South African Revenue Service

DRAFT BINDING GENERAL RULING (INCOME TAX)

DATE:

ACT: **INCOME TAX ACT 58 OF 1962**

SECTION: **SECTIONS 24J AND 31, AND PARAGRAPH 11(1) OF THE EIGHTH SCHEDULE**

SUBJECT: **TAX CONSIDERATIONS OF THE TRANSITION FROM JIBAR TO ZARONIA**

Preamble

For the purposes of this ruling –

- "**adjustment spread**'' means, in relation to ZARONIA, a spread (which may be positive, negative or zero) that is applied to the replacement benchmark to reduce or eliminate, to the extent reasonably practicable in the relevant circumstances, any economic prejudice or benefit, as applicable, to the parties to a contract, resulting from the replacement of the discontinued benchmark with the replacement benchmark;
- **"BGR"** means a binding general ruling issued under section 89 of the Tax Administration Act 28 of 2011;
- **"CAS"** means credit adjustment spread or credit adjustment;
- **"Eighth Schedule"** means the Eighth Schedule to the Act;
- "**JIBAR**" means the Johannesburg Interbank Average Rate;
- "**legacy contract**" means a contract, financial agreement, or financial instrument that, by its terms, uses JIBAR. Depending on the context, "legacy instrument" or "legacy arrangement" is used and has the same meaning as "legacy contract";
- "**paragraph**" means a paragraph of the Eighth Schedule to the Act;
- "**SARB**" means South African Reserve Bank;
- "**section**" means a section of the Act;
- **"the Act"** means the Income Tax Act 58 of 1962;
- "**ZARONIA**" means the South African Rand Overnight Index Average.

1. Purpose

This BGR clarifies the key tax implications of the transition from JIBAR to ZARONIA, a new official benchmark rate, which directly impacts legacy contracts referencing JIBAR.

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2. Background

The SARB's market reform to discontinue JIBAR and replace it with ZARONIA means that affected taxpayers can no longer rely on JIBAR in their financial contracts and must transition to ZARONIA. Consequently, the terms of legacy contracts using JIBAR may need to be amended to reference ZARONIA.

However, ZARONIA does not include a built-in credit premium or term premium and is generally lower than JIBAR. To address this difference and ensure economic equivalence, a CAS will be applied. The SARB-endorsed CAS is one mechanism to preserve economic equivalence between counterparties. In some circumstances, parties may agree on a negotiated CAS or another commercially supportable adjustment mechanism that more accurately preserves their economic position than the SARB-endorsed CAS. Any such adjustment must be negotiated at arm's length to maintain economic equivalence and avoid any material difference in economic value. A credit adjustment is added to the legacy contract to compensate investors and lenders for credit risk and preserve value during the transition. Therefore, a change in the benchmark reference rate plus the relevant CAS is not regarded by SARB and market participants as a substantial modification or derecognition of legacy contracts. New contracts are generally unaffected, as the credit adjustment spread is negotiated at inception.

3. Discussion

3.1 Additional payments

If the CAS has equalised the difference resulting from the change in rates, there should be no material differences, and no further payments should be required. If top-up or additional payments are nonetheless made, they will be assessed under ordinary principles of the Act, depending on the nature of the instrument (interest-bearing arrangement, derivative, or lease), the nature of the payment, and the specific facts and circumstances of the applicable contract and taxpayer.

3.2 Interest-bearing arrangements – section 24J

Section 24J governs the tax treatment of the incurral and accrual of interest on instruments, and affected legacy contracts could be subject to this provision. It also applies to the adjusted gain or adjusted loss on the transfer of an instrument. A "disposal" is a form of "transfer" of an instrument for the purposes of section 24J. However, the amendment of a legacy instrument on market-standard terms in response to the requirements of the rate reform is not considered a "disposal" for tax purposes and will therefore not give rise to a "transfer" of a legacy instrument under section 24J.

The "yield to maturity" is the compound interest rate that equates the present value of all amounts, payable or receivable, over the term of the instrument to its initial issue or transfer price. To the extent that the redetermination of the yield to maturity, after applying CAS or another commercially supportable adjustment, maintains economic equivalence and does not result in a material transfer of economic value, the present value of all future amounts payable or receivable over the term of the legacy instrument should equal its initial value.

3.3 Capital gains tax

For the Eighth Schedule to apply, there must be a disposal of an asset, as contemplated in paragraph 11. The principle under paragraph 11 is that a person must have disposed of an asset by parting with the whole or a portion of it. While "variation"

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appears among the events listed in paragraph 11 that may give rise to a disposal, the word "variation" must be interpreted in the context of the disposal of an asset.

A variation could involve the establishment of legal title to an asset or the improvement or enhancement of an asset. However, in such events, no disposal occurs because nothing has been disposed of.[1]

To the extent that the rights of the holder of the legacy instrument are not changed to constitute a variation, conversion, or exchange as contemplated in the Eighth Schedule, there is no disposal of the legacy instrument.

If parties agree to amend the terms of a legacy contract in response to the withdrawal of a reference rate, it is expected that the amendment will not be treated as a variation of the legacy contract under the Eighth Schedule, and it will continue to be the same contract.

3.4 Transfer pricing – section 31

For legacy arrangements that were concluded at arm's length, any change in the reference rate to account for the rate reform from JIBAR to ZARONIA, which remains economically equivalent, should continue to be an arm's length arrangement. Therefore, to the extent that a contract or agreement is amended solely for the purpose of responding to rate reform, the parties to a contract that references a change from JIBAR to ZARONIA would be acting at arm's length in response to the benchmark reform, and the amendment does not give rise to a tax benefit to any of the parties to the contract or agreement.

4. Ruling

To the extent that the amendment of a legacy contract preserves economic equivalence and does not result in a material transfer of value –

- there is no transfer of the instrument for purposes of section 24J;
- there is no disposal of the legacy contract for purposes of the Eighth Schedule; and
- if the contract was concluded at arm's length and is amended only to reflect the change in rates as a result of the rate reform, the amendment does not give rise to a tax benefit under section 31.

This ruling constitutes a BGR issued under section 89 of the Tax Administration Act 28 of 2011.

5. Period for which this ruling is valid

This BGR applies with effect from date of issue of the final BGR and is valid until it is withdrawn, amended, or the relevant legislation is amended.

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SOUTH AFRICAN REVENUE SERVICE

[1] For more detail, see the *Comprehensive Guide to Capital Gains Tax*.

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