Section 24J: new provisions relating to maturity dates

By Mathabo Magolego

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Section 24J of the Income Tax Act, 1962, is one of the more complicated sections of the act. It addresses the accrual and incurral of interest on "instruments". An instrument is any form of interest-bearing arrangement, whether in writing or not, but excluding any lease agreement.

An important factor in determining the accrual and incurral of interest on an instrument is the "yield to maturity" of the instrument.

The yield to maturity is the rate of compound interest in each accrual period at which the present value of all amounts payable or receivable in relation to the instrument during the "term" of such instrument equals the issue price or transfer of the instrument.

The term of the instrument (that is, the period from the issue or transfer of the instrument to the date of redemption) is thus equally an important component to the yield to maturity formula.

There are various ways in which the term of an instrument can exist. Two of these types of terms have been identified in the Taxation Laws Amendment Act, No 24 of 2011, as anti-avoidance mechanisms used by taxpayers so as to fall outside the ambit of section 24J of the act, and changes to the act have been enacted to curb such behaviour.

Accordingly, two new definitions have been added to section 24J(1) of the act, namely "date of redemption" and "demand instrument", and the definition of "term" has been revised.

Date of redemption

The concept of "date of redemption" deals with two types of scenarios. The first scenario is where the terms of an instrument specify a date on which all liability to pay all amounts in terms of that instrument will be discharged, and the date so specified is, in terms of the instrument, not subject to change - whether as a result of any right which is fixed or contingent of the holder of that instrument, or otherwise.

The date of redemption, in this case, will be regarded as the date specified in the terms of the instrument, and the term of the instrument will end on such date.

Where the terms of the instrument do not specify a date, or the date specified is subject to change, the date of redemption will be regarded as the date on which, on a balance of probabilities, all liability to pay all amounts in terms of that instrument is likely to be discharged.

Thus the yield to maturity calculation for debt instruments with uncertain maturity dates (for example, the date specified in the terms is subject to change) will be based on a date on which all liability to pay all amounts under the terms of the instrument is, on a balance of probabilities, likely to occur.

The term of an instrument with a specified date of redemption or an uncertain date of redemption will be regarded as the period commencing on the date of issue or transfer of that instrument and ending on the date of redemption of that instrument as specified above.

Demand instruments

A demand instrument is defined to mean "any instrument where the holder of that instrument has, at any time during a year of assessment, a right to require the redemption of that instrument at any time before the date specified in terms of that instrument as the date of redemption of that instrument".

This type of instrument creates a great deal of uncertainty for purposes of calculating the yield to maturity, as the maturity date of the instruments is generally unknown.

In terms of the new definition of the word "term", these types of instruments will be regarded as having a term of 365 days commencing on the date of issue or transfer of the instrument. This means that the yield to maturity calculation will be determined with a term reference of one year.

Where an instrument is regarded as a demand instrument, it cannot also be regarded as an instrument falling under the definition of "date of redemption".
Perpetual debt

Another type of instrument which is currently receiving consideration from a tax policy point of view is an instrument with no maturity date. National Treasury is currently considering reclassifying these types of instruments to equity, as opposed to debt.

This would mean that all amounts incurred and accrued on these instruments will be treated as dividends in the hands of both the payor and payee of the amounts. The payments would no longer be deductible in the hands of the payor, and the receipt by the payee may be subject to the new withholding tax on dividends.

The new definitions came into operation with effect from April 1, and apply in respect of amounts received by or accrued to, or incurred by, any person during years of assessment commencing on or after that date.

It would be worthwhile for taxpayers to revisit the terms of any instruments to assess whether any of the terms would result in adverse implications for the parties involved.

Furthermore, any instruments with no maturity date should also be reviewed in anticipation of such instruments being treated as equity, resulting in no deduction for the payor and possible withholding tax on dividends for the payee.

Mathabo Magolego is a senior associate in ENS's Tax department.

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