



TAX

Are raising fees similar to interest?

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The tax court, in a reportable judgment handed down on 13 January 2025, considered whether raising fees are finance charges which are similar to interest, and therefore, tax-deductible on the same basis as interest.

The tax dispute centred around the tax deductibility of raising fees incurred by the taxpayer when it financed and refinanced the acquisition of some of its business assets. As part of the funding arrangements, an entity within the lender's group of companies charged a raising fee calculated as a percentage of the loan capital, which had to be paid in one lump sum as a pre-condition for the lender advancing the loan capital.

The taxpayer claimed a deduction for the raising fees paid on the basis that they met the definition of "*interest*", which includes any finance charges similar to normal interest. Taxpayers are eligible to claim a deduction for amounts which meet the definition of "interest" in section 24J of the Income Tax Act, 58 of 1962, even if the amounts are capital in nature, provided only that the expense is incurred in the course of carrying on a trade and in the production of income.

The definition of "interest" used to include finance charges "related" to interest, but this was amended to include only finance charges "similar" to interest. The amendment was presumably in response to the judgment of the Supreme Court of Appeal in *C:SARS v South African Custodial Services* 2012 (1) SA 522 (SCA), in which the phrase "*related finance charges*" was given a broad interpretation to include a variety of payments related to a finance transaction, including payments which are clearly dissimilar to interest, such as legal fees relating to the transaction.

In *ITC 1963 85 SATC 246*, a dispute about whether raising fees constituted "*related finance charges*" prior to the amendment of the definition of "interest", the taxpayer was successful in its argument that raising fees were indeed "related finance charges" and thus deductible as "interest" for tax purposes.

The recent tax court judgment is the first to consider the meaning of the new phrase "similar finance charges", and it did so in the context of raising fees. The court conducted an interpretative exercise and concluded that this exercise entails a determination of the meaning embedded in the text as "*the most compelling and coherent account the interpreter can provide*", which is considered following a unitary approach taking into account the text, context and purpose of the provision in question.

The court held that since the definition of "*interest*" describes the term as "*interest or similar finance charges*", one should interpret it to mean something which is an alternative to interest, and something other than interest. The court further explained that the word "similar" does not mean identical but rather requires the finance charges to bear a relevant resemblance to interest (i.e. characteristics which make it similar).

The court considered the elements of distinction and similarity between raising fees and interest.

SARS argued that raising fees must have the fundamental characteristics of common law interest, but the court disagreed and held that SARS seemed to conflate the meaning of "similar" and "same".

Another point on which SARS sought to distinguish the raising fees was that they were separate and distinct from the interest because they were incurred before the effective dates of the funding agreements. The court held that the timing was not a relevant dissimilarity between interest and raising fees, as it did not change the nature of the raising fee charges.

SARS also argued that the raising fees differed from interest in that the payment of the raising fees was an advance condition to the loan capital being advanced, whereas the interest was payable on future dates subsequent to the advance of the loans. The court held that this argument was premised on the incorrect notion that interest was paid for the use of the loan capital when, in fact, they were loans for consumption.

Perhaps linked to the previous point, SARS further pointed out that the raising fees were not compensation for the use or benefit of the loan money because the fees had to be paid before the taxpayer would receive the benefit of the loans. The court disagreed on the basis that the raising fees formed part and parcel of the compensation which the taxpayer had to give for the loans – without payment of the raising fees, the taxpayer would not have had the benefit of the loan capital.

With reference to an argument by SARS that, although the raising fees were expressed as a percentage of the loans, they were not fixed with reference to the time value of money and/or the capital outstanding at any point during the term of the loans, the court held that SARS seems to appreciate that the fact that a percentage fee is charged is a similarity, but in also requiring the fee to take into account the time value of money or the capital outstanding from time to time is to incorrectly elevate the meaning of "similarity" to "sameness".

SARS argued that the raising fees were consideration for arranging the loans and not for the use of the loans, but the court's take on that was that it demonstrates the close proximity or association between the raising fees and the loans and is indicative of a relevant similarity between interest and raising fees.

The fact that interest was paid periodically and raising fees once-off was held not to be a relevant dissimilarity. The court considered that the same "*interest*" definition was used for "*hybrid interest*" (which is not fixed with reference to the time value of money/interest rate). Therefore, the fact that raising fees were once-off lump sum payments (i.e. not determined with reference to the time value of money) did not make them dissimilar to "*interest*" (as defined). Rather, the raising fees were found to be similar to interest in that they were determined with reference to the size of the loan capital and for the benefit of the loan capital, because without the taxpayer agreeing to pay the raising fees, the taxpayer would not have obtained the finance. Consequently, the obligation to pay the raising fees was considered part and parcel of the financing agreements, similar to the obligation to pay interest on the loan capital.

For these reasons, the court concluded that the most compelling and coherent interpretation was that the raising fees in question were "*similar finance charges*" to interest, as envisaged in the definition of "*interest*" in section 24J of the Income Tax Act and that such an interpretation would "*not yield an unbusinesslike and unwieldy result*".



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