

TAX AMENDMENT ON INTEREST CAP EFFECTIVE 01.07.19: By Jonathan Hore

Some businesses can afford to have an early Christmas following the pronouncement by the Minister of Finance & Economic Development that micro, small or medium enterprises (SMMEs) and Variable Rate Loan Stock Companies (VRLSCs) will not have their interest expenses limited for tax purposes, effective 1 July 2019. The pronouncement was made through a new piece of legislation cited as Statutory Instrument 58 of 2019 which was gazetted on 6 December 2019. This follows the enactment in December 2018 of Income Tax Amendment Act No. 38 of 2018 which limited interest deductions for companies through a rather technical formula to 30% of what is called Tax EBITDA.

The said December 2018 law limited tax deductions on all forms of interest whether from banks, shareholders or any other source. This caused a lot of debate in the business world as any excess interest above the 30% cap is added back to profits, thereby increasing tax costs. It became apparent that most corporates would be affected as financing is pivotal to the operations of businesses. Only banks and insurance companies were initially exempted from the interest capping law.

The said law was of great concern to major property developers who operate through the VRLSC vehicle as they naturally incur massive debenture interest bills due to their capital composition. It is through such vehicles that malls such as Game City and Riverwalk in Gaborone were built. Further, the SMMEs which are known as the largest employer in most economies, Botswana included, were equally concerned about the law. This then resulted in lobbying for the interest limitation to exempt SMMEs and VRLSCs, over and above banks and insurance companies. The SMMEs and VRLSCs were exempted through Income Tax Amendment Act No. 18 of 2019 (Amendment Act) which was enacted on 28 August 2019 but could only commence on issuance of a notice, which was done on 6 December 2019.

SMMEs, AS DEFINED

VRLSCs are a well-established business structure and they were already defined in the Income Tax Act and as such, there was no doubt as to who falls under that category. However, the Amendment Act defined SMMEs as companies which do not own 20% shareholding or more in another company or that have another company owning at least 20% of their shares. Put differently, SMMEs are companies which do not belong to a group of companies and their interest expenses will also not be limited. However, those companies which belong to groups (at least 20% shareholding held by corporates) will have the interest limited. Technically, all companies owned by individual shareholders will not have their interest expenditure limited. Any companies which have corporate shareholders with less than 20% shareholding will also not have to consider the interest cap. It is critical not to confuse the ordinary meaning of SMMEs with that used in the Act as even large

corporates with hundreds of millions of turnover may still qualify as SMMEs. The critical issue is the percentage of shareholding by other corporates.

THE POSITIVES

The said commencement brings a lot of relief to most SMMEs as the majority of them cannot operate without financing. As stated above, SMMEs are a critical sector of any economy as it is commonly known that they create more jobs than large corporates combined. Further, given efforts to diversify the economy away from diamonds, SMMEs play a key role in that national drive.

Whilst owners of SMMEs may afford to put smiles on their faces, their degree of relief wanes when compared to that of the VRLSC sector, which was under intense pressure from the said law than anyone else, as stated above. Since most VRLSCs are listed, they will not have to worry about possible divestment by their unitholders due to reduced shareholder returns which could have ensued had they not been exempted from the interest cap. To seal the relief, the effective date of the commencement date of the exemptions was backdated to 1 July 2019, which coincided with the commencement date of the 30% cap per the December 2018 law. Effectively, the newly exempted groups of taxpayers (SMMEs & VRLSCs) do not need to worry about interest cap and huge tax bills at all.

PRACTICAL ISSUES

Whilst the law brings in the much-needed relief, some capital-intensive sectors of the economy such as mining, manufacturing and non-VRLSC property developers need to brace themselves for interest expenses limitations and heavier tax bills. From an implementation perspective, it is yet to be seen whether the taxman accepts that the law will not be applicable if a taxpayer is in a loss situation (a negative figure) as the Tax EBITDA requires that there be taxable income (a positive figure).

The Court of Appeal held in one tax case that taxable income is a positive figure. Further, the new law is not the only one which deals with interest deductions as taxpayers are, per one section 50A of the Income Tax Act, not allowed a tax deduction where withholding tax is not paid to BURS on interest due to non-residents. These sections do not speak to each other. There is need for the taxman to clarify how these two sections will be applied, to avoid over-taxation. Lastly, only interest incurred from 1 July 2019 must be limited and this appears not to be so clear to many taxpayers, judging from recent results announcements made by most VRLSCs.