



Tax & Legal – News Alert



January 2024

Deductibility of Interest by an Investment Holding Company

Section 24J(2) of the Income Tax Act 58 of 1962 (the Act) deals with the deduction of interest expenditure incurred from carrying on a trade in the production of income. In the Johannesburg High Court case (Case No A3094/2022) between the Commissioner for South African Revenue Services (SARS) (the Commissioner) and Unitrans Holdings Limited (the Taxpayer), the court, inter alia, considered whether the taxpayer's interest expense was incurred in the production of income derived from carrying on a trade and whether an understatement penalty was correctly imposed.

The matter related to corporate income tax assessments issued in respect of the 2011 year of assessment in terms of which SARS disallowed an interest deduction on the basis that it was not incurred in the conduct of any trade nor was it in the production of income. The Taxpayer is an investment holding company and initially claimed that it conducted a trade in money lending with the purpose of making a profit from on-lending borrowed funds to its subsidiaries. The rate of interest charged by the Taxpayer on funds on-lent was equal to or was less than the rate of interest at which it borrowed the money. SARS disputed that the taxpayer conducted a trade as a money lender and that the expenditure was incurred in the production of income. The Taxpayer ultimately contended that it incurred interest on funds borrowed from group companies with a view to making loans to group companies in the course of its lending trade carried on by it and in the production of income in the form of interest to be earned from the loans to group companies. Apart from the lending trade, the taxpayer does not identify any other trade.

The Tax Court found that the Taxpayer had produced no evidence to suggest continuity and no system or plan of laying out and collecting money, being features of a trade of money lending. Further, the Court highlighted that the Taxpayer had recorded in its tax return that it had not concluded any transaction in terms of section 24J which made it difficult for the Court to concur with the Taxpayer's claims of carrying on a trade in money lending. Similarly, the Tax Court concluded that the Taxpayer failed to demonstrate that the interest expense was incurred in the production of income. The interest expense was incurred to advance the business interests of its subsidiary companies through which it would earn dividend income.

In the High Court, the Taxpayer abandoned its argument that it traded as a money lender in favour of the argument that it traded as an investment holding company. It is irrelevant what trade the Taxpayer conducted as the section allows for the deduction if the Taxpayer derive income from any trade. However, the interest expenditure must be incurred in the production of that income.

While the High Court recognised that the Taxpayer conducted an investment trade, it concluded that the taxpayer earned exempt income in the form of dividends (through investment in subsidiaries). Ultimately, the High Court held that the interest expenditure was not proven to have been incurred in the production of income from conducting trade as an investment holding company. It went further, stating that the intention was never to earn any income, but rather subjugating its profit-making potential to the interests of the group companies. This argument was bolstered by the fact that the Taxpayer declared in its tax returns that it had not entered into any transactions as contemplated in section 24J of the Act.

On the question of the imposition of an understatement penalty, the High Court held that SARS was entitled to impose an understatement penalty as the error was not that of a bona fide inadvertent error. This was based on the conclusion that the taxpayer did not commit a mistake as the Taxpayer had maintained its tax position that it was entitled to claim the deduction. The Court noted that if, in fact, the Taxpayer had made an error, it could and should have corrected it at the inception of the audit or when the tax dispute commenced.

Taxpayers can draw a number of conclusions from this case. First, Taxpayers should be clear on the trade they conduct and how they intend to make a profit from that trade. It is apparent from the change in argument between the Tax Court and the High Court that the Taxpayer was not clear on this and could thus not elucidate this to SARS or to the Court. This certainly impacted the Taxpayer's ability to provide the linkage between expenditure and the income-earning operation. Second, Taxpayers should take every effort to make accurate and full disclosures in all tax returns submitted to SARS. In this case, the tax returns were utilised as evidence against the Taxpayer's argument. Finally, while the courts continue to debate the meaning of "bona fide inadvertent error" and the application thereof, Taxpayers should take cognisance of the conflicting viewpoints and that taking a tax position that is found to be incorrect by the courts may not constitute an "inadvertent error".

For more information contact:



Lesley Bosman
Associate Director
Corporate Tax
lesley.bosman@kpmg.co.za
M: +27 82 719 5523



Aneeqah Meyer
Tax Consultant
Corporate Tax
aneeqah.meyer@kpmg.co.za
M: +27 79 524 4865

kpmg.com/socialmedia



[Privacy](#) | [Legal](#)

© 2024 KPMG Services Proprietary Limited, a South African company with registration number 1999/012876/07 and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.