Interest expense arises from the enjoyment of credit and its deductibility for income taxes is guided by the general deduction formula interpreted using common law.

The general deduction formula is derived from section 15(2)(a) of the Income Tax Act [Chapter 23:06], which asserts that a deduction for income tax purposes is awarded if there is an **expenditure or loss** and it has been **incurred** for the **purposes of trade or in production of income** and is **not capital** in nature.

That interest is a cost of financing make interest clearly an **expenditure**. The timing of its **incurrance** depends on the nature of the contract but as the finance is utilised the interest expense will be incurred. Incurred is interpreted to mean whenever there is an unavoidable obligation to pay, then the expenditure is incurred. This is regardless of whether the payment has actually been made or not.

Where borrowings have not been made and applied for the **purposes of trade or in production of income**, then the interest shall not be deductible. For example, Interest expenses on borrowings made for domestic purposes is not deductible. Lastly the interest must not be capital in nature and the term capital is not defined in the Taxes Act. Rather common law is used to interpret whether an amount is **capital** in nature or not.

Under common law, interest takes the character of the purpose for which the loan was used. *CIR Vs Genn & Co*

- Loan was used for working capital management such as inventory.
  Since inventory is revenue in nature and tax deductible all things being equal, so shall the interest.

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- Loan was used to acquire a capital asset which qualifies for capital allowances.
  The interest shall be capital in nature and capitalised to the assets and deductible as a capital allowance.
- Loan was used to acquire a capital asset which does not qualify for capital allowances.
  The interest shall be capital in nature and not qualify for capital allowances too.

From the foregoing it would mean that if a loan was obtained and used to acquire land, that interest will not be deductible in any form (i.e. as interest or as capital allowance). Practically however it would appear that the Revenue authority has been awarding interest deductions even for credit that was used to acquire assets that are capital in nature and that do not rank for capital allowances.

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