

Cross Border Interest Paid by a South African Resident: Tax Issues that Arise



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Cross border transactions, as well as growth in international trade between companies within the same group, has increased significantly in recent years. This often results in debts between resident and non-resident companies and numerous complexities from a South African tax perspective.

Interest payments by residents to non-residents are generally subject to interest withholding tax (WHT) at 15%. Whether WHT applies depends on whether a Double Tax Agreement (DTA) between South Africa and the country of residence of the recipient exists to give South Africa the rights to tax. It also depends on whether the interest is subject to South African income tax (as opposed to interest WHT) in the hands of the non-resident recipient.

The resident company is required to determine whether WHT is to be withheld from the interest paid. A withholding rate lower than 15% may be applied in terms of the DTA if the resident is, on date of payment, in possession of a declaration from the recipient that a lower rate applies in terms of the DTA. The recipient should also undertake to notify the resident in writing should the circumstances

affecting the application of the DTA change.

The resident company can claim a deduction in the year of assessment in which the interest was incurred if the requirements for deductibility are met. The interest deduction may, in certain instances, be limited. This interest deduction is limited in respect of debts owed to a person that is not subject to tax on the interest in South Africa, and applies if the creditor is in a "controlling relationship" with the debtor. The limitation only applies if South Africa does not have the right to tax, either in terms of the South African Income Tax Act or the DTA. The limitation is based on a formula that applies a percentage to the resident's taxable income. The limitation does not apply if the creditor funded the loan from a financial institution that is not in a "controlling relationship" with the debtor, provided that the rate of interest does not exceed the "official" rate of interest plus 100 basis points.

The presence of a "connected person" relationship also triggers transfer pricing issues. The terms and conditions of the agreement should be at arm's length. If the agreement is not at arm's length with regards to the quantum of the loan or the interest rate, and one of the parties derives a South African tax benefit, the excess amount may not be deducted by the resident company and is deemed to be a dividend in specie paid by the resident to the non-resident and subject to the dividends WHT.

If companies in the same group transact, they should be aware of their tax responsibilities and the application of the DTA. They should also ensure that agreements are done at arm's length in order to address any transfer pricing issues that may arise.