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THIN CAPITALISATION TAX RULES DON'T AFFECT SOEs

You may know that effective 1 July 2019, thin capitalisation laws were expanded to cover almost every business such that not all interest expenses are deductible for tax purposes. There however have been inconsistent application of the interest limitation provisions by some taxpayers and consultants, which have unfortunately resulted in interest limitation being applied on government owned enterprises, otherwise known as SOEs. We will analyse this misinterpretation of the law in detail below. In this article, words importing the masculine shall be deemed to include the feminine.

The background

The Income Tax Act was amended to restrict or limit loan interest deductions for tax purposes. The restriction on the said repayments is generally known as thin capitalisation rules. In other words, it's a restriction placed on entities that are predominantly financed through loans, with little capital and reserves.

Having clarified the essence of thin capitalisations or interest limitation rules, let us now have look at what the law says and establish why such rules do not apply to government owned entities.

The law

The Act now prescribes that the net interest expense of entities should not exceed the 30% of Tax EBIDA, otherwise the excess interest is denied and added back to profits. For the avoidance of doubt, tax EBITDA is technically the total of taxable income, net interest expense (interest expense less interest income), depreciation and amortisation. Further, the Act provides that the said interest limitation applies on loan granted between two or more associated companies, whether resident or non-resident in which one company has at least 20% of its shares owned by another company.

As highlighted above, it is imperative to note that the law places a restriction on the claiming of interest between associated companies where the transacting entity is owned at least 20% by another company. Consequently, this technically means that in order for the thin capitalisation rules i.e., interest limitation, to apply on government owned entities, the government itself should be regarded as a company for tax purposes.

Enter government

The Income Tax Act provides that the term "company includes any body corporate; any specified corporation; collective investment undertaking; and any association or society whether incorporated or registered or not, but does not include a partnership; any charitable, religious or educational institution or a trust established for public purposes." Consequently, a government falls outside the ambit of a company as defined by the Act. From the above definition of company, it is apparent that government doesn't fall under the ambit of company as defined. This is so as it is not a body corporate or an association, among other terms mentioned in the definition. Technically, this means government owned entities are not bound by the interest limitation provisions and as such, they can claim the interest expense in full. One way to look at it is that government owned entities do not belong to a group of companies if their sole shareholder is the Government of Botswana and as such, the interest limitation rules do not apply to them.

Conclusion

Interest limitation rules will still apply to SOEs which have the government as one of their shareholders and the SOE belongs to a group of companies where one company owns at least 20% shareholding in another company. As stated above, where an SOE has its sole shareholder as the government, we don’t even open our mouths to talk about interest limitation; it’s unthinkable!

Well folks, we hope that was insightful. As us the two Yours Truly say goodbye, remember to pay to Caesar what belongs to him. If you want to join our free Tax WhatsApp group, send us a text on the cell number below.