitution states that "every court must prefer any reasonable interpretation of legislation that is consistent with international law over any alternative interpretation that is inconsistent with international law."

International law is a "body of rules and principles which are binding upon states in their relations with one another".<sup>158</sup> International law comprises the express legal agreements between states, such as tax treaties, as well as general rules binding on all states.<sup>159</sup>

It is submitted that the OECD Model Tax Convention and the Commentary on the Convention constitute customary international law by means of *usus* and *opinio juris sive necessitatis*.<sup>160</sup>

*Usus* requires evidence of a settled practice by a state. The vast majority of South African agreements for the avoidance of double taxation are based on the Model Tax Conventions of the OECD. The definition of "permanent establishment" in section 1 of the Act makes express reference to the definition in the OECD Model Tax Convention on Income and Capital. It is therefore submitted that the OECD Convention and commentary thereto, including the continuing work done by the OECD, constitutes evidence of South African state practice. It is noted by the DTC that:

"Since the OECD recommendations have become globally accepted standard, and as a member of the G20 and the OECD BEPS Committee, it is important for South Africa to work

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<sup>157</sup> 55 SATC 231. Page 246.

<sup>158</sup> Dugard, J. 2009. *International Law: A South African Perspective*. Third Edition. Page 1.

<sup>159</sup> Dugard, J. 2009. *International Law: A South African Perspective*. Third Edition. Chapter 1. Page 1.

<sup>160</sup> Dugard, J. 2009. *International Law: A South African Perspective*. Third Edition. Page at paragraph B.

together with the international community to come up with a holistic approach to properly address the BEPS issues."<sup>161</sup>

*Opinion juris* requires a state to feel itself bound to a particular rule.<sup>162</sup> Commentary by the DTC regarding the application of the OECD indicates that the application of the OECD recommendations must be tailored to South African circumstances.<sup>163</sup> It is submitted that the evidence of South Africa's hesitance to apply the recommendations without due consideration to the application in a South African context does not indicate a feeling of being bound by a particular rule.

Despite the hesitation, there are instances of South African courts considering the interpretation of double tax agreements in accordance with the provisions of OECD recommendations.<sup>164</sup> It may be accepted that the OECD commentary in relation to treaties constitutes customary international law, however it is submitted that other OECD recommendations have not yet reached the status of international customary law as required in the Constitution.

The recommendations by the OECD, including the BEPS Action Points may be considered "soft law", which comprise "imprecise standards...that are intended to serve as guidelines to states in their conduct".<sup>165</sup>

The OECD recommendations are therefore relevant to the interpretive process. As highlighted by the DTC it is important that the recommendations are incorporated into legislation in a manner that recognises South Africa's unique situation.

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<sup>161</sup> Davis Tax Committee Interim Report: Addressing Base Erosion and Profit Shifting in South Africa. Available from: [http://www.taxcom.org.za/docs/New\\_Folder/1%20DTC%20BEPS%20Interim%20Report%20-%20The%20Introductory%20Report.pdf](http://www.taxcom.org.za/docs/New_Folder/1%20DTC%20BEPS%20Interim%20Report%20-%20The%20Introductory%20Report.pdf). Page 18 at paragraph 2.9.

<sup>162</sup> Dugard, J. 2009. *International Law: A South African Perspective*. Third Edition. Page 33 at paragraph 2.

<sup>163</sup> Davis Tax Committee Interim Report: Addressing Base Erosion and Profit Shifting in South Africa. Available from: [http://www.taxcom.org.za/docs/New\\_Folder/1%20DTC%20BEPS%20Interim%20Report%20-%20The%20Introductory%20Report.pdf](http://www.taxcom.org.za/docs/New_Folder/1%20DTC%20BEPS%20Interim%20Report%20-%20The%20Introductory%20Report.pdf). Page 18 at paragraph 2.9.

<sup>164</sup> *AB LLC and BD Holdings LLC v Commissioner of the South African Revenue Services* unreported case number 13276. Page 16 at paragraph 22 to 25.

<sup>165</sup> Dugard, J. 2009. *International Law: A South African Perspective*. Third Edition. Page 38 at paragraph 4.

### III. CONCLUSION

Despite the uncertainty expressed by Meyerowitz in relation to the continued existence of the *contra fiscum* rule, this rule does not find application in cases of avoidance provisions on the premise of the *Glen Anil Development Corporation Ltd*<sup>166</sup> judgment. The specific application of this presumption to taxing legislation through the *contra fiscum* rule does not find application. The presumption that the legislature does not intend an unjust or inequitable result does not assist in resolving the interrelationship between section 23M and section 31.

The presumption against the unnecessary alteration of existing law may be applied to resolve a conflict between provisions of the same statute. In such an instance, the presumption is rebuttable if a contrary intention appears from the wording of the legislation in question.<sup>167</sup> In *ITC 1558*<sup>168</sup> the Court held that this maxim only applies where there is a conflict between provisions and that the maxim cannot be used to extend the application of a specific section by applying general legislation.

As indicated in Chapter 4, there is an overlap in the ambit of section 23M and section 31 as regards tax deductible interest in the context of shareholder loan funding or guarantees, where the shareholder holds more than a 50% interest in the resident company. It is unclear whether the sections must be applied to the exclusion of each other and therefore concurrently or jointly, in which case the order in which the sections apply is also uncertain. There is no apparent indication of the intention of the legislature in respect of the order of application of section 23M and section 31. The indication in the SCOF report<sup>169</sup> that section 31 applies first, is merely an indication of the understanding of the National Treasury and cannot be used as a proxy for the intention of the legislature or parliament.

The presumption that new legislation does not intend to change existing law more than is necessary manifests in the *generalia specialibus non derogant* rule, which implies

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<sup>166</sup> *Glen Anil Development Corporation Ltd v SIR* 1975 (4) SA 715 (A). Page 334 to 335.

<sup>167</sup> Devenish, G E. 1992. *Interpretation of Statutes*. First Edition. Page 283 at paragraph 4.

<sup>168</sup> 55 SATC 231. Page 246.

<sup>169</sup> South Africa, Department of National Treasury. 2014. Draft Taxation Laws Amendment Bill, 2014 and Tax Administration Laws Amendment Bill, 2014: Draft Response Document from National Treasury and SARS, as presented to SCOF. Page 15.

that the more specific of section 23M and section 31 applies to the exclusion of the more general of the two. As determined in Chapter 4, section 23M applies to a more narrowly defined subset of taxpayers, but a broader definition of interest. This section is meant to add to the set of existing provisions limiting the deductibility of interest and be "adjunct to transfer pricing". It may be submitted that the application of the *generalia specialibus non derogant* implies that section 23M overrides and excludes the application of section 31.

Arguments against the application of this rule arise from the subtle difference in the mischief remedied by each of section 23M and section 31. The broader definition of interest may also be taken as contrary to the application of this rule. The inclusion of the word "allowable" in section 23M appears to justify a concurrent application of both sections. The existence of such an interpretation would negate the application of this the *generalia specialibus non derogant* rule.

Section 233 of the Constitution requires legislation to be interpreted as consistent with international law. International law carries a specific meaning that relies on elements of *usus* and *opinio juris*. It is unlikely that all OECD publications constitute international law as contemplated in section 233 of the Constitution. However, there is a strong argument that recommendations by the OECD, including the BEPS Action Points, may be considered "soft law" as being "imprecise standards...that are intended to serve as guidelines to states in their conduct".<sup>170</sup> It is therefore preferable to interpret domestic tax legislation with regard to recommendations by OECD to the extent that it is reasonably possible.

The OECD BEPS Action Plan comprises a number of Action Points. Base erosion resulting from interest deductibility incurred on related party financing is contained in Action Point 4, whereas thin capitalisation is part of Action Point 9, which includes transfer pricing. The separation of thin capitalisation and limitations on tax deductible interest suggests that separate legislation is required.

However, the OECD BEPS Action Plan specifically states in Action Point 4 that:

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<sup>170</sup> Dugard, J. 2009. International Law: A South African Perspective. Third Edition. Page 38 at paragraph 4.

"...**transfer pricing guidance** will also be developed regarding the pricing of related party financial transactions, including financial and performance guarantees, derivatives (including internal derivatives used in intra-bank dealings), and captive and other insurance arrangements."

(Own emphasis)

Action Point 4 seems to suggest that related party financing transactions are to be dealt with in terms of transfer pricing provisions.

## CHAPTER SIX: LIMITATIONS ON TAX DEDUCTIBLE INTEREST EXPENDITURE IN THE UNITED KINGDOM

### I. INTRODUCTION

This chapter considers the measures taken in the United Kingdom to counteract manipulation of tax deductible interest in response to the BEPS dilemma. The United Kingdom was selected based on the strong influence English Law has exerted over the South African common law.

The approach taken by the United Kingdom may provide guidance as to the interaction between debt limitation rules (section 23M) and transfer pricing (section 31).

### II. RELEVANT LEGISLATION

Interest is deductible in the United Kingdom on similar principles as discussed in relation to South African legislation. Furthermore the United Kingdom imposes a withholding tax of 20% in respect of interest paid on long term loans and corporate bonds.<sup>171</sup>

Tax deductible interest will be subject to limitation to the extent that the interest rate charged or the quantum incurred is deemed to be excessive by Her Majesty's Revenue and Customs Authority ("HMRC"). It must be noted that the United Kingdom tax legislation provides for recharacterisation rules in respect of equity with debt like features and a world-wide group debt cap, which limits the amount of interest deductible by the group. There is no similar group taxation test in South Africa.

#### a) *Thin capitalisation*

Thin capitalisation is subsumed in the transfer pricing provisions set out in Part 4<sup>172</sup> of the Taxation (International and Other Provisions) Act, 2010 ("TIOPA").

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<sup>171</sup> European Private Equity and Venture Capital Association. Tax Benchmark Study 2012 (June 2013). Page 196.

<sup>172</sup> A comprehensive extract is attached as Appendix F.



Section 147 of TIOPA sets out the basic transfer pricing premise, that any amount representing the difference between the actual amount incurred by a party and the amount calculated in accordance with the arm's length principle would be disallowed, provided the preconditions are met. The first precondition is that a party to the transaction must participate directly or indirectly in the management, control or capital of an affected party. Transfer pricing applies to cross-border transactions as well as domestic transactions.

The second precondition is that the transaction must give rise to a tax benefit in the United Kingdom. A tax benefit in the United Kingdom is present where a lesser amount, including an amount of nil, is chargeable to tax and the amount of an increase in the assessed tax loss.

Thin capitalisation applies specifically in relation to "financial arrangements", which comprise any transaction guaranteeing or otherwise connected with debt, capital or other forms of finance.

The application of the thin capitalisation provisions results in an adjustment to the profit or loss, as the case may be, of the affected entity. No secondary adjustment is made in accordance with the provisions of the United Kingdom.

The transfer pricing provisions allow the HMRC to make an adjustment to the amount of any financial arrangement as well as the interest rate applicable to such arrangement.

Interpretation of the United Kingdom transfer pricing provisions, including thin capitalisation, is done in accordance with the principles set by the OECD.<sup>173</sup> This interpretation appears to be largely informed by article 9 of the OECD Model Tax Convention and the OECD Transfer Pricing Guidelines.

b) *Debt limitation rules*

The United Kingdom follows the OECD approach in relation to debt limitation, as provided in Action Point 4 of the BEPS initiative.

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<sup>173</sup> United Kingdom. Taxation (International and Other Provisions) Act. Chapter 8. 2010. Section 164.

The United Kingdom lists Action Plan 4 of the OECD BEPS Action Plan in a HMRC publication entitled: Tackling aggressive tax planning in the global economy: UK priorities for the G20-OECD project for countering Base Erosion and Profit Shifting.<sup>174</sup> In relation to this Action Point, the HMRC states that:

"The UK corporate tax code includes both types of rules: an unallowable purpose rule where a company is party to a loan or debt instrument with a main purpose of tax avoidance; and a thin capitalisation rule that applies where a company has more debt than it either could or would borrow if it was acting at arm's length from the lender or guarantor of the debt."

The United Kingdom debt limitation rules comprise the world-wide debt limitation rules, which ensure "that the interest relief claimed in the UK does not exceed the amount attributable to the group's total worldwide external debt".<sup>175</sup>

The worldwide debt limitations<sup>176</sup> are contained in section 261 of the TIOPA and the rules apply:

"to any period of account of the worldwide group for which—

(a) the **UK net debt** of the group (see sections 262 and 263), exceeds

(b) 75% of the **worldwide gross debt** of the group (see section 264)."

(Own emphasis)

"UK net debt" is defined as the sum of the net debt amounts of each company that was a relevant group company at any time during the period.<sup>177</sup>

"Net debt amounts" is in turn defined as the average of the net debt<sup>178</sup> of the company as at that company's start date and the net debt of the company as at that company's end date.

<sup>174</sup> United Kingdom, Her Majesty's Revenue and Her Majesty's Revenue and Customs. 2014. Tackling Aggressive Tax Planning in the Global Economy: UK priorities for the G20-OECD project for countering Base Erosion and Profit Shifting. Page 25 from paragraph 3.8.

<sup>175</sup> United Kingdom, Her Majesty's Revenue and Her Majesty's Revenue and Customs. 2014. Tackling Aggressive Tax Planning in the Global Economy: UK priorities for the G20-OECD project for countering Base Erosion and Profit Shifting. Page 25 from paragraph 3.8.

<sup>176</sup> A comprehensive extract is attached marked Appendix G.

<sup>177</sup> United Kingdom. Taxation (International and Other Provisions) Act. Chapter 8. 2010. Section 262.

The liabilities taken into account in determining the amount of "net debt"<sup>179</sup> are specifically defined as amounts borrowed, liabilities in respect of finance leases or amounts of such other description as the HMRC specifies in regulations.<sup>180</sup>

The "worldwide gross debt"<sup>181</sup> is defined as the average of:

- (a) the sum of the relevant liabilities of the group as at the day before the end of the first day of the period; and
- (b) the sum of the relevant liabilities of the group as at the last day of the period.

The disallowance of deductions is calculated as the amount by which the "tested expense amount" exceeds the available amount.<sup>182</sup> Entities subject to the worldwide cap are under an obligation to report the disallowances.<sup>183</sup>

The "tested expense amount" for a period of account of the worldwide group is determined as the sum of the net financing deductions<sup>184</sup> of each relevant group company.

The "available amount"<sup>185</sup> for a period of account of the worldwide group comprised to the sum of the amounts disclosed in the financial statements of the group for that period in respect of:

- (a) interest payable on amounts borrowed;
- (b) amortisation of discounts relating to amounts borrowed;

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<sup>178</sup> United Kingdom. Taxation (International and Other Provisions) Act. Chapter 8. 2010. Section 252. An amount of less than £3 million is deemed to be nil.

<sup>179</sup> United Kingdom. Taxation (International and Other Provisions) Act. Chapter 8. 2010. Section 263.

<sup>180</sup> United Kingdom. Taxation (International and Other Provisions) Act. Chapter 8. 2010. Section 263.

<sup>181</sup> United Kingdom. Taxation (International and Other Provisions) Act. Chapter 8. 2010. Section 264.

<sup>182</sup> United Kingdom. Taxation (International and Other Provisions) Act. Chapter 8. 2010. Section 274.

<sup>183</sup> United Kingdom. Taxation (International and Other Provisions) Act. Chapter 8. 2010. Section 276 *et seq.*

<sup>184</sup> United Kingdom. Taxation (International and Other Provisions) Act. Chapter 8. 2010. Section 329: References in this Part to the "net financing deduction" of a company for a period of account of the worldwide group are to— (a) the sum of the company's financing expense amounts for the period (see section 313), less (b) the sum of the company's financing income amounts for the period (see section 314).

<sup>185</sup> United Kingdom. Taxation (International and Other Provisions) Act. Chapter 8. 2010. Section 332.

- (c) amortisation of premiums relating to amounts borrowed;
- (d) amortisation of ancillary costs relating to amounts borrowed;
- (e) the financing cost implicit in payments made under finance leases;
- (f) the financing cost relating to debt factoring; or
- (g) matters of such other description as may be specified in regulations made by the Commissioners.

For purposes of this chapter "group" means for the time being, such meaning as is given by international accounting standards. However, if a group would (apart from this subsection) contain more than one ultimate parent, each of those ultimate parents, together with its subsidiaries, is to be treated as a separate group.

### **III. CONCLUSION**

As regards related party debt, the transactions are potentially subject to transfer pricing provisions. Similar to the position in South Africa, the United Kingdom transfer pricing rules use an arm's length standard applied to the rate of interest and the level of gearing must not exceed the amount that an independent third party would be prepared to lend to the taxpayer, including the quantum and rate of interest, in similar circumstances.

The United Kingdom worldwide debt limitation rules recognise the economic homogenous nature of a group of companies. It allows the group to effectively structure its debt with due regard to the best results for the group. The South Africa corollary in section 23M does not recognise this economic homogeneity and focusses solely on the South African position. This results in the South African approach being more restrictive than the approach of the United Kingdom.

The HMRC comments in its report that the design of interest limitation provisions "needs to recognise the heterogeneity of business models across sectors, particularly those that have legitimately high leverage ratios."<sup>186</sup>

SARS has a similar view expressed in the draft interpretation note<sup>187</sup> relating to the application of the arm's length principle in the context of thin capitalisation, namely that "The application of the arms' length basis is inherently of a detailed factual nature and takes into account a wide range of factors particular to the specific taxpayer concerned."

With specific focus on financial services<sup>188</sup>, the HMRC is of the view that:

"Therefore any structural interest restriction or allocation method is likely to either create asymmetries or place a disproportionate burden onto the financial sector and would, in many cases, wholly undermine their business models. We do not therefore believe that it is appropriate to apply a structural interest restriction model to the financial sector, and certainly not in relation to their day to day trading activities."

This approach should be heeded in light of the NDP objectives that provide for stimulation of foreign investment into South Africa and the primary commercial reason for utilising debt as part of an investment.

However, there is no clear indication in the TIOPA as to the interaction between thin capitalisation provisions as part of the transfer pricing regime and the worldwide debt limitation rules. It is unlikely that such a difficulty shall arise as the calculations in support of the worldwide debt limitation rules are done with reference to the balance sheets of the group companies as well as the company that is resident in the United Kingdom. It is therefore unlikely that the application of these two regimes intersect, as is the case in South Africa.

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<sup>186</sup> United Kingdom, Her Majesty's Revenue and Her Majesty's Revenue and Customs. 2014. Tackling Aggressive Tax Planning in the Global Economy: UK priorities for the G20-OECD project for countering Base Erosion and Profit Shifting. Page 25 from paragraph 3.12.

<sup>187</sup> South Africa, Department of National Treasury. 2013. Draft explanatory memorandum on the Taxation Laws Amendment Bill, 2013. Page 7 at paragraph 5.2.

<sup>188</sup> It is submitted that private equity financing and investments forms part of and is heavily integrated into financial services.

## CHAPTER SEVEN: CONCLUSIONS AND RECOMMENDATIONS

### I. SUMMARY OF FINDINGS

The summary of findings details the elements identified in each chapter in response to the problem statement and research questions.

Chapter 2 established that section 23M and section 31 arose pursuant to Action Point 4 and 9 of the OECD BEPS Action Plan. The DTC holds the view that the protection of the South African tax base must be counterbalanced by initiatives that stimulate foreign direct investment in accordance with the terms of the National Development Plan. There is also uncertainty as to the application of international recommendations and principles are applicable in South Africa without alteration to take into account specific features of the South African system.

Chapter 3 considered the current approach to the interpretation of legislation in South Africa, with specific focus on fiscal legislation. It was established that there is no material difference between the interpretation of fiscal legislation and other legislation. Furthermore, the prevailing approach to the interpretation of legislation appears to be a purposive approach. A guideline was developed for the interpretation of section 23M and section 31. The guideline consisted of three aspects: Firstly, the determination of the ordinary grammatical meaning of the words; secondly, a contextual understanding of each section; and thirdly, the purpose of each section (considering the mischief targeted by that section).

This guideline was used to determine the ambit section 23M and section 31 respectively in Chapter 4. Both provisions are considered to be anti-avoidance provisions and it is therefore preferable to interpret these sections widely.

In Chapter 4 it was determined that section 23M limits the amount of interest expenditure deductible in accordance with section 24J(2) incurred by a resident borrower where the interest is payable to or guaranteed by a lender or guarantor that holds directly or indirectly at least 50% of the equity shares or voting rights in the borrower, where the lender or guarantor is not subject to tax in the hands of the lender (regardless of the tax residency of the lender).

Similarly, that section 31 reclassifies interest incurred in excess of an "arm's length" amount, based on the loan principal or the rate of interest, as equity and levies

additional tax on the disallowance as a dividend *in specie* or as a donation. Section 31, read specifically with section 31(4), applies in respect of "financial assistance" provided by a non-resident "connected person" to a resident as regards thin capitalisation.

It was also established that the ambit of section 23M and the ambit of section 31 overlaps in respect of the taxpayers to whom these sections apply, the relationship between the resident and the non-resident persons and definition of interest. There is no apparent indication between these sections as to the interaction between them.

The calculations in Appendix E illustrate the material differences that may result from the divergent interpretations. It is noted that the order in which these sections does not appear to affect the limitation of tax deductible interest expenditure. This argument is premised on the fact that the limitation is always the smaller amount allowed as a deduction in accordance with the calculations performed as set out in section 23M and section 31.

The carry-forward provided for in section 23M(4) is, however, materially affected by the order in which these sections are applied. If section 23M is applied before section 31, it is arguable that the carry-forward is calculated as the difference between actual interest expenditure and the maximum amount deductible in terms of section 23M. The amount of the carry-forward may on this construction may still be subject to repricing during the year of assessment in which it is claimed as a deduction. It is submitted that this accords with a purposive approach to interpretation.

The ability to carry-forward such an amount may negate the reclassification of debt as equity contemplated in section 31 on the premise that the taxpayer is able to deduct the full amount of interest albeit over a longer term.

If section 31 is applied to reprice interest before the limitation is calculated in terms of section 23M, it is arguable that the taxpayer can only carry-forward the amount of the difference between the limitation calculated in terms of section 23M (based on the repriced interest) and the interest repriced in terms of section 31.

Chapter 5 considered the application of common law presumptions pertaining to statutory interpretation. Three presumptions were considered: First, the presumption against unfair or unjust legislation and its manifestation through the *contra fiscum* rule. Neither the presumption nor the rule is of assistance in relation to the dilemma arising

from the interpretation of these provisions. The *contra fiscum* rule is not applicable to the interpretation of avoidance provisions.

Secondly, the presumption against undue changes to existing law was considered and its manifestation by means of the *generalia specialibus non derogant* rule. This presumption and the rule apply in the context of conflict between sections of a piece of legislation. There are arguments that would allow the concurrent application of section 23M and section 31, merely leaving it to be determined in which order. This presumption and rule are not of assistance.

It was thirdly considered whether the presumption that legislation should be interpreted to be in agreement with international law applies in light of the proposals by the OECD. Elements of the OECD work should be considered "soft law" in the context of international law pursuant to the widespread acceptance of the OECD Model Tax Convention. This presumption is aided by section 233 of the Constitution of South Africa. The interpretation by the OECD appears to suggest that provisions dealing with the limitations on interest deductibility take either the form of a limitation through transfer pricing correction (such as thin capitalisation provisions in section 31) or a formula based calculation (such as section 23M).

Chapter 6 considered the position in the United Kingdom, which is different to the South African position in certain material aspects. The TIOPA imposes thin capitalisation limitations as part of the transfer pricing regime, but does not provide for secondary adjustments. It also provides for a worldwide group debt cap in terms of which the United Kingdom net debt must be less than 75% of the worldwide gross debt. The United Kingdom net debt is calculated with regard to the financial statements of the United Kingdom tax resident and therefore takes into account actual interest expenditure. The limitation provisions do not appear to rely on repriced interest in terms of the transfer pricing provisions.

## **II. CONCLUSIONS**

Section 23M applies to tax resident companies incurring interest in relation to debt advanced by a controlling person. Section 23M(4) provides for a carry-forward in respect of any amount of interest that is disallowed. Section 23M does not provide an express indication of whether interest subject to limitation in accordance with section 23M(2) and (3) means interest that has been subjected to repricing in terms of



section 31. Use of the word "allowed" in section 23M(2) may be indicative of such an interpretation.

However, contrary to this argument, the more specific nature of the taxpayer and the types of transaction falling within the ambit of section 23M suggests that it is the narrower of the two sections and should be applied first.

Section 31 applies to tax resident companies incurring interest expenditure in relation to financial assistance provided by connected persons. Section 31(3) provides for a secondary adjustment in terms of which the adjusted amount is considered to be a dividend *in specie* or a donation as the case may be.

However, it may be argued that section 31 is aimed at reclassifying debt as equity and that this reclassification must be done before applying the limitation in section 23M.

It is submitted that it is possible to apply section 23M and section 31 concurrently in relation to the limitation of tax deductible interest expenditure. The concurrent application of these sections does not appear to materially alter the position of a taxpayer falling within the ambit of both sections as taxpayers are limited to deducting the smaller of the allowable deduction calculated in accordance with section 23M or section 31.

These sections overlap in respect of the application to taxpayers, the definition of common law interest and the purpose of limiting excessive interest deductions. However, there is a material difference in the sanction imposed by section 23M, being subject to the carry-forward, and the reclassification and additional tax imposed in terms of section 31.

However, the calculation of the amount that a taxpayer is entitled to carry-forward in terms of section 23M(4) is materially affected by the order in which these sections are applied. There is no express guidance as to the calculation of the amount a taxpayer is entitled to carry-forward. If the carry-forward is calculated with reference to the actual amount of interest, any limitation imposed in terms of section 31 may be negated.

The common law presumptions pertaining to statutory interpretation do not appear to provide a solution in respect of this position.

It is submitted, based on the continued movement of interpretation of fiscal legislation to a more purpose approach, that section 23M and section 31 could be applied concurrently. The affected taxpayers would have to perform a calculation in terms of section 23M and a calculation in terms of section 31. The maximum deduction allowable in respect of interest expenditure incurred would be the smaller of the two answers.

The carry-forward provided for in section 23M may be therefore calculated with reference to the actual interest incurred and be subject to section 31 in the year of assessment during which it is claimed as a deduction.

### **III. SUMMARY OF CONTRIBUTIONS**

The findings and conclusions drawn as a result of the research conducted as part of this dissertation provide a basis on which it is arguable that there is an overlap in the ambit of section 23M and section 31.

It is possible to justify the concurrent application of section 23M and section 31 and in the absence of a conflict between these sections the common law presumptions pertaining to statutory interpretation do not apply.

The magnitude of difference in the net tax impact resulting from the differing ways in which the interaction can be considered might result in an inequitable position in relation to different taxpayers depending on the arm's length rate attributable to the debt in the opinion of SARS.

Furthermore, the carry-forward provided in section 23M(4) might negate the application of section 31 altogether if it is interpreted that it applies to the difference between the disallowed and actual interest.

A possible interpretive solution was provided in response to the research objective.

### **IV. RECOMMENDATION**

It is recommended that section 23M(4) be amended to indicate whether the amount a taxpayer is able to carry-forward is calculated with reference to interest that has been repaid in terms of section 31 or with reference to the actual interest expenditure incurred by the taxpayer.

An amendment of this nature should similarly provide an easy reference point from which the interaction between section 23M and section 31 could be determined.

For purposes of research expanding on the limitations on excessive interest deductions and reclassification of interest as equity, it is recommended that the determination of each of section 23M and section 31 be considered with regard to the remaining provisions of the Act.

It is also recommended that comparative studies be undertaken in relation to the limitations set out in South African domestic tax law and the domestic tax regimes of the United States of America and Japan, or other suitable jurisdictions as the case may be. Future research should also estimate the actual cost to South African taxpayers who fall within the ambit of section 23M and section 31 arising from the difficulties in interpreting these sections. Furthermore, consideration should also be given to the various other limitation provisions in the Act such as section 8F, 8FA and the withholding tax imposed in terms of section 50B.

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## South Africa - Treaty Withholding Rates Table

This chart is based on information available up to 1 July 2015. Effective date: 1 January 2014

The following chart contains the withholding tax rates applicable to dividend, interest and royalty payments by South African companies to non-residents under the tax treaties currently in force. Where, in a particular case, a treaty rate is higher than the domestic rate, the latter is applicable.

### South Africa - Treaty Withholding Rates Table

	Dividends		Interest <sup>[1]</sup>	Royalties
	Individuals, companies	Qualifying companies		
	(%)	(%)	(%)	(%)
<b>Domestic Rates</b>				
<i>Companies:</i>	15	0	15 <sup>[2]</sup>	15
<i>Individuals:</i>	15	n/a	15 <sup>[2]</sup>	15
<b>Treaty Rates</b>				
<i>Treaty With:</i>				
Algeria	15	10	10	10
Australia	15	5 <sup>[3]</sup>	10	10
Austria	15	5	0	0
Belarus	15	5	5/10 <sup>[4]</sup>	5/10 <sup>[5]</sup>
Belgium	15	5	10	0
Botswana	15	10	10	10
Brazil	15	10	15	10/15 <sup>[5]</sup>
Bulgaria	15	5	5	5/10 <sup>[5]</sup>
Canada	15	5	10	6/10 <sup>[5]</sup>
China (People's Rep.)	5	5	10	7/10 <sup>[5]</sup>
Congo (Democratic Republic)	15	5	10	10
Croatia	10	5	0	5
Cyprus	0	0	0	0
Czech Republic	15	5	0	10

	Dividends		Interest <sup>[1]</sup>	Royalties
	Individuals, companies	Qualifying companies		
	(%)	(%)	(%)	(%)
Denmark	15	5	0	0
Egypt	15	15	12	15
Ethiopia	10	10	8	20
Finland	15	5	0	0
France	15	5	0	0
Germany	15	7.5	10	0
Ghana	15	5	5/10 <sup>[6]</sup>	10
Greece	15	5	8	5/7 <sup>[5]</sup>
Grenada	— <sup>[7]</sup>	— <sup>[7]</sup>	— <sup>[7]</sup>	— <sup>[7]</sup>
Hungary	15	5	0	0
India	10	10	10	10
Indonesia	15	10	10	10
Iran	10	10	5	10
Ireland	10	5	0	0
Israel	25	25	25	0/15 <sup>[5]</sup>
Italy	15	5	10	6
Japan	15	5	10	10
Korea (Rep.)	15	5	10	10
Kuwait	0	0	0	10
Lesotho	15	15	10	10
Luxembourg	15	5	0	0
Malawi	— <sup>[7]</sup>	— <sup>[7]</sup>	— <sup>[7]</sup>	0 <sup>[8]</sup>
Malaysia	10	5	10	5
Malta	10	5	10	10
Mauritius	15	5	0	0
Mauritius (New Treaty) <sup>[9]</sup>	10	5	10	5

	Dividends		Interest <sup>[1]</sup>	Royalties
	Individuals, companies	Qualifying companies		
	(%)	(%)	(%)	(%)
Mexico	10	5	10	10
Mozambique	15	8	8	5
Namibia	15	5	10	10
Netherlands	10	5	0	0
New Zealand	15	5/15 <sup>[10]</sup>	10	10
Nigeria	10	7.5	7.5	7.5
Norway	15	5	0	0
Oman	10	5	0	8
Pakistan	15	10	10	10
Poland	15	5	10	10
Portugal	15	10	10	10
Romania	15	15	15	15
Russia	15	10	10	0
Rwanda	20	10	10	10
Saudi Arabia	10	5	5	10
Seychelles	10	5	0	0
Sierra Leone	— <sup>[7]</sup>	— <sup>[7]</sup>	— <sup>[7]</sup>	— <sup>[7]</sup>
Singapore	15	5	0	5
Slovak Republic	15	5	0	10
Spain	15	5	5	5
Swaziland	15	10	10	10
Sweden	15	5	0	0
Switzerland	15	5 <sup>[11]</sup>	5	0
Taiwan	15	5	10	10
Tanzania	20	10	10	10
Thailand	15	10	10/15 <sup>[4]</sup>	15

	Dividends		Interest <sup>[1]</sup>	Royalties
	Individuals, companies	Qualifying companies		
	(%)	(%)	(%)	(%)
Tunisia	10	10	5/12 <sup>[4]</sup>	10
Turkey	15	10	10	10
Uganda	15	10	10	10
Ukraine	15	5	10	10
United Kingdom	10/15	5	0	0
United States	15	5	0	0
Zambia	— <sup>[7]</sup>	— <sup>[7]</sup>	0 <sup>[7]</sup>	— <sup>[8]</sup>
Zimbabwe	— <sup>[7]</sup>	— <sup>[7]</sup>	— <sup>[7]</sup>	— <sup>[8]</sup>

- 1 Some treaties provide for an exemption for certain types of interest, e.g. interest paid to public bodies and institutions. Such exemptions are not considered in this column.
- 2 The rate is effective from 1 March 2015.
- 3 Provided the beneficial owner holds at least 10% of the capital of the company paying the dividends and the dividends are paid out of profits that have been subject to the normal rate of company tax.
- 4 The lower rate applies to interest derived by a bank or any other financial institution and the higher rate applies in all other cases.
- 5 The lower rate applies depending on the type of royalty.
- 6 The applicable rate is 5% if the recipient is a bank.
- 7 The treaty does not deal with the taxation of these items of income.
- 8 Provided the royalty is actually subject to tax in the residence state.
- 9 Effective from 1 January 2016.
- 10 The 15% rate applies to dividends paid by New Zealand resident companies. The 5% rate applies to dividends paid by South African resident companies where the beneficial owner is a company holding at least 25% of the capital of the company paying the dividends.
- 11 A minimum holding of 20% is required.

**Citation:** South Africa - Treaty Withholding Rates Table , Quick Reference Tables IBFD



**APPENDIX B****Section 23M: Limitation of interest deductions in respect of debts owed to persons not subject to tax under this Chapter**

(1) For the purposes of this section -

**"adjusted taxable income"** means taxable income -

(a) reduced by -

- (i) any amount of interest received or accrued;
- (ii) any amount included in the income of a person as contemplated in section 9D(2);
- (iii) any amount recovered or recouped in respect of an allowance contemplated in this Act in respect of a capital asset as defined in section 19; and

(b) with the additional of -

- (i) any amount of interest incurred;
- (ii) any amount allowed as a deduction in terms of this Act in respect of a capital asset as defined in section 19 for purposes other than the determination of any capital gain or capital loss;
- (iii) any assessed loss or balance of assessed loss allowed to be set off against income in terms of section 20;

**"average repo rate"** in relation to a year of assessment means the average of all ruling repo rates determined by using the daily repo rates during that year of assessment;

**"controlling relationship"** means a relationship where a person directly or indirectly holds at least 50 per cent of the equity shares in a company or at least 50 per cent of the voting rights in a company is exercisable by a person;

**"debtor"** means a debtor who is -

(a) a person that is a resident; or

- (b) any other person who is not a resident that has a permanent establishment in the Republic in respect of any debt claim that is effectively connected with that permanent establishment;

**"interest"** means interest as defined in section 24J;

**"issue"**, in relation to a debt, means the creation of a liability to pay or of a right to receive an amount in terms of that debt;

**"lending institution"** means a foreign bank which is comparable to a bank contemplated in the Banks Act;

**"repo rate"** means the interest rate at which the South African Reserve Bank enters into a repurchase agreement contemplated in section 10 (1) (j) of the South African Reserve Bank Act.

- (2) Where an amount of interest is incurred by a debtor during a year of assessment in respect of a debt owed to—

- (a) a creditor that is in a controlling relationship with that debtor; or
- (b) a creditor that is not in a controlling relationship with that debtor, if that creditor obtained the funding for the debt advanced to the debtor from a person that is in a controlling relationship with that debtor,

and the amount of interest so incurred is not during that year of assessment -

- (i) (aa) subject to tax in the hands of the person to which the interest accrues; or
- (bb) included in the net income of a controlled foreign company as contemplated in section 9D in the foreign tax year of the controlled foreign company commencing or ending within that year of assessment; and
- (ii) disallowed under 23N,

the amount of interest allowed to be deducted may not exceed the amount determined in accordance with subsection (3).

- (3) The amount of interest allowed to be deducted in respect of all debts owed as contemplated in subsection (2), in respect of any year of assessment must not exceed the sum of -

- (a) the amount of interest received by or accrued to the debtor; and
- (b) a percentage of that adjusted taxable income of that debtor to be determined in accordance with the formula -

$$A = B \times \frac{C}{D}$$

in which formula -

- (a) "A" represents the percentage to be determined;
- (b) "B" represents the number 40;
- (c) "C" represents the average repo rate plus 400 basis points; and
- (d) "D" represents the number 10,

but not exceeding 60 per cent of the adjusted taxable income of that debtor,

reduced by so much of any amount of interest incurred by the debtor in respect of debts other than debts contemplated in subsection (2) as exceeds any amount not allowed to be deducted in terms of section 23N.

- (4) So much of any amount of interest as exceeds the amount determined in terms of subsection (3) may be carried forward to the immediately succeeding year of assessment and, subject to subsection (2), must be deemed to be an amount of interest incurred in that succeeding year of assessment.
- (5) (5) Where an amount of interest is to be taken into account in terms of this section and in terms of section 23N, that amount of interest shall only be taken into account in terms of this section after section 23N has been applied.
- (6) This section does not apply—
  - (a) to so much of the interest as is incurred by a debtor in respect of a debt owed to a creditor as contemplated in subsection (2) where -
    - (i) that creditor funded that debt amount advanced to that debtor with funding granted by a lending institution that is not in a controlling relationship with that debtor; and
    - (ii) that interest is determined with reference to a rate of interest that does not exceed the official rate of interest as defined in paragraph 1 of the Seventh Schedule plus 100 basis points; or
  - (b) to any interest incurred by a debtor in respect of any linked unit that is held by a creditor as contemplated in subsection (2) where that creditor is a long-term

insurer as defined in the Long-term Insurance Act, a pension fund or a provident fund, if -

- (i) the long-term insurer, pension fund or provident fund holds at least 20 per cent of the linked units in that debtor;
- (ii) the long-term insurer, pension fund or provident fund acquired those linked units before 1 January 2013; and
- (iii) at the end of the previous year of assessment 80 per cent or more of the value of the assets of that debtor, reflected in the annual financial statements prepared in accordance with the Companies Act for the previous year of assessment, is directly or indirectly attributable to immovable property.

(6) This section does not apply to so much of the interest incurred by a debtor in respect of a debt owed to a creditor as contemplated in subsection (2) where -

- (i) that creditor funded that debt amount advanced to that debtor with funding granted by a lending institution that is not in a controlling relationship with that debtor; and
- (ii) that interest is determined with reference to a rate of interest that does not exceed the official rate of interest as defined in paragraph 1 of the Seventh Schedule plus 100 basis points.

(Proposed amendment: Sub-s. (6) to be substituted by s. 62 (1) of Act No. 31 of 2013 with effect from 1 January, 2016 and applicable in respect of amounts of interest incurred on or after that date.)

Wording of Sections

(Date of commencement: 1 January, 2016.)

## APPENDIX C

### Section 31: Tax payable in respect of international transactions to be based on arm's length principle

(1) For the purposes of this section -

**"affected transaction"** means any transaction, operation, scheme, agreement or understanding where -

(a) that transaction, operation, scheme, agreement or understanding has been directly or indirectly entered into or effected between or for the benefit of either or both -

(i) (aa) a person that is a resident; and

(bb) any other person that is not a resident;

(ii) (aa) a person that is not a resident; and

(bb) any other person that is not a resident that has a permanent establishment in the Republic to which the transaction, operation, scheme, agreement or understanding relates;

(iii) (aa) a person that is a resident; and

(bb) any other person that is a resident that has a permanent establishment outside the Republic to which the transaction, operation, scheme, agreement or understanding relates; or

(iv) (aa) a person that is not a resident; and

(bb) any other person that is a controlled foreign company in relation to any resident,

and those persons are connected persons in relation to one another; and

(b) any term or condition of that transaction, operation, scheme, agreement or understanding is different from any term or condition that would have existed had those persons been independent persons dealing at arm's length;

**"financial assistance"** includes any -

(a) debt; or

(b) security or guarantee.

(2) Where -

- (a) any transaction, operation, scheme, agreement or understanding constitutes an affected transaction; and
- (b) any term or condition of that transaction, operation, scheme, agreement or understanding -
  - (i) is a term or condition contemplated in paragraph (b) of the definition of "affected transaction"; and
  - (ii) results or will result in any tax benefit being derived by a person that is a party to that transaction, operation, scheme, agreement or understanding,

the taxable income or tax payable by any person contemplated in paragraph (b) (ii) that derives a tax benefit contemplated in that paragraph must be calculated as if that transaction, operation, scheme, agreement or understanding had been entered into on the terms and conditions that would have existed had those persons been independent persons dealing at arm's length.

(3) To the extent that there is a difference between -

- (a) any amount that is, after taking subsection (2) into account, applied in the calculation of the taxable income of any resident that is a party to an affected transaction; and
- (b) any amount that would, but for subsection (2), have been applied in the calculation of the taxable income of the resident contemplated in paragraph (a),

the amount of that difference must, if that person is a resident and the other person to the affected transaction is a person as contemplated in paragraph (a) (i) (bb) or (a) (iii) (bb) of the definition of "affected transaction" -

- (i) if that resident is a company, be deemed to be a dividend consisting of a distribution of an asset in specie declared and paid by that resident to that other person; or

- (ii) if that resident is a person other than a company, be deemed, for purposes of Part V, to be donation made by that resident to that other person,

on the last day of the period of six months following the end of the year of assessment in respect of which that adjustment is made: Provided that where the amount of that difference was prior to 1 January 2015 deemed to be a loan that constitutes an affected transaction, so much of that loan as has not been repaid before 1 January 2015 must -

- (a) if that resident is a company, be deemed to be a dividend consisting of a distribution of an asset in specie that was declared and paid by that resident to that other person; or
  - (b) if that resident is a person other than a company, be deemed, for purposes of Part V, to be a donation made by that resident to that other person, on 1 January 2015.
- (4) For the purposes of subsection (2), where any transaction, operation, scheme, agreement or understanding has been directly or indirectly entered into or effected as contemplated in that subsection in respect of -
- (a) the granting of any financial assistance; or
  - (b) intellectual property as contemplated in the definition of "intellectual property" in section 23l (1) or knowledge,

**"connected person"** means a connected person as defined in section 1: Provided that the expression "and no holder of shares holds the majority voting rights in the company" in paragraph (d) (v) of that definition must be disregarded.

- (5) Where any transaction, operation, scheme, agreement or understanding has been entered into between a headquarter company and -
- (a) any other person that is not a resident and that transaction, operation, scheme, agreement or understanding is in respect of the granting of financial assistance by that other person to that headquarter company, this section does not apply to so much of that financial assistance that is directly applied as financial assistance to any foreign company in which the headquarter company directly or indirectly (whether alone or together with any other company forming part of the same group of companies as

that headquarter company) holds at least 10 per cent of the equity shares and voting rights;

- (b) any foreign company in which the headquarter company directly or indirectly (whether alone or together with any other company forming part of the same group of companies as that headquarter company) holds at least 10 per cent of the equity shares and voting rights and that transaction, operation, scheme, agreement or understanding comprises the granting of financial assistance by that headquarter company to that foreign company, this section does not apply to that financial assistance;
  - (c) any other person that is not a resident and that transaction, operation, scheme, agreement or understanding is in respect of the granting of the use, right of use or permission to use any intellectual property as defined in section 23I (1) by that other person to that headquarter company, this section does not apply to the extent that the headquarter company -
    - (i) grants that use, right of use or permission to use that intellectual property to any foreign company in which the headquarter company directly or indirectly (whether alone or together with any other company forming part of the same group of companies as that headquarter company) holds at least 10 per cent of the equity shares and voting rights; and
    - (ii) does not make use of that intellectual property otherwise than as contemplated in subparagraph (i); or
  - (d) any foreign company in which the headquarter company directly or indirectly (whether alone or together with any other company forming part of the same group of companies as that headquarter company) holds at least 10 per cent of the equity shares and voting rights and that transaction, operation, scheme, agreement or understanding comprises the granting of the use, right of use or permission to use any intellectual property as defined in section 23I (1) by that headquarter company to that foreign company, this section does not apply to that granting to that foreign company.
- (6) Where any transaction, operation, scheme, agreement or understanding that comprises the granting of—
- (a) financial assistance; or



- (b) the use, right of use or permission to use any intellectual property as defined in section 23I,

by a person that is a resident (other than a headquarter company) to a controlled foreign company in relation to that resident or in relation to a company that forms part of the same group of companies as that resident, this section must not be applied in calculating the taxable income or tax payable by that resident in respect of any amount received by or accrued to that resident in terms of that transaction, operation, scheme, agreement or understanding if -

- (i) ...
- (ii) that controlled foreign company has a foreign business establishment as defined in section 9D (1); and
- (iii) the aggregate amount of tax payable to all spheres of government of any country other than the Republic by that controlled foreign company in respect of any foreign tax year of that controlled foreign company during which that transaction, operation, scheme, agreement or understanding exists is at least 75 per cent of the amount of normal tax that would have been payable in respect of any taxable income of that controlled foreign company had that controlled foreign company been a resident for that foreign tax year: Provided that the aggregate amount of tax so payable must be determined -
  - (aa) after taking into account any applicable agreement for the prevention of double taxation and any credit, rebate or other right of recovery of tax from any sphere of government of any country other than the Republic; and
  - (bb) after disregarding any loss in respect of a year other than that foreign tax year or from a company other than that controlled foreign company.

(7) Where -

- (a) any transaction, operation, scheme, agreement or understanding has been entered into between a company that is a resident (for purposes of this subsection referred to as "resident company") or any company that forms part of the same group of companies as that resident company and any foreign company in which that resident company (whether alone or together with any other company that forms part of the same group of

companies as that resident company) directly or indirectly holds in aggregate at least 10 per cent of the equity shares and voting rights and that transaction, operation, scheme, agreement or understanding comprises the granting of financial assistance that constitutes a debt owed by that foreign company to that resident company or any company that forms part of the same group of companies as that resident company;

- (b) that foreign company is not obliged to redeem that debt in full within 30 years from the date the debt is incurred;
- (c) the redemption of the debt in full by the foreign company is conditional upon the market value of the assets of the foreign company not being less than the market value of the liabilities of the foreign company; and
- (d) no interest accrued in respect of the debt during the year of assessment,

this section must not apply to such debt.

**APPENDIX D****Section 1: Definition of connected person**

**"connected person"** means—

- (a) in relation to a natural person -
  - (i) any relative; and
  - (ii) any trust (other than a portfolio of a collective investment scheme in securities or a portfolio of a collective investment scheme in property) of which such natural person or such relative is a beneficiary;
- (b) in relation to a trust (other than a portfolio of a collective investment scheme in securities or a portfolio of a collective investment scheme in property) -
  - (i) any beneficiary of such trust; and
  - (ii) any connected person in relation to such beneficiary;
- (bA) in relation to a connected person in relation to a trust (other than a portfolio of a collective investment scheme in property or a portfolio of a collective investment scheme in securities), includes any other person who is a connected person in relation to such trust;
- (c) in relation to a member of any partnership or foreign partnership -
  - (i) any other member; and
  - (ii) any connected person in relation to any member of such partnership or foreign partnership;
- (d) in relation to a company—
  - (i) any other company that would be part of the same group of companies as that company if the expression "at least 70 per cent of the equity shares in" in paragraphs (a) and (b) of the definition of "group of companies" in this section were replaced by the expression "more than 50 per cent of the equity shares or voting rights in";
  - (ii) . . . . .
  - (iii) . . . . .

(iv) any person, other than a company as defined in section 1 of the Companies Act that individually or jointly with any connected person in relation to that person, holds, directly or indirectly, at least 20 per cent of -

(aa) the equity shares in the company; or

(bb) the voting rights in the company;

(v) any other company if at least 20 per cent of the equity shares or voting rights in the company are held by that other company, and no holder of shares holds the majority voting rights in the company;

(vA) any other company if such other company is managed or controlled by -

(aa) any person who or which is a connected person in relation to such company; or

(bb) any person who or which is a connected person in relation to a person contemplated in item (aa); and

(vi) where such company is a close corporation -

(aa) any member;

(bb) any relative of such member or any trust (other than a portfolio of a collective investment scheme in securities or a portfolio of a collective investment scheme in property) which is a connected person in relation to such member; and

(cc) any other close corporation or company which is a connected person in relation to -

(i) any member contemplated in item (aa); or

(ii) the relative or trust contemplated in item (bb); and

(e) in relation to any person who is a connected person in relation to any other person in terms of the foregoing provisions of this definition, such other person:

Provided that for the purposes of this definition, a company includes a portfolio of a collective investment scheme in securities;

**Assumptions:**Assumed facts:

- 1 Company A, a South African resident borrows R10million from its sole shareholder, Company B.
- 2 Company B is a tax non-resident and resident in a treaty country.
- 3 The double taxation agreement reduces the interest withholding tax rate to 0.
- 4 Company A has taxable income over a five year period of R100 000, R200 000, R300 000, R400 000, R500 000.
- 5 Company A receives interest income of R10 000 per annum for a period of 5 years.
- 6 A static repo rate of 6% applies in respect of all five years.
- 7 Company B is not entitled to a reduction in dividends tax.
- 8 In scenario 1, SARS regards an annual interest rate of 9% as appropriate.
- 9 In scenario 2, SARS regards an annual interest rate of 3% as appropriate.

y B.

00 000 and R500 000.

Scenario 1:

Loan principal:	R	10,000,000.00
Interest rate:	0.75%	(Based on an arm's length rate)
Term:	60.00	

Amortisation table:

Repayment number	Payment	Interest	Capital	Balance	10,000,000.00	Annual interest expense:
0				R	10,000,000.00	
1	R207,583.55	R75,000.00	R	132,583.55	R	9,867,416.45
2	R207,583.55	R74,005.62	R	133,577.93	R	9,733,838.52
3	R207,583.55	R73,003.79	R	134,579.76	R	9,599,258.76
4	R207,583.55	R71,994.44	R	135,589.11	R	9,463,669.64
5	R207,583.55	R70,977.52	R	136,606.03	R	9,327,063.61
6	R207,583.55	R69,952.98	R	137,630.58	R	9,189,433.04
7	R207,583.55	R68,920.75	R	138,662.80	R	9,050,770.23
8	R207,583.55	R67,880.78	R	139,702.78	R	8,911,067.46
9	R207,583.55	R66,833.01	R	140,750.55	R	8,770,316.91
10	R207,583.55	R65,777.38	R	141,806.18	R	8,628,510.74
11	R207,583.55	R64,713.83	R	142,869.72	R	8,485,641.02
12	R207,583.55	R63,642.31	R	143,941.24	R	8,341,699.77
13	R207,583.55	R62,562.75	R	145,020.80	R	8,196,678.97
14	R207,583.55	R61,475.09	R	146,108.46	R	8,050,570.51
15	R207,583.55	R60,379.28	R	147,204.27	R	7,903,366.23
16	R207,583.55	R59,275.25	R	148,308.31	R	7,755,057.93
17	R207,583.55	R58,162.93	R	149,420.62	R	7,605,637.31
18	R207,583.55	R57,042.28	R	150,541.27	R	7,455,096.04
19	R207,583.55	R55,913.22	R	151,670.33	R	7,303,425.71
20	R207,583.55	R54,775.69	R	152,807.86	R	7,150,617.85
21	R207,583.55	R53,629.63	R	153,953.92	R	6,996,663.93
22	R207,583.55	R52,474.98	R	155,108.57	R	6,841,555.35
23	R207,583.55	R51,311.67	R	156,271.89	R	6,685,283.47
24	R207,583.55	R50,139.63	R	157,443.93	R	6,527,839.54
25	R207,583.55	R48,958.80	R	158,624.76	R	6,369,214.70
26	R207,583.55	R47,769.11	R	159,814.44	R	6,209,400.34
27	R207,583.55	R46,570.50	R	161,013.05	R	6,048,387.29
28	R207,583.55	R45,362.90	R	162,220.65	R	5,886,166.65
29	R207,583.55	R44,146.25	R	163,437.30	R	5,722,729.34
30	R207,583.55	R42,920.47	R	164,663.08	R	5,558,066.26
31	R207,583.55	R41,685.50	R	165,898.06	R	5,392,168.21
32	R207,583.55	R40,441.26	R	167,142.29	R	5,225,025.92
33	R207,583.55	R39,187.69	R	168,395.86	R	5,056,630.06
34	R207,583.55	R37,924.73	R	169,658.83	R	4,886,971.23
35	R207,583.55	R36,652.28	R	170,931.27	R	4,716,039.96
36	R207,583.55	R35,370.30	R	172,213.25	R	4,543,826.71
37	R207,583.55	R34,078.70	R	173,504.85	R	4,370,321.86
38	R207,583.55	R32,777.41	R	174,806.14	R	4,195,515.72
39	R207,583.55	R31,466.37	R	176,117.18	R	4,019,398.54
40	R207,583.55	R30,145.49	R	177,438.06	R	3,841,960.47
41	R207,583.55	R28,814.70	R	178,768.85	R	3,663,191.62
42	R207,583.55	R27,473.04	R	180,109.62	R	3,483,082.01
43	R207,583.55	R26,123.12	R	181,460.44	R	3,301,621.57
44	R207,583.55	R24,762.16	R	182,821.39	R	3,118,800.18
45	R207,583.55	R23,391.00	R	184,192.55	R	2,934,607.63
46	R207,583.55	R22,009.56	R	185,574.00	R	2,749,033.64
47	R207,583.55	R20,617.75	R	186,965.80	R	2,562,067.84
48	R207,583.55	R19,215.51	R	188,368.04	R	2,373,699.79
49	R207,583.55	R17,802.75	R	189,780.80	R	2,183,918.99
50	R207,583.55	R16,379.39	R	191,204.16	R	1,992,714.83
51	R207,583.55	R14,945.36	R	192,638.19	R	1,800,076.64
52	R207,583.55	R13,500.57	R	194,082.98	R	1,605,993.66
53	R207,583.55	R12,044.95	R	195,538.60	R	1,410,455.06
54	R207,583.55	R10,578.41	R	197,005.14	R	1,213,449.92
55	R207,583.55	R9,100.87	R	198,482.48	R	1,014,967.24
56	R207,583.55	R7,612.25	R	199,971.30	R	814,995.95
57	R207,583.55	R6,112.47	R	201,471.08	R	613,524.86
58	R207,583.55	R4,601.44	R	202,982.12	R	410,542.75
59	R207,583.55	R3,079.07	R	204,504.48	R	206,038.27
60	R207,583.55	R1,545.29	R	206,038.27	R	0.00

Annual interest received	R	10,000.00	Limitation			
Average repo rate		6% plus 400 basis points	10.0%	40.00%		
Year of assessment	Taxable income:	Actual interest	Adjusted taxable income:	Limitation	Repriced in terms of section 31	Limitation
1	1,000,000.00	R	1,021,543.25	R	454,617.30	343,080.96
2	200,000.00	R	837,834.09	R	421,133.64	280,856.96
3	300,000.00	R	632,866.33	R	922,866.33	212,795.92
4	400,000.00	R	404,179.94	R	327,671.98	138,350.28
5	500,000.00	R	149,030.23	R	639,030.23	56,921.13

APPLY SECTION 31 FIRST, THEREAFTER SECTION 23M

Using actual disallowance in terms of section 23M									
Carry-forward - 23M(4)					Using repriced interest in terms of section 31 for calculating section 23M limitation				
Actual allowable deduction:	Allowable deduction - 31:	Disallowance:	Allowable deduction - 23M:	Additional disallowance:	Carry-forward - 23M(4)	Carry-forward - 23M(4)	Carry-forward - 23M(4)	Carry-forward - 23M(4)	Carry-forward - 23M(4)
1 R	1,021,543.25	R	188,840.85	R	454,617.30	R	378,085.10	R	566,925.95
2 R	837,834.09	R	160,691.70	R	421,133.64	R	256,008.76	R	416,700.46
3 R	632,866.33	R	956,989.80	R	125,876.54	R	127,843.26	R	253,719.80
4 R	404,179.94	R	83,304.23	R	327,671.98	R	66,796.27	R	76,507.97
5 R	149,030.23	R	117,302.83	R	31,727.39	R	265,612.09	R	116,581.86
R	3,045,453.84	R	2,455,013.14	R	500,440.71	R	1,848,181.54	R	761,937.12

Dividend withholding tax:			Effective tax reduction foregone on cumulative disallowance		Effective tax reduction foregone on cumulative disallowance	
R	28,326.13	R	158,739.27		R	189,969.44
R	24,103.75	R	116,676.13		R	155,953.60
R	18,881.48	R	71,041.54		R	117,619.72
R	12,495.64	R	23,325.19		R	74,432.30
R	4,759.11	R	8,883.67		R	25,790.55
R	88,566.11	R	378,665.79		R	563,765.60

				Section 23M not repriced		Section 23M repriced		
				Carry-forward - 23M(4)	Carry-forward - 23M(4)	Carry-forward - 23M(4)	Carry-forward - 23M(4)	
				(actual interest)	(repriced interest)	(actual interest)	(repriced interest)	
Effective tax impact	R	467,231.90	R	467,231.90	R	652,331.71	R	652,331.71
Mitigated by future tax reduction from carry-forward:	-R	335,236.25	-R	169,912.85	-R	563,765.60	-R	398,442.21
Net effect in relation to the tax cost resulting from adjustment	R	131,995.65	R	297,319.05	R	88,566.11	R	253,889.50

APPLY SECTION 23M FIRST, THEREAFTER SECTION 31

Carry-forward - 23M(4)					
Actual allowable deduction:	Allowable deduction - 23M:	Disallowance:	Allowable deduction - 31:	Additional disallowance:	(actual interest)
R	1,021,543.25	R	566,925.95	R	566,925.95
R	837,834.09	R	416,700.46	R	416,700.46
R	632,866.33	R	253,719.80	R	253,719.80
R	404,179.94	R	76,507.97	R	76,507.97
R	149,030.23	R	116,581.86	R	116,581.86
R	3,045,453.84	R	1,197,272.31	R	1,197,272.31

Dividend withholding tax:		Effective tax reduction foregone on cumulative disallowance	
R	28,326.13	R	158,739.27
R	24,103.75	R	116,676.13
R	18,881.48	R	71,041.54
R	12,495.64	R	21,422.23
R	4,759.11	-R	32,642.92
R	88,566.11	R	335,236.25

	Carry-forward - 23M(4)
	(actual interest)
Effective tax impact	R 423,802.35
Mitigated by future tax reduction from carry-forward:	-R 335,236.25
Net effect in relation to the tax cost resulting from adjustment	R 88,566.11

Scenario 2:

Loan principal:	R	10,000,000.00
Interest rate:	0.25%	(Based on an arm's length rate)
Term:	60.00	

Amortisation table:

Payment number	Payment	Interest	Capital	Balance	Annual interest expense:
0				R	10,000,000.00
1	R179,686.91	R25,000.00	R	154,686.91	R 9,845,313.09
2	R179,686.91	R24,613.28	R	155,073.62	R 9,690,239.47
3	R179,686.91	R24,225.60	R	155,461.31	R 9,534,778.16
4	R179,686.91	R23,836.95	R	155,849.96	R 9,378,928.20
5	R179,686.91	R23,447.32	R	156,239.59	R 9,222,688.61
6	R179,686.91	R23,056.72	R	156,630.19	R 9,066,058.43
7	R179,686.91	R22,665.15	R	157,021.76	R 8,909,036.67
8	R179,686.91	R22,272.59	R	157,414.31	R 8,751,622.35
9	R179,686.91	R21,879.06	R	157,807.85	R 8,593,814.50
10	R179,686.91	R21,484.54	R	158,202.37	R 8,435,612.13
11	R179,686.91	R21,089.03	R	158,597.88	R 8,277,014.26
12	R179,686.91	R20,692.54	R	158,994.37	R 8,118,019.89
13	R179,686.91	R20,295.05	R	159,391.86	R 7,958,628.03
14	R179,686.91	R19,896.57	R	159,790.34	R 7,798,837.69
15	R179,686.91	R19,497.09	R	160,189.81	R 7,638,647.88
16	R179,686.91	R19,096.62	R	160,590.29	R 7,478,057.59
17	R179,686.91	R18,695.14	R	160,991.76	R 7,317,065.83
18	R179,686.91	R18,292.66	R	161,394.24	R 7,155,671.59
19	R179,686.91	R17,889.18	R	161,797.73	R 6,993,873.86
20	R179,686.91	R17,484.68	R	162,202.22	R 6,831,671.64
21	R179,686.91	R17,079.18	R	162,607.73	R 6,669,063.91
22	R179,686.91	R16,672.66	R	163,014.25	R 6,506,049.66
23	R179,686.91	R16,265.12	R	163,421.78	R 6,342,627.88
24	R179,686.91	R15,856.57	R	163,830.34	R 6,178,797.54
25	R179,686.91	R15,446.99	R	164,239.91	R 6,014,557.63
26	R179,686.91	R15,036.39	R	164,650.51	R 5,849,907.12
27	R179,686.91	R14,624.77	R	165,062.14	R 5,684,844.98
28	R179,686.91	R14,212.11	R	165,474.79	R 5,519,370.19
29	R179,686.91	R13,798.43	R	165,888.48	R 5,353,881.70
30	R179,686.91	R13,383.70	R	166,303.20	R 5,187,178.50
31	R179,686.91	R12,967.95	R	166,718.96	R 5,020,459.54
32	R179,686.91	R12,551.15	R	167,135.76	R 4,853,323.78
33	R179,686.91	R12,133.31	R	167,553.60	R 4,685,770.19
34	R179,686.91	R11,714.43	R	167,972.48	R 4,517,797.71
35	R179,686.91	R11,294.49	R	168,392.41	R 4,349,405.29
36	R179,686.91	R10,873.51	R	168,813.39	R 4,180,951.90
37	R179,686.91	R10,451.48	R	169,235.43	R 4,011,356.47
38	R179,686.91	R10,028.39	R	169,658.52	R 3,841,697.96
39	R179,686.91	R9,604.24	R	170,082.66	R 3,671,615.30
40	R179,686.91	R9,179.04	R	170,507.87	R 3,501,007.43
41	R179,686.91	R8,752.77	R	170,934.14	R 3,330,173.29
42	R179,686.91	R8,325.43	R	171,361.47	R 3,158,182.82
43	R179,686.91	R7,897.03	R	171,789.88	R 2,987,021.94
44	R179,686.91	R7,467.55	R	172,219.35	R 2,814,802.59
45	R179,686.91	R7,037.01	R	172,649.90	R 2,642,153.69
46	R179,686.91	R6,605.38	R	173,081.52	R 2,469,071.16
47	R179,686.91	R6,172.68	R	173,514.23	R 2,295,556.93
48	R179,686.91	R5,738.89	R	173,948.01	R 2,121,608.92
49	R179,686.91	R5,304.02	R	174,382.88	R 1,947,236.03
50	R179,686.91	R4,868.07	R	174,818.84	R 1,772,107.19
51	R179,686.91	R4,431.02	R	175,255.89	R 1,597,151.30
52	R179,686.91	R3,992.88	R	175,694.03	R 1,421,457.28
53	R179,686.91	R3,553.64	R	176,132.26	R 1,245,324.01
54	R179,686.91	R3,113.31	R	176,573.60	R 1,068,750.42
55	R179,686.91	R2,671.88	R	177,015.03	R 891,735.39
56	R179,686.91	R2,229.34	R	177,457.57	R 714,277.82
57	R179,686.91	R1,785.69	R	177,901.21	R 536,376.60
58	R179,686.91	R1,340.94	R	178,345.97	R 358,030.64
59	R179,686.91	R895.08	R	178,791.83	R 179,238.81
60	R179,686.91	R448.10	R	179,238.81	R 0.00
					R34,633.96

Example calculations in respect of the limitation of tax deductible interest:

Section 24J interest deduction (modelled on actual terms)									
Loan principal:	R	10,000,000.00							
Interest rate:		0.92%	per month						
Term:		60.00	months						
Amortisation table:									
Repayment number	Payment	Interest	Capital	Balance	Annual interest expense:				
0				R 10,000,000.00					
1	R217,424.23	R 91,666.67	R	125,757.56	R	9,874,242.44			
2	R217,424.23	R 90,513.89	R	126,910.34	R	9,747,332.09			
3	R217,424.23	R 89,350.54	R	128,073.69	R	9,619,258.41			
4	R217,424.23	R 88,176.54	R	129,247.70	R	9,490,010.71			
5	R217,424.23	R 86,991.76	R	130,432.47	R	9,359,578.25			
6	R217,424.23	R 85,796.13	R	131,628.10	R	9,227,950.15			
7	R217,424.23	R 84,589.54	R	132,834.69	R	9,095,115.46			
8	R217,424.23	R 83,371.89	R	134,052.34	R	8,961,063.12			
9	R217,424.23	R 82,143.08	R	135,281.15	R	8,825,781.97			
10	R217,424.23	R 80,903.00	R	136,521.23	R	8,689,260.74			
11	R217,424.23	R 79,651.56	R	137,772.67	R	8,551,488.07			
12	R217,424.23	R 78,388.64	R	139,035.59	R	8,412,452.48	R	1,021,543.25	
13	R217,424.23	R 77,114.15	R	140,310.08	R	8,272,142.39			
14	R217,424.23	R 75,827.97	R	141,596.26	R	8,130,546.14			
15	R217,424.23	R 74,530.01	R	142,894.22	R	7,987,651.91			
16	R217,424.23	R 73,220.14	R	144,204.09	R	7,843,447.82			
17	R217,424.23	R 71,898.27	R	145,525.96	R	7,697,921.86			
18	R217,424.23	R 70,564.28	R	146,859.95	R	7,551,061.92			
19	R217,424.23	R 69,218.07	R	148,206.16	R	7,402,855.75			
20	R217,424.23	R 67,859.51	R	149,564.72	R	7,253,291.03			
21	R217,424.23	R 66,488.50	R	150,935.73	R	7,102,355.30			
22	R217,424.23	R 65,104.92	R	152,319.31	R	6,950,036.00			
23	R217,424.23	R 63,708.66	R	153,715.57	R	6,796,320.43			
24	R217,424.23	R 62,299.60	R	155,124.63	R	6,641,195.80	R	837,834.09	
25	R217,424.23	R 60,877.63	R	156,546.60	R	6,484,649.20			
26	R217,424.23	R 59,442.62	R	157,981.61	R	6,326,667.59			
27	R217,424.23	R 57,994.45	R	159,429.78	R	6,167,237.81			
28	R217,424.23	R 56,533.01	R	160,891.22	R	6,006,346.59			
29	R217,424.23	R 55,058.18	R	162,366.05	R	5,843,980.54			
30	R217,424.23	R 53,569.82	R	163,854.41	R	5,680,126.13			
31	R217,424.23	R 52,067.82	R	165,356.41	R	5,514,769.72			
32	R217,424.23	R 50,552.06	R	166,872.17	R	5,347,897.55			
33	R217,424.23	R 49,022.39	R	168,401.84	R	5,179,495.71			
34	R217,424.23	R 47,478.71	R	169,945.52	R	5,009,550.19			
35	R217,424.23	R 45,920.88	R	171,503.35	R	4,838,046.84			
36	R217,424.23	R 44,348.76	R	173,075.47	R	4,664,971.37	R	632,866.33	
37	R217,424.23	R 42,762.24	R	174,661.99	R	4,490,309.38			
38	R217,424.23	R 41,161.17	R	176,263.06	R	4,314,046.31			
39	R217,424.23	R 39,545.42	R	177,878.81	R	4,136,167.51			
40	R217,424.23	R 37,914.87	R	179,509.36	R	3,956,658.15			
41	R217,424.23	R 36,269.37	R	181,154.86	R	3,775,503.28			
42	R217,424.23	R 34,608.78	R	182,815.45	R	3,592,687.83			
43	R217,424.23	R 32,932.97	R	184,491.26	R	3,408,196.57			
44	R217,424.23	R 31,241.80	R	186,182.43	R	3,222,014.14			
45	R217,424.23	R 29,535.13	R	187,889.10	R	3,034,125.04			
46	R217,424.23	R 27,812.81	R	189,611.42	R	2,844,513.62			
47	R217,424.23	R 26,074.71	R	191,349.52	R	2,653,164.10			
48	R217,424.23	R 24,320.67	R	193,103.56	R	2,460,060.54	R	404,179.94	
49	R217,424.23	R 22,550.55	R	194,873.68	R	2,265,186.87			
50	R217,424.23	R 20,764.21	R	196,660.02	R	2,068,526.85			
51	R217,424.23	R 18,961.50	R	198,462.73	R	1,870,064.11			
52	R217,424.23	R 17,142.25	R	200,281.98	R	1,669,782.14			
53	R217,424.23	R 15,306.34	R	202,117.89	R	1,467,664.24			
54	R217,424.23	R 13,453.59	R	203,970.64	R	1,263,693.60			
55	R217,424.23	R 11,583.86	R	205,840.37	R	1,057,853.23			
56	R217,424.23	R 9,696.99	R	207,727.24	R	850,125.99			
57	R217,424.23	R 7,792.82	R	209,631.41	R	640,494.58			
58	R217,424.23	R 5,871.20	R	211,553.03	R	428,941.55			
59	R217,424.23	R 3,931.96	R	213,492.27	R	215,449.28			
60	R217,424.23	R 1,974.95	R	215,449.28	R	0.00	R	149,030.23	





## APPENDIX F

### TRANSFER PRICING

#### CHAPTER 1

#### BASIC TRANSFER-PRICING RULE

##### 146 Application of this Part

This Part applies for -

- (a) corporation tax purposes, and
- (b) income tax purposes.

##### 147 Tax calculations to be based on arm's length, not actual, provision

(1) For the purposes of this section "the basic pre-condition" is that -

- (a) provision ("**the actual provision**") has been made or imposed as between any two persons ("**the affected persons**") by means of a transaction or series of transactions,
- (b) the participation condition is met (see section 148),
- (c) the actual provision is not within subsection (7) (oil transactions), and
- (d) the actual provision differs from the provision ("the arm's length provision") which would have been made as between independent enterprises.

(2) Subsection (3) applies if -

- (a) the basic pre-condition is met, and
- (b) the actual provision confers a potential advantage in relation to United Kingdom taxation on one of the affected persons.

(3) The profits and losses of the potentially advantaged person are to be calculated for tax purposes as if the arm's length provision had been made or imposed instead of the actual provision.

(4) Subsection (5) applies if -

- (a) the basic pre-condition is met, and

(b) the actual provision confers a potential advantage in relation to United Kingdom taxation (whether or not the same advantage) on each of the affected persons.

(5) The profits and losses of each of the affected persons are to be calculated for tax purposes as if the arm's length provision had been made or imposed instead of the actual provision.

(6) Subsections (3) and (5) have effect subject to -

- (a) section 165 (exemption for dormant companies),
- (b) section 166 (exemption for small and medium-sized enterprises),
- (c) section 213 (this Part generally does not affect calculation of capital allowances),
- (d) section 214 (this Part generally does not affect calculation of chargeable gains),
- (e) section 447(5) and (6) of CTA 2009 (this Part generally does not affect how exchange gains or losses from loan relationships are accounted for), and
- (f) section 694(8) and (9) of CTA 2009 (this Part generally does not affect how exchange gains or losses from derivative contracts are accounted for).

(7) The actual provision is within this subsection if it is made or imposed by means of any transaction or deemed transaction in the case of which the price or consideration is determined in accordance with any of sections 225F to 225J of ITTOIA 2005 or any of sections 281 to 285 of CTA 2010 (transactions and deemed transactions involving oil treated as made at market value).

#### **148 The "participation condition"**

(1) For the purposes of section 147(1)(b), the participation condition is met if -

- (a) condition A is met in relation to the actual provision so far as the actual provision is provision relating to financing arrangements, and
- (b) condition B is met in relation to the actual provision so far as the actual provision is not provision relating to financing arrangements.

(2) Condition A is that, at the time of the making or imposition of the actual provision or within the period of six months beginning with the day on which the actual provision was made or imposed -

(a) one of the affected persons was directly or indirectly participating in the management, control or capital of the other, or

(b) the same person or persons was or were directly or indirectly participating in the management, control or capital of each of the affected persons.

(3) Condition B is that, at the time of the making or imposition of the actual provision -

(a) one of the affected persons was directly or indirectly participating in the management, control or capital of the other, or

(b) the same person or persons was or were directly or indirectly participating in the management, control or capital of each of the affected persons.

(4) In this section "financing arrangements" means arrangements made for providing or guaranteeing, or otherwise in connection with, any debt, capital or other form of finance.

(5) For the interpretation of subsections (2) and (3) see sections 157 to 163.

## CHAPTER 2

### KEY INTERPRETATIVE PROVISIONS

#### 149 "Actual provision" and "affected persons"

(1) In this Part -

**"the actual provision"**, and

**"the affected persons"**,

have the meaning given by section 147(1).

(2) Subsection (1) does not apply if Chapters 1 and 3 to 6 apply in accordance with section 205(2) to (4) (oil-related ring-fence trades) but, in that event, in this Part -

**"the actual provision"** means the provision mentioned in section 205(1)(b), and

**"the affected persons"** means the two persons mentioned in section 205(2).

(3) Subsections (1) and (2) are subject to subsection (4).

(4) If the participation condition (see section 148) would not be met but for section 161 or 162 (cases in which actual provision relates, to any extent, to financing arrangements), then in section 147(1)(d), (2)(b), (3), (4)(b) and (5) **"the actual provision"** is a reference to the actual provision so far as relating to the financing arrangements concerned.

## **150 "Transaction" and "series of transactions"**

(1) In this Part "transaction" includes arrangements, understandings and mutual practices (whether or not they are, or are intended to be, legally enforceable).

(2) References in this Part to a series of transactions include references to a number of transactions each entered into (whether or not one after the other) in pursuance of, or in relation to, the same arrangement.

(3) A series of transactions is not prevented by reason only of one or more of the matters mentioned in subsection (4) from being regarded for the purposes of this Part as a series of transactions by means of which provision has been made or imposed as between any two persons.

(4) Those matters are -

- (a) that there is no transaction in the series to which both those persons are parties,
- (b) that the parties to any arrangement in pursuance of which the transactions in the series are entered into do not include one or both of those persons, and
- (c) that there is one or more transactions in the series to which neither of those persons is a party.

(5) In this section "**arrangement**" means any scheme or arrangement of any kind (whether or not it is, or is intended to be, legally enforceable).

## **151 "Arm's length provision"**

(1) In this Part "the arm's length provision" has the meaning given by section 147(1).

(2) For the purposes of this Part, the cases in which provision made or imposed as between any two persons is to be taken to differ from the provision that would have been made as between independent enterprises include the case in which provision is made or imposed as between two persons but no provision would have been made as between independent enterprises; and references in this Part to the arm's length provision are to be read accordingly.

## **152 Arm's length provision where actual provision relates to securities**

(1) This section applies where -

- (a) both of the affected persons are companies, and

(b) the actual provision is provision in relation to a security issued by one of those companies ("the issuing company").

(2) Section 147(1)(d) is to be read as requiring account to be taken of all factors, including -

(a) the question whether the loan would have been made at all in the absence of the special relationship,

(b) the amount which the loan would have been in the absence of the special relationship, and

(c) the rate of interest and other terms which would have been agreed in the absence of the special relationship.

(3) Subsection (2) has effect subject to subsections (4) and (5).

(4) If -

(a) a company ("L") makes a loan to another company with which it has a special relationship, and

(b) it is not part of L's business to make loans generally, the fact that it is not part of L's business to make loans generally is to be disregarded in applying subsection (2).

(5) Section 147(1)(d) is to be read as requiring that, in the determination of any of the matters mentioned in subsection (6), no account is to be taken of (or of any inference capable of being drawn from) any guarantee provided by a company with which the issuing company has a participatory relationship.

(6) The matters are -

(a) the appropriate level or extent of the issuing company's overall indebtedness,

(b) whether it might be expected that the issuing company and a particular person would have become parties to a transaction involving -

(i) the issue of a security by the issuing company, or

(ii) the making of a loan, or a loan of a particular amount, to the issuing company, and

(c) the rate of interest and other terms that might be expected to be applicable in any particular case to such a transaction.

### **153 Arm's length provision where security issued and guarantee given**

(1) This section applies where the actual provision is made or imposed by means of a series of transactions which include -

(a) the issuing of a security by a company which is one of the affected persons ("the issuing company"), and

(b) the provision of a guarantee by a company which is the other affected person.

(2) Section 147(1)(d) is to be read as requiring account to be taken of all factors, including -

(a) the question whether the guarantee would have been provided at all in the absence of the special relationship,

(b) the amount that would have been guaranteed in the absence of the special relationship, and

(c) the consideration for the guarantee and other terms which would have been agreed in the absence of the special relationship.

(3) Subsection (2) has effect subject to subsections (4) and (5).

(4) If -

(a) a company ("G") provides a guarantee in respect of another company with which it has a special relationship, and

(b) it is not part of G's business to provide guarantees generally, the fact that it is not part of G's business to provide guarantees generally is to be disregarded in applying subsection (2).

(5) Section 147(1)(d) is to be read as requiring that, in the determination of any of the matters mentioned in subsection (6), no account is to be taken of (or of any inference capable of being drawn from) any guarantee provided by a company with which the issuing company has a participatory relationship.

(6) The matters are -

(a) the appropriate level or extent of the issuing company's overall indebtedness,

(b) whether it might be expected that the issuing company and a particular person would have become parties to a transaction involving -

- (i) the issue of a security by the issuing company, or
  - (ii) the making of a loan, or a loan of a particular amount, to the issuing company, and
- (c) the rate of interest and other terms that might be expected to be applicable in any particular case to such a transaction.

#### **154 Interpretation of sections 152 and 153**

- (1) Subsections (3) to (7) apply for the purposes of sections 152 and 153.
- (2) Subsection (6) applies also for the purposes of subsection (7)(a).
- (3) "**Special relationship**" means any relationship by virtue of which the participation condition is met (see section 148) in the case of the affected persons concerned.
- (4) Any reference to a guarantee includes -
- (a) a reference to a surety, and
  - (b) a reference to any other relationship, arrangements, connection or understanding (whether formal or informal) such that the person making the loan to the issuing company has a reasonable expectation that in the event of a default by the issuing company the person will be paid by, or out of the assets of, one or more companies.
- (5) One company ("**A**") has a "participatory relationship" with another ("**B**") if -
- (a) one of A and B is directly or indirectly participating in the management, control or capital of the other, or
  - (b) the same person or persons is or are directly or indirectly participating in the management, control or capital of each of A and B.
- (6) "**Security**" includes securities not creating or evidencing a charge on assets.
- (7) Any -
- (a) interest payable by a company on money advanced without the issue of a security for the advance, or
  - (b) other consideration given by a company for the use of money so advanced,



is to be treated as if payable or given in respect of a security issued for the advance by the company, and references to a security are to be read accordingly.

### **155 "Potential advantage" in relation to United Kingdom taxation**

(1) Subsection (2) applies for the purposes of this Part.

(2) The actual provision confers a potential advantage on a person in relation to United Kingdom taxation wherever, disregarding this Part, the effect of making or imposing the actual provision, instead of the arm's length provision, would be one or both of Effects A and B.

(3) Effect A is that a smaller amount (which may be nil) would be taken for tax purposes to be the amount of the person's profits for any chargeable period.

(4) Effect B is that a larger amount (or, if there would not otherwise have been losses, any amount of more than nil) would be taken for tax purposes to be the amount for any chargeable period of any losses of the person.

(5) In determining for the purposes of subsection (3) or (4) the amount that would be taken for tax purposes to be the amount of the profits or losses for a year of assessment in the case of a non-UK resident, there is to be left out of account any income of that person which is -

(a) disregarded income within the meaning given by section 813 of ITA 2007 (limits on liability to income tax of non-UK residents), or

(b) disregarded company income within the meaning given by section 816 of that Act.

(6) For the purposes of subsections (2) to (4) -

(a) Part 7 (tax treatment of financing costs and income), and

(b) paragraph E of the list in section 1000(1) of CTA 2010 (excessive interest etc. treated as a distribution), are to be disregarded.

### **156 "Losses" and "profits"**

(1) In this Part "**losses**" includes amounts which are not losses but in respect of which relief may be given in accordance with -

(a) section 57 of ITTOIA 2005 (pre-trading expenses),

- (b) section 88 of ITA 2007 (carry forward of certain interest),
- (c) section 61 of CTA 2009 (pre-trading expenses),
- (d) sections 387 to 391 of CTA 2009 (insurance companies: non-trading deficits on loan relationships),
- (e) Chapter 16 of Part 5 of CTA 2009 (non-trading deficits on loan relationships),
- (f) section 1223 of CTA 2009 (excess of management expenses), or
- (g) Part 5 of CTA 2010 (group relief).

(2) In this Part "**profits**" includes income.

### **157 Direct participation**

(1) Subsection (2) applies for the purposes of -

- (a) this Part,
- (b) in Part 2, section 132(7), and
- (c) in Part 5, section 219(2).

(2) A person is directly participating in the management, control or capital of another person at a particular time if (and only if) that other person is at that time -

- (a) a body corporate or a firm, and
- (b) controlled by the first person.

### **158 Indirect participation: defined by sections 159 to 162**

(1) This section is about how to read the references, in this Part and in some other provisions of this Act, to indirect participation.

(2) For the purposes of sections 148(2)(a) and (3)(a) and 175(2)(a), a person is indirectly participating in the management, control or capital of another person only if section 159, 160 or 161 so provides.

(3) For the purposes of sections 148(2)(b) and (3)(b) and 175(2)(b), a person is indirectly participating in the management, control or capital of another person only if section 159, 160 or 162 so provides.

(4) For the purposes of -

- (a) sections 154(5) and 204(4),
- (b) in Part 2, section 132(7), and
- (c) in Part 5, section 219(2),

a person is indirectly participating in the management, control or capital of another person only if section 159 or 160 so provides.

### **159 Indirect participation: potential direct participant**

(1) Subsection (2) applies for the purposes of -

- (a) sections 148(2) and (3), 154(5), 175(2) and 204(4),
- (b) in Part 2, section 132(7), and
- (c) in Part 5, section 219(2).

(2) A person ("P") is indirectly participating in the management, control or capital of another person ("A") at a particular time if P would be directly participating in the management, control or capital of A at that time if the rights and powers attributed to P included all the rights and powers mentioned in subsection (3) that are not already attributed to P for the purpose of deciding under section 157 whether P is directly participating in the management, control or capital of A.

(3) The rights and powers referred to in subsection (2) are -

- (a) rights and powers which P is entitled to acquire at a future date,
- (b) rights and powers which P will, at a future date, become entitled to acquire,
- (c) rights and powers of persons other than P so far as they are rights or powers falling within subsection (4),
- (d) rights and powers of any person with whom P is connected (see section 163), and
- (e) rights and powers which would be attributed by subsection (2) to a person with whom P is connected were it being decided under that subsection whether that connected person is indirectly participating in the management, control or capital of A.

(4) Rights and powers fall within this subsection so far as they -

(a) are required, or may be required, to be exercised in any one or more of the following ways -

- (i) on behalf of P,
- (ii) under the direction of P, or
- (iii) for the benefit of P, and

(b) are not confined, in a case where a loan has been made by one person to another, to rights and powers conferred in relation to property of the borrower by the terms of any security relating to the loan.

(5) In subsections (3)(c) to (e) and (4), the references to a person's rights and powers include references to any rights or powers which the person either -

- (a) is entitled to acquire at a future date, or
- (b) will, at a future date, become entitled to acquire.

(6) In paragraph (e) of subsection (3), the reference to rights and powers which would be attributed to a connected person includes a reference to rights and powers which, by applying that paragraph wherever one person is connected with another, would be so attributed to the connected person through a number of persons each of whom is connected with at least one of the others.

(7) References in this section -

- (a) to rights and powers of a person, or
- (b) to rights and powers which a person is or will become entitled to acquire,

include references to rights or powers which are exercisable by that person, or (when acquired by that person) will be exercisable, only jointly with one or more other persons.

### **160 Indirect participation: one of several major participants**

(1) Subsection (2) applies for the purposes of -

- (a) sections 148(2) and (3), 154(5), 175(2) and 204(4),
- (b) in Part 2, section 132(7), and
- (c) in Part 5, section 219(2).

(2) A person is indirectly participating in the management, control or capital of another person at a particular time if the first person is, at that time, one of a number of major participants in that other person's enterprise.

(3) For the purposes of this section, a person ("**A**") is a major participant in another person's enterprise at a particular time if at that time -

(a) that other person ("the subordinate") is a body corporate or firm, and

(b) the 40% test is met in the case of each of two persons—

(i) who, taken together, control the subordinate, and

(ii) of whom one is A.

(4) For the purposes of this section, the 40% test is met in the case of each of two persons wherever each of them has interests, rights and powers representing at least 40% of the holdings, rights and powers in respect of which the pair of them fall to be taken as controlling the subordinate.

(5) For the purposes of this section -

(a) the question whether a person is controlled by any two or more persons taken together, and

(b) any question whether the 40% test is met in the case of a person who is one of two persons,

is to be determined after attributing to each of the persons all the rights and powers which would be attributed by section 159(2) to a person were it being decided under section 159(2) whether that person is indirectly participating in the management, control or capital of another person.

(6) References in this section -

(a) to rights and powers of a person, or

(b) to rights and powers which a person is or will become entitled to acquire,

include references to rights or powers which are exercisable by that person, or (when acquired by that person) will be exercisable, only jointly with one or more other persons.

### **161 Indirect participation: sections 148 and 175: financing cases**

(1) Subsection (2) applies for the purposes of sections 148(2)(a) and (3)(a) and 175(2)(a).

(2) A person ("P") is indirectly participating in the management, control or capital of another ("A") at the time of the making or imposition of the actual provision if -

- (a) the actual provision relates, to any extent, to financing arrangements for A,
- (b) A is a body corporate or firm,
- (c) P and other persons acted together in relation to the financing arrangements, and
- (d) P would be taken to have control of A if, at any relevant time, there were attributed to P the rights and powers of each of the other persons mentioned in paragraph (c).

(3) It is immaterial for the purposes of subsection (2)(c) whether P and the other persons acting together in relation to the financing arrangements did so at the time of the making or imposition of the actual provision or at some earlier time.

(4) In subsection (2)(d) "**relevant time**" means -

- (a) a time when P and the other persons were acting together in relation to the financing arrangements, or
- (b) a time in the period of six months beginning with the day on which they ceased so to act.

(5) In determining for the purposes of subsection (2)(d) whether P would be taken to have control of another person ("A"), the rights and powers of any person (and not just P) are to be taken to include those that would be attributed to that person by section 159(2) were it being decided under section 159(2) whether that person is indirectly participating in the management, control or capital of A.

(6) In this section "**financing arrangements**" means arrangements made for providing or guaranteeing, or otherwise in connection with, any debt, capital or other form of finance.

## **162 Indirect participation: sections 148 and 175: further financing cases**

(1) Subsection (2) applies for the purposes of sections 148(2)(b) and (3)(b) and 175(2)(b).

(2) A person ("Q") is indirectly participating in the management, control or capital of each of the affected persons at the time of the making or imposition of the actual provision if -

- (a) the actual provision relates, to any extent, to financing arrangements for one of the affected persons ("B"),

(b) B is a body corporate or firm,

(c) Q and other persons acted together in relation to the financing arrangements, and

(d) Q would be taken to have control of both B and the other affected person if,

at any relevant time, there were attributed to Q the rights and powers of each of the other persons mentioned in paragraph (c).

(3) It is immaterial for the purposes of subsection (2)(c) whether Q and the other persons acting together in relation to the financing arrangements did so at the time of the making or imposition of the actual provision or at some earlier time.

(4) In subsection (2)(d) "**relevant time**" means -

(a) a time when Q and the other persons were acting together in relation to the financing arrangements, or

(b) a time in the period of six months beginning with the day on which they ceased so to act.

(5) In determining for the purposes of subsection (2)(d) whether Q would be taken to have control of another person ("A"), the rights and powers of any person (and not just Q) are to be taken to include those that would be attributed to that person by section 159(2) were it being decided under section 159(2) whether that person is indirectly participating in the management, control or capital of A.

(6) In this section "**financing arrangements**" means arrangements made for providing or guaranteeing, or otherwise in connection with, any debt, capital or other form of finance.

### **163 Meaning of "connected" in section 159**

(1) Subsections (2) and (3) apply for the purposes of section 159 and this section.

(2) Two persons are connected with each other if one of them is an individual and the other is -

(a) the individual's spouse or civil partner,

(b) a relative of the individual,

(c) a relative of the individual's spouse or civil partner, or

(d) the spouse, or civil partner, of a person within paragraph (b) or (c).

(3) Two persons are connected with each other if one of them is a trustee of a settlement and the other is -

(a) a person who in relation to that settlement is a settlor, or

(b) a person who is connected with a person within paragraph (a).

(4) In this section -

**"relative"** means brother, sister, ancestor or lineal descendant, and

**"settlement"** and **"settlor"** have the same meaning as in section 620 of

#### **164 Part to be interpreted in accordance with OECD principles**

(1) This Part is to be read in such manner as best secures consistency between -

(a) the effect given to sections 147(1)(a), (b) and (d) and (2) to (6), 148 and 151(2), and

(b) the effect which, in accordance with the transfer pricing guidelines, is to be given, in cases where double taxation arrangements incorporate the whole or any part of the OECD model, to so much of the arrangements as does so.

(2) Subsection (1) has effect subject to -

section 147(1)(c) and (7) (oil-related provision to which Part does not apply),

sections 205 and 206 (rules for oil-related ring-fence trades),

section 217(3) to (7) (provision for sales of oil),

section 447(5) and (6) of CTA 2009 (this Part generally does not affect how exchange gains or losses from loan relationships are accounted for), and

section 694(8) and (9) of CTA 2009 (this Part generally does not affect how exchange gains or losses from derivative contracts are accounted for).

(3) In this section **"the OECD model"** means -

(a) the rules which, at the passing of ICTA (which occurred on 9 February 1988), were contained in Article 9 of the Model Tax Convention on Income and on Capital published by the Organisation for Economic Cooperation and Development, or

(b) any rules in the same or equivalent terms.



(4) In this section "**the transfer pricing guidelines**" means -

(a) all the documents published by the Organisation for Economic Cooperation and Development, at any time before 1 May 1998, as part of their Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, and

(b) such documents published by that Organisation on or after that date as may for the purposes of this Part be designated, by an order made by the Treasury, as comprised in the transfer pricing guidelines.

(5) In this section "**double taxation arrangements**" means arrangements that have effect under section 2(1) (double taxation relief by agreement with territories outside the United Kingdom).

## CHAPTER 3

### EXEMPTIONS FROM BASIC RULE

#### 165 Exemption for dormant companies

(1) Section 147(3) and (5) do not apply in calculating for any chargeable period the profits and losses of a potentially advantaged person if that person is a company which meets the condition in subsection (2).

(2) The condition is that -

(a) the company was dormant throughout the pre-qualifying period, and

(b) apart from section 147, the company has continued to be dormant at all times since the end of the pre-qualifying period.

(3) In subsection (2) "**the pre-qualifying period**" means -

(a) if there is an accounting period of the company that ends on 31 March 2004, that accounting period, or

(b) if there is no such accounting period, the period of 3 months ending with that date.

(4) In this section "dormant" has the meaning given by section 1169 of the Companies Act 2006.

#### 166 Exemption for small and medium-sized enterprises

(1) Section 147(3) and (5) do not apply in calculating for any chargeable period the profits and losses of a potentially advantaged person if that person is a small or medium-sized enterprise for that chargeable period (see section 172).

(2) Exceptions to subsection (1) are provided -

(a) in the case of a small enterprise, by section 167, and

(b) in the case of a medium-sized enterprise, by sections 167 and 168.

### **167 Small and medium-sized enterprises: exceptions from exemption**

(1) Subsections (2) and (3) set out exceptions to section 166(1).

(2) The first exception is if the small or medium-sized enterprise elects for section 166(1) not to apply in relation to the chargeable period. Any such election is irrevocable.

(3) The second exception is if -

(a) the other affected person, or

(b) a party to a relevant transaction,

is, at the time when the actual provision is or was made or imposed, a resident of a non-qualifying territory (whether or not that person is also a resident of a qualifying territory).

(4) For the purposes of subsection (3) -

(a) a "party to a relevant transaction" is a person who, if the actual provision is or was imposed by means of a series of transactions, is or was a party to one or more of those transactions, and

(b) "qualifying territory" and "non-qualifying territory" are defined in section 173.

(5) In subsection (3) "**resident**", in relation to a territory -

(a) means a person who, under the law of that territory, is liable to tax there by reason of the person's domicile, residence or place of management, but

(b) does not include a person who is liable to tax in that territory in respect only of income from sources in that territory or capital situated there.

### **168 Medium-sized enterprises: exception from exemption: transfer pricing notice**

(1) Section 166(1) does not apply in relation to any provision made or imposed if -

(a) the potentially advantaged person is a medium-sized enterprise for the chargeable period, and

(b) the Commissioners for Her Majesty's Revenue and Customs give that person a notice requiring the person to calculate the profits and losses of that chargeable period in accordance with section 147(3) or (5) in the case of that provision.

(2) A notice under subsection (1) is referred to in this Chapter as a transfer pricing notice.

### **169 Giving of transfer pricing notices**

(1) This section applies to a transfer pricing notice given to a person.

(2) The notice may be given in relation to -

(a) any provision specified, or of a description specified, in the notice, or

(b) every provision in relation to which one or other of the assumptions in section 147(3) and (5) would, apart from section 166(1), be required to be made when calculating the person's profits and losses for tax purposes.

(3) The notice may be given only after a notice of enquiry has been given to the person in relation to the person's tax return for the chargeable period concerned.

(4) The notice must identify the officer of Revenue and Customs to whom any notice of appeal under section 170 is to be given.

(5) In subsection (3) "**notice of enquiry**" means a notice under -

(a) section 9A or 12AC of TMA 1970, or

(b) paragraph 24 of Schedule 18 to FA 1998.

### **170 Appeals against transfer pricing notices**

(1) A person to whom a transfer pricing notice is given may appeal against the decision to give the notice, but only on the ground that the condition in section 168(1)(a) is not met.

(2) Any such appeal must be brought by giving written notice of appeal to the officer of Revenue and Customs identified in the notice in accordance with section 169(4).

(3) The notice of appeal must be given before the end of the period of 30 days beginning with the day on which the transfer pricing notice is given.

### **171 Tax returns where transfer pricing notice given**

(1) If a transfer pricing notice is given to a person ("T"), T may amend T's tax return for the purpose of complying with the notice at any time before the end of the period of 90 days beginning with -

(a) the day on which the notice is given, or

(b) if T appeals under section 170 against the decision to give the notice, the day on which the appeal is finally determined or abandoned.

(2) If a transfer pricing notice is given in the case of any tax return, no closure notice may be given in relation to that tax return until-

(a) the end of the period of 90 days specified in subsection (1), or

(b) the earlier amendment of the tax return for the purpose of complying with the notice.

(3) So far as relating to any provision made or imposed by or in relation to a person -

(a) who is a medium-sized enterprise for a chargeable period,

(b) who does not make an election under section 167(2) for that period, and

(c) who is not excepted from section 166(1) in relation to that provision for that period because of section 167(3),

the tax return required to be made for that period is a return that disregards section 147(3) and (5).

(4) Subsection (3) does not prevent a tax return for a period becoming incorrect if in the case of any provision made or imposed -

(a) a transfer pricing notice is given which has effect in relation to that provision for that period,

(b) the return is not amended in accordance with subsection (1) for the purpose of complying with the notice, and

(c) the return ought to have been so amended.

(5) In this section -

**"closure notice"** means a notice under -

(a) section 28A or 28B of TMA 1970, or

(b) paragraph 32 of Schedule 18 to FA 1998,

**"company tax return"** means the return required to be delivered pursuant to a notice under paragraph 3 of Schedule 18 to FA 1998, as read with paragraph 4 of that Schedule, and

**"tax return"** means -

(a) a return under section 8, 8A or 12AA of TMA 1970, or

(b) a company tax return.

## **172 Meaning of "small enterprise" and "medium-sized enterprise"**

(1) In this Chapter -

(a) **"small enterprise"** means a small enterprise as defined in the Annex,

and

(b) **"medium-sized enterprise"** means an enterprise which -

(i) falls within the category of micro, small and medium-sized enterprises as defined in the Annex, and

(ii) is not a small enterprise as defined in the Annex.

(2) For the purposes of subsection (1), the Annex has effect with the modifications set out in subsections (4) to (7).

(3) In this section **"the Annex"** means the Annex to Commission Recommendation 2003/361/EC of 6 May 2003 (concerning the definition of micro, small and medium-sized businesses).

(4) Where any enterprise is in liquidation or administration, the rights of the liquidator or administrator (in that capacity) are to be left out of account when applying Article 3(3)(b) of the Annex in determining for the purposes of this Part whether -

(a) that enterprise, or

(b) any other enterprise (including that of the liquidator or administrator), is a small or medium-sized enterprise.

(5) Article 3 of the Annex has effect with the omission of paragraph 5 (declaration in good faith where control cannot be determined etc.).

(6) The first sentence of Article 4(1) of the Annex has effect as if the data to apply to -

- (a) the headcount of staff, and
- (b) the financial amounts,

were the data relating to the chargeable period referred to in section 166(1) (instead of the period described in that sentence) and calculated on an annual basis.

(7) Article 4 of the Annex has effect with the omission of the following provisions -

- (a) the second sentence of paragraph 1 (data to be taken into account from date of closure of accounts),
- (b) paragraph 2 (no change of status unless ceilings exceeded for two consecutive periods), and
- (c) paragraph 3 (genuine estimate in case of newly established enterprise).

### **173 Meaning of "qualifying territory" and "non-qualifying territory"**

(1) In section 167(3) -

**"non-qualifying territory"** means any territory which is not a qualifying territory, and

**"qualifying territory"** means -

- (a) the United Kingdom, or
- (b) any territory in relation to which condition A or condition B is met.

(2) Condition A is that -

- (a) double taxation arrangements have been made in relation to the territory,
- (b) the arrangements include a non-discrimination provision, and
- (c) the territory is not designated as a non-qualifying territory for the purposes of this subsection in regulations made by the Treasury.

(3) Condition B is that -

- (a) double taxation arrangements have been made in relation to the territory, and
- (b) the territory is designated as a qualifying territory for the purposes of this subsection in regulations made by the Treasury.

(4) For the purposes of subsection (2)(b) a **"non-discrimination provision"**, in relation to any double taxation arrangements, is a provision to the effect that nationals of a state which is a party to those arrangements (a **"contracting state"**) are not to be subject in any other contracting state to -

(a) any taxation, or

(b) any requirement connected with taxation,

which is other or more burdensome than the taxation and connected requirements to which nationals of that other state in the same circumstances (in particular with respect to residence) are or may be subjected.

(5) In subsection (4) **"national"**, in relation to a state, includes -

(a) any individual possessing the nationality or citizenship of the state, and

(b) any legal person, partnership or association deriving its status as such from the law in force in that state.

(6) In this section **"double taxation arrangements"** means arrangements that have effect under section 2(1) (double taxation relief by agreement with territories outside the United Kingdom).

(7) Regulations under this section may only be made if a draft of the statutory instrument containing the regulations has been laid before and approved by a resolution of the House of Commons.

## CHAPTER 4

### POSITION, IF ONLY ONE AFFECTED PERSON POTENTIALLY ADVANTAGED, OF OTHER AFFECTED PERSON

#### **174 Claim by the affected person who is not potentially advantaged**

(1) Subsection (2) applies if -

(a) only one of the affected persons (in this Chapter called "the advantaged person") is a person on whom a potential advantage in relation to United Kingdom taxation is conferred by the actual provision, and

(b) the other affected person (in this Chapter called **"the disadvantaged person"**) is within the charge to income tax or corporation tax in respect of profits arising from the relevant activities (see section 216).

(2) On the making of a claim by the disadvantaged person -

(a) the profits and losses of the disadvantaged person are to be calculated for tax purposes as if the arm's length provision had been made or imposed instead of the actual provision, and

(b) despite any limit in the Tax Acts on the time within which any adjustment may be made, all such adjustments are to be made in the disadvantaged person's case as may be required to give effect to the assumption that the arm's length provision was made or imposed instead of the actual provision.

(3) Provision about claims under this section is made by -

section 175 (claim not allowed in some cases where actual provision relates to a security issued by one of the affected persons),

section 176 (claim cannot be made unless advantaged person has made return on the basis that the arm's length provision applies),

section 177 (when claim may be made or amended), and

sections 181 to 184 (option to make claims in accordance with section 182 in some cases where actual provision relates to a security issued by one of the affected persons).

(4) Subsection (2) has effect subject to -

section 180 (closing trading stock and closing work in progress in a trade),

sections 188 and 189 (effect of claims under this section on double taxation relief),

Chapter 5 (provision, where liabilities of an affected person under securities issued by that person are guaranteed, for attribution to guarantor of things done by that affected person),

section 447(5) and (6) of CTA 2009 (this Part generally does not affect how exchange gains or losses from loan relationships are accounted for), and

section 694(8) and (9) of CTA 2009 (this Part generally does not affect how exchange gains or losses from derivative contracts are accounted for).

**175 Claims under section 174 where actual provision relates to a security**

(1) A claim under section 174 may not be made if -



(a) the participation condition (see section 148) would not be satisfied but for section 161 or 162,

(b) the actual provision is provision in relation to a security issued by one of the affected persons ("**the issuer**"), and

(c) a guarantee is provided in relation to the security by a person with whom the issuer has a participatory relationship.

(2) For the purposes of subsection (1), one person ("A") has a "**participatory relationship**" with another ("**B**") if -

(a) one of A and B is directly or indirectly participating in the management, control or capital of the other, or

(b) the same person or persons is or are directly or indirectly participating in the management, control or capital of each of A and B.

(3) In subsections (1)(b) and (4)(a) "**security**" includes securities not creating or evidencing a charge on assets.

(4) For the purposes of subsection (1)(b), any -

(a) interest payable by a company on money advanced without the issue of a security for the advance, or

(b) other consideration given by a company for the use of money so advanced,

is to be treated as if payable or given in respect of a security issued for the advance by the company, and references to a security are to be read accordingly.

(5) The reference in subsection (1)(c) to a guarantee includes -

(a) a reference to a surety, and

(b) if the issuer is a company, a reference to any other relationship, arrangements, connection or understanding (whether formal or informal) such that the person making the loan to the issuer has a reasonable expectation that in the event of a default by the issuer the person will be paid by, or out of the assets of, one or more companies.

**176 Claims under section 174: advantaged person must have made return**

(1) A claim may not be made under section 174 unless a calculation has been made in the case of the advantaged person on the basis that the arm's length provision was made or imposed instead of the actual provision.

(2) A claim made under section 174 must be consistent with the calculation made on that basis in the case of the advantaged person.

(3) For the purposes of subsections (1) and (2), a calculation is to be taken to have been made in the case of the advantaged person on the basis that the arm's length provision was made or imposed instead of the actual provision if (and only if) -

(a) the calculations made for the purposes of any return by the advantaged person have been made on that basis because of this Part, or

(b) a relevant notice (see section 190) given to the advantaged person takes account of a determination in pursuance of this Part of an amount to be brought into account for tax purposes on that basis.

**177 Time for making, or amending, claim under section 174**

(1) A claim under section 174 can be made only in the period mentioned in subsection (2) or (3).

(2) If a return has been made by the advantaged person on the basis mentioned in section 176(1), the period is the two years beginning with the day of the making of the return.

(3) If a relevant notice (see section 190) taking account of such a determination as is mentioned in section 176(3)(b) has been given to the advantaged person, the period is the two years beginning with the day on which that notice was given.

(4) Subsection (5) applies if -

(a) a claim under section 174 is made in relation to a return made on the basis mentioned in section 176(1), and

(b) a relevant notice taking account of such a determination as is mentioned in section 176(3)(b) is subsequently given to the advantaged person.

(5) The disadvantaged person is entitled, within the period mentioned in subsection (3), to make any such amendment of the claim as may be appropriate in consequence of the determination contained in the relevant notice.

(6) Subsections (1) and (5) have effect subject to section 186(3) (which provides for the extension of the period for making or amending a claim).

### **178 Meaning of "return" in sections 176 and 177**

(1) In sections 176 and 177 "**return**" means -

- (a) any return required to be made under TMA 1970 or under Schedule 18 to FA 1998 for income tax or corporation tax purposes, or
- (b) any voluntary amendment of a return within paragraph (a).

(2) In subsection (1)(b) "**voluntary amendment**" means -

- (a) an amendment under section 9ZA or 12ABA of TMA 1970 (amendment of personal, trustee or partnership return by taxpayer), or
- (b) an amendment under Schedule 18 to FA 1998 other than one made in response to the giving of a relevant notice (see section 190).

### **179 Compensating payment if advantaged person is controlled foreign company**

(1) Subsection (2) applies if -

- (a) the actual provision is provision made or imposed in relation to a controlled foreign company,
- (b) in determining for the purposes of Chapter 4 of Part 17 of ICTA the amount of that company's chargeable profits for an accounting period, its profits and losses are to be calculated in accordance with section 147(3) or (5) in the case of that provision,
- (c) the whole of those chargeable profits are to be apportioned under section 747(3) of ICTA to one or more companies resident in the United Kingdom, and
- (d) tax is chargeable under section 747(4) of ICTA in respect of the whole of those chargeable profits, as so apportioned to those companies.

(2) Sections 174 to 178 have effect as if the controlled foreign company were a person on whom a potential advantage in relation to United Kingdom taxation were conferred by the actual provision.

(3) In applying sections 174 to 178 in a case in which they apply because of subsection (2) -

(a) references to the advantaged person in sections 176(3)(a) and (b) and 177(2), (3) and (4)(b) include a reference to any of the companies mentioned in subsection (1)(c), and

(b) references to corporation tax include a reference to tax chargeable under section 747(4) of ICTA.

(4) In this section -

**"controlled foreign company"** has the same meaning as in Chapter 4 of Part 17 of ICTA, and

**"accounting period"**, in relation to a controlled foreign company, has the same meaning as in that Chapter.

#### **180 Application of section 174(2)(a) in relation to transfers of trading stock etc.**

(1) Section 174(2)(a) does not affect the credits to be brought into account by the disadvantaged person in respect of -

(a) closing trading stock, or

(b) closing work in progress in a trade, for accounting periods ending on or after the day given by subsection (2).

(2) That day is the last day of the accounting period of the advantaged person in which the actual provision was made or imposed.

(3) For the purposes of this section **"trading stock"**, in relation to any trade, has the meaning given by -

(a) section 174 of ITTOIA 2005, or

(b) section 163 of CTA 2009.

#### **181 Section 182 applies to claims where actual provision relates to a security**

(1) Subsection (2) applies if -

(a) both of the affected persons are companies, and

(b) the actual provision is provision in relation to a security issued by one of those companies.

(2) A claim under section 174 may be made in accordance with section 182.

(3) For the purposes of this Part, a "**section 182 claim**" is a claim under section 174 made in accordance with section 182.

(4) In subsections (1)(b) and (5)(a) "**security**" includes securities not creating or evidencing a charge on assets.

(5) For the purposes of subsection (1)(b), any -

(a) interest payable by a company on money advanced without the issue of a security for the advance, or

(b) other consideration given by a company for the use of money so advanced,

is to be treated as if payable or given in respect of a security issued for the advance by the company, and references to a security are to be read accordingly.

### **182 Making of section 182 claims**

(1) A section 182 claim may be made by -

(a) the disadvantaged person, or

(b) the advantaged person.

(2) A section 182 claim made by the advantaged person is to be taken to be made on behalf of the disadvantaged person.

(3) A section 182 claim may be made before or after a calculation within section 176(1) has been made.

(4) A section 182 claim must be made either -

(a) at any time before the end of the period mentioned in section 177(2), or

(b) within the period mentioned in section 177(3).

(5) Subsection (4) has effect subject to section 186(3) (which provides for the extension of the period for making a claim).

### **183 Giving effect to section 182 claims**

(1) A section 182 claim is not a claim within paragraph 57 or 58 of Schedule 18 to FA 1998 (company tax returns, assessments and related matters).

(2) Accordingly, paragraph 59 of that Schedule (application of Schedule 1A to TMA 1970) has effect in relation to a section 182 claim.

(3) If -

- (a) a section 182 claim is made before a calculation within section 176(1) has been made,
- (b) such a calculation is subsequently made, and
- (c) the claim is not consistent with the calculation,

the affected persons are to be treated as if (instead of the claim actually made) a claim had been made that was consistent with the calculation.

(4) All such adjustments are to be made (including by the making of assessments) as are required to give effect to subsection (3).

(5) Subsection (4) has effect despite any limit on the time within which any adjustment may be made.

#### **184 Amending a section 182 claim if it is followed by relevant notice**

(1) Subsection (2) applies if -

- (a) a section 182 claim is made,
- (b) a return is subsequently made by the advantaged person on the basis mentioned in section 176(1), and
- (c) a relevant notice (see section 190) taking account of such a determination as is mentioned in section 176(3)(b) is subsequently given to the advantaged person.

(2) If any amendment of the claim is appropriate in consequence of the determination contained in the relevant notice, the amendment may be made by -

- (a) the disadvantaged person, or
- (b) the advantaged person.

(3) If an amendment under subsection (2) is made by the advantaged person it is to be taken to be made on behalf of the disadvantaged person.

(4) Any amendment under subsection (2) must be made within the period mentioned in section 177(3).

(5) Subsection (4) has effect subject to section 186(3) (which provides for the extension of the period for making an amendment).

## 185 Notice to potential claimants

(1) Subsection (2) applies if -

- (a) a relevant notice (see section 190) is given to any person,
- (b) the notice, or anything contained in it, takes account of a transfer pricing determination, and
- (c) it appears to an officer that there is a person ("**DP**") who is or may be a disadvantaged person by reference to the subject-matter of the determination.

(2) The officer must give to DP a notice containing particulars of the determination.

(3) A contravention of subsection (2) does not affect the validity -

- (a) of the relevant notice, or
- (b) of any determination to which the notice relates.

(4) For the purposes of this section, a person is a disadvantaged person by reference to the subject-matter of a transfer-pricing determination if (and only if) the person -

- (a) is entitled, in consequence of the making of the determination, to make or amend a claim under section 174, or
- (b) will be entitled, because of section 212(3), to be a party to any proceedings on an appeal relating to the determination.

(5) In this section -

**"officer"** means officer of Revenue and Customs, and

**"transfer-pricing determination"** means a determination of an amount that is to be brought into account for tax purposes in respect of -

- (a) any assumption made under section 147(3) or (5), or
- (b) any advance-pricing-agreement assumptions (see section 222(6)).

## 186 Extending claim period if notice under section 185 not given or given late

(1) If there is a contravention of section 185(2), the Commissioners must consider whether, as a result of the contravention, any person has been prejudiced with respect to the making or amendment of a claim under section 174.

(2) Subsection (3) applies if -

(a) there is a contravention of section 185(2), or

(b) a notice required by section 185(2) is given after the relevant notice concerned.

(3) The Commissioners may, if they think fit, treat the period for the making or amendment of a claim under section 174 in the case concerned as extended by such further period as appears to them to be appropriate.

(4) In this section "**the Commissioners**" means the Commissioners for Her Majesty's Revenue and Customs.

### **187 Tax treatment if actual interest exceeds arm's length interest**

(1) Subsection (6) applies if the following conditions are met.

(2) Condition A is that interest is paid by any person under the actual provision.

(3) Condition B is that section 147(3) or (5) applies in relation to the actual provision.

(4) Condition C is -

(a) that the amount ("**ALINT**") of interest that would have been payable under the arm's length provision is less than the amount of interest paid under the actual provision, or

(b) that there would not have been any interest payable under the arm's length provision (so that ALINT is nil).

(5) Condition D is that the person receiving the interest paid under the actual provision makes -

(a) a claim under section 174, or

(b) a section 182 claim.

(6) The interest paid under the actual provision, so far as it exceeds ALINT -

(a) is not to be regarded as chargeable under Chapter 2 of Part 4 of ITTOIA 2005,

(b) is not subject to the provisions of Part 15 of ITA 2007 (deduction of income tax at source), and

(c) is not required to be brought into account under Part 5 of CTA 2009 (loan relationships) as a non-trading credit.



## **188 Double taxation relief by way of credit for foreign tax**

(1) Subsection (2) applies if -

(a) a claim is made under section 174, and

(b) the disadvantaged person ("DP") is entitled on that claim to make a calculation, or to have an adjustment made, on the basis that the arm's length provision was made or imposed instead of the actual provision.

(2) Assumptions A and B are to be made in DP's case in relation to any credit for foreign tax which DP has been, or may be, given -

(a) under any double taxation arrangements, or

(b) under section 18(1)(b) and (2) (relief under unilateral relief arrangements).

(3) Subsection (2) has effect subject to section 189(2).

(4) Assumption A is that the foreign tax paid or payable by DP does not include any amount of foreign tax which would not be or have become payable were it to be assumed for the purposes of that tax that the arm's length provision had been made or imposed instead of the actual provision.

(5) Assumption B is that the amount of DP's relevant profits in respect of which DP is given credit for foreign tax does not include the amount (if any) by which DP's relevant profits are treated as reduced in accordance with section 174.

(6) If any adjustment is required to be made for the purpose of giving effect to any of the preceding provisions of this section -

(a) it may be made by setting the amount of the adjustment against any relief or repayment to which DP is entitled in pursuance of DP's claim under section 174, and

(b) nothing in the Tax Acts limiting the time within which any assessment is to be or may be made or amended prevents that adjustment from being so made.

(7) In subsection (5) "DP's relevant profits" means the profits arising to DP from the carrying on of the relevant activities (see section 216).

(8) In this section -

**"double taxation arrangements"** means arrangements that have effect under section 2(1) (double taxation relief by agreement with territories outside the United Kingdom), and

**"foreign tax"** means -

- (a) any tax under the law of a territory outside the United Kingdom, or
- (b) any amount that, for the purposes of any double taxation arrangements, is to be treated as if it were tax under the law of a territory outside the United Kingdom.

(9) In determining for the purposes of this section whether a person is -

- (a) under any double taxation arrangements, or
- (b) under section 18(1)(b) and (2),

to be given credit for foreign tax, ignore any requirement that a claim is made before such a credit is given.

### **189 Double taxation relief by way of deduction for foreign tax**

(1) Subsection (2) applies if -

- (a) a claim is made under section 174,
- (b) the disadvantaged person ("DP") is entitled on that claim to make a calculation, or to have an adjustment made, on the basis that the arm's length provision was made or imposed instead of the actual provision,
- (c) the application of that basis in the calculation of DP's profits or losses for any chargeable period involves a reduction in the amount of any income, and
- (d) that income is also income that is to be reduced in accordance with section 112(1) (deduction for foreign tax where no credit allowed).

(2) If this subsection applies -

- (a) the reduction mentioned in subsection (1)(c) is to be treated as made before any reduction under section 112(1), and

(b) tax paid, in the place in which any income arises, on so much of that income as is represented by the amount of the reduction mentioned in subsection (1)(c) is to be disregarded for the purposes of section 112(1).

(3) If any adjustment is required to be made for the purpose of giving effect to any of the preceding provisions of this section -

(a) it may be made by setting the amount of the adjustment against any relief or repayment to which DP is entitled in pursuance of DP's claim under section 174, and

(b) nothing in the Tax Acts limiting the time within which any assessment is to be or may be made or amended prevents that adjustment from being so made.

### **190 Meaning of "relevant notice"**

In this Chapter "**relevant notice**" means -

(a) a closure notice under section 28A(1) of TMA 1970 in relation to an enquiry into a return under section 8 or 8A of TMA 1970,

(b) a closure notice under section 28B(1) of TMA 1970 in relation to an enquiry into a partnership return,

(c) a closure notice under paragraph 32 of Schedule 18 to FA 1998 in relation to an enquiry into a company tax return,

(d) a notice under section 30B(1) of TMA 1970 amending a partnership return,

(e) a notice of an assessment under section 29 of TMA 1970,

(f) a notice of a discovery assessment under paragraph 41 of Schedule 18 to FA 1998 (which includes a discovery assessment under that paragraph as applied by paragraph 52 of that Schedule), or

(g) a notice of a discovery determination under paragraph 41 of Schedule 18 to FA 1998.

## CHAPTER 5

### POSITION OF GUARANTOR OF AFFECTED PERSON'S LIABILITIES UNDER A SECURITY ISSUED BY THE PERSON

#### 191 When sections 192 to 194 apply

(1) Sections 192 to 194 apply if -

- (a) one of the affected persons ("**the issuing company**") is a company that as liabilities under a security issued by it,
- (b) those liabilities are to any extent the subject of a guarantee provided by a company ("**the guarantor company**"),
- (c) in calculating the profits and losses of the issuing company for tax purposes, the amounts to be deducted in respect of interest or other amounts payable under the security are required to be reduced (whether or not to nil) under section 147(3) or (5), and
- (d) that reduction is required because of section 153.

(2) In subsections (1)(a) and (3)(a) "**security**" includes securities not creating or evidencing a charge on assets.

(3) For the purposes of subsection (1)(a), any -

- (a) interest payable by a company on money advanced without the issue of a security for the advance, or
- (b) other consideration given by a company for the use of money so advanced,

is to be treated as if payable or given in respect of a security issued for the advance by the company, and the reference in subsection (1)(a) to a security is to be read accordingly.

(4) In subsection (1)(b) the reference to a guarantee includes -

- (a) a reference to a surety, and
- (b) a reference to any other relationship, arrangements, connection or understanding (whether formal or informal) such that the person making the loan to the issuing company has a reasonable expectation that in the event of a default by

the issuing company the person will be paid by, or out of the assets of, one or more companies.

(5) In this Chapter -

**"the guarantor company"** has the meaning given by subsection (1)(b),

**"the issuing company"** has the meaning given by subsection (1)(a), and

**"the security"** means the security mentioned in subsection (1)(a).

## **192 Attribution to guarantor company of things done by issuing company**

(1) On the making of a claim, the guarantor company is, to the extent of the reduction mentioned in section 191(1)(c), to be treated for all purposes of the Taxes Acts as if it (and not the issuing company) -

(a) had issued the security,

(b) owed the liabilities under it, and

(c) had paid any interest or other amounts paid under it by the issuing company.

(2) Subsection (1) is subject to subsection (3).

(3) Where the issuing company's liabilities under the security are the subject of two or more guarantees (whether or not provided by the same person), TD must not exceed TR, where -

TD is the total of the amounts brought into account by the guarantor companies because of subsection (1), and

TR is the total amount of the reductions within section 191(1)(c).

(4) Provision about claims under subsection (1) is made by -

section 193 (interaction between claims under subsection (1) and claims under section 174), and

section 194 (general provision about claims under subsection (1)).

(5) In subsection (1) "the Taxes Acts" has the meaning given by section 118(1) of TMA 1970.

(6) In subsection (3) any reference to a guarantee includes -

- (a) a reference to a surety, and
- (b) a reference to any other relationship, arrangements, connection or understanding (whether formal or informal) such that the person making the loan to the issuing company has a reasonable expectation that in the event of a default by the issuing company the person will be paid by, or out of the assets of, one or more companies.

### **193 Interaction between claims under sections 174 and 192(1)**

(1) In this section **"the loan provision"** means the actual provision made or imposed between -

- (a) the issuing company, and
- (b) another company (**"the lending company"**),

which is provision in relation to the security.

(2) Subsections (3) and (4) apply if -

- (a) the guarantor company makes a claim under section 192(1), and
- (b) the lending company makes a claim under section 174 in relation to the loan provision.

(3) In determining the arm's length provision for the purposes of section 174(2)(a) in relation to the lending company's claim, additional amounts are to be brought into account as credits corresponding to the debits that fall to be brought into account by the guarantor company because of section 192(1).

(4) If -

- (a) the lending company makes its claim under section 174 before the guarantor company makes its claim under section 192(1), and
- (b) the calculation on which the lending company's claim is based does not comply with subsection (3),

the guarantor company's claim is to be disallowed.

## 194 Claims under section 192(1): general provisions

(1) A claim under section 192(1) may be made -

- (a) by the guarantor company,
- (b) if there are two or more guarantor companies, by those companies acting together, or
- (c) by the issuing company.

(2) A claim made under section 192(1) by the issuing company is to be taken to be made on behalf of the guarantor company or companies.

(3) Sections 175 to 177 apply in relation to a claim under section 192(1) made by or on behalf of any person or persons as they apply in relation to a claim under section 174 made by the disadvantaged person, but taking -

- (a) references in sections 176 and 177 to the advantaged person as references to the issuing company, and
- (b) the reference in section 177 to the disadvantaged person as a reference to the guarantor company or companies.

## CHAPTER 6

### BALANCING PAYMENTS

## 195 Qualifying conditions for purposes of section 196

(1) Conditions A to D are "the qualifying conditions" for the purposes of section 196.

(2) Condition A is that only one of the affected persons ("**the advantaged person**") is a person on whom a potential advantage in relation to United Kingdom taxation is conferred by the actual provision.

(3) Condition B is that the other affected person ("**the disadvantaged person**") is within the charge to income tax or corporation tax in respect of profits arising from the relevant activities (see section 216).

(4) Condition C is that -

- (a) a payment (the "**balancing payment**") is made, or
- (b) two or more payments (the "**balancing payments**") are made,

to the advantaged person by the disadvantaged person.

(5) Condition D is that the sole or main reason for making that payment or those payments is that section 147(3) or (5) applies.

### **196 Balancing payments between affected persons: no charge to, or relief from, tax**

(1) If each of the qualifying conditions (see section 195) is met, subsection (2) applies -

(a) to the balancing payment if, or so far as, its amount does not exceed the available compensating adjustment, or

(b) to the balancing payments if, or so far as, their total amount does not exceed the available compensating adjustment.

(2) Any payment to which this subsection applies -

(a) is not to be taken into account in calculating profits or losses of either of the affected persons for the purposes of income tax or corporation tax, and

(b) is not for any purpose of the Corporation Tax Acts to be regarded as a distribution.

(3) In subsection (1) **"the available compensating adjustment"** means the difference between PL1 and PL2 where -

PL1 is the profits and losses of the disadvantaged person calculated for tax purposes on the basis of the actual provision, and

PL2 is the profits and losses of the disadvantaged person as (or as they would be) calculated for tax purposes on a claim under section 174.

(4) For the purposes of subsection (3), take PL1 or PL2 -

(a) as a positive amount if it is an amount of profits, and

(b) as a negative amount if it is an amount of losses.

(5) In this section, the following expressions have the meaning given by section 195 -

**"the balancing payment"** and **"the balancing payments"**, and

**"the disadvantaged person"**.



## 197 Qualifying conditions for purposes of section 198

- (1) Conditions A to F are the qualifying conditions for the purposes of section 198.
- (2) Condition A is that one of the affected persons ("**the issuing company**") is a company that has liabilities under a security issued by it.
- (3) Condition B is that those liabilities are to any extent the subject of a guarantee provided by a company ("**the guarantor company**").
- (4) Condition C is that, in calculating the profits and losses of the issuing company for tax purposes, the amounts to be deducted in respect of interest or other amounts payable under the security are required to be reduced (whether or not to nil) under section 147(3) or (5).
- (5) Condition D is that that reduction is required because of section 153.
- (6) Condition E is that -
- (a) a payment (the "**balancing payment**") is made, or
  - (b) two or more payments (the "**balancing payments**") are made,
- by the guarantor company to the issuing company.
- (7) Condition F is that the sole or main reasons for making that payment or those payments are -
- (a) that section 147(3) or (5) applies because of section 153, or
  - (b) that sections 192 to 194 apply.
- (8) In subsections (2) and (9)(a) "security" includes securities not creating or evidencing a charge on assets.
- (9) For the purposes of subsection (2), any -
- (a) interest payable by a company on money advanced without the issue of a security for the advance, or
  - (b) other consideration given by a company for the use of money so advanced,
- is to be treated as if payable or given in respect of a security issued for the advance by the company, and the reference in subsection (2) to a security is to be read accordingly.

(10) In subsection (3) the reference to a guarantee includes -

- (a) a reference to a surety, and
- (b) a reference to any other relationship, arrangements, connection or understanding (whether formal or informal) such that the person making the loan to the issuing company has a reasonable expectation that in the event of a default by the issuing company the person will be paid by, or out of the assets of, one or more companies.

### **198 Balancing payments by guarantor to issuer: no charge to, or relief from, tax**

(1) If each of the qualifying conditions (see section 197) is met, subsection (2) applies to the balancing payments made by all of the guarantor companies if, or so far as, the total amount of those payments does not exceed the total amount of the reductions within section 197(4).

(2) Payments to which this subsection applies -

- (a) are not to be taken into account in calculating for the purposes of corporation tax the profits or losses of the guarantor company or companies or the issuing company, and
- (b) are not for any purpose of the Corporation Tax Acts to be regarded as distributions.

(3) In this section, the following expressions have the meaning given by section 197 -

**"the balancing payments",**

**"the guarantor company", and**

**"the issuing company".**

### **199 Pre-conditions for making election under section 200**

(1) Conditions A to E are the pre-conditions for the purposes of section 200.

(2) Condition A is that both of the affected persons are companies.

(3) Condition B is that only one of the affected persons ("**the advantaged person**")

is a person on whom a potential advantage in relation to United Kingdom taxation is conferred by the actual provision.

(4) Condition C is that the other affected person ("**the disadvantaged person**") is within the charge to income tax or corporation tax in respect of profits arising from the relevant activities (see section 216).

(5) Condition D is that the actual provision is provision in relation to a security (the "**relevant security**").

(6) Condition E is that the capital market condition is met (see section 204).

(7) In subsections (5) and (8)(a) "security" includes securities not creating or evidencing a charge on assets.

(8) For the purposes of subsection (5), any -

(a) interest payable by a company on money advanced without the issue of a security for the advance, or

(b) other consideration given by a company for the use of money so advanced,

is to be treated as if payable or given in respect of a security issued for the advance by the company, and the reference in subsection (5) to a security is to be read accordingly.

## **200 Election to pay tax rather than make balancing payments**

(1) If each of the pre-conditions (see section 199) is met, the disadvantaged person may make an election -

(a) to make no balancing payment within section 196 to the advantaged person in connection with section 147(3) or (5) applying because of section 152 in relation to the relevant security in a chargeable period, but

(b) instead, to undertake sole responsibility for discharging the advantaged person's liability to tax for that period so far as resulting from section 147(3) or (5) applying because of section 152 in relation to the relevant security.

(2) Section 203 contains provision about the making and effect of elections under this section.

(3) In this section, the following expressions have the meaning given by section 199 -

**"the advantaged person",**

**"the disadvantaged person",** and

**"the relevant security".**

## 201 Pre-conditions for making election under section 202

- (1) Conditions A to E are the pre-conditions for the purposes of section 202.
- (2) Condition A is that both of the affected persons are companies.
- (3) Condition B is that only one of the affected persons ("**the advantaged person**") is a person on whom a potential advantage in relation to United Kingdom taxation is conferred by the actual provision.
- (4) Condition C is that the other affected person ("**the disadvantaged person**") is within the charge to income tax or corporation tax in respect of profits arising from the relevant activities (see section 216).
- (5) Condition D is that the actual provision is made or imposed by means of a series of transactions which include -
- (a) the issuing of a security ("**the relevant security**") by one of the affected persons ("**the issuing company**"), and
  - (b) the provision of a guarantee by the other affected person.
- (6) Condition E is that the capital market condition is met (see section 204).
- (7) In subsections (5) and (8)(a) "**security**" includes securities not creating or evidencing a charge on assets.
- (8) For the purposes of subsection (5), any -
- (a) interest payable by a company on money advanced without the issue of a security for the advance, or
  - (b) other consideration given by a company for the use of money so advanced,
- is to be treated as if payable or given in respect of a security issued for the advance by the company, and the reference in subsection (5) to a security is to be read accordingly.
- (9) In subsection (5) the reference to a guarantee includes -
- (a) a reference to a surety, and
  - (b) a reference to any other relationship, arrangements, connection or understanding (whether formal or informal) such that the person making the loan to the issuing company has a reasonable expectation that in the event of a default by

the issuing company the person will be paid by, or out of the assets of, one or more companies.

## **202 Election, in guarantee case, to pay tax rather than make balancing payments**

(1) If each of the pre-conditions (see section 201) is met, the disadvantaged person may make an election -

(a) to make no balancing payment within section 198 to the advantaged person in connection with section 147(3) or (5) applying because of section 153 in relation to the relevant security in a chargeable period, but

(b) instead, to undertake sole responsibility for discharging the advantaged person's liability to tax for that period so far as resulting from section 147(3) or (5) applying because of section 153 in relation to the relevant security.

(2) Section 203 contains provision about the making and effect of elections under this section.

(3) In this section, the following expressions have the meaning given by section 201 -

**"the advantaged person",**

**"the disadvantaged person", and**

**"the relevant security".**

## **203 Elections under section 200 or 202**

(1) In this section "election" means election under section 200 or 202.

(2) An election must be made by being included (whether by amendment or otherwise) in the disadvantaged person's company tax return for the chargeable period in which the relevant security is issued.

(3) An election is irrevocable.

(4) An election has effect in relation to each of the affected persons for the chargeable period in which the relevant security is issued and all subsequent chargeable periods.

(5) An election is of no effect if the Commissioners for Her Majesty's Revenue and Customs give the disadvantaged person a notice refusing to accept the election.

(6) A notice under subsection (5) may be given only after a notice of enquiry in respect of the company tax return containing the election has been given to the disadvantaged person.

(Paragraph 24 of Schedule 18 to FA 1998 makes provision about notices of enquiry in respect of company tax returns.)

(7) If an election has effect in relation to an accounting period of the advantaged person, the tax mentioned in subsection (1)(b) of the section under which the election is made -

(a) is recoverable from the disadvantaged person as if it were an amount of corporation tax due and owing from that person, and

(b) is not recoverable from the advantaged person.

(8) In this section -

**"the advantaged person",**

**"the disadvantaged person" and**

**"the relevant security"-**

(a) in relation to an election under section 200, have the meaning given by section 199, and

(b) in relation to an election under section 202, have the meaning given by section 201, and

**"company tax return"** means the return required to be delivered pursuant to a notice under paragraph 3 of Schedule 18 to FA 1998, as read with paragraph 4 of that Schedule.

(9) For the purposes of subsections (2) and (4), if the relevant security was issued in a chargeable period beginning before 1st April 2004 it is to be treated as if it had been issued in the chargeable period beginning on that date.

#### **204 Meaning of "capital market condition" in sections 199 and 201**

(1) For the purposes of section 199(6) or 201(6), the capital market condition is met if -

(a) the actual provision forms part of a capital market arrangement,

(b) the capital market arrangement involves the issue of a capital market investment,

(c) the securities that represent the capital market investment are issued wholly or mainly to independent persons, and

(d) the total value of the capital market investments made under the capital market arrangement is at least £50 million.

(2) In this section -

**"capital market arrangement"** has the same meaning as in section 72B(1) of the Insolvency Act 1986 (see paragraph 1 of Schedule 2A to that Act),

**"capital market investment"** has the same meaning as in section 72B(1) of the Insolvency Act 1986 (see paragraphs 2 and 3 of Schedule 2A to that Act), and

**"independent person"** means a person -

(a) who is not the disadvantaged person, and

(b) who does not have a participatory relationship with either of the affected persons.

(3) In subsection (2) **"the disadvantaged person"** -

(a) for the purposes of the application of this section in relation to section 199(6) has the meaning given by section 199(4), and

(b) for the purposes of the application of this section in relation to section 201(6) has the meaning given by section 201(4).

(4) For the purposes of subsection (2), a person ("**A**") who is a company has a **"participatory relationship"** with one of the affected persons ("**B**") if -

(a) one of A and B is directly or indirectly participating in the management, control or capital of the other, or

(b) the same person or persons is or are directly or indirectly participating in the management, control or capital of each of A and B.

## CHAPTER 7

### OIL-RELATED RING-FENCE TRADES

#### **205 Provision made or imposed between ring-fence trade and other activities**

(1) Subsections (2) to (4) apply if -

(a) a person carries on an oil-related ring-fence trade (see section 206), and

(b) any provision is made or imposed by the person as between -

(i) the oil-related ring-fence trade, and

(ii) any other activities carried on by the person.

(2) Chapters 1 and 3 to 6 (read in accordance with Chapters 2 and 8) apply in relation to the provision as if -

(a) the oil-related ring-fence trade, and the person's other activities, were carried on by two different persons,

(b) the provision were made or imposed as between those two persons by means of a transaction,

(c) those two persons were both controlled by the same person at the time when the provision was made or imposed, and

(d) a potential advantage in relation to United Kingdom taxation was conferred by the provision on each of those two persons.

(3) Subsection (2) has effect subject to subsection (4).

(4) Chapters 1 and 3 to 6 apply in relation to the provision only if the effect of their applying is -

(a) that a larger amount is taken for tax purposes to be the amount of the profits of the oil-related ring-fence trade for any chargeable period, or

(b) that a smaller amount (including nil) is taken for tax purposes to be the amount for any chargeable period of any losses of the oil-related ring-fence trade.

(5) In subsection (4)(a), the reference to a larger amount includes, if there would not otherwise have been profits, an amount of more than nil.



## 206 Meaning of "oil-related ring-fence trade" in sections 205 and 218

(1) This section has effect for the interpretation of -

- (a) section 205, and
- (b) in Part 5, section 218(2)(f).

(2) Activities carried on by a person are an "**oil-related ring-fence trade**" carried on by that person if subsection (3) or (4) applies to the activities.

(3) This subsection applies to the activities if -

- (a) they are carried on by the person as part of a trade, and
- (b) in accordance with section 16(1) of ITTOIA 2005 or section 279 of CTA 2010 (oil-related activities), they are treated for any tax purposes as a separate trade distinct from all other activities carried on by the person as part of the trade.

(4) This subsection applies to the activities if -

- (a) they are carried on by the person as a trade, and
- (b) in accordance with section 16(1) of ITTOIA 2005 or section 279 of CTA 2010 they would, if the person did carry on any other activities as part of the trade, be treated for any tax purposes as a separate trade distinct from all other activities carried on by the person as part of the trade.

## CHAPTER 8

### SUPPLEMENTARY PROVISIONS AND INTERPRETATION OF PART

## 207 Application of Part to unit trusts

(1) This Part has effect as follows.

(2) As if a unit trust scheme were a company that is a body corporate.

(3) As if the rights of the unit holders under a unit trust scheme were shares in the company that the scheme is deemed to be.

(4) As if rights and powers of a person in the capacity of a person entitled to act for the purposes of a unit trust scheme were rights and powers of the scheme.

(5) As if provision made or imposed as between -

(a) a person in the capacity of a person entitled to act for the purposes of a unit trust scheme, and

(b) another person,

were made or imposed as between the scheme and that other person.

## **208 The determinations which require the Commissioners' sanction**

(1) A determination requires the Commissioners' sanction if it -

(a) is a transfer-pricing determination made for any of the specified purposes, and

(b) is not excepted by section 209 from the requirement for the Commissioners' sanction.

(2) In subsection (1) "transfer-pricing determination" means a determination of an amount to be brought into account for tax purposes in respect of any assumption made under section 147(3) or (5).

(3) For the purposes of subsection (1), each of the following is a specified purpose -

(a) the giving of a closure notice under section 28A(1) of TMA 1970 in relation to an enquiry into a return under section 8 or 8A of TMA 1970,

(b) the giving of a closure notice under section 28B(1) of TMA 1970 in relation to an enquiry into a partnership return,

(c) the giving of a closure notice under paragraph 32 of Schedule 18 to FA 1998 in relation to an enquiry into a company tax return,

(d) the giving of a notice under section 30B(1) of TMA 1970 amending a partnership return,

(e) the making of an assessment under section 29 of TMA 1970,

(f) the making of a discovery assessment under paragraph 41 of Schedule 18 to FA 1998 (which includes a discovery assessment under that paragraph as applied by paragraph 52 of that Schedule), and

(g) the making of a discovery determination under paragraph 41 of Schedule 18 to FA 1998.

(4) In this section "**the Commissioners**" means the Commissioners for Her Majesty's Revenue and Customs.

## 209 Determinations exempt from requirement for Commissioners' sanction

(1) A transfer-pricing determination made for a purpose specified in section 208(3) ("**the specified purpose**") does not require the Commissioners' sanction if -

- (a) an agreement about the matters to which the determination relates has been made between an officer and the person in whose case the determination is made,
- (b) the agreement is in force at the relevant time, and
- (c) the matters to which the agreement relates include the amount determined by the transfer-pricing determination.

(2) For the purposes of subsection (1)(b) -

- (a) if the specified purpose is within section 208(3)(a) to (d), "**the relevant time**" is when the notice is given,
- (b) if the specified purpose is within section 208(3)(e) or (f), "**the relevant time**" is when any notice of the assessment is given, and
- (c) if the specified purpose is within section 208(3)(g), "**the relevant time**" is when any notice of the discovery determination is given.

(3) For the purposes of subsection (1)(b), an agreement made between an officer and any person in relation to any matter is "**in force**" at any time if (and only if) -

- (a) the agreement is one that has been made or confirmed in writing,
- (b) that time is after the end of the cooling-off period, and
- (c) the person has not, before the end of the cooling-off period, served a notice on an officer stating that the person is repudiating or resiling from the agreement.

(4) In subsection (3) "**the cooling-off period**" means -

- (a) if the agreement is made in writing, the 30 days beginning with the day when the agreement is made, and
- (b) in any other case, the 30 days beginning with the day when the agreement is confirmed in writing.

(5) For the purposes of subsections (3) and (4), an agreement made between an officer and any person is "confirmed in writing" if an officer serves on the person a notice in writing -

- (a) stating that the agreement has been made, and
- (b) setting out the terms of the agreement.

(6) In this section -

**"the Commissioners"** means the Commissioners for Her Majesty's Revenue and Customs,

**"officer"** means officer of Revenue and Customs, and

**"transfer-pricing determination"** has the meaning given by section 208(2).

## **210 The requirement for the Commissioners' sanction**

(1) Subsection (2) applies in relation to a transfer-pricing determination made for a purpose specified in section 208(3)(a) to (d) if, under section 208(1), the determination requires the Commissioners' sanction.

(2) If the closure notice, or notice under section 30B(1) of TMA 1970, is given to a person -

- (a) without the determination, so far as it is taken into account in the notice, having been approved by the Commissioners, or
- (b) without a copy of the Commissioners' approval having been served on the person at or before the time when the notice is given to the person,

the notice has effect as if given in the terms (if any) in which it would have been given had the determination not been taken into account.

(3) Subsection (4) applies in relation to a transfer-pricing determination made for a purpose specified in section 208(3)(e) to (g) if, under section 208(1), the transfer-pricing determination requires the Commissioners' sanction.

(4) If notice of the assessment, or notice of the discovery determination, is given to a person -

- (a) without the transfer-pricing determination, so far as it is taken into account in the assessment or discovery determination, having been approved by the Commissioners, or
- (b) without a copy of the Commissioners' approval having been served on the person at or before the time when the notice is given to the person,

the assessment or discovery determination has effect as if made (and notified) in the terms (if any) in which it would have been made had the transfer-pricing determination not been taken into account.

(5) For the purposes of subsections (2) and (4), the Commissioners' approval of a transfer-pricing determination requiring their sanction -

(a) must be given specifically in relation to the case concerned and must apply to the amount determined, but

(b) subject to that, may be given by the Commissioners (either before or after the determination is made) in any such form or manner as the Commissioners may determine.

(6) In this section **"the Commissioners"** means the Commissioners for Her Majesty's Revenue and Customs.

## **211 Restriction of right to appeal against Commissioners' approval**

(1) In subsection (2) -

**"appeal"** means an appeal by virtue of any provision of -

(a) TMA 1970, or

(b) Schedule 18 to FA 1998 (company tax returns and related matters), and

**"approved determination"** means a determination that, for the purposes of section 210(2) or (4), has been approved by the Commissioners.

(2) The matters that may be questioned on so much of an appeal as relates to an approved determination do not include the Commissioners' approval.

(3) Subsection (2) does not apply so far as the grounds for questioning the approval are the same as the grounds for questioning the determination.

(4) In this section **"the Commissioners"** means the Commissioners for Her Majesty's Revenue and Customs.

## **212 Appeals**

(1) The appeals within this subsection are—

(a) an appeal under section 31 of, or Schedule 1A to, TMA 1970,

(b) an appeal under paragraph 34(3) of Schedule 18 to FA 1998 against an amendment of a company's return, and

(c) an appeal under paragraph 48 of that Schedule against a discovery assessment or a discovery determination.

(2) Subsection (3) applies so far as the question in dispute on an appeal within subsection (1) -

(a) is or involves a determination of whether this Part has effect, and

(b) relates to any provision made or imposed as between two persons each of whom is within the charge to income tax or corporation tax in respect of profits arising from the relevant activities (see section 216).

(3) If this subsection applies -

(a) each of the persons as between whom the actual provision was made or imposed is entitled to be a party in any proceedings,

(b) the tribunal is to determine the question separately from any other question in the proceedings, and

(c) the tribunal's determination on the question has effect as if made in an appeal to which each of those persons was a party.

(4) In subsection (1)(c) -

**"discovery assessment"** means a discovery assessment under paragraph 1 of Schedule 18 to FA 1998 (which includes a discovery assessment under that paragraph as applied by paragraph 52 of that Schedule), and

**"discovery determination"** means a discovery determination under paragraph 41 of that Schedule.

## 213 Capital allowances

(1) Nothing in this Part is to be read as affecting the calculation of the amount of any capital allowance or balancing charge made under CAA 2001.

(2) Subsection (1) does not apply in relation to claims under section 174.

## 214 Chargeable gains

(1) Nothing in this Part is to be read as affecting the calculation in accordance with TCGA 1992 of the amount of any chargeable gain or allowable loss.

(2) Nothing in this Part requires the profits and losses of any person to be calculated for tax purposes as if, in the person's case, instead of income or losses to be brought into account in connection with the taxation of income, there were gains or losses to be brought into account in accordance with TCGA 1992.

(3) Subsections (1) and (2) do not apply in relation to claims under section 174.

## 215 Manner of making adjustments to give effect to Part

Any adjustments required to be made under this Part may be made by way of discharge or repayment of tax, by the modification of any assessment or otherwise.

## 216 Meaning of "the relevant activities"

(1) In this Part "**the relevant activities**", in relation to a person ("**A**") who is one of the persons as between whom any provision is made or imposed, means activities that—

(a) are within subsection (2), and

(b) are not within subsection (3).

(2) The activities within this subsection are those of A's activities that comprise the activities in the course of which, or with respect to which, that provision is made or imposed.

(3) The activities within this subsection are any of A's activities carried on -

(a) separately from the activities mentioned in subsection (2), or

(b) for the purposes of a different part of A's business.

## 217 Meaning of "control" and "firm"

(1) References in this Part to a person controlling a body corporate or firm are to be read in accordance with section 1124 of CTA 2010.

(2) Subsection (1) has effect subject to subsection (4) and section 205(2).

(3) Subsection (4) applies if -

(a) the actual provision is made or imposed by or in relation to a sale of oil,

(b) the oil sold is oil which has been, or is to be, extracted under rights exercisable by a company ("the producer") which, although it may be the seller, is not the buyer, and

(c) at the time of the completion of the sale or when possession of the oil passes, whichever is the earlier, at least 20% of the producer's ordinary share capital is owned directly or indirectly by one or more of the buyer and the companies (if any) that are linked to the buyer.

(4) If this subsection applies, this Part has effect in relation to the actual provision as if -

(a) the buyer and the seller, and

(b) the producer, if it is not the seller,

were all controlled by the same person at the time of the making or imposition of the actual provision.

(5) For the purposes of subsection (3)(c), two companies are "**linked**" if -

(a) one is under the control of the other, or

(b) both are under the control of the same person or persons.

(6) For the purposes of subsection (3) -

(a) any question whether ordinary share capital is owned directly or indirectly by a company is to be decided as for Chapter 3 of Part 24 of CTA 2010, and

(b) rights to extract oil are to be taken to be exercisable by a company even if they are exercisable by that company only jointly with another company or two or more other companies.

(7) In this section "**oil**" includes any mineral oil or relative hydrocarbon oil, as well as natural gas.

(8) In this Part persons carrying on a trade, profession or other business in partnership are referred to collectively as a "**firm**".



## APPENDIX G

### PART 7

#### TAX TREATMENT OF FINANCING COSTS AND INCOME

##### CHAPTER 1

##### INTRODUCTION

###### 260 Introduction

(1) Chapter 2 contains provision for determining whether this Part applies in relation to any particular period of account of the worldwide group.

(2) Chapter 3 provides for the disallowance of certain financing expenses of relevant group companies arising in a period of account of the worldwide group to which this Part applies.

The total of the amounts disallowed is the amount by which the tested expense amount (defined in Chapter 8) exceeds the available amount (defined in Chapter 9).

(3) Chapter 4 provides for the exemption from the charge to corporation tax of certain financing income of UK group companies where financing expenses of relevant group companies have been disallowed under Chapter 3.

(4) Chapter 5 provides for the exemption from the charge to corporation tax of certain intra-group financing income of UK group companies where the paying company is denied a deduction for tax purposes otherwise than under this Part.

(5) Chapter 6 contains rules connected with tax avoidance.

(6) Chapter 7 defines a "**financing expense amount**" and "**financing income amount**" of a company for a period of account of the worldwide group, which are amounts that would, apart from this Part, be brought into account for the purposes of corporation tax.

(7) Chapter 8 defines the "**tested expense amount**" and the "**tested income amount**" of the worldwide group for a period of account of the group, which are totals deriving from the financing expense amounts and financing income amounts of certain group companies.

(8) Chapter 9 defines the "**available amount**" for a period of account of the worldwide group, which derives from certain financing costs disclosed in the group's consolidated financial statements.

(9) Chapter 10 contains further interpretative provisions.

## CHAPTER 2

### APPLICATION OF PART

#### 261 Application of Part

(1) This Part applies to any period of account of the worldwide group for which -

(a) the UK net debt of the group (see sections 262 and 263), exceeds

(b) 75% of the worldwide gross debt of the group (see section 264).

(2) But a period of account that is within subsection (1) is not a period of account to which this Part applies if the worldwide group is a qualifying financial services group in that period (see section 266).

(3) The Treasury may by order amend subsection (1)(b) by substituting a higher or lower percentage for the percentage for the time being specified there.

(4) An order under subsection (3) may only be made if a draft of the statutory instrument containing the order has been laid before and approved by a resolution of the House of Commons.

(5) An order under subsection (3) may only have effect in relation to periods of account of the worldwide group beginning after the date on which the order is made.

#### 262 UK net debt of worldwide group for period of account of worldwide group

(1) The reference in section 261 to the "UK net debt" of the worldwide group for a period of account of the group is to the sum of the net debt amounts of each company that was a relevant group company at any time during the period.

(2) In this section "net debt amount", in relation to a company, means the average of -

(a) the net debt of the company as at that company's start date, and

(b) the net debt of the company as at that company's end date.

For the meaning of "**net debt**", see section 263.

(3) If the amount determined in accordance with subsection (2) is less than £3 million, the net debt amount of the company is nil.

(4) If a company is dormant (within the meaning given by section 1169 of the Companies Act 2006) at all times in the period beginning with that company's start date and ending with that company's end date, the net debt amount of the company is nil.

(5) The Treasury may by order amend subsection (3) by substituting a higher or lower amount for the amount for the time being specified there.

(6) An order under subsection (5) may only be made if a draft of the statutory instrument containing the order has been laid before and approved by a resolution of the House of Commons.

(7) An order under subsection (5) may only have effect in relation to periods of account of the worldwide group beginning after the date on which the order is made.

(8) In this Chapter -

(a) "**the start date**" of a company means the first day of the period of account of the worldwide group or, if later, the first day in the period on which the company was a relevant group company, and

(b) "**the end date**" of a company means the last day of the period of account of the worldwide group or, if earlier, the last day in the period on which the company was a relevant group company.

## **263 Net debt of a company**

(1) References in section 262 to the "**net debt**" of a company as at any date are to -

(a) the sum of the company's relevant liabilities as at that date, less

(b) the sum of the company's relevant assets as at that date.

(2) The amount determined in accordance with subsection (1) may be a negative amount.

(3) For the purposes of this section, a company's "relevant liabilities" as at any date are the amounts that are disclosed in the balance sheet of the company as at that date in respect of -

(a) amounts borrowed (whether by way of overdraft or other short term or long term borrowing),

(b) liabilities in respect of finance leases, or

(c) amounts of such other description as may be specified in regulations made by the Commissioners.

(4) For the purposes of this section, a company's "**relevant assets**" as at any date are the amounts that are disclosed in the balance sheet of the company as at that date in respect of -

(a) cash and cash equivalents,

(b) amounts loaned (whether by way of overdraft or other short term or long term loan),

(c) net investments, or net cash investments, in finance leases,

(d) securities of Her Majesty's government or of the government of any other country or territory, or

(e) amounts of such other description as may be specified in regulations made by the Commissioners.

(5) Expressions used in subsections (3)(a) and (b) and (4)(a) to (c) have the meaning for the time being given by generally accepted accounting practice.

#### **264 Worldwide gross debt of worldwide group for period of account of the group**

(1) The reference in section 261 to the "worldwide gross debt" of the worldwide group for a period of account of the group is to the average of -

(a) the sum of the relevant liabilities of the group as at the day before the first day of the period, and

(b) the sum of the relevant liabilities of the group as at the last day of the period.

(2) For the purposes of this section, the "relevant liabilities" of the worldwide group as at any date are the amounts that are disclosed in the balance sheet of the group as at that date in respect of -

(a) amounts borrowed (whether by way of overdraft or other short term or long term borrowing),

(b) liabilities in respect of finance leases, or

(c) amounts of such other description as may be specified in regulations made by the Commissioners.

(3) Expressions used in subsection (2)(a) and (b) have the meaning for the time being given by the accounting standards in accordance with which the financial statements of the group are drawn up.

(4) For provision about references in this Part to financial statements of the worldwide group, and amounts disclosed in financial statements, see sections 346 to 349.

### **265 References to amounts disclosed in balance sheet of relevant group company**

(1) This section applies for the purpose of construing references in section 263 to amounts disclosed in the balance sheet of a relevant group company as at any date ("**the relevant date**").

(2) If the company -

(a) is not a foreign company, and

(b) does not draw up a balance sheet as at the relevant date,

the references are to the amounts that would be disclosed in a balance sheet of the company as at that date, were one drawn up in accordance with generally accepted accounting practice.

(3) If the company -

(a) is a foreign company, and

(b) draws up a balance sheet ("**a UK permanent establishment balance sheet**") as at the relevant date in respect of the company's permanent establishment in the United Kingdom that treats the establishment as a distinct and separate enterprise,

the references are to amounts in that balance sheet.

(4) If the company -

(a) is a foreign company, and

(b) does not draw up a UK permanent establishment balance sheet as at the relevant date,

the references are to the amounts that would be disclosed in a UK permanent establishment balance sheet as at that date, were one drawn up in accordance with generally accepted accounting practice.

(5) For the purposes of this section, a relevant group company is a **"foreign company"** if it is not resident in the United Kingdom and is carrying on a trade in the United Kingdom through a permanent establishment in the United Kingdom.

## **266 Qualifying financial services groups**

(1) The worldwide group is a qualifying financial services group in a period of account if the trading income condition -

(a) is met in relation to that period, or

(b) is not met in relation to that period, but only because of losses incurred by the group in respect of activities that are normally reported on a net basis in financial statements prepared in accordance with international accounting standards.

(2) The trading income condition is met in relation to a period of account if -

(a) all or substantially all of the UK trading income of the worldwide group for that period, or

(b) all or substantially all of the worldwide trading income of the worldwide group for that period,

is derived from qualifying activities (see section 267).

(3) In this Chapter, in relation to a period of account of the worldwide group -

**"UK trading income"** means the sum of the trading income for that period of each company that was a relevant group company at any time during that period (see section 271), and

**"worldwide trading income"** means the trading income for that period of the worldwide group (see section 272).

## **267 Qualifying activities**

In this Chapter "qualifying activities" means -

(a) lending activities and activities that are ancillary to lending activities (see section 268),

(b) insurance activities and insurance-related activities (see section 269), and

(c) relevant dealing in financial instruments (see section 270).

## 268 Lending activities and activities ancillary to lending activities

(1) In this Chapter "lending activities" means any of the following activities -

- (a) acceptance of deposits or other repayable funds,
- (b) lending of money, including consumer credit, mortgage credit, factoring (with or without recourse) and financing of commercial transactions (including forfeiting),
- (c) finance leasing (as lessor),
- (d) issuing and administering means of payment,
- (e) provision of guarantees or commitments to provide money,
- (f) money transmission services,
- (g) provision of alternative finance arrangements, and
- (h) other activities carried out in connection with activities falling within any of paragraphs (a) to (g).

(2) Activities that are ancillary to lending activities are not qualifying activities for the purposes of this Chapter if the income derived from the ancillary activities forms a significant part of the total of -

- (a) that income, and
- (b) the income derived from lending activities of the worldwide group in the period of account.

(3) In subsection (2) "income" means the gross income or net income that would be taken into account for the purposes of section 266 in calculating the UK or worldwide trading income of the worldwide group for the period of account.

(4) The Commissioners may by order -

- (a) amend subsection (1), and
- (b) make other amendments of this section in consequence of any amendment of subsection (1).

(5) In subsection (1)(h), and in the references to ancillary activities in this section and section 267(a), "activities" includes buying, holding, managing and selling assets.

(6) In this section "alternative finance arrangements" has the same meaning as in Chapter 6 of Part 6 of CTA 2009.

## **269 Insurance activities and insurance-related activities**

(1) In this Chapter "**insurance activities**" means -

- (a) the effecting or carrying out of contracts of insurance by a regulated insurer, and
- (b) investment business that arises directly from activities falling within paragraph (a).

(2) In this Chapter "**insurance-related activities**" means -

- (a) activities that are ancillary to insurance activities, and
- (b) activities that -
  - (i) are of the same kind as activities carried out for the purposes of insurance activities,
  - (ii) are not actually carried out for those purposes, and
  - (iii) would not be carried out but for insurance activities being carried out.

(3) Subsection (2) is subject to subsection (4).

(4) Activities that fall within subsection (2)(a) or (b) ("**the relevant activities**") are not insurance-related activities if the income derived from the relevant activities forms a significant part of the total of -

- (a) that income, and
- (b) the income derived from insurance activities of the worldwide group in the period of account.

(5) In subsection (4) "**income**" means the gross income or net income that would be taken into account for the purposes of section 266 in calculating the UK or worldwide trading income of the worldwide group for the period of account.

(6) In this section -

"**activities**" includes buying, holding, managing and selling assets,

"**contract of insurance**" has the same meaning as in Chapter 1 of Part 12 of ICTA, and



**"regulated insurer"** means a member of the worldwide group that -

- (a) is authorised under the law of any territory to carry on insurance business, or
- (b) is a member of a body or organisation that is so authorised.

## **270 Relevant dealing in financial instruments**

(1) In this Chapter "financial instrument" means anything that is a financial instrument for any purpose of the FSA Handbook.

(2) For the purposes of this Chapter, a dealing in a financial instrument is a **"relevant dealing"** if -

- (a) it is a dealing other than in the capacity of a broker, and
- (b) profits or losses on the dealing form part of the trading profits or losses of a business.

(3) In this section **"broker"** includes any person offering to sell securities to, or purchase securities from, members of the public generally.

## **271 UK trading income of the worldwide group**

(1) This section applies in relation to section 266 for calculating the UK trading income of the worldwide group for a period of account.

(2) The trading income for that period of a relevant group company is the aggregate of -

- (a) the gross income calculated in accordance with subsection (3), and
- (b) the net income calculated in accordance with subsection (4).

(3) The income mentioned in subsection (2)(a) is the gross income -

- (a) arising from the activities of the relevant group company (other than net-basis activities), and
- (b) accounted for as such under generally accepted accounting practice,

without taking account of any deductions (whether for expenses or otherwise).

(4) The income mentioned in subsection (2)(b) is the net income arising from the net-basis activities of the relevant group company that -

- (a) is accounted for as such under generally accepted accounting practice, or

(b) would be accounted for as such if income arising from such activities were accounted for under generally accepted accounting practice.

(5) Subsections (3) and (4) are subject to subsection (6).

(6) If a proportion of an accounting period of a relevant group company does not fall within the period of account of the worldwide group, the gross income or net income for that accounting period of the company is to be reduced, for the purposes of this section, by that proportion.

(7) Gross income or net income is to be disregarded for the purposes of subsection (2) if the income arises in respect of an amount payable by another member of the worldwide group that is either a UK group company or a relevant group company.

(8) In this section "net-basis activity" means activity that is normally reported on a net basis in financial statements prepared in accordance with generally accepted accounting practice.

## **272 Worldwide trading income of the worldwide group**

(1) This section applies in relation to section 266 for calculating the worldwide trading income of the worldwide group for a period of account.

(2) The trading income for that period of the worldwide group is the aggregate of -

(a) the gross income calculated in accordance with subsection (3), and

(b) the net income calculated in accordance with subsection (4).

(3) The income mentioned in subsection (2)(a) is the gross income -

(a) arising from the activities of the worldwide group (other than net-basis activities), and

(b) disclosed as such in the financial statements of the worldwide group,

without taking account of any deductions (whether for expenses or otherwise).

(4) The income mentioned in subsection (2)(b) is the net income arising from the net-basis activities of the worldwide group that -

(a) is accounted for as such under international accounting standards, or

(b) would be accounted for as such if income arising from such activities were accounted for under international accounting standards.

(5) In this section "net-basis activity" means activity that is normally reported on a net basis in financial statements prepared in accordance with international accounting standards.

(6) For provision about references in this Part to financial statements of the worldwide group, and amounts disclosed in financial statements, see sections 346 to 349.

### **273 Foreign currency accounting**

(1) Subject to the following provisions of this section, references in this Chapter to an amount disclosed in a balance sheet of a relevant group company, or of the worldwide group, as at any date are, where the amount is expressed in a currency other than sterling, to that amount translated into its sterling equivalent by reference to the spot rate of exchange for that date.

(2) Subsection (3) applies in relation to a period of account of the worldwide group if all the amounts disclosed in balance sheets (whether of relevant group companies, or of the worldwide group) that are relevant to a calculation under this Chapter in relation to that period are expressed in the same currency ("**the relevant foreign currency**") and that currency is not sterling.

(3) If this subsection applies -

(a) references in this Part to an amount disclosed in a balance sheet of a relevant group company, or of the worldwide group, are to that amount expressed in the relevant foreign currency, and

(b) for the purposes of determining under section 262 the net debt amount of a company, subsection (3) of that section is to have effect as if the reference to the amount for the time being specified there ("**the section 262(3) amount**") were read as a reference to the relevant amount.

(4) For this purpose "**the relevant amount**" means the average of -

(a) the section 262(3) amount expressed in the relevant foreign currency, translated by reference to the spot rate of exchange for the company's start date, and

(b) the section 262(3) amount expressed in the relevant foreign currency, translated by reference to the spot rate of exchange for the company's end date.

## **CHAPTER 3**

### **DISALLOWANCE OF DEDUCTIONS**

## **274 Application of Chapter and meaning of "total disallowed amount"**

(1) This Chapter applies if, for a period of account of the worldwide group to which this Part applies ("**the relevant period of account**") -

- (a) the tested expense amount (see Chapter 8), exceeds
- (b) the available amount (see Chapter 9).

(2) In this Chapter "**the total disallowed amount**" means the difference between the amounts mentioned in paragraphs (a) and (b) of subsection (1).

## **275 Meaning of "company to which this Chapter applies"**

References in this Chapter to a company to which this Chapter applies are to a company that is a relevant group company at any time during the relevant period of account.

## **276 Appointment of authorised company for relevant period of account**

(1) The companies to which this Chapter applies may appoint one of their number to exercise functions conferred under this Chapter on the reporting body in relation to the relevant period of account.

(2) An appointment under this section is of no effect unless it is signed on behalf of each company to which this Chapter applies by the appropriate person.

(3) The Commissioners may by regulations make further provision about an appointment under this section including, in particular, provision -

- (a) about the form and manner in which an appointment may be made,
- (b) about how an appointment may be revoked and the form and manner of such revocation,
- (c) requiring a person to notify HMRC of the making or revocation of an appointment and about the form and manner of such notification,
- (d) requiring a person to give information to HMRC in connection with the making or revocation of an appointment,
- (e) imposing time limits in relation to making or revoking an appointment,
- (f) providing that an appointment or its revocation is of no effect, or ceases to have effect, if time limits or other requirements under the regulations are not met, and

(g) about cases where a company is not a relevant group company at all times during the relevant period of account.

(4) In this section "**the appropriate person**", in relation to a company, means -

(a) the proper officer of the company, or

(b) such other person as may for the time being have the express, implied or apparent authority of the company to act on its behalf for the purposes of this Part.

(5) Subsections (3) and (4) of section 108 of TMA 1970 (responsibility of company officers: meaning of "proper officer") apply for the purposes of this section as they apply for the purposes of that section.

### **277 Meaning of "the reporting body"**

In this Chapter "**the reporting body**" means -

(a) if an appointment under section 276 has effect in relation to the relevant period of account, the company appointed under that section, and

(b) if such an appointment does not have effect in relation to the relevant period of account, the companies to which this Chapter applies, acting jointly.

### **278 Statement of allocated disallowances: submission**

(1) The reporting body must submit a statement (a "**statement of allocated disallowances**") in relation to the relevant period of account to HMRC.

(2) A statement submitted under this section must be received by HMRC within 12 months of the end of the relevant period of account.

(3) A statement submitted under this section must comply with the requirements of section 280.

### **279 Statement of allocated disallowances: submission of revised statement**

(1) If the reporting body has submitted a statement of allocated disallowances under section 278 or this section, it may submit a revised statement to HMRC.

(2) A statement submitted under this section must be received by HMRC within 36 months of the end of the relevant period of account.

(3) A statement submitted under this section must comply with the requirements of section 280.

(4) A statement submitted under this section -

- (a) must indicate the respects in which it differs from the previous statement, and
- (b) supersedes the previous statement.

## **280 Statement of allocated disallowances: requirements**

(1) This section applies in relation to a statement of allocated disallowances submitted under section 278 or 279.

(2) The statement must be signed -

- (a) if an appointment under section 276 has effect in relation to the relevant period of account, by the appropriate person in relation to the company appointed under that section, or
- (b) if such an appointment does not have effect in relation to the relevant period of account, by the appropriate person in relation to each company to which this Chapter applies.

(3) The statement must show -

- (a) the tested expense amount,
- (b) the available amount, and
- (c) the total disallowed amount.

(4) The statement must -

- (a) list one or more companies to which this Chapter applies, and
- (b) in relation to each listed company, specify one or more financing expense amounts for the relevant period of account that are to be disallowed, and give the relevant details in relation to each such amount.

(5) For this purpose "the relevant details", in relation to a financing expense amount are -

- (a) which of conditions A, B and C in section 313 is met in relation to the amount, and
- (b) the relevant accounting period of the company in which the amount would, apart from this Part, be brought into account for the purposes of corporation tax.

(6) The sum of the amounts specified under subsection (4)(b) must equal the total disallowed amount.

(7) In this section "**the appropriate person**", in relation to a company, means -

(a) the proper officer of the company, or

(b) such other person as may for the time being have the express, implied or apparent authority of the company to act on its behalf for the purposes of this Part.

(8) Subsections (3) and (4) of section 108 of TMA 1970 (responsibility of company officers: meaning of "proper officer") apply for the purposes of this section as they apply for the purposes of that section.

(9) For the meaning of "**financing expense amount**", see Chapter 7.

### **281 Statement of allocated disallowances: effect**

A financing expense amount of a company to which this Chapter applies that is specified in a statement of allocated disallowances under section 280(4)(b) is not to be brought into account by the company for the purposes of corporation tax.

### **282 Company tax returns**

(1) This section applies if -

(a) a company to which this Chapter applies has delivered a company tax return for a relevant accounting period, and

(b) as a result of the submission of a revised statement of allocated disallowances under section 279 -

(i) there is a change in the amount of profits on which corporation tax is chargeable for the period, or

(ii) any other information contained in the return is incorrect.

(2) The company is treated as having amended its company tax return for the accounting period so as to reflect the change mentioned in subsection (1)(b)(i) or to correct the information mentioned in subsection (1)(b)(ii).

### **283 Power to make regulations about statement of allocated disallowances**

The Commissioners may by regulations make further provision about a statement of allocated disallowances including, in particular, provision -

- (a) about the form of a statement and the manner in which it is to be submitted,
- (b) requiring a person to give information to HMRC in connection with a statement,
- (c) as to circumstances in which a statement that is not received by the time specified in section 278(2) or 279(2) is to be treated as if it were so received, and
- (d) as to circumstances in which a statement that does not comply with the requirements of section 280 is to be treated as if it did so comply.

#### **284 Failure of reporting body to submit statement of allocated disallowances**

- (1) This section applies if no statement of allocated disallowances is submitted under section 278 that complies with the requirements of section 280.
- (2) Each company to which this Chapter applies that has a net financing deduction for the relevant period of account that is greater than nil must reduce the amounts that it brings into account in relevant accounting periods in respect of financing expense amounts.
- (3) The total of the reductions required to be made by a company because of subsection (2) is -

$$\frac{NFD}{TEA} \times TDA$$

where -

NFD is the net financing deduction of the company for the relevant period of account (see section 329(2)),

TEA is the tested expense amount for the relevant period of account (see section 329(1)), and

TDA is the total disallowed amount (see section 274(2)).

- (4) The particular financing expense amounts that must be reduced, and the amounts by which they must be reduced, must be determined in accordance with regulations made by the Commissioners.
- (5) Regulations under this section may, in particular, include any of the following -
  - (a) provision conferring a discretion on a company required to make reductions under this section as to the particular financing expense amounts that are to be reduced,



(b) provision requiring a company required to make reductions under this section to notify another relevant group company of the particular reductions made, and

(c) provision as to the times by which such notices must be sent and as to information that must accompany such notices.

## **285 Powers to make regulations in relation to reductions under section 284**

(1) The Commissioners may by regulations make provision for the purpose of securing that a company required under section 284 to reduce the amounts that it brings into account in respect of financing expense amounts for the relevant period of account ("**a company required to make default reductions**") has sufficient information to determine their amount.

(2) Provision that may be made in regulations under subsection (1) includes provision requiring one or more members of the worldwide group to send specified information to a company required to make default reductions.

(3) The Commissioners may by regulations make provision about cases in which (whether as a result of non-compliance with regulations made under subsection (1) or otherwise) a company required to make default reductions does not possess specified information.

(4) Provision that may be made in regulations under subsection (3) includes provision as to assumptions that may or must be made in determining the amount of a reduction under section 284 of a financing expense amount.

(5) The Commissioners may by regulations make provision for determining a time later than that determined under paragraph 15(4) of Schedule 18 to FA 1998 (amendment of return by company) before which a company required to make default reductions may amend its company tax return so as to reflect a reduction under section 284.

(6) In this section "specified" means specified in regulations under this section.

## **CHAPTER 4**

### **EXEMPTION OF FINANCING INCOME**

#### **286 Application of Chapter and meaning of "total disallowed amount"**

(1) This Chapter applies if, for a period of account of the worldwide group to which this Part applies ("**the relevant period of account**") -

(a) the tested expense amount (see Chapter 8), exceeds

(b) the available amount (see Chapter 9).

(2) In this Chapter the **"total disallowed amount"** means the difference between the amounts mentioned in paragraphs (a) and (b) of subsection (1).

### **287 Meaning of "company to which this Chapter applies"**

References in this Chapter to a company to which this Chapter applies are to a company that is a UK group company at any time during the relevant period of account.

### **288 Appointment of authorised company for relevant period of account**

(1) The companies to which this Chapter applies may appoint one of their number to exercise functions conferred under this Chapter on the reporting body in relation to the relevant period of account.

(2) An appointment under this section is of no effect unless it is signed on behalf of each company to which this Chapter applies by the appropriate person.

(3) The Commissioners may by regulations make further provision about an appointment under this section including, in particular, provision -

(a) about the form and manner in which an appointment may be made or revoked,

(b) requiring a person to notify HMRC of the making or revocation of an appointment and about the form and manner of such notification,

(c) requiring a person to give information to HMRC in connection with the making or revocation of an appointment,

(d) imposing time limits in relation to making or revoking an appointment,

(e) that an appointment or its revocation is of no effect, or ceases to have effect, if time limits or other requirements under the regulations are not met, and

(f) about cases where a company does not meet condition A in section 345, or is not a member of the worldwide group, at all times during the relevant period of account.

(4) In this section "the appropriate person", in relation to a company, means -

(a) the proper officer of the company, or

(b) such other person as may for the time being have the express, implied or apparent authority of the company to act on its behalf for the purposes of this Part.

(5) Subsections (3) and (4) of section 108 of TMA 1970 (responsibility of company officers: meaning of "**proper officer**") apply for the purposes of this section as they apply for the purposes of that section.

### **289 Meaning of "the reporting body"**

In this Chapter "**the reporting body**" means -

- (a) if an appointment under section 288 has effect in relation to the relevant period of account, the company appointed under that section, and
- (b) if such an appointment does not have effect in relation to the relevant period of account, the companies to which this Chapter applies, acting jointly.

### **290 Statement of allocated exemptions: submission**

- (1) The reporting body must submit a statement (a "**statement of allocated exemptions**") in relation to the relevant period of account to HMRC.
- (2) A statement submitted under this section must be received by HMRC within 12 months of the end of the relevant period of account.
- (3) A statement submitted under this section must comply with the requirements of section 292.

### **291 Statement of allocated exemptions: submission of revised statement**

- (1) If the reporting body has submitted a statement of allocated exemptions under section 290 or this section, it may submit a revised statement to HMRC.
- (2) A statement submitted under this section must be received by HMRC within 36 months of the end of the relevant period of account.
- (3) A statement submitted under this section must comply with the requirements of section 292.
- (4) A statement submitted under this section -
  - (a) must indicate the respects in which it differs from the previous statement, and
  - (b) supersedes the previous statement.

### **292 Statement of allocated exemptions: requirements**

(1) This section applies in relation to a statement of allocated exemptions submitted under section 290 or 291.

(2) The statement must be signed -

(a) if an appointment under section 288 has effect in relation to the relevant period of account, by the appropriate person in relation to the company appointed under that section, or

(b) if such an appointment does not have effect in relation to the relevant period of account, by the appropriate person in relation to each company to which this Chapter applies.

(3) The statement must show -

(a) the tested expense amount,

(b) the available amount, and

(c) the total disallowed amount.

(4) The statement must -

(a) list one or more companies to which this Chapter applies, and

(b) in relation to each listed company, specify one or more financing income amounts for the relevant period of account that are to be exempted, and give the relevant details in relation to each such amount.

(5) For this purpose "**the relevant details**" in relation to a financing income amount are -

(a) which of conditions A, B and C in section 314 is met in relation to the amount, and

(b) the relevant accounting period of the company in which the amount would, apart from this Part, be brought into account for the purpose of corporation tax.

(6) The sum of the amounts specified under subsection (4)(b) must not exceed the lower of -

(a) the total disallowed amount, and

(b) the tested income amount (see Chapter 8).

(7) In this section "the appropriate person", in relation to a company, means -

(a) the proper officer of the company, or

(b) such other person as may for the time being have the express, implied or apparent authority of the company to act on its behalf for the purposes of this Part.

(8) Subsections (3) and (4) of section 108 of TMA 1970 (responsibility of company officers: meaning of "**proper officer**") apply for the purposes of this section as they apply for the purposes of that section.

(9) For the meaning of "**financing income amount**", see Chapter 7.

### **293 Statement of allocated exemptions: effect**

A financing income amount of a company to which this Chapter applies that is specified in a statement of allocated exemptions under section 292(4)(b) is not to be brought into account by the company for the purposes of corporation tax.

### **294 Company tax returns**

(1) This section applies if -

(a) a company to which this Chapter applies has delivered a company tax return for a relevant accounting period, and

(b) as a result of the submission of a revised statement of allocated exemptions under section 291 -

(i) there is a change in the amount of profits on which corporation tax is chargeable for the period, or

(ii) any other information contained in the return is incorrect.

(2) The company is treated as having amended its company tax return for the accounting period so as to reflect the change mentioned in subsection (1)(b)(i) or to correct the information mentioned in subsection (1)(b)(ii).

### **295 Power to make regulations about statement of allocated exemptions**

The Commissioners may by regulations make further provision about a statement of allocated exemptions including, in particular, provision -

(a) about the form of a statement and the manner in which it is to be submitted,

(b) requiring a person to give information to HMRC in connection with a statement,

(c) as to circumstances in which a statement that is not received by the time specified in section 290(2) or 291(2) is to be treated as if it were so received, and

(d) as to circumstances in which a statement that does not comply with the requirements of section 292 is to be treated as if it did so comply.

## **296 Failure of reporting body to submit statement of allocated exemptions**

(1) This section applies if no statement of allocated exemptions is submitted under section 290 that complies with the requirements of section 292.

(2) Subject to the following provisions of this section, each financing income amount for the relevant period of account of each company to which this Chapter applies is to be reduced to nil.

(3) In this section "unrestricted reduction" means a reduction of a financing income amount for the relevant period of account of a company to which this Chapter applies, determined in accordance with subsection (2).

(4) Subsection (5) applies if -

(a) the total of the unrestricted reductions, exceeds

(b) the lower of -

(i) the total disallowed amount, and

(ii) the tested income amount.

(5) Each unrestricted reduction is to be reduced by -

$$\frac{UR}{TUR} \times X$$

where -

UR is the unrestricted reduction in question,

TUR is the total of the unrestricted reductions, and

X is the excess mentioned in subsection (4).

## **297 Power to make regulations in relation to reductions under section 296**

(1) The Commissioners may by regulations make provision for the purpose of securing that a company required under section 296 to reduce the amounts that it brings into

account in respect of financing income amounts for the relevant period of account ("**a company required to make default reductions**") has sufficient information to determine their amount.

(2) Provision that may be made in regulations under subsection (1) includes provision requiring one or more members of the worldwide group to send specified information to a company required to make default reductions.

(3) The Commissioners may by regulations make provision about cases in which (whether as a result of non-compliance with regulations made under subsection (1) or otherwise) a company required to make default reductions does not possess specified information.

(4) Provision that may be made in regulations under subsection (3) includes provision as to assumptions that may or must be made in determining the amount of a reduction under section 296 of a financing income amount.

(5) The Commissioners may by regulations make provision for determining a time later than that determined under paragraph 15(4) of Schedule 18 to FA 1998 (amendment of return by company) before which a company required to make default reductions may amend its company tax return so as to reflect a reduction under section 296.

(6) In this section "specified" means specified in regulations under this section.

## **298 Balancing payments between group companies: no tax charge or relief**

(1) This section applies if -

(a) one or more financing income amounts of a company ("**company A**") for the relevant period of account are -

(i) because of section 293, not brought into account, or

(ii) because of section 296, reduced,

(b) one or more financing expense amounts of another company ("**company B**") for the relevant period of account are -

(i) because of section 281, not brought into account, or

(ii) because of section 284, reduced,

(c) company A makes one or more payments ("**the balancing payments**") to company B, and

(d) the sole or main reason for making the balancing payments is that the conditions in paragraphs (a) and (b) are met.

(2) To the extent that the sum of the balancing payments does not exceed the amount specified in subsection (3), those payments -

(a) are not to be taken into account in computing profits or losses of either company A or company B for the purposes of corporation tax, and

(b) are not to be regarded as distributions for any of the purposes of the Corporation Tax Acts.

(3) The amount mentioned in subsection (2) is the lower of -

(a) the sum of the financing income amounts mentioned in subsection (1)(a), and

(b) the sum of the financing expense amounts mentioned in subsection (1)(b).

## CHAPTER 5

### INTRA-GROUP FINANCING INCOME WHERE PAYER DENIED DEDUCTION

#### **299 Tax exemption for certain financing income received from EEA companies**

(1) A financing income amount of a company that is a member of the worldwide group ("the recipient") is not to be brought into account for the purposes of corporation tax if -

(a) it arises as a result of a payment by another company that is a member of the worldwide group ("**the payer**"),

(b) the payment is received during a period of account of the worldwide group to which this Part applies, and

(c) conditions A, B and C are met.

(2) Condition A is that, at the time the payment is received, the payer is a relevant associate of the recipient (see section 300).

(3) Condition B is that, at the time the payment is received -

(a) the payer is tax-resident in an EEA territory (see section 301), and

(b) the payer is liable to a tax of that territory that is chargeable by reference to profits, income or gains arising to the payer.



(4) Condition C is that -

(a) qualifying EEA tax relief for the payment is not available to the payer in the period in which the payment is made ("**the current period**") or any previous period (see section 302), and

(b) qualifying EEA tax relief for the payment is not available to the payer in any period after the current period (see section 303).

(5) For the meaning of "financing income amount", see section 305.

### **300 Meaning of "relevant associate"**

For the purposes of this Chapter, the payer is a "**relevant associate**" of the recipient if—

(a) the payer is a parent of the recipient,

(b) the payer is a 75% subsidiary of the recipient, or

(c) the payer is a 75% subsidiary of a parent of the recipient.

### **301 Meaning of "tax-resident" and "EEA territory"**

(1) For the purposes of this Chapter, the payer is "tax-resident" in a territory if it is liable, under the law of that territory, to tax by reason of domicile, residence or place of management.

(2) In this Chapter "**EEA territory**" means a territory outside the United Kingdom that is within the European Economic Area.

### **302 Qualifying EEA tax relief for payment in current or previous period**

(1) For the purposes of this Chapter, qualifying EEA tax relief for a payment is not available to the payer in the current period or a previous period if conditions A and B are met in relation to the payment.

(2) Condition A is that no deduction calculated by reference to the payment can be taken into account in calculating any profits, income or gains that -

(a) arise to the payer in the current period or any previous period, and

(b) are chargeable to any tax of the United Kingdom or an EEA territory for the current period or any previous period.

(3) Condition B is that no relief determined by reference to the payment can be given in the current period or any previous period for the purposes of any tax of the United Kingdom or an EEA territory by -

- (a) the payment of a credit,
- (b) the elimination or reduction of a tax liability, or
- (c) any other means of any kind.

(4) Conditions A and B are not met in relation to the payment unless every step is taken (whether by the payer or any other person) to secure that deductions are taken into account as mentioned in subsection (2) and reliefs are given as mentioned in subsection (3).

(5) Conditions A and B are not met in relation to the payment unless they would be met disregarding a failure to obtain a deduction or relief as a result of -

- (a) this Part, or
- (b) provision made as a result of double taxation arrangements between any two territories (including provision sanctioned by associated enterprise rules contained in such arrangements).

(6) For this purpose -

- (a) arrangements are "double taxation arrangements" if they are arrangements made between any two territories with a view to affording relief from double taxation, and
- (b) "associated enterprise rules" means -

- (i) rules that, on the passing of FA 2009, were contained in Article 9 of the Model Tax Convention on Income and on Capital published by the Organisation for Economic Co-operation and Development, or

- (ii) any rules in the same or equivalent terms.

### **303 Qualifying EEA tax relief for payment in future period**

(1) For the purposes of this Chapter, qualifying EEA tax relief for a payment is not available to the payer in a period after the current period if conditions A and B are met in relation to the payment.

(2) Condition A is that no deduction calculated by reference to the payment can be taken into account in calculating any profits, income or gains that -

(a) might arise to the payer in any period after the current period, and

(b) would, if they did so arise, be chargeable to any tax of the United Kingdom or an EEA territory for any period after the current period.

(3) Condition B is that no relief determined by reference to the payment can be given in any period after the current period for the purposes of any tax of the United Kingdom or an EEA territory by -

(a) the payment of a credit,

(b) the elimination or reduction of a tax liability, or

(c) any other means of any kind.

(4) The question whether a deduction can be taken into account as mentioned in subsection (2) or a relief can be given as mentioned in subsection (3) is to be determined by reference to the position immediately after the end of the current period.

(5) Conditions A and B are not met in relation to the payment unless they would be met disregarding a failure to obtain a deduction or relief as a result of -

(a) this Part, or

(b) provision made as a result of double taxation arrangements between any two territories (including provision sanctioned by associated enterprise rules contained in such arrangements).

(6) For this purpose -

(a) arrangements are "**double taxation arrangements**" if they are arrangements made between any two territories with a view to affording relief from double taxation, and

(b) "**associated enterprise rules**" means -

(i) rules that, on the passing of FA 2009, were contained in Article 9 of the Model Tax Convention on Income and on Capital published by the Organisation for Economic Co-operation and Development, or

(ii) any rules in the same or equivalent terms.

### 304 References to tax of a territory

(1) References in this Chapter to a tax of the United Kingdom are to income tax or corporation tax.

(2) References in this Chapter to a tax of a territory outside the United Kingdom are to a tax chargeable under the law of that territory that -

(a) is charged on income and corresponds to income tax, or

(b) is charged on income or chargeable gains or both and corresponds to corporation tax.

(3) For the purposes of this section, a tax chargeable under the law of a territory outside the United Kingdom does not fail to correspond to income tax or corporation tax just because -

(a) it is chargeable under the law of a province, state or other part of a country, or

(b) it is levied by or on behalf of a municipality or other local body.

### 305 Financing income amounts of a company

(1) References in this Chapter to a "financing income amount" of a company are (subject to subsection (6)) to any amount that meets condition A, B or C.

(2) Condition A is that the amount is a credit that -

(a) would, apart from this Chapter, be brought into account by the company for the purposes of corporation tax,

(b) would be so brought into account in respect of a loan relationship -

(i) under Part 3 of CTA 2009 as a result of section 297 of that Act (loan relationships for purposes of trade), or

(ii) under Part 5 of that Act (other loan relationships), and

(c) is not an excluded credit.

(3) A credit is "**excluded**" if it is in respect of -

(a) the reversal of an impairment loss,

(b) an exchange gain, or

(c) a profit from a related transaction.

(4) Condition B is that the amount is an amount that would, apart from this Chapter, be brought into account by the company for the purposes of corporation tax in respect of the financing income implicit in amounts received under finance leases.

(5) Condition C is that the amount is an amount that would, apart from this Chapter, be brought into account by the company for the purposes of corporation tax in respect of the financing income receivable on debt factoring, or any similar transaction.

(6) The provisions of Chapter 7 apply in relation to an amount that is a financing income amount of a company because of meeting condition A, B or C in this section as they apply in relation to an amount that is a financing income amount of a relevant group company because of meeting condition A, B or C in section 314.

## **CHAPTER 6**

### **TAX AVOIDANCE**

#### **306 Schemes involving manipulation of rules in Chapter 2**

(1) A period of account of the worldwide group that, apart from this section, is not within section 261(1) is treated as within that provision if conditions A, B and C are met.

(2) Condition A is that -

(a) at any time before the end of the period, a scheme is entered into, and

(b) if the scheme had not been entered into, the period would have been within section 261(1).

(3) Condition B is that the main purpose, or one of the main purposes, of any party to the scheme on entering into the scheme is to secure that the period is not within section 261(1).

(4) Condition C is that the scheme is not an excluded scheme.

#### **307 Schemes involving manipulation of rules in Chapters 3 and 4**

(1) If conditions A, B and C are met in relation to a period of account of the worldwide group ("the relevant period of account"), the tested expense amount, the tested income amount and the available amount for the period are to be calculated in accordance with section 309.

(2) Condition A is that -

(a) at any time before the end of the relevant period of account, a scheme is entered into, and

(b) the main purpose, or one of the main purposes, of any party to the scheme on entering into it is to secure that the amount of the relevant net deduction (within the meaning given by section 308) is lower than it would be if that amount were calculated in accordance with section 309.

(3) Condition B is that a result of the scheme is that -

(a) the sum of the profits of UK group companies that -

(i) arise in relevant accounting periods, and

(ii) are chargeable to corporation tax,

is less than it would be if that sum were determined in accordance with section 309, or

(b) the sum of the losses of UK group companies that -

(i) arise in relevant accounting periods (other than any taken into account in calculating profits within paragraph (a)), and

(ii) are capable of being a carried-back amount or a carried-forward amount (see section 310),

is higher than it would be if that sum were determined in accordance with section 309.

(4) Condition C is that the scheme is not an excluded scheme.

(5) If -

(a) a profit or loss arises in an accounting period of a UK group company, and

(b) a proportion of that period does not fall within the relevant period of account,

the profit or loss is to be reduced, for the purposes of condition B, by the same proportion.

### 308 Meaning of "relevant net deduction"

(1) In section 307(2) the "relevant net deduction" means -

- (a) the amount by which the total disallowed amount exceeds the tested income amount, or
- (b) if the total disallowed amount does not exceed the tested income amount, nil.

(2) In this section the "total disallowed amount" means -

- (a) the amount by which the tested expense amount exceeds the available amount, or
- (b) if the tested expense amount does not exceed the available amount, nil.

### 309 Calculation of amounts

(1) References in section 307 to the calculation of any amount or sum in accordance with this section are to the calculation of that amount or sum on the following assumptions.

(2) The assumptions are that -

- (a) the scheme in question was not entered into, and
- (b) instead, anything that it is more likely than not would have been done or not done had this Part not had effect in relation to the relevant period of account, was done or not done.

### 310 Meaning of "carried-back amount" and "carried-forward amount"

(1) In section 307 "carried-back amount" means -

- (a) an amount carried back under section 389(2) of CTA 2009 (deficits of insurance companies),
- (b) an amount carried back as a result of a claim under section 459(1)(b) of CTA 2009 (non-trading deficits from loan relationships), or
- (c) an amount carried back under section 37(3)(b) of CTA 2010 (relief for trade losses against total profits).

(2) In section 307 "**carried-forward amount**" means -

- (a) an amount carried forward under section 76(12) or (13) of ICTA (certain expenses of insurance companies),

- (b) an amount carried forward under section 436A(4) of ICTA (insurance companies: losses from gross roll-up business),
- (c) an amount carried forward under section 8(1)(b) of TCGA 1992 (allowable losses),
- (d) an amount carried forward under section 391(2) of CTA 2009 (deficits of insurance companies),
- (e) an amount carried forward under section 457(3) of CTA 2009 (non-trading deficits from loan relationships),
- (f) an amount carried forward under section 753(3) of CTA 2009 (non-trading loss on intangible fixed assets),
- (g) an amount carried forward under section 925(3) of CTA 2009 (patent income: relief for expenses),
- (h) an amount carried forward under section 1223 of CTA 2009 (expenses of management and other amounts),
- (i) an amount carried forward under section 45(4) of CTA 2010 (carry forward of trade loss against subsequent trade profit),
- (j) an amount carried forward under section 62(5) of CTA 2010 (relief for losses made UK property business),
- (k) an amount carried forward under section 63(3) of CTA 2010 (company with investment business ceasing to carry on UK property business),
- (l) an amount carried forward under section 66(3) of CTA 2010 (relief for losses made in overseas property business), or
- (m) an amount carried forward under section 91(6) of CTA 2010 (relief for losses from miscellaneous transactions).

### **311 Schemes involving manipulation of rules in Chapter 5**

(1) This section applies to a financing income amount of a company received during a period of account of the worldwide group if -

- (a) apart from this section, the financing income amount would, because of section 299, not be brought into account for the purposes of corporation tax, and



(b) conditions A, B and C are met.

(2) Condition A is that, at any time before the financing income amount is received, a scheme is entered into that secures that any of the conditions in subsections (2) to (4) of section 299 ("**the relevant section 299 condition**") is met in relation to the amount.

(3) Condition B is that the purpose, or one of the main purposes, of any party to the scheme on entering into the scheme is to secure that the relevant section 299 condition is met.

(4) Condition C is that the scheme is not an excluded scheme.

(5) If this section applies to a financing income amount, the relevant section 299 condition is treated as not met in relation to the amount.

(6) Section 305 (meaning of references to a "**financing income amount**" of a company) applies for the purposes of this section.

### **312 Meaning of "scheme" and "excluded scheme"**

(1) For the purposes of this Chapter, "scheme" includes any scheme, arrangements or understanding of any kind whatever, whether or not legally enforceable, involving a single transaction or two or more transactions.

(2) For the purposes of this Chapter, a scheme is "excluded" if it is of a description specified in regulations made by the Commissioners.

(3) Regulations under subsection (2) may make different provision for different purposes.

## **CHAPTER 7**

### **"FINANCING EXPENSE AMOUNT" AND "FINANCING INCOME AMOUNT"**

#### **313 The financing expense amounts of a company**

(1) References in this Part to a "financing expense amount" of a company for a period of account of the worldwide group are to any amount that meets condition A, B or C.

(2) Condition A is that the amount is a debit that -

(a) would, apart from this Part, be brought into account in a relevant accounting period of the company,

(b) would be so brought into account in respect of a loan relationship -

(i) under Part 3 of CTA 2009 as a result of section 297 of that Act (loan relationships for purposes of trade), or

(ii) under Part 5 of that Act (other loan relationships), and

(c) is not an excluded debit.

(3) A debit is "**excluded**" if it is in respect of -

(a) an impairment loss,

(b) an exchange loss, or

(c) a related transaction.

(4) Condition B is that the amount is an amount that would, apart from this Part, be brought into account for the purposes of corporation tax in a relevant accounting period of the company in respect of the financing cost implicit in payments made under finance leases.

(5) Condition C is that the amount is an amount that would, apart from this Part, be brought into account for the purposes of corporation tax in a relevant accounting period of the company in respect of the financing cost payable on debt factoring, or any similar transaction.

(6) If -

(a) a debit or other amount would, apart from this Part, be brought into account in an accounting period, and

(b) a proportion of that period does not fall within the period of account of the worldwide group,

the debit or other amount is to be reduced, for the purposes of this section, by the same proportion.

(7) This section is subject to sections 316 to 327.

### **314 The financing income amounts of a company**

(1) References in this Part (except in Chapter 5 and section 311) to a "**financing income amount**" of a company for a period of account of the worldwide group are to any amount that meets condition A, B or C.

(2) Condition A is that the amount is a credit that -

(a) would, apart from this Part, be brought into account in a relevant accounting period of the company,

(b) would be so brought into account in respect of a loan relationship -

(i) under Part 3 of CTA 2009 as a result of section 297 of that Act (loan relationships for purposes of trade), or

(ii) under Part 5 of that Act (other loan relationships), and

(c) is not an excluded credit.

(3) A credit is "**excluded**" if it is in respect of -

(a) the reversal of an impairment loss,

(b) an exchange gain, or

(c) a profit from a related transaction.

(4) Condition B is that the amount is an amount that would, apart from this Part, be brought into account for the purposes of corporation tax in a relevant accounting period of the company in respect of the financing income implicit in amounts received under finance leases.

(5) Condition C is that the amount is an amount that would, apart from this Part, be brought into account for the purposes of corporation tax in a relevant accounting period of the company in respect of the financing income receivable on debt factoring, or any similar transaction.

(6) If -

(a) a credit or other amount would, apart from this Part, be brought into account in an accounting period, and

(b) a proportion of that period does not fall within the period of account of the worldwide group,

the credit or other amount is to be reduced, for the purposes of this section, by the same proportion.

(7) This section is subject to sections 316 to 327.

### 315 Interpretation of sections 313 and 314

In sections 313 and 314 the following expressions have the same meaning as they have in Part 5 of CTA 2009 (loan relationships) -

**"exchange gain"** and **"exchange loss"**,

**"impairment"**,

**"impairment loss"**, and

**"related transaction"**.

### 316 Group treasury companies

(1) This section applies if, apart from this section, an amount ("**the relevant amount**") is -

(a) a financing expense amount of a group treasury company because of meeting condition A, B or C in section 313, or

(b) a financing income amount of a group treasury company because of meeting condition A, B or C in section 314.

(2) The relevant amount, and all other amounts that are relevant amounts in respect of the group treasury company and the relevant period, are treated as not being a financing expense amount or a financing income amount of the group treasury company, but only if that company makes an election for the purposes of this section in respect of the relevant period.

(3) An election under this section must be made within 3 years after the end of the relevant period.

(4) If two or more members of the worldwide group are group treasury companies in the relevant period, an election under this section made by any of them is not valid unless each of them makes such an election in respect of the relevant period before the end of the 3 year period mentioned in subsection (3).

(5) A company is a group treasury company in the relevant period if conditions 1, 2 and 3 are met.

(6) Condition 1 is that the company is a member of the worldwide group.

(7) Condition 2 is that the company undertakes treasury activities for the worldwide group in the relevant period (whether or not it also undertakes other activities).

(8) Condition 3 is that -

(a) if the company is the only company to meet conditions 1 and 2 in the relevant period, or the only other companies to meet those conditions are not UK group companies, at least 90% of the relevant income of the company for the relevant period is group treasury revenue, or

(b) if the company and one or more other companies each of which is a UK group company meet conditions 1 and 2 in the relevant period, at least 90% of the aggregate relevant income of those companies for the relevant period is group treasury revenue.

(9) For the purposes of this section, a company undertakes treasury activities for the worldwide group in the relevant period if, in that period, it does one or more of the following things in relation to, or on behalf of, the worldwide group or any of its members -

(a) managing surplus deposits of money or overdrafts,

(b) making or receiving deposits of money,

(c) lending money,

(d) subscribing for or holding shares in another company which is a UK group company and a group treasury company,

(e) investing in debt securities, and

(f) hedging assets, liabilities, income or expenses.

(10) For the purposes of this section "**group treasury revenue**", in relation to a company, means revenue -

(a) arising from the treasury activities that the company undertakes for the worldwide group, and

(b) accounted for as such under generally accepted accounting practice, before any deduction (whether for expenses or otherwise).

(11) But revenue consisting of a dividend or other distribution is not group treasury revenue unless it is a dividend or distribution from a company that is, in the relevant period -

(a) a UK group company, and

(b) a group treasury company.

(12) In this section -

**"debt security"** has the same meaning as in the FSA Handbook,

**"relevant income"**, in relation to a company, means income -

(a) arising from the activities of the company, and

(b) accounted for as such under generally accepted accounting practice,

before any deduction (whether for expenses or otherwise), and

**"relevant period"** means the period of account of the worldwide group to which the relevant amount relates.

### **317 Real estate investment trusts**

(1) This section applies if, apart from this section, an amount (**"the relevant amount"**) is -

(a) a financing expense amount of a company because of meeting condition A in section 313, or

(b) a financing income amount of a company because of meeting condition A in section 314.

(2) The relevant amount is treated as not being a financing expense amount or a financing income amount of the company if the finance arrangement is one to which section 211 of CTA 2009 does not apply because of section 599(3)(a) of CTA 2010.

### **318 Companies engaged in oil extraction activities**

(1) This section applies if, apart from this section, an amount (**"the relevant amount"**) is -

(a) a financing expense amount of a company because of meeting condition A or condition B in section 313, or

(b) a financing income amount of a company because of meeting condition A or condition B in section 314.

(2) The relevant amount is treated as not being a financing expense amount or a financing income amount of the company if conditions 1 and 2 are met.

(3) Condition 1 is that the company is treated, in the accounting period in which the amount is brought into account, as carrying on a ring fence trade (see section 277 of CTA 2010).

(4) Condition 2 is that the amount falls to be brought into account in calculating the profits of that trade for that accounting period.

### **319 Intra-group short-term finance: financing expense**

(1) This section applies if, apart from this section, an amount ("**the relevant amount**") is a financing expense amount of a company ("**company A**") because of meeting condition A in section 313.

(2) The relevant amount is treated as not being a financing expense amount of company A, but only if an election is made for this purpose.

(3) Such an election may not be made unless conditions 1 and 2 are met.

(4) Condition 1 is that company A and the other party to the loan relationship ("**company B**") are both members of the worldwide group.

(5) Condition 2 is that the finance arrangement is a short-term loan relationship as respects the period of account of the worldwide group.

(6) An election under this section may only be made -

(a) jointly by company A and company B, and

(b) within 36 months of the end of the period of account of the worldwide group to which the relevant amount relates.

(7) An election under this section is irrevocable.

(8) In this section "**short-term loan relationship**" has the meaning given in section 321.

### **320 Intra-group short-term finance: financing income**

(1) This section applies if -

(a) under section 319, the relevant amount is treated as not being a financing expense amount of company A, and

(b) apart from this section, the relevant amount is a financing income amount of company B because of meeting condition A in section 314.

- (2) The relevant amount is treated as not being a financing income amount of company B.
- (3) In this section "**company A**" and "**company B**" have the same meaning as in section 319.

### **321 Short-term loan relationships**

(1) For the purposes of section 319, the finance arrangement is a short-term loan relationship as respects the period of account of the worldwide group ("**the relevant period**") if -

- (a) regulations made by the Commissioners provide for it to be so, or
- (b) condition A or B is met.

(2) Condition A is that the finance arrangement does not terminate during the relevant period and -

- (a) to the extent that the finance arrangement provides for the creation of money debt, its terms require all money debt created under it to be settled within 12 months of money debt first being created under it, and
- (b) to the extent that the finance arrangement is otherwise a loan relationship, its terms provide for it to terminate within 12 months of its coming into force.

(3) Condition B is that the finance arrangement terminates during, or after the end of, the relevant period and -

- (a) to the extent that the relationship provided for the creation of money debt, all money debt created under it was settled within 12 months of money debt first being created under it, and
- (b) to the extent that the relationship was otherwise a loan relationship, it terminated within 12 months of its coming into force.

(4) The Treasury may, by regulations, make provision about other circumstances in which the finance arrangement is to be taken not to be a short-term loan relationship as respects -

- (a) the relevant period, or
- (b) any part or parts of the relevant period.



(5) Regulations under subsection (4) may include provision for the finance arrangement to be taken never to have been a short-term loan relationship as respects the relevant period or the part or parts of it.

(6) Regulations under subsection (4) may only be made if a draft of the statutory instrument containing the regulations has been laid before and approved by a resolution of the House of Commons.

(7) The Commissioners may by regulations make provision (including provision conferring a discretion on the Commissioners) about circumstances in which regulations under subsection (4) are not to apply in relation to the finance arrangements.

### **322 Stranded deficits in non-trading loan relationships: financing expense**

(1) This section applies if, apart from this section, an amount ("**the relevant amount**") is a financing expense amount of a company ("company A") because of meeting condition A in section 313.

(2) The relevant amount is treated as not being a financing expense amount of company A, but only if an election is made for this purpose.

(3) Such an election may not be made unless each of conditions 1 to 4 is met.

(4) Condition 1 is that company A and the other party to the loan relationship ("**company B**") are both members of the worldwide group.

(5) Condition 2 is that company B -

(a) is resident in the United Kingdom, or

(b) is not resident in the United Kingdom and is carrying on a trade in the United Kingdom through a permanent establishment in the United Kingdom.

(6) Condition 3 is that, under section 457 of CTA 2009, company B carries forward an amount of non-trading deficit and sets it off against non-trading profits of an accounting period that falls wholly or partly within the period of account of the worldwide group.

(7) Condition 4 is that the amount of non-trading deficit carried forward and set off is equal to, or greater than, the relevant amount.

(8) An election under this section may only be made -

(a) jointly by company A and company B, and

(b) within 36 months of the end of the period of account of the worldwide group to which the relevant amount relates.

### **323 Stranded deficits in non-trading loan relationships: financing income**

(1) This section applies if -

(a) under section 322, the relevant amount is treated as not being a financing expense amount of company A, and

(b) apart from this section, the relevant amount is a financing income amount of company B because of meeting condition A in section 314.

(2) The relevant amount is treated as not being a financing income amount of company B.

(3) In this section "**company A**" and "**company B**" have the same meaning as in section 322.

### **324 Stranded management expenses in non-trading loan relationships: financing expense**

(1) This section applies if, apart from this section, an amount ("**the relevant amount**") is a financing expense amount of a company ("**company A**") because of meeting condition A in section 313.

(2) The relevant amount is treated as not being a financing expense amount of company A, but only if an election is made for this purpose.

(3) Such an election may not be made unless each of conditions 1 to 5 is met.

(4) Condition 1 is that company A and the other party to the finance arrangement ("**company B**") are both members of the worldwide group.

(5) Condition 2 is that company B is a company with investment business (within the meaning of Part 16 of CTA 2009) and -

(a) is resident in the United Kingdom, or

(b) is not resident in the United Kingdom and is carrying on a trade in the United Kingdom through a permanent establishment in the United Kingdom.

(6) Condition 3 is that company B is allowed a deduction under section 1219 of CTA 2009 (expenses of management of a company's investment business) in respect of an

accounting period that falls wholly or partly within the period of account of the worldwide group ("**the relevant period**").

(7) Condition 4 is that the amount of the deduction allowed is equal to, or greater than, the relevant amount.

(8) Condition 5 is that the calculation of company B's total profits for the relevant period for the purposes of corporation tax results in a loss if company B's credit is not included in that calculation.

(9) An election under this section may only be made -

(a) jointly by company A and company B, and

(b) within 36 months of the end of the period of account of the worldwide group to which the relevant amount relates.

(10) In this section "**company B's credit**" means the credit to company B that arises from the debit to company A as a result of which condition A in section 313 is met.

### **325 Stranded management expenses in non-trading loan relationships: financing income**

(1) This section applies if -

(a) under section 324, the relevant amount is treated as not being a financing expense amount of company A, and

(b) apart from this section, the relevant amount is a financing income amount of company B because of meeting condition A in section 314.

(2) The relevant amount is treated as not being a financing income amount of company B.

(3) In this section "company A" and "company B" have the same meaning as in section 324.

### **326 Charities**

(1) This section applies if, apart from this section, an amount ("**the relevant amount**") is a financing expense amount of a company because of meeting condition A, B or C in section 313.

(2) The relevant amount is treated as not being a financing expense amount of the company if the creditor is a charity.

(3) In this section -

**"charity"** means any body of persons or trust established for charitable purposes only, and

**"creditor"** means—

(a) if the relevant amount is a debit that meets condition A in section 313, the loan creditor who receives the payment in relation to which the relevant amount arises, and

(b) if the relevant amount meets condition B or C in section 313, the recipient of the payment in relation to which the relevant amount arises.

### **327 Educational and public bodies**

(1) This section applies if, apart from this section, an amount ("the relevant amount") is a financing expense amount of a company because of meeting condition A, B or C in section 313.

(2) The relevant amount is treated as not being a financing expense amount of the company if the creditor is -

(a) a designated educational establishment,

(b) a health service body,

(c) a local authority, or

(d) a person that is prescribed, or is of a description of persons prescribed, in an order made by the Commissioners for the purposes of this section.

(3) The Commissioners may not prescribe a person, or a description of persons, for the purposes of this section unless they are satisfied that the person, or each of the persons within the description, has functions some or all of which are of a public nature.

(4) In this section -

**"creditor"** means -

(a) if the relevant amount is a debit that meets condition A in section 313, the loan creditor who receives the payment in relation to which the relevant amount arises, and

(b) if the relevant amount meets condition B or C in section 313, the recipient of the payment in relation to which the relevant amount arises,

**"designated educational establishment"** has the same meaning as in section 105 of CTA 2009, and

**"health service body"** has the same meaning as in section 985 of CTA 2010.

### **328 Interpretation of sections 316 to 327**

In sections 316 to 327 **"finance arrangement"** means -

(a) in the case of an amount that is a debit or credit that meets the condition in section 313(2) or 314(2), the loan relationship to which the debit or credit relates,

(b) in the case of an amount that meets the condition in section 313(4) or 314(4), the finance lease to which the amount relates, and

(c) in the case of an amount that meets the condition in section 313(5) or 314(5), the debt factoring or similar transaction to which the amount relates.

## **CHAPTER 8**

### **"TESTED EXPENSE AMOUNT" AND "TESTED INCOME AMOUNT"**

#### **329 The tested expense amount**

(1) References in this Part to the **"tested expense amount"** for a period of account of the worldwide group are to the sum of the net financing deductions of each relevant group company.

(2) References in this Part to the **"net financing deduction"** of a company for a period of account of the worldwide group are to -

(a) the sum of the company's financing expense amounts for the period (see section 313), less

(b) the sum of the company's financing income amounts for the period (see section 314).

(3) References in subsection (2) to a company's financing expense amounts or financing income amounts for a period of account of the worldwide group do not include any amount that arises as a result of a transaction that takes place at a time at which the company is not a relevant group company.

(4) If the amount determined in accordance with subsection (2) is negative, the net financing deduction of the company for the period is nil.

(5) If the amount determined in accordance with subsection (2) is small (see section 331), the net financing deduction of the company for the period is nil.

### **330 The tested income amount**

(1) References in this Part to the **"tested income amount"** for a period of account of the worldwide group are to the sum of the net financing incomes of each UK group company.

(2) The reference in subsection (1) to the **"net financing income"** of a company for a period of account of the worldwide group is to -

(a) the sum of the company's financing income amounts for the period (see section 314), less

(b) the sum of the company's financing expense amounts for the period (see section 313).

(3) References in subsection (2) to a company's financing expense amounts or financing income amounts for a period of account of the worldwide group do not include any amount that arises as a result of a transaction that takes place at a time at which the company is not a UK group company.

(4) If the amount determined in accordance with subsection (2) is negative, the net financing income of the company for the period is nil.

(5) If the amount determined in accordance with subsection (2) is small (see section 331), the net financing income of the company for the period is nil.

### **331 Companies with net financing deduction or net financing income that is small**

(1) An amount determined in accordance with section 329(2) or 330(2) is "small" if it is less than £500,000.

(2) The Treasury may by order amend subsection (1) by substituting a higher or lower amount for the amount for the time being specified there.

(3) An order under subsection (2) may only be made if a draft of the statutory instrument containing the order has been laid before and approved by a resolution of the House of Commons.

(4) An order under subsection (2) may only have effect in relation to periods of account of the worldwide group beginning after the date on which the order is made.

## CHAPTER 9

### "AVAILABLE AMOUNT"

#### 332 The available amount

(1) References in this Part to the **"available amount"** for a period of account of the worldwide group are to the sum of the amounts disclosed in the financial statements of the group for that period in respect of -

- (a) interest payable on amounts borrowed,
- (b) amortisation of discounts relating to amounts borrowed,
- (c) amortisation of premiums relating to amounts borrowed,
- (d) amortisation of ancillary costs relating to amounts borrowed,
- (e) the financing cost implicit in payments made under finance leases,
- (f) the financing cost relating to debt factoring, or
- (g) matters of such other description as may be specified in regulations made by the Commissioners.

(2) An amount that falls within any of paragraphs (a) to (g) of subsection (1) is to be disregarded for the purposes of that subsection to the extent that -

- (a) the amount represents a dividend payable in respect of preference shares, and
- (b) those shares are recognised as a liability in the financial statements of the group for the period.

#### 333 Group members with income from oil extraction subject to particular tax treatment in UK

(1) In calculating the available amount, an amount disclosed in the financial statements of the worldwide group (**"the external finance amount"**) must be disregarded if conditions A and B are met.

(2) Condition A is that a member of the worldwide group is treated in a relevant accounting period as carrying on a ring fence trade (see section 277 of CTA 2010).

(3) Condition B is that the external finance amount falls to be brought into account for the purposes of corporation tax in calculating the profits of that trade for that accounting period.

(4) In this section "**relevant accounting period**", in relation to a member of the worldwide group, means an accounting period of the member that falls wholly or partly within the period of account of the worldwide group.

### **334 Group members with income from shipping subject to particular tax treatment in UK**

(1) In calculating the available amount, an amount disclosed in the financial statements of the worldwide group ("**the external finance amount**") must be disregarded if conditions A and B are met.

(2) Condition A is that a member of the worldwide group is, for a relevant accounting period, a tonnage tax company for the purposes of Schedule 22 to FA 2000.

(3) Condition B is that the external finance amount -

(a) is taken into account in computing relevant shipping profits of that company for that accounting period, or

(b) comprises deductible finance costs outside the ring fence, to the extent that they are adjusted under paragraph 61 or 62 of Schedule 22 to FA 2000.

(4) In this section -

"**relevant accounting period**", in relation to a member of the worldwide group, means an accounting period of the member that falls wholly or partly within the period of account of the worldwide group, and

"**relevant shipping profits**" has the same meaning as in Schedule 22 to FA 2000 (see Part 6 of that Schedule).

### **335 Group members with income from property rental subject to particular tax treatment in UK**

(1) In calculating the available amount, an amount disclosed in the financial statements of the worldwide group ("**the external finance amount**") must be disregarded if conditions A and B are met.



(2) Condition A is that a member of the worldwide group is treated in a relevant accounting period as carrying on a separate business under section 541 of CTA 2010 (ring-fencing of property rental business).

(3) Condition B is that the external finance amount falls to be brought into account in calculating the profits arising from that business in that accounting period.

(4) In this section "**relevant accounting period**", in relation to a member of the worldwide group, means an accounting period of the member that falls wholly or partly within the period of account of the worldwide group.

### **336 Meaning of accounting expressions used in this Chapter**

Subject to any provision to the contrary, expressions used in this Chapter have the meaning for the time being given by international accounting standards.

## **CHAPTER 10**

### **OTHER INTERPRETATIVE PROVISIONS**

#### **337 The worldwide group**

In this Part "the worldwide group" means any group of entities that -

- (a) is large, and
- (b) contains one or more relevant group companies.

#### **338 Meaning of "group"**

(1) Subject to subsections (2) and (3), in this Part "**group**" has the meaning for the time being given by international accounting standards.

(2) If a group would (apart from this subsection) contain more than one ultimate parent, each of those ultimate parents, together with its subsidiaries, is to be treated as a separate group.

(3) An entity that is a parent of the ultimate parent of a group is to be treated as not being a member of the group.

(4) Subsections (2) and (3) do not apply for the purposes of section 339.

#### **339 Meaning of "ultimate parent"**

(1) For the purposes of this Part, "ultimate parent", in relation to a group, means an entity that -

- (a) is a member of the group,
- (b) is a corporate entity or a relevant non-corporate entity,
- (c) is not a subsidiary (whether direct or indirect) of a corporate entity or a relevant non-corporate entity, and
- (d) is not a collective investment scheme.

(2) In this section "**collective investment scheme**" has the meaning given by section 235 of FISMA 2000.

### **340 Meaning of "corporate entity"**

(1) In this Part "**corporate entity**" means (subject to subsection (4)) -

- (a) a body corporate incorporated under the laws of any part of the United Kingdom or any other country or territory, or
- (b) any other entity that meets conditions A and B.

(2) Condition A is that the person or persons who have an interest in the entity hold shares in the entity, or interests corresponding to shares.

(3) Condition B is that the amount of profits to which each person who has an interest in the entity is entitled depends upon a decision that -

- (a) is taken by the entity or members of the entity, and
- (b) is taken after the period in which the profits arise.

(4) The following are not corporate entities for the purposes of this Part -

- (a) the Crown,
- (b) a Minister of the Crown,
- (c) a government department,
- (d) a Northern Ireland department, or
- (e) a foreign sovereign power.

### 341 Meaning of "relevant non-corporate entity"

(1) In this Part **"relevant non-corporate entity"** means an entity -

- (a) that is not a corporate entity, and
- (b) in relation to which conditions A and B are met.

(2) Condition A is that shares or other interests in the entity are listed on a recognised stock exchange.

(3) Condition B is that the shares or other interests in the entity are sufficiently widely held.

(4) For this purpose shares or other interests in an entity are **"sufficiently widely held"** if no participator in the entity holds more than 10% by value of all the shares or other interests in the entity.

(5) Section 454 of CTA 2010 (meaning of participator) applies for the purposes of this section.

(6) In the application of that provision for those purposes, references to a company are to be treated as references to an entity.

### 342 Treatment of entities stapled to corporate, or relevant non-corporate, entities

(1) If a corporate entity is stapled to another entity, the two entities are treated for the purposes of this Part as if -

- (a) they were one entity, and
- (b) that one entity were a corporate entity.

(2) If a relevant non-corporate entity is stapled to another entity, the two entities are treated as if -

- (a) they were one entity, and
- (b) that one entity were a relevant non-corporate entity.

(3) For the purposes of this section, an entity ("**entity A**") is **"stapled"** to another ("**entity B**") if, in consequence of the nature of the rights attaching to the shares or other interests in entity A (including any terms or conditions attaching to the right to transfer the interests), it is necessary or advantageous for a person who has, disposes of or acquires shares or other interests in entity A also to have, to dispose of or to acquire shares or other interests in entity B.

### 343 Treatment of business combinations

- (1) This section applies if two corporate entities -
- (a) are not subsidiaries of the same entity, but
  - (b) are treated under international accounting standards as a single economic entity by reason of being a business combination achieved by contract.
- (2) The two entities are treated for the purposes of this Part as if -
- (a) they were one entity, and
  - (b) that one entity were a corporate entity.

### 344 Meaning of "large" in relation to a group

- (1) For the purposes of this Part, a group is **"large"** at any time if (and only if) any member of the group is not at that time within the category of micro, small and medium-sized enterprises as defined in the Annex to Commission Recommendation 2003/361/EC of 6 May 2003 ("**the Annex**").
- (2) In its application as a result of subsection (1), the Annex has effect subject to the following qualifications.
- (3) If a member of the group is in liquidation or administration, the rights of the liquidator or administrator (in that capacity) are to be left out of account when applying Article 3(3)(b).
- (4) Article 3 has effect with the omission of paragraph (5) (declaration in good faith where control cannot be determined etc.).
- (5) The first sentence of Article 4(1) has effect as if the reference to the latest approved accounting period of a member of the group were to the current accounting period of that member.
- (6) Article 4 has effect with the omission of -
- (a) the second sentence of paragraph (1) (data to be taken into account from date of closure of accounts),
  - (b) paragraph (2) (no change of status unless ceilings exceeded for two consecutive periods), and
  - (c) paragraph (3) (estimate in case of newly established enterprise).

### 345 Meaning of "UK group company" and "relevant group company"

- (1) This section applies for the purposes of this Part.
- (2) A company is a **"UK group company"** if -
- (a) it meets condition A, and
  - (b) it is a member of the worldwide group.
- (3) A company is a **"relevant group company"** if -
- (a) it meets condition A, and
  - (b) it meets condition B.
- (4) Condition A is that the company -
- (a) is resident in the United Kingdom, or
  - (b) is not resident in the United Kingdom and is carrying on a trade in the United Kingdom through a permanent establishment in the United Kingdom.
- (5) Condition B is that the company is either -
- (a) the ultimate parent of the worldwide group, or
  - (b) a relevant subsidiary of the ultimate parent of the worldwide group.
- (6) A company is a **"relevant subsidiary"** of the ultimate parent of the worldwide group if the company is a member of the worldwide group and -
- (a) the company is a 75% subsidiary of the ultimate parent,
  - (b) the ultimate parent is beneficially entitled to at least 75% of any profits available for distribution to equity holders of the company, or
  - (c) the ultimate parent would be beneficially entitled to at least 75% of any assets of the company available for distribution to its equity holders on a winding-up.
- (7) Chapter 6 of Part 5 of CTA 2010 (equity holders and profits or assets available for distribution) applies for the purposes of subsection (6)(b) and (c) as it applies for the purposes of section 151(4) of that Act.

### 346 Financial statements of the worldwide group

- (1) This section applies for the purposes of this Part.
- (2) References to financial statements of the worldwide group are to consolidated financial statements of the ultimate parent and its subsidiaries; and references to a balance sheet of the worldwide group are to be read accordingly.
- (3) References to a period of account of the worldwide group are to a period in respect of which financial statements of the worldwide group are drawn up.

### **347 Non-compliant financial statements of the worldwide group**

- (1) This section applies if -
  - (a) financial statements of the worldwide group are drawn up in respect of a period,
  - (b) those financial statements are not acceptable, and
  - (c) the amounts disclosed in those financial statements are materially different from those that would be disclosed in IAS financial statements for the period.
- (2) This Part (apart from this section) applies as if IAS financial statements had been drawn up in respect of the period.
- (3) For the purposes of this section, financial statements are "**acceptable**" if -
  - (a) they are drawn up in accordance with international accounting standards,
  - (b) they meet such conditions relating to accounting standards, or accounting principles or practice, as may be specified in regulations made by the Commissioners, or
  - (c) conditions A, B and C are met.
- (4) Condition A is that -
  - (a) the companies whose results are included in the financial statements, and
  - (b) the companies whose results would be included in IAS financial statements of the worldwide group for the same period, were such statements drawn up, are the same.
- (5) Condition B is that -
  - (a) the transactions whose results are reflected in the amounts mentioned in section 332(1)(a) to (g) in the financial statements, and

(b) the transactions whose results would be reflected in those amounts in IAS financial statements of the worldwide group for the same period, were such statements drawn up, are the same.

(6) Condition C is that the amounts mentioned in section 332(1)(a) to (d) in the financial statements are calculated using the effective interest method.

(7) In this section, references to IAS financial statements of the worldwide group for a period are to financial statements of the group for the period drawn up in accordance with international accounting standards.

### **348 Non-existent financial statements of the worldwide group**

(1) This section applies if financial statements of the worldwide group are not drawn up in respect of a period ("**the relevant period**").

(2) If the relevant period is 12 months or less, this Part (apart from this section) applies as if IAS financial statements had been drawn up in respect of the relevant period.

(3) If the relevant period is more than 12 months, this Part (apart from this section) applies as if IAS financial statements had been drawn up in respect of each period to which subsection (4) applies.

(4) This subsection applies to a period if -

(a) it is the first period of 12 months falling within the relevant period,

(b) it is a period of 12 months falling within the relevant period that begins immediately after the end of the period mentioned in paragraph (a), or immediately after the end of a period determined under this paragraph, or

(c) it is a period of less than 12 months that -

(i) begins immediately after the end of the period mentioned in paragraph (a) or after the end of a period determined under paragraph (b), and

(ii) ends at the end of the relevant period.

(5) In this section, references to IAS financial statements of the worldwide group for a period are to financial statements of the group for the period drawn up in accordance with international accounting standards.

### **349 References to amounts disclosed in financial statements**

(1) References in this Part to amounts disclosed in financial statements include an amount comprised in an amount so disclosed.

(2) References in this Part to amounts disclosed in financial statements do not include, in the case of an amount that -

(a) is an amount mentioned in section 332(1)(a) to (g), and

(b) has been capitalised and is accordingly included in the balance sheet comprised in the financial statements, any part of that amount that was included in a balance sheet comprised in financial statements for an earlier period.

(3) References in this Part to amounts disclosed in financial statements do not include-

(a) any amount disclosed in respect of a group pension scheme, or

(b) any amount disclosed in respect of any entity that is not a member of the group.

### **350 Translation of amounts disclosed in financial statements**

(1) References in this Part (except in Chapter 2) to an amount disclosed in financial statements for a period are, where the amount is expressed in a currency other than sterling, to that amount translated into its sterling equivalent.

(2) The exchange rate by reference to which the amount is to be translated is the average rate of exchange for the period calculated from daily spot rates.

### **351 Expressions taking their meaning from international accounting standards**

(1) For the purposes of this Part, the following expressions have the meaning for the time being given by international accounting standards -

**"effective interest method",**

**"entity",**

**"parent", and**

**"subsidiary".**

(2) The Commissioners may by order amend this section.

### **352 Meaning of "relevant accounting period"**



For the purposes of this Part, a "relevant accounting period" of a company, in relation to a period of account of the worldwide group, means any accounting period that falls wholly or partly within the period of account of the worldwide group.

### **353 Other expressions**

In this Part -

**"the Commissioners"** means the Commissioners for Her Majesty's revenue and Customs,

**"FISMA 2000"** means the Financial Services and Markets Act 2000,

**"FSA Handbook"** means the Handbook made by the Financial Services Authority under FISMA 2000, and

**"HMRC"** means Her Majesty's Revenue and Customs.



Annexure G

## University of Pretoria

### Declaration of originality

This document must be signed and submitted with every  
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Full names of student:

**Shirleen Amanda Ritchie**

Student number: **u04353986**

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3. I have not used work previously produced by another student or any other person to hand in as my own.
4. I have not allowed, and will not allow, anyone to copy my work with the intention of passing it off as his or her own work.

Signature of student:.....

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