

**THE MEANING OF "*received by*" AND "*accrued to*" IN THE INCOME TAX ACT,
58 OF 1962 AS EXPRESSED BY SOUTH AFRICAN COURTS**

by

JACQUES EASTES

STUDENT NUMBER 15300405

A DISSERTATION SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE DEGREE

LLM (TAX LAW)

IN THE FACULTY OF LAW

at the

UNIVERSITY OF PRETORIA

Supervisor: Dr. Carika Fritz

OCTOBER 2018

DECLARATION

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

JACQUES EASTES

OCTOBER 2018

ABBREVIATIONS

ACJ	Acting Chief Justice
ADCJ	Acting Deputy Chief Justice
AJA	Acting Judge of Appeal
JA	Judge of Appeal
J	Judge
AJ	Acting Judge
CIR	Commissioner for Inland Revenue
CJ	Chief Justice
ITA	Income Tax Act
ITC	Income Tax Cases
LAWSA	The Law of South Africa
SARS	South African Revenue Service
SIR	Secretary for Inland Revenue

TABLE OF CONTENTS

DECLARATION	2
ABBREVIATIONS	3
TABLE OF CONTENTS	4-5
CHAPTER 1: INTRODUCTION AND BACKGROUND	6
1.1 BACKGROUND	6
1.2 PROBLEM STATEMENT AND IMPORTANCE OF THE STUDY	8-9
1.3 RESEARCH OBJECTIVE	10
1.4 RESEARCH QUESTIONS	10
1.5 RESEARCH METHODOLOGY	10
1.6 LIMITATIONS OF STUDY	10
1.7 CHAPTER OUTLINE	10-13
CHAPTER 2: THE INTERPRETATION OF FISCAL LEGISLATION	
2.1 THE MAIN APPROACHES	14
2.2 "STARE DECISIS" AND INTERPRETATION	19
CHAPTER 3: THE MEANING OF "RECEIVED BY" AND "ACCRUED TO" AS EXPRESSED IN THE <i>GELDENHUYS AND DELFOS</i> JUDGMENTS	20
3.1 CIR v PEOPLES STORES (WALVIS BAY) (PTY) LTD, 1990 (2) SA 353 (A)	24
CHAPTER 4: SPECIFIC SCENARIOS AND REPORTED JUDGMENTS	
4.1 ON BEHALF OF SOMEONE ELSE	26
4.2 PENDING DISPUTES	31
4.3 A DEPOSIT OR AN AMOUNT IN ADVANCE	33
4.4 RECIPROCAL OBLIGATIONS	35
4.5 INTEREST	42
4.6 DISCOUNT TRANSACTIONS	44

4.7	CESSION OF INCOME	46
4.8	WAIVING INCOME	48
4.9	DATE AND VALUATION	51
	CHAPTER 5: ILLEGAL RECEIPTS	54
	CHAPTER 6: CONCLUSION	63
	LIST OF REFERENCES	66

CHAPTER 1

1.1 BACKGROUND

Gross income as prescribed in the Income Tax Act, Act 58 of 1962 (hereinafter "ITA") is used to determine a person's taxable income. Without a gross income a person will not be liable for normal tax.¹ The definition of gross income in Section 1 of the ITA contains the words "received by or accrued to". As such in South Africa a taxpayer will not be liable for income tax under the ITA, without a "receipt" or an "accrual" as envisaged in the definition of gross income in section 1 of the ITA. However, the ITA does not supply a definition of the words "receive by or accrued to".

Accordingly, judges, lawyers, tax advisors and the South African Revenue Service (hereinafter "SARS") (hereinafter "interpreters of tax legislation") are forced to examine reported judgments to establish the meaning of "received by or accrued to". When interpreters of tax legislation interpret the words "received by or accrued to", the specific facts and circumstances of every scenario must be considered as will be seen from the discussion of the case law in this dissertation.

The definition of gross income in section 1 of the ITA provides a general description of what gross income entails. Section 1 of the ITA supplies several items to be found in subsections (a) to (n) that are items that are to be included in gross income.

Gross income consists of:²

- The total amount in cash or otherwise;
- Received by or accrued to or in favour of the person;

1 Croome *et al Tax Law: An Introduction* (2013) 27.

2 Section 1 of the ITA;
See also Croome *et al* (2013) 64 to 65;
See also De Koker: *Silke on South African Income Tax* – Chapter 2 (para 2 and para 2.1).

- Excluding receipts or accruals of a capital nature.

The abovementioned is generally known as the statutory formula used to determine a taxpayer's taxable income.³ South African courts have stressed that the point of departure should be that the court is or should not concern itself with accounting entries in a taxpayer's books of account, or with accounting principles and practice, but with the provision of the statutory formula contained in the ITA.⁴

First, the correct legal interpretation is of great importance as it ensures legal certainty for the interpreters of tax legislation. Second, the correct interpretation is important in a modern society with various types of commercial transactions to ensure that "a receipt or an accrual" is included in a person's gross income during the correct year of assessment. Interpreters of tax legislation must also look at the date and valuation of "a receipt or an accrual" to ensure that it is included in a person's gross income during the correct year of assessment and for the correct monetary amount.

Legal certainty corresponds with the Rule of Law as entrenched in section 1 of the Constitution, 1996 which entails that the state must act in accordance with the law. South African courts must therefore, when reviewing a specific interpretation given to "a receipt or an accrual", uphold the Rule of Law, because the primary purpose of judicial review is to uphold the Rule of Law.⁵ Thus, if the law is certain there is no room to justify non-compliance with the law by the state and a tax payer in the Republic of South Africa.

Therefore the interpreters of tax legislation must research reported judgments to understand how the South African courts already dealt with the interpretation of "a

3 Section 1 of the ITA: "*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 other 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 the Republic, during such year or period of assessment, excluding receipts or accruals of a capital nature, but including, without in any way limiting the scope of this definition, such amounts (whether of a capital nature or not) so received or accrued as are described herein under, namely ...*"

4 Swart G "Recoupments, Accounting Practice, and Income-Tax Principles" (2003) 15 SA MERC LJ 459.

5 Lenta P "Constitutional Interpretation and the Rule of Law" (2005) 2 STELL LR 297.

receipt or an accrual" in reported judgments. The aforesaid will equip the interpreter of tax legislation with an understanding of how the courts deal with the interpretation of statutes, and specifically the interpretation of "a receipt or an accrual". An interpreter of tax legislation will then be in a position to give a favourable interpretation, and use already established principles to be found in reported judgments to support an interpretation to be given to "a receipt or an accrual" in a specific scenario. An interpreter of tax legislation may also be in a position to use established principles from the reported judgments to supply a new interpretation to be given to "a receipt or an accrual" in a specific scenario, as each case must be decided upon its own applicable facts.

By reading the most important reported judgments that will be discussed in this dissertation, an interpreter of tax legislation will come to realise that the interpretation to be given to "a receipt or an accrual" is not an exercise in isolation. The specific facts of a scenario and the other spheres of law that may be applicable to a specific scenario must be taken into account when interpreting "a receipt or an accrual".

In a modern democratic society such as South Africa the nature of commercial transactions changes daily. This will bring about new disputes about the interpretation to be given to "a receipt or an accrual" in a specific scenario. When faced with a new interpretation dispute an interpreter of tax legislation must look for guidance in reported judgments in support of a specific interpretation in the everlasting pursuit of legal certainty.

1.2 PROBLEM STATEMENT AND IMPORTANCE OF THE STUDY

The South African courts have held that the words "received by or accrued to" in favour of any person in the definition of gross income in section 1 of the ITA, specifically relates to the taxpayer and that the words "received by" must mean "received by the taxpayer on his own behalf and for his own benefit".⁶ Therefore, a taxpayer cannot be held accountable for "a receipt" if the "receipt" was not for the

6 *Geldenhuis v CIR* 1947 (3) SA 256 (C) at 267.

taxpayer's own benefit and advantage. From reading the most important Law Reports that dealt with "received by" or "accrued to" there is no doubt that disputes regarding taxpayers' tax liability for a "received by" or "accrued to" arose (and will arise). Disputes already decided upon by the South African Courts in relation to the interpretation and meaning of "received by" include the following:

- When a taxpayer received amounts of money on behalf of someone else;⁷
- When an amount of money was the subject of a pending dispute;⁸
- When a taxpayer received an illegal receipt;⁹
- When a taxpayer received a deposit or an amount of money in advance.¹⁰

The interpretation of "accrued to" has also not been without difficulty as is evidenced by South African case law.¹¹ On the one hand, the South African courts held that the specific wording "accrued to" means when a payment becomes "due and payable" to a taxpayer.¹² On the other hand, the South African courts held that the wording "accrued to" means "entitled to" whether or not it is only payable in a later year of assessment.¹³ The South African Courts in relation to the interpretation and meaning of "accrued to" already adjudicated upon the following scenarios:

- When can it be said that an amount has "accrued to" a taxpayer when contracts that place reciprocal obligations on the parties to the contract, are involved?¹⁴

7 *SIR v Smant* 1973 (1) SA 754 (A); *Bell's Trust v CIR* 1948 (3) SA 480 (A); *Rishworth v SIR* 1964 (4) SA 493 (A).

8 *CIR v Golden Dumps (Pty) Ltd* 1993 (4) SA 110 (A).

9 *Delagoa Bay Cigarette Co Ltd v CIR* 32 SATC 47; *COT v G* 1981 (4) SA 167 (ZA); *ITC* 1545 54 SATC 464; *ITC* 1789 67 SATC 205; *ITC* 1792 67 SATC 236; *MP Finance Group CC (In Liquidation) v CSARS* 2007 (5) SA 521 (SCA).

10 *Brookes Lemos Ltd v CIR* 1947 (2) SA 976 (A).

11 *WH Lategan v CIR* 2 SATC 16; *CIR v Delfos* 6 SATC 92.

12 *CIR v Delfos* 6 SATC 92.

13 *WH Lategan v CIR* 2 SATC 16; *CIR v People's Stores (Walvis Bay) Ltd* 1990 (2) SA 353 (A).

14 *ITC* 316 8 SATC 166; *ITC* 1847 73 SATC 126; *ITC* 1415 48 SATC 179.

- How should the concept of "accrued to" be interpreted when one deals with interest?¹⁵
- How should the concept of "accrued to" be interpreted when one deals with discount transactions?¹⁶
- How the concept of "accrued to" should be interpreted when one deals with the cession of income?¹⁷
- Whether or not it is legal for a taxpayer to avoid tax liability by waiving income prior to the "accrual" thereof?¹⁸

South African courts had a different opinion when it comes to the interpretation of the words "received by or accrued to". It is important for the interpreters of tax legislation to correctly interpret the words "received by or accrued to" as contained in section 1 of the ITA, as this will create legal certainty not only for taxpayers when doing tax planning, but also for tax enforcers prior to proceeding to enforce a possible tax obligation.

1.3 RESEARCH OBJECTIVE

The main objective of this study is to supply an overview of how the South African courts already went about in interpreting "received by or accrued to" in the definition of gross income in section 1 of the ITA.

The secondary objective of this study will be to consider the "date and valuation of receipts and accruals", to establish if it may have an influence or not on the interpretation that needs to be given to the words "received by or accrued to" in the ITA.

15 *Cactus Investments (Pty) Ltd v CIR* 1999 (1) SA 315 (SCA).

16 *Gud Holdings (Pty) Ltd v CSARS* 69 SATC 115.

17 *Hiddingh v CIR* 1941 AD 111; *ITC* 1378 45 SATC 230.

18 *Van Heerden and Others v The State* 73 SATC 7.

It is necessary to do the aforesaid to ascertain when a taxpayer has received a "receipt" or an "accrual" for tax purposes and should be taxed thereon.

1.4 RESEARCH QUESTIONS

This study will seek to address the following research questions:

- Do the South African Courts interpret the words "receipt" or an "accrual" as contained in the definition of gross income in Section 1 of the ITA in isolation by only taking tax law into account?
- Whether or not the date and valuation of a "receipt" or an "accrual" plays any significant role in the interpretation of the words "received by or accrued to"?
- Whether or not it will be possible in the South African context for the Legislator to supply a statutory definition for the words "received by and accrued to" as contained in the definition of "gross income" contained in section 1 of the ITA?

1.5 RESEARCH METHODOLOGY

The methodology for the study mainly consists of identifying and analysing specific scenarios and case law in South Africa, where the South African courts already dealt with the interpretation of "receipt by or accrued to" in general and, in specific scenarios. South African case law will also be analysed to see how the date and valuation of "receipts" and "accruals" are dealt with by the South African courts. Attention will be given to the circumstances and facts of decided cases to establish what impact the specific circumstances and facts had, if any, on how the South African courts interpret "received by or accrued to" as contained in the definition of gross income in section 1 of the ITA. The interpretation and opinions of writers, where applicable, will also be considered.

1.6 LIMITATIONS OF STUDY

This study is limited to the opinions of writers and authors writing about the South African law and South African case law.

1.7 CHAPTER OUTLINE:

Chapter 1

This chapter deals with the background, problem statement, research objective, research questions and the limitations of the study.

Chapter 2

This chapter deals with the interpretation of statutes; the *stare decicis* rule and the impact thereof on the interpretation of the words "received by or accrued to".

Chapter 3

This chapter will deals with the 1947 judgment of *Geldenhuis v CIR*¹⁹ and the 1933 judgment of *CIR v Delfos*.²⁰ It is important to deal in a chapter with the aforesaid two judgments as from the judgments the divergent interpretation of "received by" and "accrued to" will become clear.

Chapter 4

This chapter will deal with:

19 1947 (3) SA 256 (C), 14 SATC 419.
20 1933 AD 242, 6 SATC 92.

- How the words "received by" should be interpreted when a taxpayer received money on behalf of someone else; and
- When money is the subject of a dispute and/or a pending dispute; and
- How "received by" should be interpreted when a taxpayer received a deposit or an amount of money in advance; and
- When it can be said that an amount of money has "accrued to" a taxpayer when one is dealing with contract placing reciprocal obligations on the parties to the contract; and
- The concept of "accrued to" when one is dealing with interest; and
- The concept "accrued to" when one deals with discount transactions; and
- The concept of "accrued to" in relation to the cession of income; and
- Whether or not a taxpayer can legally avoid tax liability by waiving income prior to an "accrual"; and
- Whether or not the date and valuation of a "receipt" or an "accrual" plays any significant role in the interpretation of the words "received by or accrued to"?

Chapter 5

This chapter deals with illegal "receipts" and specifically if an objective approach should be followed or a subjective approach should be followed as was done by the Supreme Court of Appeal in *MP Finance Group CC (In Liquidation) v CSARS*.²¹

21 2007(5) SA 521 (SCA).

Chapter 6

This chapter concludes the dissertation and also contains the author of this dissertation's own conclusions as to the interpretation of the words "received by" and "accrued to". This chapter will deal with whether or not it will be of any assistance in the South African context if the legislator supplies a statutory definition to the words "received by" and "accrued to" as contained in the definition of "gross income" contained in section 1 of the ITA.

CHAPTER 2 - THE INTERPRETATION OF FISCAL LEGISLATION

2.1 THE MAIN APPROACHES

There are two main approaches to the interpretation of legislation. The first approach is called the literal rule of interpretation approach (“the literal approach”) and the second approach is called the purposive interpretation approach (“the purposive approach”).¹ It is important to distinguish between the literal approach and the purposive approach because when an interpreter of tax legislation favours the one approach above the other it will influence the outcome of the interpretation that is given to the legislation and specifically to the interpretation of “received by and accrued to” in a specific scenario. It is important for the purpose of this dissertation to deal with the distinction between the two main approaches to interpretation of legislation because as will be seen from a discussion of the case law herein, that although a purposive approach is to be preferred since the Constitution, 1996, the literal approach can and are still used by the interpreters of legislation.

The literal approach dictates that the language (words) that are used in legislation should be given their ordinary grammatical meaning, unless in doing so it will result in an absurd interpretation of the legislation. Accordingly the interpreter of legislation must look at the specific language and words that the legislator used in legislation and should give effect thereto by ascribing the ordinary grammatical meaning of the words to them. This is how the interpreter of legislation will then arrive at the intention of the legislature, according to the literal approach.²

In *Glen Anil Development Corporation Ltd v Secretary for Inland Revenue*³ the Court directly quoting from *Commissioner for Inland Revenue v Simpson*, 1949 (4) SA 678 (AD) explained the literal approach as follows:

“It simply means that in a taxing act one has to look at what is clearly said. There is no room for an intendment. There is no equity about tax. There is no presumption as to tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used.”

1 Goldswain GK “*The Purposive Approach to the Interpretation of Fiscal Legislation – the Winds of Change*” (2008) 2 *Meditari Accountancy Research* Vol. 16 no 2 2008 107 1007.

2 De Koker: *Silke on South African Income Tax* – Chapter 25, paragraph 25.1A and paragraph 25.1B.

3 1975 (4) SA 715 (A) at 727.

Therefore, the literal approach argues that if a piece of legislation supplies a definition of a specific word in the definition clause, it will be safe to assume that the intention of the legislature was to ascribe that meaning to the relevant word. An interpreter of tax legislation should therefore, according to the literal approach not read anything in or imply anything when interpreting legislation. Accordingly, the definition supplied, in a definition clause contained in legislation, should be read into the relevant section, phrase or sentence that is the subject of interpretation. If the meaning of a specific word is not defined in the definition clause of legislation and the meaning is not clear to the interpreter, then the interpreter may use a dictionary definition, unless doing so will lead to an absurd interpretation.⁴

The saying “there is no equity in tax” will according to the literal approach in many instances be the guiding principle when fiscal legislation is to be interpreted.⁵ If the wording of legislation is clear, it must be applied despite the result being harsh.⁶ If a fiscal legislation provision is ambiguous, the relevant provision should be construed and interpreted *contra fiscum* (in favour of the taxpayer).⁷

The *contra fiscum* rule means that legislation imposing a burden upon a taxpayer, should when there is doubt be interpreted in favour of the taxpayer, and the *contra fiscum* rule is not applicable in a scenario where a provision in a statute grants special privileges or exemptions.

The *contra fiscum* rule is not applicable to section 103 of the ITA,⁸ being the ITA’s general anti-avoidance rule. The *contra fiscum* rule will therefore also not be applicable to section 80 A-L of the ITA that deals with the general anti-avoidance rule.

4 ITC 1860 74 SATC 371.

5 CIR v Memogin (Pty) Ltd 1983 (4) SA 935 (A).

6 Cactus Investments (Pty) Ltd v CIR 1999 (1) All SA 345 (A).

7 Glen Anil at 715.

8 Van Wyk T “Tax Law: Interpretation of Fiscal Legislation” (1976) De Rebus September 1976 455 to 456.

Therefore fiscal legislation according to the literal approach should be interpreted in the same manner as any other legislation. The legislator's true intention is always of paramount importance, and is decisive of the meaning of the legislation.⁹

According to Botha¹⁰ the primary rule of interpretation dictates that if words in legislation are not ambiguous, then the ordinary meaning of the words should be ascribed to the words. If words in legislation are ambiguous, vague, misleading or if a strict literal approach has an absurd interpretational end result, then an interpreter is allowed to not follow the primary rule of interpretation but is then allowed to look at secondary interpretation methods.

Secondary interpretation methods comprise *inter alia* of the long title of the Act and headings in the Act. To look at and compare other and different languages, in terms of which the legislature published the Act to compare it to the language under interpretation, is also a secondary method of interpretation. When the secondary methods of interpretation still fail to assist in interpreting a piece of legislation, then the Court can look at the so-called tertiary interpretation methods that *inter alia* comprises of the common law presumptions of interpretation.

The common law presumptions of interpretation, verbalises expectations that a legislature will follow basic tenets and aspirations of the legal system. A detailed discussion of the common law presumptions falls beyond the scope of this dissertation.¹¹

⁹ *Glen Anil* at 715.

¹⁰ Botha CJ (2012): *Statutory Interpretation: An Introduction for Students (5th Edition)*, page 91 to 92.

¹¹ The common law presumptions *inter alia* comprises of: (1) statutory law does not alter the existing law more than is necessary (2) a statute does not apply retrospectively (3) statute law is not invalid or purposeless (4) a reference to conduct in a statute is valid conduct (5) delegated legislative power must be exercised by the *delegatus* itself (6) remedial statutes must be construed generously (7) statutory law has no extra-territorial effect (8) the same words and phrases in a statute has the same meaning (9) statutory law is not unjust or inequitable or unreasonable (10) statutory law applies to general and not specific instances (11) statutory law promotes the public interest and (12) statutory law does not oust the jurisdiction of the Courts (13) statutory law does not violate international law (14) statutory law does not bind the state; See Joubert WA *The Law of South Africa*, Volume 25(1) – 2nd Ed, Volume – Statute Law and Interpretations - presumptions, par 333 to 347 2004 (4) SA 490 (CC) at 521.

The words and their ordinary meaning are important to the supporters and interpreters of legislation that supports the literal approach. Equities are unimportant even if the end result is harsh.

The Constitution, 1996 plays an important role when legislation is interpreted. In *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs and Tourism*¹² the Court stated that, the starting point in interpreting any legislation is the Constitution.

De Koker¹³ says that under the influence of the bill of rights, the South African courts have moved away from the continued application of the strict literal approach towards a purposive construction of legislation, according to which the purpose or object of the legislation must be asserted from the words used, viewed in their proper context, and the legislation must then be interpreted in such a way as to advance the purpose for which the provision in question was enacted.

The courts in South Africa are moving away from the literal approach of interpretation and place more emphasis on the purpose with which the legislature has enacted legislation. The interpreter of legislation must strive to give an interpretation or according to the purposive approach the interpreter of legislation must strive to give an interpretation that give effect to the purpose and the purpose must be used with the appropriate meaning of the language as a guide to establish the intention of the legislature.¹⁴

De Koker¹⁵ in arguing that a purposive approach should rather be followed than a literal approach states that statutory interpretation should accord with what promotes the general legislative purpose underlying a statutory provision, and that the legislative purpose is the light that should guide statutory interpretation. De Koker¹⁶ further argues that in asserting the purpose of the provision, wider contextual

12 De Koker: *Silke on South African Income Tax* – Chapter 25 (par 25.1D).

13 C: *SARS v Air World CC & Another*, 1970 SATC 48 (SCA); In *Commissioner, South African Revenue Service v Miles Plant Hire (Pty) Ltd*, 2014 (3) SA 143 (GP) the court also favoured a more purposive approach in interpreting fiscal legislation.

14 De Koker: *Silke on South African Income Tax* – Chapter 25 (par 25.1D).

16 De Koker: *Silke on South African Income Tax* – Chapter 25 (par 25.1D).

considerations may be invoked, even where the language is unambiguous - the so-called "purposive construction" of statutes, and that in applying the purposive approach to interpretation does not necessarily neglect the language used, which must be understood in its popular sense as utilised in ordinary parlance, yet balanced by the context in which it is used.

Section 39 (2) of the Constitution, 1996, also indicates favouritism for a purposive approach to the interpretation of legislation, in that it requires that legislation be interpreted and developed in accordance with the spirit, purport and objects of the Bill of Rights.

The purposive approach to the interpretation of legislation is therefore preferred rather than a literal approach to the interpretation of legislation. Although a purposive approach to interpret legislation is to be preferred, it does not mean that the literal approach to the interpretation of legislation is abolished, because to date of this dissertation there is no reported judgment that explicitly provides that the literal approach to interpreting legislation is abolished and may not be used.

Even if a purposive approach is to be used in interpreting legislation the language used by the legislature still plays an important role and cannot simply be ignored. I therefore conclude that, in my opinion the literal approach to interpreting legislation forms an integral part of the purposive approach to interpretation because if a statute and the meaning of the statute are clear, the purpose would be established.

2.2 “STARE DECISIS” AND INTERPRETATION

The literal and purposive approach to the interpretation of legislation should be considered in conjunction with the doctrine of “stare decisis”. The doctrine “stare decisis” comes from the Latin maxim “*stare decisis et non quieta movere*” meaning that one stands by previous decisions and does not disturb settled points.¹⁷ South Africa inherited the doctrine of “stare decisis” from English law.

South African courts will therefore regard themselves bound by previous decisions of its own unless it is concluded that, the earlier decision was wrongly decided.¹⁸

The doctrine “stare decisis” must be borne in mind by an interpreter of legislation when a decision involving a legal principle and the interpretation thereof is to be made. The object of the doctrine is to avoid uncertainty and confusion.

When a decision on a legal principle has been delivered by a superior court, it should be followed by all courts of equal and inferior status.¹⁹ Accordingly, the interpreters of tax legislation must keep the doctrine of “stare decisis” in mind when they look at reported judgments to assist with the interpretation of fiscal legislation. An inferior court will therefore have to follow a specific interpretation given to a statute or a section of a statute by a superior court, if such a precedent exists.

Therefore whether an interpreter of tax legislation prefers the literal approach or the purposive approach to interpretation of statutes, in terms of “stare decisis” the specific interpretation given by a superior court must be adhered to until it is overruled by that court as wrong, or overruled as wrong by a court that is in a more superior position. An interpreter of tax legislation should therefore always strive to rely upon principles established in reported judgments by the most superior court, unless an interpreter can convince a court that its previous interpretation was wrong or should not be followed because the factual matrix is different.

17 Tshiki P “*Precedent, stare decisis and the Constitution*”; see also Joubert WA *The Law of South Africa*, Volume 5(2) – 2nd Ed, Volume – Courts – stare decisis, par 163.

18 Devenish G “*The doctrine of Precedent in South Africa*” (2007) *Obiter* 1 to 4.

18 Joubert WA *The Law of South Africa*, Volume 5(2) – 2nd Ed, Volume – Courts – stare decisis, par 163.

As will be seen from the reported judgments, the difficulty is that, although a purposive approach to the interpretation of legislation is to be favoured, numerous established principles were historically established by for instance the then Appellate Division premised upon a literal approach to interpretation. According to “stare decisis” these principles will have to be followed and applied even though a purposive approach is to be favoured, until the historical principle in a specific scenario is overruled by the modern day Supreme Court of Appeal.

It is now necessary to turn to the reported judgments to see how the South African courts go about in their interpretation of “received by and accrued to” in general and in specific scenarios that were already considered by the South African courts.

Formatted: Font: Not Bold

CHAPTER 3 - THE MEANING OF “RECEIVED BY” AND “ACCRUED TO” AS EXPRESSED IN THE *GELDENHUYS AND DELFOS* JUDGMENTS.

A practical example of the literal approach and purposive approach to the interpretation of statutes, together with the impact of “stare decisis” thereon, can be illustrated by the two reported judgments mentioned in the heading above.

First, in *Geldenhuis v Commissioner for Inland Revenue*¹ the Appellant, a widow was married to her late husband in community of property. The Appellant’s late husband carried on farming operations during his lifetime until he died on 15 October 1930.

On 29 September 1923 the Appellant and her late husband executed a mutual will. The will provided that the survivor should remain in full and undistributed possession of the whole of the joint estate and enjoy the fruits and income thereof during his or her lifetime. The will also appointed their six children as their sole and universal heirs.

The Appellant accepted the benefits conferred upon her under the joint will. The assets of the joint estate of the Appellant and her husband comprised of livestock at the date of the death of the deceased. After the death of her husband, the Appellant continued to carry on the farming operations.

During 1931 the Appellant sold some of the lands and some of the flock died during a drought. The numbers of the flock were never made up again after the drought as it was also considered that the farm was over stocked at the time of the death of the Appellant’s husband.

The Appellant decided to give up farming operations and the children of the Appellant agreed to the sale of the flock. A public auction was scheduled and the flock was sold and on the same day the Appellant ceased farming operations. The proceeds of the sale were paid over by the auctioneer to the Appellant by way of cheque.

1 1947 (3) SA 256 (C), 14 SATC 419.

The Appellant deposited the cheque into her private banking account and received the receipt of the proceeds into her own name. The Appellant used the proceeds to invest in a bond in her favour. The Appellant also enjoyed the use of the interest that was paid in terms of the bond. The Commissioner contended that the Appellant is liable to be taxed on the proceeds of the sale of the flock.²

Dealing with whether or not the Appellant was liable to be taxed on the proceeds, Steyn J held that both “income” and “taxable income” are in their respective definitions linked up with the definition of “gross income” and it is clear from the definition of “gross income” that the words “received by or accrued to or in favour of any person” relate to the taxpayer and the words “received by” must mean “received by the taxpayer on his own behalf for his own benefit”.³

Herbstein AJ opined that the words “accrued to or in favour of” clearly indicate that “the total amount” which accrues must accrue to the person who is to be charged.

Accordingly, and because in this case there was a usufruct which is a personal servitude that constitutes the right to use the property of another person, the Court in-depth dealt with the principles of usufructs.⁴ The principles of usufructs swayed the Court to find that when an usufructary of a flock of sheep, with the consent of its heirs, sells such a flock, at the time when its numbers are below its proper compliment and converts it into cash, an usufructary is not acting in pursuance of legal rights as an usufructary and the proceeds from such a sale do not accrue to him personally, but accrues to the heirs.

Therefore, the Court ruled that when the Appellant received the purchase price of the sheep, the Appellant did not become entitled to the money, which remained the property of the heirs in terms of the principles of usufructs.

² *Geldenhuis* page 258-260.

³ *Geldenhuis*, page 265-266.

⁴ *Geldenhuis*, page 260-265.

On reading the *Geldenhuis* judgment, it becomes clear that the Court did not interpret the words “received by and accrued to” in isolation, but interpreted the words “received by and accrued to” by taking into account the facts of the case, i.e. that the Court was dealing with the underlying principles of usufructs and the rights of usufructaries. The Court also declined to follow the literal approach to interpretation when the Court had to interpret the then applicable taxing Act and specifically section 14 of Act 31 of 1941.

Herbstein AJ⁵ said that the problem that arose was whether a usufructary of a flock of sheep who farms with them, becomes liable in terms of sec.14 of Act 31 of 1941, as amended, for the payment of tax on the proceeds of the sheep (less any adjustment in terms of the section), if she disposes of the sheep and invest the proceeds in some other way. Herbstein AJ made it clear that the Court was not dealing with any increase over the original number of the flock, for such sheep would belong to the usufructary. The Court’s consideration was limited to the sheep of which the remained the property of the owners.

In proceeding, Herbstein AJ held that, if the section under consideration was to be construed literally, it would subject any person who has engaged in pastoral, agricultural or other farming operations during the relevant year of assessment and who disposed of livestock during that year of assessment liable for tax on the proceeds of such stock. If the section is to be construed literally, ownership would become irrelevant. Herbstein AJ in dealing with the applicable legal test held that:

“The vital test is whether the stock was disposed of ‘by him or on his behalf.’ On the literal construction of the section, a usufructary who by agreement with the remainder disposed of a flock of sheep because she had decided to give up farming and invested the proceeds in some other form, would make herself liable to pay tax.”

5 *Geldenhuis*, page 265-266.

The Court further said that liability should, in the circumstances of the case, and if the section is to be literally construed, be paid by the usufructuary out of her private funds as she could not do so out of the proceeds of the sale since the sheep were not her property. The proceeds would also not become hers.⁶

Herbstein AJ⁷ concluded that in consideration of these possibilities leads one to doubt whether such a literal construction can be correct and to search for an alternative construction which avoid these hardships and absurdities.

The principles established by the *Geldenhuis* judgment have not yet been overruled by any higher court in South Africa. Therefore, the principles established in the *Geldenhuis* judgment to interpret the words “received by or accrued to” is still the current legal position, and they are that the total amount must “accrue to the person” that stands to be taxed. According to the principle of the “stare decisis” interpreters of tax legislation therefore must take the principles in the *Geldenhuis* judgment in to account when interpreting “received by or accrued to”.

Second, in *CIR v Delfos*,⁸ Delfos was a director of a South African company and received a salary of 3000 pounds per annum. Delfos was also entitled to 200 pounds in fees. During the years 1923 to 1929 Delfos, was not paid his full salary. For these years in question, cumulatively, Delfos was short paid in the amount of 9 900 pounds. During the year of assessment ending 30 June 1930, the company paid Delfos the amount of 9 900 pounds, being the amount that was due to Delfos for the period 1923 to 1929.

Delfos in his tax returns only included the amounts actually received from the company. The company on the other hand, in the relevant years of assessment, in the company's returns included the full salary of Delfos.

6 *Geldenhuis*, page 265-266.

7 *Geldenhuis*, page 265-266.

8 1933 AD 242, 6 SADC 92

Delfos received the 9 900 pounds in the 1930 year of assessment, the commissioner assessed Delfos on the basis that the 9 900 pounds formed a portion of his gross income for the 1930 year of assessment. Delfos objected to the assessment and litigation ensued.

Wessels CJ⁹ held that the question the Court needed to decide upon was whether the amounts received by Delfos was part of the income of Delfos for the 1930 year of assessment, or whether the unpaid amounts should be referred back to the past years of assessment, in which it ought to have been paid to Delfos.

The Court had to deal with the principle established in the *Lategan*-judgment. Wessels CJ and Curlewis JA supported and enforced the *Lategan*-principle by holding that an amount will only accrue to a person once that amount becomes due and payable.

De Villiers JA and Stradford JA had different views and held to the effect that an amount will only accrue to a person once that amount is paid. Beyers JA, was silent on the aspect and did not express an opinion which left the Appellate Division divided on the issue.

The *Delfos*-judgment written by the Appellate Division, which is a more superior court than the court who decided upon the *Lategan*-principle, did not overrule the *Lategan*-principle and, as indicated, two of the judges supported the *Lategan*-principle. The two judges who supported the *Lategan*-principle were also the senior judges that presided over the appeal. Therefore an inferior court will have to comply with the “stare decisis” rule and apply the *Lategan*-principle. The effect of the aforesaid judgment was that it created legal uncertainty because it was not clear whether or not the *Lategan* -principle is a sound principle or not.

The *Lategan*-principle was therefore established by the court favouring a purposive approach to interpretation, even though the judgment was granted years prior to the

9 *Delfos*, page 97.

Constitution, 1996 being operative. It therefore illustrates that a purposive approach to the interpretation of statutes is not a new approach to the interpretation of statutes.

3.1 CIR v PEOPLES STORES (WALVIS BAY) (PTY) LTD

The uncertainty created by the *Delfos*-judgment was remedied and clarified in *CIR v Peoples Stores (Walvis Bay) (Pty) Ltd*,¹⁰ when the Appellate Division brought clarity to the difference before the *Lategan*-judgment and the *Delfos*-judgment by endorsing and accepting the correctness of the *Lategan*- principle. The Appellate Division in the *CIR v Peoples Stores (Walvis Bay) (Pty) Ltd* -judgment held to the effect that an amount accrues in the tax year that the taxpayer becomes entitled to it. The *CIR v Peoples Stores (Walvis Bay) (Pty) Ltd*-judgment is discussed more fully in Chapter 4 of this dissertation.

The South African Courts had already in the judgments of *Geldenhuys* and *Delfos* expressed divergent opinions on the meaning of “received by or accrued to”. However, it becomes clear that the Courts did not interpret the words “received by or accrued to” in isolation, but took the specific facts and underlying law such as the rights and obligations of usufructs into account, in giving meaning to the words “received by or accrued to”.

As indicated above, the Appellate Division in *CIR v Peoples Stores (Walvis Bay) (Pty) Ltd* –judgment brought clarity to the confusion it created with its earlier judgment in *Delfos*. Because *Delfos* was a descission by the Appellate Division, only the Appellate Division could have done so authoritatively in complying with “stare decisis”.

Therefore, in pursuing legal certainty in accordance with “stare decisis” the *CIR v Peoples Stores (Walvis Bay) (Pty) Ltd* –judgment must be followed by the

10 1990 (2) SA 353 (A).

interpreters of tax legislation including all courts inferior to the Appellate Division by relying and applying the so called *Lategan*-principle as good standing law when giving an interpretation to “accrued to”.

The two judgments above supplies the interpreter of tax legislation with a general understanding of the purposive and literal approaches to the interpretation of statutes and specifically how “accrued to” was already interpreted by the courts in general. It further supplies the interpreter of tax legislation with a practical example of how “stare decisis” impacts the interpretation of statutes and the legal uncertainty it can create if not applied strictly and if not dealt with in full by a court giving a judgment. After investigating the general approach that the courts have given to “accrued to” it is necessary to investigate specific scenarios wherein the courts already pronounced upon the interpretation of “received by and accrued to”.

CHAPTER 4 - SPECIFIC SCENARIOS

This chapter will deal with specific scenarios that have been considered by the South African Courts when interpreting “received by and accrued to”. This chapter will indicate how the specific underlying factual matrix and legal principles relevant to a specific case influenced the South African Courts when interpreting the words “received by and accrued to”.

4.1 ON BEHALF OF SOMEONE ELSE

The South African Courts had already dealt with and interpreted “received by” in circumstances when a taxpayer received money on behalf of someone else, so as to establish whether such income would form part of the taxpayer’s gross income.¹

In *Bell’s Trust v Commissioner for Inland Revenue*² a trust was the registered holder of shares in a private company. The trust deed provided for the devolution of the rights of a child of the settlor on such child’s death, and it provided that (a) the trustee shall pay to the children all dividends and bonuses and other monies which shall accrue on the said shares; (b) the minors’ share of the income and dividends shall be retained by the trustees until the age of 21.

The company declared a dividend and the amount received for the shares was 4 700 pounds. The taxable income of the company was 34 703 pounds. The Commissioner in terms of sections 33, 36 and 37 of the Income Tax Act 31 of 1941, treated the sum of 32 621 pounds as being that portion of the taxable income of the company which attach to the shares of the trust. The Commissioner took 4 700 pounds of the amount of 32 621 pounds and divided/apportioned it in equal proportions. The remaining balance was included in the taxable income of the trust. The trustees on behalf of the trust objected to the assessment.

The grounds of the appeal upon which the objection was based, was to the following effect:³

¹ Geldenhuys judgment in Chapter 3 above.

² 1948 (3) SA 480 (A).

³ *Bell’s Trust-judgement* at page 481.

- That if regard was held to the Deed of Trust, the major children should have been “shareholders” of the company in terms of section 33(4) of the Income Tax Act 31 of 1941 and one fifth of the sum of 32 621 pounds should have been determined as the extent of the rights of each of the beneficiaries to participate in the profits of the company and should have been apportioned to the beneficiaries in terms of section 33(4), 36 and 37 of Income Tax Act 31 of 1941;
- That 19 572 pounds 12s. should not have been deemed to be taxable income or income subject to super tax in the hands of the trust if regard was had to the Deed of Trust.

Centlivres JA⁴ held that the solution to the problem in the present case was to be found in the construction of the definition of “shareholder” in sections 33(4), 36 and 37 of Income Tax Act 31 of 1941 which read as follows:

“ ‘shareholder’ in relation to any company means the registered shareholder in respect of any share, except that where some person other than the registered shareholder is entitled, whether by virtue of any provision in the memorandum or articles of association of the company or under the terms of any agreement or contract, or otherwise, to all or part of the benefit of the rights of participation in the profits or income attaching to the shares so registered, such other person, to the extent that he is entitled to such benefits, shall also be deemed to be a shareholder”.

By relying upon this definition, the Court held that the trust and the major children were shareholders. The major children were shareholders because they were entitled to part of the benefit of rights of participation in the profits or that attached to the shares which were registered in the name of the trust.⁵

The Court further held that the major children had the right to participate in and did participate in the distributed profits.⁶ The major children did not have any right to

4 *Bell's Trust*, page 488.

5 *Bell's Trust*, page 489.

6 *Bell's Trust*, page 490.

participate in any undistributed profits. The Court held that the only person to whom the Commissioner could apportion the undistributed profit was to the trust as the registered shareholder representing uncertain beneficiaries. The conclusion was therefore that the Commissioner was correct in apportioning to the major children their share of the distributed profits.⁷

In the *Bell's Trust*-judgment the Court relied on the definition of "shareholder" in Act 31 of 1941 together with the specific wording of the Trust Deed, in interpreting "received by" to reach its conclusion. The Court therefore again did not interpret the words "received by" in isolation.

In *Rishworth v Secretary for Inland Revenue*⁸ two brothers (a) and (b) were the joint owners of a property that they leased to a company in turn for monthly rent. The shareholders in the company who leased the property were (c) the son of (a), (d) and (e) the son of (b).

When (b) died, his wife inherited his half share in the property. The wife of (d) married the Appellant. The shareholders decided to sell the entire shareholding in the company, but excluded the lease from the negotiations. The company ceded the interest in the lease to (c) at a monthly rent.

There was a family understanding that if (e) joined in the sale, then (c) and (d) would pay to (e) monthly rent.⁹ This arrangement took the form of a cession by the Appellant's wife and by (c) in favour of (e). It provided that (c) and the Appellant's wife ceded to (e) the right to receive out of the share of the rent payable to each of them under the lease, the sum of 50 pounds per month and that this sum would be paid from the estate of (b) directly to (e).¹⁰

7 *Bell's Trust*, page 494.

8 1964 (4) SA 493 (A).

9 *Rishworth*, page 498.

10 *Rishworth*, page 498 to 499.

In the Appellant's income tax return the Appellant deducted 600 pounds which the Commissioner disallowed. The Court held that the cession should be read as a whole and by doing so the rent had accrued to the Appellant's wife each month.¹¹ The Commissioner's assessment was upheld.

The cession in this case considered together with all the facts of the case, led the Court to conclude that the rent "accrued to" the Appellant's wife each month. The cession played an important role in the Courts interpretation in "accrued to".

In *Secretary for Inland Revenue v Smart*¹² the Respondent was a managing director and shareholder of the M Company. As the M Company was unable to pay its indebtedness to N Company, it was agreed that the M Company should become a subsidiary of the N Company and that the Respondent would be paid an amount in cash and the balance will be paid to the Respondent in shares in the M Company.

It was agreed that the Respondent would be assured of a return of 10% on the par value of the shares and that the M Company would undertake under clause 5(1) of the agreement entered into, to procure that it or the M Company would make to the taxpayer at the end of each month while the agreement remained in force an amount equal to 1/120th of the aggregate value of the shares in the company beneficially owned by the taxpayer at the beginning of that month.¹³

The Respondent sold all but one of the shares held in the M Company to P. The purchase price to the Respondent was to be paid by P in instalments. It was also agreed between the Respondent and P that the Respondent shall have no claim to the payments due to the Respondent in terms of clause 5(1) which read that as far as it was permissible to do so, the seller (Respondent) ceded his right to such payment to the purchaser (P).

11 *Rishworth*, page 501.

12 1973 (1) SA 754 (A).

13 *Smart*, page 759.

The directors of the M Company refused to allow P to transfer the shares into his name. The agreement of sale between P and the Respondent was never cancelled. P defaulted on his payments to the Respondent as contractually agreed to and was indebted to the Respondent in the amount of R67 500.00.

M Company continued to make the payments to the Respondent in terms of clause 5(1), but the Respondent did not pay over these amounts to P, but instead deducted such payments from P's indebtedness to him. The Respondent sued P for the balance. In terms of a Deed of Sale S acquired all the shares sold to P. Because the shares were still registered in the name of the Respondent, S undertook to compensate P.¹⁴

The Respondent in his returns indicated that the sum of R4 910.00 received from M Company under clause 5(1) for the period although received by him, was ceded to P. The Appellant included in his income as remuneration the total amount received by him in terms of clause 5(1) being R13 333.00. The taxpayer objected on the ground that the monies received under clause 5(1) accrued to P and not to himself.

The Court held that the amounts received under clause 5(1) were intended to preserve a return on the taxpayer's investment and that it was not remuneration. The Court held that the Respondent was in effect disposing of his shares and the fruits thereof, the right to his shares and fruits thereof being ceded before it accrued to the Respondent. The effect of cession was that it divested the Respondent of his right to receive future payments before such payments accrued to him and the right received future payments accordingly vested in P.¹⁵

The Court concluded that the payments never "accrued to" the Respondent and that the Respondent was obliged to transmit them to P, if he received them from M Company and he did not receive them for his own benefit. Accordingly, the Court held that the payments never formed part of the taxpayer's income and the payments were not taxable in the taxpayer's hands.

¹⁴ *Smant*, page 760.

¹⁵ *Smant*, page 763 to 764.

From considering the abovementioned judgments, the Courts used the underlying agreements and factual matrix of a particular scenario to attach a proper interpretation to “received by and accrued to”. The facts and underlying agreements and transactions in any given scenario therefore plays an important role and an interpreter of tax legislation must consider any underlying agreement and the facts of a specific case, as it influences the interpretation of “received by and accrued to”. The aforesaid approach amounts to a purposive approach. The court therefore in dealing with money received on behalf of someone else, does not at all go about the interpretation process in isolation by merely taking tax law into account.

4.2 PENDING DISPUTES

When should an amount of money that forms the subject matter of a *bona fide* dispute be included in a taxpayer’s gross income? If a taxpayer is involved in litigation and he, she or it may in future be awarded money pursuant to a judgment by a court, the question that arises is when is a taxpayer obliged to include the money in his gross income? Should it be included for instance when the taxpayer institutes court action claiming the money or should it only be included in gross income once a court had a final say in dispute? The courts in the Republic of South Africa already dealt with the aforesaid difficulty as will be seen from the discussion of the judgments that follows.

In *Commissioner for Inland Revenue v Golden Dumps (Pty) Ltd*¹⁶ the Respondent was obliged in terms of a judgment of the Appellant Division to deliver shares to a former employee (“Nash”) against payment of a fixed amount of money. The Respondent in its income tax return for the year ending 30 June 1985, claimed as a deduction cost it had incurred in purchasing the shares for delivery to Nash less the amount paid by Nash in terms of the judgment. The Commissioner did not allow the deduction. The shares in question had been offered to Nash at a stated price in a letter dated 19 September 1980 in which Nash had been offered employment by the

16 1993 (4) SA 1110 (A).

Respondent. Nash accepted the offer and fulfilled all the requirements which would have entitled him to the shares.¹⁷

In 1981 Nash in writing demanded delivery of the shares against payment of the price. The Respondent denied liability to pay Nash the demanded price. Subsequently, Nash instituted proceedings in a local division claiming delivery of the shares, against payment of the price therefore. The action instituted by Nash was successful which led to the judgment obliging the Respondent to deliver the shares to Nash against payment by Nash of the purchase price for the shares.

In the appeal regarding the tax liability the Commissioner contended that the parties' rights and obligations existed at the time of the institution of the action by Nash against the Respondent and that the obligation of the Respondent to deliver the shares had actually been incurred within the meaning of section 11(a) of the ITA, during the 1981 year of assessment.

The Commissioner further contended that the judgment against the Respondent for the delivery of the shares to Nash, did not constitute a novation, and did not amount to the fulfilment of a condition which resulted in the liability of the Respondent arising. The Commissioner contended that the judgment against the Respondent served to confirm the rights and obligations of Nash and the Respondent, which rights and obligations already existed in 1981.¹⁸ Therefore, the Commissioner argued that the expenditure had not been incurred during the 1985 year of assessment, but during the 1981 year of assessment.

In dealing with this factual matrix, Nicholas AJA¹⁹ held that a liability is contingent where there is a claim which is genuinely disputed and not vexatiously or frivolously disputed. In such a case, being one which is genuinely disputed, the ultimate outcome of the case will be confirmed only if the claim is admitted or if it is finally upheld by a decision of a court or an arbitrator. Nicholas AJA further held that if at

17 *Golden Dumps*, page 113-115.

18 *Golden Dumps*, page 115.

19 *Golden Dumps*, page 118.

the end of a tax year in which a deduction is claimed, the outcome of the dispute is undetermined, it cannot be said that a liability has been actually incurred. A taxpayer could not properly claim the deduction in that tax year and the Commissioner could not properly allow such a deduction.

Nicholas AJA²⁰ said that in this case at the crucial date for the 1981 year of assessment, the outcome of the disputed claim by Nash was still undetermined and liability was then no more than impending. The ultimate outcome of the disputed claim would be known only upon the delivery of a judgment and in this case the judgment was only delivered in 1985, which lay four years in the future.

The court therefore held that the expenditure had only been “actually incurred” during the 1985 tax year of assessment and not the 1981 year of assessment.

Although the *Golden Dumps*-judgment deals with deductions, the principles therein are also applicable to interpret the words “received by”. This is so because it can be argued that if an amount of money is the subject matter of a *bona fide* dispute, then such an amount of money will only have been “received by” when a final judgment of a court is given. Whilst litigation is a *bona fide* proceeding, it cannot be said that a taxpayer should be liable to include the money of its claim in its gross income for the year of assessment in which the dispute arose.

The *Golden Dumps*-judgment is a judgment by the Appellate Division and according to “stare decisis” it must be followed by the interpreters of tax legislation when dealing with pending disputes. It established the principle that a tax payer is only obliged to include money received in the year of assessment when a final judgment on a *bona fide* claim was given by a court. Therefore, if a claim is not *bona fide*, it must be included in the year in which it arose or became due. Tax payers will therefore not be in a position to postpone their tax liability by initiating *mala fide* litigation. An interpreter of tax legislation must take the principles established in the

20 *Golden Dumps*, page 118.

Golden Dumps-judgment in to account, when dealing with pending disputes and interpreting “accrued to and received by” as the litigation must be *bona fide* litigation.

The principle of *bona fide* litigation is an illustration thereof, that the court will scrutinise the nature of the pending litigation, and therefore when dealing with pending disputes, the interpretation process is also not done in isolation but by taking the nature of the pending litigation into account.

4.3 A DEPOSIT OR AN AMOUNT IN ADVANCE

How should the interpreters of tax legislation interpret “received by” when a taxpayer received money in advance as a deposit?

In *Brookes Lemos Ltd v Commissioner for Inland Revenue*²¹ the Appellant was a manufacturer who sold its products in bottles that contained a notification on them indicating that they were and remained the property of the Appellant, and could not be used for any other purposes. The Appellant’s invoices had printed on it a notice that all bottles bearing the Appellant’s trademark or brand were delivered subject to the condition that the bottles were to remain the property of the Appellant. During January 1943, with regard to certain of the Appellant’s products, the Appellant began to adopt the practice of requiring payment of a money deposit for each container delivered to a customer.

If such a customer returned the container and/or a similar container to the Appellant, the Appellant would pay to the customer an amount of money equal to the amount of the deposit and no obligation was imposed upon the customer or undertaken by the customer to return the container.²²

21 1947 (2) SA 976 (A).

22 *Brookes*, page 980.

During 1943 the practice of the Appellant became in some respects compulsory by reasons of Government Notice 1433 issued on the 6th day of May 1943, which cancelled Government Notice 1812 of the 4th day of September 1942.²³ Government Notice 1433 contained a provision to the effect that a person was precluded from selling or disposing of any glass container to another person unless the person supplied, handed over a similar container, or paid or was debited with, a fixed fee by the price controller in respect of such a container.²⁴ The Special Income Tax Court had included in the Appellant's gross income the monies collected by the Appellant from its customers by way of deposit on the glass containers.

On appeal the Appellant argued that the deposit fees were not gross income, because (a) the deposit fees were not received by the Appellant in the sense in which that word is used in the definition of gross income, and (b) if it was to be "received" in terms of the definition, then they were receipts of a capital nature.

Watermeyer CJ²⁵ held that the Appellant was not a trustee holding the deposits on account of its customers as security for the return of the bottles. The deposits held by the Appellant became the property of the company and could be used as the company pleased. The deposits were not receipts of a capital nature in that they were not proceeds of a realisation of capital, but were ordinary receipts produced by an operation undertaken to earn profit.

The Appellant's appeal was dismissed and the deposit receipts were included in the Appellant's gross income.

Watermeyer CJ²⁶ concluded the judgment by saying in his own words that:

"But that is not a consideration which can influence our decision we have, in the words of Innis C.J. in the case of *C.I.R v George Forrest Timber Co. Ltd* (1924) AD 516 at p.521:- 'To take the facts as they stand and apply the provisions of the statute'. If we do that it is clear that the deposit receipts were

23 *Brookes*, page 980.

24 *Brookes*, page 981.

25 *Brookes*, page 983.

26 *Brookes*, page 984.

gross income in the hands of the Appellant. It follows that the appeal must be dismissed with costs.”

It is clear that the Court in the *Brookes*- judgment applied a so-called literal approach to the interpretation of “received by”. The court disallowed any equities in the interpretation process and applied the previously established principle that was previously established by the same court.

The approach followed by the court is the correct approach as the court adhered to the rule “stare decisis”, as it followed the already established principle in the *CIR v George Forrest Timber Co. Ltd*-judgment. It is a decision by the Appellate Division and must therefore be followed by interpreters of tax legislation when interpreting “received by” in the context of deposits or money received in advance by a taxpayer.

4.4 RECIPROCAL OBLIGATIONS

The principle of reciprocity recognises the fact that in many contracts the common intention of the parties, whether it is expressed or unexpressed, is that there should be an exchange of performances.²⁷

In *ESE Financial Services (Pty) Ltd v Cramer*²⁸ Corbett J said that in a bilateral contract certain obligations may be reciprocal in that the performance of one may be a condition upon the performance, or tender of performance, of the other. The reciprocity may itself be bilateral in the sense that performance or a tender of performance may represent concurrent conditions, in that each may be conditional upon the other. Corbett J illustrated the aforesaid by using the example of a cash sale, indicating that the delivery of the *res vendita* and payment of the purchase price should occur simultaneously. Corbett J also indicated that reciprocity may be one-sided in that the complete performance of contractual obligations by one party may be a condition precedent to the performance of the other party.

27 Christie’s The Law of Contract in South Africa (6th Ed) (2010) 437. See also *BK Tooling (Edms) Bpk v Scope Precision Engineering (Edms) Bpk* 1979 (1) SA 391 (A).

28 1973 (2) SA 805 (C) at page 808-809.

In other words the obligations, though inter-dependent, fall to be performed consecutively. A further example given by the Corbett J was a *locatio-conditio operis* where the *conductor operis* is normally obliged to carry out the work which he is engaged to do before the contract money can be claimed. In such a case the obligation to pay the money is conditional on the pre-performance of the obligation to carry out the work, but, of course the converse does not apply.

Corbet JA further held that reciprocity of obligations does not depend merely upon the time fixed for the performance. The mere fact that a contract specifies that the obligations are due to be formed on the same day does not lead to the inference that the parties intended them to be reciprocal.

For reciprocity to exist there must be such a relationship between the obligation by the one party and due by the other party, as to indicate that one was undertaken in exchange for the performance of the other and, in case where the obligations are not consecutive or *vice versa*.

The principle of reciprocity does not apply to each and every contract. To establish whether or not it is applicable to a contract, is a question of interpreting the relevant contract, assisted by a presumption that any bilateral contract (one in which each party undertakes obligations towards the other), the common intention is that neither should be entitled to enforce the contract unless he has performed or is ready to perform his own obligations.²⁹ The aforesaid is also known as the *exceptio non adimpleti contractus*.

Therefore, to establish whether or not the principle of reciprocity will be applicable to any contract it must be decided based upon each and every specific contract. The principle of reciprocity also influenced the South African Courts when interpreting "accrued to".

²⁹ Christie's The Law of Contract in South Africa (6th Ed) (2010) 437. See also *BK Tooling (Edms) Bpk v Scope Precision Engineering (Edms) Bpk* 1979 (1) SA 391 (A).

In *ITC 316*³⁰ the Court had to deal with a contract of sale and purchase and the effect thereof it had on the interpretation of “accrued to”. A portion of the Appellant’s farm was cultivated for gum trees. The Appellant sold a portion of the gum tree plantation but remained the owner of the ground.

The purchaser had the right to fell the portion of the gum tree plantation. In terms of the contract of sale between the Appellant and the purchaser, a lump sum of money was to be paid down on completion of all the relevant and necessary documentation to secure the purchaser’s rights. The balance of the purchase consideration was to be paid in annual instalments over a six year period.

In terms of the agreement the purchaser was given a period of ten years within which to fell and remove the gum trees. The sale agreement also made provision for an extension of the period subject to compensation to be paid to the seller.³¹

The agreement of sale further provided that the new growth, after the plantations had been fell, should become the property of the seller. After the relevant year of assessment, the rights of the Appellant and the purchaser were further embodied in terms of a lease to the purchaser of the ground upon which the plantation stood and that agreement by giving by the seller of a bond for an amount equal to the lump sum paid down under the purchase agreement, the amount secured being payable only on breach by the seller of his obligations under the contract.

The Appellant included in his taxable income for the relevant year of assessment the lump sum paid to him on the completion of the agreement. The Appellant excluded the instalments payable in the subsequent years.³²

The Commissioner required the inclusion in the Appellant’s gross income the instalments at present value because it had accrued to the Appellant on the completion in the year of assessment of the contract of purchase. The Appellant’s

30 8 SATC166.

31 *ITC 316*, page 166.

32 *ITC 316*, page 166.

main contention in Court was that there could be no accrual of an amount in any year of assessment, unless it was due and payable in that year of assessment.³³

The appeal Court held that the words “accrued to” must be construed as including an amount which the Appellant had become entitled to receive at a date after the close of that year of assessment. The Court held that the title must import a clear and enforceable right to receive the money.

The Court held that in this case there could be no “accrual” at the date when the contract was made between the Appellant and the purchaser of the plantations if the later payments under the contract were depended upon the performance by the Appellant of duties and obligations under the contract.³⁴

The Court in this case, relied upon the specific terms of the contract of sale between the Appellant and the purchaser and the principles of reciprocity to interpret whether or not the instalment payments had “accrued to” the Appellant.

An interpreter of tax legislation must therefore always take into account the specific terms of an underlying contract. The terms of an underlying contract will give an indication of the nature of a specific transaction to see whether it can be said that an amount of money “accrued to” a taxpayer.

In *ITC 1415*³⁵ the Appellant was a minister who retired in 1985. The Appellant had served the congregation for a consecutive period of 19 years. After his retirement the Appellant was served with additional assessments for the tax years 1976, 1978, 1979, 1982 and 1983, thereby increasing his taxable income for those years by the sum of R20 462.00 and imposing normal tax plus an additional penalty tax amounting in all to R14 027.00.

33 *ITC 316*, page 166.

34 *ITC 316*, page 167.

35 48 SATC 179.

The Appellant objected on the basis that the amount of R20 462.00 had neither been received by nor had accrued to the Appellant. The Court of first instance overruled the Appellant's objection and the Appellant appealed to the Special Income Tax Court.³⁶

The contract between the Appellant and the congregation stipulated that the Appellant's monthly salary shall be paid on the 17th day of each month. The Appellant's congregation had financial difficulties and the Appellant periodically renounced a part of his salary.³⁷

There was evidence before the Court for consideration that the renunciation was effected by a written instruction given to the congregation's cashier before the 17th of every month.

The Court looked at the legal principles and obligation of an employment contract and held that it placed reciprocal obligations upon the parties thereto. The Court held that in terms of an employment contract the employee must first comply with his obligations in terms of the employment agreement before the employer had the obligation to remunerate the employee. The Court stated as follows:

"n Dienskontrak skep wederkerige verbintenisse en prestasieverpligtinge. By ontstentenis van 'n beding tot die teendeel, moet die werknemer dus sy diensverpligtinge daarkragtens nakom voordat hy geregtig word op prestasie deur die werkgewer van sy betalingsverpligtinge. In die saak *Prins v Universiteit van Pretoria*, 1980 (2) SA 171 (T), op 174F, stel sy Edele Regter Coetzee dit pittig soos volg: 'Die dienskontrak (lucatio conductio operarum) skep regte en verpligtinge vir beide werkgewer en werknemer. Soos aangestip deur De Wet en Yeats (LOC CID) is, net soos by die gewone huurkontrak van sake, die werkgewer nie verplig om loon of salaris te betaal waar hy nie die genot en gebruik van die werknemer se werkvermoë gehad het nie."³⁸

The Appellant's appeal was successful. The Court reasoned to the effect that the amounts of remuneration that the Appellant had periodically accepted was less than

36 *ITC 1415*, page 179.

37 *ITC 1415*, page 180.

38 *ITC 1415*, page 185.

his agreed remuneration, and did not “accrue” to the Appellant. Kriegler J, said it as follows:

“Om op te som, na my mening het die *ad hoc* afgestane bedrae die Appellant nie toegeval nie en het dit ook nie ten gunste van hom toegeval nie. Dit skyn vir my te wees die begrip wat werkgewer en werknemer gehad het. Ek lei dit af van die feit dat die kerkraad deurgaans genoeë geneem het daarmee dat sy boekhouding slegs die werklike-betaalde bedrae aangedui het en dat daar namens hom aan die Ontvanger van Inkomste verklaar is dat slegs die werklike ontvangte bedrae die Appellant se besoldiging uitgemaak het.”³⁹

The Court therefore again looked at the principles of the specific contract being an employment contract (principle of reciprocity) and at the factual evidence before it (how the Appellant and its congregation in practice worked on a monthly basis) in deciding the issue as it did. The courts therefore do not go about the interpretation of tax legislation in isolation, but an underlying contract plays a vital role in the interpretation process.

In *ITC 1847*⁴⁰ the Court dealt with an interesting scenario. The Appellant carried on mining operations that yielded exportable fluorspar and such fluorspar contained concentrations of calcium fluoride which was used *inter alia* in the production of hydrofluoric acid which had several industrial applications. The Appellant in terms of five transactions sold the fluorspar to overseas customers.

The taxpayer dispatched the fluorspar to the overseas customers via ship from Durban. The fluorspar was shipped free on board and the taxpayer in each instance arranged and paid for the insurance of the freight and recovered the cost of the insurance from the purchaser at a later stage.⁴¹ The commissioner contended that in each instance the price of the exported fluorspar had accrued upon the delivery thereof to the ship in Durban and the procurement of the bill of lading to the purchaser's order. The taxpayer's evidence played a pivotal role in the Court's decision and was summarised as follows:

39 *ITC 1415*, page 188.

40 *73 SATC 126*

41 *ITC 1847*, page 127.

- Purchasers had strict requirements for a high percentage of calcium fluoride (normally 97%) in the fluorspar delivered.
- Fluorspar became very easily contaminated during stock piling and transportation.
- The moisture content of fluorspar needed to be carefully managed as it varied and this resulted in higher transportation costs and reduction of the purity of the product.
- Moisture content fluctuated during transportation.
- Appellant would only be paid for the actual dry metric tonnage of the fluorspar as determined after delivery to the purchaser in the country of destination.
- By reason of the above, the delivery of the fluorspar was subject to inspection and analysis by independent essayists nominated by the purchaser in the country of destination.
- If the fluorspar did not comply with the specifications of the purchaser, the whole shipment could be rejected by the purchaser, but in practice they would negotiate a reduced price if the delivered product did not meet the specifications.
- Minor discrepancies in meeting the standards required by the purchaser could result in large adjustments to the finally agreed price.
- Although sometimes there would be advance payments made by the purchaser, the seller had no right or entitlement to appropriate these receipts until the final price had been determined, consequent upon the inspection in the country of destination.⁴²

The Commissioner contended that in each instance the price of the exported fluorspar accrued to the Appellant upon delivery of the fluorspar to the ship in Durban and the procurement of the bill of lading to the purchaser's order. The Appellant's case was that the accrual of the price to it only took place after the inspection and analysis by the assayists in the country of destination.⁴³ The Court

42 *ITC 1847*, page 127.

43 *ITC 1847*, page 127.

therefore had to decide when did the right to claim payment in respect of the export fluorspar vest in the Appellant?

The Court held that the right to claim payment only vested in the Appellant once the price had become certain or had been asserted. Therefore pending the outcome of the assayist's inspection in the destination country, there had been no accrual of the price. The Appellant's appeal was therefore successful.

In *ITC 1847* the Court heavily relied upon how the transaction between the Appellant and the overseas purchaser was structured. The Court therefore also had to scrutinise the evidence that was adduced before the Court to see how the specific transaction between the Appellant and the overseas purchaser worked in practice. The court then used the specific transaction and the facts of the specific scenario to interpret "accrued to".

It is therefore evident that when an interpreter of tax legislation is called upon to interpret "accrued to" (under circumstances where there is a contractual relationship involved), it is important to investigate the underlying transaction or contract(s) to establish how the parties structured the transaction or to establish what the parties actually intended to achieve with their contract.

The law of contract therefore plays an important role in the interpretation of "accrued to" when an interpreter of tax legislation is to supply an interpretation to "accrued to" where reciprocal obligations are involved. Therefore as illustrated by the reported judgments above, the interpretation process when dealing with reciprocal obligations is not a process that is done by the court in isolation.

4.5 INTEREST

Taxpayers earn interest from various commercial transactions in a modern society filled with different commercial opportunities. The earning of interest is a daily occurrence. The question that arises is when can it be said that interest “accrued to” a taxpayer and should be included in a taxpayer’s gross income?

In *Cactus Investments (Pty) Ltd v Commissioner for Inland Revenue*⁴⁴ the taxpayer company A was a subsidiary of company B. Company A’s main functions was to hold and manage company B’s preference share book. In 1987 a scheme was devised to enable company A to make interest bearing investments without attracting liability for income tax. The scheme entailed the exchange of taxable interest income for a non-taxable dividend income by way of cession and counter cession. In terms of this scheme, company A, during 1988 and 1989, made several interest bearing fixed deposits and loans and executed numerous cessions of the right to receive the interest. In return, company A took cession of the borrower’s rights to receive dividends.

The Commissioner assessed the interest as being subject to normal tax during 1988 and the 1989 years of assessment. Company A unsuccessfully objected to the assessment. Company A successfully appealed to the Special Income Tax Court which hold that the interest had been ceded before its accrual and accordingly the assessments were set aside. The Commissioner appealed to the Transvaal Provincial Division which held that the right to claim interest had accrued to the taxpayer on the dates on which the investments had been made and had not been affected by the cessions and accordingly the assessments were restored. In a further appeal by company A the issue was when the interest income had accrued as intended in the definition of gross income in Section 1 of the ITA in a further appeal to the Supreme Court of Appeal.

44 1999 (1) SA 315 (SCA).

Hefer JA held that, the expression “accrued to” in Section 5(1) and the definition of gross income in Section 1 of the ITA had been interpreted in *Commissioner for Inland Revenue v Peoples Stores (Walvis Bay) (Pty) Ltd*, 1990 (2) SA 353 (A) as requiring no more than that the person concerned had become entitled to the right in question. The entitlement to any particular right was regulated by the common law.

The court further held and looked at the investment scheme agreements and held that there was nothing in any of the agreements indicating that the ordinary principles of the common law applicable to loans for consumption did not apply. The court also held that the common law, unless the parties otherwise agreed, dictated that a lender of money became entitled to the right to receive interest on the stipulated future date, as soon as the lender made funds available to the borrower. Company A was therefore assessed as the appeal was unsuccessful and dismissed.

Hefer JA,⁴⁵ continued by saying that the expression ‘accrue to’ in Section 5(1) and the definition of ‘gross income’ has been interpreted in the *Peoples Stores* case to mean ‘has become entitled to’ and at common law, unless the parties otherwise agree, a lender of money becomes entitled to the right to receive interest as soon as he has made the funds available to the borrower. Hefer JA said that this is the plain effect of the act as it stands and we cannot on equitable grounds apply it in any other manner.

The court in the *Cactus* investments judgment therefore followed a literal approach to the interpretation of “accrued to”, but also relied upon the common law rights of parties to a loan to adjudicate upon this case by interpreting “accrued to” as it did.

The effect of the court’s interpretation of “accrued to” in the *Cactus*-judgment is that (although from the perspective of a money lender), interest will “accrue to” on the specific day that an investment is made. The aforesaid obviously has heavy implications on taxpayers as they will have to immediately account for interest under

45 *Cactus*, page 323C – D.

circumstances where interest is usually accumulated and earned over a period of time.

The Legislator became aware of the heavy burden that was placed upon a taxpayer and introduced special timing rules in Section 24 J of the ITA, which has the practical effect that interest “accrues to” a taxpayer on a daily basis over a period of time.

A taxpayer will have to bring him, her or itself within the ambit of Section 24 J of the ITA to receive any benefit from the timing rules and if not possible a taxpayer will be heavily taxed on the principle established by the *Cactus*-judgement, which is that interest “accrues to” a taxpayer on the day an investment is made. It must also be remembered that the *Cactus*-judgment is a judgment by the Supreme Court of Appeal and in complying with “stare decisis” all inferior courts will be bound to follow the *Cactus*-judgement.

4.6 DISCOUNT TRANSACTIONS

When dealing with discount transactions, it needs to be established that if and when, a taxpayer gives a customer a discount for early payment, what the amount should be that should be included in the taxpayer’s gross income. Should it be the full selling price or should it be the full purchase price less the discount amount?⁴⁶

In *Gud Holdings (Pty) Ltd v SARS (2007)*,⁴⁷ the Appellant had a business as a manufacturer and distributor of automotive parts. The Appellant sold the automotive parts to wholesalers. The Appellant had a discount scheme in place whereby wholesale purchasers would become entitled to a settlement discount if payment was made in respect of each sale by the 25th day of the month following in which the Appellant issued an invoice to the wholesaler.

The Appellant’s discount scheme was envisaged in and contained in the Appellant’s standard terms of sale. The wholesalers by themselves deducted the settlement

46 RC Williams: Income Tax in South Africa: Cases and Materials, 3rd Ed (2009) 97.

47 69 SATC 115 (N).

discount and only paid over to the Appellant the amount after the discount. Almost all the wholesalers took advantage of the Appellant's discount scheme.⁴⁸

In the Appellant's accounting records, the Appellant reflected the gross selling price less the settlement discount. For the tax year ending 30 June 2003 the Appellant showed the amount accrued to as the sales figure less the prompt payment discount offered in terms of the standard terms and conditions of the Appellant. SARS audited the Appellant and raised an additional assessment for the 2003 year of assessment, in which SARS increased the Appellant's gross income by R4,371 015.00, being the full amount of the invoices less the payments received.⁴⁹

The Tax Court held that the amount which accrued to the Appellant at the end of the tax year was the full amount of the unpaid purchase price and the Appellant was entitled to an adjustment only in the cases where payment was affected within the period stipulated in the Appellant's standard terms and conditions in the following tax year. The Appellant appealed this decision.⁵⁰

The Appeal Court held that the question was precisely what had "accrued to" the Appellant as at 30 June 2003. The Court held that the wholesalers became indebted for the full invoice price supplied by the Appellant, only if the wholesaler's payment was tardy.

The settlement discount contained in the Appellant's standard conditions of sale was not so much as a "discount", but rather a penalty which would be added for late payment. The Court held that based on the judgment in the *Lategan*-case, it was erroneous to suggest that the full invoiced price had accrued to the Appellant as part of the Appellant's gross income.⁵¹ The appeal succeeded and the assessment of R4,371 015.00 was set aside.

48 *Gud*, page 2.
49 *Gud*, page 3.
50 *Gud*, page 4.
51 *Gud*, page 7.

Williams⁵² criticises the judgment to the extent that the correct conclusion was reached but for the wrong reasons. There was no question in this case according to Williams of a simulated transaction. The simple question was, as the Court pointed out, what had “accrued to” the taxpayer as at 30 June 2003?

Williams stipulates that the question could only be answered by a legal analysis of the taxpayer’s standard terms and conditions of sale. Williams contends that the taxpayer’s standard terms and conditions of sale had to be interpreted as it stands. Williams says that upon the occurrence of the stipulate event, being the early payment, a resolute condition was fulfilled and for that reason, contrary to the judgment the position of a penalty, the right to payment of the full purchase price fell away. For the aforesaid reason, the taxpayer became entitled only to the discounted price, which was paid by the wholesaler.

Considering discount transactions, it therefore becomes clear that if a taxpayer operates a discount payment scheme, the court will scrutinise the taxpayer’s terms and conditions used by the taxpayer in conducting business. It is therefore advisable for taxpayers to properly formulate the terms and conditions of their discount scheme. The specific terms and conditions of a discount scheme will therefore play a pivotal role in the interpretation of “accrued to” by a tax interpreter when dealing with discount schemes, as the court will not interpret “accrued to” in isolation.

4.7 **CESSION OF INCOME**

The question arises whether a taxpayer would be liable for tax if a taxpayer cedes income due prior to the income accruing to the taxpayer. It is therefore necessary to interpret the concept of “accrued to” when dealing with cession of income. It is however important to firstly obtain an understanding of what a cession entails.

52 R C Williams: Income Tax in South Africa: Cases and Materials (3rd Ed), p.99

Christie⁵³ opines that a cession may be regarded as the opposite of a delegation, because it involves the substitution of a new creditor (the cessionary) for the original creditor (the cedent), but the debtor remains the same. If the effect of the transaction is not to divest the cedent of his right to sue the debtor it is not a cession. Cession is also sometimes described as a form of novation. Cession differs from novation because it does not require the consent of the debtor, and it does not result in a new contract that replaces the existing one.

In *Hidding v CIR*⁵⁴ Hidding left a will in which he bequeathed to the taxpayer an immovable property subject to a *fideicommissum* in favour of specified persons for three generations. The taxpayer was accordingly in terms of the will entitled for the duration of his life to receive income from the immovable property.

Pursuant to litigation, the immovable property was sold in terms of an order of Court and the proceeds of the sale were paid to Hidding's executor to hold and invest. The executor had instructions to pay over the nett income to the taxpayer during his lifetime and on his death to deal with the income and capital as directed by the will.

The taxpayer during 1943 in terms of a deed, assigned to certain relatives, a portion of the income from the trust estate. The Commissioner had the view that the amounts paid over to the relatives under the deed had to be included in the taxpayer's income. The taxpayer objected to this on the basis that the amounts in question did not form part of his gross income.

The issue the Court had to decide was whether or not the income which the taxpayer paid to the relatives formed part of the taxpayer's gross income?⁵⁵ The Court held that the amounts paid over by the taxpayer to the relatives did not form part of the taxpayer's gross income because the effect of the deed was a cession entered into

53 Christie's The Law of Contract in South Africa (6th Ed) (2010) 482.

54 11 SATC 205.

55 R C Williams: Income Tax in South Africa: Cases and Material (3rd Ed), p.155 to 156.

by the taxpayer which divested the taxpayer of the right to the income before the income accrued to the taxpayer.

The Court therefore constructed and looked at the specific written cession contract that served before it to conclude if the taxpayer alienated the right to the income before the income accrued to the taxpayer.⁵⁶

It is therefore possible for a taxpayer to enter into a cession to divest him from income that is to be his income prior to the income accruing to the taxpayer. In such an instance, the taxpayer will not be held liable for tax as the cession divests the taxpayer's right to receive the income and accordingly the income would not have "accrued to" the taxpayer. However, care should be taken when dealing with a cession as the ITA's Anti Avoidance Provisions counteract tax avoidance.⁵⁷ Tax avoidance can be described as a scheme utilised by a taxpayer to circumvent the tax laws. The aforesaid schemes to avoid tax are countered by the ITA's Anti Avoidance Provisions.⁵⁸

When dealing with a cession a difficulty that may arise is where a cedent physically receives the money after entering into a valid cession. If the income actually accrued in the hands of the cessionary, then the cedent merely receives the income on behalf of the cessionary. In these circumstances the income received should not be included in the cedent's gross income merely based upon the fact that he physically received the money. The income must still be included in the gross income of the cessionary.⁵⁹

Therefore, an interpreter of tax legislation should scrutinise a cession and the specific terms of a cession, to make sure that a taxpayer do not merely use the contractual principles of a cession to avoid a tax liability.

56 R C Williams: *Income Tax in South Africa: Cases and Material* (3rd Ed), p.156

57 Section 7 of the ITA and paragraph [c] in the definition of gross income.

58 Croome *et al* (2013) 22 to 23.

59 Croome *et al* (2013) 79; See also *ITC 1378 45 SATC 230*, where a shareholder ceded rights to dividends in future to a specific fund for a specific time period. The Court held that the rights to the future dividends was conditional and had been ceded and accordingly the dividends subsequently distributed by the company were taxable in the hands of the cessionary.

The terms of the cession will therefore play an important role in the interpretation to be given to “accrued to” because when dealing with a cession, the court’s interpretation of “accrued to” is not done in isolation but by taking the specific nature and terms of the cession into account.

4.8 WAIVING INCOME

Dealing with the principle of waiving income, the question arises whether or not it will be legally tenable for a taxpayer to waive income, prior to the income accruing to the taxpayer in such circumstances and thereby avoiding a tax liability?

The effect of a waiver of a right is that the right is extinguished and the relevant obligation. Waiver is a factual question. The party who alleges waiver in litigation has the onus to prove the waiver relied upon. A waiver may either be expressly or impliedly. An implied waiver will be established by looking at the conduct which will be inconsistent with an intention to enforce a right.⁶⁰

In *Van Heerden & Others v The State*⁶¹ the accused persons and entities were charged with criminal charges.⁶² The facts in this case related to commission that was waived by a close corporation that conducted an estate agency business. In this case the Court had to decide whether or not the commission waived by the close corporation “accrued to” the close corporation prior to the close corporation waiving its entitlement thereto. If the Court was to find that it did accrue to the close corporation, then the close corporation would have been guilty.

The Court held that the dispute was to be resolved on a proper interpretation of the contract in question. The Court specifically looked at the commission clause of the contract. There were a so-called main contract of commission between the close corporation and its principal and individual contracts between the close corporation and buyers of immovable property.

60 Amler’s Precedents of Pleadings (8th Ed) (2015), p.384 to 386

61 73 SATC 7

62 *Van Heerden* page 16 to page 17.

The Court however held that one should look at the main contract between the close corporation and its principal. The specific commission clause in this case read as follows:

“9.1 The consultancy (NCC) shall be entitled to receive commission of 5 (five) percentum on all its sales in respect of corporate mansions, executive lodges, family homes and erven in the resort development effected and concluded by the consultancy.”⁶³

In this case the close corporation, prior to an immovable property being sold and registered in the relevant Deeds Office, waived the commission earned. The aforesaid was done with more than one transaction. The amount of commission waived by the close corporation amounted to R500 000.00. The close corporation did not include the waived commission in the amount of R500 000.00 in its tax return.

The Court had to consider whether or not the close corporation's right to receive payment of the commission was conditional or on the transfer of the properties in the Registrar of Deeds' office and/or whether or not the close corporation divested itself of receiving the right to the commission prior to the commission accruing to the close corporation.

By interpreting the above quoted clause, the Court held that the use of the words “concluded” in the clause was indicative thereof that any commission was subject to a successful transfer of the relevant property in the Deeds Office. Accordingly, the Court held that the right to commission was therefore conditional upon the successful transfer and registration of a property in the Deeds Office. The close corporation was correct. The accused persons in *Van Heerden* were acquitted on the charges.

63 *Van Heerden* judgment at paragraph 35.

The *Van Heerden*-judgment is an indication of how important the facts underlying a transaction can be and, how important the specific wording in contract can be.

The *Van Heerden*-judgment is again an indication thereof that the interpretation process is not at all done in isolation, but in fact a process undertaken by specifically taking into account all facts and the specific words included into a contract.

4.9 DATE AND VALUATION

A taxpayer's gross income is calculated at the end of the year of assessment. Gross income includes receipts and accruals. The nature of an accrual does not cover an amount that a taxpayer already received during the period of assessment.⁶⁴ When one has to deal with a value of a receipt, there exists no difficulty. A receipt is simply the value of whatever a taxpayer received.

However, when one deals with an "accrual" the same cannot be said. Two scenarios should be distinguished. First, one has to look at where the accrued amount accrued to the taxpayer during the year of assessment and when that amount became both due and payable during the year of assessment, but that amount so accrued to the taxpayer is still outstanding at the end of the year of assessment. In this instance the value of the accrual will simply be the value of the amount which is outstanding to the taxpayer at the end of the year of assessment.⁶⁵

Second, one has to look a scenario where an amount is only due and payable at a date following the end of the year of assessment. The market value of such a future accrual would strictly speaking be worth less than the face value on the last day of the year of assessment.⁶⁶ The question then arises what value a taxpayer for such an accrual ought to include in his gross income?

64 Croome *et al* (2013) 72.

65 Croome *et al* (2013), p.73.

66 Croome *et al* (2013), p.73.

In *CIR v Peoples Stores (Walvis Bay) (Pty) Ltd*⁶⁷ the taxpayer was a subsidiary in the Edgars Group of companies. The taxpayer was a retailer of clothing, footwear and other goods. The taxpayer sold goods on what was referred to as a six-month revolving credit scheme. The scheme entailed that a customer who purchase goods on credit had to pay the amounts charged to the customer's account in six equal monthly instalments. On the last day of the year of assessment in issue, instalments under the six-month revolving credit scheme were only payable in the following year of assessment, and it amounted to R341 281.00. The commissioner was of the view that the sum should be included in the taxpayer's gross income.

The taxpayer had a different view and objected to the assessment and contended that instalments which were neither payable nor paid during the current year of assessment should not be included in the taxpayer's gross income for the relevant year of assessment. In the alternative the taxpayer contended that the face value of the instalments ought not to be included in the taxpayer's gross income, but only the value of what that is presently worth.

The issue the Court had to decide on was whether or not an amount "accrue" to the taxpayer when it is "due", i.e. when the taxpayer become entitled to it or only when it is both due and payable?

The Court adopted and applied the *Lategan*-principle and held that an amount accrues in the tax year that the taxpayer becomes entitled to it. It therefore does not matter whether or not such an amount is due and payable.

Williams⁶⁸ reacts to the *CIR v Peoples Stores*-judgment as follows:

- The decision in *Lategan* takes as it's starting point the principle that the word "amount" in the definition of gross income is not only money, but also includes other forms of property which has a money value. The value of all receipts and accruals of a non-capital nature must therefore be included in a

67 1990 (2) SA 353 (A)

68 R C Williams: *Income Tax in South Africa* (3rd Ed): Cases and Materials, p.94 to 95

taxpayer's gross income in the year in which the accrual takes place. Where property is money, the value is its nominal value. Where property is something else than money, its money value must be included in the taxpayer's gross income.

- Where the amount consists of a right to be paid a specific amount of money in future, which will be paid in a future year of assessment, the realisable value of the right to future payment will not be nominal value, but a reduced value. The aforesaid principle was affirmed in *CIR v Peoples Stores (Walvis Bay) (Pty) Ltd*, but has since been overridden by an enactment of a provision to the definition of gross income which requires that the full value, that is to say the face value of such a debt, must be included in a taxpayer's gross income.
- The *Lategan*-decision is clear that where a debt payable in future is discounted in order to arrive at its present value, this is entirely separate from the question whether the debt is good or bad.
- In *Peoples Stores* the Court upheld the correctness of both the first leg being "accrued" means "has become entitled to" and the second leg, that "present value" of a right to future payment is arrived at by discounting its face value to allow for the fact that it is not immediately payable.

Swart⁶⁹ opines that since the People store's judgment it is now settled that the "due and payable" principle is untenable and can no longer be relied upon.

It is therefore self-evident that when an interpreter of tax legislation is to interpret "receipt by" or "accrued to" that a taxpayer should also consider the principles above which relates to the date and valuation of a "receipt by" or "accrued to", in giving a proper meaning thereto.

69 Swart GJ "The Accrual of Income-Some Answers" (1990) 97 SA MERC LJ 97.

CHAPTER 5

Prior to *MP Finance Group CC (in liquidation) v CSARS*¹ the South African Courts had a consistent approach in dealing with illegal activities and income received from illegal activities. The Courts followed a so-called objective approach when dealing with illegal activities and illegal receipts.² The so-called objective approach was changed to a so-called subjective approach.

5.1 ILLEGAL RECEIPTS

In *ITC 1792*³ the Appellant was employed as a stockbroker. The Appellant accepted instructions from clients to buy and sell securities and in doing so acted as their agent in terms of a mandate. In the Appellant's 1990 to 1991 year of assessment, the Appellant included in its gross income certain profits and later submitted an amended tax return to exclude the profits previously included on the grounds that it did not constitute and/or formed part of his gross income as the Appellant did not beneficially receive same. The Commissioner contended differently and included the profits in the Appellant's gross income.

The evidence before Court indicated that the Appellant during the 1990 and 1991 years of assessment became involved in a syndicate with dealers or portfolio managers and they manipulated certain share transactions. In general it was established that the syndicate knew beforehand which shares were intended to be purchased and the syndicate with this knowledge bought the shares in the name of a different entity.

The Appellant was convicted of fraud and had been sentenced to imprisonment. The Appellant did make restitution of all the legal profits to M with interest. The Appellant acted for M. On the evidence the Court found that it was clear that the Appellant, when buying the shares, acted contrary to the terms of its mandate given to him by M. The Appellant, when entering into transactions, was to benefit the syndicate and himself and not M.

1 2007 (5) SA 521 (SCA), 69 SATC 141.

2 Croome *et al*, p.70.

3 67 SATC 236.

The Court had to consider whether or not the transactions and the profits gained therefrom were received by the Appellant in the 1990 and 1991 years of assessment so as to establish whether or not same falls within the Applicant's gross income.

The Court held that in order for there to be a "receipt" the money should be "received" by the taxpayer for his own benefit. In this case the subjective intention of the syndicate and Appellant was to receive the secret profits for themselves. This however, did not mean that "legally" they had "received" the profits for their own benefit and to understand the distinction the Court had to look at the law of agency.⁴

The Court further held that the shares originally acquired by the syndicate did not belong to the syndicate, but it belonged to M, being the principal. The Court held that this was so because the law does not give effect to the subjective intention of the syndicate and the agent to appropriate the shares or profit, but deems the agent to have received them for and on behalf of the principal.⁵

In conclusion the Court held that it followed in law that the shares originally purchased nor the profits realised therewith, belonged to the Appellant or the syndicate. Neither the shares nor profits realised therewith was received by the Appellant for its own right and/or for its own benefit, but was received by M, the principal. Accordingly the profits earned by the Appellant during the 1990 and 1991 years of assessment did not fall within the Appellant's gross income.

Therefore, in *ITC 1792* it becomes clear that in dealing with illegal receipts, the court followed a so-called objective approach when the court had to interpret "received by and accrued to".⁶

4 *ITC 1792*, page 236.

5 *ITC 1792*, page 236.

6 See also *ITC 1810* 68 SATC 189 where the Court dealing with a pyramid scheme and interest also held that the Appellant in that judgment did not accrue to the Appellant and therefore did not form part of his gross income.

In *MP Finance Group CC (in liquidation) v CSARS*⁷ the taxpayer operated an illegal pyramid scheme. The taxpayer misappropriated substantial amounts of money. The question in essence was whether or not the amounts misappropriated by the taxpayer should form part of the taxpayer's gross income and therefore liable to be taxed. The Court held that the taxpayer intended to benefit from the amounts of money it misappropriated.

The Court therefore held that the monies misappropriated did form part of the taxpayer's gross income and the taxpayer was accordingly held liable to be taxed thereon. In holding the aforesaid the Court rejected the taxpayer's argument, that because the misappropriated amounts were received pursuant to an illegal scheme, the scheme was liable in law to immediately refund the deposits received to the investors; and therefore, it could not be said that the scheme "received" the deposits within the meaning of gross income in Section 1 of the ITA, and accordingly not liable to be taxed thereon.⁸

From reading the judgment the Court favoured a subjective approach when dealing with illegal receipts in that the Court considered whether the taxpayer intended to benefit from the amounts.

Since the *MP Finance Group (in liquidation)*-judgment the Court changed from an objective approach when dealing with illegal receipts to a more subjective approach when dealing with illegal receipts.

Muller⁹ opines that the South African Courts confused the concept of "accrued to" and "received by" when dealing with the taxation of illegal receipts. The illegality of receipts cannot be excluded from taxation because of a policy consideration. Muller further states that the subjective approach should be followed when one is dealing with "received by" and the objective approach should be followed when one is dealing with "accrued to", because when dealing with a "receipt" the intention of the

7 2007 (5) SA 521 (SCA), 69 SATC 141.

8 Surtees P "The Law of Taxation" (2007) 1089 *Annual Survey of South African Law*, 1089 - 1089

9 Muller E "The Taxation of Illegal Receipts: A Pyramid of Problems!" (2007) *Obiter* 166

taxpayer is important. When dealing with “accrued to” the intention of the taxpayer is less important.

Classen¹⁰ welcomes the *MP Finance Group (in liquidation)*-judgment because the decision makes illegal receipts subject to taxation. Classen further states that the intention of the taxpayer should be used to establish the moment when an illegal amount of money has been “received by or accrued to” a taxpayer.

Goldswain¹¹ considers the *MP Finance Group (in liquidation)*-judgment to be unconstitutional in that it deprives defrauded investors of their property and therefore the judgment contravenes section 25 of the Constitution, 1996. Section 25 of the Constitution, 1996 entail that nobody may be deprived of their property except in terms of a law of general application. Therefore, by following a subjective approach and making illegal receipt subject to taxation, the defrauded investor’s money/property is used to pay tax and they are therefore deprived of their property.

From the above it is clear that the *MP Finance Group CC (in liquidation)* can be criticised and is indeed a so-called controversial judgment. However, whether or not that may be so, if the rule of “stare decisis” discussed in chapter 2 above is to be taken into account, the interpreters of tax legislation will have to comply with the principles laid down in the *MP Finance Group CC (in liquidation)*-judgment, i.e. that when dealing with illegal receipts, a subjective approach should be followed when interpreting “received by”.

MP Finance Group CC (in liquidation)-judgment, further indicates that the interpretation process is not done in isolation, but that the court also took into account the subjective intention of the taxpayer in supplying the interpretation to “received by” as it did. Although some writers opines different to what the court held in the *MP Finance Group CC (in liquidation)*-judgment, it must be remembered that the opinions of writers do not overrule courts and in accordance with “stare decisis”

10 Classen L “Legality and Income Tax – is SARS “entitled to” levy income tax on illegal amounts “received by” a taxpayer? (2007) SA MERC LJ 534.

11 Goldswain G “Illegal Activities: Taxability of Proceeds” (2008) 22 *Tax Planning* 143 146; See also Croome *et al*, p.70

an interpreter of tax legislation will have to follow a subjective approach when an interpretation is to be given to “received by” in the context of illegal receipts.

CHAPTER 6- CONCLUSION

I deem it relevant to refer to the introductory words reported in *Langston Clothing (Properties) CC v Danco Clothing (Pty) Ltd*¹, where Schutz JA started off the judgment (dealing with an interpretation issue), by saying:

“The same words often mean different things to different people. This helps to keep the forensic pot boiling. The dispute in this case affords a simple if stubborn example.”

There will be future disputes that will keep the forensic pot boiling in respect of the meaning and interpretation to be given to “received by or accrued to” in a specific scenario. As seen from the reported judgments discussed above, the interpretation process is not a process to be conducted in isolation. Interpreters of tax legislation must analyse the specific underlying facts, evidence and contract(s) of each scenario calling for an interpretation of “received by or accrued to”. Put differently interpreters of tax legislation must look at other spheres of the law and legal principles involved in a specific scenario so as to properly interpret “received by or accrued to”.

It is impossible to interpret “received by or accrued to” in isolation by only taking the provisions of the ITA and general tax law into account. An interpreter of tax legislation must also have an in-depth knowledge of the totality of the South African Law to supply a purposive meaning to the words “received by” or “accrued to” as illustrated by the various judgments.

To cater for the various transactions and possible conflicting interpretations it is of the utmost importance to adhere to the principle of “stare decisis”. In my opinion the principle of “stare decisis” promotes and supports legal certainty the best in a commercial world filled with uncertainties.

The date and valuation of an “accrual or receipt” also play an important role in the interpretation process, as it will indicate in which year of assessment an “accrual or a receipt” must be included in the taxable income of a taxpayer.

¹ 1998 (4) SA 885 (SCA).

In conclusion, the Legislator should not in my opinion, supply a statutory definition in the ITA for “received by” or “accrued to” as it will be impossible to supply such a definition to cater for all the different and various possible scenarios, and commercial transactions that may become relevant in a modern South Africa. The commercial world with its various transactions is not at all sterile, as indicated with the reported judgments that were discussed above.

LIST OF REFERENCES

Legislation

Constitution of the Republic of South Africa, 1996.

The Income Tax Act, Act 58 of 1962.

Articles

Swart G "Recouplings, Accounting Practice, and Income-Tax Principles" (2003) 15 SA Merc LJ 459.

Goldswain GK "The Purposive Approach to the Interpretation of Fiscal Legislation – the Winds of Change" (2008) 2 *Meditari Accountancy Research* Vol.16 no 2 2008 107.

Van Wyk T "Tax Law: Interpretation of Fiscal Legislation" (1976) *De Rebus* September 455.

Tshiki P "President, stare decisis and the Constitution" (2004) *De Rebus* October 55.

Devenish G "The doctrine of President in South Africa" (2007) *Obiter* 28 1-22.

Surtees P "The Law of Taxation" (2007) 1089 *Annual Survey of South African Law*, 1089 – 1089.

Muller E "The Taxation of Illegal Receipts: A Pyramid of Problems!" (2007) *Obiter* 28 (1) 166-181.

Classen L "Legality and Income Tax – is SARS 'entitled to' levy income tax on illegal amounts 'received by' a taxpayer? (2007) SA MERC LJ 534.

Goldswain G "Illegal Activities: Taxability of Proceeds" (2008) 22 *Tax Planning* 143.

Swart GJ "The Accrual of Income-Some Answers" (1990) 97 SA Merc LJ 97.

Lenta P "Constitutional Interpretation and the Rule of Law" (2005) 2 STELL LR 272.

Textbooks

Amler's Precedents of Pleadings (8th Ed) (2015) LexisNexis.

Botha CJ Statutory Interpretation: An Introduction for Students (*5th Edition*) (2012) Juta.

Christie's The Law of Contract in South Africa (6th Ed) (2010) LexisNexis.

Croome *et al* Tax Law: An Introduction (2013) Juta.

De Koker: Silke on South African Income Tax (2016) LexisNexis.

Joubert WA The Law of South Africa, Volume 5(2) – 2nd Ed, (2016) LexisNexis.

R C Williams: Income Tax in South Africa: Cases and Materials (2009) LexisNexis.

Case Law

Bell's Trust v CIR 1948 (3) SA 480 (A).

Brookes Lemos Ltd v CIR 1947 (2) SA 976 (A).

Cactus Investments (Pty) Ltd v CIR 1999 (1) SA 315 (SCA).

CIR v Golden Dumps (Pty) Ltd 1993 (4) SA 110 (A).

COT v G 1981 (4) SA 167 (ZA).

CIR v Delfos 6 SATC 92.

CIR v People's Stores (Walvis Bay) Ltd 1990 (2) SA 353 (A).

Delagoa Bay Cigarette Co Ltd v CIR 32 SATC 47.

Geldenhuis v CIR 1947 (3) SA 256 (C).

Gud Holdings (Pty) Ltd v CSARS 69 SATC 115.

Hiddingh v CIR 1941 AD 111.

ITC 1545 54 SATC 464.

ITC 1789 67 SATC 205.

ITC 1792 67 SATC 236.

ITC 316 8 SATC 166.

ITC 1847 73 SATC 126.

ITC 1415 48 SATC 179.

ITC 1378 45 SATC 230.

Langston Clothing (Properties) CC v Danco Clothing (Pty) Ltd 1998 (4) SA 885 (SCA).

MP Finance Group CC (In Liquidation) v. CSARS 2007(5) SA 521 (SCA).

Rishworth v SIR 1964 (4) SA 493 (A).

SIR v Smant 1973 (1) SA 754 (A).

Van Heerden and Others v The State 73 SATC 7.

WH Lategan v CIR 2 SATC 16.