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Telkom case: Exchange losses on shareholder loans

Investments in foreign operations often include shareholder loans denominated in foreign currencies. Telkom disposed of such a shareholder loan at a substantial loss. It applied a disposal rate to deduct this as an exchange loss against its taxable income. SARS disallowed the deduction on the basis that it represented a loss that was beyond the scope of section 24I, which deals with gains or losses on foreign exchange transactions. The Supreme Court of Appeal considered this dispute and provided valuable guidance on the interpretation of tax legislation in the process. This article provides a brief review of this aspect of the judgment in the Telkom case.

The Supreme Court of Appeal ('the SCA') delivered judgment in *Telkom SA SOC Limited v C:SARS* (Case no 239/19) [2020] ZASCA 19 on 25 March 2020. One of the matters considered in this case related to a deduction claimed by Telkom SA SOC Ltd ('Telkom') in respect of losses suffered on shareholder loans advanced to a foreign company. This article briefly reviews this aspect of the case.

Background to the loan

From 2007 to 2011 Telkom advanced shareholder loans to Multi-Links Telecommunications Ltd ('Multi-Links'), a Nigerian company controlled by the Telkom group. By October 2011 Multi-Links owed Telkom approximately USD531 million. The prospects of repayment were remote. The Telkom group disposed of its investments in Multi-Links to a third party. The shareholder loans were disposed of for USD100.

Relevant legislation and dispute

Section 24I of the Income Tax Act deals with gains and losses on foreign exchange transactions. It generally requires taxpayer to account for exchange differences on exchange items on an unrealised basis. In the context of exchange items between related parties, section 24I(10) required that exchange gains or losses should only be taken into account upon realisation. The gain or loss had to be determined as the difference between the ruling exchange rates on the realisation date and the date that the exchange item arose. The ruling exchange rate for a loan is generally the spot rate. The definition of ruling exchange rate however caters for a situation where the consideration for the disposal of the loan was determined by applying a rate other than the spot rate. In that case, the ruling exchange rate is the disposal rate, which is determined by dividing the amount received in respect of the disposal by the foreign currency amount.

Telkom applied a disposal rate as the ruling exchange rate at the time of the disposal. It determined this rate as R799 (being the consideration from the disposal) divided by the loan balance of USD531 million. Telkom claimed a deduction of approximately

R3,9 billion in terms of section 24I in respect of the losses suffered on the shareholder loans.

The Commissioner disallowed the deduction on the basis that the selling price of USD 100 was not determined with reference to currency exchange rates. It argued that this amount reflected the perceived value of the loan, which represented something other than a gain or loss on a foreign exchange transaction to which section 24I applied. The Commissioner adjusted Telkom's taxable income to reflect an exchange gain on the loan.

The Tax Court rejected Telkom's argument.

Judgment and analysis

In the SCA Swain JA ruled that:

- ▶ The term ruling exchange rate should be interpreted in the context of section 24I as whole. In this context, rate refers to the value of a particular currency, not a broader discount rate. Currency exchange rates played no role in determining the consideration for the loan of USD 100.
- ▶ Section 24I dealt with gains or losses caused by foreign exchange fluctuations, not other business losses that result from the deterioration of the quality of the loan.
- ▶ The Commissioner's interpretation of section 24I accorded with its purpose and was neither unjust, inequitable or unreasonable. Since there was no ambiguity in the interpretation of that section 24I, the *contra fiscum* rule did not apply.

It is submitted that the principle that taxpayers who dispose of loans denominated in a foreign currency at a loss should take from this judgment is that a distinction must be made between losses suffered as a result of fluctuation in currency exchange rates and those that reflect other circumstances (such as the deterioration in the value of the loan). Section 24I only applies the former, while other provisions (for example, paragraph 56 of the Eighth Schedule) govern the latter.

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