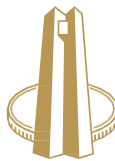


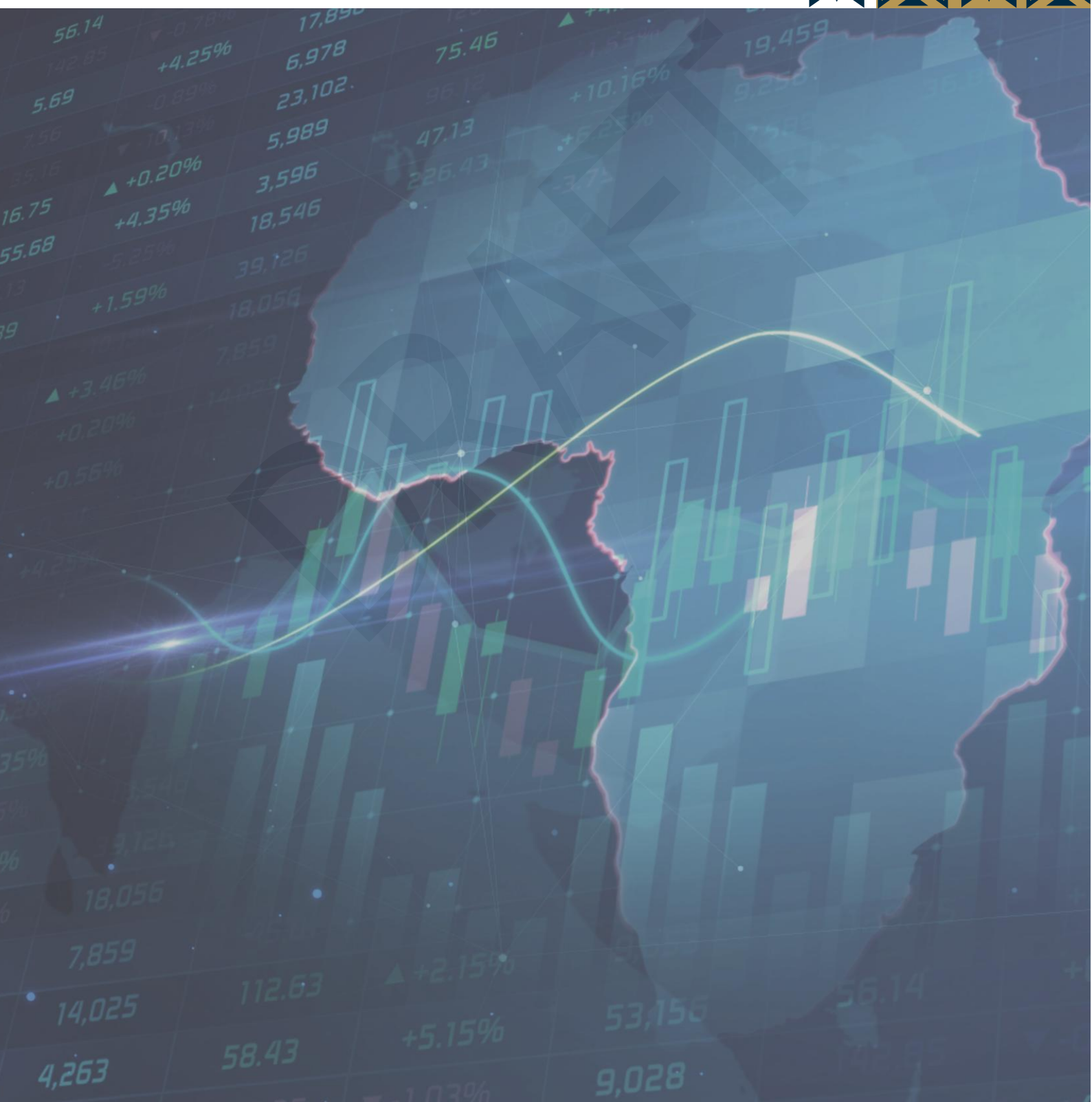
Tax considerations of transitioning from Jibar to ZARONIA for legacy contracts

Prepared by

**The Market Practitioners Group's
Accounting and Tax Workstream**



SOUTH AFRICAN RESERVE BANK



Contents

List of acronyms	3
1. Introduction	4
2. Background	4
3. Approach	6
4. Impacted taxpayers	6
5. Accounting treatment of rate reform	7
5.1 Taxpayers applying IFRS 9	7
5.1.1 Change in contractual terms under IFRS 9	7
5.1.2 Modification and rate reform.....	7
5.1.3 International Accounting Standards Board guidance	8
5.2 Taxpayers not applying IFRS 9	8
6. Fallback spread	9
7. Capital gains tax – whether there is a disposal event	9
7.1 Does a modification of a legacy contract result in a disposal?	9
8. Additional payments	12
9. Specific classes of financial instruments	12
9.1 Interest-bearing arrangements: Section 24J	12
9.1.1 Transfer of an interest-bearing arrangement	12
9.1.2 Impact of rate reform when interest is calculated based on accrual amounts for the accrual period	12
9.1.3 Impact of rate reform when interest is calculated in accordance with the alternative method	13
9.1.4 Other considerations	14
9.2 Leases	14
9.3 Derivatives and other financial instruments measured at fair value	15
9.3.1 Taxpayers that are covered persons	15
9.3.2 Taxpayers that are not covered persons	15
10. Other tax sections	16
10.1 Specific interest limitation rules: Section 23M, 23N	16
10.2 Section 8FA – hybrid interest	16
11. Transition costs (section 11(a) and section 11(c))	16
12. International tax aspects	17

12.1	Transfer pricing and documentation.....	17
12.2	Interest withholding tax.....	18
13.	Value-added tax.....	18
14.	Recommendations.....	19

List of acronyms

BGR	Binding General Ruling
CAS	credit adjustment spread
CGT	capital gains tax
Euribor	Euro Interbank Offered Rate
FVTPL	fair value through profit and loss
HMRC	UK tax agency His Majesty's Revenue and Customs
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IBOR	interbank offered rates
IFRS	International Financial Reporting Standards
ISDA	International Swaps and Derivatives Association
ITA	Income Tax Act 58 of 1962, as amended
Jibar	Johannesburg Interbank Average Rate
Libor	London Interbank Offered Rate
LMA	Loan Market Association
MPG	Market Practitioners Group
SARB	South African Reserve Bank
SARS	South African Revenue Service
STBM	standard turnover-based method
Tibor	Tokyo Interbank Offered Rate
UK	United Kingdom
VAT	value-added tax
ZARONIA	South African Overnight Index Average

1. Introduction

The South African Reserve Bank (SARB) has been engaging market participants on the need to reform local interest rate benchmarks. To provide the market with enough time for the transition, the SARB started publishing the South African Rand Overnight Index Average (ZARONIA) for observation in November 2022. This allowed market participants to monitor its performance and assess the impact of adopting it as a replacement for the Johannesburg Interbank Average Rate (Jibar) up until the formal endorsement of ZARONIA in November 2023.

Market participants are now preparing for the final phase of the transition, which may introduce additional complexities and challenges. Over time, Jibar has faced criticism due to weaknesses inherent in its calculation methodology. Notably, Jibar is calculated based on expert judgement rather than actual transactions. This makes Jibar potentially susceptible to manipulation and losing its representativeness.

Unlike Jibar, ZARONIA is calculated based on actual overnight transactions in the wholesale funds market, accurately reflecting the cost of overnight borrowing. This representativeness is a desirable and essential characteristic of a benchmark interest rate. This makes it comparable to the Euro Short-Term Rate (€STR) and the Sterling Overnight Index Average (SONIA). The goal of the benchmark reform is to instill greater confidence in the financial markets.

ZARONIA is considered transparent and complies with international standards for risk-free rates, making it the preferred reference rate for rand-denominated financial contracts.

The purpose of this document is to:

- Assess the potential tax consequences stemming from the reference rate reform, focusing specifically on legacy contracts that currently reference Jibar and will need to transition to ZARONIA.
- Provide a technical foundation for engagement with the South African Revenue Service (SARS) and National Treasury, aiming to encourage the issuance of formal guidance – such as a tax guide, Interpretation Note or Binding General Ruling – to assist taxpayers in navigating the tax implications of the reference rate reform and promote tax certainty.

For the purposes of this document ‘**legacy contract**’ refers to an agreement that must be amended due to the reference rate reform and was entered into before the adoption of ZARONIA. In contrast, a ‘**new contract**’ is an agreement that references ZARONIA and does not require amendment due to the reform.

Unless otherwise indicated, references to sections in this document pertain to sections of the Income Tax Act 58 of 1962, as amended (ITA) and references to paragraphs are to the Eighth Schedule to the ITA.

2. Background

Reference rates are commonly used to measure financial instruments, such as derivatives and interest-bearing arrangements. These rates, also called benchmark rates, are further used to discount provisions in financial reporting and for risk measurement or estimation. Globally, reference rates are being reformed due to concerns about reliability and robustness of existing interbank benchmarks. The Financial Stability Board published its final report on this matter in March 2014, recommending enhanced governance and oversight to strengthen major global reference rates, such as the London Interbank Offered Rate (Libor), Euro Interbank Offered Rate (Euribor) and Tokyo Interbank Offered Rate (Tibor) or to establish alternatives to existing benchmarks. The report

does not specifically mention the South African rand, nor does it recommend a reference rate for South Africa.

The SARB initiated a programme to reform domestic reference rates and mandated the Market Practitioners Group (MPG) to facilitate decision making on alternative reference rates and coordinate a market-wide transition away from Jibar. The MPG recommends adopting ZARONIA, an overnight risk-free rate, to replace the current term reference rate, Jibar, a term rate with a risk premium (i.e. a credit premium and term premium).

According to the SARB's official announcement, the publication of Jibar will cease on 31 December 2026. As such, businesses are required to transition affected financial instruments from referencing Jibar to ZARONIA or other suitable alternative reference rates.

Changes to financial instruments can occur where amendments are made to either (i) replace the referenced benchmark rate; (ii) introduce fallback provisions; or (iii) make incidental amendments resulting from the benchmark replacement.

Fallback provisions would determine how the contract should operate if the designated benchmark rate is permanently discontinued, becomes unrepresentative or can no longer be used.

An example of an incidental amendment related to benchmark replacement is where a contractual amendment is made to the applicable interest margin to better align the risk-free replacement rate with the discontinued rate.

Contracts that do not include fallback language will require amendment because of the reference rate reform.

It is expected that the changes to contracts referencing Jibar, in response to the reference rate reform, will be relatively minor and that the economics of the transaction between the parties will be maintained.

This is expected to be the case where a business does no more than change its contracts in a demonstrably market standard way. For example, making amendments by adopting language, reference rates, conventions, or guidance from organisations such as the International Swaps and Derivatives Association (ISDA) or Loan Market Association (LMA) would be considered market standard when amending legacy contracts and adopting alternative reference rates (fallback language). Market standard would also include incorporating changes based on recommendations from the MPG and SARB.

3. Approach

Our approach was to:

- Review the accounting guidance paper.
- Examine guidance published by the United Kingdom (UK) tax agency His Majesty's Revenue and Customs (HMRC) regarding the tax implications for businesses arising from the withdrawal of Libor and other benchmark rate reforms (published 12 January 2021).
- Assess financial instruments that use reference rates, along with the relevant tax principles for the variation or amendment of these instruments.
- Evaluate the tax consequences for taxpayers resulting from the reference rate reform, including the transition of existing Jibar deals to ZARONIA and the structuring of new deals referencing ZARONIA.

4. Impacted taxpayers

Both issuers and holders of financial instruments referencing Jibar are impacted. As a result, reference rate reform is widespread across multiple industries and has the potential to impact a broad range of taxpayers, including both corporates and individuals.

While issuers of financial instruments are typically corporate taxpayers, individual taxpayers can also be impacted. For instance, individuals may still hold financial instruments that reference Jibar.

The impact of the rate reform is therefore not limited to a specific industry or taxpayer class. However, it will naturally be more material for taxpayers in the financial services industry, as issuing and holding financial instruments are core parts of their business.

From a tax perspective, corporate taxpayers should carefully consider how their Jibar-linked financial instruments are classified and measured, and whether the accounting treatment of these instruments aligns with the tax treatment. For example, banks registered under the Banks Act 94 of 1990 and authorised users as defined in section 1 of the Financial Markets Act 19 of 2012, generally do not need to apply different tax treatments from those adopted under the International Financial Reporting Standards (IFRS) for financial instruments measured at fair value through profit and loss (FVTPL) under IFRS 9 and that fall within the scope of section 24JB.

References to financial instruments also include leasing and other contracts as well as money market instruments, loans, bonds and derivatives, unless the context indicates otherwise.

5. Accounting treatment of rate reform

5.1 Taxpayers applying IFRS 9

5.1.1 Change in contractual terms under IFRS 9

IFRS 9, the accounting standard applicable to financial instruments, is used by most corporate taxpayers in South Africa.

IFRS 9 outlines the accounting treatment for modifications of financial instruments. These modifications apply only to instruments classified and measured at amortised cost. If the instrument is classified at fair value, modifications are treated as a fair value movement through profit or loss.

IFRS 9 defines a *modification* as an instance where the “contractual cash flows of a financial instrument are renegotiated or otherwise modified, and the renegotiation or modification does not result in derecognition of that financial asset”.

A modification typically occurs when the contract's terms (e.g. the interest rate, repayment schedule, or other key terms) are altered. A substantial modification occurs when the renegotiation or modification of contractual cash flows is significant enough that the original asset's cash flows expire and a new asset is created. Substantial modifications result in derecognition of the original (i.e. existing) financial instrument and the recognition of a new (i.e. modified) financial instrument. Any difference in the carrying value of the instrument is derecognised and the new instrument is recognised in profit and loss.

This means the original financial instrument is extinguished and a new instrument is recognised, meaning the original asset or liability is treated as disposed of, potentially triggering a disposal event for tax purposes.

- A substantial modification could include the following:
 - Significant changes to the principal amount, interest rate, maturity date, or other key terms that affect the financial structure.
 - If the modification involves changes other than a rate change (e.g. changes in the principal amount, repayment terms, or covenants), it may also be considered substantial.

In the case of a substantial modification, a *modification gain or loss* is calculated as the amount arising from adjusting the gross carrying amount of a financial asset to reflect the renegotiated or modified cash flows. The entity recalculates the gross carrying amount of a financial asset as the present value of the estimated future cash flows through the expected life of the modified asset that are discounted at the financial asset's original effective interest rate (or the original credit-adjusted effective interest rate for purchased or originated credit impaired assets).

If the modification is not substantial, it will be treated as a continuation of the existing financial liability or asset and any changes in contractual cash flows would impact the effective interest rate of the financial instrument as calculated under IFRS 9.

5.1.2 Modification and rate reform

A change to a contract resulting from the benchmark interest rate reform by regulatory authorities usually means a change in the base interest rate and adding a margin spread on a financial instrument. As noted above, this change could occur by amending the existing contract, entering

a new contract, or activating a fallback clause (terms in the original contract that enables switching to a new benchmark interest rate).

5.1.3 International Accounting Standards Board guidance

The International Accounting Standards Board (IASB) addressed the accounting impact of rate reforms in two phases. Phase 1 amendments provide temporary relief from applying specific hedge accounting requirements for hedging relationships directly affected by rate reform. Phase 2 amendments address issues that may affect financial reporting after an interest rate benchmark is replaced by its alternative benchmark rate.

Phase 2 includes certain relief measures. The key reliefs are the following:

- Changes in contractual cash flows

When changing the basis for determining contractual cash flows for financial assets and liabilities (including lease liabilities), the relief has the effect that the changes that are required as a direct consequence of rate reform and are economically equivalent, will not result in an immediate gain or loss in the income statement. The amendments to IFRS 9 and 16 provide a practical expedient for accounting for these changes. As a practical expedient, an entity is permitted to account for the changes to cash flows that relate directly to the rate reform, simply as a change to the floating interest rate (for example, the effective interest rate is updated to reflect the change in an interest rate benchmark from Jibar to a risk-free rate without adjusting the carrying amount). This expedient applies when changes to cash flows required by reform are necessary as a direct consequence of rate reform and the new basis for determining the contractual cash flows is economically equivalent to the previous basis. As a result of the practical expedient discussed above, the modification to the contractual cash flows will be classified as non-substantial as opposed to a substantial modification. This means that the instrument is not required to be derecognised and there is no immediate income statement impact.

- Hedge accounting

The hedge accounting relief will allow most International Accounting Standards (IAS) 39 or IFRS 9 hedge relationships that are directly affected by rate reform to continue. However, additional ineffectiveness might need to be recorded.

5.2 Taxpayers not applying IFRS 9

There may be parties to legacy contracts that do not apply IFRS 9 in preparing their annual financial statements, or do not prepare annual financial statements at all. While the accounting treatment may help in understanding the nature of modifications to legacy contracts and their impact on net profit before tax, tax rules and principles can operate independently from the accounting treatment. Except for certain cases where tax legislation specifically allows for the adoption of accounting principles for specific classes of taxpayers, such as section 24JB, or under the alternative method under section 24J, the tax principles detailed in the sections below will apply equally to all classes of taxpayers.

6. Fallback spread

Due to its calculation methodology and the underlying components, among other factors, ZARONIA is generally lower than Jibar. Unlike Jibar, which includes built-in credit and term premium components, ZARONIA is a near risk-free rate. To compensate for the additional yield that investors may require for taking on credit risk, credit adjustments (i.e. risk premium) on existing contracts will be needed to account for the differences between ZARONIA and Jibar during the transition.

The credit adjustment is therefore intended to ensure that economic equivalence is achieved during the transition. The Transition, Coordination and Planning Workstream has recommended that ISDA's standardised methodology for calculating a fallback spread based on a five-year median may be used. Adopting this methodology would represent a market standard approach for amending legacy contracts. The SARB has endorsed a credit adjustment spread (CAS) methodology to transition instruments from Jibar to ZARONIA to minimise value transfer. Therefore, to equalise the difference between Jibar and ZARONIA, a CAS will be applied. The CAS calculation is an industry-wide applicable number and will be visible to the public via platforms such as Bloomberg.

Importantly, although a contract may be repriced with the addition of a CAS due to rate reform, the intention is not to leave any party in a significantly different economic position. Therefore, it is likely that the present value of the instrument before and after the base rate change will remain the same. Consequently, where parties have equalised the difference between Jibar and ZARONIA using the SARB-endorsed CAS, no additional amendments to the contract should be required for transition purposes. It is not expected that any further payments or steps will need to be taken by the parties to compensate for a transfer of value as a result of the transition, as each party should already be in an economically equivalent position.

Therefore, a change in reference rate, with the addition of a credit adjustment to leave each party in an economically equivalent position and no other contractual changes, should not result in a substantial modification or derecognition, as there is expected to be no change in the present value of the future cash flows.

New contracts will typically not be affected by credit adjustments, as this can be negotiated by both parties at the inception of the new contracts.

7. Capital gains tax – whether there is a disposal event

7.1 Does a modification of a legacy contract result in a disposal?

The definition of an 'asset' under the Eighth Schedule is broad, covering any right or interest in property, whether movable, immovable, tangible or intangible. For a loan instrument, the lender's right to receive interest qualifies as an asset for capital gains tax (CGT) purposes. Various court cases have established principles to support this. Watermeyer CJ noted in *CIR v Estate CP Crewe & another*¹ that "[o]ne would expect that when the estate of a person is described as consisting of property, what is meant by property is all rights vested in him which have a pecuniary or economic value. Such rights can conveniently be referred to as proprietary rights and they include *jura in rem*, real rights such as rights of ownership in both immovable and movable property, and *jura in personam* such as debts and rights of action". The court in *Butcher Bros*² held that rights or

¹ 1943 AD 656, 12 SATC 344 at 352.

² *Commissioner for Inland Revenue v Butcher Bros (Pty) Ltd* 1945 AD 301; 13 SATC 21.

interests that can be measured in monetary terms, such as contractual rights, qualify as assets. This principle was later reinforced in the *Brummeria Renaissance* case,³ where the court confirmed that the right to receive interest, though intangible, holds quantifiable value and therefore qualifies as an asset. However, the specific value of the asset must be determined based on the circumstances of each arrangement.

When there is a change in the contractual terms or cash flows of financial instruments, such as an amendment of a reference rate, existing tax principles should be applied to determine whether the contractual amendments could result in a 'disposal' for tax purposes.

Under para 11(1) of the Eighth Schedule to the ITA, a disposal is any event, act, forbearance, or operation of law that results in the creation, *variation*, transfer, discharge, or extinction of an asset.

A disposal event for tax purposes typically occurs when a financial asset is disposed of, extinguished, or transferred. It should therefore be considered whether a modification due to rate reform gives rise to a disposal of the financial instrument for tax purposes.

The key test for determining if a disposal event has occurred is whether the modification leads to a new financial instrument or a new contractual relationship, effectively extinguishing the original financial instrument.

A key issue is whether the transition from Jibar to ZARONIA constitutes a 'variation' or 'discharge' under the Eighth Schedule that triggers a disposal.

The SARS Comprehensive Guide to Capital Gains Tax Issue 9 (p. 89) states that while a variation is included in the events listed in paragraph 11 of the Eighth Schedule to the ITA that may give rise to a disposal, "[t]he word 'variation' must be interpreted in the context of the disposal of an asset. The principle underlying paragraph 11 is that a person must have disposed of an asset in the sense of having parted with the whole or a portion of it". This principle is reflected in the events listed in items (a) to (g) of para 11(1). A variation could, of course, involve the establishment of legal title to an asset or the improvement or enhancement of an asset. However, such events are not disposals because:

- nothing has been disposed of – in fact, something additional has been acquired; and
- costs associated with such variations are included in the base cost of an asset under para 20.

The question therefore is whether there is a difference between the rights that the holder of a loan instrument has before and after the conversion of the rate on the loans from Jibar to ZARONIA that could be akin to "having parted with the whole or a portion of it". If there is no difference, or if there is no substantive difference or change in the rights attached, there will be no 'disposal' for CGT purposes.

In many cases it is possible to ensure that the rights of the holder of the loan instrument are not changed to such a degree that it would constitute a variation, conversion, or exchange as contemplated by the Eighth Schedule. This is usually the intention of most taxpayers in instances of market standard rate reform. Where the taxpayer has simply varied its financial instruments to transition in this manner, the transition would not lead to a disposal, as the lender retains the substantive right to receive interest, even if under altered terms.

³ *Brummeria Renaissance (Pty) Ltd and Others* (391/06) [2007] ZASCA 99; [2007] 4 All SA 1338.

However, it would be relevant to consider the intention of the parties regarding the modifications or changes to the contract. In ITC 1719,⁴ Erasmus J emphasised that the determination of a person's intention requires more than a superficial assessment and that the intention of a taxpayer must "be determined not on the bare bones of the relevant transactions, but on the conspectus of all the relevant facts and attendant circumstances". The intention of the parties, and how this is reflected in the legal documents, will be significant factors in determining whether the changes legally constitute an amendment to an existing financial instrument, or the redemption and replacement of an existing financial instrument with a new one.

It should be accepted that if the modification of the contract does not go beyond the transitional adjustments in a market standard manner – meaning it is not substantial enough to alter the economic characteristics of the contract – the change should not constitute a disposal of an asset for tax purposes. This approach is consistent with the fact that a variation to accommodate a rate reform in a market standard manner would not give rise to a substantial modification for accounting purposes where the practical expedient applies. The practical expedient is allowed when changes to cash flows required by reform are necessary as a direct consequence of rate reform and the new basis for determining the contractual cash flows is economically equivalent to the previous basis.

While a change in interest rate due to a change in reference rate alone should not result in a disposal for tax purposes, taxpayers may go beyond what is required for rate reform. For example, a change in the terms of a financial instrument that also includes changes to other key terms could result in a disposal event if the modification or variation is substantial enough to alter the economic characteristics of the asset, thus resulting in the cancellation of the original debt and the creation of a new debt (i.e. novation). In *Tauber v Von Abo*,⁵ Van Rensburg J described novation as follows: "Novation can be described as the replacing of an existing obligation by a new one, the existing obligation being **discharged** by the new obligation" (emphasis added). Where a disposal event has in fact occurred, existing tax principles should be applied to determine the tax consequences. It is worth noting, however, that the scope of this paper does not extend to a scenario where taxpayers go beyond what is required to account for the rate reform.

In summary, where the parties agree to change the terms of an instrument to respond to the withdrawal of a reference rate, it is expected that SARS would not view this as a variation of the existing instrument for CGT purposes and the amended contract should be regarded as the same contract entered into at the same time as the original one. This would apply, for example, where the parties agree to replace Jibar with ZARONIA, regardless of whether the spread on the instrument is amended via the application of the CAS, to ensure that the economics of the transaction remain the same.

The adoption of market standard methods and incorporation of market standard guidance is expected to provide sufficient evidence of the intention of the parties to amend legacy contracts to address the rate reform.

⁴ (2001) 64 SATC 73 (SEC) at 76.

⁵ [1984] 4 All SA 563 (E).

8. Additional payments

As noted above, when parties have equalised the difference between Jibar and ZARONIA using the SARB-endorsed CAS, no additional amendments to the contract should be necessary for the transition. It is therefore not expected that any further payments or actions will be required to compensate either party for a transfer of value resulting from the transition, as both parties should already be in an economically equivalent position.

However, if parties, after applying the CAS, agree that one party is liable for an additional payment to the counterparty (whether as a one-off or a series of payments), this would fall outside the scope of standard market practice for the Jibar transition. Such arrangements may trigger additional tax implications that should be considered based on the facts of each case.

In these instances, top-ups or additional payments (whether made as a one-off or at intervals) supplementary to changes in the interest rate, will need to be assessed in accordance with the ITA principles. The nature of the relevant instrument(s) will determine which sections of the ITA apply. In other words, the applicable sections of the ITA will depend on the type of financial instrument (such as interest bearing arrangements, derivative instruments, or leases), the nature of the additional payments and the taxpayer's factual circumstances.

9. Specific classes of financial instruments

9.1 Interest-bearing arrangements: Section 24J

Interest-bearing arrangements and the tax principles of incurral and accrual of interest are addressed in section 24J of the ITA. Section 24J covers 'instruments', which include interest-bearing debts, repurchase agreements, and rights or obligations to receive or pay interest. Section 24J(2) allows for the deduction of interest, while section 24J(3) provides for the inclusion of amounts in gross income. Several legacy contracts impacted by the rate reform fall within the scope of section 24J.

9.1.1 Transfer of an interest-bearing arrangement

Section 24J also applies to the 'transfer' of an instrument, which includes transferring, selling, assigning, or otherwise disposing of such an instrument by the holder or issuer, except for redemption. Based on the analysis above, a 'disposal' for tax purposes would be considered a transfer of that instrument in terms of section 24J. In this instance, section 24J applies to the calculation of gains or losses from the transfer. However, as previously noted, it is not expected that the mere amendment of a legacy contract on market standard due to rate reform will result in a 'disposal' for tax purposes. Therefore, it will also not result in the 'transfer' of a financial instrument for the purposes of section 24J.

9.1.2 Impact of rate reform when interest is calculated based on accrual amounts for the accrual period

Section 24J provides for spreading interest (and any premium or discount) over the period or term of the financial arrangement by compounding the interest over fixed accrual periods using a predetermined rate, referred to as the 'yield to maturity'. The yield to maturity method (also known as the accrual method) requires interest to be spread on a compounding accrual basis over the

instrument's term. A rate (being the yield to maturity) is calculated so that, when applied to the adjusted initial amount, it results in an amount equal to the accrual amount.

Where there are changes to the interest rate, as would be expected during rate reform, future interest payments will differ from the amounts used to calculate the original yield to maturity and a new yield to maturity will have to be redetermined. The effect of the redetermination ensures that accrual amounts already included in the taxpayer's taxable income are not affected by the changes in relation to the instrument.

In other words, where the ZARONIA rate replacing Jibar for a legacy contract is lower or higher than Jibar, this will require a redetermination of the yield to maturity and, consequently, new accrual amounts based on the revised rate. This redetermination is expected to be immaterial, considering that after applying the CAS, the ZARONIA rate is already economically equivalent to the Jibar rate for the legacy contract.

For tax purposes, this redetermination would be no different from any other required change to an instrument's interest rate within the scope of section 24J. This relative change does not create an immediate gain or loss but rather changes the amount of interest taxed or deducted over the remaining life of the instrument.

9.1.3 Impact of rate reform when interest is calculated in accordance with the alternative method

As an alternative to the yield-to-maturity method, section 24J also allows for using an alternative method to calculate interest included in gross income or deducted from the income of a taxpayer in relation to the financial assets and liabilities.

The alternative method is defined as a way to calculate interest for any class of instruments, provided it is applied consistently in accordance with IFRS for financial reporting purposes. This method must also achieve substantially the same timing of accrual and incurrence of interest as the yield to maturity method. The phrase "produces substantially the same result" is not defined but the Explanatory Memorandum accompanying the amendment noted the following: "The proposed amendment of the definition of 'alternative method' updates the reference... to the concept of 'produces substantially the same result', which is the expression that achieves a correlation of **approximately 90 percent**"⁶ (emphasis added). From an IFRS perspective, when applying the practical expedient, an entity is permitted to account for the changes to cash flows that relate directly to rate reform, simply as a change to the floating interest rate (i.e. the effective interest rate is updated to reflect the change in an interest rate benchmark from Jibar to ZARONIA without adjusting the carrying amount).

The requirements for implementing the change align with section 24J's alternative method, so the tax treatment of the class of financial instruments to which the taxpayer has applied the alternative method will follow the accounting treatment, provided the requirements, including the "produces substantially the same result" test, are satisfied.

Therefore, the change in the base rate and the applicable tax treatment of the financial instruments measured at amortised cost will be included in the effective interest rate, as calculated in terms of IFRS 9. This will reflect the economic reality and should equate to the yield to maturity as defined in section 24J. The relative change will result in no immediate gain or loss, as it does not affect the carrying amount of the financial instruments but may impact the amount of interest taxed or

⁶ National Treasury. (2017). [Explanatory Memorandum on the 2017 Taxation Laws Amendment Bill](#). Pretoria: National Treasury, p. 97, clause 43.

deducted going forward. In other words, the change will be reflected in the effective interest rate used to calculate the interest income or expense accrued in respect of the applicable instruments. Given that the overriding principle during the transition is to ensure economic equivalence, any change in the effective interest rate used to calculate the interest income or expense of the applicable instruments should be marginal.

9.1.4 Other considerations

As noted above, when parties have used the SARB-endorsed CAS to equalise the difference between Jibar and ZARONIA, no additional contract amendments should be required to ensure economic equivalence before and after the rate reform. If, however, in remote circumstances the parties agree that top-up or additional payments are required beyond the CAS, section 24J would prescribe whether such payments should be taken into account in the determination of the yield to maturity.

Where the instrument does not fall within the scope of section 24J by virtue of the application of section 24J(12), the general tax principles would be applied in determining how such amounts are taxed or deducted, as discussed in point 9 of this document.

9.2 Leases

Leases are accounted for under IFRS 16. For accounting purposes, the IASB allows a practical expedient for lessees where the lease payment is indexed to a rate that is discontinued. This expedient allows the lessee to update the discount rate to reflect the change in interest rate. However, the tax treatment of leases does not necessarily follow their accounting treatment. For example, if a lease is also an interest-bearing arrangement, section 24J will apply and the consequences of rate reform will therefore be determined in terms of section 24J. Where a lease does not fall within the scope of section 24J, actual lease payments accrued or received by the lessor are taxable as gross income or deductible for the lessee, provided the requirements of section 11(a) are met. Lease premiums within the scope of section 11(g) may also be applicable.

Where the original contract is a lease, the variation of reference rates for accounting or commercial purposes may impact the lease rental payments. For example, if the cash flows under the original instrument representing rental payments are lower due to the new reference rate, the lessee may be required to pay the lessor for the shortfall, or monthly rental payments may be renegotiated. Such renegotiated payments or contractual variations should be assessed in terms of the principles discussed above to determine whether the variation amounts to a disposal for tax purposes. If no disposal occurs for tax purposes, the amended contracts would simply continue to follow their current tax treatment, albeit with rental payments calculated using an amended benchmark rate.

For any lease premium (typically a lump sum paid at the start of the lease), the tax treatment remains unchanged. Amendments due to rate reform would likewise follow the usual rules in that the amount must be spread over the period of the lease term, including renewal periods, up to a maximum spread of 25 years.

9.3 Derivatives and other financial instruments measured at fair value

The transition from Jibar to ZARONIA for legacy contracts may affect the valuation of certain financial instruments and derivatives, as a vast number of derivative contracts reference an interest rate. The tax treatment of derivative contracts will depend on the class of taxpayer and specifically whether the taxpayer qualifies as a 'covered person' as defined in section 24JB.

9.3.1 Taxpayers that are covered persons

Section 24JB deals with the taxation of any profit or loss recognised by 'covered persons' for financial instruments measured at FVTPL under IFRS 9 and are not excluded from the application of section 24JB in terms of section 24JB(2)(a) to (c). For instruments measured at FVTPL under section 24JB and not excluded under section 24JB(2)(a) to (c), any change in fair value arising as a consequence of reference rate reform that is recorded in profit and loss for IFRS 9 purposes, the covered person will apply section 24JB, and the amount recorded in profit and loss will be included in, or deducted from, taxable income as appropriate.

For financial instruments that are not measured at FVTPL, the covered person will apply existing income tax principles, as further discussed below.

9.3.2 Taxpayers that are not covered persons

If section 24JB does not apply, the normal income tax principles for gross income, expenditure or losses, and disposals will apply for derivative and other instruments measured at FVTPL. Changes in the value of derivative contracts that are unrealised, are generally only considered for tax purposes once that instrument is eventually realised or settled, unless specific tax provisions apply. Therefore, in assessing derivative contracts, the key question is whether the variation of the legacy contract constitutes a disposal. Where a disposal has occurred, the tax consequences will be determined by standard tax principles, as with any other disposal.

Where the derivative is an 'interest rate agreement' as defined in section 24K, section 24K will regulate the accrual and incurral of amounts in respect of interest rate agreements. Once an amount has been determined as outlined in the definition of 'interest rate agreement', the timing of the accrual and incurral must be calculated on a day-to-day basis.

Where the amount is to be calculated with reference to a variable rate, it must be calculated using the variable rate applicable on the date of calculation to determine all amounts payable or receivable after that date (section 24K(3)). Consequently, rate reform will only impact section 24K with respect to the variable rate used to determine amounts payable or receivable. As noted above, this variable rate is expected to be economically equivalent before and after the rate reform.

Section 24K merely determines the timing of the accrual or incurral of amounts in relation to interest rate agreements and does not affect general tax principles, such as the source principle or the classification of amounts as capital or revenue in nature.

10. Other tax sections

10.1 Specific interest limitation rules: Section 23M, 23N

'Interest', for the purposes of sections 23M and 23N, relies in part on the definition of interest as defined in section 24J. Section 23M further expands on the definition, where relevant, to include the following:

- Amounts incurred or accrued under any interest rate agreement as defined in section 24K(1).
- Any finance cost element recognised for IFRS purposes in respect of any lease arrangement that constitutes a finance lease as defined in IFRS16.

Commercially, under certain circumstances, these amounts may be calculated using a variable rate such as Jibar. If any amounts are calculated with reference to ZARONIA, taxpayers should consider the impact on interest limitation rules under sections 23M and 23N.

10.2 Section 8FA – hybrid interest

Section 8FA applies only if there is both 'interest' and an 'instrument' as defined in section 24J. 'Hybrid interest' in relation to any debt owed by a company in terms of an instrument, means any interest where the amount of that interest is not determined by a specified rate of interest or by the time value of money. Where an instrument is subject to rate reform, this would necessarily involve a specified rate, so section 8FA should not apply. The mere presence of rate reform implies the instrument's interest is tied to a specified rate. Consequently, any change to account for changes from Jibar to ZARONIA would continue to fall outside of the scope of section 8FA, as ZARONIA is a specified rate of interest.

11. Transition costs (section 11(a) and section 11(c))

Financial institutions and companies with Jibar-linked contracts will need to reassess the terms of their contracts to integrate ZARONIA, which may result in additional costs for existing contracts.

Although most standard agreements incorporate fallback provisions to mitigate risks from market disruptions and stipulate how contracts will continue to operate where the original or designated benchmark rate is permanently discontinued, for most taxpayers the transition will result in additional costs. These may include legal fees, professional and consultation fees, technology expenses, administrative and secretarial costs, system updates and other expenses necessary for renegotiating or amending existing contracts.

Generally, the deductibility of an amount is determined according to section 11(a) read with section 23 (the so-called 'general deduction formula'). For legal costs likely to arise from responding to the benchmark reform, section 11(c) provides for the deduction of legal expenses incurred during a taxpayer's ordinary trading activities. To claim a deduction for legal expenses, these costs must not be capital in nature.

The affected institutions, borrowers and lenders that incur legal and transitional costs, would be required to evaluate the deductibility of the transitional costs, including an assessment on the question of whether legal fees incurred would not be regarded as an expense of a capital nature. It is important to note that each case depends on its specific facts. For example, in the case of a loan arrangement, the nature of the cost incurred by the taxpayer is usually determined by the purpose for which the funds were borrowed.

In the case of the rate reform, it is generally appropriate to conclude that costs incurred in relation to rate reform should not be capital in nature, as these costs are a necessary concomitant of trade. However, for the requirement to reform interest rates from a regulatory and market conduct perspective, it would not have been necessary for taxpayers to amend their contracts. These costs associated with the transition are therefore not dissimilar to costs required to comply with statutory rules or other regulatory requirements. In addition to determining the nature of the costs incurred, taxpayers should further consider the general principle in section 11 that expenditure should be actually incurred while carrying on of any trade.

12. International tax aspects

12.1 Transfer pricing and documentation

Market interest rates play a crucial role in establishing financing terms between related companies, ensuring that international transactions follow fair terms and comply with tax regulations.

Often, the fair market price of financial instruments may be based on Jibar as a reference rate. The arm's length interest rate charged on intra-group loans could be set at Jibar plus a margin.

The rate reform and implementation of the Accounting Standards Boards practical expedient require that any change in the rate is economically equivalent to the previous basis and that such basis is commercially reflective of market conditions. Consequently, for arrangements that were concluded at arm's length, any change in the reference rate from Jibar to ZARONIA that remains economically equivalent should also be at an arm's length.

In other words, in the instance where the change to the interest rate is made in terms of market standard recommended practices to achieve the economically equivalent position between the parties, there should be no tax benefit for either party that needs to be considered within the scope of section 31. This would be consistent with the practice used by HMRC when Libor was replaced with the secured overnight financing rate (SOFR). In guidance issued by HMRC,⁷ HMRC stated that it will generally accept that parties to a contract referencing Libor would, acting at arm's length, agree to make changes to the contract in response to benchmark reform. It would therefore not normally be necessary to reassess whether the terms of the original agreement are at arm's length, as this is tested when the provision was originally entered into.

Consequently, to the extent that taxpayers amend contracts solely for the purposes of responding to rate reform, SARS should accept that parties to a contract that references Jibar would, acting at arm's length, agree to make changes to the contract to respond to the benchmark reform.

While ordinarily there would be no need to reassess whether the terms of the initial agreement meet the arm's length standard (since this is assessed when the provision is first set), Multinational Enterprises Groups should update their documentation to reflect the withdrawal of certain reference rates from the applicable dates. Groups should also ensure that amendments to financial instruments between connected persons are made on an arm's length basis.

Where an amendment is made in line with market standard terms, for example under ISDA or LMA documents using alternative reference rates and conventions as recommended by the MPGs, SARS should accept that the arm's length nature of these transactions is preserved.

⁷ Guidance on the taxation implications for businesses from the withdrawal of Libor and other benchmark rate reform (Jan 2021)

12.2 Interest withholding tax

For interest withholding tax, interest is defined in section 50A as ‘interest’ as contemplated in paragraph (a) or (b) of the definition of ‘interest’ in section 24J, but does not include any amount of interest deemed to be a dividend *in specie* in terms of section 8F(2) or 8FA(2).

In instances where interest is subject to interest withholding tax, the tax is levied on the amount of interest paid. Rate reform will therefore not have any impact on the levy, exemption and collection of withholding tax, except that the rate used for calculating the interest has changed.

13. Value-added tax

Binding General Ruling 16 (BGR16), Issue 3 (effective 1 January 2024) sets out the pre-approved standard turnover-based method (STBM) of apportionment which vendors may rely on. BGR16 references Jibar and, in anticipation of the transition, also defines ZARONIA. In addition, BGR16 also includes general notes (Notes) that provide guidance on applying the formula set out in the ruling. Note 3 specifically clarifies that, should Jibar no longer apply, ZARONIA may be used (and assumes that ZARONIA is equivalent to Jibar).

Vendors noted that, as at July 2025, the 12-month Jibar rate (which includes a risk premium) is 7.64%, while the ZARONIA rate (a risk-free rate) is 7.11%. Thus, when applying ZARONIA (instead of Jibar) to calculate the yield for items such as dividends and interest in the STBM, higher amounts will be included in the denominator, which would reduce the value-added tax (VAT) apportionment ratio based on the formula applied.

SARS should consider any adverse impact this may have on vendors who have obtained private binding VAT apportionment rulings from SARS that remain in effect during the transition period and reference Jibar rates. The extent of the impact will vary depending on each vendor’s specific circumstances and the wording of the ruling.

As such, we recommend the definition of ZARONIA considers all relevant economic factors currently included in the Jibar rate and that it includes a CAS (refer to the discussion in **Error! Reference source not found.** above).

We therefore request that SARS (by way of a ruling) considers and clarifies the following matters:

- Whether, for purposes of applying BGR16, a ZARONIA-based rate (referenced in the BGR16 Notes) should be adjusted to an economic equivalent of Jibar
- How vendors should address transitional periods where a vendor’s financial year ends during the transition period (i.e. 12-month Jibar at the end of the financial year, ZARONIA, or an apportionment of these rates).
- Confirm that regardless of the transition, all existing private binding VAT apportionment rulings;
 - will remain valid, not increasing the burden on vendors to re-apply;
 - any reference to Jibar will automatically be replaced with a rate which is economically equivalent to ZARONIA, so as not to prejudice the vendor economically; and
 - to the extent that such rulings are made subject to the BGR16 Notes, so that any change to BGR16 automatically apply to such rulings.

14. Recommendations

We recommend that SARS issues a Binding General Ruling (BGR) that confirms its interpretation and application of the provisions in the tax laws relating to the proposed benchmark rate reform are aligned to those outlined in this paper.

It is also recommended that the impact on VAT apportionment as envisaged in BGR16 or private binding rulings be further considered to ensure that no unintended consequences arise due to this coming change as detailed in paragraph 13 above.

DRAFT