

# Tax & Exchange Control

## ALERT

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#### Adjusting a definition

The circular reference error is a scourge that has plagued many tax practitioners' spreadsheets since the amendment to section 20 of the Income Tax Act 58 of 1962 (ITA) at the end of 2021. This amended section 20 dictates that it can only be applied once all other sections of the ITA have been applied. However, a similar provision appears in the definition of "*adjusted taxable income*" in section 23M, the result being a conflict between the two sections and the question of which to apply first?



## Adjusting a definition

The circular reference error is a scourge that has plagued many tax practitioners' spreadsheets since the amendment to section 20 of the Income Tax Act 58 of 1962 (ITA) at the end of 2021. This amended section 20 dictates that it can only be applied once all other sections of the ITA have been applied.

However, a similar provision appears in the definition of "*adjusted taxable income*" in section 23M, the result being a conflict between the two sections and the question of which to apply first?

Section 23M of the ITA limits the deductibility of interest expenditure by a company where (i) that interest is paid to another company within the same group or in a controlling relationship (as defined), and (ii) the interest will not be subject to tax in South Africa. This limitation, however, is calculated with reference to a percentage of that company's taxable income as adjusted in line with the definition of "*adjusted taxable income*".

Therefore, for the application of section 23M, it is imperative to calculate a company's "*adjusted taxable income*" so that the correct deduction can be claimed. This calculation requires a company's taxable income to be calculated first. Taxable income, however, results from the set-off of income with assessed losses, which losses in turn can now only be used to the extent

permitted in section 20. Therefore, the use of assessed losses under section 20 depends on the deduction allowable under section 23M, while the deduction allowable under section 23M depends on the extent to which assessed losses can be used under section 20. If trying to apply the two at the same time, the circular reference error cited above will be the result.

In its most recent Taxation Laws Amendment Bill, published on 31 July 2023, National Treasury has sought to solve the conundrum. It has proposed that the definition of "*adjusted taxable income*" will now contain the proviso that it must be calculated using taxable income determined before applying section 23M and before "*setting off any balance of assessed loss*". This means that section 23M will need to be applied before section 20.

Arguably, this is good news for taxpayers. As section 20 limits the use of assessed losses, while section 23M limits the deductibility of interest (calculated as a portion of taxable income), this will likely mean that more interest may be deducted under section 23M, while taxable income will likely be less, resulting in a lesser portion of an accumulated assessed loss being utilised.

The potential knock-on effect will be less tax payable in a current year of assessment, and the preservation of assessed losses to be carried forward into following years of assessment.

**Nicholas Carroll**

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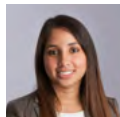
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Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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