11 February 2018

The National Treasury

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**RE: 2018 BUDGET: DEBT BENEFIT TRIGGERED BY CHANGES IN TERMS OR CONDITIONS OF A DEBT**

We thank you for the ongoing consultation in relation to the substitution of the debt benefit rules for the debt reduction rules; and more specifically, the triggering of a debt benefit by changes in terms or conditions of a debt. The 2017 Taxation Laws Amendment Act substituted section 19 and paragraph 12A of the Eighth Schedule to the Income Tax Act. These amendments have become effective from years of assessment commencing on or after 1 January 2018.

We write to you to reiterate our request (made at the Annexure C workshop on 5 December 2017) for an announcement in the 2018 Budget that this effective date will be postponed to no earlier than 1 January 2019, with retrospective effect. We set out our reasons below.

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To recap, the most significant changes made by this substitution in relation to the trigger of a debt benefit by changes in terms or conditions of a debt can be summarised as follows:

- Under the old rules, only realised events (such as where there was a debt reduction due to the actual waiver of a loan) triggered tax consequences (recoupments; loss of tax attributes; etc) in the hands of the borrower. Under the new rules on the other hand, notional unrealised benefits will additionally trigger tax consequences in the hands of the borrower regardless of whether or not these benefits will ever realise. For example, assume the term of a loan is extended by a bank from say 2 to 5 years to enable the borrower to repay. This extension triggers potential adverse tax consequences even if the debt is fully repaid (as the parties hope). Not only does this trigger work against a well-intended debt workout, the 2017 legislation does nothing to reverse these adverse tax consequences even if the perceived evil of debt reduction never occurs (i.e. the debt is fully repaid).

- Under the old rules, the tax consequences were based on the amount of the actual debt reduction. However, under the new rules, the tax consequences are based on a notional amount, being the excess of face value of the debt over the market value of the debt after the change in the terms and/or condition of the loan. No cognisance is taken of the market value of the loan before the change in the terms and/or conditions of the loan nor the extent to which it may already have deteriorated. Therefore, the current rules are actually punishing efforts to restore value of troubled companies where the value of their loans have already declined by the time the debt restructuring takes place. Banks mainly provide relief in the hope of obtaining full repayment – not to manipulate tax consequences.

- Under the old rules, there was group relief from the Capital Gains Tax consequences. Under the new rules there is no group relief from the Capital Gains Tax consequences unless the borrower is dormant. For example, if a holding company subordinates a loan to its subsidiary to restore its subsidiary to solvency for going concern purposes, the subsidiary will suffer the debt benefit consequences. Many groups have been streamlining and clearing intra-group debt to improve management efficiencies so as to better cope with the current period of ongoing domestic challenges. We see no reason to target this improvement of efficiencies when the current system eliminates both intra-group gains as well as losses.

We do not repeat our discussions on our concerns regarding the substantive nature and design of the amendments here. We are not seeking to pre-empt the consultative process in the 2018 legislative cycle which should provide adequate opportunity for these issues to be explored further with a wide variety of stakeholders. Suffice it to say that the concerns that have been raised are significant and that further consultation is likely to shine further light on the potential adverse consequences to the economy.

We understand from our engagements at the Standing Committee on Finance on 8 November 2017 as well as from the Annexure C workshop on 5 December 2017 that National Treasury would be considering and consulting on the need for further amendments to the debt benefit rules during the course of the 2018 legislative cycle. We are also anticipating an announcement in the 2018 Budget to this effect. However, even if such an announcement is made, we are concerned about the taxpayer uncertainty which has been caused by the 2018 effective date of legislation. We would accordingly request that an upfront effective date be given in Annexure C so taxpayers have a better fixed understanding of the way forward.

Hence, we reiterate the request made by various stakeholders at the Annexure C workshop on 5 December 2017 for an announcement in the 2018 Budget that this effective date will be postponed to no earlier than 1 January 2019, with retrospective effect.

We appreciate the opportunity for engagement throughout the legislative process and would like to reiterate our willingness to assist in ensuring that the proposals achieve their desired objectives.

Yours sincerely

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**Chief Executive Officer**