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South African's Interest Limitation Rules: An Overview

Background

Multinational enterprises (MNE's) regularly engage in cross-border intercompany financing arrangements which commonly involve borrowing and lending between entities within the same group. The cross-border intercompany financing arrangements conducted by these MNE's may prompt tax avoidance concerns as such arrangements have the potential to contribute to base erosion and profit shifting (BEPS) implications.

Section 23M of the Income Tax Act, 1962 (Act No. 58 of 1962) (hereafter 'Income Tax Act' or 'ITA') was first introduced in 2013 (coming into effect on 1 January 2015), as a means to address potential tax avoidance, which is often achieved through excessive interest payments made to foreign related parties located in low or no-tax jurisdictions where interest income is not adequately taxed, stemming from these arrangements, thereby securing South Africa's tax base.

In this article we will offer a wide overview into section 23M's purpose and application in terms of cross-border intercompany financing arrangements for the purpose of providing taxpayers with a simplified yet meaningful understanding of the components of the section.

Section 23M of the ITA aims to limit the amount of interest that a debtor ('borrower') who is in a direct or indirect **controlling relationship** with a creditor ('lender'), may deduct from its taxable income in respect of debt owed to that creditor where either:

- The interest income that is received or accrued to a non-resident lender is **not subjected to tax** in South Africa (SA); or
- The non-resident lender is subject to tax (i.e., withholding tax) at a rate that does not exceed 15%.

For the purposes of section 23M, **"interest"** refers to interest as contemplated in section 24J of the Act and includes:

- Amounts incurred or accrued under any "interest rate agreement" in terms of section 24K(1)
- Any finance cost element in terms of IFRS 16 finance lease agreement
- Any amount taken into account in determining taxable income in terms of section 24I(3) and (10A); and
- Any amount deemed as interest in terms of section 24JA.

However, the interest in terms of section 23M excludes any amount that is deemed to be a dividend in *specie* as contemplated in sections 8F and 8FA.

The following scenario is a potential instance where the interest deduction may be limited in terms of Section 23M of the ITA:

The deduction of interest paid by a South African tax resident to a lender that is a United Kingdom ("UK") tax resident may be limited in terms of Section 23M as follows:

Firstly, the interest income received by the UK tax resident may be exempt from tax in South Africa in terms of Section 10(1)(h) of the Income Tax Act.

Secondly, Article 11 of the Double Taxation Agreement (DTA) between SA and the UK reduces the withholding tax on interest income received by the UK tax resident from 15% to 0%, which is below 15%.
The provisions of section 23M of the Income Tax Act will apply when **ALL** the following criteria are met:

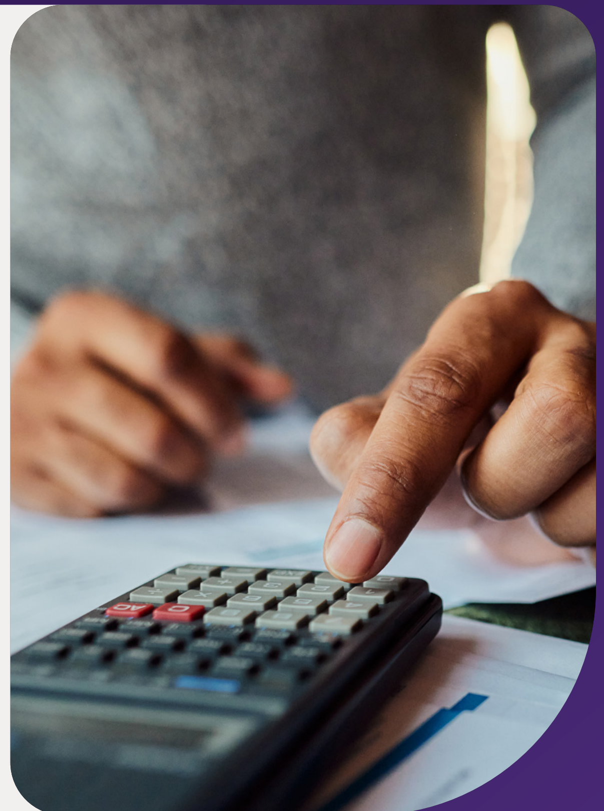
1. Interest is incurred by the debtor that is subject to tax in South Africa on its taxable income.
2. The debtor (borrower) should be a person who is resident or non-resident that have permanent establishments in South Africa to which a debt-claim is effectively connected.
3. There is a controlling relationship between lender and borrower. Section 23M also applies to back-to-back loan where the creditor obtained funding from a person that is in a controlling relationship with the debtor to advance a debt to the debtor and,
4. The interest (or related interest) incurred by the borrower –
   a. is not subject to tax in the hands of persons (lender), or
   b. is not included in the net income of a controlled foreign company (CFC) in the foreign tax year of that CFC commencing or ending within that year of assessment in terms of section 9D,
5. The interest should not have been disallowed under another limitation provision, for instance section 23M does not apply to interest that was already disallowed under section 23N

Tax Implications

As contemplated in point (3)(a) of the scope above, where any amount of interest (or related interest) incurred is not included in the creditor's income, and withholding tax on the interest was or will be levied on that amount. The amount of interest "not subject to tax" is determined in accordance with the formula:

$$A = B \times (C - D) \div C$$

Where:
A = the amount to be determined
B = the aggregate of any amount of interest incurred or paid to which the withholding tax on interest applies;
C = 15%
D = rate at which withholding tax has or will be levied on such amount of interest multiplied by 100



[1]Means taxable income calculated before applying this section and before setting off any balance of assessed loss that has been carried forward from the preceding year of assessment adjusted for interest and amounts relating to assets.

Limitation of Interest deduction

Where the provisions of section 23M apply, the amount by which the interest deduction may not exceed is determined using the formula: **X + (A% × Y) – Z**, which is, the sum of the interest received by or accrued to the debtor **(X)**, and the amount determined by multiplying the debtor's adjusted taxable income **(Y)** by **30% (A)**, reduced by any interest incurred by the debtor excluded from the section 23M scope, excluding any amount that is disallowed as a deduction in terms of section 23N **(Z).**

It is important to note that the results of the calculation of the interest limitation deduction may not be less than zero.

Furthermore, it should be noted that any amount in excess of this limitation may be carried forward to the immediately succeeding year of assessment and is deemed to be an amount of interest incurred in that succeeding year of assessment, which essentially means it should be included in the amount of interest incurred in the succeeding year for purposes of determining the new interest limitation.

Moreover, where an amount of interest is to be taken into account in terms of both this section and section 23N, the latter section takes precedence, and the amount of interest shall only be taken into account for the purposes of section 23M after section 23N has been applied.

Application

Example:

Suppose Company X (SA-resident) borrows R2 million from Company Z (Switzerland-based parent holding company of Company X which also holds 100% of its equity shareholding) and suppose Company X incurred interest of R250 000 in the current year of assessment.

Additional information:

Interest received or accrued to Company X= R125 000
Interest paid to Bank Z = R231 000
The calculated adjusted taxable income = R1 500 000.

Considerations

The interest that is paid to Company Z is exempt from Corporate Income Tax (CIT) in terms of section 10(1)(h) of the ITA as it is a foreign entity with no permanent establishment in the Republic. A domestic withholding tax (WHT) would otherwise apply; however, the WHT on the interest would be reduced to 5% in terms of Article 11(1) of the Double Taxation Agreement (DTA) between SA and Switzerland.

Additionally, the interest on the loan incurred by the SA-based debtor (Company X) is owed to the foreign creditor (Company Z) who are in a direct controlling relationship with each other by virtue of holding 100% (i.e. more than 50%) of the equity shareholding in Company X.

Notably, the scope of section 23M, namely that the interest paid to Company Z is **"not subject to tax"** in South Africa and a direct **"controlling relationship"** exists between the Company Z and the Company X, has in this case been satisfied.

Therefore, section 23M will be applied to limit the deductibility of the interest incurred by Company X.

Solution:

Section 23M provides that the interest payable of R250 0000 will be limited as follows:
The interest deductible in relation to the intercompany loan will be limited to the sum of the interest received by or accrued to Company X and 30% of Company X's adjusted taxable income, reduced by any interest incurred by Company X that "falls outside the ambit of section 23M".

R125 000 + (30% * R1 500 000) – 231 000
= R344 000

In this scenario, the maximum allowable interest is limited to R344 000, however as this amount exceeds the actual interest incurred of R250 000, the full interest is deductible in the current year of assessment.

Conclusion

In conclusion, it is important to note that despite the government's continued efforts in trying to clarify and simplify the application of section 23M, its widened scope introduces practical complexities pertaining to its implementation. Taxpayers are therefore urged to critically analyse section 23M's applicability in all cross-border intercompany financing arrangements to ensure tax compliance.

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Input Tax Pitfalls That Could Cost Your Business – And How to Avoid Them

Input Tax is defined in the section 1 of the Value Added Tax (VAT) Act as tax charged or payable by (i) a supplier on the supply of goods and services made by that supplier to the vendor or (ii) the vendor on the importation of goods by that vendor. Input tax claims are essential for business cash flow management. They allow companies to recover VAT paid on business expenses, ensuring that tax is not a cost item but a pass-through. Yet, in practice, many businesses find themselves on the receiving end of SARS input tax denials. These denials can be disruptive, leading not only to liquidity challenges but also to additional penalties, interest, and strained relations with the tax authority.

Understanding why input tax claims are denied and how to prevent this outcome is critical for every business, from Small Medium Enterprises (SMEs) to large corporates.

Why Input VAT Matters

VAT is structured as a consumption tax ultimately carried by the end consumer. Businesses serve as conduits in this process, charging output tax on their sales while recovering input tax on their expenses. However, when input tax claims are denied, businesses effectively bear a tax cost that was never intended for them. This can influence pricing strategies, erode profitability, and even disrupt competitiveness in certain industries.

Common Pitfalls Leading to Input Tax Denials

While legislation sets out clear rules on what qualifies as input tax, the application often reveals grey areas and operational weaknesses. Some of the most common pitfalls include:

- **Invalid or Missing Tax Invoices**
  SARS places great emphasis on the quality of documentation. A valid tax invoice must contain specific details such as the supplier's VAT registration number, the purchaser's details, and a clear description of the goods or services supplied. The risk is that minor omissions can invalidate the invoice and thus the claim.

- **Expenses Not Linked to Taxable Supplies**
  Input tax is only deductible if the expenditure relates directly to the making of taxable supplies. Expenses that directly relate to the making of exempt supplies such as financial services or residential rentals fall outside the net and thus irrecoverable. When businesses earn income from both taxable and exempt supplies, errors in apportionment of the VAT are a common issue.

- **Timing Errors**
  VAT legislation prescribes that claims must be made within five years of the tax invoice date. Consequently, any VAT claims that fall outside the prescribed period will be rejected by SARS.

- **Entertainment and Motor Vehicle**
  The VAT Act specifically denies input tax on certain categories of expenditure, such as entertainment costs, club subscriptions, and motor cars even if such expenses are incurred for taxable activities. Businesses often overlook these prohibitions when processing expense claims, particularly for client lunches or company motor cars.

- **Supplier Non-Compliance**
  If a supplier is not a vendor or has been deregistered, the VAT reflected on the invoice is invalid. Purchasers cannot claim input tax in such cases, even if the supplier charged it in error. This places an administrative burden on the purchaser to confirm supplier VAT status.

The Business Impact of Denied Input Tax

The denial of input tax claims can have consequences beyond the immediate tax liability. For many businesses, cash flow is essential, and the inability to recover significant amounts of VAT can create liquidity pressure. Furthermore, penalties and interest levied by SARS for "incorrect claims" add a further financial strain. In some cases, recurring denials of input tax may even damage a company's tax compliance profile, leading to more frequent audits and strained relationship with the tax authority.

Strategies to Prevent Input VAT Denials

The good news is that most denials are preventable through robust systems and proactive compliance management. Some best practices include:

- **Invest in Strong Internal Controls**
  Automating invoice capture and validation processes reduces human error. Systems should flag incomplete or non-compliant invoices before VAT returns are submitted.
- **Keep Meticulous Records**
  SARS audits rely heavily on supporting documentation. Maintaining accurate and accessible records strengthens a business's position in disputes.
- **Verify Supplier Compliance**
  Simple checks, such as confirming VAT registration numbers with SARS, can prevent invalid claims from slipping through.
- **Undertake Periodic VAT Health Checks**
  Engaging tax advisors or conducting internal reviews can help identify systemic risks and rectify them before they escalate.

By understanding the common pitfalls and building simple safeguards, businesses can protect their cash flow, maintain profitability, and reduce the risk of disputes with SARS. In today's business environment, where cash flow is critical, effective VAT management is not merely a compliance requirement, but also a sound financial strategy.

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Section 23A: Limitation of allowances granted to lessors of certain assets

Background

Section 23A (S23A) of the South African Income Tax Act (ITA) is an anti-avoidance provision, that was introduced to prevent the misuse of accelerated capital allowances by lessors of affected assets. Its principal function is to ring-fence specific capital allowances, limiting their deduction to only the rental income generated from those specific assets.

In essence, Section 23A ensures that the tax benefits from specified capital allowances on affected assets are aligned with the income generated by those affected assets, thereby preventing the artificial reduction of other taxable income sources.

When is S23A applicable?

Section 23A is applicable if a taxpayer lets out an **'affected assets'** as defined in section 23A(1). In terms of section 23A "affected asset" means any machinery, plant, implement, utensil, article, aircraft or ship which has been let and in respect of which the lessor is or was entitled to an allowance under section 11 (e), 12B, 12BA, 12C, 12DA or 37B (2) (a), whether in the current or a previous year of assessment, but excluding any such asset let by the lessor under an **operating lease** or any such asset which was during the year of assessment mainly used by the taxpayer in a non-letting trade.

Of significance is that section 23A applies if the asset is not let under a qualifying **"operating lease"**. An operating lease is defined in section 23A(1) as a lease of movable property concluded by a lessor in the ordinary course of a business (not being a banking, financial services or insurance business) of letting such property, provided certain requirements are met. A lease is considered an operating in terms of section 23A if;

I. the lease involves lease of a movable
II. the property may be hired by members of the general public directly from that lessor, for periods of less than one month.
III. the cost of maintaining such property and of carrying out repairs thereto required in consequence of normal wear and tear, is borne by the lessor; and
IV. the risk of destruction or loss of or other disadvantage to such property (other damage due to improper care) is not assumed by the lessee.

The determination of whether a particular asset is used mainly in a non-letting trade is contingent upon the specific facts and circumstances. In the case of Sekretaris van Binnelandse Inkomste v Lourens Erasmus (Eiendoms) Bpk , the court held that, in the context of an exemption for the previously applicable undistributed profits tax, the word "mainly" meant a quantitative standard of more than 50%. Similarly, in the context of this exclusion, "mainly" is also construed to mean more than 50%.

In assessing whether an asset has been used mainly in a non-letting trade , during a year of assessment, a comparison must be made between the period that the asset formed part of the trade of letting and the period it formed part of another trade. An asset is deemed to form part of a trade of letting for as long as it is made available for letting purposes. The fact that the asset was not actually let during the period it was made available for letting does not exclude it from being considered part of the trade of letting.

[2] Sekretaris van Binnelandse Inkomste v Lourens Erasmus (Eiendoms) Bpk 1966 (4) SA 434 (A)

Tax Implications when 23A is applicable

Limitation

Section 23A(2) limits the specified capital allowances on affected assets to a lessor's net rental income from those assets. The limitation is applied on an aggregate basis, and not on an asset-by-asset basis. Thus, the sum of the specified capital allowances on all affected assets is limited to the sum of the net rental income derived from all affected assets.

Furthermore, the term rental income is defined in Section 23A(1) as income derived by way of rent from the letting of any affected asset in respect of which an allowance has been granted to the lessor under section 11 (e), 12B, 12BA, 12C, 12DA or 37B (2) (a), whether in the current or any previous year of assessment, and includes any recoupment under section 8(4) of an amount deducted in any year of assessment for any affected asset and any amount derived from the disposal of any affected asset.

If the rental-related deductions (other than the specified capital allowances) exceed the rental income resulting in a net rental loss in a particular year or assessment, no specified capital allowances on affected assets will be deductible. Should the rental income from affected assets exceed the deductions, the specified capital allowances on affected assets will be allowed to the extent of the excess.

Appropriate apportionment

An apportionment applies when a lessor has incurred deductible expenditure relating to both rental income from affected assets and other income. In these circumstances an appropriate apportionment must be made to determine the portion of the deductions relating to the rental income from affected assets.

Notably, the Act does not prescribe a specific formula for determining an appropriate apportionment of expenditure. Instead, an appropriate apportionment is based on the facts of each case, and any fair and reasonable apportionment, based on the merits of the case, will be accepted.

Consequently, the apportionment will be required, for example, for general administrative overheads. Meyerowitz D,(2010) notes that where the affected asset itself is used to produce both rental and other income, then even the direct expenditure will have to be apportioned, for instance. In the ratio the respective incomes bear to one another, or in the ratio that the rental periods bear to the periods during which the affected asset is used to produce other income.

[3] Meyerwitz. D, 2010. Meyerowitz Administration of Estate and their Taxation, 1st Edition.

Carry-forward of disallowed capital allowances

The specified capital allowances that have been disallowed under section 23A(2) are carried forward to the succeeding year of assessment under section 23A(4). The amount so carried forward is deemed to be a deduction to which the taxpayer is entitled to in that succeeding year of assessment, subject to any limitation imposed by section 23A(2).

Accordingly, the capital allowances carried forward will be allowed only when there is sufficient net rental income from the letting of affected assets. Disallowed capital allowances are carried forward indefinitely until absorbed by any future net rental income.

An affected asset qualifying to be written off in, for example, three years under the specified allowance provision, but with a carry-forward under section 23A(4), will still be an affected asset in year four provided the requirements of the definition continue to be met, even if no allowance is claimable under the specified allowance provision in the fourth year.

Consequently, the implication is that allowances previously disallowed will continue to be ring-fenced against taxable income derived from the letting of affected assets. At the same time, capital allowances on other affected assets may be set off against the rental income from a fully depreciated affected asset.

Conclusion

In conclusion, Section 23A of the South African Income Tax Act serves as a critical anti-avoidance provision, limiting the deduction of specified capital allowances on affected assets to the net rental income generated from those assets. Taxpayers must carefully consider the implications of Section 23A when letting out affected assets, ensuring compliance with the ring-fencing requirements and apportionment rules to avoid unintended tax consequences.

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SARS Updates

Diesel Refund Scheme Amendment – Effective 1 April 2026

From 1 April 2026, primary sector claimants operating on land will be entitled to claim a refund on 100% of eligible diesel used in qualifying farming, forestry, and mining activities.

Key Changes

1. Full Refund of Eligible Diesel

   Claimants may now recover the full amount of the diesel levy on qualifying on-land activities. This replaces the previous partial refund structure and simplifies the calculation process.

2. Scope of Application

   The amendment applies specifically to diesel used in:

   - Farming operations
   - Forestry activities
   - Mining operations

   provided such activities meet the qualifying criteria under the Diesel Refund Scheme.

3. Administrative Simplification

   The amendment is intended to streamline administration by:

   - Eliminating complex apportionment calculations
   - Reducing compliance burdens
   - Improving clarity and consistency in claims

Transitional Arrangements

Although the amendment is legally effective from 1 April 2026, the practical implementation will align with the VAT return cycle:

- The new 100% refund rate will first be reflected in the April 2026 VAT return.
- As this return is submitted in May 2026, the adjusted refund will effectively be processed from the May 2026 submission period.
- Claims for diesel used prior to 1 April 2026 must still be calculated under the previous refund structure.

Practical Implications for Claimants

- Businesses should ensure accurate segregation of diesel usage between qualifying and non-qualifying activities.
- Internal accounting systems should be updated to reflect the 100% refundable rate from 1 April 2026.

Proper record-keeping remains essential to support claims in the event of verification or audit.

Recently Published Rulings

Binding General Rulings

Number	Date issued	Applicable legislation	Subject
Binding General Ruling 74	3 October 2025	Value-Added Tax Act, 1991	VAT treatment of certain supplies of goods or services made by municipalities to a national or provincial government

Binding Private Rulings

Number	Date issued	Applicable legislation	Subject
Binding Private Ruling 416	13 November 2025	Income Tax Act, 1962, and Value-Added Tax Act, 1991	VAT treatment of certain supplies of goods or services made by municipalities to a national or provincial government
Binding Private Ruling 415	12 November 2025	Value-Added Tax Act, 1991	VAT treatment of certain supplies of goods or services made by municipalities to a national or provincial government
Binding Private Ruling 424	06 February 2026	Income Tax Act, 1962	Interest incurred on loan funding used to redeem preference shares and settle dividends

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