

**A CRITICAL ANALYSIS OF THE INTERPRETATION AND APPLICATION
OF THE “INCOME FROM TRADE” REQUIREMENT CONTAINED IN
SECTION 20(1) OF THE INCOME TAX ACT, 58 OF 1962 WITH REGARD
TO THE CARRYING FORWARD OF THE BALANCE OF ASSESSED
LOSSES**

by
PIETER GROENWALD KROGH

Submitted in partial fulfilment of the requirements for the degree
LLM Tax Law

in the
FACULTY OF LAW

at the
UNIVERSITY OF PRETORIA

Supervisor:
Adv C. Louw

September 2012

DISCLAIMER

I, Pieter Groenwald Krogh, hereby declare that this dissertation is my own, unaided work. It is being submitted in partial fulfilment of the prerequisites for the degree of Master's in Tax Law at the University of Pretoria. It has not been submitted before for any degree or examination in any other University.

.....

Pieter Groenwald Krogh

30 September 2012

TABLE OF CONTENTS

CHAPTER 1: INTRODUCTION TO THE RESEARCH	1
1.1 BACKGROUND.....	1
1.2 OPTIONS AVAILABLE WHEN INTERPRETING A STATUTE.....	2
1.3 OBJECTIVE OF THE STUDY	4
1.4 RESEARCH METHODOLOGY	4
CHAPTER 2: ANALYSING THE POSSIBLE DIFFERENT INTERPRETATIONS OF “INCOME” AS FOUND IN THE “INCOME FROM TRADE” REQUIREMENT IN SECTION 20(1) OF THE INCOME TAX ACT, 58 OF 1962	6
2.1 ANOMALOUS SITUATIONS.....	8
2.2 SPECIAL CASES DO NOT CREATE GENERAL RULES.....	12
2.3 SECTION 103(2) SCENARIO	15
2.4 CONCLUSION WITH REGARDS TO THE INTERPRETATION OF INCOME IN THE SECTION 20 INCOME FROM TRADE REQUIREMENT	16
CHAPTER 3: IS INCOME FROM TRADE IN A CURRENT YEAR, EVEN WHEN IT LEADS TO UNINTENDED RESULTS, A PREREQUISITE CAST IN STONE BEFORE AN ASSESSED LOSS INCURRED IN A PREVIOUS YEAR MAY BE CARRIED FORWARD?.....	18
3.1 THE ARGUMENT FOR THE INCOME FROM TRADE REQUIREMENT.....	18
3.2 THE ARGUMENT AGAINST THE INCOME FROM TRADE REQUIREMENT.....	22
3.3 CONCLUSION	25
CHAPTER 4: WOULD A COURT OF LAW BE ENTITLED TO FOLLOW A PURPOSIVE INTERPRETATION OF SECTION 20(1) OF THE ACT IN CASES WHERE UNINTENDED RESULTS AND ANOMALOUS SITUATIONS ARE NOT DESIRABLE	28
4.1 GRAMMATICAL INTERPRETATION.....	28
4.2 PURPOSIVE INTERPRETATION	31
4.3 CONCLUSION	36
REFERENCES.....	41
CASES.....	43
ACTS.....	46

LIST OF TABLES

Table 1: Example of income from different trades 10

LIST OF ABBREVIATIONS

A	Appeal Court of South Africa
AD	Appellate Division of the Supreme Court of South Africa
CIR	Commissioner of Inland Revenue
Commissioner	Commissioner of the South African Revenue Services
COT	Commissioner of Taxes
ITC	Income Tax Court (Special Court)
S./s.	Section(s)
SARS	South African Revenue Services
SATC	South African Tax Cases
SCA	Supreme Court of Appeal
SIR	Secretary for Inland Revenue
The Act	Income Tax Act, 58 of 1962, as amended
V	Versus

ABSTRACT

For a taxpayer to be able to carry forward a balance of an assessed loss from a prior year, there are two conditions which have to be fulfilled according to section 20 of the South African Income Tax Act, 58 of 1962 namely:

- The taxpayer has to be carrying on a trade and,
- Income has to be generated from the trade.

The onus to prove that both these requirements have been met rests on the taxpayer in terms of section 82 of the Income Tax Act. This study looks at the second requirement which has been a contentious issue as far as its interpretation is concerned. The first point of departure was to analyse the meaning of “income” in this requirement as there have been conflicting views between the South African Revenue Service’s Interpretation Note No. 33 and various High Court and Supreme Court of Appeal court cases. The area of concern is whether “income” in this context should have its ordinary meaning per the Income Tax Act of “gross income less exempt income” or whether it should be “pre-tax profit” or “taxable income”.

The implementation of the “income from trade” requirement often leads to anomalies, unintended results and uncertainty with the application of section 20 of the Income Tax Act. This study takes a look at the “income from trade” requirement and whether the way it is implemented makes good tax policy by analysing the arguments for and against the retention of this requirement. The study also addresses the issue as to whether the use of the purposive interpretation, as opposed to the grammatical interpretation, of section 20 of the Income Tax Act could possibly be followed in cases where the implementation of the “income from trade requirement” leads to anomalies, unintended results and uncertainty with the correct application of section 20.

A CRITICAL ANALYSIS OF THE INTERPRETATION AND APPLICATION OF THE “INCOME FROM TRADE” REQUIREMENT CONTAINED IN SECTION 20(1) OF THE INCOME TAX ACT, 58 OF 1962 WITH REGARD TO THE CARRYING FORWARD OF THE BALANCE OF ASSESSED LOSSES

CHAPTER 1: INTRODUCTION TO THE RESEARCH

1.1 BACKGROUND

This mini-dissertation deals with two important concepts in the Income Tax Act, 58 of 1962¹ (hereafter referred to as ‘the Act’), namely “assessed losses” and the “income from trade requirement”. Section 20(2)² defines “assessed losses” as any amount by which the deductions admissible under section 11³ exceed the income in respect of which they are so admissible. According to section 20(1)⁴, a taxpayer is allowed to deduct from trade income in the current year, per section 20(1)(a)⁵ the balance of the assessed loss brought forward from the previous year, and per section 20(1)(b)⁶, an assessed loss incurred during the current year in any trade in the Republic of South Africa.

The problematic phrase in section 20⁷ is “income from trade” and the interpretation of what is exactly meant by this seemingly unproblematic requirement has led to much uncertainty regarding the meaning of “income” in this context as well as in what way the “income from trade” prerequisite

¹ Income Tax Act, 58 of 1962.

² *Supra* fn. 1, s.20(2).

³ *Supra* fn. 1, s.11.

⁴ *Supra* fn. 1, s.20(1).

⁵ *Supra* fn. 1, s.20(1)(a).

⁶ *Supra* fn. 1, s.20(1)(b).

⁷ *Supra* fn. 1, s.20.

should be handled and in what way it should be interpreted. One of the four maxims that Smith (1904)⁸ highlighted with regard to good taxation practice was “certainty” which meant that the tax that each individual was obliged to pay ought to be certain and not arbitrary.

1.2 OPTIONS AVAILABLE WHEN INTERPRETING A STATUTE

There are two options available when it comes to the interpretation of a statute. The first option is the “grammatical approach” where the words of the statute are given their ordinary, grammatical meaning, contextualised and then interpreted. This is the natural choice which is always first exploited as it is the general rule⁹ The second option is the “purposive approach”, which was spelt out in the *Land en Landbou Bank van Suid-Afrika v Rousseau* 1993 (1) SA 513(A)¹⁰ appeal case where the following was stated regarding the interpretation of statutes in South Africa:

“The general rule is that words of a statute must be given their ordinary grammatical meaning unless to do so would lead to absurdity so glaring that it could never have been contemplated by the legislator, or where it would lead to a result contrary to the intention of the legislator, as shown by the context or by such other considerations that the court is justified in taking into account.

In this event, the court may depart from the ordinary effect of the words to the extent necessary to remove the absurdity and give effect to the true intention of the legislator”.

When section 20(1) of the Act¹¹ is interpreted in the grammatical way, it is clear that it contains two requirements to accomplish a set-off, namely:

- That the taxpayer should be carrying on a trade and;
- That income should be generated from a trade.

However, the South African Revenue Service (SARS) makes concessions to the requirement that income be generated from a trade by the taxpayer in Interpretation Note 33 (2010)¹² by allowing a

⁸ Smith A (1904) *An inquiry into the nature and causes of the wealth of nations*. Available at: www.econlib.org/cgi-bin/printarticle.pl (accessed on 2 February 2012).

⁹ *Land en Landbou Bank van Suid-Afrika v Rousseau* 1993 (1) SA 513(A) 518 H-J.

¹⁰ *Ibid.*

¹¹ *Supra* fn. 4.

¹² Interpretation Note: No.33 (issue 2) - 30 June 2010.

company that has proved it is carrying on a trade during the current year of assessment, to set off its balance of assessed losses from the preceding year, notwithstanding the fact that income may not have accrued from the carrying on of that trade. SARS makes the further concession that to prevent an anomalous situation from arising; they will also allow a company to set off an assessed loss from trade against non-trade income. The inconsistency between the grammatical interpretation of the Act¹³ and Interpretation Note 33¹⁴ forms the crux of the problem.

As stated in Interpretation Note: no 33¹⁵:

“... for many years a debate has raged around whether a company that has traded during the current year but has derived no income from trade in that year will be entitled to set off its balance of assessed loss from the preceding year”.

In *ITC 1830*, 70 SATC 123¹⁶, it was held that the SARS interpretation of section 20¹⁷ was not correct in law as it was not in accordance with the Act¹⁸ and thus, SARS' interpretation was not binding on both SARS and the taxpayer.

An “anomalous position”¹⁹ arises as section 11(a) – (x) of the Act²⁰ allows a taxpayer to deduct allowable expenditure incurred in the carrying on of a trade regardless of whether or not income has been derived from the trade. Should the taxpayer not generate any income from his trade but still incur expenditure that is deductible, this will result in the taxpayer incurring assessed losses. The grammatical interpretation of section 20(1)²¹, read with sections 11(a) – (x)²² may result in “unintended results” as stated by Judge Geldenhuys²³ and agreed by SARS's interpretation of

¹³ *Supra* fn. 1.

¹⁴ *Supra*. fn. 12.

¹⁵ *Ibid.*

¹⁶ *ITC 1830*, 70 SATC 123.

¹⁷ *Supra* fn. 7.

¹⁸ *Supra* fn. 1.

¹⁹ De Koker AP (2011) *Silke on South African Income Tax*. Durban: LexisNexis Butterworths, p. 173.

²⁰ *Supra* fn. 1, s11(a)-(x).

²¹ *Supra* fn. 4.

²² *Supra* fn. 20.

²³ *Supra*. fn. 16.

section 20²⁴ in Interpretation Note 33²⁵. The question then arises as to whether the court may be entitled to follow a purposive interpretation of section 20(1)²⁶ in cases where "unintended results" are not desirable.

The purpose of this study is thus, to examine in some depth the "income from trade" requirement. The arguments for and against this requirement will be presented with specific reference to the relevant sections in the Act²⁷, relevant court cases, articles and interpretations notes which have been written on this matter.

1.3 OBJECTIVE OF THE STUDY

This study will endeavour to suggest changes to section 20(1)²⁸. These changes might possibly put the long raging debate to rest and create more certainty and equity. In so doing, the Act²⁹ might conform more closely to two of the four maxims of: equity, certainty, convenience and economy as set out by Smith³⁰ regarding good taxation laws. In addition, the possible remedies available to the taxpayer regarding the "income from trade" requirement contained in section 20(1)³¹ will be explored.

1.4 RESEARCH METHODOLOGY

²⁴ *Supra* fn. 7.

²⁵ *Supra*. fn. 12.

²⁶ *Supra* fn. 4.

²⁷ *Supra* fn. 1.

²⁸ *Supra* fn. 4.

²⁹ *Supra* fn. 1.

³⁰ *Supra*. fn. 8.

³¹ *Supra* fn. 4.

The research will follow a historical approach combined with a comprehensive qualitative literature review on the relevant sections of the Act³², articles written on the subject, the relevant court cases, as well as SARS Interpretation Note no 33³³ and its predecessor³⁴.

³² *Supra* fn. 1.

³³ *Supra*. fn. 12.

³⁴ Interpretation Note: No.33 (issue 1) - 4 July 2005.

CHAPTER 2: ANALYSING THE POSSIBLE DIFFERENT INTERPRETATIONS OF “INCOME” AS FOUND IN THE “INCOME FROM TRADE” REQUIREMENT IN SECTION 20(1) OF THE INCOME TAX ACT, 58 OF 1962

The “income from trade requirement” contained in section 20(1)³⁵ has been covered in a cloud of controversy since its inception. The first problem that arose was what the real meaning of the word “income” was. Was it “income” as envisaged in its defined meaning in section 1³⁶ as gross income less exempt income or did it have some other meaning in this particular context? There is a presumption that the same words in the same statute have a similar meaning which was confirmed in *ITC 1420* (1986), 49 SATC 69³⁷ where the court said:

“Once a term has been defined in a statute, it is to be interpreted throughout that statute as bearing the same meaning unless the court is satisfied that the defined meaning would be wrong in a particular context...”.

However, in *CIR v Simpson* 1949(4) SA 678 (A)³⁸, the court held that the word “income” for the purpose of sections 7(2) to 7(7)³⁹ had to be given the meaning of profits and gains accruing to the taxpayer and not “income” as defined in the Act⁴⁰. Section 20(1)(a)⁴¹ provides for the set off, against the income derived by any person from carrying on any trade in the Republic, of any balance of assessed loss incurred by the taxpayer in any previous tax year which has been carried forward from the preceding tax year.

In *Conshu (Pty) Ltd v Commissioner for Inland Revenue* 1994 (4) SA 603 (A), 57 SATC 1⁴², the majority held in an *obiter dictum* that the word “income” as used in the introductory part of section

³⁵ *Supra* fn. 4.

³⁶ *Supra* fn. 1, s.1.

³⁷ *ITC 1420*(1986), 49 SATC 69

³⁸ *CIR v Simpson* 1949 (4) SA 678 (A) at 695.

³⁹ *Supra* fn. 1, s.7(2)-(7).

⁴⁰ *Supra* fn. 1.

⁴¹ *Supra* fn. 5.

⁴² *Conshu (Pty) Ltd v Commissioner for Inland Revenue* 1994 (4) SA 603 (A), 57 SATC 1.

20(1)⁴³ was not used in its defined sense of “gross income less exempt income” but rather as having the meaning of “taxable income”. The practical effect of the majority decision above is that if in a subsequent year another assessed loss is incurred (in other words there is no “taxable income”) only the latter will be carried forward and not the assessed loss from year one. The minority, Judges Hoexter and Grosskopf, found as follows:

“The result would be so inconsistent with the scheme of the act that it would require clear language to achieve it ... The mere fact that the provisions regarding deductions appear in sections of the Act before section 20 cannot lead to this result ... in my view both the language of the Act, and the clear policy underlying it, lead to a different conclusion ... It follows that “income in section 20 bears its ordinary meaning as defined in section 1. Section 20 does not require for its application that the taxpayer must have made profit during the relevant year of assessment.”

Following the above decision, there was some confusion as the majority and minority judgments revealed direct opposing views regarding the interpretation of “income” as contained in the “income from trade” requirement in section 20⁴⁴. To add to the problem, SARS issued a statement at the request of Coetzee⁴⁵ stating that:

“At present the approach of SARS is to determine the taxable income (assessed loss) of every company for a particular tax year not having regard to the Conshu judgment. We fully agree with your views that the judgment handed down in that case with regard to the majority judgment, should it be applied as found, would have a draconic effect on the manner in which the carry forward of losses is concerned”.

The fact of the matter is that in 1998 when the above statement was issued by SARS it was in direct opposition to the majority decision in the *Conshu*⁴⁶ case which was an Appellate Division case. SARS therefore followed the minority decision in its interpretation of section 20⁴⁷ of an Appeal court decision that income in section 20⁴⁸ was to have the defined meaning according to the Act and not the meaning of “taxable income” which is the pre-tax profit.

⁴³ *Supra* fn. 4.

⁴⁴ *Supra* fn. 7.

⁴⁵ *Supra*. fn. 38.

⁴⁶ *Supra*. fn. 42.

⁴⁷ *Supra* fn. 7.

⁴⁸ *Ibid*.

Consider the following scenario:

- Company A has been running a business for 10 years and has always made a taxable profit, however in year 11 due to an economic recession it makes a R100 000 loss .
- The company employs 500 workers and decides that instead of shutting down the business, the shareholders will keep the company afloat by investing more money in the company or negotiating a further loan.
- In year 12, the company incurs a further loss of R150 000 and still decides to continue its trading operations. In year 13 the company returns to profitability.

It would be in the government's interest to reward the company for not closing and battling on through the hard times by allowing it to carry forward its losses incurred in the previous 2 years and setting them off against current and future income to be earned as 500 employees still retained their income source and did not have to rely on government assistance. According to the majority decision in *Conshu*⁴⁹ only the R150 000 loss incurred in year 12 would be able to be carried forward and the R100 000 loss incurred in year 11 would be lost forever as no taxable income was made in year 12. Taking the above scenario into consideration, the majority decision in *Conshu*⁵⁰ makes neither good business sense nor good tax policy. This might be the reason why SARS does not want to follow it, especially in a country like South Africa, where unemployment has reached endemic proportions which was reported at 23.9% in the last quarter of 2011.⁵¹

2.1 ANOMALOUS SITUATIONS

Ngalwana⁵² discusses the whole concept of what meaning "income" in the section 20(1)⁵³ income from trade requirement has or should have. He argues that the term income is used in the sense of taxable income in section 20(1)⁵⁴, not only because the phrase that qualified income in section

⁴⁹ *Supra*. fn. 42.

⁵⁰ *Ibid*.

⁵¹ Trading Economics (2012) *South Africa unemployment rate*. Available at: <http://www.tradingeconomics.com/south-africa/unemployment-rate> (accessed 2 February 2012).

⁵² Ngalwana VR (1998) Corporate taxation and the utilization of assessed losses in South Africa. *South African Mercantile Law Journal*. Vol. 10, p193 - 220.

⁵³ *Supra* fn. 4.

⁵⁴ *Ibid*.

11(1) of the 1925⁵⁵ and 1941⁵⁶ Acts has been omitted from the current set-off provision, but also because an interpretation of the term in its defined sense would result in anomalous situations which are inconsistent with the scheme of the Act⁵⁷. To explain the anomalous situation referred to above, Ngalwana⁵⁸ illustrates this by following the three steps to be taken to calculate income, taxable income or an assessed loss:

Step one:

Determine gross income as defined.

Step two

Determine income as defined by subtracting exempt income.

Step three:

Determine taxable income or assessed loss by subtracting allowable deductions in terms of sections 11 to 19⁵⁹ from income as defined.

To determine whether there is a taxable income or an assessed loss all three steps have to be conducted. Ngalwana⁶⁰ then concludes that if having ascertained an assessed loss in step three of year one and then carrying it forward to year two and setting-off that assessed loss against defined income calculated by only using two steps would be anomalous as it would be ignoring allowable deductions.

The situation becomes progressively worse where a taxpayer, carries on a number of trades because it becomes unclear as to against which trade's income, as defined, does one set off the accumulated assessed loss. Subject to section 20A⁶¹, section 20(1)(b)⁶² allows the set-off of trade

⁵⁵ Income Tax Act, 40 of 1925.

⁵⁶ Income Tax Act, 31 of 1941.

⁵⁷ *Supra* fn. 1.

⁵⁸ *Supra*. fn. 52.

⁵⁹ *Supra* fn. 1, s.11 - 19.

⁶⁰ *Supra*. fn. 52.

⁶¹ *Supra* fn. 1, s.20A.

⁶² *Supra* fn. 6.

income against the accumulated assessed losses incurred by the taxpayer from other trades in the same year. Ngalwana illustrates the problem that arises as follows:

Table 1: Example of income from different trades

Trade A		Trade B		Trade C	
Gross Income	R100	Gross Income	R150	Gross Income	R100
Exempt Income	R(50)	Exempt Income	R(70)	Exempt Income	R(0)
Income	R50	Income	R80	Income	R100
Deductions	R(90)	Deductions	R(90)	Deductions	R(30)
Assessed loss	R(40)	Assessed loss	R(10)	Taxable income	R70

Source: Ngalwana VR (1998) Corporate taxation and the utilization of assessed losses in South Africa. *South African Mercantile Law Journal*. Vol 10, p193 – 220⁶³.

The question that arises in the above example is, against which income should the assessed losses of Trade A and Trade B be set off?

- Should it be against the taxable income of Trade C of R70 thereby following Harm's⁶⁴ majority view in the *Conshu*⁶⁵ case? The result of following this method would give an answer of R20.
- Alternatively should it be against income as defined in the Act⁶⁶ therefore, following the minority view in *Conshu*⁶⁷? If this route is taken, further questions arise such as: against which income must the assessed losses be deducted, Trade A, Trade B or Trade C? A combination of any income from any two trades or should it be the sum of all three trades, or income from Trade C as it was the only trade that had taxable income? The answer is not readily available.

It is partly due to the uncertainty above that Ngalwana⁶⁸ comes to the conclusion that although the word "income" was used in its defined sense in the 1925⁶⁹ and 1941⁷⁰ Acts and interpreted in this

⁶³ *Supra*. fn. 52.

⁶⁴ *Supra*. fn. 42.

⁶⁵ *Ibid*.

⁶⁶ *Supra* fn. 1.

⁶⁷ *Supra*. fn. 42.

⁶⁸ *Supra*. fn. 52.

⁶⁹ *Supra*. fn. 55.

way by the Courts, due to above reasons Harms⁷¹ interpreted “Income” as per section 20(1) of the Act⁷² as being “taxable income” correctly.

Swart⁷³ argues that Harm’s⁷⁴ view of section 20(1)⁷⁵ that “income” in the “Income from trade” requirement does not have the defined meaning of gross income less exempt income but rather that of “taxable income” is in conflict with the underlying principles of the general deduction formula per section 11(a)⁷⁶, which are that “an expense or loss incurred in the production of income is not disqualified as a deduction on the grounds of its failure to produce income in the same or future tax years or within a specific period”. Swart⁷⁷ then also comes to a conclusion that Harm’s view in the *Conshu*⁷⁸ case is impractical and when it comes to the set off of an assessed loss against income from other trades per section 20(1)(b)⁷⁹ he notes that the “ anomalies are manifest”.

We have therefore got two learned writers who in their respective articles just as the case was with the majority and minority views in *Conshu*⁸⁰ directly in opposition to each other. It therefore appears that whatever way “income” per section 20(1)⁸¹ is interpreted, be it its defined meaning of gross income less exempt income or taxable income, when it comes to implementing 20(1)(b)⁸² when setting off of an assessed loss against income or losses from other trades, there will be anomalies.

⁷⁰ *Supra*. fn. 56.

⁷¹ *Supra*. fn. 42.

⁷² *Supra* fn. 7.

⁷³ Swart GJ (1996) The utilization of assessed losses by companies: a reappraisal after *Conshu* (Pty) Ltd v Commissioner for Inland Revenue. *SA Mercantile Law Journal*. Vol. 8(1), p119-144.

⁷⁴ *Supra*. fn. 42.

⁷⁵ *Supra* fn. 4.

⁷⁶ *Supra* fn. 1, s.11(a).

⁷⁷ *Supra*. fn. 73.

⁷⁸ *Supra*. fn. 42.

⁷⁹ *Supra* fn. 6.

⁸⁰ *Supra*. fn. 42.

⁸¹ *Supra* fn. 4.

⁸² *Supra* fn. 6.

What both writers however have in common is that they both requested in the respective articles that the section 20⁸³ legislation should be revisited to clear up the uncertainty that surrounds the income requirement and the context in which the word “income” is used in this section especially after the opposing obiter statements in the *Conshu*⁸⁴ case.

Regarding the meaning of “income” in the context of section 20(1)(a)⁸⁵ in the *Conshu*⁸⁶ case, there was a meaningful difference between the majority of three judges which found income not to have its defined meaning of “gross income less exempt income” but rather the meaning of taxable income thus, a taxable profit, and the minority Judges Hoexter and Grosskopf JJA⁸⁷ who found that there was no reason why “income” in the context of section 20(1)⁸⁸ should not have its defined meaning. Swart⁸⁹ and Ngalwana⁹⁰ in their articles also posed opposing views on how assessed losses should be carried forward based on the definition and interpretation of income and taxable income. The Commissioner then issued a statement at the request of Coetzee⁹¹ wherein they said they follow the minority judgment.

2.2 SPECIAL CASES DO NOT CREATE GENERAL RULES

Turning to a very recent Appeal Court decision that of *Commissioner of South African Revenue Services v Founders Hill* 73 SATC 183⁹² in which the facts were briefly as follows: AECl owned some property which it had held for many years which the board of AECl decided to sell or develop based on a memorandum of recommendation which they had received on 2 March 1989.

⁸³ *Supra* fn. 7.

⁸⁴ *Supra*. fn. 42.

⁸⁵ *Supra* fn. 5.

⁸⁶ *Supra*. fn. 42.

⁸⁷ *Ibid*.

⁸⁸ *Supra* fn. 4.

⁸⁹ *Supra*. fn. 73.

⁹⁰ *Supra*. fn. 52.

⁹¹ Coetzee H (1998) Assessed losses – the final blow? *Accountancy SA*. Vol (October issue) p19 - 33.

⁹² *Commissioner of South African Revenue Services v Founders Hill* 73 SATC 183.

After receiving legal advice it formed a company “Founders Hill” in 1993, a wholly owned subsidiary of AECl. AECl then sold some of its property to “Founders Hill” which was to act as a realisation company by selling these properties acquired from AECl to AECl’S best advantage. Once these properties had been so realised “Founders Hill” would be voluntarily wound up within a period of one year. “Founders Hill” spent eleven million rand in developing and marketing these properties. The commissioner taxed “Founders Hill” on the profits it realised when selling these properties as he contended that as in *Natal Estates Ltd v Secretary for Inland Revenue 1975 (4) SA 177 (A)*⁹³ “Founders Hill” had crossed the rubicon and had changed its intention from realising capital assets to carrying on a business of selling land for profit.⁹⁴

“Founders Hill” argued that it was merely a realisation company whose sole purpose was to sell the land it had purchased from AECl as a capital asset to AECl’s best advantage. “Founders Hill” referred to *Commissioner of Taxes v Booyens Estates Ltd*⁹⁵ and *Commissioner for Inland Revenue v Stott*⁹⁶ as authority for its contention.

However when asked why AECl had not sold the above properties themselves instead of forming “Founders Hill” (a wholly owned subsidiary of AECl) and then selling it to them to develop and sell, the counsel for “Founders Hill” could offer no explanation other than AECl had taken legal advice to this effect. It is therefore clear that the legal advice “Founders Hill” had obtained namely to create a realisation company “Founders Hill” and then sell its property to this company who would then develop and realise the property so acquired to AECl’s best advantage had been based on the assumption that an inter posed realisation company will at all times stand in the shoes of the entity which had transferred the assets to it, and as such hold these assets as capital assets.⁹⁷

Judge Lewis said the following in delivering his judgement in the *Founders Hill*⁹⁸ Appeal Case “*Calling an entity a realisation company (and limiting its objects and restricting its selling activities in respect of the assets transferred to it), is not itself a magical act that inevitably makes the profits derived from the sale of these assets capital of nature*”. He further said that in situations where the

⁹³ *Natal Estates Ltd v Secretary for Inland Revenue 1975 (4) SA 177 (A)*.

⁹⁴ *Supra*. fn. 92.

⁹⁵ *Commissioner of Taxes v Booyens Estates Ltd 1918 AD 576 at 595*.

⁹⁶ *Commissioner for Inland Revenue v Stott 1928 AD 252 at 263*.

⁹⁷ *Supra*. fn. 92.

⁹⁸ *Ibid*.

original holder of the assets could without the creation of a subsidiary company which has the sole purpose to sell what was capital assets in the original owners hands, have realised the assets himself, there could hardly be an intention on the part of the realisation company to sell the property acquired as a capital asset.

He then poses the question “*if the sole purpose of the transfer to the realisation company is so that it can realise the property, on what basis can it be said that it ever held it as capital?*” Judge Lewis then refers to the *Berea West Estates (Pty) Ltd v Secretary for Inland Revenue* 1976 (2) SA 614(A)⁹⁹ and *Malone Trust v Secretary for Inland Revenue* 1977 (2) SA 819(A)¹⁰⁰ cases where realisation companies had been created to realise assets held by previous owners to their best advantage and where the profits so realised had been judged to be capital and not income of nature. He then makes the distinction between cases where assets are sold to a realisation company from a single owner with the sole purpose of realising it and the *Berea West*¹⁰¹ case where more than one person sold the assets to the realisation company and the *Malone*¹⁰² case where without the creation of the realisation company or trust, selling of the asset would have been complex or impossible. In these two above mentioned cases there was a strong justification for the formation of a realisation company or trust.¹⁰³

In the final instance Judge Lewis comes to the conclusion that the *Founders Hill*¹⁰⁴ case differs from the *Berea West*¹⁰⁵, *Malone*¹⁰⁶, *Rand v Albern Land Co Ltd* (1920) TC 629 (KB)¹⁰⁷, *Inland Revenue Commissioners v Westleigh Estates Co Ltd* (1924) KB 390¹⁰⁸ and *Commissioner of Taxes v Melbourne Trust Ltd* (1914) AC 1001 (PC)¹⁰⁹ which are all cases where realisation

⁹⁹ *Berea West Estates (Pty) Ltd v Secretary for Inland Revenue* 1976 (2) SA 614(A).

¹⁰⁰ *Malone Trust v Secretary for Inland Revenue* 1977 (2) SA 819(A).

¹⁰¹ *Supra.* fn. 99.

¹⁰² *Supra.* fn. 100.

¹⁰³ *Supra.* fn. 92..

¹⁰⁴ *Ibid.*

¹⁰⁵ *Supra.* fn. 99.

¹⁰⁶ *Supra.* fn. 100.

¹⁰⁷ *Rand v Albern Land Co Ltd* (1920) TC 629 (KB).

¹⁰⁸ *Inland Revenue Commissioners v Westleigh Estates Co Ltd* (1924) KB 390.

¹⁰⁹ *Commissioner of Taxes v Melbourne Trust Ltd* (1914) AC 1001 (PC).

companies where created to achieve a different main purpose over and above the mere realisation of property and that “*Special Cases do not create general rules*”.

2.3 SECTION 103(2) SCENARIO

The *Conshu*¹¹⁰ case was a section 103(2)¹¹¹ scenario. A section 103(2)¹¹² scenario occurs where company A (Pty) Ltd has a one million rand assessed loss and company B (Pty) Ltd which is profitable acquires the total share capital of company A and then sells company B to company A which then receives income from company B’s profitable business which continues as is. Company B therefore acquired company A with the sole purpose to utilise company A’s assessed loss to reduce its tax liability.

It is clear that in the above case we have the trafficking/ purchase of an assessed loss for the sole purpose to avoid or reduce a tax liability. Section 103(2)¹¹³ of the Act was specifically introduced to prevent the trafficking in assessed losses.

Section 103(2)¹¹⁴ has the following three requirements which must all be satisfied before it can be applied:

- There must be an agreement affecting a company or a change in the shareholding of a company.
- which results in a receipt or an accrual of income or a capital gain by the company.
- the purpose of this agreement or change must be solely or mainly to utilise any assessed loss, balance of assessed loss, capital loss or assessed capital loss to avoid or reduce a tax liability.

When all three these requirements are met the assessed loss so acquired may not be set off against income which was generated through this agreement or change of shareholding¹¹⁵. In the

¹¹⁰ *Supra*. fn. 42.

¹¹¹ *Supra* fn. 1, s.103(2).

¹¹² *Ibid*.

¹¹³ *Ibid*.

¹¹⁴ *Ibid*.

¹¹⁵ De Koker AP (2011) *Silke on South African Income Tax*. Durban: LexisNexis Butterworths p.795.

*Conshu*¹¹⁶ case, we had a typical section 103(2)¹¹⁷ scenario and it was in this scenario that Judge Harms in his majority decision found that in section 20(1)(a)¹¹⁸ the term “income” carried the meaning of “taxable income”, which is pre-tax profit, and not its defined meaning as per section 1¹¹⁹ of the Act.

2.4 CONCLUSION WITH REGARDS TO THE INTERPRETATION OF INCOME IN THE SECTION 20 INCOME FROM TRADE REQUIREMENT

As the *Conshu*¹²⁰ case was a section 103(2)¹²¹ scenario and it could be argued that the interpretation of “income” in the context of section 20(1)(a)¹²² as having the meaning of “taxable income” instead of its defined meaning would only be applicable to cases which have a section 103(2)¹²³ scenario thus “special cases”. If this is found to be the case, then the comment that Judge Lewis¹²⁴ made that “*special cases do not create general rules*” is very important, because it would mean that the majority decision regarding the interpretation of the word “income” in section 20(1)(a)¹²⁵ as being “taxable income” would as a special section 103(2)¹²⁶ case only be applicable in such a scenario and not create a general rule. The Commissioner also stated in his most recent interpretation note 33¹²⁷ “SARS accepts that in the context of section 103(2)¹²⁸ it is the tainted “pre-tax profit” that is ring-fenced and not an individual item of tainted “income” as defined”. It could then

¹¹⁶ *Supra*. fn. 42.

¹¹⁷ *Supra* fn. 111.

¹¹⁸ *Supra* fn. 5.

¹¹⁹ *Supra* fn. 36.

¹²⁰ *Supra*. fn. 42.

¹²¹ *Supra* fn. 111.

¹²² *Supra* fn. 5.

¹²³ *Supra* fn. 111.

¹²⁴ *Supra*. fn. 92.

¹²⁵ *Supra* fn. 5.

¹²⁶ *Supra* fn. 111.

¹²⁷ *Supra*. fn. 12.

¹²⁸ *Supra* fn. 111.

be argued that in any other cases where there is no section 103(2)¹²⁹ scenario the meaning of income as per section 20(1)(a)¹³⁰ would carry its ordinary defined meaning of gross income less exempt income.

The discussion above whether the interpretation of income in section 20(1)¹³¹ in the *Conshu*¹³² case by the majority was a special case or not due to its 103(2)¹³³ scenario, is still an open question, and far from settled. A degree of certainty will only arise should there be a future appeal court case regarding the interpretation or meaning of income in the section 20¹³⁴ “*Income from trade*” requirement where there is no section 103(2)¹³⁵ scenario.

Will the appeal court then find “*Income*” to have its defined meaning of section 1¹³⁶ of the Act being *gross income less exempt income* or will it have a meaning of *taxable income* as per the majority decision in the *Conshu*¹³⁷ case? It is by no means certain what the outcome will be.

¹²⁹ *Supra* fn. 111.

¹³⁰ *Supra* fn. 5.

¹³¹ *Supra* fn. 4.

¹³² *Supra*. fn. 42.

¹³³ *Supra* fn. 111.

¹³⁴ *Supra* fn. 7.

¹³⁵ *Supra* fn. 111.

¹³⁶ *Supra* fn. 36.

¹³⁷ *Supra*. fn. 42.

CHAPTER 3: IS INCOME FROM TRADE IN A CURRENT YEAR, EVEN WHEN IT LEADS TO UNINTENDED RESULTS, A PREREQUISITE CAST IN STONE BEFORE AN ASSESSED LOSS INCURRED IN A PREVIOUS YEAR MAY BE CARRIED FORWARD?

3.1 THE ARGUMENT FOR THE INCOME FROM TRADE REQUIREMENT

In *Robin Consolidated Industries Ltd v CIR* (1997) 2 ACC SA 195 (A)¹³⁸ the Supreme Court of Appeal rejected the minority decision in *Conshu*¹³⁹. The court followed the *SA Bazaars (Pty) Ltd v CIR* 1952 (4) SA 505 (A)¹⁴⁰ and the *New Urban Properties Ltd v Secretary for Inland Revenue* 1966 (1) SA 217 (A), 27 SATC 175¹⁴¹ judgements wherein the latter case it was explicitly said that: “a balance can be carried forward from any year only if a balance has been struck in that year, which clearly means: if an assessment has been issued for that year reflecting the balance of assessed loss at the “end of it.”

This meant that if there was no income or loss from trading in a given year the assessed loss would not be able to be carried forward and therefore be discarded. Olivier¹⁴² felt that the decision in *Robin Consolidated Industries Ltd v Commissioner for Inland Revenue*¹⁴³ could not be seen to be authority for the view “that if in year two no income is derived, but a further loss is incurred, the assessed loss could also not be carried forward”, as on the facts of the case, no further loss was incurred in year two. In the *Robin*¹⁴⁴ case, the court had to decide whether they should depart from the rule established in the *SA Bazaars* case¹⁴⁵ that “if there is no income or loss from trading the

¹³⁸ *Robin Consolidated Industries Ltd v CIR* (1997) 2 ACC SA 195(A)

¹³⁹ *Supra.* fn. 42.

¹⁴⁰ *SA Bazaars (Pty) Ltd v CIR* 1952 (4) SA 505 (A).

¹⁴¹ *New Urban Properties Ltd v Secretary for Inland Revenue* 1966 (1) SA 217 (A), 27 SATC 175.

¹⁴² Olivier, L (2002) Assessed losses: a note on trade and income requirements, *Stellenbosch Law Review*, Vol 13, Issue 3.

¹⁴³ *Supra.* fn. 138.

¹⁴⁴ *Ibid.*

¹⁴⁵ *Supra.* fn. 140.

assessed loss disappears". The court decided not to depart from the rule. Olivier¹⁴⁶ expressed the view that the implication of this decision was that "even if another assessed loss is incurred in a subsequent year, the assessed loss from the previous year does not disappear, and the reason is that the existence of this further loss necessitates an assessment, in other words a new balance is struck in year two". Two objections can be raised against this interpretation namely; the wording of section 20¹⁴⁷ explicitly requires an assessed loss to be set off against income derived from trade in the following year and in sec 20(2A)(b)¹⁴⁸, taxpayers other than companies are specifically excluded from the "income from trade" requirement, and this therefore indicates that this requirement is by implication applicable to companies¹⁴⁹.

Both Swart¹⁵⁰ and Olivier¹⁵¹ feel that there is no commercial justification or equity in disallowing an assessed loss to be carried forward if no income is derived in the subsequent year, and that no legal certainty currently exists, which SARS also acknowledges has to date, not yet been resolved¹⁵² In *Commissioner of South African Revenue Services v Megs Investments (Pty) Ltd and another* 2005 (4) SA 328 SCA, 66 SATC 175¹⁵³, the court had to consider the "income from trade" requirements. The court reverted to the *ratio decidendi* in *Robin*¹⁵⁴ by noting that set-off was only admissible if the taxpayer could prove that the set-off was:

- against income derived from trade and;
- where the balance of assessed loss has been carried forward from the preceding year.

The Commissioner's argument in *CSARS v Megs Investments (Pty) Ltd*¹⁵⁵ was that the respondent had not proved that they carried on a trade during 1996 as their activities during that year were

¹⁴⁶ *Supra*. fn. 142.

¹⁴⁷ *Supra* fn. 7.

¹⁴⁸ *Supra* fn. 1, s.20(2A)(b).

¹⁴⁹ *Supra*. fn. 138.

¹⁵⁰ *Supra*. fn. 73.

¹⁵¹ *Supra*. fn. 142.

¹⁵² *Supra*. fn. 12.

¹⁵³ *Commissioner of South African Revenue Services v Megs Investments (Pty) Ltd and another* 2005 (4) SA 328 SCA, 66 SATC 175.

¹⁵⁴ *Supra*. fn. 138.

¹⁵⁵ *Supra*. fn. 153.

mere acts in preparation for trading at an unspecified time in the future. The Appeal court upheld the decision in both the Income Tax Special Court and the High Court that the respondent's activities of trying to establish a similar business in Angola to the one that they were conducting in South Africa did in fact amount to the carrying on of a trade within the wide definition of trade in section 1¹⁵⁶. However, it was conceded by the respondent that there had to be a causal relationship between the trade they carried on and the income thus derived. The matter as to whether there had to be income from trade was never decided in *Megs*¹⁵⁷ as it was conceded by the counsel for the respondent. The *Megs*¹⁵⁸ case, though an Appeal court case, cannot be seen as the final authority for the principle that "a company that has traded but failed to earn any trade income was not entitled to set off its assessed loss". Judge Jones AJA¹⁵⁹ made it very clear that his decision was based on the concession made by the respondents. The question as to whether there must be income from trade for an assessed loss to be carried forward from a previous year remains unresolved as no binding precedent has been established by the Supreme Court of Appeal¹⁶⁰.

*ITC 1830*¹⁶¹ was the first time the court did not shy away from the "income from trade" principle where the Judge in his judgement addressed the following:

- When you interpret section 20(1)¹⁶², in the grammatical way, which is to give words their plain meaning, an assessed loss cannot be brought forward and set off if there was no income generated in the current year against which it could be set off. Although reference was made of the *Conshu*¹⁶³ and *Megs*¹⁶⁴ cases in support of this view, neither of these two cases cited had this as their *ratio decidendi* but the observation was rather *obiter dictum* in both cases. Reference was also made to the decisions made in two Income Tax cases; *ITC 664*, 16 SATC

¹⁵⁶ *Supra* fn. 36.

¹⁵⁷ *Supra*. fn. 153.

¹⁵⁸ *Ibid*.

¹⁵⁹ *Ibid*.

¹⁶⁰ *Supra*. fn. 12.

¹⁶¹ *Supra*. fn. 16.

¹⁶² *Supra* fn. 4.

¹⁶³ *Supra*. fn. 42.

¹⁶⁴ *Supra*. fn. 153.

125¹⁶⁵ and *ITC 1679*, 62 SATC 294¹⁶⁶, where it was held that there had to be income against which a balance could be struck should an assessed loss be brought forward from a previous year.

- In *ITC 777*, 19 SATC 320¹⁶⁷, the Commissioner did not argue the point that there was no income in the current year and therefore the balance of assessed loss could not be brought forward from a previous year to be set off in the current year. This omission by the Commissioner did not however mean that one could jump to the conclusion that income in the current year was no longer a requirement to bring forward the balance of an assessed loss from a previous year to be set off in the current year.
- When a taxpayer's activities are split into different tax years, anomalies might arise. This was however not sufficient reason not to give effect to the grammatical interpretation of section 20(1)¹⁶⁸.
- It was concluded that it was fixed in law that unless there was a continuity of trade in the current year, there could not be a set off of a balance of assessed loss brought forward from a previous year and that it was reasonable to assume that the legislature also intended through section 20(1)¹⁶⁹ that there should be a continuity of income in the current tax year.
- The fact that a taxpayer other than a company is specifically allowed to carry forward the balance of assessed loss from a previous year even though there is no income generated in the current year per section 20(2A)(b)¹⁷⁰ makes it clear that the legislature intended that the derivation of income in the current year, in the case of a company, is a prerequisite for the carrying forward of a balance of an assessed loss from a previous year.
- With reference to Interpretation Note 33 of 2005¹⁷¹, it was decided that the Commissioner could not and did not intend to change the law by making certain concessions to address unintended results.

The court in *ITC 1830*¹⁷² therefore confirmed the principle and continued existence of the income from trade requirement before a balance of an assessed loss may be brought forward and set off in the following year of assessment.

¹⁶⁵ *ITC 664*, 16 SATC 125.

¹⁶⁶ *ITC 1679*, 62 SATC 294.

¹⁶⁷ *ITC 777*, 19 SATC 320.

¹⁶⁸ *Supra* fn. 4.

¹⁶⁹ *Ibid.*

¹⁷⁰ *Supra* fn. 148.

¹⁷¹ *Supra*. fn. 34.

After discussing *ITC 1830*¹⁷³, SARS made the following comment in Interpretation Note 33¹⁷⁴ saying: “... *some commentators have incorrectly suggested that SARS departed from the view expressed in this note by taking the matter on appeal. However, at no stage did SARS concede that the taxpayer had carried on a trade and in these circumstances SARS will invoke the ‘income from trade’ requirement*”. From this comment, it seems that the only real use SARS has for the income from trade principle is to invoke the clause only and only when they have difficulty in proving that the taxpayer was not carrying on a trade. The question that then arises is whether this is indeed fair and equitable as it was an established fact that the onus of proving that the taxpayer was carrying on a trade lies with the taxpayer.

3.2 THE ARGUMENT AGAINST THE INCOME FROM TRADE REQUIREMENT

Swart¹⁷⁵ looks at the predecessors of sections 20 and 17(2) of the Income Tax Act, 41 of 1917¹⁷⁶ and sec 11(3) of the Income Tax Acts of 1925¹⁷⁷ and 1941¹⁷⁸ which embodied the provisions dealing with allowable general deductions under the respective consolidation Acts where he concluded that the same basic principles applying to general allowable deductions were also applicable to the set off of an assessed loss.

Swart¹⁷⁹ points out that the only real change that occurred when the Income Tax Act of 1962¹⁸⁰ came into being was that section 20¹⁸¹ was included in the new Act, separate from the provisions

¹⁷² *Supra*. fn. 16.

¹⁷³ *Ibid*.

¹⁷⁴ *Supra*. fn. 12.

¹⁷⁵ *Supra*. fn. 73.

¹⁷⁶ Income Tax Act, 41 of 1917.

¹⁷⁷ *Supra*. fn. 55.

¹⁷⁸ *Supra*. fn. 56.

¹⁷⁹ *Supra*. fn. 73.

¹⁸⁰ *Supra* fn. 1.

¹⁸¹ *Supra* fn. 7.

dealing with allowable deductions in section 11¹⁸². In *Sekretaris van Binnelandse Inkomste v Olifantsrivier Koöperatiewe Wynkelders Bpk* 1976 (3) SA 261 (A)¹⁸³, it was stated that there is a presumption that Parliament does not intend to change the law by a mere consolidating measure, but that this presumption can be rebutted where the Act of Parliament states this in clear language. Swart¹⁸⁴ concludes that “... *there is no indication in the formulation of ss11 and 20(1) that income so derived is used in s 20(1) in a sense different from that in s 11 where it clearly carries its defined meaning*”.

In *Sub-Nigel Ltd v Commissioner for Inland Revenue* 1948 (4) SA 580 (A)¹⁸⁵, the principle was established that expenditure incurred for the purpose of earning income will be deductible in the year in which it is incurred, irrespective of the fact that no income is generated in the current or future tax years. Swart¹⁸⁶ states that the principles laid down in *Sub-Nigel*¹⁸⁷ should be consistently applied with regards to section 11¹⁸⁸ and section 20(1)¹⁸⁹ by making the following observations:

- The fact that section 20(1)¹⁹⁰ allows a taxpayer to carry forward an assessed loss from a previous tax year to the next means that section 20(1)¹⁹¹ accepts that a taxpayer's allowable expenses might exceed the income generated in a specific tax year.
- The whole intention of section 20(1)¹⁹² was to allow a taxpayer to recover expenditure and losses which exceeded the income generated in a specific tax year in future tax years. This application was specifically recognised in *Lockie Bros Ltd v Commissioner for Inland Revenue*

¹⁸² *Supra* fn. 3.

¹⁸³ *Sekretaris van Binnelandse Inkomste v Olifantsrivier Koöperatiewe Wynkelders Bpk* 1976 (3) SA 261 (A).

¹⁸⁴ *Supra*. fn. 73.

¹⁸⁵ *Sub-Nigel Ltd v Commissioner for Inland Revenue* 1948 (4) SA 580 (A).

¹⁸⁶ *Supra*. fn. 73.

¹⁸⁷ *Supra*. fn. 185.

¹⁸⁸ *Supra* fn. 3.

¹⁸⁹ *Supra* fn. 4.

¹⁹⁰ *Ibid.*

¹⁹¹ *Ibid.*

¹⁹² *Ibid.*

1922 TPD 42 at 44¹⁹³ and also in *Commissioner of Inland Revenue v Louis Zinn Organization (Pty) Ltd* 1958 (4) SA C177 (A), 22 SATC 85¹⁹⁴.

- The attempt to divide a taxpayer's trading activities into different yearly sections is an artificial exercise.
- Where a taxpayer failed to provide an adequate amount of income, the total amount of allowable expenses and losses incurred should be recoverable from pre-tax income in the current or future tax years.
- As was the case with the predecessors of section 20(1)¹⁹⁵, the whole rationale behind allowing the set off of a balance of assessed loss brought forward from a previous tax year is to give effect to the principles on which the general deduction formula is based. The failure to produce income in a specified period does not preclude the deduction of an expense or loss incurred in the production of income.

If a company has one week's trading in a year resulting in income of say R1 000, it gets to keep its assessed loss and carry it forward whereas if the company has a year's trading with no resultant income it loses its assessed loss. From the above example, it appears grossly unfair and draws one to the conclusion that the disallowance of the company to carry forward its assessed loss could never have been the legislator's intention with section 20(1)¹⁹⁶. The whole question of equity goes further when you consider that section 20(2A)(b)¹⁹⁷ allows a taxpayer who is an individual and not a company to set off his assessed loss against non-trade income whereas the company is not allowed to do so as it must derive income from the trade carried on. According to Swart¹⁹⁸, this result "... violates the precept of horizontal equity where taxpayers in the same position should be treated in the same way. This may render the requirement susceptible to constitutional attack under s 8 of the Constitution of the Republic of South Africa Act 200 of 1993 unless the discriminatory aspect of s 20(1) can be justified in terms of s 33(1) of the constitution".

¹⁹³ *Lockie Bros Ltd v Commissioner for Inland Revenue* 1922 TPD 42 at 44.

¹⁹⁴ *Commissioner for Inland Revenue v Louis Zinn Organization (Pty) Ltd* 1958 (4) SA C177 (A), 22 SATC 85.

¹⁹⁵ *Supra* fn. 4.

¹⁹⁶ *Ibid.*

¹⁹⁷ *Supra* fn. 148.

¹⁹⁸ *Supra*. fn. 73.

It must be borne in mind that there is a fundamental difference between a balance of assessed loss sitting in a company and an assessed loss incurred by an individual in the sense that there can be trafficking in assessed losses incurred by companies but not in the case of individuals. Therefore, it is doubtful whether companies and individuals, when it comes to assessed losses, are taxpayers in similar positions.

In *CIR v Louis Zinn Organization (Pty) Ltd*¹⁹⁹, Schreiner ACJ, when describing the methodology for determining a balance of assessed loss, said the following: “*If there has been a working loss in the tax year the balance to go forward will be increased. If there has been no previous balance the assessed loss in the tax year will be the balance or assessed loss carried forward*” which in essence is support for the view that a company should be able to strike a balance even if its “*income so derived (tax profit or loss) is nil.*”²⁰⁰

3.3 CONCLUSION

Considering the arguments in favour of the ‘income from trade’ requirement and those against objectively, the following conclusions can be made:

- The first step in legislative interpretation is to follow the grammatical interpretation²⁰¹. Should the grammatical interpretation of section 20(1)²⁰² be followed, the clear and unambiguous wording of this section states as a requirement, that in the case of companies, before a company can set off its assessed loss carried forward from a previous year, there should be income from trade generated in the year in which the set off is so required. Spiro²⁰³, Isaacs, Lazer, Fielding and Wells²⁰⁴ also concur with the above interpretation.
- Section 20(2A)(b)²⁰⁵ specifically allows natural persons to carry forward a balance of assessed loss from one year to the next, notwithstanding the fact that no income was generated from

¹⁹⁹ *Supra*. fn. 194.

²⁰⁰ *Supra*. fn. 12.

²⁰¹ *Supra*. fn. 9.

²⁰² *Supra* fn. 4.

²⁰³ Spiro, E (1952) *Income Tax deductions: Whether balance of assessed loss prior to non-trading period thereafter deductible*. Cape Town: The Taxpayer, p214.

²⁰⁴ Isaacs I, Lazer L, Fielding WD & Wells MJ (1963) *Law and practice of South African Income Tax*. Durban: LexisNexis Butterworths, p535.

²⁰⁵ *Supra* fn. 148.

trade in the current year and therefore, by implication, this is not the case when it comes to companies²⁰⁶.

- In *ITC 1830*²⁰⁷, the grammatical interpretation was followed and the ‘income from trade’ requirement in the current tax year was said to be a prerequisite for the carrying forward of an assessed loss from a previous tax year. This decision was given in a tax case which does not create a binding precedent. As this has not been decided in a Supreme Court of Appeal, the courts are likely to follow the decision in *ITC 1830*²⁰⁸. Emslie and Davis²⁰⁹ are of the opinion that the Judge in *ITC 1830*²¹⁰ exceeded his authority by issuing a declaratory order instead of confirming the Receiver’s assessment.
- Interpretation note 33²¹¹ reflects an interpretation which is contrary to the grammatical interpretation of section 20(1)²¹² and the judgement in *ITC 1830*²¹³. Meyerowitz points out that the strict reading of section 20(1)²¹⁴ may result in anomalies and an absurdity which would entitle the courts to depart from the literal meaning of the words. According to Emslie and Davis²¹⁵, if the grammatical interpretation is followed, it results in bad tax policy as it penalises companies heavily in the sense that should they forfeit an assessed loss, they would be unable to ever recover such loss from taxable income generated in future years. According to Swart²¹⁶, this could have serious implications for the company’s financial viability and even lead to bankruptcy and premature closure.

²⁰⁶ De Koker AP, Emslie TS & Frame CR. (1988). *Income Tax in South Africa*. Durban: Butterworths, p248 at 11.35.

²⁰⁷ *Supra*. fn. 16.

²⁰⁸ *Ibid*.

²⁰⁹ Emslie TS and Davis DM (2011) *Cumulative supplement to income tax cases and materials*. Cape Town: The Taxpayer, p171.

²¹⁰ *Supra*. fn. 16.

²¹¹ *Supra*. fn. 12.

²¹² *Supra* fn. 4.

²¹³ *Supra*. fn. 16.

²¹⁴ *Supra* fn. 4.

²¹⁵ *Supra*. fn. 209.

²¹⁶ *Supra*. fn. 73.

- SARS is of the view that it will invoke the income from trade requirement as contained in section 20(1)²¹⁷ whenever SARS is of the opinion that a company has not fulfilled the carrying on of a trade requirement²¹⁸. This stance by SARS seems to be contrary to Smith's²¹⁹ good tax policy maxim of certainty as the same application principle of the invoking of the income from trade requirement is not consistently applied by SARS.

²¹⁷ *Supra* fn. 4.

²¹⁸ *Supra*. fn. 12.

²¹⁹ *Supra*. fn. 8.

CHAPTER 4: WOULD A COURT OF LAW BE ENTITLED TO FOLLOW A PURPOSIVE INTERPRETATION OF SECTION 20(1) OF THE ACT IN CASES WHERE UNINTENDED RESULTS AND ANOMALOUS SITUATIONS ARE NOT DESIRABLE

As section 20(1)²²⁰ stands, an important consideration that needs to be addressed is whether a court of law is compelled to follow a purposive interpretation of this section especially in cases where there are anomalies which may result in unintended results. Keeping in mind that the primary rule of legislative interpretation that the ordinary, grammatical meaning of words should be applied, the first logical place to find the defined meaning of a word is in the dictionary. A word is given its ordinary meaning per the dictionary and then contextualised in terms of the manner in which it has been applied followed by the interpretation based on its contextual use.

4.1 GRAMMATICAL INTERPRETATION

In *ITC 1804*, 68 SATC 105²²¹, Boruchowitz J said that the grammatical approach to the interpretation of a statute took preference over any contextual and commercial interpretation which, he further concluded, had consistently been the case for a very long time.

In *ITC 12895*²²² (2011), Judge Fabricius found that as there was no absurdity or ambiguity contained in the relevant paragraph of the Act, he elected to follow the “old fashioned” grammatical method of interpreting the actual words used in the Act.

In *Mankayi v Anglo Gold Ashanti* 2010 (5) SA 137 SCA²²³, Judge Malan again preferred the grammatical approach regarding interpretation of statutes in contrast to trying to ascertain what the policy or object behind the legislation was. He then referred to the *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 530²²⁴ case in which Innes CJ came to the conclusion that every statute contains a policy or object and that should the grammatical interpretation lead to

²²⁰ *Supra* fn. 4.

²²¹ *ITC 1804*, 68 SATC 105.

²²² *ITC 12895*.

²²³ *Mankayi v Anglo Gold Ashanti* 2010 (5) SA 137 SCA.

²²⁴ *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 530.

doubtfulness the court may well have to use other recognised methods of interpretation to ascertain the underlying policy or object of such legislation.

Innes pointed out that judges have the power to interpret but not to legislate as a judge cannot give another meaning to the plain words used in a statute that it would normally have just to arrive at what he thought the policy or objective of the statute was.

Judge Schutz JA, in *Standard Bank Investment Corporation Ltd v Competition Commissioner* 2000 (2) SA 797 (SCA) at 810 to 811²²⁵, said “Also the constitution, which expresses many values and rights in general terms must have its language respected” and then he refers to what Kentridge AJ said in *S v Zuma and others* 1995 (2) SA 642 (CC) at 652 I – 653 B²²⁶:

“While we must always be conscious of the values underlying the Constitution, it is nonetheless our task to interpret a written instrument. I am well aware of the fallacy of supposing that general language must have a single ‘objective’ meaning. Nor is it easy to avoid the influence of one’s personal intellectual and moral preconceptions. But it cannot be too strongly stressed that the Constitution does not mean whatever we might wish it to mean. We must heed Lord Wilberforce’s reminder that even a constitution is a legal instrument, the language of which must be respected. If the language used by the lawgiver is ignored in favour of a general resort to ‘values’ the result is not interpretation but divination.”

Schutz JA²²⁷ then goes further to say that a constitution “*embodying fundamental rights should as far its language permits be given a broad construction.*”

In *Cape Brandy Syndicate v IRC* 1921²²⁸, the strict and literal rule of interpretation was followed and it was emphasised that, regarding a Tax Act, there was no room for intendment, equity or implied considerations, only the actual language used. The *Cape Brandy Syndicate*²²⁹ decision was followed by the Supreme Court, which gave the impression that fiscal legislation should be interpreted differently from other legislation.

²²⁵ *Standard Bank Investment Corporation Ltd v Competition Commissioner* 2000 (2) SA 797 (SCA) at 810 to 811.

²²⁶ *S v Zuma and others* 1995 (2) SA 642 (CC)” at 652 I – 653 B.

²²⁷ *Supra.* fn. 225.

²²⁸ *Cape Brandy Syndicate v IRC* 1921.

²²⁹ *Ibid.*

This impression was rebutted by the court in *Farrar's Estate v CIR* 1926 TPD 501²³⁰ where it was held that tax laws had the same status as the other laws in a legal system. This was confirmed in the *Glen Anil Development Corporation Ltd v SIR* 1975 (4) SA 715²³¹ case where it was said that apart from the implementation of the “contra fiscum” rule in the case of ambiguity in a fiscal provision there is no case to be made why fiscal legislation should be interpreted differently than any other legislation. In *Secretary for Inland Revenue v Kirsch* 1078 (3) SA 93 (T)²³², it was further held that the normal principles of legislation also applied to tax legislation.

In *Ochberg v CIR* 1931 (AD)²³³ a sole shareholder rendered services to a company and was allocated additional shares in the company as consideration for services rendered. The majority of the court concluded that the value of the shares must be determined objectively and taxed accordingly. As in the *Cape Brandy Syndicate* case, the strict and literal interpretation of the meaning of “amount received” was applied in the *Ochberg*²³⁴ case.

In *ITC 12895*²³⁵, Judge Fabricius referred to the following authoritative appeal court cases *Standard Bank Investment Corporation Ltd v Competition Commissioner*²³⁶ and *East London Municipality v Abrahamse* 1997 (4) SA 613 SCA” at 632 G to H²³⁷.

In *Standard Bank Investment Corporation Ltd v Competition Commissioner*²³⁸, Judge Schutz JA said that in his view, legislation should have its language respected. Parliament gives government its authority to legislate and this is done by enacting statutes which are expressed in words. Therefore the grammatical approach should be followed and extraneous factors left for later.

²³⁰ *Farrar's Estate v CIR* 1926 TPD 501.

²³¹ *Glen Anil Development Corporation Ltd v SIR* 1975 [4] SA 715.

²³² *Secretary for Inland Revenue v Kirsch* 1078 [3] SA 93 [T].

²³³ *Ochberg v CIR* (1931) (AD).

²³⁴ *Ibid.*

²³⁵ *Supra.* fn. 222.

²³⁶ *Supra.* fn. 225.

²³⁷ *East London Municipality v Abrahamse* 1997 (4) SA 613 SCA” at 632 G to H.

²³⁸ *Supra.* fn. 225.

4.2 PURPOSIVE INTERPRETATION

With the advent of the constitution, the strict literal interpretation of fiscal legislation had to give way to a more equitable approach in line with the principles of the constitution. Constitutional interpretation is not concerned with a search to find the literal meaning of legislation, but the recognition and application of constitutional values. Section 2 of the Constitution²³⁹ reads as follows:

“The constitution is the supreme law of the Republic; law or conduct inconsistent with it is invalid, and the obligations imposed by it must be fulfilled.”

Section 39 of the Constitution²⁴⁰ says the following regarding the interpretation of the “Bill of Rights”:

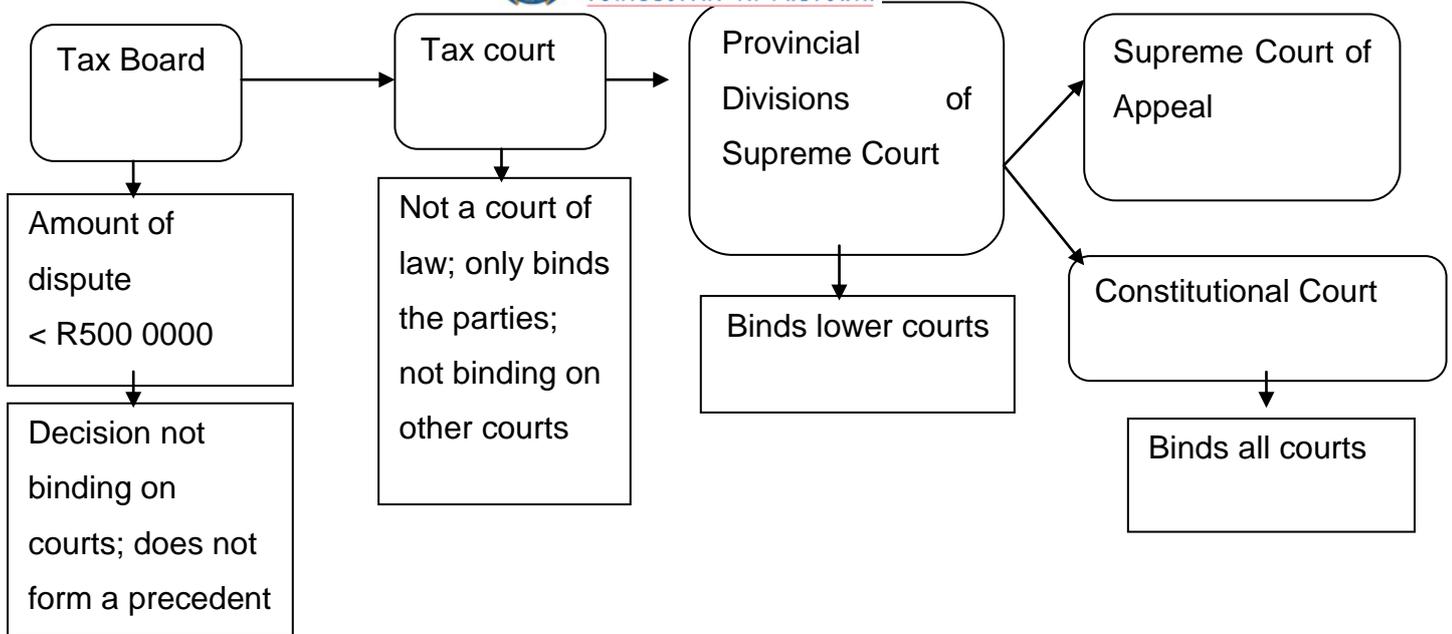
When interpreting the Bill of Rights, a court, tribunal of forum – must promote the values that underline an open and democratic society based on human dignity, equality and freedom; must consider international law; and may consider foreign law. When interpreting any legislation, and when developing the common law or customary law, every court, tribunal or forum must promote the spirit, purpose and objects of the Bill of Rights.

When interpreting legislation, the judiciary is obliged to promote the protection of the liberty of a person, their property and the enforcement of the principles of human dignity, equality, fairness and transparency by public officials.

When looking at the hierarchy of the South African courts, the “stare decisis” rule is found which is the “principle of legal precedence” and can be illustrated as follows:

²³⁹ Constitution of the Republic of South Africa, 1996.

²⁴⁰ *Ibid.*



It is important to realise that the Constitution²⁴¹ reigns supreme. Although legislation may override common law, it cannot override the Constitution and thus all legislation must be interpreted in such a way that the values and aims of the Bill of Rights²⁴² are promoted.

Strict literal interpretations have therefore given way to purposive interpretation. The purpose of the legislature is determined by taking into account all surrounding circumstances and resources.

Even in the *Ochberg v CIR*²⁴³ case where the majority of the court concluded that the value of the shares must be determined objectively and taxed accordingly, resulting in a strict and literal interpretation, the question that invariably arose was whether the taxpayer in the *Ochberg*²⁴⁴ case really received something of economic value? His economic wealth did not increase at all. The minority judgment in this case held that the taxpayer was not liable for income tax on the shares received, because the shares bought did not add wealth to the taxpayer. In his minority judgment, Stratford JA²⁴⁵, held that “*he can find nothing in the Income Tax Act which compels us to designate to income something which every principle of reason and common-sense tells us is nothing of the kind.*”

²⁴¹ *Supra.* fn. 239.

²⁴² *Ibid.*

²⁴³ *Supra.* fn. 233.

²⁴⁴ *Ibid.*

²⁴⁵ *Ibid.*

There may however be departure from the ordinary grammatical language when it gives rise to absurdity. The absurdity is then removed by giving effect to the intention of the legislature (*Landbou Bank*²⁴⁶ and *Venter*²⁴⁷).

In *Geldenhuis v CIR*²⁴⁸, a lady and her predeceased husband executed a mutual will under which the survivor was to enjoy the fruits and income of the joint estate for his or her life time, the children of the marriage being appointed sole and universal heirs of the estate. The joint estate included a flock of sheep. The lady decided to give up farming, and her children agreed to the sale of the flock. The proceeds from the disposal of the flock were deposited into her bank account.

The questions before the court were whether the proceeds from the sale of the flock be subject to income tax in her hands and whether she “received” an “amount.” The court held that technically it may be said that if the purchase price is paid to her and it is “received” by her. However the expression “received by him” means that the money must be received by her in such circumstances that she becomes entitled to it.

Though the usufructuary received the purchase price of the sheep she did not become entitled to the money, which remained the property of the remainder man. It never became part of her “gross income” and so must be excluded from the determination of her “taxable income”. The court thus departed from the ordinary grammatical meaning of “received by” by interpreting it to mean that a person must be entitled to the amount.

This was confirmed in *Land and Landbou Bank van Suid-Afrika v Rousseau*²⁴⁹ where the following was stated regarding the interpretation of statutes in South Africa:

“The general rule is that words of a statute must be given their ordinary grammatical meaning unless to do so would lead to absurdity so glaring that it could never have been contemplated by the legislator, or where it would lead to a result contrary to the intention of the legislator, as shown by the context or by such other considerations that the court is justified in taking into account. In this event the court may depart from the ordinary effect of the words to the extent necessary to remove the absurdity and give effect to the true intention of the legislator.”

²⁴⁶ *Supra.* fn. 9.

²⁴⁷ *Venter v Rex* 1907 (TS).

²⁴⁸ *Geldenhuis v CIR* (1947) (CPD).

²⁴⁹ *Supra.* fn. 9.

In *Memel Plc v IRC* 1996 STC 1336²⁵⁰ the United Kingdom Court of Appeal held that the approach to interpreting Double Tax Agreements should be purposive and international. In *Public Carriers Association and others v Toll Road Concessionaries (Pty) Ltd and others* 1990 (1) SA 925 at 943²⁵¹, Judge Smalberger JA said that where there is an ambiguity in a legislative Act, the purposive interpretation can be used to arrive at the intention of the Act by considering the purpose of the particular Act. In *Commissioner of South African Revenue Services v Airworld CC* 2007 SCA 147, 70 SATC 48²⁵², it was held that although the starting point of interpreting a statute is to consider whether the words “*properly considered in its context, is nevertheless ambiguous*” because should this be the case, one must use other rules of interpretation which are normally designed to arrive at an interpretation which accommodates the words used as well as the underlying intention of the particular statute.

The court goes further to confirm that in recent years, more emphasis is placed on the purpose why a specific statute was enacted and that the interpreter must try and do an interpretation which accommodates the purpose while also considering the words used as a guide. This amounted to the “purposive construction”. According to the *Airworld*²⁵³ case, the purpose of interpretation gives effect to the purpose why the relevant piece of legislation was enacted but is also compatible with the language used to create the statute. This implies that the purposive interpretation can therefore not give an interpretation which is clearly at odds with the language used.

In *Commissioner of South African Revenue Services v Multi-choice Africa* (218/10) (2011) ZASCA 41²⁵⁴, Judge Majiedt JA followed the “purposive interpretation” method. The case concerned a tariff classification dispute in which Multi-choice contended that there was no ambiguity in the description of the item and effect should be given thereto. They relied on the contra fiscum rule and on a passage in the *Johannesburg City Council v Norven Investments (Pty) Ltd* 1993 91 SA 627 (A) at 638 A – C²⁵⁵ case and the following dictum by Lord Blackburn in *Coltness Iron Co v Black*

²⁵⁰ *Memel Plc v IRC* 1996 STC 1336.

²⁵¹ *Public Carriers Association and others v Toll Road Concessionaries (Pty) Ltd and others* 1990 (1) SA 925 at 943.

²⁵² *Commissioner of South African Revenue Services v Airworld CC* 2007 SCA 147, 70 SATC 48.

²⁵³ *Ibid.*

²⁵⁴ *Commissioner of South African Revenue Services v Multi-choice Africa* (218/10) (2011) ZASCA 41.

²⁵⁵ *Johannesburg City Council v Norven Investments (Pty) Ltd* 1993 91 SA 627 (A) at 638 A – C.

1881 (6) APP CAS 315²⁵⁶ “... no tax can be imposed on the subject without words in the Act of Parliament clearly showing an intention to lay a burden on him” (at 330). The Commissioner contended that the word “reproducing” was a patent mistake on the part of the legislature and that it should have read “reception.”

Judge Majiedt²⁵⁷ said that the problem that has to be addressed was that the wording of item 124.75 was completely at odds with the structure of the enactment, and in particular with tariff heading 85.28 which uses the word “reception” instead of “reproducing.”

There were good reasons to uphold the Commissioner’s contention that the word “reproducing” was the result of a “patent error” on the part of the legislature. That the item as it stood would plainly be repugnant to the entire structure of the enactment and to the legislature’s intention. It was common cause that the decoder is not a “reproducing apparatus for television.” Also that each and every item heading repeats the tariff heading word for word, except 124.75 which replaces the word “reception” with “reproducing.”²⁵⁸

The Judge²⁵⁹ referred to the case of *Venter v Rex*²⁶⁰ where Innes CJ held that “a court may depart from the ordinary meaning of the plain words of a statute where to give effect thereto would lead to absurdity so glaring that it would never have been contemplated by the legislature”²⁶¹.

In the *Multi Choice*²⁶² case Judge Solomon J in a separate concurring judgment made the following comments: That the departure from the ordinary meaning of plain words in a statute is warranted if the result of a literal interpretation would be “something which is repugnant to the intention of the legislature (at 921).” Then he quotes the *Johannesburg City Council v Norven*²⁶³ and cases cited there as authority for the fact that the contra fiscum rule is only applicable where there is some doubt as to the true meaning of an ambiguous enactment.

²⁵⁶ *Coltness Iron Co v Black* 1881 (6) APP CAS 315.

²⁵⁷ *Supra.* fn. 254.

²⁵⁸ *Ibid.*

²⁵⁹ *Ibid.*

²⁶⁰ *Supra.* fn. 247.

²⁶¹ *Supra.* fn. 9.

²⁶² *Supra.* fn. 254.

²⁶³ *Supra.* fn. 255.

Solomon then goes further to say that in the *Multi Choice*²⁶⁴ case, the repugnance is overwhelmingly evident when the entire structure of the enactment is examined. He then comes to the conclusion after referring to *Hanekom v Builders Market Klerksdorp (Pty) Ltd and others* 2007 SA 95 (SCA): (2006) ZASCA para 7 – 9²⁶⁵ that it is allowable for a court to interpret an enactment which is repugnant to the intention of the legislature in order to give effect to that intention and to make it compatible with other provisions. With reference to *Commissioner, SARS v Trend Finance (Pty) Ltd and another* 2007 (6) SA 117 (SCA); (2007) ZASCA²⁶⁶, he finds that this applies equally to the Act. In the end the court deviated from the grammatical approach to interpretation and followed the purposive interpretation approach.

One must also be mindful of the Interpretation Act 33 of 1957²⁶⁷ which states the following regarding its application:

“The provisions of this Act shall apply to the interpretation of every law (as in this Act defined) in force, at or after the commencement of this Act in the Republic or in any portion thereof, and to the interpretation of all by-laws, rules, regulations or orders made under the authority of any such law, unless there is something in the language or context of the law, by-law, rule, regulation or order repugnant to such provisions or unless the contrary intention appears therein”.

4.3 CONCLUSION

After considering all the relevant court cases regarding the interpretation of statutes the following conclusion is reached:

- Your first port of call when interpreting a statute is the dictionary.
- There are two ways of interpreting a statute: First, the grammatical way, which has been our law ever since the beginning of time. Give a word its ordinary meaning, you then contextualise it and then interpret it.
- The second manner of interpretation of a statute is called a purposive interpretation. The

²⁶⁴ *Supra*. fn. 254.

²⁶⁵ *Hanekom v Builders Market Klerksdorp (Pty) Ltd and others* 2007 SA 95 (SCA): (2006) ZASCA para 7 – 9.

²⁶⁶ *Commissioner of South African Revenue Services v Trend Finance (Pty) Ltd and another* 2007 (6) SA 117 (SCA); (2007) ZASCA 59, para 6 and footnote 2.

²⁶⁷ Interpretation Act 33 of 1957.

interpretation tries to determine what the intention of the lawmaker was. You determine what the lawmaker had in mind or what his intention was when drafting that piece of legislation and then interpret the statute in the manner the lawmaker had in mind. This is very subjective as the interpretation only assumes what the intention of the legislature was given whatever limited, documented information is available.

The biggest problem here is that you rationalise. You want the Act to say something therefore you define what the intention of the lawmaker was, some notional concept and then you squeeze the word to assist what you want it to say. The courts however, only run to this approach if the grammatical approach leaves them in no-man's land (*Landbou Bank*²⁶⁸ and *Venter*²⁶⁹).

We therefore have the following situation regarding the interpretation of statutes:

The grammatical approach is followed in the first instance, unless it leads us in to no-man's land due to the words being ambiguous or leads to absurdity so glaring that it never could have been contemplated by the legislator, or it would lead to a result contrary to the intention of the legislator, as shown by the context or by such other considerations that the court is justified in taking into account (*Landbou Bank*²⁷⁰ and *Vente*²⁷¹).

In this event the court may depart from the ordinary effect of the words and follow the purposive interpretation to the extent necessary to remove the absurdity and give effect to the true intention of the legislation. Now, in the case of interpreting section 20(1)²⁷², the grammatical approach has led to anomalous situations as well as unintended results. Will this then give a court of law enough reason or justification to switch to the purposive interpretation and try to determine the true intention of the legislator?

Well, this was exactly what was considered in *ITC 1830*²⁷³ by Judge Geldenhuys who found as follows: "*The existence of anomalies is insufficient reason not to give effect to the wording of Sec*

²⁶⁸ *Supra*. fn. 9.

²⁶⁹ *Supra*. fn. 247.

²⁷⁰ *Supra*. fn. 9.

²⁷¹ *Supra*. fn. 247.

²⁷² *Supra* fn. 4.

²⁷³ *Supra*. fn. 16.

20(1).” And he came to this conclusion by referring to *Robin Consolidated industries Ltd v Commissioner for Inland Revenue*²⁷⁴ case where Judge Schultz JA said: “*Then it is argued that we should construe this subsection so as to iron out the anomalies that may arise from the Act’s artificial separation of taxpayers activities into discrete tax years. But the fact that this separation may work anomalously is not a reason for not giving effect to it, as is illustrated in CIR v Sunnyside Centre (Pty) Ltd 1997 91) SA 68 (A) at 73 D – E*”.

The tax court in *ITC 1830*²⁷⁵ therefore held that SARS was in no position to change the law by making concessions which were not compatible with the plain language used in section 20(1)²⁷⁶.

In the final instance after considering everything that has been said in the previous pages, the following conclusion can be reached:

When regarding the “income from trade” requirement contained in section 20²⁷⁷, we have looked at the arguments for and against this requirement as a prerequisite to having an assessed loss allowed to be set off.

The fact of the matter which is also acknowledged by SARS in its Interpretation Note no 33²⁷⁸, is that this “*question remains unresolved and no binding precedent has been established by the Supreme Court of Appeal*”.

The question then arises whether the courts will possibly be justified in following a purposive interpretation of section 20(1)²⁷⁹ if the grammatical approach should lead to unintended results and other anomalies, just like SARS did in Interpretation Note no 33²⁸⁰

After studying many court cases regarding interpretation of statutes it seems that although the courts have in recent years placed emphasis on the purpose with which the legislature has

²⁷⁴ *Supra*. fn. 138.

²⁷⁵ *Supra*. fn. 16.

²⁷⁶ *Supra* fn. 4.

²⁷⁷ *Supra* fn. 7.

²⁷⁸ *Supra*. fn. 12.

²⁷⁹ *Supra* fn. 4.

²⁸⁰ *Supra*. fn. 12.

enacted the relevant provision thus what we now call the purposive interpretation. Most judges and the relevant cases discussed above bear this out, will only employ or consider the purposive approach if the words of an statute given their ordinary grammatical meaning lead to a clear ambiguity or as stated in the *Landbou Bank*²⁸¹ case as: an “*absurdity so glaring that it could never have been contemplated by the legislature, as shown by the context or by such other considerations that the court is justified in taking into account*”.

If you therefore look at the case law to interpret sec 20(1)²⁸² almost all of them support the requirement that a trade must have been carried on and also that there had to be income from that trade against which the balance of assessed loss brought forward could be set off²⁸³.

The situation now is that it has been established that the grammatical “literal” interpretation of section 20(1)(a)²⁸⁴ can give rise to anomalies and unintended results²⁸⁵.

The question is whether these anomalies and unintended results are of such a nature that it gives rise to an absurdity which would entitle a court to depart from the literal meaning of the words.

In *ITC 1830*²⁸⁶, Judge Geldenhuys was of the opinion that this was not the case. One must of course hasten to say that the tax court judgment does not create binding decisions (precedents) and other courts are therefore not bound by this decision. One could only speculate that while this may be the case technically speaking that other courts in a similar scenario would probably follow this judgment.

In Meyerowitz’s²⁸⁷ commentary on the decision in *ITC 1830* he wrote the following: “*We think that this literal reading of section 20(1)(a)*²⁸⁸, *in the context of all the provisions relating to the*

²⁸¹ *Supra*. fn. 9.

²⁸² *Supra* fn. 4.

²⁸³ *Supra*. fn. 209.

²⁸⁴ *Supra* fn. 5.

²⁸⁵ See *ITC 1830*, 70 SATC 123 and Interpretation Note: No 33 (issue 2) – 30 June 2010.

²⁸⁶ *Supra*. fn. 16.

²⁸⁷ Meyerowitz D (2008) *Meyerowitz on Income Tax*. Cape Town: The Taxpayer, page 93 – 5.

²⁸⁸ *Supra* fn. 5.

determination of taxable income, does not give rise to anomalies only, but to an absurdity which would entitle a Court to depart from the literal meaning of the words.”

It would therefore appear that there is a possibility that a court could apply the purposive interpretation when considering section 20(1)(a)²⁸⁹ but it is by no means a clear cut case and at best uncertain.

It is also doubtful whether it is good tax policy to penalise a company which continues to exist by confiscating its balance of assessed loss brought forward from previous tax years just because it failed to earn income in the current tax year. Most of the tax writers have over a number of years pleaded for the legislation to be amended to cure the anomalies and absurdities caused by the “income from trade requirement” contained in section 20(1)²⁹⁰ of the act as opposed to the litigation route hoping for a favourable outcome which is all but assured.

How then should the legislation regarding section 20(1)²⁹¹ be changed to put an end to all this controversy and uncertainty?

I would like to make the following suggestion namely that the “earning of income from trade” requirement be scrapped/deleted so that the only requirement left for an assessed loss to be set off in future years would be that the taxpayer “carried on a trade.”

²⁸⁹ *Supra* fn. 5.

²⁹⁰ *Supra* fn. 4.

²⁹¹ *Ibid.*

REFERENCES

Coetzee H (1998) Assessed losses – the final blow? *Accountancy SA*. October issue, p19 – 33.

De Koker AP, Emslie TS & Frame CR. (1988). *Income Tax in South Africa*. Durban: Butterworths

De Koker AP (2011) *Silke on South African Income Tax*. Durban: LexisNexis Butterworths.

Emslie TS and Davis DM (2011) *Cumulative supplement to income tax cases and materials*. Cape Town: The Taxpayer.

Dickenson B (2010) Assessed losses: is earning income from trade a critical factor in carrying forward your assessed loss? *Tax Alert*. October 2010.

Ger B (2005) A little less likely to lose that loss. *De Rebus*. Vol. 14(447), p42 - 43.

Isaacs I, Lazer L, Fielding WD & Wells MJ (1963) *Law and practice of South African Income Tax*. Durban: Butterworths, p535.

Meyerowitz D (2008) *Meyerowitz on Income Tax*. Cape Town: The Taxpayer, page 93 – 5.

Ngalwana VR (1998) Corporate taxation and the utilization of assessed losses in South Africa. *South African Mercantile Law Journal*. Vol. 10, p193 - 220.

Olivier L (2002). Assessed losses: a note on the trade and income requirements. *Stellenbosch Law Review*. Vol. 13(3), p387 - 393.

Smith A (1904) *An inquiry into the nature and causes of the wealth of nations*. Available at: www.econlib.org/cgi-bin/printarticle.pl (accessed 2 February 2012).

South African Revenue Services 2005 *Interpretation Note: No. 33 Issue 1, 4 July 2005*.

South African Revenue Services 2010 *Interpretation Note: No. 33 Issue 2, 30 June 2010*.

Spiro, E (1952) *Income Tax deductions: Whether balance of assessed loss prior to non-trading period thereafter deductible*. Cape Town: The Taxpayer.

Swart GJ (1996) The utilization of assessed losses by companies: a reappraisal after *Conshu (Pty) Ltd v Commissioner for Inland Revenue*. *SA Mercantile Law Journal*. Vol. 8(1), p119-144.

The Taxpayer. (1995). Income deduction: Set-off of assessed loss: Section 20 of Act 58 of 1962. Vol. 44, issue 3.

The Taxpayer. (1997). Income Tax: Assessed loss of company: Section 20(1) of Act 58 of 1962. Vol. 46, issue 8.

Williams RC (1999). Carrying forward the balance of an assessed loss for income tax purposes. *South African Law Journal*. Vol. 116(1), p11 - 13.

CASES

Berea West Estates (Pty) Ltd v Secretary for Inland Revenue 1976 (2) SA 614 (A).

Commissioner of Taxes v Booyens Estates Ltd 1918 AD 576 at 595.

Cape Brandy Syndicate v IRC (1921 Kings Bench).

Coltness Iron Co v Black 1881 (6) APP CAS 315.

Commissioner of Inland Revenue v Louis Zinn Organization (Pty) Ltd 1958 (4) SA C177 (A), 22 SATC 85.

Commissioner for Inland Revenue v Simpson 1949 (4) SA 678 (A).

Commissioner for Inland Revenue v Stott 1928 AD 252 at 263.

Commissioner of South African Revenue Services v Airworld CC 2007 SCA 147, 70 SATC 48.

Commissioner of South African Revenue Services v Founders Hill 73 SATC 183.

Commissioner of South African Revenue Services v Megs Investments (Pty) Ltd and another 2005 (4) SA 328 SCA, 66 SATC 175.

Commissioner of South African Revenue Services v Multi-choice Africa (218/10) (2011) ZASCA 41.

Commissioner of South African Revenue Services v Trend Finance (Pty) Ltd and another 2007 (6) SA 117 (SCA); (2007) ZASCA 59

Commissioner of Taxes v Booyens Estates Ltd 1918 AD 576 at 595.

Commissioner of Taxes v Melbourne Trust Ltd (1914) AC 1001 (PC).

Conshu (Pty) Ltd v Commissioner for Inland Revenue 1994 (4) SA 603 (A), 57 SATC 1.

Dadoo Ltd v Krugersdorp Municipal Council 1920 AD 530.

East London Municipality v Abrahamse 1997 (4) SA 613 SCA” at 632 G to H.

Farrar’s Estate v CIR 1926 TPD 501.

Glen Anil Development Corporation Ltd v SIR 1975 (4) SA 715.

Hanekom v Builders Market Klerksdorp (Pty) Ltd and others 2007 SA 95 (SCA): (2006) ZASCA para 7 – 9.

Inland Revenue Commissioners v Westleigh Estates Co Ltd (1924) KB 390.

ITC 664, 16 SATC 125.

ITC 777, 19 SATC 320.

ITC 1679, 62 SATC 294.

ITC 1420 (1986), 49 SATC 69.

ITC 1804, 68 SATC 105.

ITC 1830, 70 SATC 123.

ITC 12895.

Johannesburg City Council v Norven Investments (Pty) Ltd 1993 91 SA 627 (A) at 638 A – C.

Land en Landbou Bank van Suid-Afrika v Rousseau (1) 1993 SA 513 (A) 518 H-J.

Lockie Bros Ltd v Commissioner for Inland Revenue 1922 TPD 42 at 44.

Malone Trust v Secretary for Inland Revenue 1977 (2) SA 819(A).

Mankayi v Anglo Gold Ashanti 2010 (5) SA 137 SCA.

Memel Plc v IRC 1996 STC 1336.

Natal Estates Ltd v Secretary for Inland Revenue 1975 (4) SA 177 (A).

New Urban Properties Ltd v Secretary for Inland Revenue 1966 (1) SA 217 (A), 27 SATC 175.

Ochberg v CIR 1931 (AD).

Public Carriers Association and others v Toll Road Concessionaries (Pty) Ltd and others 1990 (1) SA 925 at 943.

Rand v Albern Land Co Ltd (1920) TC 629 (KB).

Robin Consolidated Industries Ltd v CIR (1997) 2 ACC SA 195 (A).

S v Zuma and others 1995 (2) SA 642 (CC) at 652 I – 653 B.

SA Bazaars (Pty) Ltd v CIR 1952 (4) SA 505 (A).

Secretary for Inland Revenue v Kirsch 1078 (3) SA 93 (T).

Sekretaris van Binnelandse Inkomste v Olifantsrivier Koöperatiewe Wynkelders Bpk 1976 (3) SA 261 (A).

Standard Bank Investment Corporation Ltd v Competition Commissioner 2000 (2) SA 797 (SCA).

Sub-Nigel Ltd v Commissioner for Inland Revenue 1948 (4) SA 580 (A).

Venter v Rex 1907 (TS).

ACTS

Constitution of the Republic of South Africa, 1996.

Income Tax Act, 41 of 1917.

Income Tax Act, 40 of 1925.

Income Tax Act, 31 of 1941.

Income Tax Act, 58 of 1962.

Interpretation Act, 33 of 1957.