



# Welcome tax proposals to the debt relief rules

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When debt is reduced or written off, certain adverse tax consequences may arise for the debtor. The tax provisions dealing with the debt relief rules are contained in section 19 and paragraph 12A of the Eighth Schedule to the Income Tax Act, 1962 (the “Act”). The current debt relief rules were introduced by the Taxation Laws Amendment Act, 2017 and are applicable in respect of years of assessment commencing on or after 1 January 2018.

The trigger for the application of these debt relief rules is a “concession or compromise”. The definition of “concession or compromise” as it currently reads is widely worded with the result that a change to the terms of a loan, for example, the redenomination of the currency of a loan from say, USD to ZAR, may trigger the debt relief rules. The Draft Taxation Laws Amendment Bill, 2018 (“**Draft TLAB**”) proposes amendments to section 19 and paragraph 12A. If promulgated, the proposed amendments will have the welcome result that by merely changing the term of a loan, the provisions of paragraph 12A and section 19 should not be triggered.

This article briefly sets out the debt relief rules in the context of a change to the terms of a loan under current legislation and the proposed amendments in the Draft TLAB which are relevant in this regard.

## Current debt relief rules (section 19 and paragraph 12A)

Section 19 applies where a “debt benefit”, in respect of a debt owed by a person, arises by reason of or as a result of a “concession or compromise” in respect of that debt and the amount of that debt was used by that person to fund, directly or indirectly, any expenditure in respect of which a deduction was granted in terms of the Act. Paragraph 12A of the Eighth Schedule represents the capital gains tax equivalent of section 19. It essentially applies where the debt was applied to fund capital expenditure or allowance assets.

Where there is a “debt benefit”, the value of the debt benefit must be taken into account in determining the taxable income of the taxpayer and the manner in which the debt benefit is taken into account will depend on whether the debt was used to fund deductible or capital expenditure.

In terms of the current wording of section 19 and paragraph 12A, a “concession or compromise” is defined in paragraph (a) (i) of the definition thereof, *inter alia*, as any arrangement in terms of which any term or condition applying in respect of a debt is changed or waived. Accordingly, the conversion of a loan claim from, say, a USD claim to a ZAR claim should, in our view, constitute a “concession or compromise” on the basis that one of the terms of the loan claim has been changed. In such circumstances, it will then be necessary to consider if a “debt benefit” arises (a discussion of which is beyond the scope of this article).

## Proposed amendments in terms of the Draft TLAB

The draft explanatory memorandum to the Draft TLAB states the following in respect of the current debt relief provisions that were introduced by the Taxation Laws Amendment Act, 2017:

“...the debt relief rules would be triggered when –

- (a) A change in the terms or conditions of a debt or the substitution of a debt occurs;
- (b) An obligation in respect of a debt is substituted for another obligation; and
- (c) A debt is converted into shares.”

However, according to the explanatory memorandum, following the 2017 amendments to the debt relief rules, concerns were raised regarding the practical application of such rules. As regards the possibility that an arrangement in terms of which a term or condition applying in respect of a debt is changed may constitute a “concession or compromise”, the explanatory memorandum notes the following:

“Although there is an understanding that voluntary intra-group debt subordinations may be used for tax structuring, however, the inclusion of any changes in the terms or conditions of a debt as a ‘concession or compromise’ may have the unintended consequence of affecting legitimate transactions ... As such, it is argued that the inclusion of a change in the terms and conditions of a debt as a ‘concession or compromise’ is more of a blunt instrument aimed at targeting a narrow group of taxpayers and as a result, it should be removed.”

Accordingly, the Draft TLAB proposes an amended definition of a “concession or compromise” which, if promulgated, will provide as follows in terms of paragraph (a) thereof:

“‘concession or compromise’ means any arrangement in terms of which—

- (a) a debt is—
  - (i) cancelled, waived or remitted; or
  - (ii) extinguished by—

(aa) redemption of the claim in respect of that debt; or  
(bb) merger by reason of the acquisition of the claim in respect of that debt,

by the person owing that debt or by any person who is a connected person in relation to that person, otherwise than as the result or by reason of the implementation of an arrangement described in paragraph (b);...

The amended definition, if promulgated in its current form, is deemed to have come into operation retrospectively on 1 January 2018 and apply in respect of years of assessment commencing on or after that date.

In respect of the amended definition of “concession or compromise” as proposed in the Draft TLAB, the explanatory memorandum states as follows:

“Under the revised definition, circumstances under which the debt relief rules will apply will be limited to realisation events. In terms of the new definition, there will be **no regard to changes in the terms and conditions of taxpayers’ debt arrangements unless they result in a realisation event.**” (our emphasis).

In our view, in terms of the proposed definition of “concession or compromise” in the Draft TLAB (in contrast with the current definition thereof) the following scenarios should not “constitute a “concession or compromise”:

- the conversion of an existing loan claim from one denomination to another (eg, the redenomination of the currency of a loan from say USD to ZAR);
- the subordination or the release of the subordination of a claim; and
- the cession of a loan claim.

The application of the debt relief rules in section 19 and paragraph 12A should accordingly not be triggered in the scenarios set out above. However, it should be noted that the Draft TLAB is still in draft form and is subject to change prior to its promulgation. We therefore recommend that the impact of the proposed amendments are considered by taxpayers upon promulgation.

In conclusion, the proposed amended definition of “concession or compromise” in the Draft TLAB is to be welcomed. It clarifies that changes in the terms and conditions of taxpayers’ debt arrangements that do not give rise to realisation events should not trigger the debt relief rules in the Act. In our view, this an equitable outcome as the application of the debt relief rules in instances that do not result in a realisation event may have adverse tax consequences for taxpayers without giving rise to a corresponding loss to the fiscus.

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