Revised debt restructuring tax rules

The Taxation Laws Amendment Bill introduces a revised set of rules that will apply to debt restructuring transactions that occur during years of assessment that commence on or after 1 January 2018. The scope of the new rules are arguably wider than the existing provisions. Some relief is afforded in a domestic group context for dormant companies and debt capitalisation transactions.

The Taxation Laws Amendment Bill (TLAB) that was published by the National Treasury on 25 October 2018 contains a revised set of rules that apply to debt restructuring transactions. This article provides a high level overview of some of the changes that will take effect for years of assessment starting on or after 1 January 2018.

Scope of the rules

The existing debt reduction rules, which came into effect during 2012, apply when the amount by which a debt is reduced exceeds the consideration for that reduction. As an example, if a person owes a creditor R100, but reaches a settlement in terms of which the person only pays R60 to settle the full debt of R100, a debt reduction of R40 arises. In the context of debt capitalisation transactions, SARS, in Interpretation Note 91, states that a debt reduction may arise if the value of the shares issued to extinguish a debt is less than the amount of the debt. Taxpayers have obtained a number of rulings from SARS for transactions that have a similar effect as a debt capitalisation transaction. However, the rulings confirmed that these proposed transactions did not give rise to debt reductions.

The revised rules will apply to concession or compromise transactions. These transactions consist of two categories.

The first category is changes to or waivers of any terms or conditions that apply to a debt. This includes the substitution of debt obligations. The debt benefit, which may have tax implications, in the case of such a transaction is the amount by which the face value of the debt, prior to the arrangement, exceeds the market value of the debt claim (presumably after the arrangement).

The second category relates to debt capitalisation transactions. A debt restructuring falls within this category if the debt is, directly or indirectly, converted or exchanged for shares or is settled by applying the proceeds from shares issued by the company. The amount that may have tax implications in the case of these transactions depends on whether the person who acquired shares in the arrangement held shares in the company before the transaction. If the person held shares before, the debt benefit is the amount by which the face value of the debt before the transaction exceeds the amount by which the market value of shares held by the person in the company increased as a result of the transaction. If the person did not hold shares in the company prior to the transaction, the debt benefit is the amount by which the face value of the debt exceeds the market value of the shares acquired by the person.

It is submitted that the revised rules broaden the situations that may trigger tax implications when debts are restructured. The new rules could arguably apply to situations where the amount of the capital debt outstanding remains fully owing to the creditor. Borrowers in financial distress may find it difficult to restructure their obligations in a manner that does not attract tax consequences, as they may have been able to do previously.

Relief

The exclusion from having to make adjustments to the base cost of assets in respect of reduced debts owing between group companies has been replaced with relief from all tax implications of a debt restructuring in the following instances:

- debts owing by dormant domestic group companies, or
- debts settled, directly or indirectly, by means of shares issued within a domestic group context.

(November 2017)

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