Introduction

Action 4, Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, of the OECD/G20 BEPS Project. Third party and related party interest is perhaps one of the most simple of the profit-shifting techniques available in international tax planning. The range of acceptable levels of interest in relation to profits suggested by the OECD (10 to 30 per cent) appears to be significantly lower than those contained in specific South African anti-avoidance provisions.

Research focus

What describes the funding structures of different types of entities, in particular foreign owned entities and domestically owned entities, and how is it related to other characteristics of the firms?

Methodology

Analysis of:
- Levels of gearing (Debt-to-equity ratio)
- Levels of funding costs (Interest-to-EBITDA)

Results

Debt-to-equity ratios

Net interest-to-EBITDA detailed findings

Conclusions

- Basis rate of 40% for interest limitation in section 23M appears to be appropriate (80% of taxpaying companies in South African in this range or lower)
- Net interest-to-EBITDA ratio for Foreign Held Companies higher than other categories for 75th percentile and upwards
- Foreign Held Entities in 75th Percentile and upwards:
  - mainly large companies
  - more entities involved in real estate, financial services and insurance as well as agricultural than overall population
  - more of these entities held from low tax jurisdictions such as Mauritius, British Virgin Islands, Cyprus, Guernsey.