



# Tax Alert

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## SARB scrapping interest rate caps

**The South African Reserve Bank's ("SARB") scrapping of the caps on interest rates on inbound borrowings throws into sharper relief the need for cross-border loans from related parties to be tested against the arm's length principle.**

Previously, the SARB capped the interest on related party loans to prime for Rand denominated loans or foreign base rate for foreign denominated loans. In South Africa's recent Budget Speech, the Minister of Finance indicated that these caps would be abolished and going forward, the loans would need to be market related and reported to the SARB.

This means that transfer pricing rules will hold even greater sway requiring the interest rate to be arm's length. Until now, if there was any suggestion that the interest rate was too low, the lender could assert that the Central Bank / SARB limited the interest rate and thus it remains compliant with the lender's transfer pricing rules. That defence will no longer be valid once the scrapping of the interest rate caps comes into effect. So, if the existing rates appear to be below arm's length, the lender may be in breach of their country's transfer pricing rules. Accordingly, where there are foreign inbound loans from foreign related parties, companies should assess whether the arm's length rate is higher than the current rate on the loan if that rate was merely set at the SARB limit.





From the SA borrower's perspective, of course, the test is that the interest rate should not be too high.

As the SARB circular directs Authorised Dealers to refer to SARS' Interpretation Note 127 ("IN127"), it is expected that the Authorised Dealer must satisfy themselves that the positions adopted in IN127 are complied with. The Authorised Dealer may thus want to see the transfer pricing policy document regarding the loan. From the borrower's perspective, there would have to be evidence proving that both the interest rate and the amount of debt fall within the arm's length parameters. IN127 explains SARS's view on how to test both the interest and the amount of debt to ensure they are not excessive.

In order to determine the arm's length interest rate, one needs to benchmark the loan against other borrowings by companies with similar credit ratings, factoring in the term of the loan, as well as its currency. Other factors to bear in mind are whether the quantum of the loan is excessive, as well as the fact that the South African prime rate is likely to be abolished, and interest rates will be calculated relative to Zaronia.

PwC South Africa has teams that specialise in the transfer pricing of debt. Please contact any of the team members listed below for further details.

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