

## Taxability of Local Interest in the Hands of Non-Residents

Currently, local interest income which is received by or accrues to a non resident entity or natural person during a tax year is exempt from South African normal income tax, unless

- at any time during the year in question such entity or natural person carried on business through a permanent establishment in South Africa, or
- in the case of a natural person, he/she was physically present in South Africa for a period exceeding 183 days in aggregate during that year.

With effect from 1 March 2011, it is proposed in draft legislation, that this exemption will only apply in respect of interest from (inter alia) the following sources.

- Government debt instruments
- Listed debt instruments (i.e. on JSE)
- Bank interest (including Reserve Bank)
- Interest on a debt due by a non-resident to another non-resident
- On the purchase price of any goods imported into or exported from South Africa
- Any other debt owed by a non-resident
- Collective investment schemes (i.e. unit trust portfolios)

It is not clear whether such interest income earned by a local trust and awarded to a non-resident trust beneficiary will also be entitled to the exemption. We would argue that the exemption does apply as the conduit pipe principle ensures that trust income awarded to a beneficiary retains its character and nature.

It is clear however that other forms of interest income will no longer form part of tax exempt interest e.g.

- Interest on loans to local companies and close corporations.
- Interest on loans to local natural persons.

With effect from 1 March 2011, all local interest income (other than from sources listed above) will be subject to normal South African income tax. For foreign entities the tax rate would presumably be a flat 33%. For natural persons, the normal tax tables will presumably apply.



How such tax will be collected is not clear. Possibly a withholding tax regime will need to be introduced.

As an example, a foreign holding company currently lends funds to its wholly owned operating subsidiary in South Africa. Until now, the interest paid (subject to certain thin capitalisation and transfer pricing rules) was deductible by the subsidiary for South African tax purposes, but the interest earned by the foreign holding company was tax exempt in South Africa. In future, such interest will be taxable in South Africa in the hands of the holding company.

Obviously, the actual tax liability of the non-resident could also be affected by a Double Tax Agreement between the two countries which might grant taxing rights only in the country of residence of the holding company.

At this stage, planning ahead needs to be considered.

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