

# **REPUBLIC OF SOUTH AFRICA**

## **DEPARTMENT OF FINANCE**

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### **Taxation of inflation linked bonds**

In terms of section 24J of the Income Tax Act, 1962 interest on bonds is taxed on a yield to maturity basis. It is important to note that both coupon payments and the difference between the acquisition cost and the nominal value of a bond is defined as interest and is taxable for income tax purposes. An inflation linked bond is a variable rate instrument for purposes of section 24J. A “variable rate” is defined as a rate determined with reference to an interest or indexation rate or similar factor, being a rate or factor that varies or may vary during the term of the instrument. Furthermore, all bonds are included in the definition of an instrument for purposes of section 24J. The effect of these provisions is that amounts in respect of adjustments for inflation in the case of inflation linked bonds will be treated as interest and subject to the accrual rules contained in section 24J. The full amount of the inflation adjustment is therefore taxable, as is the case in Canada, New Zealand and the United States.

The tax liability is to be determined annually taking into account any adjustments to the principal amount and the coupon payments as a result of changes in the CPI. In determining the appropriate “yield to maturity” cash flows after the end of the year of assessment should be based on an assumed constant level of the known index as at year end. See the attached example illustrating the tax payable on an inflation linked bond.

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## ASSUMPTIONS

Date of acquisition of the CPI bond	30 May 2000																								
Amount invested	R1 000 000																								
Amount of principal of CPI bond on date of issue	R1000 000																								
Coupon dates	30 November / 30 May																								
Date of maturity of bond	30 May 2005																								
Coupon rate as percentage of adjusted capital value	5%																								
Tax year	March to February																								
Consumer price index applicable to coupon payments	<table border="1"> <thead> <tr> <th>Month</th><th>Index</th></tr> </thead> <tbody> <tr><td>May 2000</td><td>100.0</td></tr> <tr><td>Nov 2000</td><td>103.0</td></tr> <tr><td>May 2001</td><td>106.1</td></tr> <tr><td>Nov 2001</td><td>109.3</td></tr> <tr><td>May 2002</td><td>112.6</td></tr> <tr><td>Nov 2002</td><td>115.9</td></tr> <tr><td>May 2003</td><td>119.4</td></tr> <tr><td>Nov 2003</td><td>123.0</td></tr> <tr><td>May 2004</td><td>126.7</td></tr> <tr><td>Nov 2004</td><td>130.5</td></tr> <tr><td>May 2005</td><td>134.4</td></tr> </tbody> </table>	Month	Index	May 2000	100.0	Nov 2000	103.0	May 2001	106.1	Nov 2001	109.3	May 2002	112.6	Nov 2002	115.9	May 2003	119.4	Nov 2003	123.0	May 2004	126.7	Nov 2004	130.5	May 2005	134.4
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IRR monthly	Year	Month	Cashflows	Monthly accrual	Tax value	Taxable income
0.46761%	2000	5	(1,000,000)	0	1,000,000	
		6	0	4,676	1,004,676	
		7	0	4,698	1,009,374	
		8	0	4,720	1,014,094	
		9	0	4,742	1,018,836	
		10	0	4,764	1,023,600	
		11	25,750	4,786	1,002,636	
		12	0	4,688	1,007,325	
	2001	1	0	4,710	1,012,035	
		2	0	4,732	1,016,767	42,517
		3	0	4,754	1,021,522	
		4	0	4,777	1,026,299	
		5	25,750	4,799	1,005,348	
		6	0	4,701	1,010,049	
		7	0	4,723	1,014,772	
		8	0	4,745	1,019,517	
		9	0	4,767	1,024,284	
		10	0	4,790	1,029,074	
		11	25,750	4,812	1,008,136	
		12	0	4,714	1,012,850	
	2002	1	0	4,736	1,017,586	
		2	0	4,758	1,022,344	
		3	0	4,781	1,027,125	
		4	0	4,803	1,031,928	
		5	25,750	4,825	1,011,003	
		6	0	4,728	1,015,731	
		7	0	4,750	1,020,480	
		8	0	4,772	1,025,252	
		9	0	4,794	1,030,046	
		10	0	4,817	1,034,863	
		11	25,750	4,839	1,013,952	
		12	0	4,741	1,018,693	
	2003	1	0	4,763	1,023,457	
		2	0	4,786	1,028,243	
		3	0	4,808	1,033,051	
		4	0	4,831	1,037,881	
		5	25,750	4,853	1,016,985	
		6	0	4,755	1,021,740	
		7	0	4,778	1,026,518	
		8	0	4,800	1,031,318	
		9	0	4,823	1,036,140	
		10	0	4,845	1,040,985	
		11	25,750	4,868	1,020,103	
		12	0	4,770	1,024,873	
	2004	1	0	4,792	1,029,666	
		2	0	4,815	1,034,480	
		3	0	4,837	1,039,318	
		4	0	4,860	1,044,178	
		5	25,750	4,883	1,023,310	
		6	0	4,785	1,028,095	
		7	0	4,807	1,032,903	
		8	0	4,830	1,037,733	
		9	0	4,853	1,042,585	
		10	0	4,875	1,047,460	
		11	25,750	4,898	1,026,608	
		12	0	4,800	1,031,409	
	2005	1	0	4,823	1,036,232	
		2	0	4,845	1,041,077	
		3	0	4,868	1,045,945	
		4	0	4,891	1,050,836	
		5	1,055,750	4,914	(0)	
		6		(0)		
		7		0		
		8		0		
		9		0		
		10		0		
		11		0		
		12		0		
	2006	1		0		
		2		0		
			287,500	287,500		42,517

IRR monthly	Year	Month	Cashflows	Monthly accrual	Tax value	Taxable income
0.59610%	2001	2	(1,016,767)	0	1,016,767	
		3	0	6,061	1,022,828	
		4	0	6,097	1,028,926	
		5	26,525	6,133	1,008,534	
		6	0	6,012	1,014,546	
		7	0	6,048	1,020,594	
		8	0	6,084	1,026,678	
		9	0	6,120	1,032,798	
		10	0	6,157	1,038,954	
		11	27,325	6,193	1,017,822	
		12	0	6,067	1,023,890	
	2002	1	0	6,103	1,029,993	
		2	0	6,140	1,036,133	73,216
		3	0	6,176	1,042,309	
		4	0	6,213	1,048,523	
		5	27,325	6,250	1,027,448	
		6	0	6,125	1,033,573	
		7	0	6,161	1,039,734	
		8	0	6,198	1,045,932	
		9	0	6,235	1,052,167	
		10	0	6,272	1,058,439	
		11	27,325	6,309	1,037,423	
		12	0	6,184	1,043,607	
	2003	1	0	6,221	1,049,828	
		2	0	6,258	1,056,086	
		3	0	6,295	1,062,382	
		4	0	6,333	1,068,714	
		5	27,325	6,371	1,047,760	
		6	0	6,246	1,054,006	
		7	0	6,283	1,060,289	
		8	0	6,320	1,066,609	
		9	0	6,358	1,072,967	
		10	0	6,396	1,079,363	
		11	27,325	6,434	1,058,472	
		12	0	6,310	1,064,782	
	2004	1	0	6,347	1,071,129	
		2	0	6,385	1,077,514	
		3	0	6,423	1,083,937	
		4	0	6,461	1,090,399	
		5	27,325	6,500	1,069,574	
		6	0	6,376	1,075,950	
		7	0	6,414	1,082,363	
		8	0	6,452	1,088,815	
		9	0	6,490	1,095,306	
		10	0	6,529	1,101,835	
		11	27,325	6,568	1,081,078	
		12	0	6,444	1,087,522	
	2005	1	0	6,483	1,094,005	
		2	0	6,521	1,100,527	
		3	0	6,560	1,107,087	
		4	0	6,599	1,113,686	
		5	1,120,325	6,639	0	
		6		0		
		7		0		
		8		0		
		9		0		
		10		0		
		11		0		
		12		0		
	2006	1		0		
		2		0		
			321,358	321,358	73,216	

IRR monthly	Year	Month	Cashflows	Monthly accrual	Tax value	Taxable income
0.75852%	2002	2	(1,036,133)	0	1,036,133	
		3	0	7,859	1,043,992	
		4	0	7,919	1,051,911	
		5	28,150	7,979	1,031,740	
		6	0	7,826	1,039,566	
		7	0	7,885	1,047,452	
		8	0	7,945	1,055,397	
		9	0	8,005	1,063,402	
		10	0	8,066	1,071,468	
		11	28,975	8,127	1,050,621	
		12	0	7,969	1,058,590	
	2003	1	0	8,030	1,066,619	
		2	0	8,091	1,074,710	95,702
		3	0	8,152	1,082,862	
		4	0	8,214	1,091,076	
		5	28,975	8,276	1,070,377	
		6	0	8,119	1,078,496	
		7	0	8,181	1,086,677	
		8	0	8,243	1,094,919	
		9	0	8,305	1,103,224	
		10	0	8,368	1,111,593	
		11	28,975	8,432	1,091,049	
		12	0	8,276	1,099,325	
	2004	1	0	8,339	1,107,664	
		2	0	8,402	1,116,066	
		3	0	8,466	1,124,531	
		4	0	8,530	1,133,061	
		5	28,975	8,595	1,112,681	
		6	0	8,440	1,121,121	
		7	0	8,504	1,129,625	
		8	0	8,568	1,138,193	
		9	0	8,633	1,146,827	
		10	0	8,699	1,155,525	
		11	28,975	8,765	1,135,315	
		12	0	8,612	1,143,927	
	2005	1	0	8,677	1,152,604	
		2	0	8,743	1,161,347	
		3	0	8,809	1,170,156	
		4	0	8,876	1,179,032	
		5	1,187,975	8,943	0	
		6		0		
		7		0		
		8		0		
		9		0		
		10		0		
		11		0		
		12		0		
	2006	1		0		
		2		0		
			324,867	324,867	95,702	

IRR monthly	Year	Month	Cashflows	Monthly accrual	Tax value	Taxable income
0.99090%	2003	2	(1,074,710)	0	1,074,710	
		3	0	<b>10,649</b>	1,085,359	
		4	0	<b>10,755</b>	1,096,114	
		5	29,850	<b>10,861</b>	1,077,125	
		6	0	<b>10,673</b>	1,087,799	
		7	0	<b>10,779</b>	1,098,578	
		8	0	<b>10,886</b>	1,109,463	
		9	0	<b>10,994</b>	1,120,457	
		10	0	<b>11,103</b>	1,131,560	
		11	30,750	<b>11,213</b>	1,112,022	
		12	0	<b>11,019</b>	1,123,041	
	2004	1	0	<b>11,128</b>	1,134,169	
		2	0	<b>11,238</b>	1,145,408	<b>131,298</b>
		3	0	11,350	1,156,758	
		4	0	11,462	1,168,220	
		5	30,750	11,576	1,149,046	
		6	0	11,386	1,160,432	
		7	0	11,499	1,171,930	
		8	0	11,613	1,183,543	
		9	0	11,728	1,195,271	
		10	0	11,844	1,207,115	
		11	30,750	11,961	1,188,326	
		12	0	11,775	1,200,101	
	2005	1	0	11,892	1,211,993	
		2	0	12,010	1,224,002	
		3	0	12,129	1,236,131	
		4	0	12,249	1,248,380	
		5	1,260,750	12,370	0	
		6		0		
		7		0		
		8		0		
		9		0		
		10		0		
		11		0		
		12		0		
	2006	1		0		
		2		0		
			<u>308,140</u>	<u>308,140</u>		<u>131,298</u>

IRR monthly	Year	Month	Cashflows	Monthly accrual	Tax value	Taxable income
1.39756%	2004	2	(1,145,408)	0	1,145,408	
		3	0	16,008	1,161,416	
		4	0	16,231	1,177,647	
		5	31,675	16,458	1,162,430	
		6	0	16,246	1,178,676	
		7	0	16,473	1,195,149	
		8	0	16,703	1,211,852	
		9	0	16,936	1,228,788	
		10	0	17,173	1,245,961	
		11	32,625	17,413	1,230,749	
		12	0	17,200	1,247,949	
		2005	1	0	17,441	1,265,390
	2		0	17,685	1,283,075	201,967
	3		0	17,932	1,301,006	
	4		0	18,182	1,319,189	
	5		1,337,625	18,436	0	
	6			0		
	7			0		
	8			0		
	9			0		
	10			0		
	11			0		
	12			0		
	2006	1		0		
		2		0		
			256,517	256,517		201,967

IRR monthly	Year	Month	Cashflows	Monthly accrual	Tax value	Taxable income
2.39775%	2005	2	(1,283,075)	0	1,283,075	
		3	0	30,765	1,313,840	
		4	0	31,503	1,345,342	
		5	1,377,600	32,258	(0)	
		6		(0)		
		7		0		
		8		0		
		9		0		
		10		0		
		11		0		
		12		0		
		2006	1		0	
	2			0		94,525
			94,525	94,525		94,525



IRR monthly	Year	Month	Cashflows	Monthly accrual	Tax value	Taxable income
0.90842%	2000	5	(1,000,000)	0	1,000,000	
		6	0	9,084	1,009,084	
		7	0	9,167	1,018,251	
		8	0	9,250	1,027,501	
		9	0	9,334	1,036,835	
		10	0	9,419	1,046,254	
		11	25,750	9,504	1,030,008	
		12	0	9,357	1,039,365	
	2001	1	0	9,442	1,048,807	
		2	0	9,528	1,058,335	84,085
		3	0	9,614	1,067,949	
		4	0	9,701	1,077,650	
		5	26,525	9,790	1,060,915	
		6	0	9,638	1,070,553	
		7	0	9,725	1,080,278	
		8	0	9,813	1,090,091	
		9	0	9,903	1,099,994	
		10	0	9,993	1,109,986	
		11	27,325	10,083	1,092,745	
		12	0	9,927	1,102,672	
	2002	1	0	10,017	1,112,688	
		2	0	10,108	1,122,796	118,312
		3	0	10,200	1,132,996	
		4	0	10,292	1,143,289	
		5	28,150	10,386	1,125,524	
		6	0	10,225	1,135,749	
		7	0	10,317	1,146,066	
		8	0	10,411	1,156,477	
		9	0	10,506	1,166,983	
		10	0	10,601	1,177,584	
		11	28,975	10,697	1,159,307	
		12	0	10,531	1,169,838	
	2003	1	0	10,627	1,180,465	
		2	0	10,724	1,191,189	125,518
		3	0	10,821	1,202,010	
		4	0	10,919	1,212,929	
		5	29,850	11,019	1,194,098	
		6	0	10,847	1,204,945	
		7	0	10,946	1,215,891	
		8	0	11,045	1,226,937	
		9	0	11,146	1,238,083	
		10	0	11,247	1,249,330	
		11	30,750	11,349	1,229,929	
		12	0	11,173	1,241,102	
	2004	1	0	11,274	1,252,376	
		2	0	11,377	1,263,753	133,164
		3	0	11,480	1,275,233	
		4	0	11,585	1,286,818	
		5	31,675	11,690	1,266,833	
		6	0	11,508	1,278,341	
		7	0	11,613	1,289,954	
		8	0	11,718	1,301,672	
		9	0	11,825	1,313,496	
		10	0	11,932	1,325,429	
		11	32,625	12,041	1,304,844	
		12	0	11,854	1,316,698	
	2005	1	0	11,961	1,328,659	
		2	0	12,070	1,340,729	141,276
		3	0	12,179	1,352,908	
		4	0	12,290	1,365,198	
		5	1,377,600	12,402	(0)	
		6		(0)		
		7		0		
		8		0		
		9		0		
		10		0		
		11		0		
		12		0		
	2006	1		0		
		2		0		36,871
			639,225	639,225		639,225