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Introduction and Tax Considerations of ZARONIA as the Key Reference Rate

This publication marks the first in a series of tax alerts examining the transition from the Johannesburg Interbank Average Rate (**JIBAR**) to the South African Rand Overnight Index Average Rate (**ZARONIA**). Over the coming months, we will unpack the key tax, legal, and operational considerations arising from this significant market development.

Background

The South African Reserve Bank (**SARB**) has been working with various stakeholders to revise local interest rate benchmarks.[1] JIBAR, long used as a reference rate, has been deemed financially unstable due to inherent flaws in its design methodology.

To address this, SARB has introduced ZARONIA, which is based on actual overnight transactions in the wholesale funds market. ZARONIA reflects the true cost of overnight borrowing, is transparent, and aligns with international standards for risk-free rates. It is now the preferred reference rate for Rand-denominated financial contracts.

Impact of the transition

The shift from JIBAR to ZARONIA will affect issuers and holders of financial instruments referencing JIBAR. This change is expected to impact a wide range of taxpayers, including individuals and corporates, with a more pronounced effect on those in the financial services sector due to the nature of their business activities.

Corporate taxpayers should assess how JIBAR-linked instruments are classified and measured, and ensure that their accounting treatment aligns with the applicable tax treatment.

Key tax considerations

1. Interest and section 24J

Section 24J of the Income Tax Act (ITA) governs interest-bearing arrangements and outlines the principles of incurral and accrual of interest.

It defines a 'transfer' to include the sale, assignment, or other disposal of an instrument, excluding redemption. If the transition to ZARONIA qualifies as a transfer under section 24J, the tax consequences must be assessed.

Section 24J also prescribes the use of the 'yield to maturity' method, which spreads interest (including premiums or discounts) over the term of the instrument on a compounding accrual basis.

Rate reform will necessitate recalculating the yield to maturity, as future interest payments will differ from those originally projected.

Where ZARONIA replaces JIBAR in legacy contracts, a redetermination of accrual amounts under the yield-to-maturity method will be required.

2. Capital Gains Tax (CGT)

Under the Eighth Schedule to the ITA, an asset includes any right or interest in property. A lender's right to receive interest qualifies as an asset for CGT purposes.

Per paragraph 11(1) of the Eighth Schedule, a 'disposal' includes any event that results in the creation, variation, transfer, or extinction of an asset.

To the extent that there is a variation in a lender's right to receive interest arising from the transitioning from JIBAR to ZARONIA the taxpayer would have to assess whether this potentially constitutes a disposal for tax purposes and whether CGT is applicable.

3. Additional payments

Where additional payments are made to facilitate the transition of legacy contracts, the tax implications of such payments must be considered.

Relevant provisions include the general gross income principles, section 11(a), paragraph 20 of the Eighth Schedule, and potentially sections 24J or 24JB of the ITA.

Conclusion

The transition from JIBAR to ZARONIA is expected to affect a broad spectrum of taxpayers. It is essential for taxpayers to understand the implications of this change and assess whether their financial instruments and contracts may be impacted.

Contracts referencing JIBAR should be reviewed for potential tax consequences arising from the transition to ZARONIA.

[1] Extracted from Tax Considerations of Transitioning from JIBAR to ZARONIA for Legacy Contracts issued by the South African Reserve Bank

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