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Finality to Debt Benefit Rules

by Siyanda Gaetsewe

The Taxation Laws Amendment Act, 2018 ("**TLAA**"), which was promulgated on 17 January 2018, amended South African tax legislation by overhauling two provisions relating to the reduction of debt, (the "**Debt Benefit Rules**"), namely section 19 of the Income Tax Act, 1962 (the "**ITA**") and paragraph 12A of the Eighth Schedule to the ITA (the "**Eighth Schedule**"). This article will examine the notable areas where the legislation per the TLAA differs and the importance of the timing of the application of such amendments.

Some amendments to the Debt Benefit Rules are effective retrospectively, as from years of assessment commencing on or after 1 January 2018. These proposed amendments were first introduced in the Draft Taxation Laws Amendment Bill, 2018 which was published for comment on 16 July 2018. This caused a great deal of uncertainty as the proposed amendments were only in draft and were subject to possible change, which made it difficult for taxpayers to manage their tax affairs during 2018.

In this regard, the most significant amendments relate to paragraph (*a*) of the definition of "concession or compromise". Previously, the definition of "concession or compromise" included "any arrangement in terms of which—

(*a*) **any**—

(i) **term or condition applying in respect of a debt is changed or waived; or**

(ii) obligation is substituted, whether by means of novation or otherwise, for the obligation in terms of which that debt is owed …" (our emphasis added)

Therefore, under the previous section 19 and paragraph 12A of the Eighth Schedule to the ITA, changes to any terms or conditions applying to existing arrangements would give rise to a "debt benefit" where the face value of the debt exceeded the market value thereof as a result of the change. The change to the term or condition need not have resulted in a new debt or novation of the existing debt. Thus, any change that could result in a change in the market value of the debt would (in the absence of an exclusion applying) have had far-reaching consequences for debt arrangements that were normal in the course of business, for example, changing the interest rate or extending the repayment date of a debt.

As per the TLAA, paragraph (*a*) of the definition of "concession or compromise" has been amended to include "any arrangement in terms of which—

(*a*) a debt is—

(i) cancelled or waived; or
(ii) extinguished by—
(aa) redemption of the claim in respect of that debt by the person owing that debt or by any person that is a connected person in relation to that person; or
(bb) merger by reason of the acquisition, by the person owing that debt, of the claim in respect of that debt, otherwise than as the result or by reason of the implementation of an arrangement described in paragraph (*b*) …"

Therefore, the approach taken in defining "concession or compromise" under the current section 19 and paragraph 12A of the Eighth Schedule to the ITA, is much narrower and is welcomed, in that not all changes to terms or conditions applying to existing arrangements would constitute a concession or compromise, which could have given rise to a "debt benefit" where the face value of the debt exceeded the market value thereof.

The reason for the amendment provided in the Explanatory Memorandum to the Draft Taxation Laws Amendment Bill, 2018 is that "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 the taxpayer has been placed in a better position as a result of the amendments, the retrospective nature of the amendments does not dilute the presumption that an amendment to legislation should be prospective as it was previously held in *S v Mhlungu*, which held that the presumption was not intended to exclude the benefits of rights but rather to prevent the limitation of rights.

On the other end of the spectrum are amendments to section 19 and paragraph 12A of the Eighth Schedule to the ITA, which are potentially onerous to the taxpayer, in that they are effective prospectively as from years of assessment commencing on or after 1 January 2019.

Such notable amendments include the insertion of section 19(6A) read with the substitution in paragraph 12A(4)(*b*) of the Eighth Schedule. In broad terms, these provisions have been inserted to address situations where a debt was applied to fund an asset which is disposed of in a year prior to the year in which the debt benefit arises.

The impact of these provisions is effectively that if the amount of capital gain or loss or recoupment that a taxpayer would have had, had a debt benefit arisen, differs from the amount of capital gain or loss or recoupment that arose by virtue of the disposal, then the difference must be taken into account for purposes of determining a capital gain or loss or recoupment in terms of sections 19 or paragraph 12A, in the year in which the debt benefit arises.

Although the current amendments tick all the boxes here, an important consideration is whether the future application of the legislation to events from the past (ie, retrospective application of legislation), is unconstitutional. In *Pienaar Brothers (Pty) Ltd v CSARS and the Minister of Finance*, the High Court dealt with the Taxation Laws Amendment Act, 2007 which inserted section 44(9A) into the ITA. The court, in that case, held that it is not necessarily unconstitutional for legislation which is not in favour of the taxpayer to be retrospective. The decision has not been challenged in a higher court, however this case should not be viewed as authority that any amendments made to the legislation that are made retrospectively would pass constitutional muster. The particular context and impact of the amendment for the taxpayer as well as the fiscus would need to be considered.

Therefore, in our view, the amending legislation relating to section 19(6A) and paragraph 12A(4)(*b*) of the Eighth Schedule has correctly been made prospective and not retrospective.

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