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A CRITICAL ANALYSIS OF THE IMPLICATIONS OF COMMISSIONER SOUTH AFRICAN REVENUE SERVICE V BRUMMERIA RENAISSANCE (PTY) LTD ON THE TAXATION OF THE BENEFITS OF INTEREST-FREE SHAREHOLDERS' LOANS

by

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Submitted in partial fulfilment of the requirements for the degree

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ABSTRACT

A CRITICAL ANALYSIS OF THE IMPLICATIONS OF COMMISSIONER SOUTH AFRICAN REVENUE SERVICE V BRUMMERIA RENAISSANCE (PTY) LTD ON THE TAXATION OF THE BENEFITS OF INTEREST-FREE SHAREHOLDERS' LOANS

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The ruling by the Supreme Court of Appeal in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* on 13 September 2007 added to and amended South African case law regarding the critical definition of 'gross income' in the Income Tax Act 58 of 1962. The court diverged from the existing precedent – set in *Stander v Commissioner for Inland Revenue* – that receipts that "could not be converted into cash and could not be transferred to anyone else" are not taxable. In *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* the court ruled that what is key is that the benefit has an ascertainable monetary value. Accordingly, the benefits of interest-free loans can be valued – using the weighted prime overdraft interest rate – and can be taxed.

This decision has been the subject of much debate, centring on the aptness of the amended view of 'gross income', the *quid pro quo* principle discussed in the judgement, the valuation method, and the implications of these for taxpayers.

The purpose of this study is to present arguments and additional information to this continued debate, looking particularly at the impact of *Commissioner South African*

Revenue Service v Brummeria Renaissance (Pty) Ltd on interest-free shareholders' loans, without attempting to provide a definitive answer to this debate.

This non-empirical study explores the topic through a review of literature, with the sources cited being mainly published public articles, tax text books and conference papers retrieved from the internet.

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OPSOMMING

‘N KRITIESE BESKOUIING VAN DIE GEVOLGE VAN *COMMISSIONER SOUTH AFRICAN REVENUE SERVICE V BRUMMERIA RENAISSANCE (PTY) LTD* OP DIE BELASTING VAN DIE VOORDEEL VAN RENTEVRYE AANDEELHOUERLENINGS

deur

MANTENG RUTH PHASHA

STUDIELEIER	**:**	**PROF M CRONJE**
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Die beslissing op 13 September 2007 deur die Hoogste Hof van Appèl in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* het byvoegings en wysigings gemaak tot Suid-Afrikaanse hofuitsprake rakende die belangrike omskrywing van “bruto inkomste” in die Inkomstebelastingwet 58 van 1962. Die hof het afgewyk van die bestaande presedent wat in *Stander v Commissioner for Inland Revenue* geskep is dat ontvangstes wat nie in kontant omgeskakel kan word nie en nie na enigiemand anders oorgedra kan word nie, nie belasbaar is nie. In *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* het die hof beslis dat die feit dat die voordeel ‘n bepaalbare monetêre waarde het die sleutelaspek is.. Gevolglik kan die waarde van die voordele van rentevrye lenings bepaal word – deur middel van die geweegde prima oortrekkingskoers – en kan dit belas word.

Oor hierdie beslissing is reeds hewige debat gevoer, met die fokus op die toepaslikheid van die gewysigde siening van “bruto inkomste”, die *quid pro quo*-beginsel wat in die uitspraak bespreek is, die waardasiemetodes en die gevolge daarvan vir belastingpligtiges.

Die doel van hierdie studie is om argumente en addisionele inligting te voorsien ten einde die debat voort te sit, met spesifieke klem op die impak van *Commissioner South African*

Revenue Service v Brummeria Renaissance (Pty) Ltd op belastingvrye aandeelhouerslenings, sonder om te poog om 'n definitiewe antwoord op hierdie debat te lewer.

Hierdie nie-empiriese studie ondersoek die onderwerp deur 'n oorsig te gee van die literatuur, met aangehaalde bronne wat hoofsaaklik bestaan uit gepubliseerde openbare artikels, belastinghandboeke en konferensiereferate wat van die internet verkry is.

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CHAPTER 1

INTRODUCTION AND PROBLEM STATEMENT

1.1 BACKGROUND

South African tax on income is levied in terms of the Income Tax Act 58 of 1962 ('the Act'). The Act clearly defines who is liable for tax in section 1. It stipulates that for an amount received by a taxpayer to be taxable in South Africa, it must meet all sub-requirements of 'gross income' as defined in section 1 of the Act (Jordaan, Koekemoer, Stein, Stiglingh, van Schalkwyk & Wassermann, 2006:11).

There is a set precedent and it is accepted that in areas where the Act does not provide clear definitions, case law interpretations may be applied in order to define the terms pertaining to the Income Tax Act. The meaning of the term 'gross income' is therefore derived by applying both the definition in section 1 of the Act and applicable case law. (Jordaan *et al*., 2006:12.).

Petersen (2007:2) states that since the judgement passed in *Stander v Commissioner for Inland Revenue*, 1997 (3) SA 617 (C) (59 SATC 212), taxpayers' opinion has been that where a receipt of an item "could not be converted into cash and could not be transferred to anyone else", that receipt would consequently not be taxable.

On 13 September 2007 the Supreme Court of Appeal of South Africa delivered a decision in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*, 2007 *SCA 99 (RSA*) *(69 SATC 205)* which appeared to contradict the decision in *Stander v Commissioner for Inland Revenue,* and established a new precedent that the question at hand is not whether the receipt by the taxpayer can be converted into cash or can be transferred from one person to another, but rather whether the receipt has a monetary value (*Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* 2007:12).

The court's decision has led to varied interpretation and speculation by tax experts and opinion writers. It is therefore anticipated that the South African Revenue Service will release an Interpretation Note, setting out the practical application of this decision in the treatment of the benefits arising from interest-free loans (Integritax, 2007:[1]).

Opinion writers have expressed different views of the court's decision, some saying the decision is on the mark, and others expressing views gravely divergent. The court ruled on the gross income terms "amount" and "accrued to", while terms such as "excluding receipts or accruals of a capital nature" were not presented for argument (Bowman Gilfillan Tax Team, n.d.:[1]). This suggests that the decision in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* should not be applied indiscriminately, as it did not address all aspects of the gross income definition.

The broad subject of this research is to contrast the nature of the loans in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* with interest-free shareholders' loans. The analysis starts with a discussion on the aptness of the application of the gross income definition and pre-existing case law in arriving at the final decision in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*.

The discussion in this study will be initiated through a critical review of the interpretations of the ruling in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* in comparison with existing definitions of gross income in the Act and interpretations in case law; and also through a consideration of possible future implications of the ruling in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* to widely used interest-free shareholders' loans. The practical importance of assessing the impact of the ruling in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* on interest-free shareholders' loans arises due to the extensive use of these loans as a method of bringing funds into businesses.

1.2 CORE RESEARCH QUESTION

The central question is whether interest-free loan arrangements – interest-free shareholders' loans in this instance – will result in gross income inclusion as a result of the precedent set by the ruling in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*.

This study will present additional information to the continued debate of determining the impact of *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* on interest-free loan arrangements – interest-free shareholders' loans in this instance – and is not an attempt to provide a definitive answer to this debate.

1.3 SPECIFIC RESEARCH QUESTIONS

The main question of whether the future application of the ruling in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* will result in similar benefits arising from interest-free loans being included in gross income for all interest-free loan arrangements, will be analysed and broken down into the following sub-enquiries:

- to which sub-requirements of the gross income definition has *Commissioner South African Revenue v Brummeria Renaissance (Pty) Ltd* added additional insight?;
- to which sub-requirements of the gross income definition did the ruling in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* not add any additional insight or meaning and how could these sub-requirements be interpreted?; and
- how could the ruling in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* affect other similar loans such as interest-free shareholders' loan arrangements?

1.4 IMPORTANCE AND BENEFITS OF THE PROPOSED STUDY

Considerable trepidation has risen as a result of the ruling in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd.* Although the ruling has caused significant alarm, especially with regards to the wide use of interest-free loans in South Africa, application of a narrow interpretation to this ruling indicates that this concern might not be warranted. (Dachs, 2008:[1].).

According to Surtees (2007:[2]), most tax experts are of the opinion that the precedent set by *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* applies only to interest-free loans that are granted as a direct exchange for goods and services (i.e. granted on the basis of *quid pro quo*). Surtees (2007:[2]) also points out that a recent disclosure demand by South African Revenue Service calling for a company in KwaZulu-Natal to supply information regarding interest-free loans granted to its subsidiary company, may be an indication that South African Revenue Service is looking to apply the ruling to all interest-free loans regardless of whether they are granted in exchange for goods or services or granted for capital expansion or working capital requirements.

Although it is anticipated that the South African Revenue Service will release an Interpretation Note setting out guidelines on the interpretation of *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd,* in the meantime the ambiguity around the interpretation of the tax effects of existing terms and conditions of interest-free loans prevails (Integritax, 2007:[1]).

The academic and practical importance of the study stems from the need for an outline and assessment criteria which evaluates the most suitable manner of interpreting the gross income definition, taking into consideration the reach and the impact of the judgement passed in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*.

1.5 DELIMITATIONS AND ASSUMPTIONS

In exploring the research questions, the following assumptions and delimitations will be observed:

- aspects of the ruling in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* that relate to tax rules and reopening of tax assessments, mainly provided for in section 79(1),81 (4) and 81 (5) of the Act will not form part of this study;
- only the aspects and implications of the ruling that relate to the interpretation of the gross income definition will be given consideration in the study;
- the effect of the ruling on other taxes such as donations tax, capital gains tax and other taxes levied by South African Revenue Service will not be considered;
- taxable income calculation will be restricted to inclusion of amounts arising from gross income, and aspects relating to taxable income inclusion through application of capital gains provisions in the Act will be excluded;
- although the *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* case may have far-reaching consequences, any comparative analysis to be made will be limited to similar types of loan arrangements (although not restricted to property loans, as in the case *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd)*); and
- the study only applies the precedent set by the case law rulings and it will hold off from any legal expert opinions and any discussions of detailed general legal rules regarding the principles and regulations of interpreting case law.

1.6 DEFINITION OF KEY TERMS

Table 1: Meaning of terms used in this document

Term	Meaning
Life right	Right to occupy a property until cancellation of the agreement or the death of the property occupant.
"Money's worth" principle	The principle of assigning value to a receipt/ benefit by taking into consideration the restrictions imposed that affect the ability of the recipient to turn the receipt/benefit into cash.
"Money value" principle	The principle of assigning value to a receipt/benefit by looking at the market value as a reference, without taking into consideration the restrictions on the ability of the recipient to turn the receipt/ benefit into cash.
The Act	The Income Tax Act, No 58 of 1962
The Republic	The Republic of South Africa
Quid pro quo	Something given up for another thing (i.e. an exchange of something for something else)

1.7 SUMMARY OF LITERATURE REVIEW

To summarise the literature:

- for an amount to be taxable it must meet all the requirements of the gross income definition;
- the decision in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* adds to and amends certain interpretations applicable to the section 1 gross income definition contained in the Act;

- in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* the "received by/ accrued to" and the "amount" aspects of the gross income definition were contested and arguments regarding the term "excluding receipts or accruals of a capital nature" were not presented;
- the finding in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* disagreed with the interpretation of the term "amount" as decided in *Stander v Commissioner for Inland Revenue* and further resolved that the decision at hand is not whether the receipt by the taxpayer can be converted into cash or can be transferred from one person to another, but rather whether the receipt has an determinable monetary value.

Comment writers question the valuation method applied to determine the "amount" in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* (Bowman Gilfillan Tax Team, n.d.:[1]). Possible valuation methods outlined in the Act will be discussed further in the literature of this study.

Also to be expanded on in the literature, is the reach and the applicability of the ruling in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*, taking into consideration:

- the new Draft Interpretation Note issued by South African Revenue Service on 18 October 2008;
- the conclusions reached in *XYZ (Pty) Ltd v Commissioner South African Revenue Service*, 2008 (SATC 12244); and
- the *quid pro quo* concept raised in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd.*

1.8 RESEARCH DESIGN AND METHODS

The essential purpose of this non-empirical study is to explore, through review of literature, the reach and impact of the new avenue of interpreting certain gross income concepts that

has arisen in the South African tax as expanded in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*.

Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd has given rise to many questions, mainly regarding interpretation of the gross income definition. The requirement to add further insight to the issues will be undertaken through an interpretive research concept with a goal of promoting understanding.

The source of information will predominantly be public internet websites, internet-based scholarly journals, applicable tax legislation, tax cases and tax interpretation notes. As far as possible, only credible websites (e.g. google scholar), E-books and books available at the University library catalogue will be used as a source. As tax laws are amended on a regular basis, sources not older than three years will mainly be used.

1.9 CONCLUSION

The main principle in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* is that if a receipt cannot be converted into cash, it does not necessarily imply that the receipt does not have a determinable value. This is the view applied throughout this study document as it was affirmed by the recent ruling in *XYZ (Pty) Ltd v Commissioner South African Revenue Service*. Implications of the new Draft Interpretation Note issued by South African Revenue Service on 18 October 2008 will also be considered.

CHAPTER 2

GROSS INCOME DEFINITION

2.1 INTRODUCTION

The court, in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* (2007:7), held that taxpayers' gross income should include the benefit flowing from the right to retain and use loan capital free of interest, because it has a determinable worth. In South African income tax law, gross income is the basis of determining if income tax is payable by a taxpayer, thus it is important to determine if a receipt by a taxpayer meets the gross income definition (Huxham & Haupt, 2009:16).

Although gross income is defined in section 1 of the Act, it is accepted that in areas where the Act does not provide clear definitions for terms case law interpretations may be applied (Jordaan *et al*., 2006:12).

The discussions below will outline the gross income definition in the Act, followed by interpretations of gross income in case law and opinions by comment writers on gross income interpretation.

2.2 THE GROSS INCOME DEFINITION CONTAINED IN THE ACT

Gross income is defined in section 1 of the Act as:

"Gross income, in relation to any year or period of assessment, means-

> (i) in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident; or

(ii) in the case of any person other than a resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within or deemed to be within the Republic,

during such year or period of assessment, excluding receipts or accruals of a capital nature..."

It is important to note that the definition is two-fold, and separately defines gross income criteria to be met by residents and non-residents. For purpose of this study, the gross income definition will be limited to that applying to residents and will exclude aspects relating to non-residents.

Other aspects of the gross income definition relating to special receipts, specifically included in gross income through application of sections (ii) (a)-(n) of section 1 of the Act will not be addressed by this study.

2.3 KEY COMPONENTS OF THE DEFINITION

The key condition for inclusion of a receipt of a benefit by a taxpayer into gross income is that the receipt must fulfil all the required components of the gross income definition. Inability to fulfil any one of the requirements will preclude the receipt from inclusion in gross income. (Jordaan *et al.,* 2006:11.).

Jordaan *et al.* (2006:11) in the interpretation of the "gross income" definition, note the following as key required components of the definition:

- amount;
- received by or accrued to;
- year of assessment; and
- excluding receipts or accruals of a capital nature.

Although South African income tax is levied by application of the Income Tax Act, it is accepted that in instances where the Act does not provide a clear definition case law

interpretations can be applied to define the Income Tax Act terms. Since not all of these terms are defined, it is necessary to apply relevant case law to interpret the terms that comprise the gross income definition (Jordaan *et al.,* 2006:12).

Of the four key components to the gross income definition, only the term “year of assessment” is defined in the Act. The other terms (“amount”, “received by or accrued to” and “excluding receipts or accruals of a capital nature”) are not defined in the Act, but their meaning can be construed through application of various case law rulings.

2.3.1 Amount

As stated above, the gross income term “amount” is not defined in the Act. The meaning of the term is obtained from many court judgements that include *Lategan v Commissioner for Inland Revenue,* 1926 CPD 203 (2 SATC 16), *Commissioner for Inland Revenue v Delfos,* 1993 AD 242 (6 SATC 92), *Lace Proprietary Mines Ltd v Commissioner for Inland Revenue,* 1938 AD 267 (9 SATC 349)*, Commissioner for Inland Revenue v People's Stores (Walvis Bay) (Pty) Ltd*, 1990 (2) SA 353 (A) (52 SATC 9)*, Stander v Commissioner for Inland Revenue*, 1997 (3) SA 617 (C) (59 SATC 21) and *Tennant v Smith* [1892] AC 150 (HL) (British case).

Two distinct schools of interpretation – the “money's worth” and “money value” principles – can be derived from the above court rulings to confer meaning on the term “amount”. The “money value” principle opposed to the “money's worth” principle does not look at whether the property at hand has value in the hands of the recipient taxpayer, but rather considers if the property has a value to the general public (i.e. market value of the property). These principles are further discussed in detail below.

2.3.1.1 “Money's worth” principle

The “money's worth” principle of interpreting the term “amount” emerged from English case law in *Tennant v Smith* [1892] AC 150 (HL) (HM Revenue & Customs, n.d.:[1]).

In *Tennant v Smith* a bank employee was living at no charge in a flat (accommodation) provided on the bank's premises. The accommodation was provided with a sub-letting restriction on the occupant (Cassidy, 2007:189). The court ruled that:

- where a taxpayer is in possession of a receipt which "is capable of being turned into money from its own nature", then the receipt or benefit has a worth in money to the taxpayer; and
- profit is an indication of the financial advantages and monetary worth that is generated by an individual in their own right (HM Revenue & Customs, n.d.:[1]).

To summarise the above, the "money's worth" principle looks at whether the holder of the commodity is able to turn it into a receipt that is due in money form.

To further elaborate, the synopsis by Cassidy (2007:189) states that, from *Tennant v Smith,* earnings are understood in terms of "money or money's worth". The court ruling concluded that a non-cash benefit constitutes income if it is capable of being converted into cash. If the benefit does not constitute money that 'comes into the pocket' then it is not income (Cassidy, 2007:189).

The "money's worth" principle was also applied in *Stander v Commissioner for Inland Revenue*. Here the South African Revenue Service sought to impose income tax on the value of the overseas holiday prize that Stander had won (Morphet, 2008:[1]).The court in its judgement in *Stander v Commissioner for Inland Revenue* held that:

- the overseas holiday prize was awarded with conditions that restricted saleability;
- Stander was not in possession of goods of which a monetary value could be placed; and
- no amount could be placed on the value of the prize, it therefore did not meet the "gross income" definition, thus was not taxable. (Morphet, 2008: [1].).

2.3.1.2 "Money value" principle

Another interpretation of the gross income term "amount" is derived from the "money value" principle.

The "money value" principle is applied in *Lategan v Commissioner for Inland Revenue, 1926 CPD 203 (2 SATC 16), Commissioner for Inland Revenue v People's Stores (Walvis Bay) (Pty) Ltd, 1990 (2) SA 353 (A) (52 SATC 9)* and *Lace Proprietary Mines Ltd v Commissioner for Inland Revenue ,* 1938 AD 267 (9 SATC 349)

In *Commissioner for Inland Revenue v People's Stores (Walvis Bay) (Pty) Ltd* (1990:10-20) the "money value" principle is quoted with reference to the decisions made in various preceding cases as follows:

- "... the word 'amount' must be given a wider meaning, and must include not only money, but the value of every form of property earned by the taxpayer, whether corporeal or incorporeal, which has a money value ..."
- "... the fact that the valuation may sometimes be a matter of considerable complexity does not detract from the principle that all income having a money value must be included ..."

In summary the above "money value" principle ruling in *Commissioner for Inland Revenue v People's Stores (Walvis Bay) (Pty) Ltd*, opposed to the "money's worth" principle, rules that when attaching value the term "amount," the general public market value is considered without looking at restrictions of sale that are imposed on the recipient of the income.

2.3.2 Received by or accrued to

As in the case of the gross income term "amount", the term "received by/ accrued to" is not defined in section 1 of the Act, therefore the meaning of the term is derived through

interpretation established in case law. In this instance the main case of reference for the interpretation is *Lategan v Commissioner for Inland Revenue*.

In *Lategan v Commissioner for Inland Revenue* a wine farmer had sold wine and the receipts of the proceeds from the sale were spread over a couple of years. The court held that:

- although parts of the proceeds of sale were not payable on the date of delivery of the wine, this would not affect the timing of accrual of the proceeds of the sale; and
- on delivery of the wine, the seller became entitled to the full proceeds of the sale; thus the full proceeds of the sale accrued to him at that date. (van Rensburg, 2008:[1].).

Therefore the general rule from *Lategan v Commissioner for Inland Revenue* is that benefits received are taxable in full in the year of assessment of receipt of the benefit to the extent that the taxpayer has acquired the right/ entitlement to claim disbursement of the benefits (Jordaan *et al.,* 2006:14).

From the decision in *Lategan v Commissioner for Inland Revenue* the term "accrued" can be further elaborated to mean that the taxpayer has:

- become "entitled to" something unconditionally;
- a legal power over something;
- not a contingent right; and
- not a possibility to earn but has a right to earn. (van Rensburg, 2008:[1].).

Other court decisions summarised in Jordaan *et al.* (2006:13-14.) define the term "received by/ accrued to" as follows:

- in *Geldenhuys v Commissioner for Inland Revenue*, 1947 (3) SA 256 (C) (43 SATC 419) it was held that where a taxpayer has received an amount "on his own behalf for his own benefit", then the amount has accrued to such taxpayer;

- in *Commissioner for Inland Revenue v Genn & Co (Pty) Ltd*, 1955 (3) SA 293 (A) (20 SATC 113) it was held that physical control of money does not necessarily entail accrual, for example physical control over borrowed funds comes with a direct obligation to repay the borrowed funds, thus such a receipt of money has not 'accrued' to the taxpayer; and
- in *Ochberg v Commissioner for Inland Revenue*, 1931 CPD 256 (6 SATC 1) it was held that when a taxpayer has an unconditional right to claim payment, then an accrual has occurred.

2.3.3 Year of assessment

The term "year of assessment" is the only key term of the gross income definition that is defined in the Act.

Year of assessment is defined in section 1 of the Act as a period that ends at the last day of February or a period ending on the last day of the company financial year.

2.3.4 Excluding receipts or accruals of a capital nature

To interpret the term "excluding receipts or accruals of capital nature" prevailing definitions and interpretations existing in case law are applied.
Jordaan *et al.* (2006:19-24) in discussion of the capital and income nature of receipts, look at various case decisions which incorporate the following conclusions:

- in *Commissioner for Inland Revenue v Visser*, 1973 TPD 77 (8 SATC 271) it was held that income is what is borne through employment of capital;
- in *Elandsheuwel Farming (Edms) Bpk v SBI*, 1978 (1) SA 101 (A) (39 SATC 163) it was held that income is derived through activities linked to the furtherance of business such as realisation of stock-in-trade or floating capital. Where the asset was acquired or held by the taxpayer with the view of holding it in order to derive

income from the use of the asset, the receipt on sale of the asset will constitute a capital receipt; and

- *Pyott Ltd v Commissioner for Inland Revenue,* 1945 AD 128 (13 SATC 121) indicates that receipts are either capital or revenue in nature, not both.

Accordingly Brincker, Schoeman, Vorster and Erasmus (2007:20) quoted the following principle from *Commissioner of Taxes v Booysen Estates Ltd,* 32 SATC 10 to interpret revenue and capital nature of receipts*:*

- "... revenue [is] derived from capital productively employed ...";
- "... there is no definite test that can always be applied in order to determine whether a gain or profit is income or not ..." ;and
- "... the revenue or profit derived from a thing without its changing owners is rather to be considered as income than as capital".

To summarise the statements made here, many of the tests of making a distinction between the revenue and capital nature of receipts are not definitive, it is the intention of the taxpayer that is the main factor that determines the nature of a receipt (Jordaan *et al*., 2006:21). In a transaction where property is transferred and proceeds are exchanged without a change of ownership of the property, the receipt of the proceeds may be considered to be revenue in nature (Brincker *et al.,* 2007:20).

If it was the taxpayer's intention to hold the asset as "the tree that bears fruit" or as "fixed capital", then the proceeds on realisation of the asset are capital in nature, but if the intention was to hold the asset as "floating capital" or as "stock-in-trade", then the proceeds on realisation of such an asset are revenue in nature (Jordaan *et al.*, 2006:19-24).

2.4 CONCLUSION

Gross income as defined in section 1 of the Act has four key components. Of the four components, only the term "year of assessment" is defined in the Act. Interpretations from

case law are applied to give meaning to the terms “amount”, “received by/ accrued to” and “excluding receipts or accruals of a capital nature”.

There are two schools of interpretation for the term “amount”: the “money value” principle and the “money’s worth” principle. The ruling in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* has added much-needed insight in making the choice between these schools of interpretation. This is to be discussed in chapter 3 along with the interpretation in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* of other gross income terms.

CHAPTER 3

INTERPRETATION OF GROSS INCOME IN COMMISSIONER SOUTH AFRICAN REVENUE SERVICE V BRUMMERIA RENAISSANCE (PTY) LTD

3.1 INTRODUCTION

The case between the Commissioner for the South African Revenue Service and Brummeria Renaissance (Pty) Ltd was heard on 24 August 2007 and the judgement thereof delivered on 13 September 2007. The respondents to the case were Brummeria Renaissance (Pty) Ltd (first respondent), Palms Renaissance (Pty) Ltd (second respondent) and Randpoort Renaissance (Pty) Ltd (third respondent).

The judgement is referred to as *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*, 2007 *SCA 99 (RSA*) *(69 SATC 205)*. (*Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*, 2007:1.). For the purpose of this report it is referred to as *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd.*

Prior to examining the impact of the ruling and the decisions in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd,* it is important to understand the factual details and the arguments upon which this case was based. Detailed below are the facts and arguments presented in the case together with a discussion on how *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* interpreted the principle of *quid pro quo*, the term “amount” and the term “received by/ accrued to”.

In *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* the court did not permit raising of arguments relating to capital nature of the receipt (Bowman Gilfillan Tax Team, n.d.:[1]). Therefore, the ruling in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* bears no impact nor alters existing case law interpretations concerning the term “excluding receipts or accruals of capital nature”.

The discussion in chapter 5.2 outlines "what if" arguments to assess the possible impact and implications of applying existing case law to assess the capital/ revenue nature of the receipts in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd.*

3.2 THE UNDERLYING FACTS PRESENTED IN *COMMISSIONER SOUTH AFRICAN REVENUE SERVICE V BRUMMERIA RENAISSANCE (PTY) LTD*

The facts presented to the court in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* (2007:2) were that:

- the respondents in the court case were companies in the business of developing retirement villages;
- agreements were entered into between the property developers and the potential occupants of property units;
- the significant features of the agreements were that-
  - the potential property occupant provided a loan that is interest-free to the property developer;
  - the interest-free loan was advanced to provide funding for the construction of a property unit in the retirement village;
  - a debenture finance instrument was issued in furtherance of the loan;
  - the title deed of the property was registered as security in favour of the potential property occupant;
  - a right of lifelong occupation of the property unit was conferred on the potential property occupant,
  - the ownership of the property unit remained with the property developer;
  - an interest-free loan was advanced in return for the lifelong property occupation right; and
  - the loan would be repaid on cancellation of the agreement or upon the occupant's death (whichever is the earlier event).

In summary, the main feature of the agreement was that the potential property occupant was provided a "life right" to occupy the property in exchange for granting an interest-free loan (Olivier, 2008:152). This statement is concurred with in the synopsis by Brincker *et al.* (2007:13) that points out that in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* "the right to occupy the units was inseparably linked to the continued making of the interest-free loan". This linkage is what is called *quid pro quo* and will be explored further in chapter 3.6.

3.3 THE ARGUMENTS RAISED IN *COMMISSIONER SOUTH AFRICAN REVENUE SERVICE V BRUMMERIA RENAISSANCE (PTY) LTD*

In the statement of arguments the property development companies raised a range of grounds in their appeal to the court. The two argument statements that are most relevant are that:

- the interest-free loan receipts did not meet the gross income definition of the terms "amount" and "received by/ accrued to"; and
- in terms of section 79(1) of the Act, the South African Revenue Service was not allowed to reopen previous tax assessments. (*Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*, 2007:4.).

Derivation that can be made from first point above is that the main areas of the gross income definition that were under contention was the terms "amount" and "received by/ accrued to". The arguments raised in the second point above relates to section 79(1) of the Act, although relevant in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd,* have been excluded from the scope of discussions in this study because they do not pertain to interpretation of gross income.

3.4 THE JUDGEMENT DECISION IN *COMMISSIONER SOUTH AFRICAN REVENUE SERVICE V BRUMMERIA RENAISSANCE (PTY) LTD*

The judgement delivered summed up the Commissioners' grounds of assessment as follows:

- the property developers were in the business of properties, therefore the property units were capital assets;
- the property units realisation in the developers' business was either through sale to a purchaser in return for sale proceeds from the unit purchaser, or through granting occupation rights to an occupier of the property unit;
- the right to occupy the property was a prerequisite for granting the benefit of the right to retain and use the loan interest-free;
- the property developers had a gross income receipt because the right to the interest-free loan had accrued to them and had an determinable monetary value; and
- the value of the right to retain and use the interest-free loans was calculated with reference to the banks' weighted prime overdraft rate. (*Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*, 2007:3-4.).

The judgement conclusion therefore determined that the right to use the interest-free loans is gross income which accrues to a taxpayer and the monetary value of the right is taxable (*Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*, 2007:6-7).

3.5 GROSS INCOME DEFINITION INTERPRETATION

When indicating the relevant parts of the definition of gross income that were under consideration, in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* (2007:4-5) the following was emphasised to be the definition upon which the judgement will be raised:

> "… in relation to any year or period of assessment, was at the time ... the total amount, in cash or otherwise, received by or accrued to ... during such year or period of assessment from a source within the Republic, excluding receipts or accruals of a capital nature."

The Act is continually amended and it is therefore important that the judgement in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* makes reference to the applicable gross income definition. This would then be the definition contained in the amended Act prevailing as at the date of receipt of the cash/ benefit by the taxpayer.

3.5.1 Gross income definition as interpreted in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*

3.5.1.1 Definition of "received by or accrued to"

To interpret the term "received by or accrued to" the court married the facts presented in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty)* Ltd to past rulings by the courts. This was done to contextualise the existing case law interpretations against the background of the facts presented.

In the interpretations, neither additions nor amendments were made to the existing case law interpretations of the term. Thus, the *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* judgement did not provide additional insight to the already existing case law interpretations of the term "received by or accrued to".

In the interpretations, the *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* applied the judgement of *Commissioner for Inland Revenue v People Stores (Walvis Bay) (Pty) Ltd*. In doing so it was submitted that an accrual is interpreted to have occurred when the taxpayer has become entitled to the receipt. (*Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*, 2007:6-7.).

Applying the above decision from *Commissioner for Inland Revenue v People Stores (Walvis Bay) (Pty) Ltd*, it can be taken to mean that the concluding line of thought in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* was that since the property developer companies had a right to retain the loan amounts interest-free, such a right of retention is a clear indication of an "entitlement right" as defined in *Commissioner for Inland Revenue v People Stores (Walvis Bay) (Pty) Ltd*; thus an accrual occurred because the companies had an "entitlement right".

3.5.1.2 Definition of "amount"

The term "amount" was in dispute in the arguments raised in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*. The court emphasised that it is the benefit of having a right to retain and use loan capital interest-free that it seeks to include in gross income, not the loan capital. (*Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*, 2007:4-5.).

The *Lategan v Commissioner for Inland Revenue* interpretation of the term "amount" was referred to in the *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* (2007:6-7) decision.

In summary, the court in *Lategan v Commissioner for Inland Revenue* held that:

- the word 'income' does not always consist of a sum in monetary terms; and
- 'income' is produced through employment of capital and intellect. The incentive that is subsequently earned may be cash or may be in a form of "some other kind of corporeal property or in the form of rights". Brincker *et al.* (2007:13-14.).

The *Lategan v Commissioner for Inland Revenue* judgement therefore concluded that the definition of the term "amount" is not only money, but the value of every form of property earned by the taxpayer which has a monetary value.

By basing the ruling on the *Lategan v Commissioner for Inland Revenue* interpretation, the *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* judgement is therefore in support of the “money value” principle of interpreting the term “amount’, as opposed to the “money’s worth” principle.

The *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* (2007:12) decision was thus contrary to that in *Stander v Commissioner for Inland Revenue* (i.e. “money’s worth” principle of interpretation is incorrect).

3.5.2 Interpretation by Brincker *et al.*

Brincker *et al.* (2007:16-18), in a synopsis of the *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* interpretation of gross income, points out that:

- it was decided by the court that-
    - it is the value of the benefit of the right to use the loan (not the advance of the loan) that constituted gross income;
    - the loan was linked to the granting of occupation rights (*quid pro quo*);
- based on previous court rulings, the court was correct in concluding that it is not the receipt of the loan that should be included in gross income;
- the court in its decision applied *Commissioner for Inland Revenue v Cactus Investments (Pty) Ltd* correctly and resolved that the receipt of the right has a monetary value; and
- as confirmed by *Ochberg v Commissioner for Inland Revenue* the determination of the value of the right is an objective test, which looks at what value would be placed on the benefit had it been received by a third party, therefore the principle in *Stander v Commissioner for Inland Revenue* should be discounted.

3.5.3 Interpretation by Williams

Williams (2007:1-4) echoed the above interpretation of *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* and elaborated further as follows:

- the ruling *in Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* is as important as *Lategan v Commissioner for Inland Revenue and Commissioner for Inland Revenue v People's Stores (Walvis Bay) Pty Ltd;*
- the judgement gives an understanding by overturning the opinions that stated that unless a receipt can be converted into cash it cannot be included in gross income;
- the correct principle is to determine whether a non-monetary receipt has a monetary value, not to assess if the non-monetary receipt can be converted into cash; and
- the judgement is not a general rule, it may be possible to avoid the gross income inclusion if the receipt is capital in nature.

3.6 EXPLANATORY INTERPRETATION OF THE "LIFE RIGHT" PRINCIPLE

The "life right" was referred to in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* (2007:2-3) as:

> '*[d]ie reg van die okkupeerder om die eenheid te okkupeer en die fasiliteite te gebruik, onderworpe aan die reëls vanaf datum van okkupasie tot datum van beëindiging*, *as teenprestasie vir die lening en onderworpe aan die betaling van maandelikse heffings en spesiale heffings*'. '*As teenprestasie vir die lening onderneem die maatskappy om aan die okkupeerder lewensreg van die eenheid te verleen'.* '*Die grondslag van hierdie ooreenkoms is lewensreg teen 'n lening met sekuriteit*'.

From these facts, an agreement was concluded where the property occupant received a 'life right' to occupy the property unit in exchange for a loan that was backed by a security. The developer applied the interest-free loan exclusively for the development of the property unit and none of the loaned amounts were spent towards any other business

activities. (*Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*, 2007:2-3.).

Various commentaries emphasised the '*quid pro quo*' principle that was a part of the *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* judgement. In his conclusion Olivier (2008: 156) stated that only the receipt of a right to an interest-free loan that is granted as a *quid pro quo* will be taxable.

This is further supported by Brincker *et al.* (2007:16-18), who point out that it is essential to be aware that the right to occupy the units was linked to the continued making of the interest-free loan. The linking of the granting of the loan to the right of occupation thus establishes the *quid pro quo* relationship.

An alternative school of thought on the *quid pro quo* principle has subsequently unfolded as represented in this statement: according to Surtees (2007:[2]), a recent disclosure demand by South African Revenue Service calling for a company in KwaZulu-Natal to supply information regarding interest-free loans granted to its subsidiary company, may be an indication that South African Revenue Service is looking to apply the ruling to all interest-free loans regardless of whether they are granted in exchange for goods or services or granted for capital expansion or working capital requirements.

Seemingly from this statement that emanates from actions by South African Revenue Service, a conclusion that could be drawn is that a *quid pro quo* relationship is not a necessity. This statement will be further explored in chapter 6 by applying it specifically to interest-free shareholders' loans.

3.7 CONCLUSION

From the above statements, the conclusion to be derived is that *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* re-affirmed most of the previous court case rulings regarding the interpretations of the terms "amount", "received by/ accrued to". The case that was contradicted and discounted was *Stander v*

Commissioner for Inland Revenue, and therefore in assigning value to the term “amount” the monetary value of the receipt must be considered without reference to the restrictions/ limitations imposed on the recipient of the amount.

In chapter 4 future application of the principles derived in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* are expanded on with reference to how this judgement was applied in *XYZ (Pty) Ltd v Commissioner South African Revenue Service.*

CHAPTER 4

APPLICATION OF THE RULING IN COMMISSIONER SOUTH AFRICAN REVENUE SERVICE V BRUMMERIA RENAISSANCE (PTY) LTD TO XYZ (PTY) LTD V COMMISSIONER SOUTH AFRICAN REVENUE SERVICE

4.1 INTRODUCTION

The judgement in *XYZ (Pty) Ltd v Commissioner South African Revenue Service* was delivered by the Cape Tax Court on 21 January 2008 (*XYZ (Pty) Ltd v Commissioner South African Revenue Servic*e, 2008:1). This was the first court case to apply the ruling in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* (Morphet, 2008:1).

4.2 XYZ (PTY) LTD V COMMISSIONER SOUTH AFRICAN REVENUE SERVICE

4.2.1 Background

The appellant, XYZ (Pty) Ltd, carries on trade as a holiday timeshare exchange company for holiday resort developers. The respondent, the South African Revenue Service, initially alleged that an employee holiday points scheme engaged by XYZ (Pty) Ltd and its employees is taxable under the Act. (*XYZ (Pty) Ltd v Commissioner South African Revenue Servic*e, 2008:1-7.).

The South African Revenue Service subsequently submitted that the holiday points afforded to XYZ (Pty) Ltd employees constitute gross income and are a taxable fringe benefit in terms of the Act. The appellant responded that the holiday points were issued as part of a staff training initiative called “resort education” and therefore should not be taxed. (*XYZ (Pty) Ltd v Commissioner South African Revenue Servic*e, 2008:6-8.).

4.2.2 The underlying facts presented *in XYZ (Pty) Ltd v Commissioner South African Revenue Service*

In summary, the key facts presented to the court were:

- XYZ (Pty) Ltd permitted employees to visit various holiday resorts through use of a points allocation system;
- the employees had an open choice and could utilise the points at any of the resorts that are managed by XYZ (Pty) Ltd;
- the points were issued with the following restrictions-
    - only employees employed by XYZ (Pty) Ltd for more than six months were eligible to receive points;
    - a maximum of 17 000 points were issued annually per employee;
    - the points were only valid for one year and forfeited thereafter if not used;
    - the points could not be transferred or be put up for sale; nor could they be converted into cash, nor could the accommodation be rented out by the employees;
    - the points were only allowed for making accommodation bookings outside periods that are high in demand;
    - acquaintances and family of the employees could use the points only in the presence of the employee; and
    - all unused points were forfeited on termination of employment. (*XYZ (Pty) Ltd v Commissioner South African Revenue Servic*e, 2008: 3-7.).

4.2.3 The arguments raised in *XYZ (Pty) Ltd v Commissioner South African Revenue Service*

The arguments presented to the court were as follows:

- the appellant argued that the market value of the holiday accommodation benefit granted to the employees had a value of zero; and

- South African Revenue Service argued that employees tax was due because the fringe benefit arising from the holiday points could be assigned a value. (*XYZ (Pty) Ltd v Commissioner South African Revenue Servic*e, 2008:7-8.).

4.2.4 Application of the ruling in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* to the judgement in *XYZ (Pty) Ltd v Commissioner South African Revenue Service*

Referring to the ruling in *Stander v Commissioner for Inland Revenue*, XYZ (Pty) Ltd put forward an argument that the holiday points had no value. This was because of the many restrictions that were imposed to limit the employees' ability to convert the holiday points into cash. (*XYZ (Pty) Ltd v Commissioner South African Revenue Servic*e, 2008:13-14.).

Subsequently the court referred to the key principle in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* that established that restrictions imposed on realisation of proceeds by the taxpayer do not nullify the fact that a value can be assigned to such a realisation (i.e. general market value) (*XYZ (Pty) Ltd v Commissioner South African Revenue Servic*e, 2008:17).

The court, after determining that the principles of *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* were applicable, concluded that the holiday timeshare points granted the employees a right "for which an employee would have had to pay for if he or she had not been given it for nothing". The benefit thus has a monetary value to the employees. (*XYZ (Pty) Ltd v Commissioner South African Revenue Servic*e, 2008:17.).

4.3 CONCLUSION

On determining that the principles of *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* were applicable, attempts to apply Stander *v Commissioner for Inland Revenue* to interpret the gross income term "amount" were

rejected by the court in *XYZ (Pty) Ltd v Commissioner South African Revenue.* These principles set out that restrictions imposed on a taxpayer do not nullify the value of the receipt of a right by such a taxpayer.

A variety of alternative methods available to value this receipt will be discussed in chapter 5.

CHAPTER 5

ASPECTS OF GROSS INCOME NOT ADDRESSED IN COMMISSIONER SOUTH AFRICAN REVENUE SERVICE V BRUMMERIA RENAISSANCE (PTY) LTD

5.1 INTRODUCTION

As discussed in chapter 3, in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* the "accrual" and the "amount" aspects of the gross income definition were contested and arguments around the term "capital nature" were not permitted to be presented.

This chapter will advance discussions on possible implication of the issues that were not addressed or presented in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty).* These mainly pertain to the valuation of the term "amount" and interpretation of the term "excluding receipts or accruals of capital nature".

5.2 EXCLUDING RECEIPTS OR ACCRUALS OF CAPITAL NATURE

5.2.1 The decision *in Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*

In *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* the court did not permit raising of arguments relating to capital nature of the receipt (Bowman Gilfillan Tax Team, n.d.:[1]). Therefore, the ruling in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* bears no impact nor alters existing case law interpretations pertaining to the term "excluding receipts or accruals of capital nature".

This view is affirmed in Bowman Gilfillan Tax Team (n.d.:[1]) outline of the court judgement stipulating that:

- the *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* argument statement explicitly stated that the benefit received was not a "receipt" of an "amount";
- the taxpayers subsequently wanted to present evidence that the amount in question was capital in nature but the court did not allow this new evidence to be raised; and
- the taxpayers did not follow due court processes in order to include the capital nature argument in their initial or their amended statement of grounds of appeal.

5.2.2 Hypothetical application of *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*

From the Bowman Gilfillan Tax Team comments above, it can be derived that it would not be appropriate to apply the principles in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* when determining the capital nature of receipts. Therefore, in interpreting the term "excluding receipts or accruals of capital nature", prevailing definitions and interpretations existing in case law should be applied.

The various case law interpretations, as discussed above in point 2.3.4, determine that the following would be of consideration when assessing the revenue or capital nature of receipts:

- an income receipt is
  - what is produced by the principal capital;
  - generated through employment of a capital asset;
  - generated in the course of furtherance of business;
  - generated through depletion of floating capital in the production process; and
  - generated through realisation of stock-in-trade;
- a capital receipt is

- generated through realising an asset which was held to derive income through use of the asset; and
- obtained on the sale of fixed capital (an asset that remained intact through the production process). (Jordaan *et al.,* 2006:19-24.).

In summary, the principles above determine that a receipt would be capital in nature if it is from the sale of an asset that was held as fixed capital (i.e. was an asset that a taxpayer had intended to hold and use to generate income) (Jordaan *et al.,* 2006:24).

Assuming that the determination of capital nature of the receipt was open for judgement, applying the above principles to *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd,* the conclusions that could have been reached are:

- if Brummeria Renaissance (Pty) Ltd sold the properties in the ordinary course of business, it can be argued that proceeds from the sale of the properties would be revenue in nature because the properties constituted stock-in-trade;
- if the properties were built with the purpose of holding them to produce income, then the receipts generated through use of the properties would be revenue in nature, and receipts on sale of the properties would be capital in nature; and
- if Brummeria Renaissance (Pty) Ltd surrenders the right of occupation of the property, but keeps title and ownership thereof, then it could be interpreted that it has not sold or let go of a capital producing asset, then any receipts or rights conferred from such a surrender is not of a capital nature.

This is supported by principle in *COT v Booysen Estates Ltd*, 1918 AD (32 SATC 10). According to the synopsis in Brincker *et al. (*2007:20) "[i]t is true that there is no definite test that can always be applied in order to determine whether a gain or profit is income or not, but it may safely be asserted that the revenue or profit derived from a thing without its changing owners is rather to be considered as income than as capital."

From this statement it can therefore be derived that when an owner of property grants to another a right of occupation of that property without a change of ownership, as was the case in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty)*),

any consideration – in this case the right to enjoy the benefit of an interest-free loan – must be income in nature. This case law interpretation therefore suggests that a benefit (in this instance an interest-free loan) received in lieu of floating capital is revenue in nature, and is thus not a capital receipt.

The ruling in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* further expanded on this and concluded (without making reference to the capital or the revenue nature of the receipt) that the benefit/ receipt has a determinable worth and has accrued to the taxpayer (*Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd,* 2007:4).

In *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* (2007:3-4) the value placed on the benefit was calculated based on the weighted prime overdraft interest rate. As already indicated, the valuation method was not contested in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*. Arguments concerning this valuation method together with other various valuation methods prescribed in the Act are discussed below.

5.3 METHODS OF VALUING THE AMOUNT

Those commenting on the court case indicate that, although they concur with the interpretation of the word "amount" in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*, they question the valuation method used to calculate the gross income amount. Some commentaries are in favour of basing the value of the benefit on the deemed value under the anti-tax avoidance provisions included in the Act, instead of the weighted average prime rate valuation method (Bowman Gilfillan Tax Team, n.d.:[1]).

In response to the above arguments, further discussion of valuation methods applied in other parts of the Act is detailed below. The valuation methods to be considered include those included in the general anti-tax avoidance provisions, transfer pricing anti-tax

avoidance provisions and the valuation of usufructs adopted in terms of donations tax provisions included in the Act.

5.3.1. Weighted prime overdraft rate valuation method applied in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*

In the *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* (2007:4) judgement, the amount required to be included in gross income was determined as "[t]he value of the benefit is determined by applying the weighted prime overdraft rate of banks to the average loan capital over the period for which the developer had the use of the loan capital during that specific year of assessment".

To elaborate further on the above, the court therefore:

- assigned the banks' prime overdraft rate in order to value the right; and
- took into account the variability of the banks' prime overdraft rate by determining the applicable weighted average rate for the period.

The key drivers of determining value, applying the weighted overdraft interest rate method, are the capital amount advanced to the property developer and the prime overdraft interest rate.

These key determinants of the value do not allow for adjustments to be made on the prime overdraft rate, accordingly a consideration of the risk profile of the borrower is not allowed (i.e. does not allow for differentiation of the rate between high and low risk borrowers). As an additional shortcoming, future application of this valuation method could see manipulation by taxpayers by simply varying the amount of the loan capital advanced.

5.3.2 Valuation methods contained in the Act

5.3.2.1 Practice Note 2 – Transfer pricing anti-tax avoidance valuation method

The income tax anti-avoidance provisions of South African taxation that relate to transfer pricing are included in section 31 of the Act. The provisions of section 31 can only be applied in the existence of an international agreement (an agreement between someone who is a resident and another who is not a resident) (Jordaan *et al*, 2006:419-420). For the purpose of this study, these requirements will be ignored and only the valuation principles contained in the provisions will be considered.

Section 31(1) of the Act contains definitions of the terms “goods” and “services”. Important to note is that the term “goods” is defined to include any real rights in any property (Jordaan *et al*, 2006:419-420). This definition could be inferred to include such “life rights” of occupation that are the centre of the *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*.

Also equally important to note is the definition the term “services” included in section 31 (1) of the Act. These are defined to include the surrender of any rights (Jordaan *et al.*, 2006:419-420), and these could be also indirectly be inferred to include surrender of the right to receive interest by advancing the loans interest-free in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*.

Section 31 (2) of the Act contains provisions that enable the South African Revenue Service authority to adjust the transaction value in instances where the transacting parties are connected persons to each other (i.e. the parties are related as defined in the Act) (Jordaan *et al.*, 2006:420). Once again, the connected person requirement will be ignored for the purpose of this study, only the valuation principles contained in the provisions will be considered.

When the provisions of section 31(1) and section 31(2) are read together with Practice Note 2 of the South African Revenue Service, the arms-length price (i.e. market price) to

which the South African Revenue Service can adjust the value of interest on loans is defined as a nominal interest rate not exceeding two percent of the weighted average of the South African prime rate (Jordaan *et al.*, 2006: 421). In *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* the market rate was determined to be the weighted prime overdraft rate. The valuation in Practice Note 2 is thus different from that contained in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd,* and could be applied as an alternative valuation method in the future.

This alternative, unlike the weighted prime overdraft rate valuation, could allow the South African Revenue Service to determine a range of rates that do not exceed two per cent of the weighted average South African prime rate to be the applicable rates for the purpose of determining a market rate. The rates on the lower end of the range could then be applied to borrowers with low credit risk profiles, thus allowing the matching of the rate and the risk profile of the borrower.

The Practice Note 2 valuation method is similar to the weighted average prime overdraft rate method, and just like the weighted average prime overdraft rate method it is also open to manipulation by taxpayers by simply varying the amount of the loan capital advanced.

5.3.2.2 General anti-tax avoidance valuation method

General anti-tax avoidance provisions were included in section 103 (1) of the Act. This section has since been repealed by the Amendment Act No. 20 of 2008 and section 80A was included in the Act, the provisions of which are more or less similar to those repealed in section 103 (1).

The Act prescribes that on establishing that the requirements of section 80A are met the provisions of section 80B will be applied to the transaction.

In terms of section 80B the Commissioner may determine the tax consequences of any avoidance arrangement for any party by:

- disregarding, combining, or re-characterising any steps in or parts of the impermissible avoidance arrangement;
- reallocating any gross income, receipt or accrual of a capital nature, expenditure or rebate amongst the parties;
- re-characterising any gross income, receipt or accrual of a capital nature or expenditure; or
- treating the impermissible avoidance arrangement as if it had not been entered into or carried out, or in such other manner as in the circumstances of the case the Commissioner deems appropriate for the prevention or diminution of the relevant tax benefit. (Huxham & Haupt, 2009:453.).

Indications are that had South African Revenue Service applied the anti-tax avoidance rule, as prescribed in section 80B of the Act, to the facts that were presented in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*, the property occupants would have been taxed on the deemed interest value of the loans and the developers would have been taxed on the deemed attributable rental value (Bowman Gilfillan Tax Team, n.d.:[1]).

The South African Revenue Service would have re-characterised the receipts by looking at the true substance of the agreement rather than its legal form. In legal form, the agreement was made-up of an interest-free loan and a right to occupy the property. Since the property developers in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* are giving away the right to occupy the property units to the potential property occupants, the true substance of the arrangement is therefore similar to that of a property lease/rental agreement.

In a lease agreement the lessor gives away the right to occupy the property to the lessee in return for a right to receive proceeds in a form of monthly rentals. In the instance of *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* the

receipt of monthly proceeds was in a form of a right to be a recipient of an interest-free loan awarded by the property occupants.

In terms of section 80B of the Act, South African Revenue Service would then set aside the legal arrangement of the agreement and tax the property developers as if they had received the monthly rentals.

5.3.2.3 Donations tax usufruct valuation method

South African taxation on donations is levied in terms of sections 54 to 65 of the Act. Section 55 contains the definition of property, which is defined to be inclusive “any right in or to property whether movable or immovable, whether corporeal or incorporeal” (Jordaan *et al.*, 2006:526).

The value to be placed on the property and property rights is defined in section 62 of the Act. The value of the property rights includes valuation of fiduciary interests such as usufruct interests, bare dominium interests and annuity income interest. (Jordaan *et al.*, 2006:530-531.).

According to Jordaan *et al.* (2006:530-531) these terms are defined as:

- fiduciary interest is an award of partial rights to property where the holder thereof does not have complete ownership rights to the property;
- usufruct interest is an entitlement to a right of unlimited use of the property without the right of disposing the property ; and
- bare dominium interest grants its holder the right to ownership of the property without the right to use the property.

To illustrate the above definitions, in the case of a holiday home property, the usufruct interest owner will have the right to occupy the property or the right to obtain rental income earned, whereas the bare dominium interest owner will have the right to the title of the property (Jordaan *et al.*, 2006:531).

Applying these definitions to the *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* scenario the property developer relinquished their right property occupation (usufruct right) and the following could be implied:

- the property occupants and the developer companies, where afforded limited interests to the properties;
- the property developer companies had bare dominium interests because they possessed the right to ownership and title to the properties; and
- the property occupants had usufruct interests because they were entitled to the lifelong right of occupation and usage of the properties.

The value of a usufruct is calculated using the formula derived in section 62 and also section 62(3) of the Act as follows:

Property usufruct value = Annual value **x** Present value factor
Annual value = Market value of property **x** 12%
Where the property donor has 100% ownership rights, the value attached to the property is the fair market value of the property.
The present value factor is calculated using the Estate Duty Act Tables A and B. Table A is the life expectancy table (refer to Appendix A) and Table B is the annuity table (refer to Appendix B). The life expectancy of a company/trust is set at 50 years (Huxham & Haupt, 2009:672-674).

Applying the above formula to agreements in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*:

- the signature date of the agreements between the unit occupants and the property developers would decide the date to be used when determining the market value of the property;
- the fair market value of the property units would be applied because the developers have 100% ownership of the property units;
- in calculating the present value factor, the length of the period of the usufruct would be determined with reference to life expectancy which is calculated based on the

age of the potential property occupant of the unit at the signature date of the agreement;

- using the Estate Duty Tax Annuity Table (Table B), at a life expectancy of 5 years, the present value factor to apply is 3.6048;
- assuming the property market value was R1 000 000 and the unit occupier had a life expectancy of 5 years, the usufruct value would be R432 576 ((R1 000 000 **x** 12%) **x** 3.6048); and
- the annualised usufruct value would then be R86 515 (R432 576/ 5 years) and the monthly rental charge would thus be R7 209.60 (R432 576/ 5years/ 12months).

This valuation method could be an alternative to be adopted by South African Revenue Service. In this case the monthly value to be attached to the right of occupation of the unit would be R7 209.60. The value derived from this valuation method is not easily manipulated by the taxpayer because it is determined using the formula and the fair market value determinant is driven by general economy forces, not by the taxpayer.

This valuation method would be more favourable to taxpayers with a longer life expectancy, for example, the monthly value for an occupant with 30 years expected life is R2 685.07, whereas the monthly value is R5 650.22 if the life expectancy is 10 years (refer to table below).

Table 2: Calculation of monthly value of usufruct

Years	Market value	12% factor	Annuity factor	Present value of usufruct	Monthly value
1	1 000 000	12%	0.8929	107 148	8 929.00
5	1 000 000	12%	3.6048	432 576	7 209.60
9	1 000 000	12%	5.3282	639 384	5 920.22
10	1 000 000	12%	5.6502	678 024	5 650.20
20	1 000 000	12%	7.4694	896 328	3 734.70
30	1 000 000	12%	8.0552	966 624	2 685.07

5.3.3 Valuation method contained in the Draft Interpretation Note

A Draft Interpretation Note containing provisions on the right to use loan capital interest-free has since been issued by the South African Revenue Service, on 13 October 2008. This is a draft document and it stipulates that:

- in property developer loan schemes advanced on the same or similar conditions to those in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd,* a usufruct valuation type of approach will be adopted (Draft Interpretation Note, 2008:5-8); and
- in the case of other interest-free loans:
  - the weighted average prime overdraft rate valuation method as applied in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* would not necessarily be the most appropriate method of valuation; and
  - the determination of value of the benefit should be assessed on a case-by-case basis and the merits of each case would determine the valuation method to be adopted. (Draft Interpretation Note, 2008:4.).

5.4 CONCLUSION

The valuation principles discussed above are just an indication of various valuation methods recognised in the Act that can be applied to value rights of similar type to those in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*.

From this it is clear that there are different angles that can be taken to arrive at the value of the right to receive the benefit of an interest-free loan. The calculation can be derived from market related interest rates or from reference to the market value of rental value of the property or it can be calculated by valuing the forgone right to occupy the property (usufruct). Although the Draft Interpretation Note contains some suggestions, it will be interesting to note which valuation method will be adopted by South African Revenue Service when it issues the much anticipated Interpretation Note.

Chapter 3 and chapter 4 presented discussions on the impact of the ruling in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* on the definition of the terms "amount" and "received by/ accrued to". The issues of valuation and capital nature of the receipt (i.e. issues that were not addressed in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd)* were discussed in this chapter.

Chapter 6 will present arguments and discussions on future application of the ruling in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* to interest-free shareholders' loan agreements.

CHAPTER 6

APPLICATION OF THE PRINCIPLES OF COMMISSIONER SOUTH AFRICAN REVENUE SERVICE V BRUMMERIA RENAISSANCE (PTY) LTD TO INTEREST-FREE SHAREHOLDERS' LOANS

6.1 INTRODUCTION

Due to the wide use of interest-free loans as a means of injecting funds into business, considerable trepidation has risen as a result of the ruling in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty)* (Dachs, 2008:1). The discussions in this chapter aim to add more to the ongoing debate of determining the impact of the judgement in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* on similar arrangements, such as interest-free shareholders' loans. As a first point of reference, a review of significant characteristics of shareholders' loans will be made.

6.2 GENERIC FEATURES OF A SHAREHOLDERS' LOAN AGREEMENT

Defined in the Compact Oxford English Dictionary; the term shareholder means an owner of shares in a company; and the term loan means a thing that is borrowed, especially a sum of money that is expected to be paid back with interest.

From the above definition of loan it can be derived that the general features of shareholders' loans that are common to all loans are that:

- an item that is possibly of monetary form is extended;
- coupled with the extension of the item is an expectation that the item will be returned; and
- an additional payout *in lieu* of interest may be expected.

6.3 CONTRAST OF SHAREHOLDERS' LOANS TO LOANS IN *COMMISSIONER SOUTH AFRICAN REVENUE SERVICE V BRUMMERIA RENAISSANCE (PTY) LTD*

As discussed in chapter 3, the most significant characteristic of the loan agreements in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* is that the rights to retain and use the loans interest-free were granted by the property occupants as an exchange (consideration) for the right of occupation of the property units (Oliver, 2008:152). The right to occupy the property was directly linked to the granting of the right to retain the loan interest-free (Brincker *et al*, 2007:13). *Quid pro quo* in this instance therefore arises directly from the exchange the right to an interest-free loan for the right of occupation of the property.

In instances where interest-free shareholders' loans are not granted in exchange for goods and/or services to be provided by the company, but are instead granted to fund the company fixed capital and working capital needs, at face value such loans appear to be unlike the loans in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* because the is no exchange of goods and/or services. This indicates that these shareholders' loans have not been granted with the intention of *quid pro quo* because the shareholders receive nothing in return for granting the company the right of using the loan interest-free.

Most tax experts are of the opinion that the precedent set in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* only applies to interest-free loans that are granted as a direct exchange for goods and services (i.e. granted on existence of a *quid pro quo*). Actions by South African Revenue Service calling for companies to supply information regarding interest-free loans granted to subsidiary companies may be an indication that South African Revenue Service is looking to apply the ruling to all interest-free loans regardless of existence of *quid pro quo*. (Surtees, 2007:[2]).

6.4 *QUID PRO QUO* REQUIREMENT EXPLANATORY IN THE DRAFT INTERPRETATION NOTE

In the meantime, until the final issuance of the Interpretation Note by the South African Revenue Service, the ambiguity around the significance of *quid pro quo* to interest-free shareholders' loans still prevails. In the interim, to clarify the divergent arguments raised above by Surtees (2007:[2]), paragraph 5.2 of the Draft Interpretation Note issued by South African Revenue Services on 13 October 2008 can be applied as follows:

- interest-free loans granted by shareholders are usually provided to fund capital expenditure or long-term working capital requirements of the company;
- the shareholders' intention in granting a loan to the company may not be in exchange for goods and/or services to be receivable from the company;
- if however the interest-free shareholders' loans are granted in exchange for goods and services, then there is *quid pro quo*; and
- where there is no *quid pro quo,* based on the context of the granting of the loan, the interest-free shareholders' loans would not necessarily be affected by the ruling in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* because the loans granted may be capital in nature. (Draft Interpretation Note, 2008:4.).

From the above statements from the Draft Interpretation Note, it appears that the South African Revenue Services has made a preliminary determination that *quid pro quo* is compulsory when applying the ruling in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*. Therefore the must be a supply of goods and/or services which is linked to the granting of the interest-free shareholders' loan in order for the ruling in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* to be applicable to shareholders' loan agreements.

As was the case in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*, once the existence of *quid pro quo* is established, the benefit of the right to the interest-free shareholders' loans must accordingly be valued, based on the

"money value" principle rather than the "money's worth" principle. In determining this value various valuation methods including those discussed in chapter 4 could be considered.

Once the value is established, the benefits flowing from right to retain and use the shareholders' loan free of interest would only be included in the gross income of the taxpayer if all the other gross income requirements are met.

The next question to be asked is how narrowly the South African Revenue Service will interpret the *quid pro quo* principle. Will it be stretched as far as surmising that an interest-free shareholders' loan given in exchange for a right to future dividend results in *quid pro quo*? This is further elaborated below.

6.5 RIGHT TO DIVIDENDS ARGUMENT

Defined in the Compact Oxford English Dictionary the term dividend means a sum of money that is divided among a number of people, such as the part of a company's profits paid to its shareholders. The definition would imply that as a company generates profits, it would make dividend payout to its shareholders out of the profits.

Adding to the general principles established in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* the concept that shareholders' interest-free loans are made with the intention of securing future dividends, it can be argued by this study that:

- additional funds received by the company in a form of the interest-free shareholders' loan will result in sustained or increased profits of the company;
- where the shareholders' loan is granted to fund fixed capital or working capital expenditure in order to sustain the company's existing profitability, then the shareholder can be seen as granting a loan in return for a right to continued future constant dividends; and
- an interest-free shareholders' loan can be seen as an exchange or a consideration paid by the shareholder for a right to future dividends that are constant or are

significantly higher than those that would have been paid had the interest-free loan not been advanced.

To the extent that the rights of receiving an interest-free shareholders' loans are granted to fund the fixed capital and/or working capital requirements of the company they can be seen as a consideration paid by the shareholders in exchange for the right to future dividends; it can be argued that *quid pro quo* does exist in the granting of these shareholders' loans (the right to interest-free loans are linked to a right to future dividends).

After establishing the existence of *quid pro quo* the receipt of the right to an interest-free shareholders' loans would then have to be quantified based on "money value" principle as was the instance in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*. Although *quid pro quo* is established, the receipt may only be included in gross income once it is established that all four sub-requirements of gross income definition have been met (for example if the receipt of the right is determined to be capital in nature, then it would not comprise gross income)

6.6 CONCLUSION

In considering the reach and applicability of the ruling in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* to similar type loans such as interest-free shareholders' loans, it has thus been determined that the principle of *quid pro quo* is important. This would imply that in instances where the interest-free shareholders' loans rights have *quid pro quo* (i.e. where the rights to an interest-free loans are granted as consideration for a services or goods to be received by the shareholders), then such loans rights are determined to be similar to those in C*ommissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*.

The open question that still remains is how widely or narrowly will the South African Revenue Services interpret the *quid pro quo* principle. If this interpretation were to include the right to sustainable or increased dividends accruing to a shareholder by granting a right to an interest-free shareholder loan to a company, then most (if not all) interest-free

shareholders' loans would fall within the principles of the ruling in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*.

Important to note is that once the existence of *quid pro quo* is established, it would be necessary to determine if the receipt of the right to an interest-free shareholders' loan meets all the requirements of the gross income definition because this would determine if the receipt is taxable or not.

CHAPTER 7

CONCLUSION

7.1 SUMMATION

The central enquiry that is the root of this study is whether interest-free loan arrangements – interest-free shareholders' loans in this instance – will result in inclusion in gross income as a result of the precedent set in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd*. The study discussions were broken down to answer these sub-enquiries:

- to which sub-requirements of the gross income definition has the *Commissioner South African Revenue v Brummeria Renaissance (Pty) Ltd* added additional insight?;
- to which sub-requirements of the gross income definition did the ruling in *the Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* not add any additional insight or meaning and how could these be interpreted?; and
- how could the ruling in the *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* affect other similar transactions (e.g. interest-free shareholders' loan arrangements)?

7.2 CONCLUSION

Although at face value it may have seemed that the judgement in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* has significantly altered the interpretation of the gross income terms, from the discussions in this study it appears the situation is not that grim and far-reaching.

The pivotal issue to be established in assessing if the precedent set in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* applies to an interest-free shareholders' loan is whether the loan was issued in exchange for goods and services (i.e. issued on the basis of *quid pro quo).* Once *quid pro quo* has been established, prior to the gross income inclusion of the right to receive the interest-free shareholders' loan, all four sub-requirements of the gross income definition must be met and a determinable monetary value must be assigned. It is important to note that it is the value of the right to receive a shareholders' loan interest-free, not the capital amount of the loan, which will be included in gross income.

In assessing if the right to the interest-shareholders' loan receipt meets the requirements of the gross income definition the following secondary points are important to note:

- the judgement in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* has not altered the existing interpretations of the gross income terms "received by/ accrued to", "year of assessment" and "excluding receipt and accruals not capital in nature". The existing interpretations of these terms still prevail and should be applied;
- with regards to interpretation of the term "amount" –
    - the ruling in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* has contradicted *Stander v Commissioner for Inland Revenue*, 1997 (3) SA 617 (C) (59 SATC 21), therefore the restrictions on the taxpayer's ability to convert the receipt to money should not be given consideration when determining the value of a benefit accruing to a taxpayer; and
    - the ruling in Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd has affirmed previous case law interpretations that support the "money value" principle and concluded that even though a non-monetary benefit received can be seen as not having "money's worth" (i.e. cannot be turned into money), it can still be assigned value;
    - the decisions in *XYZ (Pty) Ltd v Commissioner South African Revenue Service*, 2008 (SATC 12244) applied the *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* ruling and assigned

value to the taxpayers' receipt despite the existence of transfer and disposal restrictions that were imposed on the taxpayer; and

- the remaining issue around the term "amount" is how the value of the rights to interest-free loans will be assigned. The views expressed in the South African Revenue Services Draft Interpretation Note issued on 13 October 2008 determine that the value will be assessed by South African Revenue Services on a case-by-case basis, giving consideration to the facts presented. This adds further clarity and recognises that the weighted overdraft interest rate valuation method applied in *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* is not the only applicable valuation method, and this is thus an area where a taxpayer is open to challenge the South African Revenue Services.

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APPENDIX A

TABLE A

THE EXPECTATION OF LIFE AND THE PRESENT VALUE OF R1 PER ANNUM FOR LIFE CAPITALISED AT 12 PER CENT OVER THE EXPECTATION OF LIFE OF MALES AND FEMALES OF VARIOUS AGES

	Expectation of life		Present value of R1 per annum for life			Expectation of life		Present value of R1 per annum for life			Expectation of life		Present value of R1 per annum for life	
Age	Male	Female	Male	Female						Age	Male	Female	Male	Female
0	64.74	72.36	8.32791	8.33105	30	38.48	44.86	8.22694	8.2817	60	14.61	18.78	6.74206	7.34135
1	65.37	72.74	8.32828	8.33114	31	37.57	43.91	8.21538	8.27583	61	14.01	18.04	6.6301	7.25457
2	64.5	71.87	8.32776	8.33091	32	36.66	42.96	8.20257	8.2693	62	13.42	17.3	6.51232	7.1602
3	63.57	70.93	8.32714	8.33064	33	35.75	42.02	8.18836	8.2621	63	12.86	16.58	6.39301	7.06046
4	62.63	69.97	8.32644	8.33033	34	34.84	41.07	8.17262	8.254	64	12.31	15.88	6.26822	6.95537
5	61.69	69.02	8.32567	8.32999	35	33.94	40.13	8.15536	8.24509	65	11.77	15.18	6.13789	6.84161
6	60.74	68.06	8.3248	8.329.61	36	33.05	39.19	8.13647	8.23517	66	11.26	14.51	6.00726	6.72393
7	59.78	67.09	8.32381	8.32918	37	32.16	38.26	8.11558	8.22426	67	10.76	13.85	5.87165	6.59893
8	58.81	66.11	8.32271	8.32869	38	31.28	37.32	8.09274	8.21199	68	10.28	13.2	5.73403	6.46635
9	57.83	65.14	8.32146	8.32815	39	30.41	36.4	8.06781	8.19866	69	9.81	12.57	5.59182	6.32818
10	56.85	64.15	8.32007	8.32753	40	29.54	35.48	8.0403	8.18386	70	9.37	11.96	5.45165	6.18466
11	55.86	63.16	8.31849	8.32684	41	28.69	34.57	8.01067	8.16762	71	8.94	11.37	5.30775	6.03607
12	54.87	62.18	8.31673	8.32608	42	27.85	33.67	7.97844	8.14983	72	8.54	10.8	5.16744	5.88278
13	53.9	61.19	8.3148	8.32522	43	27.02	32.77	7.94344	8.13012	73	8.15	10.24	5.02437	5.72222
14	52.93	60.21	8.31265	8.32427	44	26.2	31.89	7.90547	8.10881	74	7.77	9.7	4.87876	5.55743
15	51.98	59.23	8.31029	8.3232	45	25.38	31.01	7.8638	8.08527	75	7.41	9.18	4.7349	5.38893
16	51.04	58.26	8.3077	8.32203	46	24.58	30.14	7.81924	8.05956	76	7.07	8.68	4.59354	5.21727
17	50.12	57.29	8.30489	8.32071	47	23.79	29.27	7.77109	8.03119	77	6.73	8.21	4.44663	5.04679
18	49.21	56.33	8.3018	8.31926	48	23	28.41	7.71843	8.00026	78	6.41	7.75	4.30309	4.87092
19	48.31	55.37	8.29841	8.31764	49	22.23	27.55	7.66236	7.96617	79	6.1	7.31	4.15898	4.69389
20	47.42	54.41	8.29471	8.31584	50	21.47	26.71	7.60201	7.9295	80	5.52	6.89	4.0244	4.51647
21	46.53	53.45	8.29061	8.31383	51	20.72	25.88	7.53713	7.88967	81	5.55	6.5	3.89051	4.34399
22	45.65	52.5	8.28613	8.31161	52	19.98	25.06	7.46748	7.84646	82	5.31	6.13	3.76802	4.17315
23	44.77	51.54	8.28117	8.30912	53	19.26	24.25	7.39387	7.79965	83	5.09	5.78	3.65276	4.00482
24	43.88	50.58	8.27564	8.30633	54	18.56	23.44	7.31631	7.74834	84	4.89	5.45	3.54546	3.83988
25	43	49.63	8.26959	8.30326	55	17.86	22.65	7.23234	7.69355	85	4.72	5.14	3.45232	3.67921
26	42.1	48.67	8.26274	8.29981	56	17.18	21.86	7.14414	7.63363	86	4.57	4.85	3.36864	3.52371
27	41.2	47.71	8.25516	8.29595	57	16.52	21.08	7.05178	7.56896	87	4.45	4.58	3.30066	3.37426
28	40.3	46.76	8.24677	8.29171	58	15.86	20.31	6.95225	7.49927	88	4.36	4.33	3.24907	3.23175
29	39.39	45.81	8.23737	8.28697	59	15.23	19.54	6.85004	7.42321	89	4.32	4.11	3.22597	3.10296
										90	4.3	3.92	3.21438	2.98912

(inserted from Estate Duty Act 45 of 1955)

APPENDIX B

TABLE B

PRESENT VALUE OF R1 PER ANNUM CAPITALISED AT 12 PER CENT OVER FIXED PERIODS

Years	Amount	Years	Amount	Years	Amount	Years	Amount
1	0.8929	26	7.8957	51	8.3076	76	8.3318
2	1.69	27	7.9426	52	8.3104	77	8.332
3	2.4018	28	7.9844	53	8.3128	78	8.3321
4	3.0374	29	8.0218	54	8.315	79	8.3323
5	3.6048	30	8.0552	55	8.317	80	8.3324
6	4.1114	31	8.085	56	8.3187	81	8.3325
7	4.5638	32	8.1116	57	8.3203	82	8.3326
8	4.9676	33	8.1354	58	8.3217	83	8.3326
9	5.3282	34	8.1566	59	8.3229	84	8.3327
10	5.6502	35	8.1755	60	8.324	85	8.3328
11	5.9377	36	8.1924	61	8.325	86	8.3328
12	6.1944	37	8.2075	62	8.3259	87	8.3329
13	6.4236	38	8.221	63	8.3267	88	8.333
14	6.6282	39	8.233	64	8.3274	89	8.333
15	6.8109	40	8.2438	65	8.3281	90	8.333
16	6.974	41	8.2534	66	8.3286	91	8.3331
17	7.1196	42	8.2619	67	8.3291	92	8.3331
18	7.2497	43	8.2696	68	8.3296	93	8.3331
19	7.3658	44	8.2764	69	8.33	94	8.3331
20	7.4694	45	8.2825	70	8.3303	95	8.3332
21	7.562	46	8.288	71	8.3307	96	8.3332
22	7.6446	47	8.2928	72	8.331	97	8.3332
23	7.7184	48	8.2972	73	8.3312	98	8.3332
24	7.7843	49	8.301	74	8.3314	99	8.3332
25	7.8431	50	8.3045	75	8.3316	100	8.3332

(inserted from Estate Duty Act 45 of 1955)