South African Reserve Bank

Market Practitioners Group

The Jibar transition: **The last mile**

Tax Considerations of Transitioning from JIBAR to ZARONIA for Legacy Contracts

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South African Reserve Bank

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List of acronyms

ARR Alternative Reference Rate.

IBOR Interbank Offered Rates.

ISDA International Swaps and Derivatives Association.

JIBAR Johannesburg Interbank Average Rate.

MPG Market Practitioners Group.

ONRR Overnight Reference Rate.

SARB South African Reserve Bank.

SARS South African Revenue Service.

SOFR Secured Overnight Financing Rate.

SONIA Sterling Overnight Index Average.

UK United Kingdom.

US United States of America.

ZA Republic of South Africa.

ZAR South African Rand.

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 ensure that the market had enough time for the transition during November 2022, the SARB commenced publishing ZARONIA, primarily to allow market participants to observe its performance and consider the implications of adopting it as a replacement for the JIBAR up until November 2023.

The SARB announced in 2024 that it is rounding down its observations period for the transition from Johannesburg Interbank Average Rate (JIBAR) to South African Rand Overnight Index Average (ZARONIA) as the key reference rate, and market participants are gearing up for the transition as this may attract additional complexities and challenges. Over time, JIBAR has come under lot of criticism over its financial stability risk due to its inherent weaknesses in the design methodology in benchmarking. This points out to JIBAR being calculated based on expert judgement rather than actual transactions which are desirable and essential characteristic of a benchmark interest rate and therefore making it susceptible to manipulation and opacity as well as lack of reflection to the prevailing market conditions.

Unlike JIBAR, ZARONIA is calculated based on actual overnight transactions in the wholesale funds market, thus reflecting the cost of borrowing on an overnight basis (making it comparable to the Euro Short-Term Rate and the Sterling Overnight Index Average). The purpose of the benchmark reform is to provide higher confidence in the financial markets.

ZARONIA is considered transparent and aligned with international standards for risk-free rates which place it as a preferred reference rate for Rand-denominated financial contracts.

The purpose of this document is to:

- Assess the potential tax consequences arising from the reference rate reform, with specific focus on Legacy Contracts that currently reference JIBAR and will need to transition to ZARONIA.
- Serve as a technical foundation for engagement with SARS and National Treasury, with the objective of encouraging the issuance of formal guidance, whether in the form of a tax guide, Interpretation Note or Binding General Ruling to assist taxpayers in navigating the tax implications of the reference rate reform and to promote tax certainty.

For the purposes of this document "**Legacy Contract"** means an agreement that is required to be amended due to the reference rate reform and would have been entered into before the adoption of the ZARONIA. Conversely, "**New Contract"** means an agreement that references ZARONIA and is not required to be amended due to the reference rate reform.

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

2 Background

Reference rates are widely used in the measurement of financial instruments such as derivatives and interest-bearing arrangements. In addition, reference rates (also known as benchmark rates) are also used to discount provisions for financial reporting to measure/estimate risks. Reference rates are being reformed globally in response to issues raised in relation to reliability and robustness of the existing interbank benchmark. The Financial Stability Board ("**FSB**") published their final report on this matter in March 2014, paving the way for the reform of global reference rates like LIBOR, EURIBOR, and TIBOR, by recommending enhanced governance and oversight processes to ensure their reliability and robustness or alternatives to the existing benchmark rates. The final report does not have a specific reference to the South African Rand and equally the report does not provide a recommended reference rate for South Africa.

The SARB initiated the work on the reference reform which has now been handed over to the Market Practitioners Group ("**MPG**"). The MPG has recommended that ZARONIA, an overnight, risk-free rate be adopted to replace the current term reference rate, JIBAR, a term rate with a risk premium (i.e., a credit premium and a term premium). It is anticipated that the JIBAR publication will cease in 2026. Businesses will therefore be required to transition from financial instruments which contain references to JIBAR to ZARONIA or alternative reference rates.

Changes to financial instruments can occur where amendments are made to either (i) replace the benchmark rate they refer to or, (ii) by the introduction of fallback provisions or, (iii) by making incidental amendments that are consequential to replacing the benchmark rate.

The fallback provisions can apply to determine how the contract should operate if the designated benchmark rate is permanently discontinued, or when the benchmark rate is considered unrepresentative or otherwise cannot be used.

An example of incidental amendments that are consequential to replacing the benchmark rate, would be where a contractual amendment is made to the applicable interest margin, to better equate the risk-free replacement rate to a discontinued rate.

Contracts that do not include fall back language will require amendment as a result of the reference rate reform.

It is expected that the changes to contracts for instruments that reference JIBAR for the purpose of responding 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. An example of a market standard way to change a contract would include adopting the language, reference rates, conventions or guidance provided by organisations such as the International Swaps and Derivatives Association ("**ISDA**"), or Loan Market Association ("**LMA**") in the amendment of Legacy Contracts and in the adoption of alternative reference rates (fallback language). Market standard measures would also include incorporating any changes recommended by the MPG or the SARB.

3 Approach

Our approach was to:

- Consider the accounting guidance paper.
- Consider guidance published by the HMRC on the taxation implications for businesses from the withdrawal of LIBOR and other benchmark rate reform (dated 12 January 2021).
- Review financial instruments that make use of reference rates, as well as the tax principles applicable to the variation/ amendment of financial instruments.
- Consider the tax consequences for taxpayers, of the reference rate reform for existing JIBAR deals that will need to transition to ZARONIA and for new deals that need to reference ZARONIA.

4 Impacted taxpayers

Both issuers and holders of financial instruments that reference JIBAR are impacted. The impact of reference rate reform is therefore prevalent across multiple industries and has the potential to impact a broad range of taxpayers, both corporate and individuals.

Issuers of financial instruments are typically corporate taxpayers rather than individual taxpayers, however it is not to say that the rate reform does not impact an individual taxpayer. An individual taxpayer may still be the holder of a financial instrument that references JIBAR.

The impact of the rate reform is therefore neither limited to a specific industry nor a class of taxpayer, however naturally, the impact will be more material for taxpayers in the financial services industry, since these taxpayers issue and hold financial instruments in the ordinary course of their business.

When considering the impact from a tax perspective, corporate taxpayers may find it essential to consider how its JIBAR linked financial instruments have been classified and measured; and whether the accounting treatment of these instruments aligns with the tax treatment thereof. For example, in general, banks registered under the Banks Act and authorised users as defined in section 1 of the Financial Markets Act, do not need to apply different tax treatments from those adopted for IFRS on financial instruments measured at fair value through profit and loss (“**FVTPL**”) under IFRS9 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 implies otherwise~~.~~

5 Accounting treatment of rate reform

5.1 Taxpayers that apply IFRS 9

5.1.1 Change in contractual terms under IFRS 9

The accounting standard applicable to the Financial Instruments, IFRS 9, is applied by most corporate taxpayers in South Africa.

IFRS 9 prescribes the accounting treatment where there has been a modification of a financial instrument. Modifications apply only to financial instruments classified and measured at amortised cost. Modifications of instruments classified at fair value are treated as a fair value movement through profit or loss.

IFRS 9 refers to 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 is defined as a renegotiation or modification of contractual cash flows which is significant enough to result in an expiry of the cash flows of the original asset and the creation of a new asset. 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 that the original financial instrument is extinguished, and a new instrument is recognised, meaning the original asset/ liability is treated as disposed of, which may trigger a disposal event for tax purposes.

- A substantial modification could include:
    - 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 change in the rate (e.g., changes in the principal amount, repayment terms, or covenants), it may still trigger a substantial modification.

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 a substantial modification, the modification 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 in terms of IFRS 9.

5.1.2 Modification and Rate reform

A change to a contract as a result of the reform of benchmark interest rates by regulatory authorities, will typically take the form of a change in the base interest rate and an additional margin spread on a financial instrument. As noted above, the change could occur by the amendment of the existing contract, implementation of a new contract or activation of a fallback clause (terms existing in the original contract facilitating the switch to a new benchmark interest rate).

5.1.3 International Accounting Standards Board Guidance

The IASB sought to address the accounting impact that these reforms will have by tackling it in two phases. Phase 1 amendments provide temporary relief from applying specific hedge accounting requirements to hedging relationships directly affected by rate reform. The rate reform phase 2 amendments address issues that might affect financial reporting after an interest rate benchmark is replaced with its alternative benchmark rate.

Phase 2 includes certain relief measures. The key relief measures provided by the Phase 2 amendments are:

- 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 to the accounting for changes to contractual cash flows of financial assets, financial liabilities or leases impacted by rate reforms. 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). The practical expedient is permitted to apply 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 a non-substantial modification 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 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 that do not apply IFRS 9

There may be parties to Legacy Contracts that do not apply IFRS 9 in the preparation of their Annual Financial Statements, or who do not prepare Annual Financial Statements. While the accounting treatment may be relevant in understanding the nature of the modifications to Legacy Contracts and their impact on the net profit before tax of a taxpayer, the tax rules and principles can exist independently from the accounting treatment. Apart from the instances noted below in which the tax legislation specifically allows for the adoption of accounting principles for certain classes of taxpayers, such as section 24JB, or in the application of 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, amongst other things, ZARONIA is generally lower than JIBAR. Unlike JIBAR that has a built-in credit and term premium components, ZARONIA is near-risk free rate. To compensate for the additional yield that investors may demand for taking on credit risk, the credit adjustments (i.e. risk premium) on the existing contracts will be required for the differences between ZARONIA and JIBAR on the transition.

The credit adjustment is therefore intended to ensure that economic equivalence is achieved on transition. The Transition and Coordination and Planning Workstream has recommended that ISDA's standardised methodology for calculating a fallback spread based on a 5-year median may be used. The adoption of this methodology would represent a market standard approach that could be adopted for the amendment of legacy contracts. The SARB has endorsed a credit adjustment spread ("**CAS**") methodology to transition instruments from JIBAR to ZARONIA in order 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 credit adjustment spread because of rate reform, the intention will not be to leave any party in a significantly different economic position, and therefore it is likely that the present value of the instrument before and after the base rate change will be 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 therefore not expected that any further payments or steps will need to be taken by the parties to compensate any party 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 in the absence of any other contractual changes, should not result in a substantial modification and 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 Gain 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, encompassing any right or interest in property, whether movable, immovable, corporeal or incorporeal. In the context of a loan instrument, the lender's right to receive interest qualifies as an asset for Capital Gains Tax ("**CGT**") purposes. Various courts 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

[1] 1943 AD 656, 12 SATC 344 at 352.

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 interests capable of being 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 on the circumstances surrounding each arrangement.

Where there is a change in the contractual terms or cash flows in respect 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.

In terms of para 11 (1) of the Eighth Schedule to the ITA, a disposal is any event, act, forbearance or operation of law which 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, thus effectively extinguishing the original financial instrument.

A key issue in this context 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 ("**CGT Guide**") (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 is, therefore, whether there is a difference between the rights of 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 attaching thereto, there will be no 'disposal' for CGT purposes.

In many circumstances it would be possible to ensure that the rights of the holder of the loan instrument are not varied to such a degree that it would constitute a variation, conversion, or exchange as contemplated by the Eighth Schedule. This would be the intention of most taxpayers in instances of market standard rate reform. Where the taxpayer has simply varied its financial

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

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

instruments to transition in this manner, the transition would not lead to a disposal, as the lender retains the substantive right to receive interest, albeit under altered terms.

It would however be relevant to consider the intention of the parties in respect of 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 financial instrument.

It should be accepted that to the extent that the modification of the contract does not go beyond the transitional adjustments in a market standard manner i.e., 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 would be 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 permitted to apply when changes to cash flows required by reform are <u>necessary as a direct consequence of rate reform</u> and the new basis for determining the contractual cash flows is <u>economically equivalent</u> to the previous basis.

While an interest rate change alone due to the change in reference rate should not result in a disposal for tax purposes, taxpayers may go beyond what is required to account for rate reform only. For example, a change in the terms of a financial instrument, that includes other 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 in fact a disposal event has 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 for the purposes of responding 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 take account for the rate reform.

[4] (2001) 64 SATC 73 (SEC) at 76.

[5] [1984] 4 All SA 563 (E).

8 Additional payments

As noted above, 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 therefore not expected that any further payments or steps will need to be taken by the parties to compensate any party for a transfer of value because of the transition, as each party should already be in an economically equivalent position.

However, should parties, after the application of the CAS, reach agreements wherein one party becomes liable to make an additional payment to the counterparty (whether as one-off or a series of payments), this would fall outside the scope of standard market practice for the JIBAR transition. This may trigger additional tax implications that should be considered with reference to the facts applicable in each case.

In these instances, top-up or additional payments (made once off or at intervals) supplemental to changes in the interest rate, will fall to be assessed in accordance with the ITA principles and the nature of the applicable instrument(s) will determine which sections of the ITA are to be applied. In other words, the applicable sections of the ITA will depend on the nature of the financial instrument (for example interest bearing arrangements, derivative instruments or leases), the nature of the additional payments and the factual circumstances of the taxpayer.

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 included in section 24J of the ITA. Section 24J includes within its scope 'instruments', that would include interest bearing debts, repurchase agreements, the right or obligation to receive or pay interest. Section 24J(2) provides for the deduction of interest whilst section 24J(3) makes provision 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 the transfer, sale, assignment or disposal in any other manner of such instrument by the holder/ issuer, excluding the redemption of the instrument). Based on the analysis above, it can be said that a 'disposal' for tax purposes would amount to a transfer of that instrument in terms of section 24J. In this instance, section 24J would apply in the calculation of gains/ losses in respect of the transfer of the instrument. However, as noted above, it is not expected that the mere amendment of a legacy contract executed on market standard terms in response to the requirements of 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 where the amount of interest is calculated in accordance with the sum of accrual amounts in relation to the accrual period

Section 24J provides for the spreading the 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 referred to as the accrual method) requires the interest to be spread on a compounding accrual basis over the term of the instrument. A rate (being the yield to maturity) is calculated/determined which, when applied to the adjusted initial amount, results in an amount equal to the accrual amount.

Where changes occur in relation to the interest rate, as would be expected in the instance of rate reform, future interest payments will be different from the amounts used to calculate the original yield-to-maturity and the yield to maturity will have to be redetermined. The effect of the redetermination of the yield to maturity will be that accrual amounts which have already been taken into account 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 consequentially accrual amounts calculated in terms of such redetermined 'yield to maturity'. This redetermination is expected to be immaterial, considering that after the application of the CAS, the ZARONIA rate replacing JIBAR for a Legacy Contract is already economically equivalent.

This redetermination would be no different for tax purposes from any redetermination that was required in respect of a change to an interest rate to an instrument within the scope of section 24J and the relative change will result in no immediate gain or loss but rather a change in amount of interest required to be taxed or deducted, as the case may be, going forward, over the remaining life of the instrument.

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

As an alternative to the 'yield to maturity' method, section 24J also allows for the use of the alternative method in calculating interest to be 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 method of calculating interest in relation to any class of instruments which in accordance with IFRS, is consistently applied in respect of all such instruments for financial reporting purposes; and the method achieves a result in so far as the timing of the accrual and incurral of interest is concerned which produces substantially the same result achieved by the application of the yield to maturity method. The phrase 'produces substantially the same result' is not defined. 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

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

added). From an IFRS perspective, in the application of 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 the implementation of the change are therefore in line with the requirements of the use of the alternative method set out in section 24J, and 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 be reflective of 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 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. Considering, still, that the overriding principle of the transition is that economic equivalence should be maintained, the change reflected in the effective interest rate to calculate the interest income or expense of the applicable instruments should be marginal.

9.1.4 Other considerations

As noted above, where parties have equalised the difference between JIBAR and ZARONIA using the SARB endorsed CAS, no additional amendments to the contract should be required to place the parties in an economically equivalent position before and after the rate reform. If, however, in remote circumstances the parties agree that top-up or additional payments are required independent from and in addition to the application of 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 the case may be as discussed in point 9 of this document.

9.2 Leases

Leases are dealt with under IFRS 16 for accounting purposes. From an accounting perspective, the IASB makes a practical expedient available for lessees, where the lease payment is indexed to a rate that is discontinued. This practical expedient allows the lessee to update the discount rate to reflect the change in interest rate. The tax treatment of leases does not necessarily follow their accounting treatment. Where for example a lease is also an interest-bearing arrangement, section 24J will apply. 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

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https://www.treasury.gov.za/publications/RevenueLaws/2017%20Explanatory%20Memorandum%20on%20the%202017%20Taxation%20Laws%20Amendment%20Bill-15%20December%202017.pdf accrued or received by the lessor are taxable as gross income or deductible for the lessee, where 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/commercial purposes may impact the lease rental payments. For example, where the nature of the cash flows under the original instrument representing payment of rentals is lower under the new reference rate, the lessee may be required to make payment to the lessor for the shortfall or perhaps monthly rental payments are 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. Where no disposal has occurred 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 (which is typically a lump sum paid at the commencement of the lease), there would be no change in the tax treatment and amendments pursuant to rate reform would likewise follow the normal rules in that the amount must be spread over the period of the lease, including renewal periods, to a maximum spread of 25 years.

9.3 Derivatives and other financial instruments measured at Fair Value

The change from JIBAR to ZARONIA for Legacy Contracts may affect the valuation of some financial instruments and derivatives, as a vast number of derivative contracts make reference to an interest rate. The tax treatment of derivative contracts will be dependent on the class of taxpayer, and specifically whether the taxpayer is 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 recognized by "covered persons" in respect of financial instruments that are measured at FVTPL in terms of IFRS9 and are not excluded from the application of section 24JB in terms of section 24JB(2)(a) to (c). For instruments measured at FVPL in terms of section 24JB and not excluded in terms of section 24JB(2)(a) to (c), where a change in the fair value arises as a consequence of reference rate reform that is recorded in the profit and loss of the covered persons 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 the case may be.

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

Where section 24JB is not applicable, the normal income tax principles pertaining to gross income, expenditure/losses and disposals will apply in respect of derivative instruments and other instruments measured at FVPL. Changes in the value of derivative contracts that are unrealised, are generally only taken into account for tax purposes once that instrument is eventually realised/settled, unless specific tax provisions apply in respect of that instrument. Therefore, in respect of derivative contracts, the key enquiry will remain a determination of whether the variation of the legacy contract has resulted in a disposal. Where a disposal has occurred, the tax consequences of the disposal of that derivative contract will be determined in terms of normal tax principles that would have applied to a disposal under any other circumstances.

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 of amounts in relation to such an agreement 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 with reference to the variable rate applicable on the date it is to be calculated to determine all amounts payable or receivable after that date (s 24K(3)). Consequently, the only impact that rate reform will have on section 24K is in respect of the variable rate that must be applied 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 and that in respect of interest rate agreements and its provisions do not interfere with general tax principles such as the source principle or the capital or revenue nature of amounts accrued or incurred in respect of such agreements.

10 Other Tax Sections

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

"Interest" for the purposes of section 23M and section 23N relies on certain part of the definition of interest as defined in section 24J. Section 23M further includes in its definition of the interest, insofar as relevant, the following:

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

Commercially, under certain circumstances, the aforementioned amounts may be calculated with reference to a variable rate like JIBAR. To the extent that any of these amounts are calculated with reference to ZARONIA, taxpayers need to consider the impact these may have on the interest limitation rules under section 23M and section 23N.

10.2 Section 8FA – hybrid interest

Section 8FA will only become applicable if there is "interest" and an "instrument" in terms of 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 with reference to a specified rate of interest or not determined with reference to the time value of money. Where there is an instrument that is subject to rate reform, this would necessarily involve the presence of a specified rate and consequently, section 8FA should not apply. The mere fact that there was rate reform, implies that the instrument had interest determined with reference 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) & 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 bring about an additional cost to the existing contracts.

Although most standard agreements incorporate fallback provisions to mitigate risk associated with market disruptions and stipulate how the contract would continue to operate where the original or designated benchmark rate is permanently discontinued, for most taxpayers, transition will result in additional costs such as legal fees, professional and consultation fees, technological cost, administrative, secretarial costs, system updates etc., for renegotiating or amending the existing contract.

Generally, the deductibility of an amount is determined with reference to the provisions contained in section 11(a) read with section 23 (the so-called "general deduction formula"). For legal costs, which are likely to arise from responding to the reform of the benchmark, section 11(c) provides for the deduction of legal expenses that are incurred by reason of a taxpayer's ordinary trading operations. For a taxpayer to deduct legal expenses such expenses must not be of a capital nature.

The affected institutions, borrower 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 will depend on the facts attendent to it. For example, in the case of a loan arrangement, the nature of the cost incurred by the taxpayer would usually be determined with reference to the purpose for which the funds were borrowed.

In the case of the rate reform, it would however be competent to conclude that costs incurred in relation to rate reform should not be of a capital nature, considering that these costs are a necessary concomitant of trade. But 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. The costs associated with the transition are therefore not dissimilar from 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 of section 11 that expenditure should be actually incurred in the 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 adhere to fair terms and comply with tax regulations.

Often, the fair market price of financial instruments might have been determined with JIBAR as a reference rate. The arm's length interest rate charged on intra-group loans may have been based on JIBAR plus a margin.

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

In other words, in the instance where the change to the interest rate that 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 falls to be considered within the scope of section 31. This would be consistent with the practice applied by the HMRC when LIBOR was replaced by Secured Overnight Financing Rate. In guidance issued by the HMRC[7], the HMRC stated that it will normally accept that parties to a contract that references LIBOR would, acting at arm's length, agree to make changes to the contract to respond to the reform of the benchmark. It would therefore not normally be necessary to reassess whether the terms of the original agreement are arm's length as this is tested at the point 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 reform of the benchmark.

While ordinarily there would be no need to reassess whether the terms of the initial agreement meet the arm's length standard (since that assessment occurs when the provision is first established), Multinational Enterprises (MNEs) 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 undertaken on an arm's length basis.

Where an amendment takes place in line with market standard terms, for example under ISDA / Loan Market Association documents on terms which reflect the alternative reference rate and conventions used as recommended by the Market Practitioner Groups, the above-mentioned documents, SARS should accept that the arm's length nature of the transactions are preserved.

12.2 Interest withholding tax

For the purposes of 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 that is 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, withholding tax is levied on the amount of interest that is paid. The rate reform will therefore not have any impact on the levy, exemption, and collection of withholding tax, save for the fact that the rate at which that interest was calculated has been modified.

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. BGR 16

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

references JIBAR and in anticipation of the transition, it also defines ZARONIA. In addition, BGR16 also includes general notes ('Notes') that provide guidance on the application of the formula set out in the ruling. Note 3 specifically clarifies that should the JIBAR no longer be applicable, ZARONIA may be applied (and assumes that ZARONIA is equivalent to JIBAR).

Vendors noted that at July 2025, the 12-month JIBAR rate (which includes a risk premium) (7,64%) is higher than the ZARONIA rate (which is a risk-free rate (7,11%)). Thus, when applying ZARONIA (as opposed to JIBAR) to calculate the yield to appropriately reflect items such as dividends and interest in the STBM, higher amounts will be included in the denominator, therefore reducing the VAT apportionment ratio based on the formula to be applied.

SARS should consider any adverse impact that may extend to 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 the specific circumstances of each vendor and the wording of the ruling.

As such, we recommend the definition of ZARONIA considers all relevant economic factors that are taken into account in the current JIBAR rate and it includes a credit adjustment spread (we refer to the discussion in 6 above).

We therefore request SARS (by way of a ruling) to consider and clarify the following matters:

- Whether for the purposes of applying in BGR 16, a ZARONIA based rate (referenced in the BGR 16 Notes) should be adjusted to an economic equivalent of JIBAR,
- How vendors should deal with 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 or ZARONIA or an apportionment of these rates); and
- to 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 reference to 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 BGR 16's Notes, any change to BGR 16 automatically apply to such rulings.

14 Recommendations

It is our recommendation that SARS issues a Binding General Ruling (BGR) that confirms SARS' interpretation and application of the provisions of the tax laws relating to a proposed benchmark rate reform are aligned to those detailed 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 14 above.