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## SARS issues Draft Interpretation Note on Intra-group Loans

### In February this year SARS published a Draft Interpretation Note on the determination of taxable income of certain persons from international transactions covering intra-group loans.

The note provides taxpayers with guidance on the application of the arm's length principle in the context of the pricing of intra-group loans. The arm's length principle forms the basis of transfer pricing and is outlined in Section 31 of the Income Tax Act. Section 31 applies prior to considering the impact, if any, of sections that limit deduction of certain interest incurred on intra group loans (section 23M) and interest incurred in relation to group restructuring (section 23N).

#### Section 31 requires taxpayers to:

- determine whether the actual terms and conditions of any transaction, operation, scheme, agreement or understanding meeting paragraph (a) of the definition of an "affected transaction" are different from the terms and conditions that would have existed if the relevant parties had been independent persons dealing at arm's length; and
- if there is a difference which results or will result in a tax benefit for the taxpayer that is a party to the affected transaction, to calculate their taxable income or tax payable based on the arm's length terms and conditions of the affected transaction.

In the case of Intra-group loans, the principle considers both the amount of debt and the cost of the debt. SARS will consider a taxpayer's debt to be non-arm's length if, amongst other factors, some or all of the following circumstances exist:

- The taxpayer is carrying a greater quantity of debt than it could sustain on its own (that is, it is thinly capitalised).
- The duration of the lending is greater than would be the case at arm's length.
- The repayment, interest rate or other terms are not what would have been entered into or agreed to at arm's length.

Interest and other charges relating to the non-arm's length amount of affected transaction debt and the amount of interest which is non-arm's length are to be disallowed as deductions in computing taxable income. The amount of the disallowed deduction will in certain cases be deemed to be a dividend which is subject to dividends tax or a donation subject to donations tax.

The Draft Interpretation note confirms that SARS follows the guidance in the OECD Guidelines in determining the arm's length nature of an intra-group loan.

Taxpayers are encouraged to retain appropriate documentation substantiating their view extent to which the debt is considered to be arm's length.

The due date for comments to the Draft Interpretation Note is 29th April 2022.

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